

**DRAFT INTERPRETATION NOTE**

DATE:

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTION : SECTIONS 49A to 49H**  
**SUBJECT : WITHHOLDING TAX ON ROYALTIES**

**CONTENTS**

|   | <b>PAGE</b> |
|---|-------------|
| Preamble .....  | 2           |
| 1. Purpose.....   | 2           |
| 2. Background.....  | 2           |
| 3. The law.....   | 2           |
| 4. Application of the law.....  | 3           |
| 4.1 Definitions .....   | 3           |
| 4.1.1 "Foreign person".....   | 3           |
| 4.1.2 "Royalty" .....   | 3           |
| (a) "Amount".....   | 3           |
| (b) "Received or accrues".....  | 4           |
| (c) "Right of use".....   | 4           |
| (d) "Intellectual property".....  | 5           |
| (e) Scientific, technical, industrial or commercial knowledge or information.....       | 6           |
| 4.2 The rate at which the withholding tax must be calculated .....                      | 7           |
| 4.3 "Due and payable".....  | 7           |
| 4.4 Payment of the royalty.....   | 8           |
| 4.5 Exemptions from withholding tax.....  | 9           |
| 4.5.1 Exemptions under section 10(1)(l).....  | 9           |
| 4.5.2 Exemptions under section 49D.....   | 11          |
| 4.5.3 Section 31 in relation to intellectual property as defined in section 23l(1)..... | 11          |
| 4.6 Liability for payment and the obligation to withhold tax.....                       | 12          |
| 4.6.1 Liability for the payment of the tax.....   | 12          |
| 4.6.2 Liability to withhold the tax.....  | 12          |
| 4.7 Release of obligation to withhold tax.....  | 13          |
| 4.8 Reduction of the withholding rate.....  | 13          |
| 4.9 Withholding Tax on Royalties Declaration form .....                                 | 14          |

|      |   |    |
|------|---|----|
| 4.10 | Payment of the withholding tax.....                 | 14 |
| 4.11 | Refund of withholding tax on royalties .....        | 15 |
| 4.12 | Currency of payments made to the Commissioner ..... | 17 |
| 5.   | Duty to keep records .....                          | 17 |
| 6.   | Conclusion .....                                    | 18 |
|      | Annexure – The law .....                            | 19 |

### ***Preamble***

In this Note unless the context indicates otherwise –

- “**non-resident**” means a person that is not a “resident” as defined in section 1(1);
- “**section**” means a section of the Act;
- “**TA Act**” means the Tax Administration Act 28 of 2011;
- “**tax treaty**” means an agreement for the avoidance of double taxation;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes, forms and returns referred to in this Note are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issue of these documents should be consulted.

## **1. Purpose**

This Note provides guidance on the interpretation and application of sections 49A to 49H which relate to withholding tax on royalties.

## **2. Background**

The withholding tax on royalties applies to royalties paid by a resident to a non-resident for the use of intellectual property belonging to the non-resident. Like other withholding taxes, withholding taxes on royalties can potentially be reduced or eliminated by a tax treaty between the states of the contracting parties.

The withholding tax on royalties was previously contained in section 35, which provided for a withholding rate of 12%. Owing to the need for uniformity between the different types of withholding taxes, the withholding regimes were amended. Section 35 was accordingly repealed<sup>1</sup> and replaced with sections 49A to 49H with effect from 1 July 2013.<sup>2</sup> The withholding rate was increased to 15% with effect from 1 January 2015.<sup>3</sup>

## **3. The law**

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

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<sup>1</sup> By section 65(1) of the Taxation Laws Amendment Act 22 of 2012.

<sup>2</sup> By section 80(1) of the Taxation Laws Amendment Act 22 of 2012.

<sup>3</sup> By section 97(1)(b) of the Taxation Laws Amendment Act 31 of 2013.

## 4. Application of the law

### 4.1 Definitions

Section 49A contains definitions of “foreign person” and “royalty” which apply for the purposes of sections 49B to 49H.

#### 4.1.1 “Foreign person”

The term “foreign person” is defined in section 49A as “any person that is not a resident”.

The term “resident” is defined in section 1(1) and includes a natural person and a person other than a natural person meeting certain requirements.<sup>4</sup> A “foreign person” therefore includes a natural person, a deceased estate, an insolvent estate, a company and a trust.

A natural person would qualify as a resident if ordinarily resident in South Africa or physically present in South Africa for a specified number of days during a year of assessment as well as during the five years preceding the year of assessment in question. A juristic person which is incorporated, established or formed in South Africa or has its place of effective management in South Africa will also qualify as a resident.

#### 4.1.2 “Royalty”

The term “royalty”, as defined, means –

“any amount that is received or accrues in respect of—

- (a) the use or right of use of or permission to use any intellectual property as defined in section 23I; or
- (b) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information”.

The main elements of the definition of “royalty” are discussed in **4.1.2(a) to (e)**.

##### (a) “Amount”

The word “amount” was considered in *Lategan v CIR* in which Watermeyer J stated the following:<sup>5</sup>

“In my opinion, the word ‘amount’ must be given a wider meaning, and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.”

This principle was reiterated in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd*<sup>6</sup> in which it was confirmed that income, although expressed as an “amount” in the definition of “gross income” includes more than just money but may be every form of

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<sup>4</sup> See section 1(1) for the full definition of “resident”. Also see Interpretation Note 3 “Resident: Definition in relation to a Natural Person – Ordinarily Resident”; Interpretation Note 4 “Resident: Definition in relation to a Natural Person – Physical Presence Test” and Interpretation Note 6 “Resident: Place of Effective Management (Companies)”.

