

**INTERPRETATION NOTE: NO. 18 (Issue 3)**

DATE: 26 June 2015

**ACT : INCOME TAX ACT NO. 58 OF 1962**  
**SECTIONS : SECTIONS 6*quat*, 6*quin* AND 64N**  
**SUBJECT : REBATES AND DEDUCTION FOR FOREIGN TAXES ON INCOME**

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### **Preamble**

In this Note unless the context indicates otherwise –

- “**CFC**” means a controlled foreign company as defined in section 9D(1) of the Act;
- “**foreign-source amount**” means an amount derived from a source<sup>1</sup> outside South Africa;
- “**normal tax**” means South African income tax;
- “**qualifying foreign taxes**” means foreign taxes qualifying for a foreign tax rebate or deduction;
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;

<sup>1</sup> See 4.2.1 for the principles applicable to the determination of the source of an amount.

- “**South African-source amount**” means an amount derived from a source<sup>2</sup> in South Africa;
- “**the Act**” means the Income Tax Act No. 58 of 1962;
- “**the TA Act**” means the Tax Administration Act No. 28 of 2011;
- “**tax treaty**” means an agreement (including a convention) for the avoidance of double taxation;
- the terms “**South Africa**” and “**the Republic**” are treated as having the same meaning; and
- any other word or expression bears the meaning ascribed to it in the Act.

## 1. Purpose

This Note explains the scope, interpretation and application of sections 6*quat*, 6*quin* and 64N.

## 2. Background

Residents of South Africa are subject to income tax on their worldwide taxable income regardless of the source of the income. Foreign-source amounts derived by a resident of South Africa may sometimes be taxed by the country of source and by South Africa, resulting in international juridical double taxation. International juridical double taxation is the imposition of similar taxes by two or more sovereign countries on the same item of income (including capital gains) of the same person.

Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same amount is normally granted by the residence country. Thus, the source country’s right to tax generally has priority over the residence country’s right to tax. In many instances, countries provide for relief from international juridical double taxation by way of a tax treaty, although many countries (including South Africa) also provide unilateral tax relief in their domestic law.

One of the main purposes of a tax treaty is to protect taxpayers against juridical double taxation by allocating the exclusive right to tax the amount of income (or capital) to one of the contracting states. However, in some instances both states are allocated the right to tax such income or capital, thus requiring relief from double taxation to be provided for by the state of residence of the taxpayer.<sup>3</sup> A tax treaty also provides, amongst other things, a framework for resolving cross-border tax disputes and assisting in curtailing tax evasion.

Countries seek to resolve double taxation under their domestic tax laws by applying one or more of the following methods of relief:

- The credit method (also referred to as the rebate method)
- The exemption method
- The deduction method

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<sup>2</sup> Same as footnote 1.

<sup>3</sup> This may be achieved through domestic legislation or the tax treaty itself.

The following comments in the General Report of the 65<sup>th</sup> Congress of the International Fiscal Association<sup>4</sup> are relevant:

“For obvious reasons, the exemption method is widely applied by countries taxing on a territorial basis, whereas the credit method seems better designed for countries taxing on a worldwide basis. But a closer look at the applicable rules leads to a less clear-cut distinction. As a matter of fact, no country operates a pure credit system or a pure exemption system. Almost all countries mix both methods. The credit method finds its way into territorial taxation systems, as does the exemption method into worldwide taxation systems. Therefore, beyond conceptual differences between worldwide taxation and territorial taxation, all applicable systems have a hybrid character.”

The comments in paragraph 19 of the *Introduction to the Commentaries on the OECD Model Tax Convention on Income and on Capital* are also relevant in this regard:<sup>5</sup>

“For the purposes of eliminating double taxation, the Convention establishes two categories of rules. First, Articles 6 to 21 determine, with regard to different classes of income, the respective rights to tax of the State of source or situs and of the State of residence [...] In the case of a number of items of income and capital, an exclusive right to tax is conferred on one of the Contracting States. The other Contracting State is thereby prevented from taxing those items and double taxation is avoided. As a rule, the exclusive right to tax is conferred on the State of residence. In the case of other items of income and capital, the right to tax is not an exclusive one.

[...] Second, *insofar as these provisions confer on the State of source or situs a full or limited right to tax*, the State of residence must allow relief so as to avoid double taxation; this is the purpose of Articles 23A and 23B. The Convention leaves it to the Contracting States to choose between two methods of relief, *i.e.*, the exemption and the credit method.”

(Emphasis added.)

#### *South African approach*

South Africa provides relief to its residents from double taxation in its domestic law mainly by way of three different rebate methods for foreign taxes payable on income that is subject to South African normal tax or a deduction for foreign taxes payable on income that is similarly subject to South African normal tax. The rebate and deduction methods are supplemented by a number of exemptions for foreign-source amounts received by or accrued to residents.

#### *The rebate methods of relief for foreign taxes*

The following rebate methods are employed in South Africa:

- Section 6quat(1) which is the principal mechanism used to provide relief for foreign taxes proved to be payable on income derived from a foreign source that is included in a resident's taxable income. Foreign taxes falling within this category do not qualify for the section 6quat(1C) deduction or the section 6quin rebate (see below).

<sup>4</sup> Authored by Gauthier Blanluet and Philippe J. Durand - *Key Practical Issues to Eliminate Double Taxation of Business Income*, Cahiers De Droit Fiscal International, Volume 96b, Sdu Uitgevers, The Hague, The Netherlands, 2011 at page 21.

<sup>5</sup> Condensed version, dated 15 July 2014 at page 11.

- Section 6quin which provides for relief for foreign taxes paid on South African-source service income included in a resident's taxable income. Foreign taxes falling within this category may also qualify for a deduction under section 6quat(1C) (see below) – in these circumstances the taxpayer may choose the rebate under section 6quin or the deduction under section 6quat(1C), not both.
- Section 64N which provides for relief from foreign taxes paid on foreign dividends paid by a foreign company listed on the Johannesburg Stock Exchange to a resident.

Sections 6quat(1) and 6quin provide for the deduction of foreign taxes against normal tax payable. The sections are mutually exclusive. Section 64N provides for a deduction of foreign taxes against dividends tax levied under section 64E.

*The deduction method of relief for foreign taxes*

Under section 6quat(1C) a resident may claim foreign taxes, that do not qualify for the section 6quat(1) rebate, as a deduction in determining taxable income. That is, essentially, foreign taxes payable on South African-source amounts.

A resident qualifying for a section 6quat(1C) deduction may also qualify for a rebate under section 6quin when foreign taxes are paid on South African-source service income. In these circumstances the resident can elect to claim the foreign taxes as a deduction under section 6quat(1C) or as a rebate under section 6quin, not both.

Section 6quin is narrower than section 6quat(1C) as it *only* caters for foreign taxes paid on South African-source income from services, while section 6quat(1C) caters for foreign taxes proved to be payable on any amounts of South African-source income.

In contrast to sections 6quat(1) and 6quat(1C), section 6quin provides for a foreign tax rebate even if a resident has a right of recovery of the foreign tax payable by the resident. However, should the resident receive a refund of the foreign tax withheld, or be discharged from a liability to pay such foreign tax, the amount refunded or discharged is treated as an amount of normal tax payable by the resident.<sup>6</sup>

A resident that earns multiple amounts during a particular year of assessment, each with its own foreign tax liability, could possibly apply a combination of the methods of relief provided for in sections 6quat(1), 6quin, 64N and 6quat(1C), depending on the nature of the particular amount.

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<sup>6</sup> Section 6quin(5).

**Example 1 – Alternative methods of relief for foreign taxes proved to be payable**

*Facts:*

A South African resident derives the following income in the year of assessment:

<b>Nature of income item</b>	<b>Foreign taxes paid or proved to be payable</b>
	R
(A) Trading income derived from Country A (the income constitutes a foreign-source amount).	15 000
(B) Fees received for managerial services rendered in South Africa to a person resident in Country B (the income constitutes a South African-source amount).	20 000
(C) Royalty income received from a person resident in Country C (the income constitutes a South African-source amount).	30 000
(D) Foreign dividends received from a dual listed foreign company on shares listed on the Johannesburg Stock Exchange (the income constitutes a foreign-source amount).	20 000

**Note:**

No tax treaties are in place for scenarios (A), (B) and (C).

*Result:*

The South African resident is entitled to the following rebates or deductions in the year of assessment, namely, for the –

- (a) foreign taxes contemplated in (A), a foreign tax rebate under section 6quat(1),
- (b) foreign taxes contemplated in (B), a foreign tax rebate under section 6quin or alternatively a deduction under section 6quat(1C),
- (c) foreign taxes contemplated in (C), a deduction under section 6quat(1C), and
- (d) foreign taxes contemplated in (D), a foreign tax rebate for dividends tax purposes under section 64N.

*Exemption for certain foreign-source amounts*

The aforementioned foreign tax rebate methods and the deduction method are supported by a broad range of exemptions for certain types of foreign-source income and capital gains received by or accrued to a resident, for example:

- Exemption for foreign dividends when a resident (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10% of the total equity shares and voting rights in the foreign company declaring the foreign dividend [section 10B(2)(a)].
- Exemption for foreign dividends that relate to amounts previously included in the income of a resident under South Africa's CFC rules [section 10B(2)(c)].

- Partial exemption for foreign dividends received or accrued which are not otherwise exempt under section 10B(2); the exempt portion is calculated according to the formula included in section 10B(3). For example, in the case of a natural person the exempt portion equals the amount of the foreign dividend multiplied by 25 / 40.
- Exemption for remuneration income received or accrued by a resident employee for services that were rendered outside South Africa during a period exceeding 183 full days in aggregate during a 12-month period and for a continuous period exceeding 60 full days during that period [section 10(1)(o)(ii)].
- Exemption for pensions derived by a resident from a source outside South Africa for past services rendered outside South Africa [section 10(1)(gC)(ii)].
- Exemption from capital gains tax arising from the disposal of equity shares in foreign companies by a resident if certain requirements are met [paragraph 64B of the Eighth Schedule].

*Order of deducting foreign tax rebates from the amount of normal tax payable*

SARS calculates a resident's final tax liability by deducting the rebates from normal tax according to the sequence of the sections in the Act, namely:

	R
<i>Natural person</i>	
Normal tax payable	XXX
Less: Primary, secondary and tertiary rebates under section 6	(XXX)
Less: Medical scheme fees tax credit under section 6A	(XXX)
Less: Additional medical expenses tax credit under section 6B	(XXX)
Less: Foreign tax rebate under section 6quat(1)	(XXX)
Less: Foreign tax rebate under section 6quin	<u>(XXX)</u>
Result: Final tax payable	<u>XXX</u>
<i>Any person other than a natural person</i>	
Normal tax payable	XXX
Less: Foreign tax rebate under section 6quat(1)	(XXX)
Less: Foreign tax rebate under section 6quin	<u>(XXX)</u>
Result: Final tax payable	<u>XXX</u>

The sum of the rebates available under sections 6, 6A, 6B, 6quat(1) and 6quin could potentially exceed the amount of normal tax payable.<sup>7</sup> To the extent that the sum of those rebates exceeds the normal tax payable, any excess is forfeited and is not refundable – see examples 1, 5 and 6 in **Annexure B**. In addition, the excess may not be carried forward to the next year of assessment for purposes of determining the final tax payable in that year. This is different to the situation in which the amount of the qualifying foreign taxes exceeds the amount of the section 6quat(1) rebate. In this situation paragraph (ii) of the proviso to section 6quat(1B)(a) specifically provides that the excess foreign taxes may sometimes be carried forward to the next year of assessment to potentially qualify for a foreign tax rebate in that year (see **4.8**).

<sup>7</sup> The possibility arises as a result of, for example, the sections 6, 6A and 6B rebates which are potentially available to natural persons.



*A comparison of the rebate methods and the deduction method*

Foreign taxes taken into account as a tax rebate reduce a resident's liability for normal tax. However, if taken into account as a deduction from income, the foreign taxes merely reduce a resident's taxable income. In most cases, it will benefit a resident if the foreign taxes payable qualify for a tax rebate rather than a deduction because a rebate reduces the normal tax payable on a rand-for-rand basis.

**Example 2 – Comparison of tax payable under deduction and rebate methods**

*Facts:*

A resident company derives foreign income of R100 on which foreign taxes of 25% (R25) are proved to be payable. The South African corporate rate of tax is 28%.

*Result:*

	<b>Deduction Method</b>	<b>Rebate Method<sup>8</sup></b>
	R	R
Taxable income from a foreign source	100,00	100,00
Less: Foreign taxes qualifying for deduction	<u>(25,00)</u>	<u>(Nil)</u>
Taxable income after deduction of foreign taxes	<u>75,00</u>	<u>100,00</u>
Normal tax (28%)	21,00	28,00
Less: Foreign tax rebate	<u>(Nil)</u>	<u>(25,00)</u>
Final normal tax payable	<u>21,00</u>	<u>3,00</u>
<b>Total tax (normal tax and foreign tax)</b>	<b><u>46,00</u></b>	<b><u>28,00</u></b>

*Grossing-up of foreign-source amounts*

The requirement to include the gross foreign-source amount in gross income, and not the amount which is net of the foreign tax liability incurred on that gross foreign-source amount, is fundamental to any foreign tax rebate system. The amount subject to tax is the gross foreign-source amount before the deduction of foreign taxes.

The foreign taxes would incorrectly be taken into account twice if only the net foreign-source amount were to be included in gross income, first, as a deduction and, secondly, as a foreign tax rebate.

**3. The law**

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

**4. Section 6quat(1) – Rebate in respect of foreign taxes on income**

**4.1 Introduction to the foreign tax rebate method of relief under section 6quat(1)**

Section 6quat(1) is South Africa's primary mechanism for avoiding double taxation. The term "rebate" means "a deduction from an amount to be paid" and, more specifically, under section 6quat refers to a deduction of foreign taxes from normal tax otherwise payable.

South Africa grants this relief unilaterally through domestic legislation and bilaterally through most of its tax treaties.

<sup>8</sup> Under section 6quat(1).

Section 6 $quat$  provides detailed rules covering, amongst others, the following:

- The receipts and accruals that potentially qualify for a rebate [section 6 $quat$ (1)].
- The amount of the rebate and the person entitled to the foreign tax rebate [section 6 $quat$ (1A)].
- Limitations on the amount of foreign tax qualifying for a foreign tax rebate, for example, the overall limitation [section 6 $quat$ (1B)].
- Carry-forward of a balance of excess foreign taxes [section 6 $quat$ (1B)].
- The deduction of certain foreign taxes [section 6 $quat$ (1C) and (1D)].
- The interaction with tax treaties [section 6 $quat$ (2)].
- The exclusion of specific compulsory payments from a tax on income [section 6 $quat$ (3)].
- The conversion of amounts of foreign tax from a foreign currency to rand [section 6 $quat$ (4)].
- Revision of previous assessments in order to allow for the rebate or deduction of the correct amount of foreign taxes payable [section 6 $quat$ (5)].

The application of the foreign tax rebate results in a foreign-source amount only being subject to normal tax when the foreign tax is less than the normal tax. The net normal tax generally equals the difference between the two tax rates multiplied by the foreign-source amount. The foreign taxes are “topped up” by normal tax so that the combined normal and foreign tax on the foreign-source amount is equal to the normal tax which would, but for the rebate, be due under the Act. Under this principle the residence country effectively only has a residual right to tax income derived by its residents from a foreign source.

**Example 3 – Rebate method when the normal tax rate exceeds the foreign tax rate**

*Facts:*

A resident company earns foreign-source income of R100 000. No other income is earned by the resident company. In the country of source the income is subject to foreign tax at a rate of 10% which results in a tax liability of R10 000. No South African deductions are available against the foreign-source income.

For South African tax purposes the full amount of R100 000 is included in the resident’s taxable income. Normal tax is payable at a corporate rate of 28%, that is, R28 000.

*Result:*

The foreign tax rebate reduces the normal tax payable on the foreign-source income to R18 000 [(28% – 10%) × R100 000].

See **Example 35** for an example where the foreign tax rate exceeds the normal tax rate.

The impact of a residence basis of taxation is thus that the residence country generally taxes any amount sourced in that country<sup>9</sup> irrespective of the residency status of the recipient and also taxes residents of that country on foreign-source amounts to the extent that the domestic tax exceeds the foreign tax of the country where the foreign amount is sourced and taxed.

Under section 6quat(1) a foreign tax liability can only be set off against a liability for normal tax and cannot be rebated against other domestic taxes applicable to residents, for example –

- turnover tax on micro businesses [section 48A]; or
- dividends tax [section 64E(1)].

The obligation to provide double tax relief diminishes to the extent that a resident is the recipient of a benefit resulting in the reduction of double taxation (for example, through the application of a tax treaty or the receipt of a foreign rebate) or receives a refund of foreign taxes. These aspects are taken into account in determining the amount of the foreign tax which qualifies for a section 6quat(1) rebate.

#### 4.2 Foreign-source amounts included in taxable income [section 6quat(1)]

Under section 6quat(1) the following foreign-source amounts (see discussion of the term “source” in 4.2.1) that are included in a resident’s taxable income will, subject to section 6quat(2),<sup>10</sup> qualify for a foreign tax rebate:

- Any income received by or accrued to a resident from a source outside the Republic [section 6quat(1)(a)].

The term “income” means “income” as defined in section 1(1), that is, gross income less exemptions. This generally means that foreign taxes which are attributable to exempt income will not qualify for a foreign tax rebate under section 6quat(1). There is, however, an exception for foreign taxes attributable to foreign dividends that are partially exempt under section 10B(3). The full amount of the foreign taxes applicable to the exempt portion of the foreign dividends under section 10B(3) will potentially qualify for a foreign tax rebate under section 6quat(1).<sup>11</sup> (See 4.5.3 and Annexure B for examples.)

- Any portion of the net income of a CFC as contemplated in section 9D which is attributed to a resident under section 9D(2) [section 6quat(1)(b)].
- Any taxable capital gain as contemplated in section 26A from a foreign source [section 6quat(1)(e)].
- Any amount dealt with in section 6quat(1)(a), (b) and (e) which is received by or accrued to another person, for example, a trust, but which is deemed to be derived by a resident under section 7 or paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule [section 6quat(1)(f)(i) and (ii)].
- Any amount dealt with in section 6quat(1)(a), (b) and (e) which forms part of the capital of a trust established in a foreign country and which is regarded as income under section 25(2A) or a capital gain or loss under paragraph 80(3) of the Eighth Schedule derived by a resident [section 6quat(1)(f)(iii)].

<sup>9</sup> Unless it is specifically exempt.

<sup>10</sup> See 4.9.3.

<sup>11</sup> Paragraph (ii) of the proviso to section 6quat(1A).

A resident will not qualify for a foreign tax rebate under section 6quat(1) when tax has been levied by a foreign country on a South African-source amount of income.<sup>12</sup>

#### 4.2.1 Meaning of the term “source” for purposes of the section 6quat(1) rebate

Source is a crucial concept in a residence-based tax system like South Africa when –

- determining taxes levied on non-residents; and
- applying the rules for foreign tax rebate relief applicable to foreign-source amounts included in a resident’s taxable income.

This is consistent with the findings of research conducted on behalf of the International Fiscal Association as is apparent from the opening paragraph of the General Report of the 34<sup>th</sup> Congress of the International Fiscal Association:<sup>13</sup>

“While they are of relatively greater or lesser significance in individual country tax systems, all of the tax regimes examined have rules found either in internal laws or treaty practice, involving distinctions as to whether income and expenses of taxpayers are domestic or foreign. There are two basic purposes for which such distinctions are made. First in importance is the fact that whether income is domestic or foreign is frequently a stated basis for determining whether a taxpayer is liable for tax on such income. Even where the rule is not stated in terms of source, the basis for taxation is usually stated in terms of an economic or factual connection of activities or property with a geographical location. A second purpose for using rules of geographic origin is a tool for relieving double taxation. While some countries relieve double taxation of their residents through the foreign tax credit method and others through exemption, in fact most countries employ in their domestic laws and/or treaties a mixture of these approaches.”

Although the Act contains specific source rules for certain types of income, “source” is not defined in the Act and there is no universal definition or understanding of the meaning of “source”.

The question whether an amount arises from a South African-source (alternatively referred to as a source within South Africa) or a foreign source (alternatively referred to as a source outside South Africa) is critically important in the context of section 6quat as South African residents, who are subject to tax on a worldwide basis, will only potentially qualify for a section 6quat(1) rebate on foreign-source amounts.

In South Africa when determining the source of an amount the approach adopted is to consider –

- domestic tax legislation, namely, section 9(2) and (4);
- common law as formulated by the South African courts; and
- the application of the articles of relevant tax treaties.

A tax treaty may override the position which would otherwise be reached under sections 9(2) and (4) or common law. See **Example 4**.

<sup>12</sup> South African-source amounts may qualify for a rebate in limited circumstances under section 6quin (see 7).

<sup>13</sup> Authored by Robert J. Patrick jr. – *Rules for determining income and expenses as domestic or foreign*, Cahiers De Droit Fiscal International, Volume LXVb, (1980), Kluwer, Rotterdam, The Netherlands, at page 15.

This approach is relevant for purposes of determining the source of gross income<sup>14</sup> and for purposes of calculating foreign tax rebates under sections 6quat(1) and 6quin, and the deduction of foreign taxes under section 6quat(1C).

In applying this approach, if the source of an amount is South Africa, it will be treated as South African-source for South African tax purposes irrespective of whether it originates from a foreign jurisdiction and is treated as being foreign-source under the foreign jurisdiction's legislation.

**(a) Section 9(2) and 9(4)**

Sections 9(2) and 9(4) contain specific source rules for certain items of income and capital gains. The provisions of section 9(2) and 9(4) will override the common law position [see 4.2.1(b)] in the case of a conflict. However, the articles of a tax treaty [see 4.2.1(c)] override the provisions of section 9(2) and 9(4) and common law in the case of a conflict.

The source rules contained in section 9(2) and 9(4) do not cover all types of income. For example, neither section 9(2) nor section 9(4) have a source rule for income derived from independent and dependent professional services.

The source of items of income which are not specifically covered by the Act will be determined under common law principles as formulated by the South African courts and possibly a tax treaty (if one is applicable in the particular circumstances).

**(b) Common law as formulated by the South African courts**

The particular items of income received by or accrued to a taxpayer and the facts and circumstances applicable to these items of income need to be considered when applying common law principles to determine the source of the income. The facts are critical. In *Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes, Southern Rhodesia* Stratford CJ quoted with approval that:<sup>15</sup>

“‘Source, means, not a legal concept, but something which a practical man would regard as a real source of income’, ‘the ascertainment of the actual source is a practical hard matter of fact.’ (see *Ingram's work*, p.66).”

The purpose of this Note is not to provide an in-depth source analysis of particular items of income. However, the source of income has generally been defined by the courts in terms of a two level analysis, firstly, the identification of the originating cause of the income (as opposed to the quarter from which it was received) and, secondly, the location of that originating cause.<sup>16</sup> The courts have also noted that the originating cause may occur in different places and may even occur in different countries.<sup>17</sup>

For example, a resident company manufactures teapots, which are sold internationally, in two factories. One factory is located in South Africa and the other factory is located in Country B. South Africa does not have a tax treaty with Country B. Assume that based on the specific facts and circumstances of the case the originating cause of the income is the manufacturing activity which is conducted

<sup>14</sup> As defined in section 1(1).

<sup>15</sup> 1938 AD 282, 9 SATC 363 at 379.

<sup>16</sup> *CIR v Lever Brothers & Unilever Ltd* 1946 AD 441, 14 SATC 1 at 8; *Overseas Trust Corporation v CIR* 1926 AD 444, 2 SATC 71.

<sup>17</sup> *CIR v Lever Brothers & Unilever Ltd* 1946 AD 441, 14 SATC 1 at 10.

in two locations. The source of the income arising from the sale of the teapots would therefore need to be apportioned between South Africa and Country B in terms of an appropriate method.

The same approach applies for purposes of determining the source of gross income for non-residents<sup>18</sup> and for purposes of calculating foreign tax rebates for residents under sections 6*quat*(1) and 6*quin*, and the deduction of foreign taxes under section 6*quat*(1C). Accordingly, the South African jurisprudence in relation to determining source for purposes of gross income remains valid for determining source for purposes of section 6*quat* and the other aforementioned sections.

Some tax commentators have suggested that the word “source” should be interpreted differently for the purposes of section 6*quat* than from the way in which it is interpreted in relation to the definition of “gross income”.<sup>19</sup> They argue that in the context of section 6*quat* the term “source” should be given the less-restrictive meaning of “the quarter from which it comes” rather than the meaning of “originating cause”. The purpose of this Note is not to provide an in-depth analysis of the meaning of source or to discuss alternative views on source. Nevertheless, SARS has considered this view, but does not accept it.

**(c) Deeming source rules in tax treaties which override actual source rules**

A tax treaty between South Africa and a foreign country may contain “deemed source” rules for determining the source of certain items of income and capital gains. In circumstances where this is the case, the outcome from applying the deemed source rules is applied for purposes of the Act as a whole.

Accordingly, if the outcome of the application of the deemed source rules in a tax treaty<sup>20</sup> is that the source of a particular amount is different to the position reached when applying the provisions of section 9 and common law principles, the deemed tax treaty source rules applies for purposes of, for example, gross income and section 6*quat*.

It could mean that South Africa loses its right to tax a non-resident on actual South African-source income or that South Africa needs to grant a resident a foreign tax rebate under section 6*quat*(1) on actual South African-source income. However, this is an acceptable consequence of tax treaties.

**Example 4 – Deeming source rule for interest under a tax treaty**

*Facts:*

A resident company derives interest income as a result of money lent to a Namibian resident. The funds are used by the Namibian resident in South Africa.

<sup>18</sup> Definition of “gross income” in section 1(1).

<sup>19</sup> As defined in section 1(1).

<sup>20</sup> Taking into account any agreement reached in an applicable mutual agreement procedure.

*Result:*

Under section 9(2)(b)(ii) interest income is derived from a source in South Africa when it is received for the use or application in South Africa by any person of funds or credit obtained under any form of interest-bearing arrangement. However, under paragraph 5 of article 11 of the tax treaty entered into between South Africa and Namibia, the interest income is deemed to be derived from a source in Namibia as the payer is a person resident in Namibia. Paragraph 5 of article 11 reads as follows:

“5. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State.”

Accordingly, notwithstanding the fact that the funds are used by the Namibian resident in South Africa, the source of the interest is Namibia as paragraph 5 of article 11 of the tax treaty overrides the source rule under section 9(2)(b)(ii).

While the tax treaty treats the interest income earned by the resident company as being derived from a source in Namibia, and therefore permits Namibia to impose tax on such interest income under paragraph 2 of article 11 of the tax treaty, South Africa still has the right to tax the interest income in the hands of the resident company under paragraph 1 of article 11 of the tax treaty. However, under article 23 of the tax treaty, South Africa<sup>21</sup> will need to provide a rebate for the tax, if any, suffered in Namibia. South Africa will exercise its right to tax the income by including the interest in the resident company's gross income and taxable income and may potentially grant a rebate for Namibian tax on the interest income under section 6quat(1).

**Example 5 – No deeming source rule for interest under a tax treaty***Facts:*

A resident company derives interest income as a result of money lent to a person resident in Country Z. The funds are utilised in South Africa. Country Z taxed the resident company on the interest.

The tax treaty entered into between South Africa and Country Z does not provide for a deemed source rule for interest income in favour of Country Z.

*Result:*

Under section 9(2)(b)(ii) interest income is derived from a source in South Africa when it is received for the use or application in South Africa by any person of funds or credit obtained under any form of interest-bearing arrangement.

South Africa will not grant a rebate under section 6quat(1) for the taxes levied by Country Z on the interest income because the interest income is derived from a source in South Africa.

**Example 6 – Source: interaction between common law and the tax treaty***Facts:*

A resident company manufactures teapots in South Africa which are sold in stores run by the resident company in South Africa and Country X.

<sup>21</sup> As the country of residence.

Assume that based on the specific facts and circumstances of the case the originating cause of the income is the manufacturing activity which is conducted in South Africa.

The business profit article in the tax treaty entered into between South Africa and Country X provides that –

“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 in that other State. If the enterprise carries on business in that manner, 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”.

(Emphasis added.)

The store operated by the resident company in Country X constitutes a permanent establishment as defined in the tax treaty. Accordingly, under the tax treaty South Africa and Country X have a right to tax the income.

*Result:*

Section 9(2) does not contain a specific source rule for income derived from the manufacture of goods. However, under common law, based on the originating cause being in South Africa, the income is determined to be from a source in South Africa. The common law position is, however, overridden by the tax treaty in circumstances where the business profit article of the tax treaty gives Country X a right to tax the profits attributable to the permanent establishment in Country X, the income underlying the attributable profits will effectively be treated as being from a foreign source. This means that the resident will potentially qualify for relief under section 6quat(1) for the taxes paid on such income in Country X.

#### 4.2.2 The source of income from services

The term “services” is not defined in the Act and should, therefore, be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used.

The Merriam-Webster dictionary<sup>22</sup> defines the word “service” as:

“1 *a*: the occupation or function of serving <in active *service*>  
*b*: employment as a servant <entered his *service*>  
 2 *a*: the work performed by one that serves <good *service*>  
 ....  
 4: the act of serving: as  
 ...  
*b*: useful labor that does not produce a tangible commodity —usually used in plural <charge for professional *services*>.”

“Services” include independent professional services such as scientific, literary, artistic, educational or teaching activities as well as the activities of physicians, lawyers, engineers, architects, dentists and accountants.

<sup>22</sup> [www.merriam-webster.com/dictionary/service](http://www.merriam-webster.com/dictionary/service) [Accessed 12 February 2015].



**Example 7 – Distinction between services and goods***Facts:*

X is employed by ABC (Pty) Ltd, a company which manufactures washing machines. ABC (Pty) Ltd sells the washing machines to local and international customers and also provides a repair service to domestic clients in the unlikely event that the washing machine breaks down.

*Result:*

X renders employment services to ABC (Pty) Ltd and ABC (Pty) Ltd renders repair services to its customers. The repair services are distinguishable from the goods that ABC provides to its customers.

**(a) General approach**

Determining the source of service income can be complex, particularly as the type of service and the fact that it may be rendered in multiple locations may impact on the determination of the location(s) of source. Despite the possible complexities, the approach to be followed is the same as that discussed in **4.2.1**.

Section 9(2) has source rules for some types of service income, but not all, and in considering the application of section 9(2) taxpayers will need to consider the particular service rendered and whether it falls into one of the provisions of section 9(2).

In the absence of section 9(2) applying it will be necessary to apply common law principles. Consequently the concept of “originating cause” remains valid for purposes of determining the true source of income derived from services. In *COT v Shein*<sup>23</sup> the court held that the true source of income derived from managerial service fees is where the services are rendered.

In addition, taxpayers will need to consider whether a tax treaty applies to their particular circumstances and, if so, the effect of any applicable deemed tax treaty source rules. For example, a number of South Africa’s tax treaties have a deemed source rule for income derived from independent professional services.

**Example 8 – Tax treaty providing for a deemed-source rule for service income***Facts:*

A resident company provides technical consulting services to a company resident in Swaziland under an agreement negotiated and concluded in South Africa. The services are rendered in South Africa. The company in Swaziland does not have a presence in South Africa and *vice versa* for the resident company.

Under Swaziland’s domestic tax law a withholding tax of 15% is imposed on fees derived from independent professional services remitted to South Africa. The tax treaty reduces the rate of the withholding tax to 10%.

*Result:*

The true source of the fees is where the services are rendered, that is, South Africa.

<sup>23</sup> 1958 (3) SA 14 (FC), 22 SATC 12 at 15.

However, article 13(5) of the tax treaty between South Africa and Swaziland, which deals with technical fees, provides as follows:

“Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State...”

Article 13(5) overrides the true source for the service fees and deems the fees to be from a source in Swaziland for purposes of the Act and the tax treaty. As a result, article 13(2) gives Swaziland a right to tax the income subject to the limitation that the tax charged may not exceed 10% of the gross amount of the fees.

South Africa also has a right to tax the income in the hands of the resident company<sup>24</sup> but article 22 imposes an obligation on South Africa to provide relief for the tax suffered in Swaziland. This obligation is met by South Africa potentially providing a foreign tax rebate under section 6quat(1). In order to qualify for the rebate all the requirements of section 6quat must be met. For example, although Swaziland imposed the withholding tax at the domestic rate of 15%, the 5% withholding tax above the permitted rate of 10% will not meet the “proved to be payable” requirement (see 4.3.2) and will accordingly not qualify for the rebate.

Note: In the absence of article 13(5), the amount would be South African-source irrespective of whether Swaziland’s domestic tax law treated the amount as being sourced in South Africa or Swaziland.

#### **(b) Dominant originating cause versus subsidiary causes**

In considering the facts and circumstances of a particular item of service income, taxpayers must consider whether the service itself is the dominant originating cause or whether in the particular case the service is incidental to and part of another activity which is the dominant originating cause. The principle of determining the dominant originating cause in cases where there is more than one originating cause is not unique to service income. It has, however, been specifically mentioned here as it is an issue which taxpayers frequently need to consider in the context of service-related income.

#### **Example 9 – Subsidiary and separate originating cause**

*Facts:*

A, a resident, manufactures factory equipment in South Africa. As part of the sale of the equipment, A provides on-site assistance with the installation of the equipment. Most, but not all, of A’s clients are located in South Africa.

During the year A sold equipment to C in Zimbabwe and sent a technician to Zimbabwe to assist with the installation. A does not have a permanent establishment in Zimbabwe.

In addition to the manufacture and sale of the equipment, A concludes contracts with some clients to provide on-site monthly maintenance services.

A has concluded a maintenance contract with three South African clients and C.

<sup>24</sup> Article 13(1) of the tax treaty between South Africa and Swaziland.

*Result:**Sale and installation*

In this case, the manufacturing of the equipment, and not the installation thereof, is the dominant originating cause and the source of the income is accordingly South Africa.

It is incorrect to treat the service as the dominant originating cause or to split out the installation services and treat them separately. This is the case irrespective of whether multiple invoices are issued or whether the equipment and installation are itemised separately on the invoices. The installation services are merely an incidental part of the composite supply and installation of the equipment.

*Maintenance contracts*

The monthly service contract is separate from the manufacture and sale of the equipment. The true source of the income will be where the services are rendered (see **4.2.2(c)** for the need to apportion service income between locations).

**(c) Apportionment of service income between different locations**

The location of the source of the income is, in the absence of section 9(2), section 9(4) or an article in a tax treaty providing otherwise, where the service is physically rendered if the originating cause of income is the rendering of the service. This may be in more than one location in which case an apportionment of the source of the income will be required (assuming the locations are in different countries).

For example, a single invoice may be issued for services carried out partly in South Africa and partly outside South Africa. In these situations it is necessary to consider what services were conducted in which location and to apply an appropriate basis to apportion the source of the income to its appropriate location. This is critically important because, for example, in the case of a resident it will impact on whether that resident is entitled to relief from double taxation under sections 6quat(1), 6quat(1C) or 6quin.

