A CRITICAL ANALYSIS OF THE INTERPRETATION OF THE TERM “ASSOCIATED ENTERPRISE” IN PROVISIONS IN SOUTH AFRICAN DOUBLE TAXATION AGREEMENTS BASED ON ARTICLE 9 OF THE ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT’S MODEL TAX CONVENTION ON INCOME AND ON CAPITAL

Thesis presented in partial fulfilment of the requirements for the degree of Master of Laws at the Stellenbosch University

André Greeff

Supervisor:
Dr Izelle du Plessis

Date: **DECEMBER 2020**

DECLARATION

By submitting this dissertation electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the authorship owner thereof (unless to the extent explicitly otherwise stated) and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Date: 15 July 2020

ABSTRACT

To the extent that a contracting state has no applicable double taxation agreement ("DTA") in place, that contracting state will rely solely on its domestic law to regulate transfer pricing related matters. Many states, however, enter into DTAs that are intended to *inter alia* reduce the risk of economic double taxation. Most of these DTAs are based on the Organization for Economic Cooperation and Development's Model Tax Convention (the "OECD's MTC"). Article 9 of the OECD's MTC aims to prevent transfer pricing manipulation by associated enterprises, as well as to provide associated enterprises with relief from economic double taxation. However, Article 9 is only applicable if

> "an enterprise of a contracting state participates … in the management, control or capital of an enterprise of the other contracting state, or the same persons participate … in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state."[1]

DTAs, however, generally do not define the terms contained in the phrase "participates in the management, control or capital." This may result in uncertainty regarding the applicability of a DTA provision identical to Article 9 of the OECD MTC. This dissertation illustrates the possibility of economic double taxation arising as a result of a corresponding contracting state disallowing a requesting for a corresponding transfer pricing adjustment in terms of a DTA provision identical to Article 9(2) of the OECD MTC due to such state disagreeing with the initial primary adjustment. Such disagreement may arise due to differing interpretation of the term "associated enterprise."

It appears that there are at least two possible solutions to eliminating economic double taxation from arising as a result of a primary transfer pricing adjustment. The first being for contracting states to agree to an autonomous or universal definition of an associated enterprise (which would arguably require consensus amongst all contracting states that the context of Article 9 requires otherwise than to interpret the terms therein in accordance with the domestic law of a particular contracting state). The alternative would be for contracting states to apply the modified "new approach"

[1] OECD *Model Tax Convention on Income and on Capital* 29-30.

(that is, the DTA is to be interpreted in accordance with the contracting state applying the DTA), which would arguably require contracting states to ignore the existing paragraph 6 of the Commentary on Article 9 of the OECD MTC.[2]

Considering the historical context of Article 9, together with the purpose thereof, it is concluded that "participation in management or capital" ought to be interpreted as meaning that a person requires a dominant level of participation in management or capital in order to be associated.

Regarding "control," it is concluded that the context of Article 9 (in the form of the Commentary to Article 9[3] and the OECD Transfer Pricing Guidelines (""TPG")[4]) requires "control" to be interpreted as *de facto* control in the narrow sense.

[2] Which provides that a corresponding state is not obliged to make a corresponding transfer pricing adjustment if it disagrees with the initial transfer pricing adjustment.

[3] OECD *"Commentary on Article 9: Concerning the taxation of associated enterprises" in Model tax convention on income and on capital* (Full Version) 10 ed (2017) para 2.

[4] OECD *Transfer pricing guidelines for multinational enterprises and tax administrations* (2017) 176.

ACKNOWLEDGEMENTS

I would like to thank Dr Izelle du Plessis, whom I have been privileged to call my supervisor. I would not have been able to write this dissertation without her guidance and support, for which I am greatly appreciative.

I would also like to thank my parents, Dr Adri van Zyl and Dr Christo Greeff, for their constant encouragement, support and financial assistance. I will forever be grateful for all that you have done for me, thank you.

TABLE OF ABBREVIATIONS

BEE	Black Economic Empowerment
CC	Close corporation
CFC	Controlled Foreign Company
DTA	Double Taxation Agreement
HMRC	Her Majesty's Revenue and Customs
IFA	International Fiscal Association
IP	Intellectual Property
IRS	Internal Revenue Service
MLI	Multi-Lateral Instrument
MNE	Multinational Enterprises
OECD	Organization for Economic Cooperation and Development
OECD MTC	Organization for Economic Cooperation and Development's Model Tax Convention
OECD TPG	Organization for Economic Cooperation and Development's Transfer Pricing Guide
SA	South Africa
SARS	South African Revenue Service
TIOPA	Taxation (International and Other Provisions) Act of 2010
UK	United Kingdom
USA	United States of America

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION

1.1 Introduction to the purpose of transfer pricing regulations

The price that members of a multinational group of companies ("a group member"), which are taxed in separate states, charge and pay each other for goods or services is referred to as the transfer price. The mere fact that intra-group transactions take place enables Multinational Enterprises ("MNEs") to benefit the group as a whole by allocating the group's profits towards the group members that reside within states that impose tax at relatively low rates. This is because each group member is generally taxed separately by that group member's resident state,[5] coupled with the fact that when different entities are subject to common control, transfer prices are not determined by true market forces.[6]

The fact that each group member is taxed separately by that group member's resident state has given rise to the incentive for MNEs to apply transfer prices that are not at arm's length, which is typically referred to as transfer mispricing.[7] The following example will illustrate this point:

Example:

Company R is a beer retailer and company P is a beer producer. Company R is the sole shareholder of company P. Both companies reside in state A, which imposes income tax on its residents at 33%. Company P produces a case of beer at a cost of R100 and sells it to company R for R200. Company R incurs another R40 of distribution costs to sell a case of beer, which company R sells at R400 per case of beer. Company P, therefore, makes R100 profit per case and company R makes R160 profit per case, which would leave the group with a net profit of R174,20 per case.[8] If company P were to relocate its residence to state B, which imposes tax at a rate of 3% on its residents, then the group's net profit would be R204,20 per case.[9]

---

[5] Although the general rule is that entities are taxed on a residence basis, taxation on a source basis is also a possibility.

[6] G Cottani "Transfer pricing" (2014) *IBFD Topical Analysis* <https://www.africataxjournal.com/wp-content/uploads/2018/04/An-Overview-of-Transfer-Pricing-by-IBFD-1.pdf> (accessed 22-04-2020).

[7] The terms "transfer mispricing" and "transfer pricing manipulation" are used interchangeably in this dissertation.

[8] Group net profit after income tax = [company P's profit per case – 33%] + [company R's profit per case – 33%].

[9] Group net profit after income tax = [company P's profit per case – 3%] + [company R's profit per case – 33%].

Although the example above shows how a MNE can increase its profits, there is nothing illegal in structuring one's affairs to ensure one pays only the amount of tax that one owes.

As mentioned above, due to the fact that each group member is generally taxed separately by each respective group member's resident state, "the allocation of [profits] with respect to MNEs can have a major impact on the tax revenue of individual states."[10] The following example, which refers to the previous example with company P and company R, will illustrate the benefits that a MNE can accrue from manipulating its transfer prices.

Example:
Company R still resides in state A and company P still resides in state B. In this instance, however, company R pays company P R360 per case instead of R200 per case. Therefore, company P now makes R260 per case and company R no longer makes a profit for selling a case of beer. Although the group profit per case of beer sold will still amount to R260, the group's net profit will be R252,20 per case[11] instead of R204,20 per case. The increase in net profit is directly attributable to the decreased tax liability in state A. The decreased tax liability is due to an increase in the MNEs profits being allocated to company P, residing in state B, which only imposes tax at 3% instead of 33% as done by state A. Thus, by paying company P more for each case, which enabled company R to shift its profits to company P, the group has increased the group's net profit.

It seems evident that the main purpose of transfer pricing regulations is to protect a state's tax base from artificial, or manipulated, profit shifting.[12] In arduous economic conditions, putting increased pressure on the *fiscus*, this purpose has become amplified.

---

[10] G Kofler "Article 9: Associated Enterprises" in E Reimer & A Rust (eds) *Klaus Vogel on Double Taxation Conventions* (2015) 579 594.

[11] Group net profit after income tax= [company P's profit per case – 3%] + [company R's profit per case – 33%].

[12] The other purpose of transfer pricing regulations is to promote neutrality between independent enterprises and associated enterprises by preventing associated enterprises from enjoying a tax advantage that an independent enterprise cannot enjoy, giving rise to a distortion in their relative competitive positions. (RSJ Dwarkasing *Associated enterprises: A concept essential for the application of the arm's length principle and transfer pricing* LLD dissertation, Tilburg University (2011) 555.)