<sup>5</sup> 1926 CPD 203, 2 SATC 16 at 19.

<sup>6</sup> 1990 (2) SA 353 (A), 52 SATC 9 at 21.

property earned by the taxpayer which has a money value. Every form of property includes corporeal and incorporeal property as well as debts and rights of action.

In *C: SARS v Brummeria Renaissance (Pty) Ltd & others*,<sup>7</sup> it was held that even though something cannot be turned into money, this did not mean that it did not have a monetary value. It was also held that an objective test must be applied when determining whether an amount has a money value.

If a taxpayer receives an amount in the form of an asset as opposed to cash, the market value of the asset constitutes an amount and should be included in the taxpayer's gross income.<sup>8</sup> The market value of an asset given to the owner of intellectual property in exchange for the use of the property would constitute the amount received as a royalty.

**(b) “Received or accrues”**

The words “received” and “accrues” are not defined in the Act but have received judicial consideration.

In *Geldenhuys v CIR*, Steyn J stated that the words “received by” must mean –<sup>9</sup>

“received by the taxpayer on his own behalf for his own benefit”.

In *CIR v Genn & Co (Pty) Ltd*, Schreiner JA stated the following:<sup>10</sup>

“It certainly is not every obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income.”

In *WH Lategan v CIR*, Watermeyer J stated the following on the meaning of “accrued”:<sup>11</sup>

“In his Lordship's opinion the words in the Act ‘has accrued to or in favour of any person’ merely meant ‘to which he has become entitled’.”

Thus, a royalty includes any amount received by a person on that person's own behalf and for that person's own benefit as well as those amounts that the person is entitled to but which have not yet been received.

**(c) “Right of use”**

In transactions involving intellectual property, the user of the property is generally obliged to make recurring payments in the form of royalties to the owner. These payments allow the user to legally make use of the property.

Royalty payments are generally made only for the “right of use” of the intellectual property, since they do not afford the user any ownership rights in the property. Ownership remains with the owner at all times during the agreement as well as upon its termination.

<sup>7</sup> 2007 (6) SA 601 (SCA), 69 SATC 205.

<sup>8</sup> See *Lace Proprietary Mines Ltd v CIR* 1938 AD 267, 9 SATC 349.

<sup>9</sup> 1947 (3) SA 256 (C), 14 SATC 419 at 430.

<sup>10</sup> 1955 (3) SA 293 (A), 20 SATC 113 at 123.

<sup>11</sup> 1926 CPD 203, 2 SATC 16 at 20. The entitlement principle was confirmed in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 19.

**(d) “Intellectual property”**

Section 49A refers to intellectual property as defined in section 23I. Section 23I defines “intellectual property” as any –

- “(a) patent as defined in the Patents Act including any application for a patent in terms of that Act;
- (b) design as defined in the Designs Act;
- (c) trade mark as defined in the Trade Marks Act;
- (d) copyright as defined in the Copyright Act;
- (e) patent, design, trade mark or copyright defined or described in any similar law to that in paragraph (a), (b), (c) or (d) of a country other than the Republic;
- (f) property or right of a similar nature to that in paragraph (a), (b), (c), (d) or (e); and
- (g) knowledge connected to the use of such patent, design, trade mark, copyright, property or right;”.

The following words, as defined in their respective Acts, should be noted:

- A “patent” means “a certificate in the prescribed form to the effect that a patent for an invention has been granted in South Africa”.<sup>12</sup>
- A “design” means “an aesthetic design or a functional design”.<sup>13</sup>
  - An “aesthetic design” means “any design applied to any article, whether for the pattern or the shape or the configuration or the ornamentation thereof, or for any two or more of those purposes, and by whatever means it is applied, having features which appeal to and are judged solely by the eye, irrespective of the aesthetic quality thereof”.<sup>14</sup>
  - A “functional design” means “any design applied to any article, whether for the pattern or the shape or the configuration thereof, or for any two or more of those purposes, and by whatever means it is applied, having features which are necessitated by the function which the article to which the design is applied, is to perform, and includes an integrated circuit topography, a mask work and a series of mask works”.<sup>15</sup>
- A “trade mark”, other than a certification trade mark<sup>16</sup> or a collective trade mark,<sup>17</sup> means “a mark used or proposed to be used by a person in relation to goods or services for the purpose of distinguishing the goods or services in relation to which the mark is used or proposed to be used from the same kind of goods or services connected in the course of trade with any other person”.<sup>18</sup>

<sup>12</sup> Definition of “patent” in section 2 of the Patents Act 57 of 1978.

<sup>13</sup> Definition of “design” in section 1(1) of the Designs Act 195 of 1993.

<sup>14</sup> Definition of “aesthetic design” in section 1(1) of the Designs Act.

<sup>15</sup> Definition of “functional design” in section 1(1) of the Designs Act.

<sup>16</sup> A “certification trade mark” is defined in the Trade Marks Act 194 of 1993 and means a mark registered or deemed to have been registered under section 42.

<sup>17</sup> A “collective trade mark” is defined in the Trade Marks Act and means a mark registered under section 43.

<sup>18</sup> Definition of “trade mark” in section 2(1) of the Trade Marks Act.

Paragraph (e) of the definition of “intellectual property” includes intellectual property that is defined or described in any similar international legislation. In the United Kingdom, for example, a creator’s artistic, literary, dramatic and musical work is protected by the Copyright, Designs and Patents Act, 1988. By applying paragraph (e), these works will also be regarded as intellectual property as defined in section 23I.