The appropriate basis of apportionment will depend on the facts and circumstances of the particular case. For example, if the *same* service is rendered in two countries and the same hourly rate is charged then time may be an appropriate basis of apportionment. However, if a different rate is charged then a pure time basis would not be appropriate. Further, if the nature of the service rendered in the two locations is different that would also need to be taken into account in the apportionment.

**4.3 Requirements that must be met in order for foreign taxes to be regarded as qualifying foreign taxes [section 6quat(1A)]**

Foreign taxes must meet all the requirements set out in **4.3.1** to **4.3.4** in order to potentially qualify for a rebate under section 6quat(1). In addition, if the foreign tax relates to a capital gain or to attributed income of a CFC, the total amount of foreign taxes which potentially qualifies for a rebate is limited. These limits, as well as a general limitation, are discussed in **4.5**, **4.6** and **4.7**.

### 4.3.1 The taxes must be payable on income

In determining whether or not a particular foreign tax qualifies as a tax on income, the basic scheme of application of the foreign tax must be compared with that of the Act. The foreign tax will only be accepted as a tax on income if the basis of taxation is substantially similar to that of the Act.

The United States Supreme Court in *Biddle v. Commissioner*<sup>25</sup> established the principle, uniformly followed in subsequent case law and enshrined in the regulations,<sup>26</sup> that, in deciding whether a foreign tax is an “income tax” for purposes of section 901,<sup>27</sup> the term “income tax” will be given meaning by referring to the income tax system of the United States of America and measuring the foreign tax against the essential features of that system:

“The phrase ‘income taxes paid,’ as used in our own revenue laws, has for most practical purposes a well-understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in section 131.”

To a certain extent it is immaterial that the detail of a foreign tax law differs from South Africa’s domestic tax law. The important consideration is whether the basis of taxation is substantially similar. For example, a foreign tax law may include certain items of income or may allow certain exclusions or deductions not included or allowed under South African domestic tax law, however it could still be considered a tax on income.

In contrast, the mere fact that a foreign tax is regarded as a tax on income by the country levying the tax or that the same term is used is not sufficient. The precise nature of the foreign tax and the meaning of particular terms must be determined and considered. That is, the foreign tax liability must be a tax on income within the South African concept thereof. SARS levies the following taxes on income:<sup>28</sup>

- Normal tax on taxable income, which includes a taxable capital gain [section 5]
- Withholding tax on royalties, a final tax payable by non-residents on income derived from royalties or similar payments [section 49A-G]
- Withholding tax on interest (effective 1 March 2015) [section 50(B)(1)]
- Withholding tax on service fees (effective 1 January 2016) [section 51(B)(1)]
- Withholding tax on foreign entertainers and sportspersons, a final tax [section 47B(2)]
- Turnover tax on micro businesses [section 48A]
- Dividends tax [section 64E(1)]

<sup>25</sup> 302 U.S. 573,579 (1938).

<sup>26</sup> Treasury Regulation § 1.901-2(a)(2)(i) supports the doctrine established in the *Biddle* case.

<sup>27</sup> Of the relevant legislation of the United States of America.

<sup>28</sup> See Binding General Ruling No. 9 (Issue 2) dated 19 February 2013 “Taxes on Income and Substantially Similar Taxes for Purposes of South Africa’s Tax Treaties” – available on [www.sars.gov.za](http://www.sars.gov.za). Withholding tax on service fees is not referred to in the Binding General Ruling as it was only introduced after the ruling was published.

Any foreign taxes which are substantively similar in nature to the aforementioned taxes will be considered a tax on income. The aforementioned withholding taxes are all imposed as a final withholding tax. Withholding taxes which constitute an advance payment on an ultimate foreign tax liability would not qualify as a foreign tax on income, however the underlying ultimate foreign tax liability may itself qualify as a tax on income. For example, foreign taxes similar to employees' tax, provisional tax and section 35A withholding tax levied on payments made to non-resident sellers of immovable property in South Africa would not qualify as a tax on income. (See "Advance payments" in 4.3.2 for more detail.)

#### *Taxes covered by a tax treaty*

Taxes covered in a tax treaty between South Africa and another country will often, but not necessarily, qualify as a tax on income. For example, the French wealth tax is covered in the tax treaty between South Africa and France,<sup>29</sup> however it will not qualify as a tax on income because it is levied on unrealised increases in the market value of a person's assets which is not a basis that is similar to South Africa's capital gains tax regime (which is a tax on income). Accordingly, if a resident is subject to a wealth tax in France, the resident will not be entitled to a foreign tax rebate under section 6quat(1) for that tax.

#### *Taxes levied on gross receipts*

Taxes levied on a gross receipts basis are similar to taxes levied on a turnover basis. The term "gross receipts" generally has a wider meaning than the term "turnover" and includes gross sales and capital gains whereas "turnover" would generally only include gross sales. Both bases are concerned with taxing receipts, often at a fixed percentage, and it is irrelevant whether the recipient makes a net profit or loss.

Although South Africa primarily taxes taxpayers on a taxable income basis, certain taxpayers are taxed on a turnover basis when qualifying as and electing to register as a micro business. As noted, turnover tax on micro businesses is a tax on income which means taxes levied by foreign tax jurisdictions on gross receipts or turnover will also constitute a tax on income provided the basis is similar.

Clearly, the amount subject to tax on a gross receipt or turnover basis will not be equal to the amount subject to tax on a net profit basis but this does not mean that the full amount of the foreign tax will not potentially qualify for a rebate. For example, if Country X taxes an amount on a gross basis and South Africa taxes it as part of taxable income, the amount subject to tax in Country X will be more than the amount subject to tax in South Africa. The amount of foreign tax could be greater than or less than the amount of South African tax depending on the rate at which it is levied. The amount of foreign tax will qualify for a section 6quat(1) rebate assuming it meets all the requirements and will be subject to the limitation formula in section 6quat(1B)(a) (see 4.5).

#### **Example 10 – Limiting foreign taxes levied on gross receipts**

##### *Facts:*

Company Z, a resident, earns income from independent professional services rendered in Country A. The presence of Company Z in Country A does not create a permanent establishment for Company Z in that country.

<sup>29</sup> See paragraph 3(a)(iv) of article 2 of the tax treaty between South Africa and France.

In year 1 Company Z earned gross income of R100 000 and incurred operating expenses of R80 000 for services rendered in Country A. Country A levies tax on independent professional services at a rate of 10% on gross receipts. The tax payable in Country A is R10 000 ( $R100\,000 \times 10\%$ ) for year 1.

Company Z has other taxable income of R50 000 sourced in South Africa. Normal South African tax totals R19 600 [ $(R50\,000 + R20\,000) \times 28\%$ ].

*Result:*

From a South African tax perspective the full amount of the foreign tax of R10 000 potentially qualifies for the rebate but will be subject to the limitation in section 6quat(1B)(a).

*Calculation:*

$$\frac{\text{Taxable income derived from all foreign sources (A)}}{\text{Taxable income derived from all sources (B)}} \times \text{Normal tax payable on (B)}$$

$$= R20\,000 / R70\,000 \times R19\,600$$

$$= R5\,600$$

Therefore, the amount of the rebate in year 1 will be limited to R5 600 but the excess of R4 400 ( $R10\,000 - R5\,600$ ) may be carried forward to year 2 under paragraph (ii) of the proviso to section 6quat(1B)(a) to potentially qualify for a foreign tax rebate in that year.

*Liability for interest, additional foreign taxes, fines and penalties*

A liability for interest, additional foreign taxes, fines, penalties or any other similar obligation imposed under the tax laws of a foreign country is not regarded as a tax on income and does not qualify for a foreign tax rebate.

Furthermore, the aforementioned expenses, except possibly for interest depending on the facts, are generally not deductible for tax purposes under section 11(a) read with section 23(g) as all the requirements for deduction are unlikely to be met. (See 4.5.2 for a discussion regarding why taxes on income do not qualify for a deduction under section 11(a) read with section 23(g).)

In addition, section 23(o)(ii) prohibits the deduction of fines and penalties.

*Foreign taxes that do not constitute taxes on income*

Examples of taxes that are not considered to be a tax on income include –

- commodity or consumption taxes;
- value-added tax;
- sales tax;
- customs and excise duties;
- import and export duties;
- estate and inheritance taxes;
- annual wealth taxes;
- net worth taxes;

- environmental taxes such as a greenhouse gas tax or carbon tax;
- resource royalties;
- mineral export levies;
- company duties;
- business licence and other trade taxes;
- stamp duties or security transfer taxes;
- transfer duties;
- registration duties;
- franking credits;<sup>30</sup>
- skills development levies and unemployment insurance fund contributions;
- property or real estate taxes;
- gift or donation taxes;
- purchase tax, similar taxes and employers' contributions collected for the financing of a social insurance scheme;
- capital transfer taxes; and
- capital taxes.<sup>31</sup>

Section 6quat(3) specifically excludes compulsory payments to a foreign government which constitute consideration for the right to extract any mineral or natural oil from being considered a tax on income.

**Example 11 – Whether a foreign tax on securities qualifies as a tax on income for purposes of the section 6quat(1) rebate**

*Facts:*

A resident invests in interest-bearing bonds issued in Country A. Country A levies a tax on bonds issued in that country which is payable by the issuers of the bonds but recoverable from the bondholders. The tax is imposed at a rate based on the taxable value of the bonds.

*Result:*

The tax is levied on the issue of the interest-bearing bonds and is not linked in any way to the income earned of either the issuer or holder. The tax is not regarded as a tax on income for South African tax purposes.

<sup>30</sup> For example in Australia dividends paid to shareholders by Australian resident companies are taxed under a system known as imputation. The tax paid by the company is allocated to shareholders by franking credits attached to the dividends they receive. Detailed information available from [www.ato.gov.au/Business/Imputation/In-detail/Refunding-franking-credits/Refunding-franking-credits---individuals/](http://www.ato.gov.au/Business/Imputation/In-detail/Refunding-franking-credits/Refunding-franking-credits---individuals/) [Accessed 12 February 2015].

<sup>31</sup> Capital taxes include, for example, taxes levied at irregular and infrequent intervals on the values of the assets or net worth owned by institutional units or on the values of assets transferred between institutional units as a result of legacies, gifts *inter vivos* or other transfers.

*Production sharing agreement for the extraction of minerals and natural oil*

Different governments have different fiscal regimes which effectively “charge” third parties for the right to extract minerals and oil. In addition to traditional income taxes, two common methods of “charging” are the payment of royalties on the minerals and natural oil extracted, and entering into production sharing contracts.

As noted previously, the term “taxes on income” specifically excludes any compulsory payment made to the government of any other country which constitutes consideration for the right to extract any mineral or natural oil.<sup>32</sup> This would include royalty payments which are made in cash or kind.

The particular production sharing contract is critical but, as a generalisation, production sharing contracts are often structured in such a way that they stipulate the percentage of the resources that the government is entitled to and the percentage of resources to which the contractor is entitled. The right to and ownership of the specified resources is established upfront and as such even when the resources are transferred to the government or sold on their behalf there is no payment *per se* by the contractor to the government which requires consideration. The agreement will also stipulate which costs the different parties will incur and may stipulate that the contractor will be responsible for all third party costs. The contractor is often responsible for providing the capital, services and technical knowledge.

If the production sharing agreement is structured in such a way that the contractor is required to make a payment to the government in return for extracting the related resources and to settle that payment through product (not cash), the payment will not be considered to be a payment of a tax on income<sup>33</sup> and accordingly will not qualify for a rebate under section 6quat(1).

**4.3.2 The taxes must be proved to be payable to any sphere of government of any country other than South Africa in respect of an existing foreign tax liability**

*Proved to be payable*

A tax will be “proved to be payable” if the resident has an unconditional legal liability to pay the tax and the resident has either paid the tax or will have to pay the tax in the future. An unconditional legal liability to pay the foreign tax only arises once all the events that fix the amount of the foreign tax, and the resident’s liability, have taken place.

Given that the relevant foreign tax will only qualify to be dealt with under section 6quat if it is “proved to be payable” **and** the resident does not have “any right of recovery” of the tax (see **4.3.3**), it is apparent that an unconditional legal liability in the context of section 6quat means that the foreign tax must have been levied legitimately under the foreign jurisdiction’s tax law and tax treaty (if applicable) before it can qualify for a rebate under section 6quat. If the foreign tax has not been levied legitimately under the domestic law of the foreign jurisdiction or has been levied contrary to the clear provisions of a tax treaty (if applicable), it cannot be said that the foreign tax is “proved to be payable” or that the resident does not have a “right of recovery”. For example, if a foreign jurisdiction imposes a tax that is clearly not in accordance with the foreign jurisdiction’s tax law or tax treaty (if applicable), but it is paid, with or without prejudice or challenge, by the resident, that foreign tax will not

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<sup>32</sup> Section 6quat(3).

<sup>33</sup> Section 6quat(3).



be regarded as “proved to be payable” and the resident will not be regarded as not having a “right of recovery” for purposes of section 6quat. Such foreign tax will accordingly not qualify for a foreign tax rebate under section 6quat(1) or a deduction under section 6quat(1C).

Practically this situation tends to arise in the context of withholding taxes when tax treaties often provide for a rate of tax which is lower than the domestic rate provided for in domestic tax legislation. Under section 6quat(1) the amount of foreign tax potentially qualifying for a rebate is limited to the tax which may be levied under the tax treaty. The resident has the option of seeking a refund of the excess withholding tax from the foreign tax authorities. The excess withholding taxes do not qualify for a deduction under section 6quat(1C), section 11(a) or any other section.

**Example 12 – Foreign country imposing withholding tax at domestic rate instead of lower rate specified in the tax treaty**

*Facts:*

South Africa has concluded a tax treaty with Country X under which the latter may levy a withholding tax of 10% of the gross amount of interest being remitted from Country X. However, Country X insists on levying its domestic tax rate of 25% on interest income remitted to a resident of South Africa.

The source of the interest is located in Country X.

*Result:*

The resident only has an unconditional legal obligation to pay 10%, even though 25% was withheld. Accordingly, the resident may only claim a rebate to the extent of 10% as specified in the tax treaty under section 6quat(1). The remaining 15% may not be claimed as a rebate under section 6quat(1).

**Example 13 – Withholding taxes levied on services rendered in a foreign country, no permanent establishment in the foreign country**

*Facts:*

A, a resident, renders services to B (Pty) Ltd (B) in Country D. A does not have a permanent establishment in Country D. B withholds and remits 10% withholding tax to Country D's tax authorities. The income is foreign source.

South Africa has a tax treaty with Country D. The tax treaty does not contain a technical services article. This means that irrespective of Country D's domestic law, the tax treaty gives South Africa the sole taxing right and does not permit Country D to charge any tax, for example, a withholding tax, on the service fees paid by B to A.

*Result:*

The foreign withholding tax will not qualify for a tax rebate under section 6quat(1) because under the tax treaty Country D should not have withheld the withholding tax and accordingly it cannot be “proved to be payable” as there is no unconditional legal obligation to make the payment. The foreign taxes will also not qualify for a section 6quat(1C) deduction or a section 6quin rebate as the service income is foreign source.

A can approach County D's tax authorities for a refund and, if that fails, can follow a mutual agreement procedure under the tax treaty.

**Example 14 – Withholding taxes levied on services rendered in a foreign country with a technical services article that permits withholding taxes to be levied, no permanent establishment in the foreign country**

*Facts:*

C, a resident, renders services to D (Pty) Ltd (D) in Country E. C does not have a permanent establishment in Country E. D withholds and remits 10% withholding tax to the tax authorities of Country E. The income is sourced in Country E.

South Africa has a tax treaty with Country E. The tax treaty contains a technical services article which permits Country E to tax the amount but the tax charged may not exceed 10%.

*Result:*

The foreign withholding tax is validly withheld under the tax treaty and will qualify for a tax rebate under section 6quat(1) assuming the other detailed requirements of the section are met.

The disputed amount of a foreign tax liability, for example, when a resident exercises a right to contest a foreign tax liability by lodging the equivalent of an objection or taking a matter to alternative dispute resolution or to court, will not be allowed as a rebate while the tax is in dispute and not yet finally determined. The amount of the foreign tax liability under dispute will only be taken into account for purposes of determining the foreign tax rebate as and when the dispute is finally resolved. The dispute will be regarded as being resolved when, taking into account all the facts, all reasonable legal remedies relating to the tax liability have been exhausted or a decision in the matter is no longer open to such remedies, subject to what is said in the paragraph below. Taxpayers may be called upon to provide evidence to support a claim that all reasonable legal remedies have been exhausted or extinguished. SARS will not allow a rebate on the disputed amount even if the resident has paid the amount pending resolution of the dispute.

There could be cases where the taxpayer has decided not to commence or continue with the dispute process or the decision is no longer open to dispute but the foreign government's treatment is nevertheless clearly incorrect. The relevant tax in these circumstances is not considered to be "proved to be payable". Thus, for example, if a foreign government, in contravention of the tax treaty with South Africa, incorrectly withholds foreign tax from payments to residents, that foreign tax will not be considered to be proved to be payable notwithstanding that the dispute process was, for example, commenced but not completed.

The section refers to an amount which is payable. This means that actual payment need not yet have taken place. However, if an amount remains outstanding for an extended period of time this may call into question whether there is indeed an unconditional obligation to pay the amount.

Foreign taxes that are waived or rebated by a foreign government, for example, in tax sparing arrangements,<sup>34</sup> do not qualify for a foreign tax rebate under section 6quat(1). The reason being that the amount of tax waived or rebated represents an amount of tax which is not payable to a foreign government. This position may, however, be altered by the provisions of a tax treaty. For example, refer to article 22(2) of the tax treaty with Botswana which provides that in certain circumstances the term "Botswana tax paid" is deemed to include the amount of tax which would have been paid in Botswana but for the tax sparing arrangement.

*Payable to any sphere of government of a foreign country*

The taxes must be payable to any sphere of government of a foreign country, for example, it includes taxes paid at a national, state, provincial, local and municipal level. A foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes. Taxes on income imposed at a supra-national level, for example, tax imposed by the European Union on pensions paid to its former employees, do not qualify for a foreign tax rebate under section 6quat(1) because it is not a tax levied by a sphere of government of a foreign country.

*Advance payments*

Many countries impose some form of advance payment for a tax liability that is only finally determined and becomes unconditional at a future date. The specific terms of these systems vary but are generally based upon the taxpayer's tax liability for the preceding year of assessment or an estimate of its liability for the current year of assessment. An advance payment of an income tax liability imposed by a foreign tax jurisdiction, which is similar to South Africa's employees' tax or provisional tax payments, is made on an estimated tax liability rather than an unconditional final tax liability. Accordingly, advance payments of tax are not taxes which are proved to be payable to a foreign government, they are merely advance payments of taxes which may ultimately be proved to be payable to a foreign government.

**Example 15 – Foreign withholding taxes on foreign-source royalty income**

*Facts:*

R, a resident company, derives royalty income derived from a source in Country S.

Country S levies a withholding tax on royalty payments made by its residents to non-residents at a rate of 15%. The withholding tax levied on royalty payments made to non-residents is not a final withholding tax. A final tax determination is made on an annual basis based on taxable income which is subject to a corporate tax rate of 20%.

*Result:*

The tax withheld does not represent taxes proved to be payable and, therefore, the taxes withheld do not qualify for a foreign tax rebate under section 6quat(1).

<sup>34</sup> Tax sparing arrangements are often used to incentivise foreign investment in a country and may involve a residence country giving a tax credit not only for foreign taxes paid to the source country but also on tax spared or waived by the host country.

### **Example 16 – Foreign withholding taxes on foreign-source service income**

*Facts:*

A natural person resident in South Africa takes up employment in Country Z with a foreign employer for 12 months commencing on 1 June 2013.

The resident's remuneration for the above-mentioned period is subject to a payroll withholding tax in Country Z. The payroll withholding tax is similar to South Africa's employees' tax system and represents an advance payment of the resident's tax liability in Country Z. The resident's tax liability in Country Z is determined on an assessment basis.

The resident discloses the foreign-source income in the resident's South African tax returns for the 2014 and 2015 years of assessment respectively.

South Africa does not have a tax treaty with Country Z.

*Result:*

The payroll withholding taxes levied on the service income sourced in Country Z do not constitute foreign taxes that are proved to be payable without a right of recovery. The final foreign tax proved to be payable is only determined upon assessment. Therefore these withholding taxes do not qualify for a foreign tax rebate under section 6quat(1).

The final foreign tax liability, which may only arise months after the advance payments have been made, is the amount which will be regarded as being "proved to be payable" for purposes of the section 6quat(1) rebate and the section 6quat(1C) deduction. Part of the final foreign tax liability may have been paid through means of the advance tax system and part of it may still be payable in the future. In contrast, the excess of the advance payments above the final foreign tax liability is generally refunded to the taxpayer and does not qualify for a rebate under section 6quat(1). SARS recognises that cash flow timing mismatches will occur if the foreign tax year ends after the South African tax year. As a result, SARS may regard the advance or provisional tax payment as being "proved to be payable" for purposes of the section 6quat(1) rebate and section 6quat(1C) deduction *to the extent that* the resident taxpayer can satisfy SARS that such payments correspond to and do not exceed the final foreign tax liability. This should minimise the cash flow impact.

An understanding of the foreign tax is critical in determining whether or not the foreign tax payment is an advance payment which is similar to South Africa's employees' tax or provisional tax. For example, in some self-assessment countries, although called provisional payments, the payment is in substance a final payment which is based on actual taxable income for the particular year of assessment, not an estimate, and is not an interim partial payment made during the year which is subject to change based on the final amount submitted by the taxpayer. It is called provisional because it may be amended if the taxpayer is reviewed or audited and the calculation that the taxpayer submitted is amended. In this situation, and subject to obtaining a detailed understanding of the foreign tax, SARS may treat the payment as a final tax payment and not a provisional tax payment.

(See 6.4 for a discussion regarding the treatment of foreign provisional tax payments when calculating South African provisional tax payments.)

*Person who is potentially entitled to claim a foreign tax rebate*

The person who is potentially entitled to claim a foreign tax rebate under section 6quat(1) is the person who is liable to pay the foreign tax. In the context of withholding taxes, although the payer of an amount is required to withhold and remit an amount of tax to the government, the tax itself is generally levied on the amount which is received by or accrues to the payee and the payee is the person who is liable to pay the foreign tax, not the payer. The specific wording of the legislation is always important but the withholding and remittance of the tax are often just the means of collection under which the payer makes the payment on behalf of the payee. Withholding taxes are generally triggered at the point in time at which the payer makes the payment to the payee and thus this is also the point in time at which the foreign tax is “proved to be payable”.

#### **4.3.3 The taxes must be payable without any right of recovery by any person**

The obligation to provide double tax relief diminishes to the extent that a resident receives or is entitled to receive a refund of foreign taxes or is the recipient of a benefit which effectively results in the removal (or reduction) of double taxation. These aspects are taken into account in determining the amount of foreign tax that potentially qualifies for a rebate.

A resident is only entitled to claim a section 6quat(1) rebate for a foreign tax on income to the extent that the amount of the foreign tax is proved to be payable to a sphere of government of a foreign country *without a right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment before such year of assessment)*.

The term “right of recovery by any person” is interpreted very broadly and includes any form of relief against a foreign tax liability. For example, a refund, credit, rebate, remission, or deduction, is considered to be a right of recovery. Any other form of economic benefit to which a person becomes entitled to in consequence of the payment of the relevant tax is also considered to be a “right of recovery by any person”.

Examples of economic benefits include:

- Goods
- Services
- Fees or other payments
- Rights to use, acquire or extract any resources or other property
- Discharge of contractual obligations<sup>35</sup>

The right of recovery may be held by the taxpayer or by any other person and it therefore includes situations in which a shareholder of a company receives a refund for the tax paid by the company. The amount which the company could potentially

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<sup>35</sup> In *Klaus Vogel on Double Taxation Conventions*, 3 ed, 1997, Kluwer Law International Ltd, London, United Kingdom in paragraph 154 at page 1223, the author remarks that “[i]f any of the tax collected is returned to the taxpayer in the form of a (non-repayable) subsidy – as it is in certain cases under Brazilian law – the allowable credit is restricted to the amount of tax remaining after the deduction of the subsidy...”.

claim as a rebate under section 6quat(1) would be reduced by the amount of the refund the shareholder receives.

If the resident is entitled to but chooses not to seek a refund, the excess will still not qualify for a rebate under section 6quat(1) because the existence of a right of recovery and not the enforcement thereof is the relevant factor. A resident must disclose relevant information to SARS when any person becomes entitled to a right of recovery on a foreign tax liability incurred by that resident.

**Example 17 – Recovery of foreign tax liability by means of a government subsidy**

*Facts:*

Two resident retail companies formed a joint venture in Country A to distribute and sell products owned by the government of Country A. In Country A the joint venture is regarded as a taxable entity. The joint venture sold the products at inflated prices which resulted in an increase in its liability for tax. The government of Country A in turn gave the joint venture a subsidy as a form of economic incentive to compensate for the extra taxes paid due to the inflated sale prices.

In South Africa each company claimed a foreign tax rebate based on its proportionate share of the total amount of foreign taxes paid by the joint venture without taking into account the amount of the government subsidy.

*Result:*

The treatment adopted by the two resident retail companies is incorrect. In determining the rebate available under section 6quat(1), the foreign tax liability must be reduced by the amount of the government subsidy. The amount of the government subsidy must be apportioned between the companies based on each company's interest in the joint venture.

**4.3.4 The taxes must be payable on amounts included in a resident's taxable income [section 6quat(1)]**

The inclusion of foreign-source amounts in taxable income is also discussed in 4.2.

The term "taxable income" is defined in section 1(1) to mean the aggregate of –

- (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and
- (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act;

It is evident from this definition that taxable income can be a positive or negative figure, that is, result in an "assessed loss" as defined [section 20(2)]. Paragraph (a) would become negative when the amounts allowed under Part I of Chapter II exceed the income of a person. Furthermore, Part I of Chapter II includes section 20 which deals with assessed losses.

Accordingly, even if the taxpayer has an assessed loss it does not mean that the foreign-source income has not been included in taxable income. It may have been included in taxable income in which case, assuming all the other requirements are met, the foreign tax would potentially qualify for a rebate although not in that

particular year. The reason therefore is that section 6quat(1B)(a) provides that the rebate shall not exceed an amount which bears to the total normal tax payable the same ratio as total foreign taxable income bears to total taxable income (see 4.5). An assessed loss means that normal tax for that year is nil and accordingly the amount of the foreign tax rebate in that year of assessment is also nil. However, it will be possible for the taxpayer to carry forward the balance of excess qualifying foreign taxes to the succeeding year of assessment under paragraph (ii) of the proviso to section 6quat(1B)(a) (see 4.8) to potentially qualify for a foreign tax rebate in that year.

#### **Example 18 – Set off of local trading losses against foreign trading profits**

##### *Facts:*

A resident company derives foreign-source income from Country S of R100 000 in year 1. Country S allowed deductions of R40 000 and levied tax of 10% on the taxable profit of R60 000. The income was also taxable in South Africa at a rate of 28%, however deductions of only R30 000 were allowable under the Act.

The resident company also conducted other operations in South Africa which gave rise to income of R250 000 and deductions of R350 000.

##### *Result:*

##### *Calculation of South African taxable income/assessed loss:*

	R	R
<i>Foreign trade</i>		70 000
Gross income	100 000	
<i>Less:</i>		
Deductions	<u>30 000</u>	
<i>South African trade</i>		(100 000)
Gross income	250 000	
<i>Less:</i>		
Deductions	<u>350 000</u>	
Assessed losses for current year		(30 000)

The existence of an assessed loss does not mean that the foreign income of R100 000 has not been included in taxable income. It has been included in taxable income and therefore the foreign tax of R6 000 ( $R60\,000 \times 10\%$ ) potentially qualifies for a foreign tax rebate but not in year 1 due to the application of the limitation in section 6quat(1B)(a) and paragraph (ii) of the proviso thereto.

#### **Example 19 – Effect of foreign trading losses on the determination of a section 6quat(1) rebate**

##### *Facts:*

A resident company conducts its primary trading operations in South Africa. It also has a branch in Country N.

##### **Year 1**

The company derives trade income from a South African source amounting to R100 000. Corporate income tax is levied in South Africa at a rate of 28%. Its branch in Country N incurred an assessed loss of R300 000.

**Year 2**

The company derives trade income from a South African source amounting to R100 000. South Africa's corporate income tax rate remains unchanged at 28%. Its branch in Country N derived taxable income of R400 000. Foreign tax is levied in Country N at the rate of 5%.

*Result:*

**Year 1****Tax position in Country N**

In Country N the branch has an assessed loss of R300 000 which is carried forward to year 2 under that country's domestic tax legislation.

**Tax position in South Africa**

For South African tax purposes the foreign assessed loss of R300 000 is ring-fenced under paragraph (b) of the proviso to section 20(1) and is carried forward to year 2. The local trade income of R100 000 will be subject to normal tax in South Africa at the rate of 28%.

**Year 2****Tax position in Country N**

	R	R
Taxable income for year 2		400 000
Less: Assessed loss brought forward from year 1		<u>(300 000)</u>
Taxable income		<u>100 000</u>
Tax levied at 5%		<u>5 000</u>

**Tax position in South Africa**

(1) Taxable income from a foreign source		
Taxable income for year 2	400 000	
Less: Assessed loss brought forward from year 1	<u>(300 000)</u>	100 000
(2) Trade income from a South African source		<u>100 000</u>
Taxable income (all sources)		<u>200 000</u>
Normal tax payable at 28%		56 000

Section 6quat(1B)(a) rebate limitation:

$$\begin{aligned}
 & \frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable} \\
 &= \text{R100 000} / \text{R200 000} \times \text{R56 000} \\
 &= \text{R28 000}
 \end{aligned}$$

Therefore the full amount of foreign tax of R5 000 will qualify for the foreign tax rebate in year 2.



**Example 20 – Set off of foreign trading losses against foreign trading profits***Facts:*

A resident company conducts operations in Country S which gives rise to income of R20 000 000, deductible expenses of R10 000 000 and foreign tax of R4 000 000. The corporate tax rate in Country S is 40%.

The resident company also conducts operations in Country T which gives rise to income of R10 000 000 and deductible expenses of R14 000 000. The tax loss of R4 000 000 means there is no foreign tax payable in Country T.

The resident company's operations in South Africa give rise to income of R15 000 000 and deductible expenses of R10 000 000. The corporate tax rate is 28%.

*Result:*

	R	R
South African taxable income/assessed loss		
<b>Foreign operations</b>		6 000 000
Taxable income in Country S (R20 million less R10 million)	10 000 000	
Assessed loss in Country T (R10 million less R14 million)	<u>(4 000 000)</u>	
<b>South African operations</b>		<u>5 000 000</u>
<b>Total taxable income for current year of assessment</b>		11 000 000
Normal tax payable at 28%		3 080 000

Section 6quat(1B)(a) rebate limitation:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= \text{R6 000 000} / \text{R11 000 000} \times \text{R3 080 000}$$

$$= \text{R1 680 000}$$

Therefore the section 6quat(1) rebate is limited to R1 680 000, however paragraph (ii) of the proviso to section 6quat(1B)(a) provides that the excess of R2 320 000 may be carried forward to the following year of assessment to rank for a foreign tax rebate in that year.

The effective combined foreign tax rate equals 66,7%.

*Calculation:*

$$\text{Total foreign taxes} / \text{Total foreign taxable income} \times 100\%$$

$$= \text{R4 000 000} / \text{R6 000 000} \times 100\%$$

$$= 66,67\%$$

The effective combined foreign tax rate is significantly higher than the tax rate of Country S of 40%. This arises because paragraph (b) of the proviso to section 20(1) does not prohibit the set-off of foreign trading losses against foreign trading profits.

*“Transactions” between a South African resident’s head office and its own foreign permanent establishment*

A resident’s South African presence (for example, a head office in Cape Town) may “transact” with its own foreign permanent establishment (for example, a branch in Country A) and for accounting purposes charge a fee including a mark-up on those “transactions” (for example, accounting services in the form of the relevant portion of the related employees’ salaries plus consumables plus a mark-up). However, from a South African tax perspective when calculating taxable income and attributing profits to the South African presence and the foreign permanent establishment, transactions within one legal entity are not recognised. Accordingly, the fee payable by the foreign branch to the head office is not recognised in the resident’s hands (that is, there is no gross income) and the foreign branch may only be allocated a relevant portion of the external costs excluding any internal mark-up.

Assuming the services are rendered in the foreign country, it means that if, for example, the foreign government levies a foreign withholding tax on the payments by the foreign branch to the head office, the South African resident will not qualify for a section 6quat(1) rebate. The reason therefore is that the accounting fee “charged” by the foreign branch is not recognised for tax purposes and there is no foreign-source income which has been included in the resident’s taxable income. This applies irrespective of whether the withholding tax was levied on the cost portion of the “fee” or the full “fee” including the mark-up and irrespective of whether or not the withholding tax was permitted under a tax treaty (if one was applicable).<sup>36</sup>

*Foreign taxes payable in respect of exempt dividends*

As noted in 4.2, foreign taxes which are attributable to exempt income will generally not qualify for a foreign tax rebate under section 6quat(1) as the foreign taxes must be payable on amounts included in a resident’s taxable income. However, in the case of foreign taxes attributable to foreign dividends that are partially exempt under section 10B(3), the full amount of the foreign taxes applicable to the exempt portion under section 10B(3) will potentially qualify for a foreign tax rebate under section 6quat(1).<sup>37</sup> While the full amount of the exempt foreign dividends must be included under paragraph (ii) of the proviso to section 6quat(1A) in the resident’s taxable income for the purpose of determining the amount of foreign taxes which potentially qualify for the rebate available under section 6quat(1), those foreign taxes will still be subject to the limitation formula provided for in section 6quat(1B) - see 4.5.3.

#### **4.4 Person liable for the qualifying foreign tax liability [section 6quat(1A)]**

##### **4.4.1 General remarks**

Generally speaking, the person who is potentially entitled to claim a foreign tax rebate under section 6quat(1) is the person who is liable to pay the foreign tax.

However, in certain circumstances, section 6quat(1A) permits a resident to take an amount of foreign tax into account notwithstanding that another person was liable for the amount of foreign tax. For example, in calculating the rebate under section 6quat(1) a resident must take into account an amount of foreign tax which

<sup>36</sup> South Africa has reserved the right to use the version of Article 7 of the OECD Model Tax Convention, and the relevant commentary, immediately prior to the July 2010 update. See Model Tax Convention on Income and on Capital, condensed version, 15 July 2014 page 464.

<sup>37</sup> Paragraph (ii) of the proviso to section 6quat(1A).

that resident's spouse was liable for, provided the amount is deemed to have accrued to the resident under section 7(2).<sup>38</sup>

It should also be noted that in respect of withholding taxes, the payee is the person who is liable to pay the tax even though the tax is withheld by and physically paid over to the foreign government by the payer of the amount. The physical payment is done on behalf of the payee and the payee is the person who is liable for the tax (see 4.3.2).