Transfer pricing regulations are not only found in states' domestic legislative provisions, but also in the Organization for Economic Cooperation and Development's Model Tax Convention on Income and on Capital ("OECD MTC"), which is generally used by most contracting states as a model when contracting states negotiate and enter into DTAs.[13] In addition to the purpose of domestic transfer pricing provisions (that is; protecting a state's tax base), the transfer pricing regulations contained in Article 9 of the OECD MTC also aims to avoid international economic double taxation[14] from arising,[15] which would hinder cross-border transactions and the movement of capital.[16] [17]

1.2 Transfer pricing regulations

1.2.1 Domestic legislation

Although the general point of departure is that an enterprise's income is to be taxed by the state in which that enterprise resides, most states have introduced domestic legislation that aims to prevent transfer pricing manipulation to protect the state's tax base. Transfer pricing manipulation has been defined as "the over or under-invoicing of related party transactions in order to … exploit cross-border differences in [tax] rates."[18] Transfer pricing regulations aim to overcome this risk by enforcing "connected persons" or "associated enterprises" to apply the arm's length principle. The arm's length principle is best explained as follows:

---

[13] Since the OECD MTC is used as a model, provisions contained in a DTA often derive from the provisions contained in the OECD MTC.

[14] International double taxation is the unwanted consequence that arises due to an overlap in two states' jurisdiction to tax, in other words separate states tax the same income. International double taxation can either be in the form of economic double taxation or juridical double taxation. Economic double taxation is the taxation of the same income (by more than one jurisdiction) in the hands of different persons, whereas juridical double taxation is the taxation of the same income (by more than one jurisdiction) in the hands of the same person. J Rogers-Glabush *IBFD international tax glossary* 6 ed (2009) 112.

[15] OECD *Transfer pricing guidelines for multinational enterprises and tax administrations* (2017) 202.

[16] 15.

[17] See the text to part 1 2 2 of this chapter for further details pertaining to Article 9 of the OECD MTC.

[18] L Eden "Taxes, transfer pricing and the multinational enterprise" in AM Rugman & TL Brewer (eds) *The Oxford handbook of international business* (2001) 591 593-594.

> "[T]he arm's length principle can be tied to the concept that … before purchasing a product at a given price, independent enterprises normally would be expected to consider whether they could buy the same product on otherwise comparable terms and conditions but at a lower price from another party."[19]

Transfer pricing regulations usually allow tax authorities to adjust the actual price to the arm's length price. Such an adjustment may give rise to economic double taxation to the extent that the taxpayer whose profits have been adjusted upwards will be liable for tax on that adjusted amount that has already been taxed in that taxpayer's foreign associated enterprise's hands. If the other contracting state agrees with this primary adjustment, then an applicable DTA provision that is based on Article 9(2) of the OECD MTC would allow a corresponding adjustment is to be made by that other contracting state in order to avoid economic double taxation from arising. Article 9(2) of the OECD MTC provides as follows:

> "Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits." [20]

The fact that every state implements its own transfer pricing legislation, however, means that an overlap in jurisdiction to tax could arise. In other words, one state may consider a corresponding transfer pricing adjustment not to be applicable due to that state having a different interpretation of what constitutes an associated enterprise. This position is supported by the Commentary[21] on Article 9 of the OECD MTC, which provides the following:

---

[19] OECD *Transfer pricing guidelines* para 1.40.

[20] OECD *Model tax convention on income and on capital (Full Version)* I and II 10 ed (2017) 29-30.

[21] Paragraph 3 of the Introduction to the OECD MTC provides that "member countries, when concluding or revising bilateral conventions, should conform to this Model Convention as interpreted by the Commentaries thereon … and their tax authorities should follow these Commentaries … when applying and interpreting the provisions of their bilateral tax

"[A corresponding] adjustment is not automatically to be made in State B simply because the profits in State A have been increased … State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment made in State A is justified both in principle and as regards the amount."[22]

Accordingly, the Commentary above provides that a contracting state may refuse to make a corresponding transfer pricing adjustment to the extent that it does not consider the primary adjustment, which was made by the other contracting state, to be justified in principle. This is illustrated in the following example:

Example:
Company R resides in state A and company P resides in state B. Assume that state B only considers one to be an associated enterprise if one of the companies is a majority shareholder of the other company, but state A has a broader definition of the term associated enterprise that includes companies that are at least 90% dependent on another particular company for the supply of goods. If company R was not a majority shareholder of company P, but company R merely depended solely on company P to provide it with stock, then state A would regard companies R and P as associated enterprises. This would, in terms of state A's domestic legislation, entitle state A to adjust the price charged and paid between companies R and P for the goods that they sold to or purchased from each other. If state B were to omit to do a corresponding transfer pricing adjustment, then international economic double taxation would arise as the same profit, although not in the hands of the same person, would then be taxed twice.

The interpretation of the phrase "associated enterprise" is also material when considering the second leg of justification required by the Commentary in order for a corresponding adjustment to be made (that is; the corresponding state must agree with the primary adjustment as regards the amount). This is due to the fact, as pointed

conventions that are based on the Model Convention." Based on this introduction contained in the OECD MTC, it appears that the Commentary to the OECD MTC is intended to be used as a contextual, interpretive tool when applying DTAs that are modelled after the OCED MTC. Although South Africa is not a member of the OECD, South Africa is an observer of the OECD's Committee of Fiscal Affairs. According to Olivier and Honiball South African courts have accepted that the Commentary may be used in the interpretation of DTAs despite SA not being an OECD member. L Olivier & Honiball M International tax: A South African perspective 4 ed (2008) 311.

[22] OECD *Commentary on Article 9* para 6.

out by academics, that the “concept of associated enterprises is essential for the application of the arm’s length principle, which is the internationally recognised tax standard for transfer pricing.”[23] Without a mutual interpretation of what constitutes an associated enterprise, application of the methods used to determine an arm’s length price will give rise to varied results. This is because almost all the transfer pricing methods provided by the Organization for Economic Cooperation and Development’s Transfer Pricing Guide (“OECD TPG”)[24] require one to make some form of comparison between prices charged by independent entities and associated enterprises.

1.2.2 The OECD Model Tax Convention on the arm’s length principle

To the extent that a contracting state has no applicable DTA in place, that contracting state will rely solely on its domestic law to regulate transfer pricing related matters. Many states, however, enter into DTAs that are intended, *inter alia*, to reduce

---

[23] R Dwarkasing “The concept of associated enterprises” (2013) 41 *Intertax* 412-429, 412.

[24] SARS’ Practice Note 7 provides for the status of the OECD Guidelines in SA (which is that the OECD TPG should be followed in the absence of specific guidance in terms of this Practice Note, the provisions of section 31 or the tax treaties entered into by South Africa). Although the Practice Note is not law, it does fall within the ambit of a practice generally prevailing as defined by the Tax Administration Act 28 of 2011 (“TAA”). A “practice generally prevailing” is “a practice set out in an official publication regarding the application or interpretation of a tax Act” (as provided by section 1 of the TAA as read with section 5(1) of the TAA). The term “official publication” is defined in s1 of the TAA and includes “a practice note issued by a senior SARS official or the Commissioner”. In terms of section 99(1) of the TAA, SARS is barred from issuing an additional assessment if the amount which should have been assessed to tax under the preceding assessment was, in accordance with the practice generally prevailing at the date of the preceding assessment, not assessed to tax; or the full amount of tax which should have been assessed under the preceding assessment was, in accordance with the practice, not assessed. Put simply, although the OECD Guidelines are not law in SA, SARS cannot raise an additional assessment in contravention of the OECD Guidelines.

the risk of double taxation.[25] South Africa's DTAs are generally based on the OECD's MTC.[26]

Article 9(1) of the OECD's MTC provides the following:

> "Where
> a) an enterprise of a contracting state participates … in the management, control or capital of an enterprise of the other contracting state, or
> b) the same persons participate … in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state,
>
> and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."[27]

Article 9(1) of the OECD's MTC clearly aims to prevent transfer pricing manipulation by associated enterprises. Preventing transfer pricing manipulation is to be done by bringing all MNEs transfer pricing policies in line with the economic realities of their respective transactions. This can be achieved by ensuring that the transfer price imposed does not differ from the price that would have been set by independent entities.[28] However, Article 9(1) is only applicable if

> "a) an enterprise of a contracting state participates … in the management, control or capital of an enterprise of the other contracting state, or b) the same persons participate … in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state."[29]

---

[25] Double taxation is the unwanted consequence that arises due to an overlap in two states' jurisdiction to tax, in other words separate states both want to tax the same income. Double taxation can either be in the form of economic double taxation or juridical double taxation. Economic double taxation is the taxation of the same income in the hands of different persons, whereas juridical double taxation is the taxation of the same income in the hands of the same person. J Rogers-Glabush *IBFD international tax glossary* (2009) 112.