Further, paragraph (f) of the definition of “intellectual property” includes “property or right of a similar nature”. This concept was analysed in *C: SARS v SA Silicone Products (Pty) Ltd* in which Heher JA stated the following:<sup>19</sup>

“The expression, properly interpreted, requires, in my view, that any property which is similar in nature shall possess fundamental characteristics common to those possessed by the specifically identified properties; minor or superficial similarities will not of themselves suffice...The common natures of the identified properties...embrace their intellectual origins, *ie* their derivation from a creative mind, their potential for commercial exploitation, the fact that the law regards such exploitation as creating a justifiable monopoly which is available only to the creator of the property or persons to whom the creator transfers his rights according to law and that the law accords the rights and protection of ownership to such property.”

Each case must be considered on its merits when applying the above criteria.

**(e) Scientific, technical, industrial or commercial knowledge or information**

Under section 49A, any amount received by or accrued to a person will be classified as a royalty if the person imparts or undertakes to impart any knowledge or information of a scientific, technical, industrial or commercial nature.

The online *Oxford Dictionary* defines “impart” as meaning –<sup>20</sup>

“1. Make (information) known”.

Thus, a payment received by or accrued to a person for imparting (for example through instruction or teaching) scientific, technical, industrial or commercial knowledge or information will be considered a royalty.

In addition, an amount will also be regarded as a royalty if it is received by or accrued to a person who provides or agrees to provide any assistance or service relating to the application or use of the knowledge or information. For example an amount will be a royalty if received by a person in return for showing the user of intellectual property how to put the knowledge or information to use or if received by a person with industrial knowledge in exchange for demonstrating how to use an invention in an industrial project.

The term “knowledge” is defined in the *Oxford Dictionaries* as follows:<sup>21</sup>

“Facts, information, and skills acquired through experience or education; the theoretical or practical understanding of a subject.”

The term “information” is defined in the *Oxford dictionaries* as follows:<sup>22</sup>

“Facts provided or learned about something or someone.”

<sup>19</sup> [2004] 2 All SA 1 (SCA), 66 SATC 131 at 139.

<sup>20</sup> <https://en.oxforddictionaries.com/definition/impart> [Accessed 8 March 2017].

<sup>21</sup> <https://en.oxforddictionaries.com/definition/knowledge> [Accessed 8 March 2017].

<sup>22</sup> <https://en.oxforddictionaries.com/definition/information> [Accessed 8 March 2017].

The words “scientific, technical, industrial or commercial” are not defined in the Act. It is submitted that the ambit of Part IVA is very wide and covers all forms of intellectual property.

#### 4.2 The rate at which the withholding tax must be calculated

The rate of withholding tax on royalties is specified in section 49B(1).

Royalties paid or which became due and payable on or after 1 July 2013 but before 1 January 2015 attracted a withholding rate of 12% of the amount of royalties paid.<sup>23</sup>

For all royalties paid or which become due and payable on or after 1 January 2015, the withholding tax is calculated at a rate of 15% of the amount of royalties paid.<sup>24</sup>

#### 4.3 “Due and payable”

Under section 49B(2) the payment of the royalty is deemed to be made on the earlier of the date on which it –

- is paid; or
- becomes due and payable.

The words “due” and “payable” have been considered in various judgments. In *CIR v Janke*<sup>25</sup> Stratford J cited the following observation of Searle J in *Stafford v Registrar of Deeds*:<sup>26</sup>

“It is clear that the word ‘payable’ is sometimes construed as meaning ‘payable at a future time’ or ‘in respect of which there is a liability to pay’. It is also true that it is sometimes used to mean ‘payable immediately’ or ‘actually due and presently demandable’.”

In *Singh v C: SARS*, Olivier JA stated the following:<sup>27</sup>

“The word ‘payable’ can have at least two different meanings, viz ‘. . . (a) that which is due or must be paid, or (b) that which may be paid or may have to be paid . . . The sense of (a) is a present liability – due and payable – . . . (b) . . . a future or contingent liability’.”

An amount may thus be due under a contract (*dies cedit*) but not payable (*dies venit*). An amount will be payable only when the time for payment arrives. For an amount to be “due and payable” the amount must not only be owing, but a person must have the right to claim payment of it.<sup>28</sup>

<sup>23</sup> See section 97(1)(a) of the Taxation Laws Amendment Act 31 of 2013.

<sup>24</sup> See section 97(1)(b) of the Taxation Laws Amendment Act 31 of 2013.

<sup>25</sup> 1930 AD 474, 4 SATC 269 at 276.

<sup>26</sup> 1913 CPD 329.

<sup>27</sup> 2003 (4) SA 520 (SCA), 65 SATC 203 at 216.

<sup>28</sup> The discussion on “due and payable” has been extracted from the *Comprehensive Guide to Dividends Tax* dated 23 February 2015 in paragraph 3.2.1.

**Example 1 – Deemed payment of a royalty and the rate of withholding tax to be levied***Facts:*

X, a resident of the United Kingdom, entered into an agreement with B, a South African resident, entitling B to make use of X's intellectual property. According to the agreement, X is entitled to receive royalties from B for the use of the property. For the 2016 year of assessment, the payment of the royalties was required to be made by 31 July 2016. B actually made payment on 15 July 2016.

*Result:*

Under section 49B(2) a royalty is deemed to be paid on the earlier of the date on which it is paid (15 July 2016) or when it becomes due and payable (31 July 2016). The royalty is thus deemed to be paid to X on 15 July 2016.