#### 4.4.2 Application of section 6quat(1A)

The qualifying foreign tax liability taken into account in calculating the section 6quat(1) rebate must be payable by any of the following persons –

- that resident in respect of –
  - any income received by or accrued to that resident from a foreign source; or
  - any taxable capital gain as contemplated in section 26A derived from a foreign source; or
- a CFC in respect of the portion of the CFC's net income as contemplated in section 9D which is attributed to that resident under section 9D(2); or
- a person in respect of the amounts mentioned in the first bullet point if the amount is deemed to have accrued to that resident under section 7 or paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule [section 6quat(1)(f)(i) and (ii)]; or
- a person in respect of the amounts mentioned in the first bullet point which represents the capital of a trust established in a foreign country and which is included in that resident's income under section 25B(2A) or is taken into account in determining that resident's aggregate capital gain or aggregate capital loss under paragraph 80(3) of the Eighth Schedule [section 6quat(1)(f)(iii)].

In addition, when the resident is either a member of a partnership or a beneficiary of a trust and the partnership or trust is liable for tax as a separate entity in a foreign country, a proportional amount of tax payable by that entity is deemed to be payable by that resident member or beneficiary for purposes of section 6quat. The proportional amount must be determined with reference to the resident's interest in the entity in relation to the total interest held in that entity.

Examples of circumstances when foreign tax, which must be taken into account in calculating a resident's section 6quat(1) rebate, is payable by someone other than the resident include –

- a resident's spouse when the underlying income is deemed to have accrued to that resident under section 7(2);
- a resident's minor child when the underlying income is deemed to have accrued to that resident parent under section 7(3) or (4);
- a trust or the beneficiary of a trust when paragraphs 68 to 72 of the Eighth Schedule deems the gain to have accrued to that resident;

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<sup>38</sup> Section 6quat(1A)(f).

- a trustee of a discretionary trust when section 25B(2A) applies to include an amount in that resident's taxable income;
- a partnership (established in a foreign country that treats a partnership as a person for tax purposes) in respect of an amount included in that resident partner's taxable income; and
- a CFC in respect of a proportional amount included in that resident's taxable income under section 9D.

#### 4.5 Limitation on the amount of the rebate [section 6quat(1B)(a)]

The amount of foreign taxes which qualify for the section 6quat(1) rebate in a particular year of assessment is the lesser of –

- the sum of the qualifying foreign taxes;<sup>39</sup> or
- the amount calculated under the limitation formula as set out below.

The limitation formula is calculated as follows:<sup>40</sup>

$$\frac{\text{Taxable income derived from all foreign sources (A)}}{\text{Taxable income derived from all sources (B)}} \times \text{Normal tax payable on (B)}$$

“Taxable income derived from all foreign sources” includes all amounts of foreign source income that were included in the resident's total taxable income regardless of the rate of foreign tax (if any) to which those amounts are subject. The taxable income of both the numerator and the denominator is determined according to South African tax law.

Normal tax is the South African tax calculated on taxable income before the deduction of any rebates contemplated in sections 6, 6A, 6B, 6quat(1) and 6quin respectively.

The purpose of the limitation in section 6quat(1B)(a) is to ensure that the rebate granted for foreign taxes paid only relates to the foreign income included in a resident's taxable income. Hence if no foreign income is included in a resident's taxable income, no foreign tax rebate will be available even if the resident paid foreign tax. The purpose of the section 6quat(1) foreign tax rebate is not to provide relief for all foreign taxation thereby subsidising the tax base of foreign jurisdictions, but rather to provide relief to residents for the foreign taxes proved to be payable to the extent that the foreign-sourced amount has also been taxed in South Africa.

The application of the limitation formula results in normal tax only being reduced by foreign taxes payable on foreign-source amounts; it cannot reduce normal tax payable on South African-source amounts. The limitation is an “overall” limitation in the sense that all the foreign-source amounts derived from different foreign sources are added together without being subdivided further between the different foreign countries from which the amounts were derived. This is in contrast to the “per country” limitation or the “per income item” limitation adopted in some countries.

<sup>39</sup> The sum of qualifying foreign taxes is potentially limited in relation to situations dealing with capital gains (see 4.6) and attributed income of CFCs (see 4.7).

<sup>40</sup> Section 6quat(1B)(a).

Effectively the “overall” limitation divides a resident’s taxable income into two separate components, namely, taxable income derived from –

- a source within South Africa; and
- a foreign source.

Under an overall limitation system, all qualifying foreign taxes are aggregated and the rebate is limited (capped) at the lesser of the aggregate of the foreign taxes payable and the proportion of normal tax payable on the resident’s foreign taxable income as calculated by the limitation formula.

Before applying the limitation formula, one must in the first instance determine –

- what income is sourced within South Africa; and
- what income is sourced outside South Africa.

In this regard please refer to the discussion in **4.2.1**.

Secondly, a taxable income computation must be performed under South African tax principles and requirements in order to determine the taxable income resulting from the –

- the income derived from sources within South Africa; and
- the income derived from foreign sources.

In determining the taxable income derived from a foreign source –

- any expenditure incurred which is directly attributable to such income must be deducted from such income (assuming it meets the requirements for deductibility under the relevant section and irrespective of whether such expenditure is incurred in or outside South Africa); and
- a portion of any general expenses incurred which are not directly attributable to income derived either from a source within South Africa or a source outside South Africa, for example, head office expenses, must be apportioned between taxable income<sup>41</sup> derived from –
  - a source within South Africa; and
  - a foreign source,

based on any method which gives a fair and reasonable apportionment appropriate to the circumstances of the particular case (for example, turnover, gross profit or value of fixed assets).<sup>42</sup>

#### **Example 21 – Domestic expenses attributable to foreign-source income**

*Facts:*

A resident company obtains advice from a South African legal adviser on the operations of a foreign branch located in Country A.

<sup>41</sup> Assuming it meets the requirements for a deduction.

<sup>42</sup> This approach is endorsed in *International Tax Primer*, 2 ed, 2002, Kluwer Law International, The Hague, The Netherlands at page 48 where Brian Arnold advocates two methods for allocating expenses, namely tracing and apportionment.

*Result:*

Although the expenses are incurred locally it relates directly to the resident company's foreign operations and may be deducted from the foreign branch's income when calculating the taxable income derived from foreign sources.

**Example 22 – Foreign expenses attributable to South African-source income***Facts:*

A resident company obtains advice from a solicitor based in London for a deal it is concluding for the sale of various products manufactured in South Africa to a person resident in London.

The resident company also has a branch in London which manufactures a different line of products to those manufactured in South Africa.

*Result:*

The expense relates directly to the sale of products manufactured by the resident company in South Africa and may not be deducted from income when calculating the taxable income which arises from a foreign source (that is, the United Kingdom in which the foreign branch is located).

The expense may be deducted from South African-source income when calculating the resident's taxable income from all sources.

The Act requires<sup>43</sup> that taxable income be calculated per trade and then brings taxable income from a taxpayer's various trades together whilst taking into account that foreign trading losses may not be set off against domestic trading profits.<sup>44</sup> Consequently an expense item attributable to a particular trade must be deducted in determining that trade's taxable income and may not be deducted in determining the taxable income derived from another trade. The trades (local and foreign) of a resident that trades in and outside South Africa are regarded as two separate trades for purposes of the Act as a whole. This will be the case even if the operations conducted inside South Africa and outside South Africa are identical in nature, for example, a retail operator with retail shops in South Africa and outside South Africa.

The need to attribute expenses between South African-source income and foreign-source income in the context of foreign tax limitations has been discussed in the General Reports of two Congresses of the International Fiscal Association.<sup>45</sup>

<sup>43</sup> See, for example, the preamble to section 11 which provides that for the purposes of calculating the taxable income from carrying on any trade certain deductions are permitted and section 20(1)(b) which refers to the set off of an assessed loss from one trade against the income of another. See also related comments in A P de Koker & R C Williams *Silke on South African Income Tax* [online] (My LexisNexis: January 2015) in § 2.8 and *C v Commissioner of Taxes*, 1966 (3) SA 6(RAD) 28 SATC 127.

<sup>44</sup> Paragraph (b) of the proviso to section 20(1).

<sup>45</sup> General Report authored by Gauthier Blanluet and Philippe J. Durand - *Key Practical Issues to Eliminate Double Taxation of Business Income*, Cahiers De Droit Fiscal International, Volume 96b, Sdu Uitgevers, The Hague, The Netherlands, 2011 at page 33 to 35 and the General Report authored by Robert J. Patrick jr - *Rules for Determining Income and Expenses as Domestic or Foreign*, Cahiers De Droit Fiscal International, Volume LXVb, Kluwer, Rotterdam, The Netherlands at page 15 to 18.

**Example 23 – Classification of expenses relating to South African-source income and foreign-source income in calculating a foreign tax rebate**

*Facts:*

A resident company with a local trade and a foreign trade derives the following income in year 1:

	R
Taxable income derived from a South African source	1 000
Taxable income derived from a foreign source which is attributable to a foreign permanent establishment	100

The above-mentioned amounts do not take into account transactions in terms of which the foreign branch borrowed R100 from a financial institution in South Africa at 10% interest and invested the money borrowed in a bank deposit in the foreign country where the branch is located. The deposit earned interest at 11%.

The corporate tax rate is 40% in the foreign country and 28% in South Africa.

*Result:*

The interest expense of R10 relates to the earning of the foreign-source interest income of R11 and accordingly it must be claimed as a deduction in the calculation of the foreign-source taxable income.

	Taxable income (foreign source)	Taxable income (all sources)
	R	R
Taxable income before interest	100	1 100
Interest income	11	11
Interest expense	(10)	(10)
Taxable income	<u>101</u>	<u>1 101</u>

*Tax payable:*

Foreign tax	40,40
South African tax	308,28

*Calculation of the limitation of the rebate:*

$$\begin{aligned}
 & \frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable} \\
 &= (R101 / R1\ 101) \times R308,28 \\
 &= R28,28
 \end{aligned}$$

The amount of foreign taxes due is R40,40, however the amount qualifying for a rebate under section 6quat(1) in year 1 is limited to R28,28. The excess of R12,20 (R40,40 – R28,28) does not qualify for a foreign tax rebate in year 1 but may be carried forward to year 2 in which it will be deemed to be foreign tax paid in that succeeding year of assessment on foreign-source income.

**Example 24 – Determination of rebate (no limitation)***Facts:*

A resident company conducts its trading operations in South Africa. It also has a branch in Country L.

The following results are applicable to the year of assessment:

	<b>South Africa</b>	<b>Country L</b>	<b>Total</b>
	R	R	R
Turnover	8 000	2 000	10 000
Less: Direct expenses	(2 000)	(800)	(2 800)
Indirect expenses			<u>(600)</u>
Taxable income (all sources)			<u>6 600</u>
Foreign taxes due			108
South African normal tax due:			
R6 600 × 28%			1 848

*Result:*

Calculation of taxable income derived from Country L (that is, from a foreign source):

Turnover	2 000
Less: Direct expenses	(800)
Indirect expenses	<u>(120) *</u>
Taxable income	<u>1 080</u>

- \* = indirect expenses apportioned to branch in Country L based on turnover  
= (R2 000 / R10 000) × R600  
= R120

*Calculation of the limitation of the rebate:*

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= \frac{(R1\,080 / R6\,600) \times R1\,848}{}$$

$$= R302,40$$

The amount of foreign taxes due is only R108 therefore the full amount of R108 qualifies as a rebate and the limitation is not of application in these specific circumstances.

**Example 25 – Determination of rebate (subject to limitation)***Facts:*

During year 1 a resident company conducted share-dealing activities through a branch run by a dependent agent<sup>46</sup> in Country M.

<sup>46</sup> A dependent agent may create a permanent establishment, unlike an independent agent.



The branch bought foreign shares in a foreign company resident in Country M for R10 000 and received a gross payment of R1 000 from which withholding tax of R150 was payable. The payment was made from the foreign company's income reserves. Under Country M's tax laws the amount distributed is treated as a payment of interest and not as a payment of a dividend.

The shares are held by the resident company as trading stock. During the same year of assessment the foreign branch sold the shares for R9 500. The sale of the shares did not result in a tax liability in Country M.

Expenses of R300 were incurred on these transactions. No other transactions or activities were concluded by the resident company during year 1.

*Result:*

The amount received by the resident company does not constitute a foreign dividend<sup>47</sup> for South African tax purposes because the foreign payment is not treated as a dividend for income tax purposes under the tax laws of the country where the company paying the foreign amount is resident. The receipt of R1 000 accordingly constitutes a revenue receipt as the shares were held as trading stock and the payment was against the foreign company's income reserves (that is, it was not a capital distribution).

*Calculation of South African taxable income:*

	R
Sale of shares	9 500
Revenue receipt	<u>1 000</u>
	10 500
Less: Purchase cost	(10 000)
Other expenses	<u>(300)</u>
Taxable income – foreign-source	200
Taxable income – South African-source	<u>Nil</u>
Taxable income (all sources)	<u><u>200</u></u>
Normal tax payable (R200 × 28%)	56
Foreign withholding taxes	150

*Calculation of the limitation of the rebate:*

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= (R200 / R200) \times R56$$

$$= R56$$

The rebate relief is limited to R56.

The amount of foreign taxes due is R150, however the limitation formula applies to limit the rebate in year 1 to R56. The excess of R94 (R150 – R56) does not qualify for a foreign tax rebate in year 1 but may be carried forward to year 2 in which it will be deemed to be foreign tax paid in that year on foreign-source income.

<sup>47</sup> As defined in section 1(1).

#### 4.5.1 Application of paragraph (i) of the proviso to section 6quat(1B)(a) to deductions in respect of retirement annuity fund contributions and donations to certain organisations

In determining the taxable income derived from South African-source income and from foreign-source income, any deductions claimed for retirement annuity fund contributions [section 11(n)] and donations to certain organisations (section 18A) must be apportioned on a *pro rata* basis between income derived from those sources.

In the context of paragraph (i) of the proviso to section 6quat(1B)(a), “income” must be interpreted to mean taxable income as determined before each of the aforementioned deductions. The deductions must therefore be apportioned on a *pro rata* basis between taxable income derived from –

- sources within South Africa; and
- foreign sources,

as calculated before taking each deduction into account.

The following sequence must be followed in order to calculate the correct amounts in respect of the deductions under sections 11(n) and 18A respectively:

	R
Gross income as defined in section 1(1) from all sources	XXX
Less: Exempt income under section 10	(XXX)
Income	XXX
Less: Deductible expenditure	(XXX)
Add: Taxable capital gain from all sources	<u>XXX</u>
Taxable income before retirement annuity fund contributions and donations to certain organisations	XXX
Less: Retirement annuity fund contributions [section 11(n)] *	(XXX)
Donations to certain organisations (section 18A) **	(XXX)
<b>Taxable income from all sources</b>	<b><u>XXX</u></b>

\* When calculating retirement annuity fund contributions, the taxable capital gain must be excluded from the amount on which the 15% allowable deduction is calculated. The reason for this is that a taxable capital gain is part of taxable income and not income as required by section 11(n)(i)(aa)(A).

\*\* The taxable capital gain forms part of taxable income as determined before the section 18A deduction is calculated. Thus, taxable capital gains must be taken into account in determining this deduction which is based on taxable income.

Examples relating to natural persons are included in **Annexure B**.

#### 4.5.2 Deductibility of foreign taxes against income in determining taxable income

Under section 23(d) any tax imposed under the Act may not be deducted in determining taxable income. The fact that a deduction of foreign taxes on income is not specifically denied under section 23(d) does not mean that foreign taxes automatically qualify for a deduction. In order to qualify for a deduction the foreign taxes must meet the requirements for deductibility under an appropriate section.

Section 11(a) read with section 23(g) is relevant in determining whether a foreign tax meets the requirements for deductibility and is therefore deductible in calculating taxable income. Section 6quat(1C) also provides a deduction for foreign taxes in limited circumstances – see 5 for a discussion on section 6quat(1C).

Section 11(a) provides a deduction for expenditure and losses, which are not of a capital nature, actually incurred in the production of the income. In context, the requirement which is of particular relevance is whether the foreign tax expenditure has been incurred in the production of income.

A tax, domestic or foreign, on profits is not an expense which has been incurred in the production of income but is instead an appropriation of profits already earned. In *Port Elizabeth Electric Tramway Company Ltd v Commissioner for Inland Revenue*,<sup>48</sup> which is supportive of the principle, Watermeyer AJP and Davis J held that:

“There is certainly one type of expenditure which must be excluded, and that is expenditure payable out of income after it has been earned. An example is a tax upon profits. In a sense such expenditure might be said to be attendant upon business operations, but there is a real distinction between “charge against profits and an appropriation of profits after they have been earned.” See *Van Ryn Deep Ltd. v Commissioner for Inland Revenue* (1922, W.L.D. 22).”

In *Van Ryn Deep Ltd v CIR*<sup>49</sup> the court held that provincial tax, which had been imposed upon the profits after the profits had been earned, could in no way be said to have been an expense incurred in earning the profits or connected in any way with the production of the profits and consequently was not deductible for the purposes of income tax, the liability for which was not affected by what was done either voluntarily or involuntarily with profits after they had been earned.

Some tax commentators are of the opinion that foreign taxes on income claimed as a rebate under section 6quat(1) or section 6quin also qualify for a deduction under section 11(a). The reason appears to be that the rebate is a *deduction against normal tax payable* while a section 11(a) deduction constitutes a *deduction against income* for purposes of determining taxable income. Consequently their argument is that there is no double deduction as prohibited under section 23B. It is not, however, necessary to consider whether section 23B prohibits any double deductions or only prohibits double deductions for the purposes of determining taxable income because there is simply no deduction under section 11(a). As stated, it is SARS's view that the requirements of section 11(a) are not met as a foreign tax on profits is not an expense incurred in the production of income but is instead an appropriation of profits already earned. Accordingly, a taxpayer in those circumstances will not qualify for a deduction against income for the foreign taxes paid.

Similarly, taxes on income which are levied on a gross receipts basis, for example, a final withholding tax, are incurred *on* income and not *in* the production of income and therefore do not qualify for a section 11(a) deduction.

Taxes which are a charge against profits,<sup>50</sup> may, depending on the detailed facts, be incurred in the production of income and qualify for a deduction under section 11(a) read with section 23(g) provided all the requirements of those sections are met. For

<sup>48</sup> 8 SATC 13 (1936) CPD 241.

<sup>49</sup> 33 SATC 101 1922 WLD 22.

<sup>50</sup> A tax is a charge on profits if it is incurred irrespective of whether the taxpayer is in a taxable profit, taxable loss or break even position.

example, a resident carrying on trading operations outside South Africa which yields taxable sales income and incurs foreign customs duties. The foreign customs duties are expenditure which is incurred in the production of income and assuming all the other requirements of section 11(a) and section 23(g) are met will qualify for a deduction. The customs duties are a charge against profits and are not an appropriation of profits already earned.

#### **Example 26 – Foreign taxes qualifying for rebate**

##### *Facts:*

A municipality in Country Z levies two forms of taxes, namely –

- (1) a tax on profits; and
- (2) municipal rates and taxes based on the value of properties owned.

##### *Result:*

The tax on profits is an appropriation of profits already earned and, depending on the detailed facts, will potentially qualify for a rebate under section 6quat(1). A tax on profits is not considered to be incurred in the production of income and will not qualify for a deduction under section 11(a).

The municipal rates and taxes are a charge against profits and not a tax on profits; the expense will not qualify for a rebate under section 6quat(1). However, a charge against profits may, depending on the detailed facts, be incurred in the production of income (for example, if the property was a rental property) and the taxpayer could therefore qualify for a deduction under section 11(a) if all the other requirements of the section are met.

#### **4.5.3 The treatment of foreign taxes payable in respect of exempt foreign dividends in the limitation formula**

As noted in 4.2 and 4.3, foreign taxes which are attributable to exempt income will generally not qualify for a foreign tax rebate under section 6quat(1). However, in the case of foreign taxes attributable to foreign dividends that are partially exempt under section 10B(3), the full amount of the foreign taxes applicable to the exempt portion under section 10B(3) will potentially qualify for a foreign tax rebate under section 6quat(1).<sup>51</sup>

This “special treatment” does not extend to the limitation formula specified in section 6quat(1B).<sup>52</sup> Accordingly, the method of calculation of the limitation formula as set out in 4.5 is not directly impacted by the foreign tax payable on the portion of a foreign dividend which is exempt under section 10B(3). Paragraph (ii) of the proviso to section 6quat(1A) does not therefore create a separate limitation formula or basket for foreign dividends subject to section 10B(3). The terms “taxable income” and “normal tax payable”, as used in the limitation formula,<sup>53</sup> have their ordinary meaning as per the Act and the inclusion provided for in paragraph (ii) of the proviso to section 6quat(1A) accordingly has no application. In calculating taxable income and normal tax for purposes of the limitation formula specified in section 6quat(1B) the

<sup>51</sup> Paragraph (ii) of the proviso to section 6quat(1A).

<sup>52</sup> Paragraph (ii) of the proviso specifically says that it is “for the purposes of this subsection”, “this subsection” being section 6quat(1A). The application of the proviso is therefore limited to section 6quat(1A) and does not extend to the other provisions of section 6quat.

<sup>53</sup> See the limitation formula in 4.5.

portion of foreign dividends which are exempt under section 10B(3) is therefore excluded.

To the extent that the amount of qualifying foreign taxes payable, including the foreign taxes payable on the exempt portion of foreign dividends, exceed the amount of the rebate (after applying the limitation formula in 4.5 and the limitations in 4.6 and 4.7), the excess may be carried forward to the next succeeding year of assessment and will potentially qualify for a rebate in that year. See 4.8 for detail.

### **Example 27 – Foreign taxes qualifying for rebate**

*Facts:*

X (Pty) Ltd, a South African company, derives income from both local and foreign sources.

*Foreign-source income:*

*Foreign dividends*

X (Pty) Ltd owns 5% of the equity share capital of a company in Country F. On 20 February 2015 the foreign company declared a dividend of \$120 000 (amount before withholding tax) of which X Pty Ltd received \$5 400 (\$6 000 less withholding tax payable of \$600). For the 2015 year of assessment ending 28 February the average exchange rate was \$1 : R10.9515.

*Losses derived by a foreign branch*

X (Pty) Ltd's foreign branch yielded a taxable loss for the year of R30 000.

*South African-source income:*

During the 2015 year of assessment X (Pty) Ltd received consulting fee income of R1 000 000 and interest income of R100 000. No deductible expenses were incurred in the production of the consulting fee income or the interest income.

*Result:*

<b>1. Tax calculation</b>	R
<b>1.1 Taxable income derived from foreign sources</b>	
Foreign dividends included in gross income ( $\$6\,000 \times 11.6474$ )	69 884
Less: Section 10B(3) exemption [ $R69\,884 \times 13 / 28$ ]	(32 446)
Less: Foreign branch taxable loss	<u>(30 000)</u>
<b>Taxable income derived from foreign dividends</b>	<b><u>7 438</u></b>
<b>1.2 Taxable income derived from South African sources</b>	
Consulting fees	1 000 000
Interest income	<u>100 000</u>
<b>Taxable income derived from South African sources</b>	<b><u>1 100 000</u></b>
<b>1.3 Total taxable income derived from all sources</b>	
Taxable income derived from foreign sources	7 438
Taxable income derived from South African sources	<u>1 100 000</u>
<b>Total</b>	<b><u>1 107 438</u></b>

**1.4 Income tax calculation****a) Calculation of normal tax payable before rebates**

Normal tax payable (R1 107 438 × 28%)	310 083
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**b) Calculation of the section 6quat rebate**

Amount of foreign taxes that qualify for the rebate (\$600 × 10.9515)	6 571
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Limited to: R2 083 (see below)

Calculation of the limitation:

<u>Taxable income derived from all foreign sources</u> ×	Normal tax payable
Total taxable income derived from all sources	

= $\frac{R7\ 438}{R1\ 107\ 438}$ ×	R310 083
------------------------------------	----------

= R2 083

**Note:**

- 1) Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R32 446 qualifies for the foreign tax rebate under section 6quat(1).
- 2) R2 083 of the qualifying withholding tax of R6 571 is deductible in full. The balance of R4 488 (R6 571 – R2 083) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year.

**c) Calculation of the normal tax payable after taking into account rebates**

Normal tax payable before rebates	310 083
Less: Section 6quat(1) rebate	<u>(2 083)</u>
Amount payable	308 000

See examples 1 to 6 in **Annexure B** which illustrate the tax treatment of foreign taxes on exempt foreign dividends earned by natural persons.

**4.6 Application of section 6quat to capital gains****4.6.1 General**

As noted in **4.2**, a foreign tax on a foreign capital gain potentially qualifies for a rebate under section 6quat(1). The amount of the rebate will generally be equal to the amount of any foreign taxes paid on the taxable capital gain<sup>54</sup> reduced as required by the three-step limitation process discussed in **4.6.4**.

<sup>54</sup> Section 6quat(1A)(a)(iii).

The following capital gains tax principles are particularly relevant to any discussions regarding the availability of a section 6quat(1) rebate for foreign taxes paid on capital gains:

- The taxable capital gain is equal to the relevant inclusion rate multiplied by the person's net capital gain for the year.
- The "net capital gain" of a person is the positive amount remaining after deducting any assessed capital loss brought forward from the previous year of assessment from the aggregate capital gain for the year.
- The aggregate capital gain or loss (as appropriate) is equal to the sum of the capital gains for the year plus the other capital gains required to be taken into account less the sum of the capital losses for the year less or plus<sup>55</sup> the annual exclusion<sup>56</sup> (in the case of a natural person or special trust).

#### 4.6.2 Inclusion of a foreign-source taxable capital gain in taxable income

In determining whether the net capital gain includes a capital gain from a foreign source, a resident may choose the order in which capital gains are reduced by any capital losses and the order in which an assessed capital loss carried forward from the previous year of assessment is applied against capital gains. Accordingly, in determining the aggregate capital gain, a resident may firstly allocate capital losses against those capital gains on which no foreign tax liability was incurred. Any excess capital losses must then be applied against those capital gains derived from a foreign source which have been subject to foreign tax. Further, in determining the net capital gain, the resident may firstly allocate carried forward assessed capital losses against those capital gains on which no foreign liability was incurred.

This is relevant when calculating the general limitation (see 4.5) as it impacts on the calculation of total foreign taxable income (that is, analysing what portion of the net capital gain is foreign and hence included in taxable income from all foreign sources).

#### 4.6.3 Source of a capital gain

Section 9(2)(j) and (k) and section 9(4)(d) provide the source rules for capital gains and losses.

Section 9(2)(j) provides that the source of any capital gain or loss resulting from the disposal of immovable property or any interest or right of whatever nature to or in immovable property contemplated in paragraph 2 of the Eighth Schedule, is in South Africa if the property is located in South Africa.

Section 9(2)(k) provides that any capital gain or capital loss resulting from the disposal of an asset [other than an asset contemplated in section 9(2)(j)] is derived from a South African source when the asset is disposed of –

- by a person who is a resident and -
  - the asset is not attributable to a permanent establishment located outside South Africa; and
  - the proceeds from the disposal are not subject to any taxes on income which are payable to a foreign jurisdiction; or

<sup>55</sup> The annual exclusion reduces both gains and losses.

<sup>56</sup> The use of the annual exclusion is limited and may not be used to create or increase an aggregate capital loss.

- by a person who is not a resident and that asset is attributable to a permanent establishment of that person which is situated in South Africa.

Conversely, a capital gain or capital loss will be derived from a foreign source under section 9(4)(d) if the asset is –

- immovable property or any right or interest in immovable property located outside South Africa;
- disposed of by a person who is resident in South Africa and
  - it is attributable to a foreign permanent establishment; and/or
  - the proceeds on disposal are subject to a foreign tax on income; or
- the asset is disposed of by a person who is not resident in South Africa and it is not attributable to a South African permanent establishment.

In addition to section 9(2) and 9(4), it is necessary to consider whether a particular tax treaty is relevant and accordingly whether there are any deeming source rules in a tax treaty which override the actual source rules [see 4.2.1(c)].

#### **Example 28 – Source of a capital gain**

##### *Facts:*

A resident acquires shares in a company which is resident in Country S. The resident disposes of the shares. Under Country S's domestic tax laws the proceeds derived by a person who is not a resident of Country S from the sale of shares in a company resident in that country are subject to capital gains tax.

The sale of the shares is not attributable to a permanent establishment in Country S.

##### *Result:*

The capital gain derived from the disposal of the foreign shares is from a foreign source because the proceeds are subject to foreign tax and are not attributable to a foreign permanent establishment [section 9(4)(d)].

#### **4.6.4 The three-step limitation process**

The portion of foreign taxes qualifying for a foreign tax rebate in respect of a foreign taxable capital gain is determined under a three-step limitation process. The three steps are as follows:

- Step 1 – The comparative inclusion limitation [section 6quat(1)].
- Step 2 – The comparative rate of tax on a foreign taxable capital gain limitation [paragraph (iB) of the proviso to section 6quat(1B)(a)].
- Step 3 – The overall normal tax on taxable income limitation [section 6quat(1B)(a)].

##### *Step 1 – The comparative inclusion limitation*

In South Africa capital gains are taxed more favourably than ordinary income resulting in less than 100% of capital gains ultimately being included in taxable income.



For example, only a certain percentage of a taxpayer's net capital gain is included in taxable income. The percentage included depends on the identity of the particular taxpayer but varies between 0% – 66,6%.<sup>57</sup> The relevant percentages are as follows:

- A natural person or special trust 33,3%.
- The individual policyholder fund of an insurer 33,3%.
- The untaxed policyholder fund of an insurer 0%.
- The company policyholder fund of an insurer 66,6%.<sup>58</sup>
- In any other case, 66,6%.

Other examples include the exclusions which are provided for in the Eighth Schedule such as –

- the annual capital gain exclusion which may be deducted from a natural person or special trust's aggregate capital gain for the year;<sup>59</sup>
- the primary residence exclusion for an individual or special trust;<sup>60</sup>
- the small business assets of an individual;<sup>61</sup> and
- the personal-use assets of an individual or a special trust.<sup>62</sup>

In circumstances where less than 100% of a capital gain is included in taxable income, the full amount of foreign tax will not qualify for a foreign tax rebate under section 6*quat*(1).<sup>63</sup> Only so much of the foreign tax as is attributable to the portion of the capital gain which is included in taxable income will potentially qualify for the rebate. This is referred to as *Step 1 – The comparative inclusion limitation* and involves a comparison between the amount of the capital gain subjected to foreign tax with the amount subjected to South African normal tax, that is:

$$\frac{\text{Amount of foreign taxable capital gain included in taxable income}}{\text{Amount of foreign taxable capital gain subject to foreign taxes}} \times \text{Foreign tax payable}$$

No rebate will be given for amounts or portions thereof that are not subject to tax in South Africa.<sup>64</sup> The taxes disqualified under this step are permanently disregarded and do not qualify to be carried forward to succeeding years of assessment.

<sup>57</sup> Paragraph 10 of the Eighth Schedule.

<sup>58</sup> With effect from 1 January 2016 the risk policy fund of an insurer will also be subject to an inclusion of 66,6%.

<sup>59</sup> Paragraph 5 of the Eighth Schedule.

<sup>60</sup> Paragraph 45 of the Eighth Schedule.

<sup>61</sup> Paragraph 57(2) of the Eighth Schedule.

<sup>62</sup> Paragraph 53 of the Eighth Schedule.

<sup>63</sup> In contrast, in circumstances where 100% of the gain is included in taxable income but less than 100% of the gain is subject to foreign tax, a gross up of the foreign tax is not applicable.

<sup>64</sup> This principle in section 6*quat*(1) is not unique. For example, the Australian Tax office and the HRMC also limit the amount of foreign tax credits where the full gain is not taxed in Australia or the UK respectively. (See ATO ID 2010/175 titled *Foreign income tax offset: entitlement where foreign capital gain is only partly assessable in Australia* <http://law.ato.gov.au/atolaw/print.htm?DocID=AID%2FAID2010175%2F00001&PiT=99991231235958&Life=20100917000001-99991231235959> [Accessed 12 February 2015] and *INTM169140 - UK residents with foreign income or gains: capital gains tax: Amount of foreign tax credit relief - extent to which a gain is doubly taxed –* [www.hmrc.gov.uk/manuals/intmanual/INTM169140.htm](http://www.hmrc.gov.uk/manuals/intmanual/INTM169140.htm) [Accessed 12 February 2015]).

In addition, the disqualified taxes do not qualify for a deduction under section 6quat(1C) or any other section.

Thus, if a foreign country taxes 100% of a gain realised by a natural person resident in South Africa while South Africa only taxes 33,3% of that gain, only 33,3% of the foreign taxes on the gain will potentially qualify for a foreign tax rebate (that is, before the limitation in steps 2 and 3).

**Example 29 – Determination of the portion of a foreign tax liability that relates to a foreign taxable capital gain**

*Facts:*

A natural person resident in South Africa disposes of a fixed property (which is not the resident's primary residence) located in Country A for R1 030 000 during the resident's 2015 year of assessment. The property was acquired for no consideration.

Country A regards the proceeds as income of a revenue nature and the full amount is subject to tax at a rate of 30%.

*Result:*

The foreign tax liability amounts to R309 000 (R1 030 000 × 30%).

In South Africa the taxable capital gain is determined as follows:

	R
Capital gain	1 030 000
<i>Less:</i>	
Annual exclusion (individuals and certain special trusts only)	<u>(30 000)</u>
Net capital gain	<u>1 000 000</u>
Inclusion rate for an individual	33,3%
Taxable capital gain	333 000

Only 32,33% [(R333 000 / R1 030 000) × 100%] of the foreign tax liability will potentially qualify for a foreign tax rebate. That is, of the foreign tax of R309 000 only R99 900 (R309 000 × 32,33%) will qualify for a foreign tax rebate. The remaining R209 100 (R309 000 × 67,67%) will not be taken into account because it does not relate to an amount subject to tax in South Africa. The excess amount of R209 100 (R309 000 – R99 900) is forfeited and may not be carried forward and taken into account in the succeeding year of assessment.

*Step 2 – The comparative rate of tax on a foreign taxable capital gain limitation [paragraph (iB) of the proviso to section 6quat(1B)(a)]*

The amount of foreign tax which potentially qualifies for a rebate is further limited if a resident derives a foreign-source capital gain<sup>65</sup> on the disposal of an asset (that is, a capital gain arising on the disposal of immovable property located outside South Africa or the disposal of an asset which is subject to foreign tax or which is attributable to a foreign permanent establishment). In these circumstances the amount of any foreign taxes levied on the taxable capital gain that potentially qualifies for a section 6quat(1) rebate is limited to the amount of normal tax attributable to that taxable capital gain [paragraph (iB) of the proviso to section 6quat(1B)(a)], that is:

$$\frac{\text{Amount of foreign taxable capital gain [falling in paragraph (iB) of the proviso to section 6quat(1B)(a)] included in taxable income}}{\text{Total taxable income from all sources (A)}} \times \text{Normal tax payable on (A)}$$

A limitation calculation is performed per foreign capital gain when more than one foreign capital gain falls within step 2. No provision is made for the aggregation of foreign capital gains in applying paragraph (iB) of the proviso to section 6quat(1B)(a).