[26] *ITC 1503* (1990) 53 SATC 342 348; *ITC 1848* (2010) 73 SATC 170 para [12]; *ITC 1878* (2015) 77 SATC 349 para [14]. See also *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [18] the court referred to *SIR v Downing* 1975 (4) SA 518 (A).

[27] OECD *Model tax convention* 29-30.

[28] Also referred to as an arms-length price.

[29] OECD *Model tax convention* 29-30.

In other words, Article 9(1) is only applicable if associated enterprises transact with each other. A transfer pricing adjustment, in terms of Article 9(1), can therefore only take place if the contracting parties are associated enterprises. This amplifies the need for clarity on what constitutes an associated enterprise.

The provision, however, does not define the characteristics required to trigger the existence of an associated enterprise (that is; management, control or capital). Article 3(2) of the OECD MTC will therefore also need to be considered. This provision provides specific rules that are to apply when interpreting terms that are undefined in the applicable DTA. Article 3(2) provides the following:

> "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

Considering that the terms contained in Article 9 are undefined, Article 3(2) will be of relevance when interpreting Article 9 and will therefore also need to be considered.

On the assumption that the competent authorities have not agreed to a different meaning, Article 3(2) provides one with two alternative options when interpreting an undefined term. The first option is for the contracting state that is applying the DTA to interpret the undefined term in accordance with the meaning that term has under the contracting state's domestic law. The second option is to interpret the undefined term in accordance with its context. However such approach may only be applied in instances where the context of the provision requires the undefined term to be ascribed a meaning other than that meaning it has under the domestic law of the contracting state that is applying the provision.

In addition to comprehending how to interpret the content of Article 9, which requires one to apply Article 3(2), the relationship between DTAs (with provisions identical to Article 9 of the OECD MTC) and domestic transfer pricing laws needs to be understood to understand what legal impact a DTA provision (which is identical to Article 9 of the OECD MTC) has on taxpayers.

1.3 Research question

The general purpose of this dissertation is to investigate the interpretation of the term "associated enterprises" in Article 9 of the OECD MTC, as would more likely than not be applied by a South African court. More specifically, this dissertation will examine whether the fact that the OECD MTC does not define the terms contained in the phrase "participates in the management, control or capital" mean that Article 3(2) requires one to interpret the term in accordance with domestic legislation. Alternatively, whether the context of Article 9 of the OECD MTC provides otherwise and therefore requires one not to follow the domestic legislation's definition of associated enterprise, and, if the latter is correct, how must one interpret the term "associated enterprise". The assumption is made that the competent authorities have not agreed to a different meaning.

1.4 Methodology and nature of this dissertation

This dissertation will analyse the applicable academic literature, OECD materials, case law and other relevant documents that address the interpretation of Article 9. Firstly, academic literature, the Vienna Convention on the Law of Treaties ("Vienna Convention")[30] and court judgments addressing the relationship between DTAs, domestic legislation and the OECD MTC will be examined in order to clarify each respective instrument's status.

Thereafter the respective definitions used by different states to determine what constitutes an "associated enterprise" will be assessed. This will be done by studying the domestic legislation of a selection of states (which consists of South Africa, India, the USA, and the UK) dealing with transfer pricing and the definition of an associated enterprise.[31]

This dissertation is written from a South African perspective. However, this dissertation will also require a comparative analysis. India has been chosen as one of the jurisdictions to discuss for a number of reasons. First, because "SARS has sought guidance from Indian Revenue Authorities who have experienced much success in

[30] Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331.

[31] The South African Income Tax Act 58 of 1962, the UK's Income and Corporation Tax Act of 1988, the United States' Internal Revenue Code and the Indian Income Tax Act of 2001.

the realm of international transfer pricing."[32] The fact that India's domestic transfer pricing legislation provides for a relatively broad concept of associated enterprise[33] is the second main reason for choosing to analyse the Indian legislation. Discussing the legislative position in India will illustrate one method that has been identified as applicable amongst many states with emerging economies when defining what constitutes an associated enterprise. This definition goes beyond control in the form of shareholding or management by including *de facto* forms of control as well.[34]

The position in the United Kingdom ("UK") and the United States will also be addressed to allow for an analysis of two other methods of defining the concept of associated enterprise, one being a definition that is limited to control in shareholding or in management, and the other being a so-called "open ended concept based on control."[35] The purpose of this comparative analysis is to highlight that, to the extent that contracting states rely on their domestic law definitions to interpret what constitutes an associated enterprise, certain contracting states will be unable to agree with one another on what would constitute a justified transfer pricing adjustment (either in principle or as regards the amount).

Academic literature supporting the arguments of academics such as Dwarkasing,[36] who argues that the term associated enterprise is to be given an autonomous interpretation, and Cottani,[37] who argues that Article 3(2) requires one to interpret the term "associated enterprise" in accordance with domestic legislation, will be critically analysed so to assist in determining the preferred method in interpreting the term "associated enterprise". OECD publications and academic literature addressing the purpose of the arm's length principle will also be studied to determine the viability of an autonomous interpretation being considered a solution to this uncertainty of economic double taxation from arising.

---

[32] T Spearman "Transfer pricing rules for South African domestic intergroup transactions" (23-05-2013) *SAIT News & Press: Transfer Pricing & International Tax* <http://www.thesait.org.za/news/126410/Transfer-pricing-rules-for-South-African-domestic-intergroup-transactions.htm> (accessed 22-04-2020).

[33] Cottani "Transfer pricing" (2014) *IBFD Topical Analysis*.

[34] Dwarkasing (2013) *Intertax* 425.

[35] 425.

[36] Dwarkasing *Associated enterprises*.

[37] Cottani G "Transfer Pricing" (2016) *IBFD Topical Analyses* http://online.ibfd.org.ez.sun.ac.za/document/tp_intro>.

The OECD's MTC, the OECD's TPG and academic literature will be consulted in order to identify and understand the methods used to determine an arm's length price. This will aid in highlighting what role the definition of associated enterprise plays in calculating an arm's length price, and what consequences may possibly arise if this definition is inconsistent amongst different states.

1.5 A brief overview of the main views regarding the interpretation of what constitutes an associated enterprise (for purposes of interpreting a DTA provision identical to Article 9 of the OECD MTC)

The main views regarding the interpretation of what constitutes an associated enterprise (for purposes of interpreting a DTA provision identical to Article 9 of the OECD MTC) deals with the interpretation of a DTA provision, as opposed to domestic law provisions.

According to Cottani, Article 9 of the OECD MTC provides that the trigger that gives rise to an enterprise being considered an associated enterprise is the existence of "participation in the capital or the management or control of another enterprise."[38] Article 9, however, does not define the phrase "management, control or capital.[39]

Cottani submits that control appears to be presented as something distinct from participation in management or capital.[40] Cottani goes on to conclude that the term "control" (as well as the term "management" and "capital") is undefined and must, therefore, be interpreted in accordance with Article 3(2) of the OECD MTC.[41] This, according to Cottani, means that these undefined terms must be given the meaning contained in domestic legislation.

Dwarkasing does not concur with the view submitted by Cottani. Instead, Dwarkasing argues that an autonomous interpretation of the term "associated enterprise" appears to exist. The premise of Dwarkasing's argument arose from the 1979 OECD Report stating that it is unnecessary to define the phrase "under common control" because a broad basis of the term's understanding was assumed to exist.[42]

---

[38] Cottani "Transfer pricing" (2014) *IBFD Topical Analysis.*

[39] Cottani "Transfer pricing" (2014) *IBFD Topical Analysis.*

[40] Cottani "Transfer pricing" (2014) *IBFD Topical Analysis.*

[41] Cottani "Transfer pricing" (2014) *IBFD Topical Analysis.*

[42] Dwarkasing *Associated enterprises* 551; OECD Committee on Fiscal Affairs*. Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises* (1979).

Dwarkasing then discusses his findings from a historical analysis to gain an insight as to what this broad understanding consisted of.

After embarking on a historical analysis of Article 9 of the OECD MTC, Dwarkasing submits that "it [is] clear that 'control' is not a separate, independent criterion,"[43] but rather it is a substitute for the phrase "dominating" as was used in Article 5 of the League of Nations Report of the Fiscal Committee to the Council ("1933 Report").[44] Dwarkasing, therefore, concludes that an entity is only associated with another entity "if there is a participation in capital or management that can dominate or control the other company."