Since the payment was made on or after 1 January 2015, tax at the rate of 15% was required to be withheld from the royalty.

**4.4 Payment of the royalty**

Under section 49B(1) the amount paid in the form of a royalty is subject to the withholding tax to the extent that it has been received by or accrued to the foreign person from a source within South Africa. The words "to the extent" imply that it is possible for a foreign person to receive royalty payments for the use of intellectual property from a source within and outside South Africa. For instance, an American franchising company might license its intellectual property to a franchisee based in South Africa as well as to franchisees based in other countries. A royalty to the franchisor will become payable for the use of the intellectual property in South Africa. In this scenario, only the royalty for the use of the intellectual property in South Africa will be subject to withholding tax under section 49B(1), since the source of this income is within South Africa. The rules relating to the source of income in section 9(2)(c), (d), (e) and (f) thus have relevance.

Under section 9(2)(c), (d), (e) and (f) an amount is received by or accrued to a person from a source within South Africa if it –

- constitutes a royalty that is attributable to an amount incurred by a person that is a resident, unless the royalty is attributable to a permanent establishment which is situated outside South Africa;
- constitutes a royalty that is received by or accrues to the person for the use or right of use of or permission to use in South Africa any intellectual property as defined in section 23I;
- is attributable to an amount incurred by a person that is a resident and is received by or accrues to this person for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information, unless the amount received or accrued is attributable to a permanent establishment which is situated outside South Africa; or
- is received by or accrues to the person for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or



information for use in South Africa, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information.

The royalty must be paid *to or for the benefit* of a foreign person. As a result, the royalty need not be paid directly to the foreign person but can also be paid to the foreign person's representative or agent. Any amount withheld will be regarded as having been paid to the foreign person even if the royalty amount is paid to the person's representative or agent, since the royalty would be derived for the benefit of the foreign person.

#### **4.5 Exemptions from withholding tax**

##### **4.5.1 Exemptions under section 10(1)(l)**

Under section 10(1)(l) the amount of any royalty as defined in section 49A which is received by or accrues to any non-resident is exempt from normal tax unless –

- the foreign person is a natural person who was physically present in South Africa for more than 183 days in aggregate during the twelve-month period preceding the date on which the amount is received by or accrues to the person;<sup>29</sup> or
- the intellectual property or the knowledge or information relating to the royalty is effectively connected with a permanent establishment of the foreign person in South Africa.<sup>30</sup>

Such amounts will, however, be subject to the withholding tax on royalties. The withholding tax is a final tax<sup>31</sup> and normal tax does not apply. Since withholding tax on royalties is a final tax, an annual return of income does not have to be submitted as long as the royalty amount is the sole source of income from a South African source. Should the foreign person derive other income from a South African source, a return of income will have to be submitted.

When section 10(1)(l) does not apply, normal tax will be levied on the royalty and the amount will not be subjected to withholding tax.<sup>32</sup>

The term “permanent establishment” is defined in section 1(1) of the Act to mean –

“a permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organization for Economic Co-operation and Development: Provided that in determining whether a qualifying investor in relation to a partnership, trust or foreign partnership has a permanent establishment in the Republic, any act of that partnership, trust or foreign partnership in respect of any financial instrument must not be ascribed to that qualifying investor”.

Paragraph 1 of Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development, Condensed Version 15 July 2014 (OECD Model Tax Convention), defines “permanent establishment” as –

“a fixed place of business through which the business of an enterprise is wholly or partly carried on”.

<sup>29</sup> Section 10(1)(l)(i). See also section 49D(a).

<sup>30</sup> Section 10(1)(l)(ii). See also section 49D(b).

<sup>31</sup> Section 49B(3).

<sup>32</sup> Section 49D(1).

Paragraph 2 of Article 5 states that a “permanent establishment” includes –

- “a) a place of management;
- b) a branch;
- c) an office;
- d) a factory;
- e) a workshop, and
- f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources”.

Paragraph 21 of the Commentary on Article 12 of the OECD Model Tax Convention dealing with Royalties, states that –

“a particular location can only constitute a permanent establishment if a business is carried on therein and...that the requirement that a right or property be ‘effectively connected’ to such a location requires more than merely recording the right or property in the books of the permanent establishment for accounting purposes”.

According to paragraph 21.1, a right or property in respect of which royalties are paid will be effectively connected to a permanent establishment if the economic ownership of that right or property is allocated to the permanent establishment. Such right or property will form part of the permanent establishment’s business assets. The “economic” ownership of a right or property means the equivalent of ownership for income tax purposes of a separate enterprise, with the attendant benefits and burdens. For further guidance, refer to a report entitled *Attribution of Profits to Permanent Establishments*, OECD, Paris (2010).<sup>33</sup>

The circumstances of each case must be evaluated to determine whether intellectual property for which a royalty is paid is effectively connected to a permanent establishment.

**Example 2 – Intellectual property effectively connected to a permanent establishment**

*Facts:*

A South African branch of a foreign company developed a patent in South Africa. The South African branch constitutes a permanent establishment.<sup>34</sup> All costs associated with the patent were paid out of the branch’s bank account. The branch used the patent for business purposes in South Africa and also granted a right of use to South African companies. All royalty income from South African patent users was deposited in the branch bank account.

*Result:*

Since the branch actively uses the patent in South Africa, is responsible for developing, registering and administering the patent, and has a right to the income attributable to the ownership of the intellectual property, the intellectual property is effectively connected to the branch.