Any balance of excess foreign taxes excluded by the limitation under step 2 is forfeited and does not qualify for a deduction under section 6quat(1C) or any other section. In addition, any balance of excess foreign taxes may not be carried forward to the following year of assessment to qualify for a foreign tax rebate in that year under paragraph (ii) of the proviso to section 6quat(1B)(a).

See **Example 30**.

*Step 3 – The overall normal tax on taxable income limitation [section 6quat(1B)(a)]*

Once the limitations in steps 1 and 2 have been applied, the remaining taxes are added to the other qualifying foreign taxes proved to be payable on the amounts contemplated in section 6quat(1)(a) to (f). The final step in the limitation process is then performed, namely, the limitation under section 6quat(1B)(a) - see **4.5**.

**Example 30 – Limitation on the foreign tax credit available for an asset not attributable to a foreign permanent establishment**

*Facts:*

A South African resident company invested in 5% of the shares of a foreign company resident in Country T. The shares were acquired for R100 000. The resident company has no presence in Country T. The resident company disposes of the shares in the year of assessment for R1 000 000. Country T subjects the gain realised on the sale of the shares to a withholding tax at a rate of 30%.

<sup>65</sup> See section 9(4)(d).

Other income and foreign tax items for the year of assessment:	R
<i>Income</i>	
Taxable income sourced in South Africa	300 000
Interest income sourced in Country T	200 000
<i>Foreign Taxes</i>	
Withholding tax levied on the interest income sourced in Country T	20 000
Withholding tax levied on the foreign capital gain (R1 000 000 – R100 000) × 30%	270 000
<i>Result:</i>	
(a) Taxable capital gain from the disposal of the shares	
In South Africa the taxable capital gain is determined as follows:	
Net capital gain (R1 000 000 – R100 000)	900 000
Inclusion rate for a company	66,6%
Taxable capital gain	599 400
(b) Normal tax payable	
Taxable income sourced in South Africa	300 000
Interest income sourced in Country T	200 000
Net capital gain sourced in Country T	<u>599 400</u>
Taxable income	<u>1 099 400</u>
Normal tax at 28% = R307 832	
(c) Application of the three step limitation in section 6quat for a foreign taxable gain not attributable to a foreign permanent establishment of a resident	
<i>Step 1 – The comparative inclusion limitation:</i>	
<u>Amount of foreign taxable capital gain included in taxable income</u> × Foreign tax payable	
Amount of foreign capital gain subject to foreign taxes	
= R599 400 / R900 000 × R270 000	
= R179 820	
Accordingly, only foreign taxes of R179 820 on the capital gain potentially qualify for a section 6quat(1) rebate before applying steps 2 and 3.	
The remaining R90 180 (R270 000 – R179 820) or (R270 000 × 33,40%) will not be taken into account because it does not relate to an amount subject to tax in South Africa. This amount is forfeited.	

*Step 2 – The comparative rate of tax on a foreign taxable capital gain limitation* [paragraph (iB) of the proviso to section 6quat(1B)(a)]

The amount of any foreign taxes levied on the taxable capital gain that potentially qualifies for a section 6quat(1) rebate is limited to the amount of normal tax attributable to that taxable capital gain [paragraph (iB) of the proviso to section 6quat(1B)(a)], that is:

$$\frac{\text{Amount of foreign taxable capital gain [falling in paragraph (iB) of the proviso to section 6quat(1B)(a)] included in taxable income}}{\text{Total taxable income from all sources (A)}} \times \text{Normal tax payable on (A)}$$

$$= R599\,400 / R1\,099\,400 \times R307\,832$$

$$= R167\,832$$

Thus under Step 2 only R167 832 of the qualifying foreign taxes of R179 820 potentially qualifies for the section 6quat(1) rebate. The balance of R11 988 is forfeited.

*Step 3 – The overall normal tax on taxable income limitation* [section 6quat(1B)(a)]

Under Step 3 the remaining qualifying foreign taxes calculated in Step 2 are added to the other qualifying foreign taxes proved to be payable in respect of the amounts contemplated in section 6quat(1)(a) to (f). The final step is the overall limitation under section 6quat(1B)(a).

<b>Sum of qualifying foreign taxes</b>	R
Withholding tax on foreign-source interest income	20 000
Withholding tax on foreign-source capital gain	<u>167 832</u>
Total	187 832

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= (R200\,000 + R599\,400) / R1\,099\,400 \times R307\,832$$

$$= R799\,400 / R1\,099\,400 \times R307\,832$$

$$= R223\,832$$

Thus the full amount of R187 832 qualifies for the section 6quat(1) rebate.

## **4.7 Application of section 6quat to the attributed income of a CFC**

### **4.7.1 General**

As noted in 4.2, any portion of the net income of a CFC as contemplated in section 9D which is attributed to a resident potentially qualifies for a rebate under section 6quat(1). The amount of the rebate is calculated under the three-step limitation process discussed in 4.7.2.

In order to understand the three-step limitation process, it is necessary to have a basic understanding of certain key provisions in section 9D. These are summarised below.

Section 9D(2) includes in the income of a resident the “proportional amount” of the “net income” of a CFC. The term “proportional amount” refers to the resident’s effective interest in the “net income” of the CFC. “Net income” is defined in

section 9D(2A) and in simplified terms is the CFC's taxable income determined as if it were a resident.

The deemed inclusion in income does not apply to a resident that –

- holds less than 10% of the participation rights; and
- may not exercise at least 10% of the voting rights

in a CFC.

Paragraph (i) of the further proviso to section 9D(2A) provides that the net income of a CFC in respect of a foreign tax year will be deemed to be nil when the aggregate amount of tax payable by the CFC to all spheres of government of any country other than the Republic in respect of the foreign tax year of that CFC is at least 75% of the amount of normal tax that would have been payable in respect of any taxable income of the CFC had the CFC been a resident for that foreign tax year, or<sup>66</sup> all the receipts and accruals of the CFC are attributable to a foreign business establishment which is not required to be taken into account under 9A.

Section 9D(9)(b) excludes from “net income” any amount attributable to a “foreign business establishment”. Section 9D(9A)(a) contains a number of exceptions to this exclusion, that is section 9D(9A)(a) details a number of instances when an amount attributable to a foreign business establishment must be included in “net income”. For example, section 9D(9A)(a)(i)(aa) provides that any amount which is attributable to a foreign business establishment of a CFC must be taken into account in determining the net income of a CFC if that amount is derived from the disposal of goods by that CFC of goods that will be acquired directly or indirectly by a connected person (in relation to that CFC) who is a resident *unless* the total amount of foreign taxes payable by a CFC for a particular tax year equals at least 50% of the amount of normal tax that would have been payable by the CFC on any taxable income of the CFC had the CFC been a resident for that foreign tax year.

Under section 72A(1) a resident who directly or indirectly, together with any connected person in relation to that resident, holds at least 10% of the participation rights in a CFC (otherwise than indirectly through a resident company) must on an annual basis submit a return in the form prescribed by the Commissioner. In addition section 72A(2) requires that such a resident must have available for submission to the Commissioner when so requested, a copy of the financial statements of the CFC for the relevant tax year of that CFC. These must be translated into English, or one of South Africa's official languages, if so requested.<sup>67</sup>

Failure to comply with section 72A(2) will result in the provisions of section 6*quat* not being available in respect of any tax proved to be payable to a foreign government in respect of an amount included in the income of the resident under section 9D(2) in relation to that CFC, unless reasonable grounds exist either for the failure which is outside the control of the resident or for the resident to believe that the resident is not subject to section 72A(2).<sup>68</sup>

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<sup>66</sup> With effect from years of assessment ending on or after 1 December 2014.

<sup>67</sup> Section 33 of the TA Act.

<sup>68</sup> Section 72A(3)(b)(ii).

**Example 31 – Application of section 6quat(1) to foreign taxes paid in more than one country by a CFC**

*Facts:*

A resident company owns 100% of the shares in a CFC (CFC A) in Country A. CFC A earns dividends of R100 000 from its share investment in a company which is tax resident in Country B, the company is not a CFC. CFC A did not earn any other income.

*Taxes levied by the foreign tax jurisdictions on the dividend received by CFC A*

Country B levies a withholding tax of 10% (R10 000).

Country A levies tax of R15 000 but gives a credit of R4 000 on the foreign withholding tax payable to Country B.

Country A and Country B's tax treatment is appropriate under the tax treaty between the two countries and the domestic tax laws of each country.

*Result:*

*Proportional amount attributed under section 9D:*

The dividend of R100 000 received by CFC A from the other foreign company constitutes a foreign dividend for purposes of calculating the net income of CFC A under section 9D(2A).

Under section 10B(3) partial exemption is provided for the foreign dividend based on the ratio of 13 / 28 as the CFC is a company. The identity of the resident in whose hands attribution occurs under section 9D(2) is not relevant.

*Exempt portion of the foreign dividend:*

$$= R100\ 000 \times 13 / 28$$

$$= R46\ 429$$

Therefore the taxable portion of the foreign dividend amounts to R53 571 (R100 000 – R46 429). This amount represents the net income of CFC A and is attributed to the resident under section 9D(2).

*Amount of foreign taxes which potentially qualify for a rebate under section 6quat(1)*

The provisions of paragraph (ii) of the proviso to section 6quat(1A) provide that the amount included in the resident company's taxable income, that is, the proportional amount, must be determined without regard to section 10B(3). Accordingly, the foreign tax relating to the full amount of the dividend (R100 000) potentially qualifies for a section 6quat(1) rebate.

<b>Sum of qualifying foreign taxes</b>	
	R
<i>Country A</i>	
Tax on income levied	15 000
Less: Rebate for foreign taxes	(4 000)
<i>Country B</i>	
Withholding tax paid	<u>10 000</u>
Total foreign taxes paid	21 000
Foreign taxes potentially qualifying for a section 6quat(1) rebate is R21 000. The limitation formula provided for in section 6quat(1B) will then apply to the full amount of foreign taxes of R21 000.	

**Example 32 – Application of section 6quat(1) to foreign taxes proved to be payable by an intermediate CFC which taxes relate to the net income of a lower tier CFC resident in another foreign country**

*Facts:*

A resident company owns 100% of the shares in a CFC resident in Country A (CFC A). CFC A owns 100% of the shares in a CFC resident in Country B (CFC B).

The above-mentioned companies have a December year-end.

The following information is relevant for the 2015 year of assessment ending December:

CFC B derives passive income of R100 000. CFC B does not have a business establishment in Country B. CFC B is subject to tax in Country B on the passive income of R100 000. The foreign tax amounts to R10 000. CFC B distributes the after-tax income of R90 000 as a dividend to CFC A.

Country B does not levy any withholding tax on the dividend declared by CFC B to CFC A.

Country A has CFC rules similar to that of South Africa. The application of the CFC rules results in the attributed income which is included in CFC A's taxable income (R100 000) being subject to tax in Country A at a rate of 30% which represents a tax liability of R30 000. Country A does not give CFC A any foreign tax credits. The dividend is exempt from tax in Country A.

*Result:*

Under South Africa's CFC rules each CFC in a chain of CFCs is considered separately.

*CFC B*

Section 6quat(1A) specifically provides that the foreign taxes proved to be payable to a sphere of a foreign government by any CFC *in respect of* the proportional amount attributed to the resident may qualify for a foreign tax rebate.

CFC B's passive income of R100 000 is attributed to and included in the resident company's income under section 9D(2). Accordingly, the foreign tax paid by CFC B of R10 000 potentially qualifies for a foreign tax rebate in the hands of the resident company under section 6quat(1).



The foreign taxes paid by CFC A also potentially qualify for a foreign tax rebate in the hands of the resident company because those foreign taxes are paid by a CFC and the passive income which was attributed to CFC A under Country A's tax rules, and on which the foreign tax is payable, is the same income as that which was attributed to the resident company under section 9D(2).

#### *CFC A*

The dividend of R90 000 received by CFC A from CFC B constitutes a foreign dividend for purposes of calculating CFC A's net income under section 9D(2A). However the full amount qualifies for the participation exemption under section 10B(2)(a). Thus the net income of CFC A that is attributable to the resident company under section 9D(2) equals RNil.

Even if the dividend had been included in net income for South African attribution purposes, the foreign taxes paid by CFC A in Country A would not qualify for a rebate under section 6quat(1) as the tax was paid on attributed notional income under Country A's CFC rules and not on actual income (the dividend).

#### **4.7.2 The three-step CFC limitation process**

The amount of foreign taxes which qualify for a foreign tax rebate on the proportional amount of a CFC's income which is attributed to the income of a resident is determined under a three-step limitation process. The three steps are as follows:

- Step 1 – Determine the amount of foreign tax incurred by the CFC which is attributable to the proportional amount of net income included in the resident's income.
- Step 2 – Determine if the proportional amount of foreign tax determined in step 1 is further limited to the relevant amount of South African normal tax [paragraph (iA)(bb) of the proviso to section 6quat(1B)(a)].
- Step 3 – Apply the overall normal tax on taxable income limitation [section 6quat(1B)(a)] taking steps 1 and 2 into account.

*Step 1 – Determine the amount of foreign tax incurred by the CFC which is attributable to the proportional amount of net income included in the resident's income.*

A resident potentially qualifies for a rebate on the foreign taxes proved to be payable by a CFC that relates to the proportional amount of that CFC's net income which is included in the resident's income under section 9D.

In assessing whether the foreign tax is proved to be payable from the CFC's perspective it will be necessary to consider the applicable foreign domestic tax law and any tax treaties that are applicable to the CFC and the other foreign country. The tax treaty between South Africa and the foreign jurisdictions will not be relevant in these circumstances.

The amount of foreign taxes incurred by the CFC must be adjusted to –

- a) only reflect the resident taxpayer's effective interest in the CFC (that is, the same interest referred to above when determining the proportional amount of net income requiring attribution); and

- b) restrict the amount of foreign tax qualifying when the foreign taxable income is greater than the attributable net income calculated according to South African tax principles.<sup>69</sup>

In circumstances where the restriction under b) is applicable, the amount of foreign taxes is further limited by the amount that the net income (as determined under South African tax principles) bears to the foreign taxable income (as determined under foreign tax principles).

For example, if the resident holds 75% of the participation rights only 75% of the foreign tax is potentially available for the foreign tax rebate. In addition, if the amount of net income is R1m and the amount of foreign taxable income (in rand) is R3m, then 75% of the qualifying foreign taxes will be further limited by a ratio of 1/3. The difference of R2m was never included in the income of the resident under section 9D(2) and the foreign tax on it will therefore not qualify for a foreign tax rebate under section 6quat(1) and (1A). (See **Examples 33** and **34**)

*Step 2 – Determine if the proportional amount of foreign tax determined in step 1 is further limited to the relevant amount of South African normal tax [paragraph (iA)(bb) of the proviso to section 6quat(1B)(a)]*

To the extent that the proportional amount of net income, and hence the proportional amount of foreign taxes, includes an amount which is attributable to a CFC's foreign business establishment and which did not qualify for exclusion from attribution under section 9D(9A)(a) or 9D(9)(b), the amount of foreign taxes which potentially qualifies for a foreign tax rebate is limited. Broadly speaking, this includes amounts attributable to a foreign business establishment which are not determined on an arm's length basis or which are specifically required to be taken into account as a result of the application of section 9D(9A)(a)(i) – (vii). These amounts are referred to in this paragraph of the Note as "tainted income".

The amount of foreign taxes, as calculated under step 1, *in respect of* the tainted income is what is further limited to the amount of normal tax attributable to the inclusion of that tainted income in the resident's income under section 9D(2). That is, foreign taxes on tainted income equals:

$$\frac{\text{Proportionate share of tainted income}}{\text{Proportionate share of net income of CFC}} \times \text{Step 1 amount}$$

**Limited to:**

$$\frac{\text{Proportionate share of tainted income}}{\text{Total South African taxable income}} \times \text{Normal tax}$$

Any excess is forfeited and may not be carried forward to the next tax year.<sup>70</sup> In addition, the excess does not qualify for a deduction under section 6quat(1C) or any other section. In a number of circumstances the limitation will be applicable and must be calculated but it will not have an impact because the normal tax on the comparable amount will be greater than the foreign tax on that amount. This arises because, amongst other reasons, the CFC provisions exclude high taxed jurisdictions from attribution (see paragraph (i) of the proviso to section 9D(2A) under which the

<sup>69</sup> A gross up is not applicable when the foreign taxable income is less than the attributable net income calculated according to South African tax principles.

<sup>70</sup> Paragraph (ii) of the proviso to section 6quat(1B)(a).

net income of a CFC is deemed to be nil when its foreign taxes are at least 75% of the amount of normal tax that would have been payable had attribution been required).

**Example 33 – Limitation for an amount attributable to a CFC which is not excluded from attribution under section 9D**

*Facts:*

Resident A holds 75% of the participation rights in CFC B. CFC B's net income of R500 000 includes R150 000 of interest income which, although attributable to CFC B's foreign business establishment, did not qualify for the foreign business establishment exclusion and was required to be taken into account as a result of section 9D(9A)(a)(iii)(cc). CFC B's taxable income under the tax laws of its country of residence amounted to R490 000 while the foreign tax liability in respect thereof equalled R100 000.

Resident A's taxable income for South African tax purposes was R1 000 000 (which included 75% x R500 000 CFC B net income) and normal tax was R280 000.

*Result:*

*CFC*

Step 1: *Foreign taxes attributable to the proportional amount of net income included in taxable income (X)*

$$X = [\text{Foreign taxes} \times (\text{net income under South African tax principles} / \text{taxable income under foreign tax principles})^*] \times \text{participation interest}$$

$$X = [R100\ 000 \times (n/a^*)] \times 75\%$$

$$X = R75\ 000$$

\* not applicable as taxable income under foreign tax principles is less than net income under South African tax principles.

*Step 2:*

The limitation in paragraph (iA)(bb) of the proviso to section 6quat(1B)(a) is applicable because the R150 000 is attributable to a foreign business establishment and was included under section 9D(9A)(a)(iii)(cc).

a) *Calculation of foreign taxes attributable to non-tainted income*

$$\frac{\text{Proportionate share of non-tainted income}}{\text{Proportionate share of net income of CFC}} \times \text{Step 1 amount}$$

$$= [((R500\ 000 - R150\ 000) \times 75\%) / (R500\ 000 \times 75\%)] \times R75\ 000$$

$$= R52\ 500$$

b) *Calculation of foreign taxes attributable to tainted income*

$$\frac{\text{Proportionate share of tainted income}}{\text{Proportionate share of net income of CFC}} \times \text{Step 1 amount}$$

***is limited to***

$$\frac{\text{Proportionate share of tainted income}}{\text{Total South African taxable income}} \times \text{Normal tax}$$

$$= [(R150\,000 \times 75\%) / (R500\,000 \times 75\%)] \times R75\,000 \text{ limited to } [(R150\,000 \times 75\%) / R1\,000\,000] \times R280\,000$$

$$= R22\,500 \text{ limited to } R31\,500$$

Therefore, although the limitation is applicable and must be calculated, in this case it has no effect (limitation greater than the applicable amount).

Total foreign taxes which will be subject to the limitation under section 6quat(1B)(a) in step 3

$$= R52\,500 + R22\,500$$

$$= R75\,000$$

*Step 3: Apply the overall normal tax on taxable income limitation [section 6quat(1B)(a)] taking steps 1 and 2 into account*

Once the limitations in steps 1 and 2 have been applied, the remaining qualifying foreign taxes incurred by the CFC are added to any other qualifying foreign taxes proved to be payable on the amounts contemplated in section 6quat(1)(a) to (f). The final step in the limitation process is then performed, namely, the overall limitation under section 6quat(1B)(a). (See 4.5)

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= R375\,000 / R1\,000\,000 \times R280\,000$$

$$= R105\,000$$

Therefore, the amount of taxes which potentially qualify for a rebate in year 1 is R75 000 (see Step 1 and Step 2).

**Example 34 – Limitations for an amount attributable to a CFC (but not its foreign business establishment) which is not excluded from attribution under section 9D**

*Facts:*

A resident holds 60% of the participation and voting rights in a CFC which does not have a foreign business establishment. The net income of the CFC for year 1 is R100 000 consisting of interest income.

The resident has other foreign source taxable income of R50 000. Foreign taxes on this income amounted to R15 000.

The resident does not earn any South African-source income in year 1.

The resident's total taxable income is R110 000 ((R100 000 × 60%) + R50 000) and normal tax is R30 800 (R110 000 × 28%).

In its country of residence the CFC's equivalent taxable income amounted to R120 000 which resulted in a tax liability of R12 000 in that country.

*Result:*

*CFC*

*Step 1: Foreign taxes attributable to the proportional amount of net income included in taxable income (X)*

$$X = [\text{Foreign taxes} \times (\text{net income under South African tax principles} / \text{taxable income under foreign tax principles})^*] \times \text{participation interest}$$

$$X = [R12\ 000 \times (R100\ 000 / R120\ 000)] \times 60\%$$

$$X = R6\ 000$$

\* only applicable if taxable income under foreign tax principles is greater than net income under South African tax principles

*Step 2:*

Not applicable as the amount is not attributable to a foreign business establishment.

*Sum of total foreign taxes potentially qualifying for a rebate*

$$= R6\ 000 \text{ in relation to the CFC (taking steps 1 and 2 into account) + } R15\ 000 \text{ relating to the other foreign-source taxable income}$$

$$= R21\ 000$$

*Step 3: Calculation of the limitation of the rebate*

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= R110\ 000 / R110\ 000 \times R30\ 800$$

$$= R30\ 800$$

Therefore, the amount of taxes qualifying for a rebate in year 1 is R21 000.

See **Annexure A** for a comprehensive three-step limitation example including foreign branch operations, foreign dividend income and income attributed to a CFC.

#### 4.8 The carry-forward of a balance of excess foreign taxes

To the extent that the amount of the qualifying foreign taxes payable exceeds the amount of the rebate (calculated after applying the limitations discussed in **4.5**, **4.6** and **4.7**), the excess amount is carried forward to the immediately succeeding year of assessment in which it will potentially qualify as a foreign tax available for set off against the normal tax payable on taxable income derived from foreign sources in that year of assessment [paragraph (ii) of the proviso to section 6quat(1B)(a)].

Any balance of excess foreign taxes may not be carried forward for more than seven years, calculated from the year of assessment in which the balance was carried forward for the first time [paragraph (iii) of the proviso to section 6quat(1B)(a)].

The excess amount of foreign taxes does not relate to any taxes overpaid to SARS. It relates solely to taxes paid to foreign tax jurisdictions and SARS will not refund any

part of that excess to the relevant taxpayer or transfer it to another taxpayer such as a company in the same group of companies.

Section 6quat does not provide for the carry-back of a balance of excess foreign taxes to previous years of assessment.

The amount of the foreign tax rebate relating to the taxable foreign income derived during a year of assessment must first be used against the normal tax payable in that year. Thereafter, any balance of excess foreign taxes brought forward from the preceding year may be set off against the remaining balance of normal tax payable on taxable income derived from foreign sources [paragraph (ii)(bb) of the proviso to section 6quat(1B)(a)].

The balance of excess foreign taxes may not be used against normal tax payable on taxable income derived from South African sources (see **Example 3** in **Annexure B**).

In circumstances where the balance of excess foreign taxes includes amounts carried forward from more than one year of assessment, the excess amount determined for each year of assessment must be recorded separately and applied on a first-in-first-out basis against the normal tax payable in future years of assessment.

#### **Example 35 – Foreign tax rate exceeds the normal tax rate**

*Facts:*

A resident company derives income of R100 000 from a source in Country S. No other income is derived by the resident company from either a local or foreign source.

The income is subject to tax at a rate of 30% in Country S and 28% in South Africa.

*Result:*

	R
South African taxable income	100 000
Normal tax (R100 000 × 28%)	28 000
Less: Section 6quat(1) rebate (see note below)	<u>(28 000)</u>
South African tax payable	<u>Nil</u>

**Note:**

Qualifying foreign taxes

$$= R100\,000 \times 30\%$$

$$= R30\,000$$

*Calculation of the limitation of the rebate:*

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= R100\,000 / R100\,000 \times R28\,000$$

$$= R28\,000$$

Therefore, the rebate for the current year is R28 000 and the excess of R2 000 (R30 000 – R28 000) may be carried forward to the next year of assessment.

This means that in situations where the foreign tax rate exceeds the domestic tax rate and there is other foreign income which is taxed at a lower tax rate, South Africa is effectively giving a rebate for the double taxation and subsidising the tax base of another country. In this example, South Africa is giving a rebate equal to R28 000 for double taxation and is potentially subsidising Country S's tax base to the extent of R2 000.

See **Example 3** for an example where the normal tax rate exceeds the foreign tax rate.

### **Example 36 – Utilisation of excess foreign taxes carried forward from a previous year**

*Facts:*

A resident company conducts trading operations in South Africa as well as Country C. In year 1 the resident company had an assessed loss from its South African operations which exceeded the taxable income earned from its operations in Country C. As a result excess foreign taxes of R400 000 were carried forward under paragraph (ii) of the proviso to section 6quat(1B)(a) to year 2 to qualify for a foreign tax rebate.

In year 2 the resident company earned taxable income from the operations conducted in Country C of R1 500 000. The government of Country C granted special tax incentives in year 2 and as a result no tax was payable in Country C.

The resident company's operations in South Africa in year 2 give rise to income of R15 000 000 and deductible expenses of R10 000 000. The corporate tax rate is 28%.

*Result:*

<b>Year 2</b>	<b>R</b>
<b>South African taxable income or assessed loss</b>	
Foreign operations – Country C	1 500 000
South African operations	<u>5 000 000</u>
Total taxable income for year 2	6 500 000
Normal tax payable at 28%	1 820 000
Less: Section 6quat(1) rebate*	<u>(400 000)</u>
Final tax payable	1 420 000

\* Section 6quat(1B)(a) rebate limitation:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= R1\,500\,000 / R6\,500\,000 \times R1\,820\,000$$

$$= R420\,000$$

No foreign taxes are payable in year 2, however there was taxable income from foreign sources in year 2 and as a result the excess foreign taxes from year 1 can potentially be used in year 2. The maximum amount of rebate in year 2 is R420 000 which means that the full amount of the excess foreign taxes of R400 000 carried forward from year 1 can be fully used in year 2.

#### 4.9 Interaction between tax treaty credit method and section 6quat(1) rebate method

##### 4.9.1 Tax treaty methods for providing relief from double taxation

This paragraph of the Note discusses the article in tax treaties which deals with the elimination of double taxation not otherwise already eliminated by a country's domestic tax law or the distributive tax rules in the tax treaty. For example, a tax treaty may grant a particular country the sole taxing right which means that there is no double taxation which needs to be addressed by the article in the tax treaty specifically dealing with the elimination of double taxation.<sup>71</sup> Tax treaties employ two principles to address double taxation, namely, the exemption principle or the credit principle.

Under the credit principle, the resident state calculates the resident's tax under its domestic law taking into account the applicable provisions of the tax treaty and it then allows a deduction from its own tax for the taxes paid in the other country.<sup>72</sup> Two credit principle methods are –

- the “full credit” method under which the resident state allows a deduction from local tax of the total tax paid in the other country on income which is also taxed in the resident state; and
- the “ordinary credit” method under which the amount of the deduction from local tax permitted by the resident state for the tax paid in the other country on income that is also taxed in the resident state is limited to its own tax which is applicable to that income.

The majority of the tax treaties concluded by South Africa provide for the elimination of double taxation by way of the ordinary credit method while a few of the older treaties provide for the exemption method of relief in the article dealing with the elimination of double tax.<sup>73</sup> None of South Africa's tax treaties provide for the “full credit” method of relief.

<sup>71</sup> In *Klaus Vogel on Double Taxation Conventions* in paragraph 36a at page 1130 Vogel points out “... the heading (*Methods for elimination of double taxation*)... is misleading... it gives the impression that methods to eliminate double taxation are exclusively dealt with in Art. 23A and B (a more precise heading would be: ‘Methods for eliminating residual double taxation’).”

<sup>72</sup> Depending on the particular tax treaty, in some circumstances where the foreign tax which would otherwise be payable has been reduced in accordance with laws designed to promote economic development, the amount of the reduction is considered to be a tax paid for purposes of calculating the credit relief available under section 6quat(1) and the tax treaty. For example, see article 22(2) of the tax treaty between South Africa and Botswana.

<sup>73</sup> For example in the tax treaties with Germany, Zambia and Zimbabwe.



#### 4.9.2 General principles that apply to interactions between domestic legislation and tax treaties

In respect of the interaction between domestic legislation and tax treaties, the OECD commentary on article 23B provides the following:<sup>74</sup>

“[Operation of the credit] Article 23B sets out the main rules of the credit method, but does not give detailed rules on the computation and operation of the credit. This is consistent with the general pattern of the Convention. Experience has shown that many problems may arise. Some of them are dealt with in the following paragraphs. In many States detailed rules on credit for foreign tax already exist in their domestic laws. A number of conventions, therefore, contain a reference to the domestic laws of the Contracting States and further provide that such domestic rules shall not affect the principle laid down in Article 23B”.

On the question whether tax treaty relief provisions are complete or require further reliance on domestic law, Vogel says the following:<sup>75</sup>

“The details of both the exemption method and the credit method must be **shaped** by reference to **domestic law**, viz. in regard to reference figures – what positive and what negative elements should be included in the ‘foreign items of income’ and what in the ‘domestic’ ones, etc. – and in regard to procedures. In this connection the credit method is, however, by far the more complicated of the two, and that is why it is shaped and supplemented to a much greater extent by domestic law.”

Vogel also states the following on the relationship between domestic law and the article of a tax treaty (DTCs) dealing with the elimination of double taxation:<sup>76</sup>

“Where DTCs apply, the latter’s rules – being special provisions – take precedence over unilateral domestic arrangements ... But, to a certain extent, such unilateral rules remain applicable next to those of DTCs. For one thing, treaties provide exemption or credit **only in principle** while failing to arrange for their implementation, In such cases, domestic rules, if any, ... become applicable to **close the gaps** ... Treaties quite frequently do in fact expressly refer to domestic tax law in regard to implementation – particularly of the credit method (see synoptic table re Art. 23 A (2) / 23 B (1), *infra* m.no. 178). Moreover, where treaties **fail to eliminate double taxation or do so no more than partially**, it remains permissible under treaty law to resort, as a **supplementary means**, to domestic legislation on unilateral elimination of double taxation. Here again, the treaty is designed to do no more than restrict national law and is not meant to preclude application of favourable rules of domestic law. However, such resort to unilateral measures in addition to, and for supplementing, a DTC must, of course, not result in relief being claimed twice. ... Apart from that, resort to unilateral measures may be excluded by domestic law in cases where a DTC becomes applicable.”

The abovementioned principle is supported by Arnold:<sup>77</sup>

“The treaty provisions establish the general principle of exemption or credit. Each country is left to establish detailed rules for the implementation of the general principle.”

Thus each country is free to apply its own legislation and technique in calculating foreign tax rebates.

<sup>74</sup> OECD Commentary on Article 23B, in paragraph 60 at page 342.

<sup>75</sup> *Klaus Vogel on Double Taxation Conventions* in paragraph 38 at page 1131.

<sup>76</sup> *Klaus Vogel on Double Taxation Conventions* in paragraph 48 at page 1174.

<sup>77</sup> Brian Arnold *International Tax Primer* 2 ed (2002) Kluwer Law International, The Hague, The Netherlands at page 47.

In the South African context, section 6*quat*(2) specifically provides the taxpayer with a choice of the relief under section 6*quat* or the relief provided under a tax treaty (if applicable) (see 4.9.3).

#### 4.9.3 Choice between the tax treaty credit method and section 6*quat*(1) rebate method

As noted in 4.9.2, section 6*quat*(2) provides a resident with a choice between the relief provided for in the tax treaty (if applicable) and the relief provided for under section 6*quat*(1) or (1C) as appropriate. A resident is not entitled to claim both the section 6*quat*(1) rebate (or the deduction under section 6*quat*(1C) if applicable) and the relief provided for in the tax treaty in respect of the same taxable income derived from a country with which South Africa has concluded a tax treaty. In addition, a resident may not elect tax treaty relief and at the same time seek to apply the more favourable elements of section 6*quat* such as the carry forward of excess taxes.

The choice of relief, that is, section 6*quat*(1)<sup>78</sup> or tax treaty relief, can be exercised annually per taxable income per country. The resident is not bound by a choice made in a previous year of assessment. In circumstances where more than one treaty applies to a resident during a particular year of assessment, the resident may elect different methods of relief for each tax treaty. SARS will apply section 6*quat*(1) if the resident does not elect which form of relief must be applied.

#### 4.9.4 Tax treaty credit method – effect of wording of relevant articles

The wording of the relevant article in the tax treaty will determine how the tax treaty credit method must be applied in a specific case. Tax treaty articles can be divided into –

- those that provide for relief from double taxation under the credit method without any reference to the provisions of domestic law relating to the granting of a credit for foreign taxes (that is, section 6*quat*), and
- those that are “subject to” the provisions of the law of South Africa regarding the deduction of foreign taxes from normal tax payable in South Africa (that is, section 6*quat*).

#### 4.9.5 The tax treaty credit method – articles that are not “subject to” section 6*quat*

Some tax treaties providing for the credit method of relief are not stated to be “subject to” the provisions of domestic law relating to the granting of a credit for foreign taxes (that is, section 6*quat*). In these circumstances a resident may elect to apply the tax treaty credit method of relief instead of the section 6*quat* rebate method of relief (assume the income is foreign-source). This election is sanctioned under section 6*quat*(2).

The election is made in its entirety which means that if a resident elects the relief provided under the tax treaty, none of the provisions of section 6*quat* (including the additional relief measures) apply. For example, a person electing to use a tax treaty credit method will not be entitled to carry forward any excess foreign taxes under paragraph (ii) of the proviso to section 6*quat*(1B)(a).

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<sup>78</sup> For the rest of 4.9 and its subparagraphs assume the income is foreign source and accordingly that section 6*quat*(1C) is not applicable.

An example of a tax treaty that is not “subject to” section 6quat is the tax treaty between South Africa and Australia.<sup>79</sup> The relevant part of article 23 of the tax treaty with Australia, which deals with the elimination of double taxation, reads as follows:

- “3. In the case of South Africa, *Australian tax paid* by a resident of South Africa in respect of income taxable in Australia *in accordance with the Agreement*, shall be deducted from *the taxes due according to South African fiscal law*. *The deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income.*”

(Emphasis added.)