1.6 Overview of the content of this dissertation

Before this dissertation can address the question of how one should interpret what constitutes an associated enterprise, clarity first needs to be provided on the legal status of domestic law, DTAs, Article 9 of the OECD MTC and the Commentary thereon for one to understand what legal effect, if any, the interpretation of the term "associated enterprise" has in South Africa ("SA"). Chapter 2 of this dissertation will also assess what happens in cases of conflict between a DTA and domestic legislation, which will be done by analysing the Constitution of the Republic of South Africa, 1996 ("Constitution"), case law and the Vienna Convention. Although this dissertation will be written from a South African perspective, this chapter will compare the approaches adopted by the other above-mentioned states as well.

Chapter 3 will identify the different types of domestic interpretations of the concept "associated enterprise". This will include, firstly, a concept of associated enterprise that is limited to control in the form of shareholding and management, which on the face of it appears to be applied by states such as the UK. Secondly, a definition of associated enterprise that is based on an open-ended concept of control, as applied by states such as the United States of America ("USA"), will also be included. Finally, a definition of associated enterprise that covers *de jure* control and *de facto* relationships, as applied by states such as India, will also be discussed.

---

[43] Dwarkasing *Associated enterprises* 569.

[44] League of Nations *Report of the Fiscal Committee to the Council*, Fourth Session, Doc No C.399.M.204.1933.II.A (Geneva: League of Nations 1933) 5.

The purpose of chapter 4 is to propose a sound way of interpreting what constitutes an associated enterprise. In doing so this chapter will assess how to interpret Article 9, which also requires an assessment of the application of Article 3(2). One of the aims of this chapter is, therefore, to establish what would constitute the **context providing otherwise**, therefore requiring one to rather apply an autonomous interpretation of a term instead of the domestic definition of a term. Once clarity has been provided on what would constitute the context providing otherwise, the dissertation will move on to establish whether the context of transfer pricing regulation indicates context that requires the application of an autonomous interpretation instead of applying domestic definitions.

This will be followed by a conclusion, which will provide a summary of the findings of this dissertation. Furthermore, the conclusion will propose an interpretation of the term “associated enterprise”.

CHAPTER 2: THE RELATIONSHIP BETWEEN DOMESTIC LEGISLATION AND DOUBLE TAXATION AGREEMENTS

2.1 Introduction

As mentioned in the preceding chapter, the purpose of this dissertation is to establish how to interpret the phrase “participat[ion] … in the management, control or capital” under Article 9 of a DTA (which mirrors the OECD MTC) from a South African perspective. Before addressing how to interpret a provision contained in a DTA, it is material for one to first have an understanding of what legal effect a DTA has domestically, particularly in instances where a DTA conflicts with domestic legislation.

This chapter will consider the legal effect of a DTA, particularly in instances where a DTA conflicts with domestic legislation. This will be done by considering the legal status of a DTA, which will, in turn, be done by gleaning how DTAs are given enforceability.

This analysis will be performed by considering the text of the SA DTAs, South African legal rules and jurisprudence, as well as academic texts pertaining to the legal status of DTAs in SA. Additionally, a comparative analysis will also be done to compare the South African legal position to the position in the USA, the UK, and India.[45]

2.2 Legal status of a double taxation agreement

Academics generally accept that the particular legal framework of a state must be taken into consideration when establishing the legal status of a DTA in that particular state.[46] The method that international law is given legal effect to at a national level is of particular relevance for this purpose.

The general consensus amongst academics is that two approaches exist to giving legal effect to a DTA within a state. These contrasting approaches are referred to as the monist and dualist approaches. States that follow a monist approach consider international law and domestic law as one single legal system, while states that follow a dualist approach consider international law and domestic law as distinct from one

---

[45] Although relevant to this chapter, the relationship between domestic Controlled Foreign Company (“CFC”) legislation and DTAs will not be addressed as it falls beyond the scope of this dissertation.

[46] Olivier & Honiball *International tax* 302.

another. [47] Monist systems, therefore, consider international law as directly enforceable domestically, without any need for domestication. On the other hand, dualist systems require international law to be domesticated by way of formal incorporation into domestic law before obtaining any enforceability domestically.[48]

Although a DTA is treated as distinct from domestic law in dualist states, a DTA becomes part of domestic law in states that follow a dualist approach after a domestication process. [49] Dugard submits that three primary methods exist to domesticate a DTA.[50] The first method that Dugard identifies is embodying the text of a DTA into an act of parliament.[51] Secondly, Dugard notes that a DTA may form a schedule to a statute.[52] Lastly, Dugard states that "an enabling Act of parliament may give the executive the power to bring a treaty into effect in [domestic] law by means of proclamation or notice in the Government Gazette."[53]

2.2.1 Giving legal effect to a double taxation agreement in South Africa

On the face of it, it appears that the heading of almost all[54] of the DTAs to which SA is a party to indicate the domestic procedures for DTAs to become enacted into South African law. This submission is premised on the preamble to South African DTAs, which refer to section 231(4) of the Constitution as well as section 108(2) of the Income Tax Act 58 of 1962 ("Income Tax Act"). The wording contained in the heading of a South African DTA generally provides the following:

> "In terms of section 108(2) of the Income Tax Act, 1962 (Act No 58 of 1962), read in conjunction with section 231(4) of the Constitution of the Republic of South Africa, 1996

---

[47] J Dugard *International law: A South African perspective* 4 ed (2011); G Ferreira & A Ferreira-Snyman "The incorporation of public international law into municipal law and regional law against the background of the dichotomy between monism and dualism" (2014) 17 *PER/PELJ* 1470-1496.

[48] Ferreira & Ferreira-Snyman" (2014) *PER/PELJ* 1470-1496.

[49] I du Plessis "Some thoughts on the interpretation of tax treaties in South Africa" (2012) 24 *SA Merc LJ* 31–52 32.

[50] Dugard *International law* 7.

[51] 7.

[52] 7.

[53] 7.

[54] The SA DTA with Germany and Israel do not refer to the Constitution, assumedly because these DTAs were enacted prior to the existence of the Constitution.

> (Act No 108 of 1996), it is hereby notified that the [DTA] has been entered into with the [Contracting State] and has been approved by Parliament in terms of section 231(2) of the Constitution."

It must be noted, albeit trite, that the key element of the South African legal system is that the South African Constitution is supreme. This is expressly provided for under section 2 of the Constitution, which provides that the "Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled." An analysis of the relevant constitutional provisions pertaining to international agreements, that is section 231 of the Constitution, is therefore firstly required.

Section 231 of the Constitution provides, *inter alia*, as follows:

> "(2) An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).
>
> (3) An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.
>
> (4) Any international agreement becomes law in the Republic when it is enacted into law by national legislation; …
>
> (5) The Republic is bound by international agreements which were binding on the Republic when this Constitution took effect."

Subsection (2) read with subsection (5) clearly provides that an international agreement (such as a DTA) that has been approved by Parliament binds SA on an international level. A State's failure to comply with the provisions of such an international agreement may possibly result in adverse consequences. This, however, does not mean that the international agreement automatically becomes part of South African domestic law. This is due to subsection (4) providing that an international agreement generally becomes law in SA only once such agreement is enacted into law by national legislation. In other words, a taxpayer cannot rely on the provisions contained in a DTA until, *inter alia*, the DTA has been incorporated into South African law by the legislature. This argument was supported in the case of *Glenister v President of the Republic of South Africa*,[55] wherein the court held the following:

> "In our view, the main force of section 231(2) is directed at the Republic's legal obligations under international law, rather than transforming the rights and obligations contained in international agreements into home-grown constitutional rights and obligations. […] [T]he provision must be read in conjunction with the other provisions within section 231. Here, section 231(4) is of particular significance. […] the fact that section 231(4) expressly creates a path for the domestication of international agreements may be an indication that section 231(2) cannot, without more, have the effect of giving binding internal constitutional force to agreements merely because Parliament has approved them."[56]

In addition to section 231 of the Constitution, the preamble to most of SA's DTAs also refer to section 108 of the Income Tax Act, which provides as follows:

> "(1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.
>
> (2) As soon as may be **after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution**, **the arrangements thereby made shall be notified by publication in the Gazette and** the arrangements so notified **shall thereupon have effect as if enacted in this Act**."
> [own emphasis]

Since section 108(2) of the Income Tax Act (which is referred to in almost all of SA's DTAs) requires a DTA to be approved by Parliament in order for the DTA to have legal effect, such approval, according to section 231 of the Constitution, will result in the DTA having effect as if enacted in the Income Tax Act. In other words, as articulated by Du Plessis, "[t]he Income Tax Act, therefore, constitutes the national legislation,

[55] 2011 3 SA 347 (CC) para 181.