<sup>33</sup> The contents of this report are not examined in this Note but it can be accessed at [www.oecd.org/ctp/transfer-pricing/45689524.pdf](http://www.oecd.org/ctp/transfer-pricing/45689524.pdf) [Accessed 8 March 2017].

<sup>34</sup> Under paragraph 2(b) of Article 5 of the OECD Model Tax Convention, a permanent establishment includes a branch.

The exemption in section 10(1)(l) will therefore not apply and the royalties will be subject to normal tax. It will accordingly not be subjected to withholding tax by virtue of the exemption in section 49D(b).

#### 4.5.2 Exemptions under section 49D

Similar to the exemption under section 10(1)(l), section 49D provides that a foreign person will be exempt from withholding tax on royalties if –

- that person is a natural person who was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid;<sup>35</sup>
- the property for which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa if that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act; or
- that royalty is paid by a headquarter company<sup>36</sup> for the granting of the use, right of use or permission to use intellectual property<sup>37</sup> to which section 31 (see 4.5.3) does not apply as a result of the exclusions in section 31(5)(c) or (d).<sup>38</sup>

Generally, when the exemptions in section 49D apply, the person receiving the royalty amount will be exempt from the withholding tax on royalties but will be subject to normal tax.

#### 4.5.3 Section 31 in relation to intellectual property as defined in section 23l(1)

Section 31 provides for an adjustment to taxable income if the “affected transaction” as defined in section 31(1) is not at an arm’s length price.

Section 31(5)(c) stipulates that when a transaction dealing with intellectual property as defined in section 23l(1) has been entered into between a non-resident and a headquarter company in which the non-resident grants the use, right of use or permission to use the property to the headquarter company, section 31 will not apply to the extent that –

- the headquarter company grants the use, right of use or permission to use the intellectual property to a foreign company in which it directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10% of the equity shares and voting rights; and
- the headquarter company performs no other activity relating to the intellectual property other than granting the use, right to use or permission to use the property to the foreign company.

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<sup>35</sup> Section 49D(a).

<sup>36</sup> See section 1(1) and section 9l(1) for the definition of “headquarter company”. For further information on headquarter companies in relation to withholding tax on royalties, see Interpretation Note 87 dated 19 February 2016 “Headquarter Companies” in paragraph 5.2.2.

<sup>37</sup> As defined in section 23l.

<sup>38</sup> Section 49D(c).

Section 31(5)(d) provides that section 31 will not apply when a transaction dealing with intellectual property has been entered into between a headquarter company and a foreign company –

- in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10% of the equity shares and voting rights; and
- the headquarter company grants the use, right of use or permission to use the intellectual property to the foreign company.

If section 31 does not apply as provided for in section 31(5)(c) and (d), the exemption in section 49D(c) will apply.

#### **4.6 Liability for payment and the obligation to withhold tax**

##### **4.6.1 Liability for the payment of the tax**

Under section 49C(1), the party that is liable for the payment of the withholding tax is the foreign person receiving the royalty or to whom the royalty accrues. The amount must, however, be received or accrued from a source within South Africa under section 9(2)(c), (d), (e) or (f).

##### **4.6.2 Liability to withhold the tax**

Although the liability to pay the withholding tax rests on the foreign person receiving the royalty, an obligation to withhold the tax rests on the person making the payment of the royalty.<sup>39</sup> Under section 156 of the TA Act, this person is referred to as a withholding agent. A “withholding agent” means “a person who must under a Tax Act withhold an amount of tax and pay it to SARS”.

A withholding agent will be personally liable for the withholding tax if that agent –<sup>40</sup>

- withholds an amount but does not pay it to SARS; or
- does not withhold an amount that should have been withheld.

The person paying the royalty is thus obliged to withhold the withholding tax on the amount being paid to the foreign person (see **4.2** for an explanation of the rates). The tax so withheld will then be considered as a payment made on behalf of the foreign person.<sup>41</sup> If a withholding agent is held personally liable for an amount of tax, such amount paid or recovered from the withholding agent, is an amount of tax which is paid on behalf of the relevant taxpayer.<sup>42</sup>

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<sup>39</sup> Section 49E(1).

<sup>40</sup> Section 157(1) of the TA Act.

<sup>41</sup> Section 49C(2).

<sup>42</sup> Section 157(2) of the TA Act.

### **Example 3 – Liability to withhold the tax and calculation of the amount to be withheld**

#### *Facts:*

X, a resident of Country Z, entered into an agreement with Y, a South African resident, allowing Y to make use of X's invention. According to the agreement, X is entitled to royalties from Y for the use of the patent rights relating to the invention. The royalties are payable on or before 31 January each year and are calculated at 5% of Y's turnover for each financial year ending on 31 December. For the year ended 31 December 2015, Y's turnover was R600 000.

#### *Result:*

|                                 |         |
|---------------------------------|---------|
|                                 | R       |
| Turnover for 2015               | 600 000 |
| Royalties (R600 000 × 5%)       | 30 000  |
| Withholding tax (R30 000 × 15%) | 4 500   |

X is thus liable to pay an amount of R4 500 as a withholding tax on the royalty. Y is obliged to withhold this amount and pay it to the Commissioner. Y will then pay X R25 500 (R30 000 – 4 500).

#### **4.7 Release of obligation to withhold tax**

Under section 49E(2) no obligation to withhold tax will arise –

- to the extent that the royalty is exempt under section 49D(c) (see **4.5.2**); or
- if the foreign person receiving the royalty has submitted a declaration form to the person paying the royalty (see **4.9**) claiming exemption from withholding tax on the royalty payment under section 49D(a) or (b).