The provisions of section 6quat are not applicable when calculating the relief provided under the tax treaty. Taxpayers must refer to the wording of the particular tax treaty, or, if applicable, a separate agreement with the particular country, to determine how to calculate the tax treaty relief. For example, per the tax treaty with Australia, the wording of which is common to most treaties, the following points are relevant in calculating the tax treaty relief:

- Australian tax paid refers to the tax paid in Australia as calculated under Australian domestic law and the provisions of the tax treaty.
- “In respect of income taxable in Australia” – practically the source of the income will often be Australian, however this wording does not limit the source of the income to Australia, the income could be sourced in Australia, South Africa or even a third country. The important requirement is that the income must be taxable in Australia.
- “In accordance with the Agreement” means that a credit is only available for the foreign tax paid on items of income correctly taxed under the tax treaty.
- Taxes due according to South African fiscal law refers to the tax payable in South Africa as calculated under the Act and the provisions of the tax treaty. This requires the calculation of taxable income under the Act (that is, South African tax law).
- The deduction from South African normal tax is limited and that limit is calculated on a “per country” basis rather than on a “per income item” or an “overall” basis. That is, the maximum deduction is limited to:<sup>80</sup>

$$\text{Total South African tax payable} \times \frac{\text{(Taxable) Income concerned}^{81}}{\text{Total (taxable) income}}$$

- “Income” is interpreted to mean taxable income (see **4.9.8** – “Meaning of ‘income’ in the article dealing with the elimination of double tax in tax treaties”).
- “Total South African tax payable” is and can only be calculated under the Act (that is, South African tax law) taking into account the provisions of the applicable tax treaty. This requires, amongst other aspects, the calculation of taxable income under the Act. Total South African tax is normal tax before the section 6quat(1) rebate but,

<sup>79</sup> The wording of the specific treaty must be considered as it can vary and differences in wording can impact on the interpretation thereof.

<sup>80</sup> Words in brackets are added for clarification.

<sup>81</sup> See bullet points below for further detail.

in the case of natural persons, after the primary, secondary, tertiary and medical tax credits under sections 6A and 6B.

- “Taxable income concerned” refers to taxable income in respect of the income which is taxed in South Africa and is also taxed, in accordance with the provisions of the tax treaty, in the other country (that is, Australia in this example).
- It is therefore clear that in calculating the *pro rata* portion of the South African tax which is attributable to the income that is taxed in both countries, both the taxable income concerned and total taxable income must be calculated in accordance with the Act. SARS disagrees with the view that the limitation may be calculated with reference to the taxable income as determined under the tax laws of the other contracting state.
- The calculation of taxable income in accordance with the Act requires an allocation of the appropriate expenses to the income concerned.
- Notwithstanding the formula, the maximum deduction, across all countries applicable to a particular taxpayer, is limited to the total South African tax payable in the particular tax year and any excess foreign tax is forfeited.

### **Example 37 – Maximum deduction under treaty relief**

#### *Facts:*

A resident company conducts its trading operations in South Africa, Country A and Country B. The South African operations yielded a tax loss of R100 000, the operations in Country A yielded taxable income of R200 000 and the operations in Country B yielded taxable income of R300 000.

The resident company paid R58 000 tax in Country A and R75 000 tax in Country B.

The tax treaty between South Africa and Country A and the tax treaty between South Africa and Country B are not subject to section 6quat. The resident company elects under section 6quat(2) to use the treaty relief for the elimination of double taxation, rather than the section 6quat method of relief.

#### *Result:*

*Normal tax payable = South African normal tax – tax treaty credit*

$$\begin{aligned}
 &= [(R100\ 000) + R200\ 000 + R300\ 000] \times 28\% - R112\ 000 \text{ (see working 1)} \\
 &= R112\ 000 - R112\ 000 \\
 &= \text{Rnil}
 \end{aligned}$$

#### *Working 1:*

$$\begin{aligned}
 \text{The maximum foreign credit} &= \text{maximum Country A foreign tax credit (working 2) +} \\
 &\quad \text{maximum Country B foreign tax credit (working 3)} \\
 &= R56\ 000 + R75\ 000 \\
 &= R131\ 000.
 \end{aligned}$$

The maximum foreign tax credit in respect of all countries is, however, limited to the total normal tax payable in the particular year of assessment. Therefore, the maximum foreign tax credit under the applicable treaties is R112 000. The excess of R19 000 (maximum deduction of R131 000 – South African normal tax of R112 000) is effectively forfeited as it is not refundable and may not be carried forward to the next tax year.

*Working 2: Calculation of the maximum foreign tax credit in respect of Country A tax paid under the tax treaty on a country-by-country basis*

Country A tax paid = R58 000

Maximum treaty credit

$$= \text{Total South African tax payable} \times \frac{\text{(Taxable) Income concerned}}{\text{Total (taxable) income}}$$

$$= R112\ 000 \times R200\ 000 / R400\ 000$$

$$= R56\ 000$$

Therefore, maximum credit for Country A tax is R56 000.

*Working 3: Calculation of the maximum foreign tax credit in respect of Country B tax paid under the tax treaty on a country-by-country basis*

Country B tax paid = R75 000

Maximum treaty credit

$$= \text{Total South African tax payable} \times \frac{\text{(Taxable) Income concerned}}{\text{Total (taxable) income}}$$

$$= R112\ 000 \times R300\ 000 / R400\ 000$$

$$= R84\ 000$$

Therefore, the full amount of Country B tax of R75 000 qualifies as a credit.

#### **4.9.6 The tax treaty credit method – articles that are “subject to” section 6quat**

In providing for the credit method of relief, some tax treaties stipulate that the credit must be determined –

*“subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa”.*

(Emphasis added.)

The words “subject to” make it clear that the credit must be determined under the provisions of the Act dealing with the deduction of foreign taxes from tax payable, which in effect means section 6quat. In the context of foreign-source income, the whole of section 6quat applies and not merely certain elements of it. For example, a taxpayer may not just apply the subsection dealing with carry forward of excess foreign taxes.

Depending on the wording of the particular tax treaty, the tax treaty could place additional limitations on the relief granted, that is, additional limitations over and above the requirements of section 6quat. For example, a number of the tax treaties which include the “subject to” wording also include the same wording as discussed

above in relation to tax treaties without the “subject to” wording. This means that the article also contains the following additional limitation:

“Such deduction (*the deduction calculated in terms of section 6quat*) shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income.”

(Emphasis added.)

In these cases it would not generally make sense for a taxpayer to elect that the tax treaty method of relief apply as it would require them to calculate the relief available under section 6quat and then potentially further limit that relief under a per country limitation calculation as required under the tax treaty. Accordingly, it is likely that taxpayers would practically elect the relief provided under section 6quat in order to avoid being exposed to an additional limitation in the tax treaty. An article of this nature therefore effectively means that section 6quat(1) is often practically the only method available for determining a foreign tax rebate in respect of foreign-source income under a tax treaty which contains a “subject to” provision.

An example of a tax treaty that is “subject to” section 6quat is article 22 of the tax treaty between South Africa and Turkey<sup>82</sup> which deals with the elimination of double taxation and provides that double taxation shall be eliminated as follows:

“in South Africa, *subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa* (which shall not affect the general principle hereof), *Turkish tax paid* by residents of South Africa in respect of income which, *in accordance with the provisions of this Agreement*, may be taxed in Turkey shall be deducted from the *taxes due according to South African tax law*. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income;”

(Emphasis added.)

Assuming the amount which has been subject to double tax is foreign-source, the following points are relevant to interpreting the tax treaty relief provided under article 22(a) of the tax treaty:

- The taxpayer has a choice between the relief provided under section 6quat(1) and the relief provided under the tax treaty between South Africa and Turkey.
- Assuming the taxpayer selects the tax treaty relief, the “subject to the provisions of the law of South Africa” indicates that the provisions of section 6quat must be applied when calculating the relief provided by the tax treaty.

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<sup>82</sup> The wording of the specific treaty must be considered as it can vary and differences in wording can impact on the interpretation thereof.

Support for the principle that a resident country's domestic tax law must be applied when the treaty relief is subject to the provision of domestic law can be found in the technical explanation document released by the Treasury Department of the United States of America on the tax treaty between the United States of America and South Africa which discusses the meaning of "in accordance with the provisions and subject to the limitations of the law of the United States".<sup>83</sup>

- The wording "in respect of income which ... may be taxed in Turkey" does not limit the source of the income to a foreign source (Turkey or a third country). However in the context of section 6quat(1) the income must be foreign-source.
- Turkish tax paid refers to the tax paid in Turkey as calculated under Turkish domestic law and the provisions of the tax treaty.
- "In accordance with the provisions of this Agreement" means that a credit is only available for the foreign tax paid on items of income correctly taxed under the tax treaty.
- Taxes due according to South African tax law refers to the tax payable in South Africa as calculated under the Act and the provisions of the tax treaty. This requires, amongst other things, the calculation of taxable income under the Act (that is, South African tax law).
- Having calculated the deduction from South African normal tax under section 6quat, there is an additional tax treaty limitation to consider. The tax treaty limitation is the same as that discussed in 4.9.5 and is calculated on a "per country" basis rather than on a "per income item" or an "overall" basis. That is, the maximum deduction is limited to.<sup>84</sup>

$$\text{Total South African tax payable} \times \frac{\text{(Taxable) Income concerned}}{\text{Total (taxable) income}}$$

- "Income" is interpreted to mean "taxable income" (see 4.9.8 – "Meaning of "income" in the article dealing with the elimination of double tax in tax treaties").
- "Total South African tax payable" is and can only be calculated under the Act (that is, South African tax law) taking into account the provisions of the applicable tax treaty. This requires, amongst other things, the calculation of taxable income under the Act. Total South African tax is normal tax before the section 6quat(1) rebate but, in the case of natural persons, after the primary, secondary, tertiary and medical tax credit under section 6A and 6B.
- "Taxable income concerned" refers to taxable income in respect of the income which is taxed in South Africa and is also taxed, in accordance with the provisions of the tax treaty, in the other country (that is, Turkey in this example).

<sup>83</sup> Department of Treasury Technical Explanation of the Convention between the United States of America and the Republic of South Africa for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, article 23, available from [www.irs.gov/pub/irs-trty/safitech.pdf](http://www.irs.gov/pub/irs-trty/safitech.pdf) [Accessed 12 February 2015].

<sup>84</sup> Words in brackets are added for clarification.

- It is therefore clear that in calculating the *pro rata* portion of the South African tax which is attributable to the income that is taxed in both countries, both the taxable income concerned and total taxable income must be calculated in accordance with the Act. SARS disagrees with the view that the limitation may be calculated with reference to the taxable income as determined under the tax laws of the other contracting state.
- The calculation of taxable income in accordance with the Act requires an allocation of the appropriate expenses to the income concerned.
- Notwithstanding the formula, the maximum deduction, across all countries applicable to a particular taxpayer, is limited to the total South African tax payable in the particular tax year and any excess foreign tax is forfeited.

#### 4.9.7 Application of the tax treaty credit method and section 6quat rebate method in the same year of assessment

A resident that derives foreign-source amounts from both –

- a foreign country with which South Africa has concluded a tax treaty which provides for a credit method of relief that is effectively subject to section 6quat, and
- a foreign country with which South Africa has concluded a tax treaty which provides for a credit method of relief that is not subject to section 6quat,

within the same year of assessment and elects to follow the tax treaty credit method of relief in respect of the tax treaty that is not subject to section 6quat, must perform two separate credit limitation calculations for that year.

#### **Example 38 – Determination of section 6quat rebate and a tax treaty credit within the same year of assessment**

*Facts:*

A resident company conducts its trading operations in South Africa. It also has branches in Country L and Country M. South Africa has a tax treaty with each of these countries. The tax treaty with Country L provides for the credit method of relief and is expressly subject to section 6quat while the tax treaty with Country M provides for the credit method of relief without any express reference to section 6quat. The company elects the tax treaty credit method of relief on income derived from Country M.

For its 2015 year of assessment the following results are relevant:

<b>Description</b>	<b>South Africa R</b>	<b>Country L R</b>	<b>Country M R</b>	<b>Total R</b>
Taxable income	100 000	20 000	30 000	150 000
Foreign taxes proved to be payable		9 000	12 000	21 000
Normal tax payable at 28%				42 000



<i>Result:</i>				
<b>Description</b>	<b>South Africa R</b>	<b>Country L R</b>	<b>Country M R</b>	<b>Total R</b>
<b>(a) Calculation of the section 6quat rebate</b> [R20 000 / R150 000 × R42 000] Under the carry-forward rules of section 6quat the balance of R3 400 (R9 000 – R5 600) may be carried forward to the following year of assessment		5 600		5 600
<b>(b) Calculation of the tax treaty credit</b> [R30 000 / R150 000 × R42 000] The balance of R3 600 (R12 000 – R8 400) is forfeited and may not be carried forward as the tax treaty does not provide for the carry-forward of excess foreign taxes			8 400	8 400
<b>(c) Calculation of final normal tax payable</b> Normal tax payable before rebates <i>Less:</i> Section 6quat rebate Tax treaty credit rebate Final normal tax payable				42 000 (5 600) <u>(8 400)</u> <u>28 000</u>

#### 4.9.8 Meaning of “income” in the article of a tax treaty dealing with the elimination of double taxation

The word “income”, as used in the article of a tax treaty dealing with the elimination of double taxation when determining the limitation on the amount of the rebate available under the tax treaty, must be interpreted to mean “net income” or “taxable income”. It does not mean “income” as defined in section 1(1) of the Act.

This is in alignment with the OECD commentary on the maximum credit which provides that –<sup>85</sup>

“... the deduction which the State of residence (R) is to allow is restricted to that part of the income tax which is appropriate to the income derived from the State S, or E (so-called ‘maximum deduction’). Such maximum deduction may be computed ... by apportioning the total tax on total income according to the ratio between the income for which the credit is to be given and the total income...”.

South Africa levies income tax on taxable income and not on “income” as defined in section 1(1) (that is, the end result of gross income less exempt income). Accordingly, a ratio which is based on taxable income of the income concerned (that is, the foreign-source taxable income) to total taxable income achieves the objective of restricting the credit to that part of the tax which is appropriate to the foreign-source taxable income. Given that South Africa does not impose tax on “income” as

<sup>85</sup> Commentary on article 23B paragraph 62 at page 342.

defined in section 1(1), basing the apportionment on income or gross income is not appropriate.

By way of example, in article 22 of the tax treaty with Turkey which deals with the elimination of double taxation, the italicised “income” must be interpreted to mean taxable income as there is a clear nexus between the taxable income referred to and the tax payable in respect of that taxable income. The relevant part reads as follows:

“Double taxation shall be eliminated as follows:

a) in South Africa, subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa (which shall not affect the general principle hereof), Turkish tax paid by residents of South Africa in respect of income which, in accordance with the provisions of this Agreement, may be taxed in Turkey shall be deducted from the taxes due according to South African tax law. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the *income* concerned bears to the total *income*;

(Emphasis added.)

In the OECD commentary the meaning of the term “income” in article 23B of the OECD Model Convention is explained as follows when stating that the amount of foreign tax that may be deducted shall not exceed that part of the tax which is attributable to the *income* which may be taxed in the other state.<sup>86</sup>

“63. The maximum deduction is normally computed as the tax on net income, i.e. on the income from State E (or S) less allowable deductions (specified or proportional) connected with such income.”

#### 4.9.9 Payment of foreign tax under the tax treaty credit method

Under the tax treaty credit method, foreign taxes must be paid before the relief can be granted. In contrast, section 6quat merely provides that the foreign taxes must be proved to be *payable*. In circumstances where the foreign tax is payable but has not yet been paid, SARS will not limit the application of the credit relief provided for in the tax treaty to the foreign taxes actually paid but will include the amount which is proved to be payable.

#### 4.10 Recalculation of the section 6quat(1) rebate under section 6quat(5)

The entitlement to a foreign tax rebate under section 6quat(1) arises in the year of assessment in which a foreign-source amount (in respect of which foreign taxes are payable) is included in the resident’s South African taxable income. This is apparent from the wording of section 6quat(1) which provides that where the taxable income of a resident includes the types of foreign-source income specified in that section, that the rebate calculated under section 6quat(1) must be deducted from the normal tax payable in respect of that taxable income.

The foreign taxes may, however, be incurred in an earlier year of assessment, the same year of assessment or in a subsequent year of assessment to that in which the foreign-source amount is included in the resident’s taxable income. The entitlement to the rebate does not arise in the year of assessment in which the foreign taxes are payable but arises, as noted above, when the foreign-source income is included in taxable income.

<sup>86</sup> Commentary on article 23B in paragraph 63 at page 343.

Foreign taxes that become payable in an earlier or the same year of assessment can and must be taken into account in the calculation of the rebate under section 6quat(1). However, a question arises as to what happens when the foreign tax liability only becomes payable, or is increased or reduced, in a later year of assessment and the foreign tax rebate has already been calculated and claimed in an earlier year of assessment based on an amount of foreign tax which subsequently proves to be inaccurate.

The answer lies in section 6quat(5) which provides that notwithstanding sections 99(1)<sup>87</sup> or 100 of the TA Act, an additional or reduced assessment may be made within six years *from* the date of the original assessment under which the taxpayer was entitled to the rebate in order to give effect to an increased or reduced foreign tax credit in respect of that year.

Section 6quat(5) can also be applied to correct an overstatement or understatement error in the calculation of the amount of the rebate even if all the facts were known at the time of issue of the original assessment.

The onus rests with the taxpayer to immediately notify SARS in writing when that taxpayer claimed a rebate or deduction (or could have claimed a rebate or deduction) for purposes of section 6quat in a previous year of assessment and it is subsequently established that the actual amount of foreign tax payable exceeds or is less than that previously taken into account. The taxpayer must also provide SARS with sufficient information to be able to correct the relevant assessment assuming the timing requirements under section 6quat(5) are met.

The six-year limit does not apply if SARS is satisfied that the amount of tax proved to be payable was incorrectly reflected due to fraud, misrepresentation or non-disclosure or material facts.<sup>88</sup>

**Example 39 – Foreign taxes paid in a year subsequent to the years in which the related income accrued**

*Facts:*

A resident derives remuneration for management services from a foreign source under a three-year management contract. For South African tax purposes the income accrues as and when the services are rendered over the period of the contract even though payment only takes place at the end of the contract (that is, at the end of year 3). A final withholding tax is levied by the source country as and when payment is made (that is, in year 3).

Thus the contract income is included in the resident's taxable income in each of the three years on an accrual basis while the related foreign tax liability only arises in year 3.

<sup>87</sup> Refers to a three-year prescription period.

<sup>88</sup> The exceptions to the prescription periods under section 99(2) of the TA Act also apply to the period prescribed under section 6quat(5).

*Result:*

The foreign tax paid in year 3 must be allocated across the three years in which the management fees were earned. Revised assessments must accordingly be issued for years 1 and 2.

**Example 40 – Refund of foreign taxes in a subsequent year of assessment***Facts:*

In year 1 a resident company realises a capital gain on disposal of rental property in Country R. The capital gain is taxed in Country R in year 1 and payment is made to the tax authorities of Country R at the end of year 1. For South African tax purposes the amount is taxed in year 1. The date of issue of the original assessment for year 1 is 1 February of year 2.

During year 6 the resident company discovered that it had incurred some additional expenses in connection with the disposal of the rental property that it had neglected to claim when submitting its tax return in Country R in year 1. The resident company submitted a request for a reduced assessment in Country R. Country R's tax authorities approved the request in year 6 and as a result the tax paid for year 1 was reduced in year 6. This resulted in a refund on 31 December of year 7.

*Result:*

The reduction in foreign taxes means that the section 6quat(1) rebate originally allowed in year 1 must be reduced. This will result in a corresponding increase in the South African normal tax payable and the Commissioner will have to issue an additional assessment to rectify the matter. The Commissioner must raise the additional assessment within six years from the date of the assessment in which the rebate was originally allowed.

The six-year period ends six years from 1 February of year 2, that is, on 31 January of year 8. The resident taxpayer is obliged to inform SARS immediately that its foreign tax liability has been reduced. SARS must revise the relevant assessment on or before 31 January of year 8.

Failure by the taxpayer to disclose that the amount of the foreign tax liability was reduced will be regarded as the non-disclosure of a material fact. Consequently, SARS will not be bound by the six-year period limitation in section 6quat(5) and may revise the relevant assessment at any time.

**Example 41 – Taxes payable in foreign jurisdiction determined in a year subsequent to the year in which the related foreign-source amount is taxed in South Africa***Facts:*

A resident company holds 100% of the participation and voting rights in a CFC. A portion of the income of the CFC did not qualify for any of the exemptions in section 9D(9) and an amount equal to the "net income" of the CFC was accordingly included in the resident company's income. The CFC was also subject to tax on the income included in the resident company's taxable income in the foreign jurisdiction where it carries on its operations. Consequently, the resident company is entitled to claim a rebate under section 6quat(1).

However, because of the timing of the submission of tax the returns and payment of the taxes in the country of residence of the CFC, it was not possible to determine the amount of the foreign taxes due when the resident company submits its tax return in South Africa.

*Result:*

The resident company's assessment which included the CFC's net income may be reopened within six years under section 6quat(5) to allow a tax rebate when the foreign taxes become payable.

## 5. The deduction of foreign taxes on income under section 6quat(1C)

Section 6quat(1C) provides for the deduction of foreign taxes from the income of a resident taxpayer (as opposed to the claiming of a tax rebate). Its application is limited to foreign taxes other than taxes contemplated in section 6quat(1A). Section 6quat(1A) refers back to section 6quat(1). Broadly speaking, section 6quat(1) considers income and capital gains from a foreign source and accordingly the deduction under section 6quat(1C) is essentially limited to foreign taxes levied in respect of South African-source income derived from trade operations [the trade requirement is included in section 6quat(1C)].

Under section 6quat(1C):

- The sum of any foreign taxes on income *not* contemplated in section 6quat(1) and (1A) (see 4.2 and 4.3) may qualify as a deduction [under section 6quat(1C)] in determining the taxable income derived by any resident taxpayer from carrying on any trade.
- Taxes must be proved to be payable by that resident to any sphere of government of any country other than South Africa, without any right of recovery by any person other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any previous year of assessment.

The following aspects should be noted:

- A resident may not choose between the rebate method of relief under section 6quat(1) and the deduction method of relief under section 6quat(1C). The deduction method only applies to taxes which are not contemplated in section 6quat(1). Therefore, if the income has a foreign source, the resident can only consider the availability of a rebate under section 6quat(1) – a deduction under section 6quat(1C) is not available.
- Excess foreign taxes which result from the limitation calculation in section 6quat(1B)(a) (see 4.5) do not qualify for a deduction under section 6quat(1C).
- A resident may choose between the rebate method of relief under section 6quin and the deduction method of relief under section 6quat(1C) when foreign taxes are paid on South African-source service income.
- The foreign taxes are only deductible against taxable income derived from the carrying on of any trade. In other words, no deduction is permissible against passive income.

- The deduction under section 6quat(1C) is subject to the provisions of section 23 which deny a deduction in certain circumstances notwithstanding that the expenditure may have met the requirements for deduction under any other section. Sections 23(f) and 23(g), for example, deny a deduction if the expense was incurred in the production of an amount which does not constitute income or to the extent the expense was not laid out for purposes of trade (see preceding bullet point).
- The fact that the foreign taxes must be proved to be payable implies that the foreign tax jurisdiction must have a legal right under its laws to tax a particular item of income.
- A deduction will not be allowed when the resident, or another person, may exercise a right of recovery on the foreign tax liability, under, for example, the foreign domestic law or an applicable tax treaty.
- The foreign taxes are only deductible in the year that it is proved to be payable. It may not be deducted in an earlier or subsequent year of assessment. For example, if the foreign tax is proved to be payable in year 2 then it may only potentially qualify for a deduction in year 2 notwithstanding that the income to which it relates may have been partly included in taxable income in year 1 and partly in year 2.
- The amount of foreign taxes that may be deducted under section 6quat(1C) is limited to the taxable income [before taking into account any deduction contemplated in section 6quat(1C)] attributable to income which is subject to taxes as contemplated in that subsection.<sup>89</sup> Thus the deduction under section 6quat(1C) may not create or increase an assessed loss attributable to that income. For example, South African-source service income is subject to foreign tax in Country X of R150. Taxable income from that service income is R100. The taxpayer has a current year assessed loss from other sources of income of R500. Section 6quat(1D) limits the section 6quat(1C) deduction to R100 such that the taxable income from the South African-source service income is equal to Rnil (R100 – limited section 6quat(1C) deduction of R100 as an assessed loss may not be created or increased for that particular income stream due to the section 6quat(1C) deduction). The taxpayer's assessed loss of R500 from other sources may be carried forward and is not impacted by the application of section 6quat(1D). The application of section 6quat(1D) in relation to a natural person is also demonstrated in **Example 5 of Annexure B**.
- In determining the amount of the taxable income attributable to that income, any allowable deductions contemplated in sections 11(n) and 18A must be deemed to have been incurred proportionately in the ratio that the income bears to total income [section 6quat(1D)].
- Any excess foreign taxes under section 6quat(1C) is forfeited and will not qualify for a deduction in that year under any other section [section 23B(3)]. In addition, any excess foreign taxes may not be carried forward to the following year of assessment.

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<sup>89</sup> Section 6quat(1D).

**Example 42 – Deduction sought for foreign taxes under section 6quat(1C) when a right of recovery exists under a tax treaty**

*Facts:*

A resident provides managerial and technical support services to a client situated in Nigeria. All the work is performed in South Africa. The resident does not have a permanent establishment in Nigeria. Despite the work being done in South Africa, Nigeria levies a withholding tax on fees paid for managerial and technical support services. Acting under its domestic law Nigeria withheld the tax from the amount remitted to the resident.

*Result:*

The tax treaty between South Africa and Nigeria does not specifically deal with income derived from rendering managerial and technical support services. As a result article 7, which deals with business profits, must be applied. The article provides that 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. Under South Africa's source rules (see 4.2.1 for more detail) the real source of income derived from the rendering of managerial and technical support services is located in the country where the work is done. In this case the work is done in South Africa and the income is therefore from a South African source.

Despite the fact that Nigeria's tax laws may support its right to tax the income, article 7 in effect confers an exclusive taxing right on South Africa. The resident therefore has a right of recovery which must be exercised by approaching the Nigerian tax authorities. No deduction under section 6quat(1C) will therefore be allowed. The foreign taxes will however qualify for the section 6quin rebate as it applies notwithstanding that there is a right of recovery.

**6. Section 6quat(1) and section 6quat(1C) – general matters**

**6.1 The translation of foreign taxes to rand [section 6quat(4)]**

A resident's liability for normal tax is determined in rand. For purposes of this determination any foreign-source amount and underlying foreign tax (which qualifies either for the rebate or the deduction) in respect thereof must be translated to rand.

Any foreign taxes proved to be payable for purposes of the section 6quat(1) rebate or the section 6quat(1C) deduction must be translated to rand on the last day of the year of assessment in which the foreign-source amount is required to be included in the taxpayer's taxable income by applying the average exchange rate for that year of assessment.<sup>90</sup> The average exchange rate that must be used in translating the foreign tax liability is the average exchange rate for the year of assessment in which the foreign-source amount is included in the taxpayer's taxable income.

The average exchange rate is defined in section 1(1) in relation to a year of assessment to mean the average determined by using the closing spot rates at the end of daily or monthly intervals during that year of assessment. The chosen interval (daily or monthly) must be consistently applied per currency within a year of assessment. The spot rate is defined in section 1(1) as the appropriate quoted

<sup>90</sup> Section 6quat(4).

exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency.

Average exchange rates for a range of foreign currencies are also available on the SARS website [www.sars.gov.za](http://www.sars.gov.za). These may be used to translate foreign taxes to rand. Average exchange rates may also be –

- obtained from an authorised dealer in foreign exchange;
- compiled using spot rates obtained from an authorised dealer; or
- compiled using spot rates from [www.oanda.com](http://www.oanda.com).

#### **Example 43 – Translation of foreign taxes to rand**

*Facts:*

During year 1 a resident derives interest income from Country A on a monthly basis which is denominated in euros. The interest income is subject to a withholding tax in Country A.

*Result:*

The foreign taxes expressed in euro must be translated to rand by applying the average exchange rate between the rand and the euro for year 1.

Multiple foreign tax liabilities denominated in different currencies must each be translated separately into rand using the applicable average exchange rate.

Fluctuations in the exchange rate may cause a difference between –

- the rand equivalent of the amount of the foreign tax liability determined on the date that the liability is incurred; and
- the rand equivalent of the amount (or amounts) paid, determined on the date (or dates) of payment of the tax liability.

Any such difference has no bearing on the determination of the rand equivalent value of the taxpayer's foreign tax liability for purposes of section 6quat. Section 6quat(4) only permits the foreign tax liability to be translated at the average exchange rate that applies in the year of assessment in which the foreign-source amount is required to be included in the taxpayer's taxable income.

Section 24I, which is not dealt with in this Note, governs the tax treatment of these differences. The spot rate at the date the foreign tax liability is incurred is an important exchange rate in calculating the foreign exchange gain or loss which arises on translation and on realisation of the foreign tax liability for purposes of section 24I. There will be a difference between this rate and the average rate which section 6quat(4) permits. This difference, gain or loss, is not be taken into account for tax purposes.



**Example 44 – Translation of foreign taxes to rand at the average exchange rate***Facts:*

A resident earns income of €100 in Country B in year 1 and becomes liable for income tax in Country B in that year of assessment. The tax is only payable in year 2. The average exchange rate for year 1 equalled R14 while the spot exchange rate when the foreign taxes were paid equalled R12.

*Result:*

The foreign taxes are translated to rand for the purposes of section 6quat by applying the average exchange rate of R14, being the average exchange rate in year 1 in which the resident was obliged to include the income earned in Country B in taxable income (year 1). The difference of R2 between the average exchange rate and the spot rate at the date of payment (R14 – R12) is ignored in determining the amount of the foreign tax liability for purposes of the section 6quat rebate.

The resultant movement in the exchange rate between the date the foreign tax liability was incurred, the end of the year of assessment and the date the foreign tax liability is settled must be determined under section 24I and does not impact the section 6quat rebate determination.

**6.2 Rounding off to nearest R1 [section 6quat(4A)]**

An amount translated in accordance with section 6quat(4) (see 6.1) must be rounded off to the nearest rand if it includes a number of cents that is less than one rand. By convention, amounts of less than 50 cents are rounded down, while amounts of 50 cents or more are rounded up. Thus R100,50 would be rounded up to R101 but R100,49 would be rounded down to R100.

**6.3 Application of section 66(13A) to section 6quat**

Section 66(13A) deals with the situation in which a person (other than a company) cannot conveniently return income for a year of assessment. In such event, the Commissioner may grant permission for the person to draw accounts to a different agreed date. The agreed date may fall before or after the end of the year of assessment. There is no need to apportion the corresponding foreign tax liability between more than one South African year of assessment when the Commissioner grants permission for business income derived by a person (other than a company) from a foreign source to be returned over a period other than a year of assessment. Refer to Interpretation Note No. 19 (issue 3) dated 9 October 2013 “Year of Assessment: Accounts Accepted to a Date other than the Last Day of February” for guidance regarding the practical application of section 66(13A).

**Example 45 – Determination of section 6quat(1) rebate when foreign tax year does not match the year of assessment***Facts:*

A resident individual derives business income from the USA during the calendar year ending 31 December 2014. The foreign tax year of an individual in the USA ends on 31 December. Under section 66(13A) SARS grants permission for the individual to return the business income for the calendar year ending 31 December 2014 in the 2015 return of income (that is, in the year of assessment ending 28 February 2015).

*Result:*

The USA tax liability for the calendar year ending 31 December 2014 must be taken into account in the individual's 2015 year of assessment in determining the section 6quat(1) rebate. The tax liability must be translated into rand at the average exchange rate for the 2015 year of assessment.

In the absence of SARS granting permission under section 66(13A), the resident would have included the business income from the USA for the period 1 March 2014 – 30 December 2014 and 1 January – 28 February 2015 in the 2015 tax year. In considering the foreign tax rebate under section 6quat the appropriate portion of the USA tax liability for the year ended 31 December 2014 and 31 December 2015 would be taken into account assuming it satisfied all the requirements discussed earlier in this Note.

#### **6.4 Calculation of provisional tax payments with reference to foreign tax liabilities**

In determining the amount of provisional tax payable for South African income tax purposes, a provisional taxpayer may take into account any tax proved to be payable to the government of any other country on foreign-source income provided it will qualify as a rebate under section 6quat(1).<sup>91</sup> In practice SARS may allow provisional taxpayers to take foreign provisional tax payments (or similar advance payments) legally due and payable into account when determining their local provisional tax payments to the extent that the taxpayer is able to satisfy SARS that those payments will be or are the same or similar to the final tax liability in that country.

To the extent a deduction under section 6quat(1C) is applicable, provisional taxpayers may take into account any tax proved to be payable to the government of any other country when estimating taxable income for provisional tax purposes.

### **7. Section 6quin – Rebate for foreign taxes on South African-source service income**

#### **7.1 Background**

The overall purpose of the section 6quin rebate was explained in the Explanatory Memorandum on the Taxation Laws Amendment Bill<sup>92</sup> as follows:

“A number of African jurisdictions impose withholding taxes in respect of services (especially management services) rendered abroad if funded by payments from their home jurisdictions. These withholding taxes are sometimes imposed even when tax treaties suggest that the practice should be otherwise. ....

The net result of these African withholding taxes is double taxation with little relief. The South African tax system does not provide credits in respect of these foreign withholding taxes because these taxes lack a proper foreign source nexus. Only partial relief is afforded through the allowance of a deduction. While the South African position is theoretically correct, the practical implication of this position is adverse to South Africa's objective of becoming a regional financial centre. As long as this theoretically correct position is maintained, the only viable solution for regional operations is to shift their management location to a low-taxed or no taxed location so as to avoid double taxation.”

<sup>91</sup> Paragraphs 21(1)(a)(ii), 21(1)(b)(ii) and 23 of the Fourth Schedule.

<sup>92</sup> No. 24 of 2011 at page 101.

Subject to certain criteria and limitations, section 6quin provides a foreign tax rebate for foreign taxes paid on South African-source *service* income that is included in South African taxable income. The rebate is deducted from normal tax payable; the rebate is not a cash refund from SARS. In the event that the amount of the rebate is greater than the amount of normal tax payable in a particular year, the excess is forfeited and may not be carried forward to the next year of assessment to be used in determining the foreign tax rebate for that year of assessment. The excess does not represent a refund which is due to the taxpayer.

Section 6quin is effective for amounts of tax levied and withheld or imposed by a foreign government during years of assessment commencing on or after 1 January 2012. For natural persons and trusts this means from the 2013 year of assessment commencing 1 March 2012, while for companies it means any year of assessment commencing on or after 1 January 2012.

A rebate will not be available under section 6quin if the foreign taxes were levied and withheld or imposed in a year of assessment which commenced *before* 1 January 2012. Assuming a taxpayer meets the requirements of section 6quin, the taxpayer must deduct the rebate in the year in which the underlying South African-source service income was included in taxable income (see 7.4). The ability to claim a rebate under section 6quin in the year in which the related service income was included in the taxpayer's taxable income is subject to the normal prescription rules if that year of assessment is earlier than the year of assessment in which the foreign tax was levied and withheld or imposed by a foreign government.