[56] This view, which formed part of the minority judgment, appears to have been supported by the majority decision. This submission is premised on the wording of the majority judgment at paras 91-92.

required by the Constitution, by which the DTT becomes part of domestic law."[57] It consequently seems apparent that SA domesticates DTAs by utilising enabling legislation.

This view appears to be supported by South African courts,[58] which have held that section 108 is an enabling provision that empowers government to domesticate a treaty into South African law. This is evident from the supreme court of appeal judgment in *Krok v C:SARS*,[59] which held that "DTA['s] and the[ir] Protocol[s] … were concluded in terms of section 108(2) of the Income Tax Act 58 of 1962 read with section 231(4) of the Constitution of the Republic of South Africa, 1996".

2.3 Addressing conflict between a DTA and domestic legislation

Akehurst has previously identified the following techniques to resolve a conflict between DTAs and domestic law:

> "the first technique is to make rules derived from one source prevail over rules derived from another source: lex surerior derogate inferiori. The second technique is to make later rules prevail over earlier rules: lex posterior derogate priori. […] The third technique is to make a particular rule prevail over a general rule: lex specialis derogate generali."[60]

The author hereof is of the view that the second and third technique identified by Akehurst are simply references to the ordinary principles of legislative interpretation. It appears that there may therefore only be two general methods to address the conflict between DTAs and domestic legislation, the first being that a state can provide for rules that provide that one rule prevails over another, and the second being applying the ordinary principles of legislative interpretation.

Given that the South African legal system gives legal effect to DTAs by way of an enabling act of parliament that gives the executive the power to bring a treaty into

---

[57] I du Plessis *A South African perspective on some critical issues regarding the OECD Model Tax Convention on Income and on Capital, with special emphasis on its application to trusts* LLD dissertation, Stellenbosch University (2014) 112.
[58] *Commissioner, South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC); *CSARS v Tradehold Ltd* 2013 4 SA 184 (SCA).
[59] 2015 6 SA 317 (SCA).
[60] M Akehurst "The hierarchy of the sources of international law" (1976) 47 *British Yearbook of International Law* 273 285.

effect in [domestic] law[61] , it seems appropriate to conclude that SA can be classified as a dualist state.[62] From a South African perspective, the South African Constitutional Court unambiguously held in *Glenister v President of the Republic of South Africa*[63] that "the incorporation of an international agreement creates ordinary domestic statutory obligations. Incorporation by itself does not transform the rights and obligations in it into constitutional rights and obligations." In other words, "a treaty, once it is domesticated via legislation, has the same status as other legislation."[64] The reason for this, according to case law, is because DTAs are "enacted into law by national legislation, and can only be elevated to a status superior to that of other national legislation if Parliament expressly indicates its intent that the enacting legislation should have such status."[65]

On this point, Gutuza has previously highlighted that South African domestic legislation does not provide that the DTA will prevail over domestic legislation.[66] SA therefore clearly does not apply specific laws that provide for DTAs to trump domestic law. Conflicts between the two are therefore not addressed in such a manner.

Olivier and Honiball provide a logical explanation that, in the author's view, clarifies the South African method of addressing a conflict between DTAs and domestic law. These academics note the following:

> "in light of the fact that s 108(2) provides that once a treaty has been approved by parliament and published in the Government Gazette it becomes part of domestic law, the South African common law rules for the interpretation of statutes would be applicable also to treaties. As a result, these rules will have to be applied to resolve the conflict to the extent that international interpretation rules were not of assistance."[67]

In other words, due to the way that treaties are domesticated in SA, the South African rules of interpreting legislation must be applied to resolve any conflict. The

[61] By proclamation or notice in the *Government Gazette*.
[62] *Krok v C:SARS* 2015 6 SA 317 (SCA) para 24.
[63] 2011 3 SA 347 (CC) para 181.
[64] Du Plessis *A South African perspective* 113.
[65] *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 100.
[66] T Gutuza "Tax treaties, the Income Tax Act and the Constitution – Trump or reconcile?" (2016) 3 *SA Merc LJ* 480 507.
[67] Olivier & Honiball *International tax* 315.

Constitutional Court also expressed this view in the *Glenister* minority judgment, which held as follows:

> "if there is a conflict between an international agreement that has been incorporated into our law and another piece of legislation, that conflict must be resolved by the application of the principles relating to statutory interpretation and superseding of legislation."[68]

Based on the view from the above-mentioned Constitutional Court judgment, which is also supported by numerous academics,[69] it is clear that any conflict between a DTA and domestic legislation must be addressed by applying the ordinary rules of statutory interpretation.

2.3.1 The "stencil argument"

It is trite that states enter into DTAs with the aim of, *inter alia*, eliminating double taxation. According to Lang, DTAs "determine the extent to which each state may levy tax."[70] Lang goes on to explain how this is done by noting that the contracting states will give up taxing rights.[71] Although the purpose of Article 9 of a DTA that mirrors the OECD MTC is to address cases of economic double taxation (as opposed to allocating taxation rights between two states), such an article also puts limits on national tax authorities by "restricting a state's right to make income adjustments under domestic law"[72] (which may essentially result in giving up taxing rights over income that they would have been entitled to tax had the DTA not existed). These references to contracting states giving up taxing rights suggest that DTAs are intended to, at the very least, limit domestic tax laws in specific instances (that is; instances pertaining to the cross-border taxation of residents of two contracting states).

---

[68] *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 101.
[69] Gutuza (2016) *SA Merc LJ* 483; Olivier & Honiball *International tax* 304.
[70] M Lang *Introduction to the law of double taxation conventions* 2 ed (2013) 30.
[71] 30.
[72] Kofler "Article 9. Associated enterprises" in *Klaus Vogel on Double taxation conventions* 577-703 597.

According to Vogel, since the applicability of a DTA is confined to cross-border taxation of residents of the two contracting states, DTAs constitute special legislation (*leges specialis*).[73] Vogel concludes as follows:

> "Thus according to the old rule "Lex specialis derogat legi generali" ("special legislation overrides general legislation"), treaties override the domestic tax law that is effective at the time of their implementation. Under a supplementary rule of "Lex posterior generalis non derogart legi priori speciali" ("later general legislation does not overrule earlier special legislation"), changes of domestic tax law normally will not affect existing treaties."[74]

In other words, DTAs "recognize that each contracting state applies its own [domestic] law, and then limit the contracting states' application of that law."[75] DTAs, therefore, restrict the applicability of domestic laws. Accordingly, Vogel submits that "a tax obligation exists only if and to the extent that, in addition to the requirements of domestic law, the treaty requirements also are satisfied."[76] In other words, the DTA is the agreed-upon stencil to the entire picture that is made by the domestic law.[77]

Although not expressly stated, support for this view can be inferred from the *Tradehold* case where the court held the following:

> "Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. […] A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict."

Du Plessis has previously expressed that the court in *Tradehold* was cognisant of subsequent legislation's impact on existing treaties. This is due to the court acknowledging that DTAs "are intended to encompass not only existing taxes but also

---

[73] K Vogel "The Domestic Law Perspective" in G Maisto (ed) *Tax treaties and domestic law* (2006) 3-12 3
[74] 3.
[75] K Vogel "Double Tax Treaties and Their Interpretation" (1986) 4 *International Tax & Business Lawyer* 1-85 22.
[76] C de Pietro "Tax treaty override and the need for coordination between legal systems: Safeguarding the effectiveness of international law" (2015) 77 *World Tax Journal* <https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Pay-per-view_wtj_2015_01_int_3.pdf> (accessed 03-01-2018); K Vogel *Klaus Vogel on double taxation conventions* 3 ed (1997) 20.
[77] Vogel "The Domestic Law Perspective" in *Tax treaties and domestic law* 3.

taxes which may come into existence at later dates."[78] Du Plessis, therefore, concludes that the *Tradehold* judgment "effectively stated that a DTA will always apply in preference to domestic law in the case of conflict."[79]

Other academics have also acknowledged that "[a]ll Article 9(1) [of a DTA that mirrors Article 9(1) of the OECD MTC] does is … restrict domestic law."[80] If "Article 9(1) [of the] OECD MTC and the treaty rules corresponding to it did not in fact restrict domestic taxing rights, they would be superfluous."[81] This is because if Article 9 of a DTA (which mirrored Article 9 of the OECD MTC) did not restrict the domestic laws of the relevant Contracting states, then "…the unpalatable result would be that economic double taxation could systematically persist within the framework of Article 9."[82] The reason why economic double taxation would arise is because Article 9(2) only requires the other state to make a corresponding transfer pricing adjustment if it agrees with the primary adjustment in principle. In other words, if the other state does not agree that the parties were in fact associated and therefore subject to Article 9(1), then that other state will not alleviate the "associated" parties from economic double taxation. This would undermine the entire purpose of Article 9 of the OECD MTC, being to eliminate economic double taxation, which would make Article 9 superfluous.