The submission of the declaration must be made by a date set by the person paying the royalty. If the payer of the royalty does not set a date, submission must take place by the date of the payment of the royalty.

#### **4.8 Reduction of the withholding rate**

The rate at which tax has to be withheld can potentially be reduced by a tax treaty existing between the States of the contracting parties.

In ITC 1878, Vally J said that –<sup>43</sup>

“the purpose of Double Taxation Agreements is to ensure that there is a free flow of trade and investment across countries, as well as a recognition that taxation is not avoided by the latitude afforded by the flow of free trade and investment. To achieve this purpose the two countries that are party to the Double Taxation Agreement agree that one of them will forego revenue. Which one ultimately does so depends on the facts regarding the business enterprise's operations as well as on the interpretation of the terms of the agreement concluded between the two countries.”

Section 49E(3) provides that if a foreign person submits a declaration form (see **4.9**) to the person making payment of the royalty declaring that a tax treaty exists between the contracting States which provides for a reduced rate of tax on the

<sup>43</sup> (2015) 77 SATC 349 (J) at 359.

royalty, the payee must withhold the tax at the reduced rate. For example, the rate of 15% in section 49B may be reduced to 5% or 10% by the treaty.

As with a form submitted for exemption from withholding tax on royalties (see **4.7**), the submission date of the form may be set by the person paying the royalty. If the payer does not set a date, submission must take place by the date of payment.

#### **4.9 Withholding Tax on Royalties Declaration form**

The form “Withholding Tax on Royalties Declaration (WTRD)” must be submitted to the payer of the royalty and is available on the SARS website.

This form must be completed by the foreign person to or for the benefit of which the royalty is paid in order to give effect to –

- the exemptions from the withholding tax (see **4.7**); or
- the reduced rate of tax (see **4.8**).

The declaration form requires –

- particulars of the person making payment of the royalty;
- particulars of the foreign person;
- reason why the foreign person is exempt from the withholding tax;
- Article number of the Agreement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion existing between the contracting States;
- details of any other international agreement applicable to the foreign person; and
- the reduced rate of tax, if applicable.

Foreign persons are also obliged to inform the royalty payer in writing of any changes in their circumstances. Failure to submit the form by the required date will result in the tax being withheld at the full rate of 15%.

#### **4.10 Payment of the withholding tax**

The foreign person receiving the royalty or to whom the royalty accrues is liable for the payment of the withholding tax. This person is obliged to make payment by the last day of the month following the month during which the royalty is paid.<sup>44</sup> For example, if the royalty is paid to the foreign person in June 2016, the payment of the withholding tax on the royalty must be made no later than 31 July 2016.

The obligation resting on the foreign person to make payment will, however, fall away if the tax has been paid by another person.<sup>45</sup> In such event, the person withholding the tax is obliged under section 49F(2) to submit a return and pay the tax to the Commissioner.

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<sup>44</sup> Sections 49C and 49F(1).

<sup>45</sup> Section 49F(1).

A Return for Withholding Tax on Royalties (WTR01) must be completed for each royalty payment made to or for the benefit of a foreign person.

This return must include –

- details of the person paying the royalty;
- details of the foreign person;
- date of the royalty payment;
- applicable tax rate;
- amount of withholding tax payable; and
- interest payable on the withholding tax.

The total amount payable is equal to the withholding tax payable plus any interest. Interest will be payable by the withholding agent under section 89(2) if the withholding tax is not paid in full within the period allowed for payment.

The following methods are available for the payment of the withholding tax on royalties:

- eFiling
- Electronic payments through the internet (EFT)
- At a branch of one of the approved banks
- At a SARS branch.

Payment of the tax must be made by the last day of the month following the month in which the royalty is paid, for example, by 31 July 2016 if the royalty was paid during June 2016.

#### **4.11 Refund of withholding tax on royalties**

Section 49G enables a foreign person to obtain a refund of withholding tax under specified circumstances. The refund procedure in section 49G takes precedence over the refund procedures in Chapter 13<sup>46</sup> of the TA Act.

As stated in 4.9, a foreign person who fails to submit the declaration form by the required date will have to pay the full rate of withholding tax on the royalties received or accrued.

However, section 49G provides that the amount of withholding tax that is in excess of the amount that the foreign person would have paid had the declaration form been submitted is refundable to the foreign person if –

- an amount is withheld as required by section 49E(1);
- the declaration form referred to in section 49E(2) or (3) is not submitted to the person paying the royalty by the required date; and
- the declaration form is submitted to the Commissioner within three years after the royalty to which the declaration relates is paid.

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<sup>46</sup> This Chapter provides in section 190, for “Refunds of excess payments” and, in section 191, for “Refunds subject to set-off and deferrals.”

In practice the foreign person would usually submit the declaration form to the withholding agent together with a power of attorney within the three-year period. The withholding agent will then complete a REV16 form for refund claims and submit it together with the late declaration form and power of attorney to SARS. SARS will consider the claim and process it accordingly. As noted, the amount of any refund will usually be paid to the withholding agent and not directly to the recipient of the royalty. It is, however, possible for SARS to effect a refund directly to the foreign person, either by transferring the amount into the foreign person's South African bank account (if available) or by issuing a cheque.