## 7.2 Rebate for foreign taxes on South African-source service income [section 6quin(1)]

Section 6quin(1) provides that a rebate must be deducted from the normal tax payable by a resident when –

- any portion of that resident's taxable income is attributable to a South African-source amount which was received or accrued for services rendered; and
- an amount of tax on that amount is –
  - levied by any sphere of the government of a country other than South Africa with which South Africa has concluded a tax treaty and which is withheld by the payer when making payment to the resident;<sup>93</sup> or
  - imposed under its laws by any sphere of the government of a country other than South Africa with which South Africa has not concluded a tax treaty.<sup>94</sup>

A rebate is not available under section 6quin if the amount of tax is –<sup>95</sup>

- taken into account in determining the amount of the rebate available under section 6quat(1); or
- deducted from the income of that resident under section 6quat(1C).

<sup>93</sup> Section 6quin(1)(a).

<sup>94</sup> Section 6quin(1)(b).

<sup>95</sup> Section 6quin(3).

**Example 46 – Withholding taxes levied on services rendered in South Africa***Facts:*

A, a resident, renders services to B (Pty) Ltd (B). B is resident in Country D. The services are rendered in South Africa and A does not have a permanent establishment in Country D. Under Country D's domestic law, B withholds and remits 10% withholding tax from all payments to A to Country D's tax authorities.

South Africa has a tax treaty with Country D. The tax treaty does not contain a technical services article and accordingly, notwithstanding Country D's domestic law, the "other income" clause in the tax treaty applies and Country D is prohibited from imposing the withholding tax on the service fees paid by B to A. The article in the tax treaty which provides for the elimination of double taxation is not applicable as under the tax treaty there is no double taxation since South Africa has the sole taxing right.

*Result:*

A's taxable income will include the taxable income which is attributable to services rendered in South Africa. Notwithstanding that Country D is prohibited under the tax treaty from imposing the withholding tax on the service fees paid by B to A, A will, assuming the other requirements of the section are met, be entitled to claim the rebate under section 6quin.

*"Transactions" between a South African resident's and its own foreign permanent establishment*

See 4.3.4 (paragraph headed "*Transactions" between a South African resident's head office and its own foreign permanent establishment*). For example, in the context of section 6quin, if a resident taxpayer's head office renders services in South Africa to its own permanent establishment in a foreign country (for example, a foreign branch) and the foreign government levies a foreign withholding tax on the payments by the foreign branch to the head office, the resident will not qualify for a rebate under section 6quin. South Africa does not recognise services between a head office and a foreign branch and as such there is no underlying service income which has been included in taxable income. This applies irrespective of whether the withholding tax was levied on the cost portion of the "fee" or the full "fee" including the mark-up and irrespective of whether the withholding tax was permitted under a tax treaty (if one was applicable).

**7.2.1 Meaning of the term "source" for purposes of section 6quin(1)**

The source of an amount is determined with reference to the provisions of a tax treaty (if applicable), domestic law provisions [sections 9(2) and 9(4)] and common law as formulated by the South African courts, in that order (see 4.2.1). The principles discussed in 4.2.1(a), (b) and (c), and 4.2.2(a), (b) and (c) are also relevant when determining source of service income for purposes of section 6quin.

**Example 47 – Source of service income under section 6quin***Facts:*

A resident company provides technical consulting services to a company resident in Country A under an agreement negotiated and concluded in South Africa. The services are rendered in South Africa. The company in Country A does not have a presence in South Africa and *vice versa* for the resident company.

Under its domestic law Country A levies a withholding tax of 15% on the consulting fees remitted to South Africa. Under the tax treaty the rate of the tax is reduced to 10%.

*Result:*

The true source of the fees is where the services are rendered, that is, South Africa.

**Example 48 – Source of service income under section 6quin, deeming source rule in tax treaty applies**

*Facts:*

A resident company provides technical consulting services to a company resident in Swaziland under an agreement negotiated and concluded in South Africa. The services are rendered from South Africa. The company in Swaziland does not have a presence in South Africa and *vice versa* for the resident company.

Under the domestic tax law of Swaziland a withholding tax of 15% is imposed on fees derived from independent professional services remitted to South Africa. Under the tax treaty the rate of the tax is reduced to 10%.

*Result:*

The true source of the fees is where the services are rendered, that is, South Africa. However, article 13(5) of the tax treaty between South Africa and Swaziland overrides the true source and deems the fees to be from a source in Swaziland.

Accordingly, the resident company will not qualify for a rebate under section 6quin because the source of the underlying income is deemed to be from a foreign source. This applies to the full amount of the withholding tax withheld irrespective of whether 10% was correctly or 15% was incorrectly withheld under the treaty. The resident company may qualify for a rebate under section 6quat(1) – see **Example 8**.

**Example 49 – Source of service income under section 6quin – potential contravention of a tax treaty**

*Facts:*

A resident company provides technical consulting services to a company resident in Country A under an agreement negotiated and concluded in South Africa. The services are rendered in South Africa. The company resident in Country A does not have a presence in South Africa and *vice versa* for the resident company.

Under its domestic tax laws Country A's tax authorities withhold tax on payments made to the resident company on the above-mentioned service income.

Assume the tax treaty gives South Africa sole taxing rights.

*Result:*

The true source of the fees is where the services are rendered, that is, South Africa and South Africa has the right under the tax treaty to tax the service income. This is consistent with the tax treaty between South Africa and Country A which provides that profits or remuneration for personal (including professional) services *performed in one of the territories* shall be deemed to be profits from sources within that territory. Thus, the source is where the services are rendered, that is South Africa.

Accordingly, Country A's withholding tax represents a foreign tax on South African-source service income and therefore potentially qualifies for a section 6quin rebate provided the detailed requirements of the section are met. The fact that Country A may have contravened the tax treaty does not breach the requirements of section 6quin. The reason being that section 6quin(1)(a) requires that the foreign tax must have been levied by a foreign government with which South Africa has concluded a tax treaty and withheld when payment was made to the resident. These requirements have been met notwithstanding that it may be in contravention of the tax treaty.

## 7.2.2 Meaning of the term “services” for purposes of section 6quin

See 4.2.2.

## 7.3 Amount of the section 6quin rebate

Section 6quin(2) provides that the amount of the rebate is equal to the *lesser* of –

- the amount of foreign tax levied and withheld or imposed, as appropriate, by the foreign government under section 6quin(1) (see 7.2 and 7.3.1(a)); and
- the amount of normal tax which is attributable to the amount contemplated in that section (that is, a South African-source amount which was received or accrued for services rendered) (see 7.3.1(b)).<sup>96</sup>

The amount of foreign tax that is greater than the attributable amount of normal tax is forfeited as, unlike section 6quat,<sup>97</sup> section 6quin does not allow the excess foreign taxes to be carried forward to the next tax year. The excess will not qualify for a deduction under section 6quat(1C) as the resident has elected to use the section 6quin rebate method of relief as an alternative to the deduction method of relief under section 6quat(1C). In addition the excess is not deductible under section 11(a) read with section 23(g) or any other section of the Act.

### 7.3.1 Calculation of the section 6quin rebate – per service contract

Section 6quin(1) and (2) refer to amounts of income which have been received or accrued. Strictly speaking a separate section 6quin rebate calculation must therefore be performed for each *amount* of South African-source service income which is subject to foreign taxes as set out in 7.2. For example, if a contract provides that services will be rendered and invoiced on a monthly basis, then 12 separate calculations would be required in a single tax year.

However, subject to the exception discussed below, practically SARS accepts that the calculation may be performed per service contract per year of assessment. This is acceptable as the result obtained is not affected by adopting this approach and some of the inputs required can only be calculated on an annual basis (that is, normal tax, taxable income attributable to qualifying amounts of income received or accrued and total taxable income).

An exception arises when a single contract covers services rendered in different countries. In these circumstances a separate calculation will need to be performed

<sup>96</sup> Although the rebate is technically equal to the lesser of the applicable foreign tax and this amount, in general terms this is often referred to as the limitation in section 6quin.

<sup>97</sup> Paragraph (ii)(aa) of the proviso to section 6quat(1B)(a) (see 4.8).

per service contract per country within a year of assessment. This is required in order to prevent a low taxed country from effectively subsidising a high tax country and increasing the amount of the rebate available under section 6quin.

**(a) The amount of foreign tax levied and withheld or imposed, as appropriate, by a foreign government under section 6quin(1)**

As discussed in 7.3.1 the amount of foreign tax may be calculated per service contract per country within a year of assessment. In the case of foreign tax levied by a foreign government with which South Africa has a tax treaty, the amount of tax which will be taken into account is the amount of foreign tax which was withheld, even if incorrectly withheld under the tax treaty, from the payment made to the taxpayer.

The amount potentially qualifying for a rebate is the amount of tax levied by the foreign government. It follows that if the foreign government levies a withholding tax of, for example, 10% but the customer paying the resident withholds 30%, only 10% will potentially qualify for the rebate as the additional 20% is not a tax levied by a foreign government. Taxpayers may only claim a tax that is levied by a foreign government as a rebate under section 6quin.

Alternatively, in the case of foreign tax levied by a foreign government with which South Africa does not have a tax treaty, the amount of tax which will be taken into account is the amount of foreign tax which has been imposed under that country's domestic law. "Imposed" means that the amount must be payable under that country's law but at the date of claiming the rebate it may not yet have been paid (unless it is only imposed on payment).<sup>98</sup>

The fact that the relevant foreign taxes must be payable under law also means that the maximum amount which will be taken into account for purposes of section 6quin is the amount which the foreign government may impose under its law and if, for example, an error resulted in an amount greater than that permitted being imposed, the full amount will not qualify. This is different to the situation discussed in the preceding paragraph where South Africa has a tax treaty with the foreign country. In those circumstances the amount of foreign tax may not have been correctly imposed and withheld under the applicable tax treaty.

**(b) The amount of normal tax attributable to the amount of South African-source service income**

In determining the amount of normal tax which is attributable to the South African-source service income, SARS adopts a "*pro rata*" method of calculation. Under a *pro rata* method the *amount of attributable tax* is determined by apportioning the total normal tax payable in the ratio that the relevant amount of taxable service income bears to total taxable income.<sup>99</sup>

The use of taxable income is considered to be appropriate because South Africa levies income tax on taxable income, not on "income" as defined in section 1(1). Accordingly, a ratio which is based on taxable income of the relevant service income concerned to total taxable income achieves the objective of restricting the rebate to that part of the normal tax which is attributable to the South African-source service

<sup>98</sup> 'Imposed' is similar to the 'proved payable' wording used in section 6quat.

<sup>99</sup> A *pro rata* method is also applied when determining foreign tax rebates calculated under section 6quat and most of South Africa's tax treaties.

income. As mentioned in 4.9.8, South Africa does not levy normal tax on income and accordingly basing the apportionment on “income” as defined or gross income is not appropriate.

In the case of *Commissioner for Inland Revenue v Estate late Bulman*<sup>100</sup> the Appellate Division, in considering a similar calculation required to be made for purposes of the proviso to the First Schedule to the Estate Duty Act, 1955, held that the *pro rata* method was to be used. It is considered that the reasoning adopted by the court in that case supports the *pro rata* approach under section 6quin.

As discussed in 7.3.1 the calculation may be performed per service contract per country within a year of assessment. This means that a separate calculation of the normal tax attributable to the taxable income derived from each service contract per country covered by that contract is required in order to calculate the section 6quin rebate.

The amount of normal tax which is attributable to the South African-source service income per contract per country is equal to:

$\frac{\text{Taxable income per service contract falling under s6quin per country}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$
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Section 6quin(1) only applies to South African-source amounts of service income on which a foreign government has levied a tax payable on income (see 4.3.1 for detail). Accordingly, the amounts of taxable income included in *Taxable income per service contract falling under s6quin per country* in the formula above are only those amounts which were received or accrued and which were subject to foreign tax. In the event that a particular amount was not subject to foreign tax it will not be included. The taxable income of both the numerator and the denominator are determined according to the Act.

In calculating taxable income per service contract, the same principles as discussed under 4.5, 4.5.1 and 4.5.2, which are used in calculating taxable income for purposes of determining the section 6quat(1B)(a) limitation, are relevant. For example, determining whether an expense relates, in this case, to the South African-source service income and whether a general expense should be apportioned to the South African-source service income.

Normal tax is the South African tax calculated on total taxable income before the deduction of any rebates contemplated in sections 6, 6A, 6B, 6quat(1) and 6quin.

**Example 50 – Determination of a section 6quin rebate per individual service contract**

*Facts:*

A resident company derives taxable income from professional services provided to a South African client (Client A) and two foreign clients (Client B and Client C) during its 2015 year of assessment. All of the resident company’s business operations are conducted in South Africa, that is, the services are rendered in South Africa.

The information relevant for each contract is as follows:

R

<sup>100</sup> 1987 (1) SA 659(A), 49 SATC 1.



**Contract 1 with resident Client A**

Gross income	30 000
Deductible expenses	20 000

**Contract 2 with non-resident Client B**

Gross income	100 000
Deductible expenses	50 000
Foreign taxes imposed in relation to Contract 2	5 000

**Contract 3 with non-resident Client C**

Gross income	80 000
Deductible expenses	20 000
Foreign taxes imposed in relation to Contract 3	24 000

The resident company does not have any other operations.

The foreign countries where the foreign clients are resident do not have tax treaties with South Africa.

*Result:*

South African taxable income:

Gross income (R30 000 + R100 000 + R80 000)	210 000
Less: Deductible expenses (R20 000 + R50 000 + R20 000)	<u>(90 000)</u>
Taxable income	120 000
Normal tax payable (R120 000 × 28%)	33 600
Less: Section 6quin rebate – Contract 2 (working 1)	(5 000)
Less: Section 6quin rebate – Contract 3 (working 2)	<u>(16 800)</u>
Final tax payable	<u>11 800</u>

Working 1 – section 6quin rebate for Contract 2

Lesser of:

- Foreign tax of R5 000
- Taxable income per service contract  

$$\frac{\text{falling under 6quin per country}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= (R100\,000 - R50\,000) / R120\,000 \times R33\,600$$

$$= R14\,000$$

Therefore, the section 6quin rebate = R5 000

Working 2 – section 6quin rebate for Contract 3

Lesser of:

- Foreign tax of R24 000
- Taxable income per service contract  

$$\frac{\text{falling under s6quin per country}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= (R80\,000 - R20\,000) / R120\,000 \times R33\,600$$

$$= R16\,800$$

Therefore, the section 6quin rebate = R16 800

### **Example 51 – Determination of a section 6quin rebate per individual service contract**

*Facts:*

A resident company derives taxable income from professional services provided to a South African client (Client A) and a foreign client (Client B) during its 2015 year of assessment. All of the resident company's business operations are conducted in South Africa, that is, the services are rendered in South Africa.

Trading conditions in South Africa were particularly tough during the year resulting in unexpected operational losses. The resident company has no other operations.

The foreign country where Client B is resident does not have a tax treaty with South Africa.

The information relevant for each contract is as follows:

	R
<b>Contract 1 with resident Client A</b>	
Gross income	100 000
Deductible expenses	150 000
<b>Contract 2 with non-resident Client B</b>	
Gross income	80 000
Deductible expenses	50 000
Foreign taxes imposed in relation to Contract 2	5 000

*Result:*

South African taxable income:	R
Gross income (R100 000 + R80 000)	180 000
Less: Deductible expenses (R150 000 + R50 000)	<u>(200 000)</u>
Assessed loss	(20 000)
Normal tax payable	Nil
Less: Section 6quin rebate – Contract 2 (working 1)	<u>(Nil)</u>
Final tax payable	<u>Nil</u>

Working 1 – section 6quin rebate for Contract 2

Lesser of:

- Foreign taxes of R5 000
- Taxable income per service contract  
falling under s6quin per country × Normal tax payable  
 Taxable income derived from all sources  
 = (R80 000 - R50 000) / R20 000 (loss) × RNil  
 = RNil

Therefore, the section 6quin rebate equals RNil. The foreign taxes of R5 000 may not be carried forward to the next year and are forfeited. As an alternative to a rebate under section 6quin the resident can consider a deduction under section 6quat(1C).

#### 7.4 Timing of the section 6quin rebate

Assuming all the requirements of the section are met, the entitlement to a foreign tax rebate under section 6quin arises in the year of assessment in which the South African-source service income (in respect of which foreign taxes are withheld or payable, as appropriate) is included in the resident's South African taxable income. This is apparent from the wording of section 6quin(1).

The foreign taxes may, however, be incurred in an earlier year of assessment, the same year of assessment or in a subsequent year of assessment to that in which the South African-source service income is included in the resident's taxable income. For example, the foreign tax may only be withheld or payable when the South African-source service income is paid by the foreign payer, whereas the relevant income may have already been included in the resident's taxable income in an earlier year of assessment when it accrued to the resident. The entitlement to the rebate in these circumstances does not arise in the year of assessment in which the foreign taxes are withheld or payable (depending on whether or not South Africa has a tax treaty with the foreign country) but arises, as noted above, when the South African-source service income is included in the resident's taxable income.

Foreign taxes that are withheld or become payable (as appropriate) in an earlier or the same year of assessment must be taken into account in the calculation of the amount of the rebate under section 6quin in the year of assessment in which the related South African-source service income is received by or accrues to the resident. However, a question arises as to what happens when the foreign tax liability is only withheld or becomes payable (as appropriate), or is increased or reduced, in a later year of assessment.

The foreign taxes that are withheld or become payable in a later year of assessment but before the taxpayer has submitted the return and been assessed, must be taken into account in the year of assessment in which the relevant income has been included in the resident's taxable income. However, if the foreign tax is only withheld or becomes payable after the relevant return has been submitted and assessed, then SARS will need to issue a reduced assessment under section 93 of the TA Act taking into account the time periods stipulated in section 99 of that Act.

**Example 52 – Foreign taxes paid in a year subsequent to the years in which the underlying service income accrued**

*Facts:*

Company A, a resident, derived remuneration from Company X for management services rendered in South Africa during its 2009 year of assessment. The income was included in Company A's 2009 tax return. Company X is resident in Country Z.

Company X paid Company A in the 2015 year of assessment for the management services rendered in 2009 net of the foreign withholding tax which was withheld and paid over to Country Z's tax authority in that year of assessment.

*Result:*

Notwithstanding that Company A may meet the requirements under section 6quin, Company A would not have been able to claim the section 6quin rebate from normal tax payable in 2009, that is, the year in which the income was included in Company A's taxable income, as the relevant time periods in section 99 of the TA Act have been exceeded. In addition, Company A will not qualify for a rebate under section 6quin in the 2015 year of assessment because the section 6quin rebate must be claimed in the year the underlying income is included in taxable income which is not 2015.

**Example 53 – Foreign taxes paid in a year subsequent to the years in which the underlying service income accrued**

*Facts:*

Company A, a resident, derived remuneration from Company X for management services rendered in South Africa during its 2011 year of assessment. The income was included in Company A's 2011 tax return. Company X is resident in Country Z.

Company X paid Company A in Company A's 2012 year of assessment for the management services rendered in 2011 net of the foreign withholding tax which was withheld and paid over to Country Z's tax authority in that year of assessment.

*Result:*

The foreign tax was levied and withheld during the company A's 2012 year of assessment. Accordingly, even though the relevant income was earned in the 2011 tax year, Company A will qualify for a section 6quin rebate in the 2011 year of assessment assuming the detailed requirements of section 6quin are met. Company A will need to notify SARS and request a reduced assessment bearing in mind that SARS can only issue a reduced assessment within the time periods stipulated in section 99 of the TA Act.

**Example 54 – Foreign taxes paid in a year subsequent to the years in which the related income accrued**

*Facts:*

A resident derives remuneration for management services rendered in South Africa under a three-year management contract to a client resident in Country X. Payment for the services rendered is only made at the end of the contract (that is, at the end of year 3).

For South African tax purposes an accrual takes place as and when services are rendered over the period of the contract. Country X levies a final withholding tax as and when payment is made (that is, at the end of the contract in year 3). Thus the contract income is included in the resident's taxable income in each of the three years on an accrual basis, while the related foreign tax liability only arises in year 3.

In each of the tax years concerned the resident submitted the South African income tax return 13 months after the end of the year of assessment and was assessed on the same day.

South Africa has a tax treaty with Country X.

Each of the years concerned took place after the effective introduction of section 6quin in 2012.

*Result:*

The foreign tax paid in year 3 must be allocated across the three years in which the management fees were earned based on the amount accrued in each year.

Year 1 – at the time the income tax return was submitted and assessed, the relevant portion of the foreign tax had not been withheld and accordingly a rebate would not have been available under section 6quin(1). When the tax is withheld from payment at the end of year 3, the resident may advise SARS and request a reduced assessment under section 93 of the TA Act.

Year 2 – at the time the income tax return is submitted the foreign tax will have been withheld and it may therefore be included in the calculation of the section 6quin rebate.

Year 3 – at the time the income tax return is submitted the foreign tax will have been withheld and it may therefore be included in the calculation of the section 6quin rebate.

Similarly, in circumstances where the withholding or the foreign tax liability which resulted in a section 6quin rebate is increased after an original assessment has been issued, a taxpayer will need to request a reduced assessment<sup>101</sup> within three years after the date of assessment of the original assessment.<sup>102</sup>

In contrast, if a section 6quin rebate has been deducted from normal tax and the related foreign tax is subsequently refunded or the foreign tax liability is discharged, section 6quin(5) potentially deems the amount refunded or discharged to be normal tax payable in the year of refund or discharge (see 7.8).

## **7.5 No section 6quin rebate for foreign taxes claimed as a rebate under section 6quat(1) or a deduction under section 6quat(1C) [section 6quin(3)]**

### **7.5.1 Interaction between sections 6quat(1) and 6quin**

Section 6quin(3)(i) clarifies that an amount of foreign tax cannot qualify for a rebate under both section 6quat(1) and section 6quin(1).

There are, however, circumstances in which section 6quat(1) and section 6quin(1) will apply to different portions of the income arising under the same service contract

<sup>101</sup> Resulting from an increase in the amount of the section 6quin rebate.

<sup>102</sup> Sections 93 and 99 of the TA Act.

because the relevant services are rendered in different locations and hence the source of the amounts is different.

**Example 55 – Application of both section 6quat(1) and section 6quin to a resident**

*Facts:*

Resident company A performs project management, engineering and construction management services for a mining venture in Country X in its 2015 year of assessment.

Resident company A performs 90% of these services in South Africa and the remaining 10% in Country X. This is company A's only source of income. The total service income received was R100 000 and related expenses totalled R60 000 (assume expenses were incurred in proportion to the income earned).

Country X levies a withholding tax of 15% on the payments by the mining venture to company A.

South Africa has a tax treaty with Country X. Company A elects the relief available under section 6quin rather than the relief available under section 6quat(1C).

*Result:*

*Tax payable in Country X*

$$R100\ 000 \times 15\% = R15\ 000$$

*Allocation of foreign taxes between South African-source income and foreign-source income.*

	R
Part of foreign taxes attributable to South African sourced income	13 500

*Calculation:*

R15 000 foreign tax  $\times$  90% of services rendered in South Africa = R13 500. This portion of the foreign tax qualifies for a section 6quin rebate as it relates to South African-source service income.

Part of foreign taxes attributable to foreign-source income	1 500
---	-------

*Calculation:*

R15 000 foreign tax × 10% of services rendered in Country X = R1 500. This portion of the foreign tax qualifies for a section 6quat(1) rebate as it relates to foreign-source service income.

*Tax payable in South Africa*

\* the split between South African source and Country X source is required for purposes of the calculations in working 1 and 2 below

	<b>South African* source</b>	<b>Country X* source</b>	<b>Total</b>
	R	R	R
Service income	90 000	10 000	100 000
Less: deductions	<u>(54 000)</u>	<u>(6 000)</u>	<u>(60 000)</u>
Total taxable income	36 000	4 000	40 000
Normal tax payable at 28%	10 080	1 120	11 200
Section 6quat(1) (working 1)			(1 120)
Section 6quin (working 2)			<u>(10 080)</u>
Tax payable			<u>Nil</u>

*Working 1: Section 6quat(1) rebate*

Qualifying foreign taxes = R1 500

Limitation amount 1 120

*Calculation of the limitation of the rebate:*

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$

$$= \text{R4 000} / \text{R40 000} \times \text{R11 200}$$

$$= \text{R1 120}$$

Therefore, the section 6quat(1) rebate is limited to R1 120. The balance of the excess foreign taxes of R380 (R1 500 – R1 120) may be carried forward under paragraph (ii)(aa) of section 6quat(1B)(a) to the next year to potentially qualify for a rebate in that year.

*Working 2: Section 6quin rebate*

Rebate is equal to the lesser of:

- Qualifying foreign taxes = R13 500, and
  - $\frac{\text{Taxable income derived per service contract per country}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$
- $$= \text{R36 000} / \text{R40 000} \times \text{R11 200}$$
- $$= \text{R10 080}$$

The section 6quin rebate equals R10 080. The excess foreign tax of R3 420 (R13 500 – R10 080) is forfeited.

### 7.5.2 Interaction between sections 6quat(1C) and 6quin

An amount of foreign tax could potentially meet the requirements for a deduction from income under section 6quat(1C) and the requirements for a rebate under section 6quin(1). For example, foreign withholding tax paid on true South African-sourced service income which, in circumstances where an applicable tax treaty does not deem the income to be foreign-source, meets the detailed requirements<sup>103</sup> of section 6quat(1C) and section 6quin(1).

In these circumstances a resident may elect under section 6quat(1C) to claim a deduction from income when calculating South African taxable income. Assuming the election is validly made under section 6quat(1C), section 6quin(3)(ii) provides that no rebate under section 6quin is permitted.

The submission of the return discussed in 7.6 does not mean that the taxpayer has made a decision to apply section 6quin as opposed to section 6quat(1C). A taxpayer who has submitted a return as required in section 6quin(3A) is not restricted from electing that section 6quat(1C) as opposed to section 6quin applies.

A deduction under section 6quat(1C) may provide the best result for a resident in an overall assessed loss position. The reason being that the rebate under section 6quin would be equal to *nil* and section 6quin does not allow the carry forward of excess foreign taxes whereas a deduction under section 6quat(1C) could increase the taxpayer's assessed loss carried forward.<sup>104</sup>

The choice of whether or not to apply section 6quat(1C) is exercised annually. A resident who has more than one service contract that is subject to foreign taxes and which qualifies for a deduction under section 6quat(1C) and the rebate under section 6quin(1), may elect on a contract-by-contract basis to claim a deduction under section 6quat(1C) or a rebate under section 6quin.

### 7.6 Reporting requirements under section 6quin [section 6quin(3A)]

With effect from 1 July 2013<sup>105</sup> a resident who wishes to claim a foreign tax rebate under section 6quin on foreign taxes levied by a foreign government with which South Africa has a tax treaty and which have been withheld from payments made to the resident, must submit a return to SARS. The return must be submitted to SARS within 60 days from the date on which the foreign tax is withheld and it must be made on the "Declaration of foreign tax withheld – Section 6quin of the Income Tax Act (FTW 01)" form<sup>106</sup> which is available on [www.sars.gov.za](http://www.sars.gov.za). Failure to submit the return within the 60-day period will result in the resident not being able to claim a section 6quin rebate as a deduction from normal tax.

SARS can use this information to reduce or eliminate the foreign tax if that tax has not been levied by the treaty partner in accordance with the provisions of the relevant tax treaty. SARS may also engage in a mutual agreement procedure, as provided for

<sup>103</sup> Consideration of the detailed requirements of each section is critical, for example, a foreign tax which is subject to a right of recovery (see 4.3.3 and 5) will not qualify for a deduction under section 6quat(1C) but could potentially qualify for a rebate under section 6quin(1).

<sup>104</sup> The limitation on the amount of the deduction under section 6quat(1D), which applies to the particular item of income, would need to be taken into account.

<sup>105</sup> Date determined by the Minister of Finance in Notice No. 463; *Government Gazette* No. 36627 (02 July 2013).

<sup>106</sup> Section 25 of the TA Act.



in the tax treaty, with the tax treaty partner in an attempt to resolve the issue. In order for SARS to commence the mutual agreement procedure, the resident must have approached the foreign tax authority regarding the tax not being levied in accordance with the provisions of the tax treaty. Accordingly, if the resident has not already done so, SARS will require the resident to approach the foreign tax authority to establish whether there is in fact a dispute which needs resolution or whether there is merely an error which the foreign tax authority acknowledges and is willing to correct. The potential mutual agreement procedure will not impact on the timing of the foreign rebate under section 6quin as discussed in 7.4. That is, assuming all the requirements of the section are met, the entitlement to a foreign tax rebate under section 6quin arises in the year of assessment in which the South African-source service income (on which foreign taxes are withheld or payable, as appropriate) is included in the resident's South African taxable income and will not be delayed, for example, until the resident approaches the foreign government regarding the foreign tax or until the mutual agreement procedure is commenced or completed.

Although not required to do so under section 6quin(3A), a person who wishes to claim a foreign tax rebate under section 6quin on foreign taxes imposed by a foreign government with which South Africa does not have a tax treaty must also submit the return referred to in the preceding paragraph.<sup>107</sup>

The return is for rebates claimed under section 6quin only. It does not apply for a rebate under section 6quat(1).

## 7.7 Translation of foreign taxes to rand [section 6quin(4)]

A resident's liability for normal tax is determined in rand and any deduction from normal tax under section 6quin must also be determined in rand. Section 6quin(4) provides that any foreign tax which qualifies for the section 6quin rebate must be translated to rand on the last day of the year of assessment in which the tax is levied and withheld or imposed at the average exchange rate for that year of assessment.

The average exchange rate in relation to a year of assessment is defined in section 1(1) to be the average determined by using the closing spot rates at the end of daily or monthly intervals during that year of assessment. The chosen interval (daily or monthly) must be consistently applied per foreign currency within a year of assessment.

Average exchange rates for a range of foreign currencies are available on the SARS website [www.sars.gov.za](http://www.sars.gov.za). These may be used to translate foreign taxes under section 6quin to rand. A resident may also use the rates available on [www.oanda.com](http://www.oanda.com) to calculate average exchange rates.

### **Example 56 – Translation of foreign taxes to rand**

#### *Facts:*

During year 1 a resident derives income from services rendered within South Africa to a person resident in Country A. The service income, which is denominated in the official currency of Country A, is subject to a withholding tax in Country A as and when payment is made. Payment is made in year 2 and the payer withholds the required withholding tax in Country A's currency.

<sup>107</sup> Section 46 of the TA Act.

South Africa does not have a tax treaty with Country A.

*Result:*

The foreign taxes expressed in Country A's currency must be translated to rand by applying the average exchange rate for the year of assessment in which the tax was imposed. Under Country A's tax law, the tax is only imposed when payment takes place and accordingly the average exchange rate for year 2 must be applied in translating the foreign taxes to rand for purposes of determining the section 6quin rebate in year 1.

**Example 57 – Translation of foreign taxes to rand**

*Facts:*

During year 1 a resident derives income from services rendered within South Africa to a person resident in Country B. The service income, which is denominated in Country B's currency, is subject to tax at 40% of net profit attributable to that service income which must be calculated at the end of the year of assessment. Payment is made partly in year 1 when a provisional withholding tax of 5% is withheld from payments made to the resident and partly in year 2 when the necessary returns are submitted and any top-up (or refund) is required.

South Africa does not have a tax treaty with Country B.

*Result:*

The foreign taxes expressed in Country B's currency must be translated to rand by applying the average exchange rate for the year of assessment in which the tax was imposed. Under Country B's law the tax is imposed on net profit at the end of the year 1 and not when payment takes place. Accordingly, the average exchange rate for year 1 must be applied.

**Example 58 – Translation of foreign taxes to rand at the average exchange rate**

*Facts:*

A natural person resident in South Africa renders services from within South Africa to a person resident in Country C. The service contract lasts six months which period falls within year 1. Payment for the services rendered is made in year 2 and triggers a withholding tax in Country C in year 2.

The average exchange rate for year 1 amounted to R14 while the average exchange rate for year 2 amounted to R12.

South Africa has a tax treaty with Country C. The requirements of section 6quin are met.

*Result:*

The foreign taxes are translated to rand for purposes of section 6quin by applying the average exchange rate of R12 (the year the foreign tax is levied and withheld), while the average exchange rate in year 1 (the year of accrual) of R14 is used to translate the service income to rand as the resident has elected under section 25D(3) to translate the service income to rand by applying the average method of translation rather than the spot method of translation.

## 7.8 Foreign taxes refunded or foreign tax liabilities discharged deemed to be normal tax payable in year of refund or discharge [section 6quin(5)]

It may happen that –

- foreign taxes which were withheld by a foreign government, with which South Africa has a tax treaty, from payments to a South African resident for South Africa-sourced services, are refunded (for example, after a mutual agreement procedure); or
- foreign taxes which were payable by a South African resident on services rendered in South Africa under the laws of a foreign government with which South Africa does not have a tax treaty, are discharged (reduced).

In these circumstances, section 6quin(5) deems so much of the refund or discharge that does not exceed the rebate claimed to be normal tax payable in the year of assessment in which the refund or discharge takes place.

### **Example 59 – Refund of foreign taxes incorrectly withheld, treated as normal tax payable in year of refund**

*Facts:*

Country X with which South Africa has a tax treaty incorrectly withholds foreign tax at the domestic tax rate of Country X (15%) on services rendered by a resident to a person resident in Country X. The services are rendered in South Africa.

South Africa follows a mutual agreement procedure resulting in the refund of the 15% foreign withholding tax.

*Result:*

Under section 6quin(5) the foreign withholding tax of 15% refunded to the resident on successful completion of the mutual agreement procedure is regarded as normal tax payable by the resident.

The taxpayer's tax position before considering the application of section 6quin(5), that is whether the taxpayer is in a tax paying or an assessed loss position, is not relevant. The amount deemed to be normal tax is payable even if the taxpayer is in an assessed loss position.

For example, if a resident company which has an assessed loss in year 2 receives a refund during that year for foreign taxes which were withheld and resulted in a section 6quin rebate in year 1; the receipt of the refund will result in a liability for normal tax in year 2 notwithstanding that the resident company has an assessed loss.

As the amount of the refund or the discharge will be denominated in a foreign currency, the amount must be translated to rand for South African tax purposes. Section 6quin(5) does not prescribe a translation rule in this regard.

As section 6quin(5) does not provide a translation rule, the general rule found in section 25D(1) for the translation of amounts denominated in a foreign currency to rand, namely, the spot rate will apply.<sup>108</sup> An individual or non-trading trust may elect

<sup>108</sup> See section 25D(4) for the translation rule applicable to Head Quarter Companies.

under section 25D(3) to use the average exchange rate method of translation rather than the spot rate method of translation.

## **7.9 Calculation of provisional tax payments with reference to the section 6quin rebate**

A provisional taxpayer may take a foreign tax that will qualify for a rebate under section 6quin at the end of the year of assessment into account when determining any provisional tax payable for South African income tax purposes.

## **8. Rebate in respect of foreign taxes on dividends [section 64N]**

### **8.1 Rebate for foreign taxes on dividends paid by a foreign company [section 64N(1)]**

A foreign dividend paid by a foreign company listed on the Johannesburg Stock Exchange to a resident<sup>109</sup> is subject to dividends tax to the extent the dividend does not consist of a distribution of an asset *in specie* and is not exempt from the tax under section 64F. This foreign dividend may also have been subject to tax in a foreign jurisdiction without any right of recovery by any person.