2.3.2 The elephant in the room: Glenister and Van Ketz

Du Plessis notes that the *Tradehold* decision made no mention of the *Glenister* or *Van Kets* judgments.[83] One of the issues in the *Glenister* case was the constitutional validity of the domestic legislation that gave rise to the creation of a special investigative unit known as the "Hawks".

One of the arguments raised to invalidate the legislation that established the Hawks was that the domestic legislation was unconstitutional because the Hawks lacked the necessary independence to be an effective corruption-fighting mechanism, as was

[78] *Commissioner for the South African Revenue Service v Tradehold Ltd* 2012 3 All SA 15 (SCA) para 18.
[79] Du Plessis *A South African perspective* 118.
[80] Kofler "Article 9. Associated Enterprises" in *Klaus Vogel on double taxation conventions* 577-703 596.
[81] 602.
[82] 603.
[83] Du Plessis *A South African perspective* 118.

required in terms of an international treaty that imposed an obligation to establish an independent anti-corruption agency.[84] Although the case was not related to tax, the court in the *Glenister* case held that section 231 of the Constitution determines the legal status of an international agreement.[85] Both the majority and minority judgments in *Glenister* held that "an international agreement that becomes law in our country enjoys the same status as any other [domestic] legislation."[86]

Unfortunately, however, the court went on to state that "[international agreements] can only be elevated to a status superior to that of other national legislation if Parliament expressly indicates [such] intent."[87] The author hereof is of the view that this statement ought to be interpreted as meaning that SA does not apply the *lex superior derogate inferiori* rule. The status of superiority in regard to which provision should apply over the other is, therefore, to be answered by applying ordinary rules of statutory interpretation. Although the *Glenister* minority judgment (in an *obiter* footnote) suggested that an argument can be made that later-enacted legislation would generally supersede a previously domesticated international agreement,[88] The court did not conclude that this prospective argument is correct in law. In fact, the court stated that it does not need to "… express a firm view on this issue as it is not before us."[89] Furthermore, this argument is assumedly based on the presumption that a DTA constitutes *lex generalis* rather than *lex specialis*, which according to Vogel is incorrect. Since the applicability of a DTA is confined to cross-border taxation of residents of the two contracting states, tax treaties constitute special legislation (*lex specialis*). This *obiter* remark by the court, however, shows that the court was at least in agreement that the ordinary rules of legislative interpretation are to be applied in order to address conflicting provisions.

A fundamental point that the author hereof wishes to highlight from the *Glenister* judgment is its reliance on section 233 of the Constitution, which the court held "demands any reasonable interpretation that is consistent with international law when legislation is interpreted. There is, thus, no escape from the manifest constitutional

[84] *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 178.
[85] Para 112.
[86] Para 100.
[87] Para 100.
[88] Para 103 n 88.
[89] Para 88.

injunction to integrate, in a way the Constitution permits, international law obligations into our domestic law."[90] On this point, it has already been expressed above that DTAs (that is, international law) form part of domestic law. Where international law and domestic law are in conflict, the Constitution requires these two laws to be interpreted in a way that is consistent with international law. Since one of these two conflicting laws also constitutes international law, the reconciliation of the two conflicting laws will, therefore, need to be done in a manner that does not undermine international law. The above-mentioned quote from the *Glenister* judgment, it is respectfully submitted, could arguably, therefore, be interpreted as further support of the *lex specialis* nature of DTAs.

The South African High Court has also had to pronounce on the status of DTAs in the *Van Kets* matter. In this case, the court reaffirmed the view in the *Glenister* judgment that an international agreement (such as a DTA) is of equal status to domestic legislation. On this basis, the court stated that the ordinary rules of statutory interpretation to resolve conflicting legislation required one to read the conflicting provisions as one coherent whole.[91]

Gutuza submits that the court reconciled the purposes of the DTA and the domestic law by "indicating that a narrow interpretation of the term 'taxpayer' would result in non-compliance with [the DTA] whereas a wider interpretation would render the provisions of the Income Tax Act compatible with the obligations of the [DTA]."[92]

There are at least two fundamental differences between the *Van Kets* and *Tradehold* cases that should be highlighted. Firstly, In *Van Kets*, the applicable provision in the DTA pertained to a revenue authority's information gathering and sharing powers, whereas the applicable provision in the DTA in the *Tradehold* case dealt with the allocation of taxing rights. This distinction is, in the author's view, vital because DTAs are entered into for more than one purpose and the purpose of a provision gives context thereto, which bears weight when interpreting and applying such provision.[93]

---

[90] Para 202.

[91] *Commissioner, South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC) para 25.

[92] Gutuza (2016) *SA Merc LJ* 505.

[93] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA); *Krok v C:SARS* 2015 6 SA 317 (SCA); Art 31(1) of the Vienna Convention; A Rust "Article 3(2)" in *Klaus Vogel on double taxation* 212.

The purpose of the provisions that allocate taxing rights is to avoid juridical double taxation, while the purpose of provisions that enable the sharing of taxpayer information is intended to enable foreign tax authorities to perform their tax administrative functions. Considering the former purpose, it seems logical for a "winner-takes-all" approach to apply. It is difficult to fathom how any other approach would practically achieve the purpose of the tax allocation provisions (that is; to prevent juridical double taxation).

Gutuza notes that two camps exist when dealing with conflict between DTAs and domestic laws, being a "winner-takes-all" approach (which is where one provision trumps the other) and a reconciliatory approach (which is where the provisions are reconciled).[94] It must be borne in mind that non-compliance with DTAs may result in adverse consequences for the reneging contracting state. Considering this, together with the above-mentioned purpose of DTA provisions, it seems that the decision as to whether to apply a "winner-takes-all" or reconciliatory approach depends on whether such approach would enable the DTA provision in question to achieve its purpose. A "winner-takes-all" approach to dealing with conflict between provisions of DTAs that allocate taxing rights and domestic law arguably enables the DTA to fulfil its purpose of avoiding double taxation. On the other hand, a reconciliation approach may well be appropriate for DTA provisions with other purposes, such as improving the administrative functioning of revenue authorities. The second fundamental difference between the *Van Kets* and *Tradehold* cases is that, in *Van Kets*, the applicability of the relevant provision in the DTA was limited by the applicable domestic law. This was not the case in *Tradehold*. In fact, the position was arguably inverted in *Tradehold* in the sense that the DTA limited the taxing rights of SA's domestic law. Considering the fact that SA may be subject to adverse consequences if it does not comply with its international obligations, this distinction seems material when analysing the approaches applied by the courts when addressing the conflict between the provisions contained in the DTA and the domestic law. It is arguable that this distinction, together with the purpose of the DTA provision in question, will be fundamental when determining how to address a conflict between a DTA and domestic law. Where the purpose of the DTA provision will be undermined due to domestic law limiting the applicability of the DTAs provision, then one must first attempt to apply the principles

[94] Gutuza (2016) *SA Merc LJ* 483.

in *Van Kets* by reconciling the two conflicting provisions. On the other hand, it seems justified to conclude that the purpose of the tax allocation provisions in the DTA requires one to consider such provisions to be *lex specialis* in nature and thereby applying a "winner-takes-all" approach to conflicts between such DTA provisions and domestic law.

The *Glenister* and the *Van Kets* judgments could perhaps, in this author's view, be reconciled with that of *Tradehold* to a limited extent. As per the *Glenister* decision, international agreements that have been domesticated obtain the same legal status as other domestic legislation. Perhaps one can interpret the *Tradehold* judgment as merely clarifying the special nature of DTAs, which according to the ordinary rules of legislative interpretation (in particular the maxim *generalia specialibus non derogant*),[95] generally result in DTAs applying in preference to domestic legislation to the extent that they conflict. This particular *maxim* may only be rebutted by a clear expression of intent in the later general Act.[96] The general common law principles on statutory interpretation appear to support this view. That is, legislation which is irreconcilable with a preceding law of equal hierarchy revokes that preceding law.[97] Where, however, the subsequent legislation addresses a matter generally, prior conflicting legislation that addresses a matter specifically will be preserved in pursuance of the maxim *generalia specialibus non derogant*.[98] This general rule is to be applied with caution, given that it is presumed that a statutory provision does not purport to change existing laws more than necessary.