#### **Example 4 – Refund of withholding tax**

##### *Facts:*

A, a resident of Australia, entered into an agreement with B, a South African resident, which allowed B to make use of A's intellectual property. According to the agreement, A is entitled to royalties from B for the use of A's intellectual property. The payment of the royalties must be made by 31 January each year and is calculated at 4% of B's turnover. For the period ending 31 December 2014, B's turnover was R500 000. Article 12 of the tax treaty between Australia and South Africa provides for a reduced rate of taxation on royalties of 5% instead of 15%.

- a) Under section 49E(3), a WTR declaration form must be submitted by A to B declaring the reduced rate. Payment of the royalty was made to A on 31 January 2015. Owing to B not receiving the WTR declaration form by 31 January 2015, tax was withheld at the rate of 15% by B.
- b) On 15 July 2016, A submitted the WTR declaration form pertaining to the royalty payment that was made on 31 January 2015 to the Commissioner.

##### *Result:*

- a) B did not receive a WTR declaration form from A. Therefore, the rate of 15% was applied by B and R3 000 was correctly withheld and paid to the Commissioner on 31 January 2015. The withholding tax was calculated as follows:

|                                 | R       |
|---------------------------------|---------|
| Turnover for 2014               | 500 000 |
| Royalties (R500 000 × 4%)       | 20 000  |
| Withholding tax (R20 000 × 15%) | 3 000   |

- b) Under section 49G, A submitted the WTR form to the Commissioner within three years of the payment of the royalty. A refund of the excess amount of tax withheld was thus permissible.

|  | R       |
|--|---------|
| Turnover for 2014                            | 500 000 |
| Royalties (R500 000 × 4%)                    | 20 000  |
| Withholding tax (R20 000 × 5%)               | 1 000   |
| Refundable amount = R2 000 (R3 000 – R1 000) |         |



#### 4.12 Currency of payments made to the Commissioner

Section 49H provides that when an amount of tax relating to royalties is withheld in the currency of a foreign country, the person making payment of the withholding tax to the Commissioner is obliged to translate the foreign currency into South African Rand.

This translation must be made at the spot rate on the date on which the amount is withheld. The spot rate is defined in section 1(1) as “the appropriate quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency”.<sup>47</sup>

##### **Example 5 – Translation of foreign currency**

###### *Facts:*

XY, a resident of Country Z, entered into an agreement with AB, a South African resident, which allowed AB to make use of XY’s intellectual property in return for a royalty of Z\$2 000. The tax treaty between the two countries provides for a reduced rate of taxation of 5%.

On 1 March 2016, AB withheld an amount of Z\$100. AB paid this amount to the Commissioner on 30 April 2016. The spot rate on 1 March 2016 was Z\$1 = R10,0000 and on 30 April 2016, Z\$1 = R10,5000

###### *Result:*

Under section 49H the amount to be paid to the Commissioner must be determined using the spot rate on the date on which the tax was withheld (1 March 2016). An amount of Z\$100 × 10,0000 = R1 000 must therefore be paid to the Commissioner.

#### 5. Duty to keep records

Section 29(1) of the TA Act requires a taxpayer to keep the records, books of account or documents that –

- enable the taxpayer to observe the requirements of a tax act;
- are specifically required under a tax Act or by the Commissioner by public notice; and
- enable SARS to be satisfied that the person has observed these requirements.

The types of documents that would have to be retained would include, for example, the Withholding Tax on Royalties (WTR) Declaration form, intellectual property agreements between the contracting parties as well as any other document which would be relevant to the payment and withholding of royalties.

<sup>47</sup> See Interpretation Note 63 “Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule” for more information on spot rates and currency conversion.

The records, books of account or other relevant documents must be retained –<sup>48</sup>

- in their original form in an orderly fashion and in a safe place;
- in a form, including electronic form, prescribed by the Commissioner by public notice; or
- in a form specifically authorised by a senior SARS official.

Under section 29(3) of the TA Act the records, books of account or documents must be retained by the taxpayer for a period of five years. Under section 32 of the TA Act, a taxpayer notified or aware of an audit or investigation must retain the relevant records, books of account or documents until the audit or investigation is concluded.

## **6. Conclusion**

Sections 49A to 49H deal with the withholding tax on royalties. In essence a royalty is an amount received or accrued for the use of intellectual property as defined in section 23I or for the imparting of scientific, technical, industrial or commercial knowledge or information as well as the rendering of assistance or service in connection with the application or use of such knowledge or information. A foreign person who receives or to whom an amount accrues in the form of a royalty is liable for the payment of a withholding tax on the royalty. The person paying the royalty is, however, obliged to withhold the tax.

For royalties paid or which became due and payable on or after 1 July 2013 but before 1 January 2015, the withholding tax was required to be calculated at a rate of 12% of the amount of royalties paid. For all royalties that are paid or become due and payable on or after 1 January 2015, the withholding tax must be calculated at a rate of 15% of the amount of royalties paid.

Provision is also made for an exemption from withholding tax as well as a refund of the tax to the foreign person. If the royalty is exempt or a reduced rate applies owing to the application of a tax treaty, the foreign person is obliged to submit a declaration form to the person making payment of the royalty within a prescribed period.

**Legal Counsel**  
**SOUTH AFRICAN REVENUE SERVICE**

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<sup>48</sup> Section 30 of the TA Act.