Section 64N(1) provides for a rebate which must be deducted from the dividends tax payable on the specific dividends as set out in the preceding paragraph if the foreign dividend was subject to foreign tax. Section 64N is not applicable to a beneficial owner that is not liable for dividends tax as a result of the exemptions provided for under section 64F, because qualifying for an exemption means no dividends tax is payable and section 64N(3) provides that the amount of the rebate may not exceed the amount of dividends tax imposed on the relevant dividends. Thus, if foreign tax was payable in relation to foreign dividends paid by a foreign company listed on the Johannesburg Stock Exchange to a resident company, the amount of the rebate would be nil as the resident company is exempt from dividends tax under section 64F and as no dividends tax has been imposed the rebate is equal to nil (see 8.3).

An amount of foreign tax (for example, foreign dividend withholding tax) will not qualify for both a rebate from normal tax under section 6quat and a rebate against dividends tax under section 64N because amounts falling within the ambit of section 64N are exempt under section 10B(2)(d) and therefore the amount will not be included in the resident's taxable income. The inclusion in the resident's taxable income is a requirement in section 6quat.

#### **Example 60 – Rebate for foreign taxes on dividends**

##### *Facts:*

Company Y, incorporated in Australia, declared a cash dividend of R1 million on shares listed on the Johannesburg Stock Exchange to its South African resident holders of shares. 50% of the holders are natural persons and 50% are companies, each person holding less than 10% of the shares in Company Y.

<sup>109</sup> Foreign dividends paid by a foreign company listed on the Johannesburg Stock Exchange to non-residents are exempt from dividends tax under section 64F(1)(j).

The holders, which are companies, complied with the necessary requirements and are exempt from dividends tax under section 64F(1)(a). Company Y pays the dividend of R1 million to Regulated Intermediary A resulting in a potential dividends tax liability of R75 000 (R1 million × 50% × 15%) for the holders who are natural persons without taking into account any rebates for foreign taxes.

Company Y withheld Australian tax of R150 000 (R1 million × 15%) from the dividend paid to Regulated Intermediary A in accordance with the tax treaty between Australia and South Africa.<sup>110</sup>

*Result:*

Under section 64N(1) a rebate for foreign taxes on dividends must be deducted by Regulated Intermediary A from dividends tax of R75 000 which would otherwise be withheld from the dividends paid to the individual holders of shares under section 64H(1). The amount of the rebate is R75 000 (see **8.2** and **8.3**), therefore no dividends tax (R75 000 dividends tax – R75 000 rebate) is to be withheld by Regulated Intermediary A from the dividends paid to the individual holders of shares.

In relation to the dividends paid to holders of shares who are companies, no rebate is available as there is no dividends tax against which the rebate could be deducted and the amount of the rebate is accordingly nil.<sup>111</sup>

Regulated Intermediary A pays R850 000 (R1 million – R150 000 Australian tax) to the South African holders of shares.

**Note:**

The foreign dividends received by the resident holders of shares are included in their gross income under paragraph (k) of 'gross income' in section 1(1), but are *exempt* from normal tax under section 10B(2)(d). The holders of shares will accordingly not qualify for a rebate under section 6quat(1).

## **8.2 Amount of rebate for foreign taxes on dividends [section 64N(2)]**

The amount of the rebate is equal to the amount of any tax paid to any sphere of government of any country other than the Republic, without any right of recovery by any person, on a foreign dividend paid by a foreign company on a listed share.

A rebate will only be allowed to the extent that the amount of the foreign tax is proved to be payable to a sphere of government of a foreign country without a right of recovery.

To the extent that a beneficial owner receives a refund of foreign taxes or is the recipient of a benefit resulting in the removal or reduction of double taxation, the double taxation will either diminish or be eliminated and there would be no reason to provide relief in these circumstances.

The beneficial owner or any other person must not be able to recover the foreign taxes proved to be payable. The existence of a right of recovery, held either by the beneficial owner or any other person, means that the amount of the foreign tax liability will not be allowed as a rebate. For example, exercising a right to contest a foreign tax liability gives rise to a contingent right to recover the overpaid tax if

<sup>110</sup> Article 10(2)(b) of the tax treaty between South Africa and Australia.

<sup>111</sup> Sections 64F and 64N(3).

successful. A rebate will not be permitted while the tax is in dispute and not yet finally determined.

A further example includes a foreign jurisdiction imposing a higher domestic rate of tax on a foreign dividend than that permitted under the provisions of the relevant tax treaty. A rebate for foreign taxes actually paid will be allowed but only to the extent specified in the relevant tax treaty.

The words “right of recovery by any person” are interpreted very broadly and include any form of relief against a foreign tax liability. See **4.3.3** for the interpretation of the term “right of recovery” in the context of the section 6quat(1) rebate. For example, a refund, credit, rebate, remission or deduction, is considered to be a right of recovery. Any other form of economic benefit to which a person becomes entitled is also considered to be a “right of recovery by any person”.

### **Example 61 – Amount of rebate for foreign taxes on dividends**

*Facts:*

Company Y, incorporated in Australia, declared a cash dividend of R1 million on shares listed on the Johannesburg Stock Exchange to its South African resident holders of shares. 50% of the holders are natural persons and 50% are companies, each person holding less than 10% of the shares in Company Y.

The holders, which are companies, complied with the necessary requirements and are exempt from dividends tax under section 64F(1)(a). Company Y pays the dividend of R1 million to Regulated Intermediary A resulting in a potential dividends tax liability of R75 000 (R1 million × 50% × 15%) for the holders who are natural persons without taking into account any rebates for foreign taxes.

Company Y withheld Australian tax of R100 000 (R1 million × 10%)<sup>112</sup> from the dividend paid to Regulated Intermediary A in accordance with the tax treaty between Australia and South Africa.<sup>113</sup>

*Result:*

The amount of the rebate under section 64N(2) is equal to the amount of foreign taxes paid. Foreign tax of R100 000 (R1 million × 10%) was withheld by Company Y from dividends paid to the resident individual and company holders of shares. Foreign taxes paid must be deducted from dividends tax to be withheld by Regulated Intermediary A. Dividends tax to be withheld by Regulated Intermediary A is calculated as follows:

	R
Dividends tax to be withheld by Regulated Intermediary A	
– Individuals (R1 million × 50% × 15%)	75 000
Less: Rebate for foreign taxes on dividends – Individuals (R1 million × 50% × 10%)	<u>(50 000)</u>
Dividends tax to be withheld and paid to SARS by Regulated Intermediary A	<u>25 000</u>

<sup>112</sup> Assume withholding tax is 10% for purposes of this example.

<sup>113</sup> Article 10(2)(b) of the tax treaty between South Africa and Australia.

**Note:**

In relation to the dividends paid to holders of shares who are companies no rebate is available as there is no dividends tax against which the rebate could be deducted and the amount of the rebate is accordingly nil.<sup>114</sup> The foreign tax of R50 000 that was withheld by Company Y from dividends paid to holders of shares who are companies are not allowed as a rebate against dividends tax to be withheld by Regulated Intermediary A from the dividends paid to the individual holders of shares.

**8.3 Limitation on amount of rebate for foreign taxes on dividends [section 64N(3)]**

The amount of the rebate must not exceed the amount of dividends tax imposed on the foreign dividend.

This means that in the case of a beneficial owner that is not liable for dividends tax as a result of the exemptions provided for under section 64F, the amount of the rebate is limited under section 64N(3) to nil because the amount of dividends tax imposed on the foreign dividend is nil.

**Example 62 – Limitation on amount of rebate for foreign taxes on dividends***Facts:*

Company Y, incorporated in Australia, declared a cash dividend of R1 million on shares listed on the Johannesburg Stock Exchange to its South African resident holders of shares. 50% of the holders are natural persons and 50% are companies, each person holding less than 10% of the shares in Company Y.

The holders, which are companies, complied with the necessary requirements and are exempt from dividends tax under section 64F(1)(a). Company Y pays the dividend of R1 million to Regulated Intermediary A resulting in a potential dividends tax liability of R75 000 (R1 million × 50% × 15%) for the holders who are natural persons without taking into account any rebates for foreign taxes.

Company Y withheld Australian tax of R160 000 from the dividend paid to Regulated Intermediary A in accordance with the tax treaty between Australia and South Africa. Assume that Company Y was obliged to withhold foreign tax at a rate of 16% and that the limitation of 15% under article 10 of the tax treaty does not apply.<sup>115</sup>

*Result:*

The amount of the rebate is equal to the amount of foreign taxes of R80 000 (R160 000 × 50%) withheld from the dividends paid to holders of shares who are individuals. The rebate is, however, limited under section 64N(3) to the amount of dividends tax of R75 000 payable on dividends paid to holders of shares who are individuals:

	R
Dividends tax payable by Regulated Intermediary A – Individuals	75 000
Less: Rebate for foreign taxes, limited to amount of dividends tax	<u>(75 000)</u>
Dividends tax payable to SARS by Regulated Intermediary A	<u>Nil</u>

<sup>114</sup> Sections 64F and 64N(3).

<sup>115</sup> Article 10(2)(b) of the tax treaty between South Africa and Australia.

In relation to the dividends paid to holders of shares who are companies no dividends tax is payable and the amount of the rebate is nil.<sup>116</sup>

#### 8.4 Translation of amounts of foreign taxes on dividends [section 64N(4)]

The rebate for foreign taxes is determined in rand by translating the foreign currency amount using the same rate used to translate the foreign dividend [section 64N(4)].

A cash dividend paid by a listed company is deemed to be paid on the date it is paid and not the date when it becomes due and payable [section 64E(2)(a)(i)]. A dividend denominated in foreign currency must accordingly be translated to rand at the spot rate at the time the dividend is paid [section 64E(5)]. It follows that the foreign taxes must also be translated to rand at the spot rate applicable when the dividend is paid.

#### **Example 63 – Translation of amounts of foreign taxes on dividends**

*Facts:*

Company Y, incorporated in Australia, declared a cash dividend of R1 million on shares listed on the Johannesburg Stock Exchange to its South African resident holders of shares. 50% of the holders are natural persons and 50% are companies, each person holding less than 10% of the shares in Company Y.

The holders, which are companies, complied with the necessary requirements and are exempt from dividends tax under section 64F(1)(a). Company Y pays the dividend of R1 million to Regulated Intermediary A resulting in a potential dividends tax liability of R75 000 (R1 million × 50% × 15%) for the holders who are natural persons without taking into account any rebates for foreign taxes.

Company Y withheld Australian tax of R150 000 (R1 million × 15%) from the dividend paid to Regulated Intermediary A in accordance with the tax treaty between Australia and South Africa.<sup>117</sup>

The dividend of R1 million was converted from Australian dollar to South African rand at an exchange rate of Australian \$ 1: R9,2400 when it was paid.

*Result:*

The foreign tax paid must be translated to rand by using the exchange rate of Australian \$1: R9,2400.

#### 8.5 Proof of foreign taxes on dividends [section 64N(5)]

A company or regulated intermediary must obtain proof, in the form and manner prescribed by the Commissioner, of any tax paid to any sphere of government of any country other than the Republic that is deducted as a rebate under section 64N(1) from dividends tax payable.

<sup>116</sup> Sections 64F and 64N(3).

<sup>117</sup> Article 10(2)(b) of the tax treaty between South Africa and Australia.



## 9. Documentary proof required by SARS in respect of foreign taxes

Any foreign-source amount received by or accrued to a resident must be declared in that person's income tax return.

The onus is on a resident to prove that the resident is entitled to a foreign tax rebate under sections 6*quat*(1A), 6*quin* and 64N or a deduction under section 6*quat*(1C). Consequently a resident must keep adequate written records of amounts of income that qualify for a rebate or a deduction as well as foreign taxes proved to be payable or paid.

The requirements detailed in **9.1, 9.2, 9.3, 9.4** and **9.6** are relevant when a resident is claiming a foreign tax rebate under sections 6*quat*(1) or 6*quin*, or a deduction under section 6*quat*(1C). The requirements in **9.5** and **9.6** are relevant when claiming a rebate against dividends tax under section 64N. These requirements reflect the information which will generally be required, however SARS is not limited to the items mentioned and may request additional information and support in a particular case.

Cases in which a taxpayer is unable to meet the requirements detailed in this Note will be handled on a case-by-case basis taking into consideration the facts of the particular case, the reasons why the taxpayer is unable to meet the requirements as detailed in this Note and the alternative sources of evidence provided by the taxpayer.

With effect from 1 July 2013<sup>118</sup> a resident who wishes to claim a foreign tax rebate under section 6*quin* on foreign taxes levied by a foreign government with which South Africa has a tax treaty and which have been withheld from payments made to the resident, must submit a return to SARS.

The return must be submitted to SARS within 60 days from the date on which the foreign tax is withheld. The return must be made on the "Declaration of foreign tax withheld – Section 6*quin* of the Income Tax Act (FWT 01)" form which is available on [www.sars.gov.za](http://www.sars.gov.za). – see **7.6**. Failure to submit the return within the 60-day period will result in the resident not being able to claim a section 6*quin* rebate as a deduction from normal tax.

Taxpayers who are unable to obtain all of the required supporting documentation within the 60-day period must submit the FWT 01 form within the 60 day period as required together with a letter explaining what supporting documentation is outstanding, the reason it is outstanding and the date by when it will be submitted. This will allow SARS to consider the appropriateness of the reasons for the delay in submitting all of the required documentation within the time period specified in section 6*quin*(3A) and whether the return is still regarded as submitted even though all the required documentation has not been submitted. It is critical, however, that the return be submitted within the time period specified in section 6*quin*(3A).

A person who wishes to claim a foreign tax rebate under section 6*quin* on foreign taxes imposed by a foreign government with which South Africa does not have a tax treaty must also submit the return referred to in the preceding paragraph.<sup>119</sup>

<sup>118</sup> Date determined by the Minister of Finance in Notice No. 463; *Government Gazette* No. 36627, (02 July 2013).

<sup>119</sup> Section 46 of the TA Act.

### 9.1 Basic information required

The resident must on request provide a statement which provides the following information:

- The foreign tax year during which the income was received by or accrued to the resident.
- The precise name of the tax and the foreign country in which it was levied.
- The name of the law under which the tax was imposed.
- Whether the tax was levied by the national government, a state or local authority and the name of such authority.

### 9.2 Additional information required when the foreign tax has been withheld at source

The resident must on request provide certified copies of –

- a certificate of tax withheld, issued by the person paying the resident the amount; or
- a copy of a receipt issued by the relevant revenue authority as evidence of payment of the amount of the tax (that is that the amount withheld has been remitted).

### 9.3 Additional information required when the foreign tax has not been withheld at source and the foreign tax jurisdiction operates a system of self-assessment of income tax

The resident must on request provide certified copies of –

- the relevant parts of the foreign income tax return containing the calculation of taxable income and taxes due, schedule of provisional payments and signature of resident; and
- calculations of foreign provisional tax payable.

In addition SARS may request –

- documentary proof that a foreign tax liability has been incurred, for example, a letter from the relevant foreign tax authority or a receipt for taxes paid; and
- a certificate from the resident's auditor stating that the amount is payable.

### 9.4 Additional information required when the foreign tax has not been withheld at source and the foreign tax jurisdiction operates a system of assessment similar to South Africa

The resident must on request provide certified copies of –

- the relevant notice of assessment;
- the relevant parts of the foreign income tax return showing the calculation of the taxable income and taxes due, schedule of provisional payments and signature of the resident;
- calculations of any provisional taxes payable; and
- a copy of a statement of account issued by the relevant revenue authority requesting payment.

In addition, SARS may request further information such as –

- documentary proof that a foreign tax liability has been incurred, for example, a letter from the relevant foreign tax authority or a receipt for taxes paid; and
- a certificate from the resident's auditor stating that the amount is payable.

### 9.5 Evidence required for dividends tax

Section 64N(5) provides as follows:

“(5) A company or regulated intermediary must obtain proof of any tax paid to any sphere of government of any country other than the Republic and deducted from the dividend tax payable in terms of this section, in the form and manner prescribed by the Commissioner.”

It is therefore clear that the company declaring the dividend or the regulated intermediary must obtain the proof.

The “form and manner” has not been prescribed by the Commissioner. The following would be acceptable:

- A certificate from the foreign entity that withheld the foreign tax, indicating the amount of the dividend and the amount of the foreign tax withheld; or
- A tax assessment issued by the foreign tax authority indicating the amount of foreign tax paid on the dividend.

The proof should be provided to the company or the regulated intermediary before or by the date that the dividends tax is payable to the Commissioner.

### 9.6 Translation of information worded in a foreign language

SARS may require a resident to appoint a sworn translator to translate any documentary evidence worded in a foreign language into English.<sup>120</sup> A certificate prepared by the translator officially stating that the translation is a true rendition of the original may also be requested.

**Legal and Policy Division**  
**SOUTH AFRICAN REVENUE SERVICE**  
 Date of 1st issue : 31 March 2003  
 Date of 2nd issue : 31 March 2009

<sup>120</sup> Under section 33(1) of the TA Act a senior SARS official may by notice require a person to produce a translation of information, which is not in one of the official languages of South Africa, in one of the official languages determined by the official within a reasonable period.

**Annexure A – Comprehensive three-step limitation example including foreign branch operations, foreign dividend income and income attributed to a CFC**

**Three-step limitation example including foreign branch operations, foreign dividend income and income attributed to a CFC**

*Facts:*

A resident company derives the following income during year 1:

Income from –	R
South African operations (see note 1)	350 000
Foreign branch (see note 2)	120 000
Foreign dividend (see note 3)	70 000

The resident company has shares in the following foreign companies:

Company A (see note 4)

Company B (see note 5)

Company C (see note 6)

**Note:**

- 1) The resident company incurred expenses of R150 000 which qualify for a tax deduction against income derived from its South African operations.
- 2) The branch was entitled to deductions totalling R40 000 in both the foreign country and South Africa. The branch is obliged to pay foreign taxes of R20 000.
- 3) The dividend is declared by a foreign company which is not a CFC in relation to the resident. The resident's participation stake in the foreign company is less than 10%.

Withholding tax of R3 500 is deducted from the dividend by the tax authorities in the country of residence of the foreign company.

- 4) The resident holds 60% of the participation and voting rights in Company A which means Company A is a CFC (CFC A). CFC A does not have a foreign business establishment. The net income of CFC A for year 1 consists of interest income of R100 000. In its country of residence the CFC's equivalent taxable income amounted to R120 000 which resulted in a tax liability of R12 000 in that country.
- 5) The resident only holds 15% of the participation and voting rights in Company B, however other South Africans residents hold 60% of Company B which makes it a CFC (CFC B). CFC B has a foreign business establishment and derives interest income.  
The net income of CFC B [which constitutes interest income in excess of the *de minimus* exclusion in section 9D(9A)(a)(iii)(cc)] for year 1 equals R100 000. In its country of residence the CFC's taxable income amounted to R125 000 which resulted in a tax liability of R12 500 in that country.
- 6) The resident holds 75% of the participation and voting rights in CFC C which has a foreign business establishment. The net income of CFC C for year 1 is R100 000, made up as follows:

- R20 000 – interest income (not attributable to CFC C's foreign business establishment)

- R80 000 – “diversionary” service income as contemplated in section 9D(9A)(a)(ii) attributable to CFC C’s foreign business establishment which are not excluded from imputation under section 9D(2) in terms of either section 9D(9A)(a) or section 9D(9)(b).
- In its country of residence the CFC’s taxable income also amounts to R100 000 which resulted in a tax liability of R8 000 in that country.

*Result:*

Taxable income:

	R
South African sourced taxable income (R350 000 – R150 000)	200 000
Profits of a foreign branch (R120 000 – R40 000)	80 000
Foreign dividend [see note a)]	37 500
CFC A – attributed to income [see note b)]	60 000
CFC B – attributed to income [see note c)]	15 000
CFC C – attributed to income [see note d)]	<u>75 000</u>
Taxable income	<u>467 500</u>
Normal tax (R467 500 × 28%)	130 900
Less: Section 6quat(1) rebate [see note e)]	<u>(37 000)</u>
South African tax payable	<u>93 900</u>

**Note:**

a) Exemption under section 10B(3) amounts to R32 500

*Calculation:*

$$R70\,000 \times 13 / 28 = R32\,500$$

$$\text{Taxable portion of dividend} = R70\,000 - R32\,500 = R37\,500$$

b) Attributable net income of CFC A

$$\text{Net income (R100 000)} \times \text{participation interest (60\%)} = R60\,000$$

c) Net income (R100 000) × participation interest (15%) = R15 000

d) Net income (R100 000) × participation interest (75%) = R75 000

e) Calculation of the foreign tax rebate available

*Total foreign taxes potentially qualifying for a rebate before application of the limitation under section 6quat(1B)(a)]*

**Dividends** – the full amount of withholding tax of R3 500 potentially qualifies for a rebate [paragraph (ii) of the proviso to section 6quat(1A)].

**Foreign branch** – the full amount of R20 000 potentially qualifies for a rebate.

**CFC A:**

*Step 1: Foreign taxes attributable to the proportional amount of net income included in taxable income (X)*

$$X = [\text{Foreign taxes} \times (\text{net income under SA tax principles} / \text{taxable income under foreign tax principles})^*] \times \text{participation interest}$$

$$X = [R12\ 000 \times (R100\ 000 / R120\ 000)] \times 60\%$$

$$X = R6\ 000$$

\* only applicable if taxable income under foreign tax principles is greater than net income under South African tax principles

*Step 2: Applicability of the limitation in paragraph (iA)(bb) of the proviso to section 6quat(1B)(a)*

Not applicable – CFC A does not have a foreign business establishment in the relevant foreign country.

Therefore, the amount of foreign taxes for CFC A potentially qualifying for a rebate equals R6 000.

**CFC B:**

*Step 1: Foreign taxes attributable to the proportional amount of net income included in taxable income (X)*

$$X = [\text{Foreign taxes} \times (\text{Net income under SA tax principles} / \text{taxable income under foreign tax principles})^*] \times \text{participation interest}$$

$$X = [R12\ 500 \times (R100\ 000 / R125\ 000)] \times 15\%$$

$$X = R1\ 500$$

\* only applicable if taxable income under foreign tax principles is greater than net income under South African tax principles

*Step 2: Applicability of the limitation in paragraph (iA)(bb) of the proviso to section 6quat(1B)(a)*

The limitation in paragraph (iA)(bb) of the proviso to section 6quat(1B)(a) is applicable because net income includes an amount falling under section 9D(9A)(a)(iii)(cc). As a result, the foreign tax will be limited to the normal tax attributable to the amount, that is R4 200 [CFC B taxable income (R15 000) / total taxable income (R467 500) × normal tax (R130 900)].

Therefore, the amount of foreign taxes for CFC B potentially qualifying for a rebate = R1 500.

**CFC C:**

*Step 1: Foreign taxes attributable to the proportional amount of net income included in taxable income (X)*

$$X = [\text{Foreign taxes} \times (\text{Net income under SA tax principles} / \text{taxable income under foreign tax principles})^*] \times \text{participation interest}$$

$$X = [R8\ 000 \times (R100\ 000 / R100\ 000)] \times 75\%$$

$$X = R6\ 000$$

\* only applicable if taxable income under foreign tax principles is greater than net income under South African tax principles

*Step 2: Applicability of the limitation in paragraph (iA)(bb) of the proviso to section 6quat(1B)(a).*

The limitation is not applicable to the passive income because it is not attributable to CFC C's foreign business establishment and the limitation in the proviso only applies to specified amounts which are attributable to a CFC's foreign business establishment. That is, the foreign tax not subject to the limitation

$$= \text{Attributable foreign taxes} \times (\text{passive foreign taxable income} \times \text{participation interest}) / (\text{total foreign taxable income} \times \text{participation interest})$$

$$= R6\ 000 \times (R20\ 000 \times 75\%) / (R100\ 000 \times 75\%)$$

$$= R1\ 200$$

The limitation is applicable to the diversionary service income because net income includes an amount falling under section 9D(9A)(a)(iii)(cc).

The portion of foreign tax attributable to the diversionary income

$$= \text{Attributable foreign taxes} \times (\text{diversionary foreign taxable income} \times \text{participation interest}) / (\text{total foreign taxable income} \times \text{participation interest})$$

$$= R6\ 000 \times (R80\ 000 \times 75\%) / (R100\ 000 \times 75\%)$$

$$= R4\ 800$$

The foreign tax attributable to the diversionary income will be limited to the normal tax attributable to that amount, that is, R16 800 (see working 1 below).

Working 1:

$$(R60\ 000 / R467\ 500 \times R130\ 900)$$

$$= R16\ 800$$

Thus the full amount of foreign taxes on the diversionary income therefore potentially qualifies for a rebate because the limit is greater than the applicable amount of foreign taxes.

Therefore, the total amount of foreign taxes for CFC C potentially qualifying for a rebate equals R6 000 (R1 200 + R4 800).

**Sum of foreign taxes that potentially qualify for the foreign tax rebate**

	R
1) Foreign dividends	3 500
2) Net income of foreign branch	20 000
3) In respect of net income of CFC A	6 000
4) In respect of net income of CFC B	1 500
5) In respect of net income of CFC C	<u>6 000</u>
Total	<u>37 000</u>

*Step 3: Application of limitation under section 6quat(1B)(a)]*

*Calculation of the limitation of the rebate:*

$$\begin{aligned}
 &= \frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable} \\
 &= \frac{(\text{R}37\,500 + \text{R}80\,000 + \text{R}60\,000 + 15\,000 + \text{R}75\,000)}{\text{R}467\,500} \times \text{R}130\,900 \\
 &= \text{R}74\,900
 \end{aligned}$$

Total foreign taxes potentially qualifying for a section 6quat(1) rebate is R37 000, therefore the full amount qualifies for a rebate in year 1.



## Annexure B – Additional examples in respect of natural persons

### Example 1 – Persons married in community of property receiving foreign dividends

#### Facts:

A South African couple is married in community of property. Both are residents and 40 years of age. The couple owns 5% of the equity share capital of a company in Country F. The wife is the registered owner of the shares.

On 20 February 2015 the company declared a dividend of \$120 000 (amount before withholding tax) of which the South African couple's share amounted to \$6 000. The withholding tax payable in respect of the couple's share of the dividend amounted to \$600.

The couple elected to translate the income derived from foreign dividends to rand by using the average exchange rate method of translation as provided for under section 25D(3). The average exchange rate for the 2015 year of assessment ending on 28 February 2015 was \$1 : R10. The couple incurred interest of R10 000 in respect of the dividend received.

During the 2015 year of assessment the wife also received a salary of R100 000 from which an amount of R5 272 was withheld in respect of PAYE. In addition the couple earned interest income amounting to R62 000 on a joint investment in a South African bank.

#### Result:

#### Appropriation of foreign dividends and withholding taxes for purposes of sections 7(2A) and 7(2B)

	Total (100%) R	Wife (50%) R	Husband (50%) R
Foreign dividends included in gross income [(\$6 000 / \$1) × R10]	60 000	30 000	30 000
Withholding tax [(\$600 / \$1) × R10]	6 000	3 000	3 000

#### 1. Tax calculation for the wife

##### 1.1 Taxable income derived from foreign dividends (foreign sources)

Foreign dividends included in gross income	R 30 000
Less: Section 10B(3) exemption [R30 000 × 25 / 40]	(18 750)
<b>Taxable income derived from foreign dividends</b>	<b><u>11 250</u></b>

#### Note:

The wife's portion of the interest expense incurred in the production of foreign dividends is not deductible as a result of the prohibition under section 23(q).

##### 1.2 Taxable income derived from South African sources

Remuneration income	R	R
Local interest income [R62 000 / 2]	31 000	100 000
Less:		
Section 10(1)(i) interest exemption	(23 800)	<u>7 200</u>
<b>Taxable income derived from South African sources</b>		<b><u>107 200</u></b>

**1.3 Total taxable income derived from all sources**

	R
Taxable income derived from foreign sources	11 250
Taxable income derived from South African sources	<u>107 200</u>
<b>Total</b>	<b><u>118 450</u></b>

**1.4 Tax calculation for the wife on R118 450****(a) Calculation of normal tax payable before rebates**

	R
Normal tax payable: (Rates of tax – 2015 year of assessment)	
R118 450 × 18%	21 321

**(a) Calculation of the section 6quat rebate**

	R
Amount of foreign taxes that qualifies for the rebate	3 000
<u>Limited to:</u>	<u>2 025</u>

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R11 250</u>	×	R21 321
R118 450		
= R2 025		

**Note:**

- (1) Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R18 750 under section 10B(3) potentially qualifies for the foreign tax rebate under section 6quat(1).
- (2) R2 025 of the qualifying withholding tax of R3 000 is deductible in full. The balance of R975 (R3 000 – R2 025) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year.

**(b) Calculation of the normal tax payable after taking into account rebates**

	R
Normal tax payable before rebates	21 321
Less: Primary rebate	<u>(12 726)</u>
	8 595
Less: Section 6quat rebate	(2 025)
Less: PAYE	<u>(5 272)</u>
Amount payable	1 298

**2. Tax calculation for the husband****2.1 Taxable income derived from foreign dividends (foreign sources)**

	R
Foreign dividends included in gross income	30 000
Less:	
Section 10B(3) exemption for foreign dividends	
[R30 000 × 25 / 40]	<u>(18 750)</u>
<b>Taxable income derived from foreign dividends</b>	<b><u>11 250</u></b>

**Note:**

The husband's portion of the interest expense incurred in the production of foreign dividends is not deductible as a result of the prohibition under section 23(q).

**2.2 Taxable income derived from South African sources**

	R	R
Local interest income [R62 000 / 2]	31 000	
Less:		
Section 10(1)(i) interest exemption	(23 800)	7 200
<b>Taxable income derived from South African sources</b>		<b><u>7 200</u></b>

**2.3 Total taxable income derived from all sources**

		R
Taxable income derived from foreign sources		11 250
Taxable income derived from South African source		<u>7 200</u>
<b>Total</b>		<b><u>18 450</u></b>

**2.4 Tax calculation for the husband on R18 450****(a) Calculation of normal tax payable before rebates**

Normal tax: (rates of tax – 2015 year of assessment)

	R
R18 450 × 18%	3 321

**(b) Calculation of the section 6quat limitation**

	R
Amount of foreign taxes that qualify for the rebate	3 000
<u>Limited to:</u>	<u>2 025</u>

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax
Total taxable income derived from all sources		
<u>R11 250</u>	×	R3 321
R18 450		
= R2 025		

**Notes:**

(1) Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R18 750 under section 10B(3) potentially qualifies for the foreign tax rebate under section 6quat(1).

(2) R2 025 of the qualifying withholding tax of R3 000 is deductible in full. The balance of R975 (R3 000 – R2 025) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**(c) Calculation of the normal tax payable after taking into account rebates**

	R
Normal tax before rebates	3 321
Less: Primary rebate	(12 726)
<b>Amount payable</b>	<b><u>NIL</u></b>

**Note:**

- (1) As the amount of the primary rebate exceeds the amount of normal tax payable, no portion of the qualifying foreign tax credit of R2 025 may be used against the normal tax payable. This foreign tax rebate is forfeited. It may not be used as a rebate against normal tax payable and may also not be carried forward to the 2016 year of assessment to be used in determining a foreign tax rebate in that year of assessment. The amount of the foreign tax rebate does not qualify for a deduction under section 6quat(1C).

**Example 2 – Natural person receiving foreign dividends and foreign interest***Facts:*

A (the taxpayer), aged 30, is married to B. A and B are resident in South Africa. B is a member of the taxpayer's medical aid. For the 2015 year of assessment the taxpayer earned a pensionable salary from a South African source of R200 000 from which an amount of R25 078 was withheld in respect of PAYE.

In addition, the taxpayer received the following investment income during the 2015 year of assessment:

	<b>South African source</b>	<b>Foreign source</b>
	R	R
Dividends	Nil	56 500
Interest	121 000	44 000

The following withholding taxes were paid in respect of the above-mentioned foreign-source dividends and interest income:

Withholding taxes on foreign dividends	20 000
Withholding tax on foreign interest	8 800

The taxpayer's contract of employment requires a contribution of 8% of pensionable salary to a pension fund. In addition the taxpayer contributed R15 000 during the 2015 year of assessment to a retirement annuity fund.

During the 2015 year of assessment the taxpayer incurred qualifying medical expenses of R16 152 and made medical aid fund contributions of R25 000.

The taxpayer donated R1 500 to a public benefit organisation which has been approved for section 18A purposes. The taxpayer has a copy of a section 18A receipt for the donation.

*Result:***(a) Calculation of taxable income**

	<b>South African source</b>	<b>Foreign source</b>	<b>Total</b>
	R	R	R
<b>Gross income</b>	<b>321 000</b>	<b>100 500</b>	<b>421 500</b>
Salary income	200 000	Nil	200 000
Dividend income	Nil	56 500	56 500
Interest income	121 000	44 000	165 000
<i>Less:</i>			
<b>Exempt income</b>	<b>(23 800)</b>	<b>(35 313)</b>	<b>(59 113)</b>
Section 10B(3) exemption for foreign dividends [R56 500 × 25 / 40]	Nil	35 313	35 313
Section 10(1)(i) interest exemption	23 800	Nil	23 800
<b>Income</b>	<b>297 200</b>	<b>65 187</b>	<b>362 387</b>
<i>Less:</i>			
Pension fund contributions Section 11(k)(i) - Actual contributions R16 000 (R200 000 × 8%) <u>Limited to the greater of –</u> i) R1 750; or ii) 7,5% × R200 000 = R15 000	(15 000)	(Nil)	(15 000)
	<b>282 200</b>	<b>65 187</b>	<b>347 387</b>

Less:

Retirement annuity fund contributions

Section 11(n)(i)(aa) –

Actual contributions R15 000

Limited to the greater of:–

i) R1 750;

ii) R3 500 – R15 000 = RNil; or

iii) 15% of non-retirement funding  
employment income

= (R362 387 – R200 000) × 15%

= R162 387 × 15%

= R24 358

Limited to the actual contributions of  
R15 000

Apportionment of R15 000:

(R282 200 / R347 387 × R15 000) =

R12 185

(R65 187 / R347 387 × R15 000) =

R2 815

	<u>(12 185)</u>	<u>(2 815)</u>	<u>(15 000)</u>
<b>Taxable income before the deduction of donations</b>	<b>270 015</b>	<b>62 372</b>	<b>332 387</b>

Less:

Donation to public benefit organisation

Section 18A –

Actual donation R1 500

Limited to 10% of R332 387 = R33 239

Thus the full R1 500 may be deducted.

Apportionment of R1 500:

(R270 015 / R332 387 × R1 500) =

R1 219

(R62 372 / R332 387 × R1 500) = R281

	<u>(1 219)</u>	<u>(281)</u>	<u>(1 500)</u>
<b>Taxable income</b>	<b><u>268 796</u></b>	<b><u>62 091</u></b>	<b><u>330 887</u></b>

**(b) Calculation of normal tax before rebates**

Normal tax payable: (Rates of tax – 2015 year of assessment)

	R
On R272 700	55 957
On R58 187	
[(R330 887 taxable income – R272 700 per tax table) × 30%]	<u>17 456,10</u>
Total	73 413,10

**(c) Sum of qualifying foreign taxes which relate to total taxable foreign income**

	R
Foreign taxes payable in respect of foreign dividends (Note 1)	20 000
Foreign taxes payable in respect of foreign interest	<u>8 800</u>
Foreign taxes paid which relate to total taxable foreign income	<u>28 800</u>

Note 1: Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R35 313 potentially qualifies for the foreign tax rebate under section 6quat(1).