Of course, this argument would not be consistent with the *obiter* argument raised in a footnote by the *Glenister* minority judgment, however, as explained above the court never endorsed this view and therefore did no more than highlight this as a possible argument that could be made.

---

[95] Later general legislation does not overrule earlier special legislation.
[96] Gutuza (2016) *SA Merc LJ* 482.
[97] *Chotabhai v Union Government (Minister of Justice) & Registrar of Asiatics* 1911 AD 13; *New Modderfontein Gold Mining Co v Tvl Provincial Administration* 1919 AD 367 397; *R v Sutherland* 1961 2 SA 806 (A) 815B.
[98] *Gentiruco AG v Firestone SA (Pty) Ltd* 1972 1 SA 589 (A); *S v Hattingh* 1978 2 SA 826 (A) 829A-G

2.4 Giving legal effect to a DTA – comparative analysis

2.4.1 United States

2.4.1.1 Giving legal effect to a DTA in the United States

The Constitution of the United States[99] provides that, as with the Constitution and federal laws, treaties constitute the supreme law of the land.[100] DTAs therefore automatically obtain equal status with domestic laws. Implementing legislation is generally therefore not required.[101]

The Senate Finance Committee appears to have acknowledged that DTAs are self-executing.[102] This issue, therefore, seems trite and does not require further analysis.

2.4.1.2 Addressing conflict between a DTA and domestic law

As mentioned above, the US Constitution[103] essentially provides that DTAs are equal in standing to domestic legislation. The courts, therefore, use ordinary rules of interpretation to address conflicts.[104]

According to the court in *Whitney v. Robertson*,[105] the last in time rule is to be adopted when addressing a conflict between a DTA and domestic law. In other words, whichever was enacted most recently is to be preferred. Academics further supported this view,[106] which was later codified into domestic legislation.[107]

---

[99] Constitution of the United States of America (Amend XXVII) ("US Constitution").
[100] Article VI, cl 2.
[101] Vogel (1986) *International Tax & Business Lawyer* 20.
[102] S Rep No 110-17, at 7 (2008) (consenting to the Tax Convention with Iceland subject to the declaration that the Convention is self-executing). In Y Iwasawa "The doctrine of self-executing treaties in the United States: A critical analysis" (1985-1986) 26 *VA J Int'l L* 626 it is expressed that "a treaty is self-executing when it can be directly applied by courts or executive agencies without the need of further measures." Further measures would generally include the implementation of legislation that provides for the domestic enforceability of the DTA in question.
[103] Article VI, cl 2 of the US Constitution.
[104] *Whitney v Robertson* 124 US 190 (1888).
[105] 124 US 190 (1888).
[106] Vogel (1986) *International Tax & Business Lawyer* 20; AC Infanti "United States" in G Maisto (ed) *Tax treaties and domestic law: Volume 2 in EC and international tax law series* (2006) 356.
[107] Internal Revenue Code ("26 US Code") § 7852.

Although treaty override is possible, the United States applies a so-called "presumption of harmony," which means that it is assumed that the legislator did not intend to override an existing DTA.[108] Courts will, therefore, endeavour to interpret the DTA and the conflicting domestic legislation that deals with the same subject as one coherent whole.[109] Nevertheless, a later-enacted domestic provision will override an existing conflicting DTA to the extent that they cannot be interpreted as one coherent whole.[110]

It is worth noting that the United States Senate published a Report,[111] which provides *inter alia* the following:

> "[T]he committee finds it disturbing that some assert that a treaty prevails over later enacted conflicting legislation in the absence of an explicit statement of congressional intent to override the treaty; that it is treaties, not legislation, which will prevail in the event of a conflict absent an explicit and specific legislative override. The committee does not believe this view has any foundation in present law."[112]

Although not law, this Report appears to clearly indicate that the United States does not apply the *lex specialis* doctrine to DTAs.

---

[108] Infanti "United States" in *Tax Treaties and Domestic Law* 370.
[109] *4 Posadas v National City Bank* 296 US 497, 503 (1936).
[110] RS Avi-Yonah "Tax Treaty Overrides: A qualified Defence of U.S. Practice" in *Tax Treaties and Domestic Law* 70.
[111] OECD Committee on Fiscal Affairs *Tax Treaty Override* (1989); Senate Report 100-445, 100th Cong., 2nd Sess., Tit. I, XII H 1 (Relationship with Treaties), explaining Sec. 112 (aa) of S. 2238 (IRC Sec. 7852) (the "Senate Report").
[112] Senate Report.

2.4.2 United Kingdom

2.4.2.1 Giving legal effect to a double taxation agreement in the United Kingdom

Academics have confirmed that DTAs have no effect in the UK domestic law until domesticated by incorporating the DTA into domestic law in accordance with a domesticating act.[113] A DTA is domesticated in the UK by virtue of section 2 of the Taxation (International and Other Provisions) Act of 2010 ("TIOPA"), which provides the following:[114]

> "S2 (1) Giving effect to arrangements made in relation to other territories
> (1) If Her Majesty by Order in Council declares—
> (a) that arrangements specified in the Order have been made in relation to any territory outside the United Kingdom with a view to affording relief from double taxation in relation to taxes within subsection (3), and
> (b) that it is expedient that those arrangements should have effect, those arrangements have effect.
> (2) If arrangements have effect under subsection (1), they have effect in accordance with section 6."

Section 6 of TIOPA also needs to be taken into consideration. It provides that "double taxation arrangements have effect … **so far as** the arrangements provide [for certain listed objects and purposes]."[115] Academics have concluded that the phrase "so far as" indicates that section 6 restricts the applicability of a DTA.[116] Furthermore, academics have also suggested that "parliamentary sovereignty enables subsequent domestic legislation […] to override the effect of [DTAs]."[117]

Parliament is free to accept or reject a draft order in council. From this, it follows

---

[113] K Vogel "The domestic law perspective" in *Tax treaties and domestic law EC and international tax law series* (2006) 4; Vogel (1986) *International Tax & Business Lawyer* 20. See also International Fiscal Association ("IFA") *Cahiers Volume 101B: The notion of tax and the elimination of international double taxation or double non-taxation* (2016) 862.

[114] R Langston "Back to basics: Double tax treaties" (18-04-2012) *The Tax Journal* <https://www.taxjournal.com/articles/double-tax-treaties-44911> (accessed 18-04-2020).

[115] Section 6 of TIOPA.

[116] See also IFA *Cahiers Volume 101B* 862, referring to J Schwarz *Schwarz on tax treaties* (2013) 27.

[117] IFA *Cahiers Volume 101B* 862, referring to Baker *Double taxation conventions* 3 ed (2019) F-7.

that it is this legislative act and not the treaty itself that changes existing tax law.[118]

2.4.2.2 Addressing conflict between a double taxation agreement and domestic law

Roxan has previously stated that "since a treaty only has effect by virtue of the authority of a statute, it can have no greater authority in UK domestic law than the statute incorporating it provides."[119] Some academics, therefore, appear to be of the view that a DTA is of the same status as UK domestic legislation.

The sovereignty of Parliament is a fundamental principle in the UK.[120] Baker suggests that this enables Parliament to implement subsequent domestic legislation to override the effect of an existing DTA.[121] Roxan, however, submits that the status of this principle has been altered by the imposition of the law of the European Communities Act of 1972, which is considered to have limited the sovereignty of Parliament principle.[122]

According to Her Majesty's Revenue and Custom's ("HMRC's") international manual, a DTA "takes precedence over domestic legislation … insofar as they provide relief from double taxation."[123] HMRC seem to rely on the wording of the domesticating legislation as justification for this interpretation, which provides that a DTA will have legal effect "despite anything in any enactment." The specific wording of the UK's domesticating legislation also appears to provide that rules deriving from DTAs generally prevail over rules derived from another source. It must be emphasised that it is the content of the domesticating legislation in this particular instance, rather than the mere existence of domesticating legislation, that results in the superiority of the DTA.

---

118 IFA *Cahiers Volume 101B* 862.

119 I Roxan "United Kingdom" in G Maisto (ed) *Tax treaties and domestic law* (2006) 313-333, 319.

120 314.