**Annexure – The law****Section 1(1) – Definition of “resident”**

“resident” means any—

- (a) natural person who is—
  - (i) ordinarily resident in the Republic; or
  - (ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—
    - (aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and
    - (bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that—

- (A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a “port of entry” as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and
  - (B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; or
- (b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation: Provided that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident: Provided further that in determining whether a person that is a foreign investment entity has its place of effective management in the Republic, no regard must be had to any activity that—

- (a) constitutes—
  - (i) a financial service as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002); or
  - (ii) any service that is incidental to a financial service contemplated in subparagraph (i) where the incidental service is in respect of a financial product that is exempted from the provisions of that Act, as contemplated in section 1(2) of that Act; and
- (b) is carried on by a financial service provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), in terms of a licence issued to that financial service provider under section 8 of that Act;

**Sections 49A to 49H***PART IVA**Withholding tax on royalties*

**49A. Definitions.**—In this Part—

“foreign person” means any person that is not a resident;

“royalty” means any amount that is received or accrues in respect of—

- (a) the use or right of use of or permission to use any intellectual property as defined in section 23I; or
- (b) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information.

**49B. Levy of withholding tax on royalties.**—(1) There must be levied for the benefit of the National Revenue Fund a tax, to be known as the withholding tax on royalties, calculated at the rate of 15 per cent of the amount of any royalty that is paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received by or accrued to that foreign person from a source within the Republic in terms of section 9(2)(c), (d), (e) or (f).

(2) For the purposes of this Part, a royalty is deemed to be paid on the earlier of the date on which the royalty is paid or becomes due and payable.

(3) The withholding tax on royalties is a final tax.

(4) Where a person making payment of a royalty to or for the benefit of a foreign person has withheld an amount as contemplated in section 49E(1), that person must, for the purposes of this Part, be deemed to have paid the amount so withheld to that foreign person.

**49C. Liability for tax.**—(1) A foreign person to which a royalty is paid is liable for the withholding tax on royalties to the extent that the royalty is regarded as having been received by or accrued to that foreign person from a source within the Republic in terms of section 9(2)(c), (d), (e) or (f).

(2) Any amount of withholding tax on royalties that is—

- (a) withheld as contemplated in section 49E(1); and
- (b) paid as contemplated in section 49F(1),

is a payment made on behalf of the foreign person to which the royalty is paid in respect of that foreign person’s liability under subsection (1).

**49D. Exemption from withholding tax on royalties.**—A foreign person is exempt from the withholding tax on royalties if—

- (a) that foreign person is a natural person who was physically present in the Republic for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid; or
- (b) the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in the Republic if that foreign person is registered as a taxpayer in terms of Chapter 3 of the Tax Administration Act; or

- (c) that royalty is paid by a headquarter company in respect of the granting of the use or right of use of or permission to use intellectual property as defined in section 23I to which section 31 does not apply as a result of the exclusions contained in section 31 (5) (c) or (d).

**49E. Withholding of withholding tax on royalties by payers of royalties.**—(1) Subject to subsections (2) and (3), any person making payment of any amount of royalties to or for the benefit of a foreign person must withhold an amount of withholding tax on royalties from that payment.

(2) A person must not withhold any amount from any payment contemplated in subsection (1)—

- (a) to the extent that the royalty is exempt from the withholding tax on royalties in terms of section 49D(c); or
- (b) if the foreign person to or for the benefit of which that payment is to be made has—
  - (i) by a date determined by the person making the payment; or
  - (ii) if the person making the payment did not determine a date as contemplated in subparagraph (i), by the date of the payment,

submitted to the person making the payment a declaration in such form as may be prescribed by the Commissioner that the foreign person is, in terms of section 49D(a) or (b), exempt from the withholding tax on royalties in respect of that payment.

(3) The rate referred to in section 49B(1) must, for the purposes of that subsection, be reduced if the foreign person to or for the benefit of which the payment contemplated in that subsection is to be made has—

- (a) by a date determined by the person making the payment; or
- (b) if the person making the payment did not determine a date as contemplated in paragraph (a), by the date of the payment,

submitted to the person making the payment a declaration in such form as may be prescribed by the Commissioner that the royalty is subject to that reduced rate of tax as a result of the application of an agreement for the avoidance of double taxation.

**49F. Payment and recovery of tax.**—(1) If, in terms of section 49C, a foreign person is liable for any amount of withholding tax on royalties in respect of any amount of royalties that is paid to or for the benefit of the foreign person, that foreign person must pay that amount of withholding tax by the last day of the month following the month during which the royalty is paid, unless the tax has been paid by any other person.

(2) Any person that withholds any withholding tax on royalties in terms of section 49E must submit a return and pay the tax to the Commissioner by the last day of the month following the month during which the royalty is paid.

**49G. Refund of withholding tax on royalties.**—Notwithstanding Chapter 13 of the Tax Administration Act, if—

- (a) an amount is withheld from a payment of a royalty as contemplated in section 49E(1);
- (b) a declaration contemplated in section 49E(2) or (3) in respect of that royalty is not submitted to the person paying that royalty by the date of the payment of that royalty; and

- (c) a declaration contemplated in section 49E(2) or (3) is submitted to the Commissioner within three years after the payment of the royalty in respect of which the declaration is made,

so much of that amount as would not have been withheld had that declaration been submitted by the date contemplated in the relevant subsection is refundable by the Commissioner to the person to which the royalty was paid.

**49H. Currency of payments made to Commissioner.**—If an amount withheld by a person in terms of section 49E(1) is denominated in any currency other than the currency of the Republic, the amount so withheld must, for the purposes of determining the amount to be paid to the Commissioner in terms of section 49F(2), be translated to the currency of the Republic at the spot rate on the date on which the amount was so withheld.