- **Calculation of the section 6quat rebate**

Amount of foreign taxes that qualify for the rebate	R 28 800,00
Limited to [see (d)]	13 775,98

**(d) Calculation of the section 6quat limitation**

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Total taxable income derived from all sources}} \times \text{Normal tax}$$

$$\frac{\text{R62 091}}{\text{R330 887}} \times \text{R73 413,10}$$

$$= \text{R13 775,98}$$

**Note:**

The amount of the limitation is less than the sum of qualifying foreign taxes of R28 800 as calculated above. Thus the section 6quat rebate for the 2015 year of assessment is limited to R13 775,98 while the balance of R15 024,02 (R28 800,00 – R13 775,98) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**(e) Calculation of the section 6A and 6B rebate**

*Section 6A tax credit*

Medical scheme fees tax credit (R514 per section 6A × 12) = R6 168

*Section 6B tax credit*

Additional medical expenses tax credit = 25% of the excess of [(Medical aid contributions as exceeds 4 × medical scheme fees tax credit) + qualifying medical expenses] as exceeds 7,5% taxable income]

25% of the excess of [(R25 000 – (R6 168 × 4) + R16 152) – (taxable income × 7.5%)]

= 25% of the excess of [(R328 + R16 152) – (R330 887 × 7.5%)]

= 25% of the excess of [R16 480 – 24 816,53]

= 25% of the excess of (-R8 336,53)

A negative figure means there is no excess and the additional medical expenses tax credit is Rnil.

**(f) Calculation of the normal tax payable after taking into account rebates**

	R
Normal tax paid before rebates	73 413,10
Less: Primary rebate	<u>(12 726,00)</u>
	60 687,10
Less: Section 6A tax credit	(6 168,00)
Section 6B tax credit	-
Section 6quat rebate	(13 775,98)
PAYE	<u>(25 078,00)</u>
Amount payable	15 665,12



**Example 3 – Pensioner receiving foreign dividends and foreign interest***Facts:*

B (the taxpayer), age 70 and single, is a resident. For the 2015 year of assessment B earned a pension of R100 000 from a South African source.

In addition the taxpayer received the following income:

	<b>South African source</b>	<b>Foreign source</b>
	R	R
Dividends	Nil	56 500
Interest	121 500	44 000

The following withholding tax was paid in respect of foreign-source dividends and interest:

Withholding tax on foreign dividends	5 650
Withholding tax on foreign interest	2 000

*Other information:*

- An amount of R38 000 for out-of-pocket expenses incurred by the taxpayer qualifies as qualifying medical expenditure under section 6B.
- The taxpayer donated R5 000 to a public benefit organisation which has been approved for section 18A purposes. The taxpayer has a section 18A receipt for the donation.
- A balance of excess foreign taxes of R5 500 was brought forward from the 2014 year of assessment.

*Result:***(a) Calculation of taxable income**

	<b>South African source</b>	<b>Foreign source</b>	<b>Total</b>
	R	R	R
<b>Gross income</b>	<b>221 500</b>	<b>100 500</b>	<b>322 000</b>
Pension income	100 000	Nil	100 000
Dividend income	Nil	56 500	56 500
Interest income	121 500	44 000	165 500
<i>Less:</i>			
<b>Exempt income</b>	<b>(34 500)</b>	<b>(35 313)</b>	<b>(69 813)</b>
Section 10B(3) exemption for foreign dividends	Nil	35 313	35 313
[R56 500 × 25 / 40]			
Section 10(1)(i) interest exemption	34 500	Nil	34 500
<b>Income</b>	<b>187 000</b>	<b>65 187</b>	<b>252 187</b>

*Less:*

Donation to public benefit organisation  
Section 18A –  
Actual donation of R5 000

Limited to 10% of R252 187 = R25 219

Thus the full R5 000 may be deducted.

Apportionment of R5 000:

$(R187\,000/R252\,187 \times R5\,000) =$

R3 708

(R65 187/R252 187 × R5 000) =  
R1 292

	<u>(3 708)</u>	<u>(1 292)</u>	<u>(5 000)</u>
<b>Taxable income</b>	<b><u>183 292</u></b>	<b><u>63 895</u></b>	<b><u>247 187</u></b>

**(b) Calculation of normal tax before rebates**

Normal tax payable: (Rates of tax – 2015 year of assessment)

	R
On R174 550	31 419
On R72 637 (247 187 taxable income – 174 550 per tax table) × 25%	<u>18 159,25</u>
Total	49 578,25

**(c) Sum of foreign taxes which relate to total taxable foreign income**

	R
Foreign taxes which relate to gross foreign dividends (Note 1)	5 650
Withholding tax on foreign interest	<u>2 000</u>
Foreign taxes which relate to total taxable foreign income	<u>7 650</u>

Note 1: Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R35 313 potentially qualifies for the foreign tax rebate under section 6quat(1).

**(d) Calculation of the section 6quat rebate**

	R
Amount of foreign taxes that qualify for the rebate	7 650,00
<u>Limited to</u>	<u>12 815,41</u>

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax
Total taxable income derived from all sources		
<u>R63 895</u>	×	R49 578,25
R247 187		
= R12 815,41		

**Notes:**

(1) The amount of the limitation exceeds the sum of qualifying foreign taxes of R7 650 as calculated above. Thus the full amount of qualifying foreign taxes may be deducted from normal tax payable.

**(e) Calculation of the section 6A and 6B rebate**

*Section 6A tax credit*

Medical scheme fees tax credit = nil as B did not contribute to a medical aid.

*Section 6B tax credit*

Additional medical expenses tax credit =  $[33,3\% \times (\text{Medical aid contribution as exceeds 3 times the medical scheme fees tax credit})] + (33,3\% \times \text{qualifying medical expenditure})$

Therefore,  $[33,3\% \times \text{Rnil}] + (33,3\% \times \text{R38 000}) = \text{R12 654}$

**(f) Calculation of the normal tax payable after taking into account rebates**

	R	R
Normal tax before rebates		49 578,25
Less: Primary rebate		(12 726)
Secondary rebate		<u>(7 110)</u>
		29 742,25
Less: Section 6A tax credit		-
Section 6B tax credit		(12 654,00)
Less: Section 6quat rebate		<u>(7 650,00)</u>
		9 438,25
Less: Balance of excess foreign taxes brought forward from the 2014 year of assessment	5 500,00	
Limited to (12 815.41 – 7 650)	5 165,41	<u>(5 165,41)</u>
Amount payable		<u><u>4 272,84</u></u>

The balance of R334,59 (R5 500,00 – R5 165,41) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**Example 4 – Natural person receiving foreign dividends and a foreign capital gain***Facts:*

D (the taxpayer), aged 26, is a resident. D is married to E, also a resident, who is a member of D's medical aid.

D derives income from both local and foreign sources during the 2015 year of assessment. None of the income derived by D from a foreign source is attributable to a permanent establishment of D located outside South Africa. D's employer deducted PAYE of R25 078 based on D's domestic salary.

The following information is relevant:

R

**Income items:**

• Domestic salary income	200 000
• Foreign dividends	60 000
• Capital gain resulting from the sale of immovable property located in South Africa	410 000
• Capital gain resulting from the sale of shares in a foreign company	360 000

**Expense items:**

• Donation to section 18A approved public benefit organisation - the taxpayer has a section 18A receipt for the donation	50 000
• Qualifying medical expenses	31 548
• Medical aid fund contributions	25 000
• Foreign withholding taxes on foreign dividends	4 000
• Foreign capital gains tax levied in respect of disposal of foreign shares (Calculation: R360 000 × 20%)	72 000

*Result:***(a) Calculation of taxable income**

	<b>South African source</b>	<b>Foreign source</b>	<b>Total</b>
	R	R	R
<b>Gross income</b>	<b>200 000</b>	<b>60 000</b>	<b>260 000</b>
Salary income	200 000	Nil	200 000
Dividend income	Nil	60 000	60 000
<i>Less:</i>			
<b>Exempt income</b>	<b>(Nil)</b>	<b>(37 500)</b>	<b>(37 500)</b>
Section 10B(3) exemption for foreign dividends [R60 000 × 25 / 40]	Nil	37 500	37 500
<b>Income</b>	<b>200 000</b>	<b>22 500</b>	<b>222 500</b>
Taxable capital gain:	<u>131 211</u>	<u>115 209</u>	<u>246 420</u>
Calculation: Inclusion rate for natural persons: 33,3% Amount included in taxable income [((R410 000 + R360 000) – R30 000) × 33,3%] = R246 420			

South African portion of total taxable capital gain Calculation (R410 000 / R770 000) × R246 420 = R131 211	131 211	Nil	131 211
Foreign portion of total taxable capital gain Calculation: (R360 000 / R770 000) × R246 420 R115 209	Nil	115 209	115 209
<b>Taxable income before donations</b>	<b>331 211</b>	<b>137 709</b>	<b>468 920</b>
<i>Less:</i> Donation to approved public benefit organisation Section 18A – Actual donation equals R50 000 <u>Limited</u> to 10% of R468 920 = R46 892 Apportionment of R46 892: (R331 211 / R468 920 × R46 892) = R33 121 (R137 709 / R468 920 × R46 892) = R13 771			
<b>Taxable income</b>	<b><u>298 090</u></b>	<b><u>123 938</u></b>	<b><u>422 028</u></b>

**(b) Calculation of normal tax payable before rebates**

Normal tax payable: (Rates of tax – 2015 year of assessment)

	R
On R377 450	87 382
On R44 578	
(R422 028 taxable income – R377 450 per tax table) × 35%	<u>15 602,30</u>
Total	102 984,30

**(c) Calculation of the portion of foreign taxes levied in respect of the foreign taxable capital gain which qualifies for the rebate calculation**

	R
Total amount of foreign taxes on foreign capital gain	72 000,00
Portion of foreign taxes that relates to foreign taxable capital gain included in taxable income	23 041,80

*Calculation:**Step 1 – The comparative inclusion limitation:*

<u>Amount of foreign taxable capital gain included in taxable income</u>	×	Foreign tax payable
Amount of foreign taxable capital gain subject to foreign taxes		
<u>R115 209</u>	×	R72 000
R360 000		
= R23 041,80		

*Step 2 – The comparative rate of tax on a foreign taxable capital gain limitation [paragraph (iB) of the proviso to section 6quat(1B)(a)]*

Paragraph (iB) of the proviso to section 6quat(1B)(a) applies, therefore the amount calculated in step 1 is limited to:

<u>Amount of foreign taxable capital gain included in taxable income</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R115 209</u>	×	R102 984,30
R422 028		
= R28 113,58		

The limitation is greater than the amount calculated in step 1 and the full amount of R23 041,80 therefore potentially qualifies for the section 6quat(1) rebate calculation.

*Step 3 – The overall normal tax on taxable income limitation [section 6quat(1B)(a)] – see (d) below.*

**(d) Calculation of the section 6quat(1) rebate**

	R
Qualifying foreign taxes in respect of foreign taxable capital gain	23 041,80
Qualifying foreign taxes in respect of foreign dividends (Note 1)	<u>4 000,00</u>
Total	<u>27 041,80</u>

Note 1: Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R37 500 potentially qualifies for the foreign tax rebate under section 6quat(1).

Qualifying foreign taxes limited to: R30 243,65

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R123 938</u>	×	R102 984,30
R422 028		
= R30 243,65		

**Note:**

The full amount of R27 041,80 potentially qualifies for the section 6quat(1) rebate because it is less than the limitation amount.

**(e) Calculation of the section 6A and 6B rebate**

*Section 6A tax credit*

Medical scheme fees tax credit (R514 per section 6A × 12) R6 168

*Section 6B tax credit*

Additional medical expenses tax credit = 25% of the excess of [(Medical aid contributions as exceeds 4 × medical scheme fees tax credit) + qualifying medical expenses] as exceeds 7,5% taxable income]

25% of the excess of  $\{[(R25\ 000 - (R6\ 168 \times 4) + R31\ 548) - (\text{taxable income} \times 7.5\%)]$

= 25% of the excess of  $[(R328 + R31\ 548) - (R422\ 028 \times 7.5\%)]$

= 25% of the excess of  $[R31\ 876 - R31\ 652,10]$

= 25% of the excess of  $(R223,90)$

= 55,98

**(f) Calculation of the normal tax payable after taking into account rebates**

	R
Normal tax payable before rebates	102 984,30
Less: Primary rebate	<u>(12 726,00)</u>
	90 258,30
Less: Section 6A tax credit	(6 168,00)
Section 6B tax credit	(55,98)
Section 6quat(1) rebate	(27 041,80)
PAYE	<u>(25 078)</u>
Amount payable	31 914,52

### Example 5 – Natural person receiving both South African-source and foreign-source consulting fees and foreign dividends

#### Facts:

X (the taxpayer), aged 33, is married to Z. Both are residents. Z belongs to X's medical aid. During the 2015 year of assessment X derives income from both local and foreign sources. None of the income derived by X from a foreign source is attributable to a permanent establishment of X located outside South Africa.

X is a business management consultant who provides consulting services to a company resident in Country A of which 60% is rendered in South Africa while the remaining 40% is rendered in Country A. Under the tax laws of Country A withholding tax is levied at a flat rate of 15% in respect of the gross receipts. Country A regards all the income derived under the service contract as being derived from a source in Country A because the payment of the consulting fees are funded from Country A. South Africa regards the source of the income as the place where the services are rendered, that is 60% is sourced in South Africa and the remaining 40% is sourced in Country A.

South Africa does not have a tax treaty with Country A. X elects that the foreign taxes attributable to South African sourced service fees be deducted from income derived from service fees under section 6quat(1C).

The following information is relevant:

R

#### Income items:

- Consulting fees earned 200 000
- Foreign dividends 60 000

#### Expense items:

- Donation to section 18A approved public benefit organisation - the taxpayer has a section 18A receipt for the donation 20 000
- Qualifying medical expenses 31 548
- Medical aid fund contributions 34 496
- Deductible expenses incurred in earning consulting fees 50 000
- Foreign taxes paid in respect of consulting fees 30 000
- Foreign withholding taxes on foreign dividends 4 000

#### Result:

#### (a) Calculation of taxable income

	South African source	Foreign source	Total
	R	R	R
<b>Gross income</b>	<b>120 000</b>	<b>140 000</b>	<b>260 000</b>
Consulting fees			
SA source (R200 000 × 60%)	120 000	Nil	120 000
Foreign source (R200 000 × 40%)	Nil	80 000	80 000
Dividend income	Nil	60 000	60 000
Less:			
<b>Exempt income</b>	<b>(Nil)</b>	<b>(37 500)</b>	<b>(37 500)</b>
Section 10B(3) exemption for foreign dividends [R60 000 × 25 / 40]	Nil	37 500	37 500
<b>Income</b>	<b>120 000</b>	<b>102 500</b>	<b>222 500</b>
Less:			
Section 11(a) deduction	<b>(30 000)</b>	<b>(20 000)</b>	<b>(50 000)</b>
	30 000		50 000



Expenses attributable to SA-sourced service income (Calculation: R50 000 × 60%)			
Expenses attributable to foreign-sourced service income (Calculation: R50 000 × 40%)		20 000	
<b>Taxable income before the deduction of donations</b>	<b>90 000</b>	<b>82 500</b>	<b>172 500</b>
<i>Less:</i>			
Donation to approved public benefit organisation Section 18A – Actual donation R20 000			
<u>Limited to 10% of R172 500 = R17 250</u>			
Apportionment of R17 250: (R90 000 / R172 500 × R17 250) = R9 000			
(R82 500 / R172 500 × R17 250) = R8 250	(9 000)	(8 250)	(17 250)
<b>Taxable income before section 6quat(1C) deduction</b>	<b><u>81 000</u></b>	<b><u>74 250</u></b>	<b><u>155 250</u></b>
<i>Less:</i>			
Section 6quat(1C) deduction Foreign taxes attributable to SA-sourced service income = R18 000 Calculation: R30 000 × 60% Limited to R81 000 [section 6quat(1D)]	(18 000)	(Nil)	(18 000)
<b>Taxable income</b>	<b><u>63 000</u></b>	<b><u>74 250</u></b>	<b><u>137 250</u></b>

**(b) Calculation of normal tax payable before rebates**

Normal tax payable: (Rates of tax – 2015 year of assessment)	R
R137 250 × 18%	24 705

**(c) Calculation of the section 6quat(1) rebate**

	R
Qualifying foreign taxes in respect of consulting fees	12 000
Calculation: R30 000 × 40%	
Qualifying foreign taxes in respect of foreign dividends	<u>4 000</u>
Total	<u>16 000</u>

Under paragraph (ii) of the proviso to section 6quat(1A) the amount of foreign taxes attributable to the exempt foreign dividends of R37 500 under section 10B(3) potentially qualifies for the foreign tax rebate under section 6quat(1).

Limited to: 13 365

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R74 250</u>	×	R24 705
R137 250		
= R13 365		

**Note:**

The balance of excess foreign taxes amounting to R2 635 (R16 000,00 less R13 365) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**(d) Calculation of section 6A and 6B rebate**

*Section 6A tax credit*

Medical scheme fees tax credit (R514 per section 6A × 12)                      R6 168

*Section 6B tax credit*

Additional medical expenses tax credit = 25% of the excess of [ {(Medical aid contributions as exceeds 4 × medical scheme fees tax credit) + qualifying medical expenses} as exceeds 7,5% taxable income]

25% of the excess of [ {(R34 496 – (R6 168 × 4) + R31 548) – (R137 250 × 7.5%) ]

= 25% of the excess of [ (R9 824 + R31 548) – (R137 250 × 7.5%) ]

= 25% of the excess of [R41 372 – R10 293,75]

= 25% of the excess of (R31 078,25)

= R7 769,56

**(e) Calculation of the normal tax payable after taking into account rebates**

	R	R
Normal tax payable before rebates		24 705
Less: Primary rebate		<u>(12 726)</u>
		11 979
Less: Section 6A tax credit	(6 168,00)	
Section 6B tax credit	(7 769,56)	
Limited to	11 979,00	<u>(11 979)</u>
Final tax payable before section 6quat(1) rebate		Nil
Less: Section 6quat(1) rebate	13 365	
Limited to	Nil	
Amount payable (refundable)		<u>    Nil</u>

**Note:**

The balance of excess foreign taxes of R13 365 (R13 365 see **(c)** above – Nil) is forfeited and may not be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**Example 6 – Natural person receiving both South African-source and foreign-source consulting fees and foreign dividends**

*Facts:*

X (the taxpayer), aged 33, is married to Z. Both are residents. Z belongs to X's medical aid.

During the 2015 year of assessment X derives income from both local and foreign sources. None of the income derived from a foreign source is attributable to a permanent establishment located outside South Africa.

X is a business management consultant who provides consulting services to a company resident in Country A of which 60% is rendered in South Africa while the remaining 40% is rendered in Country A. Under the tax laws of Country A withholding tax is levied at a flat rate of 15% in respect of the gross receipts. Country A regards all the income derived under the service contract as being derived from a source in Country A because the payment of the consulting fees are funded from Country A. South Africa regards the source of the income as the place where the services are rendered, that is 60% is sourced in South Africa and the remaining 40% is sourced in Country A.

South Africa does not have a tax treaty with Country A. X elects that the foreign taxes attributable to South African-source service fees be deducted from normal tax under section 6quin.

The following information is relevant:

R

**Income items:**

- Consulting fees earned 200 000
- Foreign dividends 60 000

**Expense items:**

- Donation to section 18A approved public benefit organisation - the taxpayer has a section 18A receipt for the donation 20 000
- Qualifying medical expenses 31 548
- Medical aid fund contributions 34 496
- Deductible expenses incurred in earning consulting fees 50 000
- Foreign taxes paid in respect of consulting fees 30 000
- Foreign withholding taxes on foreign dividends 4 000

*Result:*

**(a) Calculation of taxable income**

	<b>South African source</b>	<b>Foreign source</b>	<b>Total</b>
	R	R	R
<b>Gross income</b>	<b>120 000</b>	<b>140 000</b>	<b>260 000</b>
Consulting fees			
SA source (R200 000 × 60%)	120 000	Nil	120 000
Foreign source (R200 000 × 40%)	Nil	80 000	80 000
Dividend income	Nil	60 000	60 000
<i>Less:</i>			
<b>Exempt income</b>	<b>(Nil)</b>	<b>(37 500)</b>	<b>(37 500)</b>
Section 10B(3) exemption for foreign dividends [R60 000 × 25 / 40]	Nil	37 500	37 500
<b>Income</b>	<b>120 000</b>	<b>102 500</b>	<b>222 500</b>
<i>Less:</i>			
	<b>(30 000)</b>	<b>(20 000)</b>	<b>(50 000)</b>

Section 11(a) deduction Expenses attributable to SA-sourced service income (Calculation: R50 000 × 60%)	30 000		50 000
Expenses attributable to foreign- sourced service income (Calculation: R50 000 × 40%)		20 000	
<b>Taxable income before the deduction of donations</b>	<b>90 000</b>	<b>82 500</b>	<b>172 500</b>
<i>Less:</i> Donation to approved public benefit organisation Section 18A – Actual donation R20 000  <u>Limited to 10% of R172 500 = R17 250</u> Apportionment of R17 250: (R90 000 / R172 500 × R17 250) = R9 000 (R82 500 / R172 500 × R17 250) = R8 250	(9 000)	(8 250)	(17 250)
<b>Taxable income</b>	<b><u>81 000</u></b>	<b><u>74 250</u></b>	<b><u>155 250</u></b>

**(b) Calculation of normal tax payable before rebates**

	R
Normal tax payable: (Rates of tax – 2015 year of assessment) R155 250 × 18%	27 945

**(c) Calculation of the section 6quat(1) rebate**

	R
Qualifying foreign taxes in respect of foreign-source consulting fees (R30 000 × 40%)	12 000,00
Qualifying foreign taxes in respect of foreign dividends (Note 1)	<u>4 000,00</u>
Total	<u>16 000,00</u>

Note 1: Under paragraph (ii) of the proviso to section 6quat(1A) the full amount of foreign taxes attributable to the exempt foreign dividends of R37 500 potentially qualifies for the foreign tax rebate under section 6quat(1).

Limited to: 13 365

*Calculation of the limitation:*

<u>Taxable income derived from all foreign sources</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R74 250</u>	×	R27 945
R155 250		
= R13 365		

**Note:**

The balance of excess foreign taxes amounting to R2 635 (R16 000 less R13 365) may be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

**(d) Calculation of the section 6quin rebate**

	R
Qualifying foreign taxes in respect of South African-source consulting fees (R30 000 × 60%)	18 000,00
<u>Limited</u> to normal tax attributable to taxable income derived from a South African source:	14 580

*Calculation of the limitation:*

<u>Taxable income derived from applicable SA sourced services</u>	×	Normal tax payable
Total taxable income derived from all sources		
<u>R81 000</u>	×	27 945
R155 250		
= R14 580		

**Note:**

The balance of excess foreign taxes of R3 420 (R18 000 less R14 580) is forfeited.

**(e) Calculation of section 6A and 6B rebate**

*Section 6A tax credit*

Medical scheme fees tax credit (R514 per section 6A × 12)      R6 168

*Section 6B tax credit*

Additional medical expenses tax credit = 25% of the excess of [(Medical aid contributions as exceeds 4 × medical scheme fees tax credit) + qualifying medical expenses] as exceeds 7,5% taxable income]

= 25% of the excess of [(R34 496 – (R6 168 × 4) + R31 548) – (R155 250 × 7.5%)]

= 25% of the excess of [(R9 824 + R31 548) – (R155 250 × 7.5%)]

= 25% of the excess of [R41 372 – R11 643,75]

= 25% of the excess of (R29 728,25)

= R7 432,06

**(f) Calculation of the normal tax payable after taking into account rebates**

	R	R
Normal tax payable before rebates		27 945
Less: Primary rebate		<u>(12 726)</u>
		15 219
Less: Section 6A tax credit		(6 168)
Section 6B tax credit		<u>(7 432,06)</u>
Final tax payable before section 6quat(1) and 6quin rebate		1 618,94
Less:		
Section 6quat(1) rebate	13 365	
Section 6quin rebate	<u>14 580</u>	
	27 945	
Limited to:	<u>1 618,94</u>	(1 618,94)
Amount payable (refundable)		<u>    Nil</u>

**Note:**

The balance of excess foreign taxes of R26 326,06 (R27 945 – R1 618.94) is forfeited and may not be carried forward to the 2016 year of assessment to be used in determining the foreign tax rebate for that year of assessment.

## Annexure C – The law

### Section 6quat

**6quat. Rebate or deduction in respect of foreign taxes on income.**—(1) Subject to subsection (2), where the taxable income of any resident during a year of assessment includes—

- (a) any income received by or accrued to such resident from any source outside the Republic; or
- (b) any proportional amount contemplated in section 9D; or
- (c) . . . . .
- (d) . . . . .
- (e) any taxable capital gain contemplated in section 26A, from a source outside the Republic; or
- (f) any amount—
  - (i) contemplated in paragraph (a) or (b) which is received by or accrued to any other person and which is deemed to have been received by or accrued to such resident in terms of section 7;
  - (ii) of capital gain of any other person from a source outside the Republic and which is attributed to that resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule; or
  - (iii) contemplated in paragraphs (a), (b) or (e) which represents capital of a trust, and which is included in the income of that resident in terms of section 25B(2A) or taken into account in determining the aggregate capital gain or aggregate capital loss of that resident in terms of paragraph 80(3) of the Eighth Schedule,

there must be deducted from the normal tax payable in respect of that taxable income a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment) by—

- (a) such resident in respect of—
  - (i) any income contemplated in subsection (1)(a); or
  - (ii) . . . . .
  - (iii) any amount of taxable capital gain as contemplated in subsection (1)(e); or
- (b) any controlled foreign company, in respect of such proportional amount contemplated in subsection (1)(b), subject to section 72A(3); or
- (c) . . . . .
- (d) . . . . .
- (e) . . . . .
- (f) any other person contemplated in subsection (1)(f)(i) or (ii) or any trust contemplated in subsection (1)(f)(iii), in respect of the amount included in the taxable income of that resident as contemplated in subsection (1)(f),



which is so included in that resident's taxable income: Provided that—

- (i) where such resident is a member of any partnership or a beneficiary of any trust and such partnership or trust is liable for tax as a separate entity in such other country, a proportional amount of any tax payable by such entity, which is attributable to the interest of such resident in such partnership or trust, shall be deemed to have been payable by such resident; and
  - (ii) for the purposes of this subsection, the amount so included in such resident's taxable income must be determined without regard to section 10B(3).
- (1B) Notwithstanding the provisions of subsection (1A)—
- (a) the rebate or rebates of any tax proved to be payable as contemplated in subsection (1A), shall not in aggregate exceed an amount which bears to the total normal tax payable the same ratio as the total taxable income attributable to the income, proportional amount, taxable capital gain or amount, as the case may be, which is included as contemplated in subsection (1), bears to the total taxable income: Provided that—
    - (i) in determining the amount of the taxable income that is attributable to that income, proportional amount, taxable capital gain or amount, any allowable deductions contemplated in sections 11(*n*), 18 and 18A must be deemed to have been incurred proportionately in respect of income derived from sources within and outside the Republic;
    - (iA) the taxes contemplated in subsection (1A)(*b*) that are attributable to any proportional amount which—
      - (aa) . . . . .
      - (bb) relates to any amount contemplated in section 9D(9A)(*a*) which is not excluded from the application of section 9D(2) in terms of that section or section 9D(9)(*b*),
 shall in aggregate be limited to the amount of the normal tax which is attributable to those proportional amounts;
    - (iB) the taxes contemplated in subsection (1A)(*a*)(iii) which are attributable to any taxable capital gain in respect of an asset which is not attributable to a permanent establishment of the resident outside the Republic, must in aggregate be limited to the amount of normal tax which is attributable to that taxable capital gain;
    - (ii) where the sum of any such taxes proved to be payable (excluding any taxes contemplated in paragraphs (iA) and (iB) of this proviso) exceeds the rebate as so determined (hereinafter referred to as the excess amount), that excess amount may—
      - (aa) be carried forward to the immediately succeeding year of assessment and shall be deemed to be a tax on income paid to the government of any other country in that year; and
      - (bb) be set off against the amount of any normal tax payable by that resident during that year of assessment in respect of any amount derived from any other country which is included in the taxable income of that resident during that year, as contemplated in subsection (1), after any tax payable to the government of any other country in respect of any amount so included during such year of assessment which may be deducted in terms of subsections (1) and (1A), has been deducted from the amount of such normal tax payable in respect of such amount so included; and
    - (iii) the excess amount shall not be allowed to be carried forward for more than seven years reckoned from the year of assessment when such excess amount was for the first time carried forward;

- (b) . . . . .  
 (c) . . . . .  
 (d) . . . . .  
 (e) . . . . .

(1C) For the purpose of determining the taxable income derived by any resident from carrying on any trade, there may at the election of the resident be allowed as a deduction from the income of such resident so derived the sum of any taxes on income (other than taxes contemplated in subsection (1A)) proved to be payable by that resident to any sphere of government of any country other than the Republic, without any right of recovery by any person other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment.

(1D) Notwithstanding the provisions of subsection (1C), the deduction of any tax proved to be payable as contemplated in that subsection shall not in aggregate exceed the total taxable income (before taking into account any such deduction) attributable to income which is subject to taxes as contemplated in that subsection, provided that in determining the amount of the taxable income that is attributable to that income, any allowable deductions contemplated in sections 11(n), 18 and 18A must be deemed to have been incurred proportionately in the ratio that that income bears to total income.

(2) The rebate under subsection (1) and the deduction under subsection (1C) shall not be granted in addition to any relief to which the resident is entitled under any agreement between the governments of the Republic and the said other country for the prevention of or relief from double taxation, but may be granted in substitution for the relief to which the resident would be so entitled.

(3) For the purposes of this section—

**“controlled company”** . . . . .

**“controlling company”** . . . . .

**“group of companies”** . . . . .

**“qualifying interest”** . . . . .

**“taxes on income”** does not include any compulsory payment to the government of any other country which constitutes a consideration for the right to extract any mineral or natural oil.

(4) For the purposes of this section the amount of any foreign tax proved to be payable as contemplated in subsection (1A) or (1C) in respect of any amount which is included in the taxable income of any resident during any year of assessment, shall be translated to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment.

(4A) If the amount translated in accordance with subsection (4) includes a number of cents that is less than one rand, that amount must be rounded off to the nearest rand.

(5) Notwithstanding section 99(1) or 100 of the Tax Administration Act, an additional or reduced assessment in respect of a year of assessment to give effect to subsections (1) and (1A) may be made within a period that does not exceed six years from the date of the original assessment in respect of that year.

**Section 6quin****6quin. Rebate in respect of foreign taxes on income from source within Republic.—**

(1) Subject to subsections (3) and (3A), where any portion of the taxable income of a resident is attributable to an amount that is from a source within the Republic and is received by or accrued to that resident in respect of services rendered within the Republic, and an amount of tax in respect of that amount is—

- (a) (i) levied by any sphere of government of any country—
  - (aa) other than the Republic; and
  - (bb) with which the Republic has concluded an agreement for the avoidance of double taxation; and
- (ii) withheld when the amount is paid to that resident by the person making the payment; or
- (b) imposed by any sphere of government of any country—
  - (aa) other than the Republic; and
  - (bb) with which the Republic has not concluded an agreement for the avoidance of double taxation,
 in terms of the laws of that country,

a rebate determined in accordance with subsection (2) must be deducted from the normal tax payable by that resident.

(2) (a) For the purposes of paragraph (a) of subsection (1), the rebate is an amount equal to the lesser of—

- (i) the amount of normal tax which is attributable to the amount received or accrued as contemplated in that subsection; or
- (ii) the amount of tax levied and withheld as contemplated in that paragraph.

(b) For the purposes of paragraph (b) of subsection (1), the rebate is an amount equal to the lesser of—

- (i) the amount of normal tax which is attributable to the amount received or accrued as contemplated in that subsection; or
- (ii) the amount of tax imposed as contemplated in that paragraph.

(3) No rebate may be deducted in terms of this section if—

- (a) the amount of tax levied and withheld as contemplated in subsection (1)(a);
- (b) the amount of tax imposed as contemplated in subsection (1)(b); or
- (c) any portion of any amount contemplated in paragraph (a) or (b),

is—

- (i) taken into account in determining any amount of any rebate that is, in terms of section 6quat(1), deducted from the normal tax payable by that resident; or
- (ii) deducted from the income of that resident in terms of section 6quat(1C).

(3A) Where an amount of tax is levied and withheld as contemplated in subsection (1)(a), no rebate may be deducted in terms of this section if the resident contemplated in subsection (1) does not, within 60 days from the date on which that amount of tax is withheld, submit to the Commissioner a return that the amount of tax was levied and withheld as contemplated in subsection (1)(a).

(4) For the purposes of subsection (2)(a)(ii) and (b)(ii), the amount of any tax—

- (a) levied and withheld as contemplated in subsection (1)(a); or
- (b) imposed as contemplated in subsection (1)(b),

must be translated to the currency of the Republic on the last day of the year of assessment in which that tax is so levied and withheld or imposed, by applying the average exchange rate for that year of assessment.

(5) Where, during any year of assessment, a rebate has been deducted in terms of this section from the normal tax payable by a resident as a result of any amount of tax having been—

- (a) levied and withheld as contemplated in subsection (1)(a); or
- (b) imposed as contemplated in subsection (1)(b),

and, in any year of assessment subsequent to that year of assessment, the resident—

- (i) receives any amount by way of refund in respect of the amount of tax so levied and withheld; or
- (ii) is discharged from any liability in respect of the amount of tax so imposed,

so much of the amount so received or the amount of that discharge as does not exceed that rebate must be deemed to be an amount of normal tax payable by that resident in respect of that subsequent year of assessment.

## Section 64N

**64N. Rebate in respect of foreign taxes on dividends.**—(1) A rebate determined in accordance with this section must be deducted from the dividends tax payable in respect of a dividend contemplated in paragraph (b) of the definition of “dividend” in section 64D.

(2) The amount of the rebate contemplated in subsection (1) is equal to the amount of any tax paid to any sphere of government of any country other than the Republic, without any right of recovery by any person, on a dividend contemplated in subsection (1).

(3) The amount of the rebate contemplated in subsection (2) must not exceed the amount of the dividends tax imposed in respect of the dividend contemplated in subsection (1).

(4) For the purposes of this section, the amount of any tax paid as contemplated in subsection (2) must be translated to the currency of the Republic by applying the exchange rate used to convert the amount of the dividend in respect of which that tax is paid to the currency of the Republic.

(5) A company or regulated intermediary must obtain proof of any tax paid to any sphere of government of any country other than the Republic and deducted from the dividend tax payable in terms of this section, in the form and manner prescribed by the Commissioner.