121 Baker *Double taxation conventions* F-7.

122 Roxan "United Kingdom" in *Tax treaties and domestic law* 315.

123 HMRC "INTM267626: Foreign banks trading in the UK through permanent establishments: Interaction of double tax agreements with UK domestic law" (09-0-2016) *Gov.uk* <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm267626> (accessed 04-01-2020).

2.4.3 India

2.4.3.1 Giving legal effect to a double taxation agreement in India

India applies the dualist approach for the implementation of international law at domestic level.[124] Domestic law and international law are therefore treated as two separate legal systems. This means that international treaties do not automatically become part of Indian domestic law. DTAs can therefore only be enforced domestically once such DTA in question has been incorporated into domestic law.[125]

Article 253 of the Indian Constitution allows parliament to domesticate DTAs. Article 253 provides that parliament may implement "any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body." More specifically, section 90 of the Income Tax Act 43 of 1961 allows for the Indian Government to enter into DTAs with other states.

2.4.3.2 Addressing conflict between a double taxation agreement and domestic law

Circulars[126] issued by The Central Board of Direct Taxes, which forms part of India's Department of Revenue in the Ministry of Finance, appears to have clarified that DTAs override Indian domestic law.[127] Most notably, circular 789 clarified that where a

---

[124] *Jolly Jeorge Verghese & Anr v The Bank of Cochin AIR* 1980 SC 470.

[125] SK Agarwal "Implementation of international law in India: Role of judiciary" (14-06-2010) *SSRN* <https://ssrn.com/abstract=1864489> (accessed 06-09-2010).

[126] Government of India: Income Tax Department "Circular No. 789 Clarification regarding taxation of income from dividends and capital gains under the Indo-Mauritius Double Tax Avoidance Convention (DTAC)" (13-04-2000) *Government of India* <https://www.incometaxindia.gov.in/Communications/Circular/910110000000000483.htm> (accessed 04-01-2020) and Government of India: Income Tax Department "Circular No. 333 Double Taxation Relief & Transfer Pricing" (02-04-1982) *Government of India* <https://www.incometaxindia.gov.in/_layouts/15/dit/pages/viewer.aspx?path=http://www.incometaxindia.gov.in/communications/circular/910110000000000699.htm&k=&opt=&isdlg=0&path=http://www.incometaxindia.gov.in/communications/circular/910110000000000699.htm&k=&opt=&isdlg=0> (accessed 04-01-2020).

[127] A Narayan & B Mala "Tax treaty override: A detailed study" (undated) *SAPR Law Blog* 32 <http://www.saprlaw.com/taxblog/tax_treaty_override-A_detailed_study.pdf> (accessed 04-01-2020).

specific provision is made in the DTA, that provision will prevail over the general provisions contained in the Income Tax Act. This seems to indicate that India relies on the *Lex specialis derogat legi generali* rule to address conflict between DTAs and domestic laws.

Additionally, the Indian High Court[128] has previously held as follows:

> "where there exists a provision to the contrary in the agreement, there is no scope for applying the law of any one of the respective contracting states to tax the income and the liability to tax has to be worked out in the manner and to the extent permitted or allowed under the terms of the agreement."

In other words, when there is a conflict between a DTA and Indian domestic law, the DTA is considered to override the Indian domestic legislation. The Supreme Court of India has also confirmed this point when it previously had to consider, in the case of *CIT v. Torquoise Investment and Finance Ltd*,[129] whether the provisions of a DTA override the Indian domestic tax law. The judgment, in this case, appears to validate the conclusion that a DTA will override the Indian domestic legislation if the domestic laws are inconsistent with the DTA.

2.5 Conclusion

From the above analysis, two approaches to incorporating a treaty into law appear to exist. First, in states such as the United States, DTAs are self-executing. This means that once entered into, a DTA creates rights and liabilities for taxpayers. The second method of incorporating a DTA into domestic law is to utilise enabling legislation, as is done in SA, India and the UK. In terms of this method, a DTA has no legal effect within a state until it has been incorporated into domestic law.

After having analysed the prevailing legislation, Commentary and case law from SA, the United States, the UK and India, it appears that two general methods to address conflict between DTAs and domestic legislation exist. The first being that a state can provide for rules that provide that one rule prevails over another (the *lex surerior derogate inferiori* rule), such as in the UK.

---

[128] *CIT v VR.S.R.M. Firm* 208 ITR 400.
[129] (2006) 202 CTR MP 395, 2008 299 ITR 143 MP.

The second general method identified in this analysis is the ordinary principles of legislative interpretation, particularly the *lex specialis derogat legi generali* rule (such as in SA and India).

Although the United States utilises domestic legislation to address conflicts between DTAs and domestic legislation, the content of that legislation stems from ordinary principles of legislative interpretation. Unlike SA and India, however, the United States does not apply the *lex specialis* rule. Instead, the United States applies the *posterior derogate priori* rule. Later-enacted domestic legislation can, therefore, supersede existing DTAs in the United States.

The United States is therefore different from SA, India and the UK in the sense that the United States does not give preference to a DTA over domestic legislation *per se*. Instead, the United States enforces the later-enacted provision, albeit from a DTA or domestic legislation.

Due to the ability of DTAs to restrict the applicability of domestic laws, consensus is needed amongst all states regarding the interpretation of the terms in DTAs (such as the phrase “participat[ion] … in the management, control or capital”). In the absence thereof, the risk of economic double taxation arises (which would derive from a corresponding state being entitled to deny a taxpayer the right to a corresponding transfer pricing adjustment due to such state disagreeing with the primary adjustment either in principle or as regards the amount).

CHAPTER 3: DIFFERING DOMESTIC DEFINITIONS OF THE TERM "ASSOCIATED ENTERPRISE" (OR TERMS IN LIEU THEREOF)

3.1 Introduction

This chapter will identify the different relationships that trigger the applicability of domestic transfer pricing rules in SA, India, the UK, and the United States. The purpose of this discussion is to establish whether there are any differences in the domestic triggers of local transfer pricing rules, which may give rise to economic double taxation. The different categories, or types of domestic definitions, of associated enterprise, will, therefore, be analysed in this chapter.

This will include, firstly, a concept of associated enterprise that is limited to control in the form of shareholding or management or control stemming from a document governing a company (such as a memorandum of incorporation), which is applied by states such as the UK. Secondly, a definition of associated enterprise that is based on an open-ended concept of control, as applied by states such as the USA, will also be included. Finally, a definition of associated enterprise that covers a broad interpretation of *de facto* control, as applied by states such as India, will also be discussed. The South African definition will be analysed first.

3.2 South Africa

3.2.1 Domestic trigger for a possible transfer pricing adjustment

Although the DTAs to which SA is a party refer to an "associated enterprise," the term is not expressly defined in any South African legislation. Section 31, read with section 1, of the South African Income Tax Act 58 of 1962 ("Income Tax Act") is the primary legislation that regulates transfer pricing amongst associated enterprises. These sections, however, utilise the term "connected person" instead of the phrase "associated enterprise."

Before one can delve into the definition of what constitutes a connected person, one must first understand the relevance of the term, which will be addressed below.

3.2.2 The domestic relevance of the term "connected person"

3.2.2.1 General

Although the focus of this dissertation is the interpretation of the term "associated enterprise", or a term similar thereto, from a transfer pricing perspective, it must be noted that the term "connected person" is utilised by the South African Income Tax Act for other purposes as well. These sections generally seem to be of an anti-avoidance nature. An example of this is found in the Eighth Schedule to the Income Tax Act, which makes provisions for so-called "value shifting arrangements". A value shifting arrangement is defined in paragraph 1 of the Eighth Schedule to the Act as the following:

> "An arrangement by which a person retains an interest in a company, trust or partnership, but the market value of that person's interest decreases following a change in the fights or entitlements of the interests in the company, trust or partnership, while the value of that person's connected person's direct or indirect interest in it increases, or his connected person acquires a direct or indirect interest in it."

3.2.2.2 The relevance of the term "connected person" concerning transfer pricing

Subsection (2) of section 31, which effectively provides for the arm's length principle, reads as follows:

> "(2) where –
>
> (a) any transaction, operation, scheme, agreement or understanding **constitutes an affected transaction**; and
>
> (b) any term or condition of that transaction, operation, scheme, agreement or understanding –
>
> (i) is a term or condition contemplated in paragraph (b) of the definition of "affected transaction"; and
>
> (ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,
>
> the taxable income or tax payable by any person contemplated in paragraph (b)(ii) that derives a tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length." [own emphasis]

As is evident from the above, section 31 of the Income Tax Act does not refer to the term "connected persons." The relevance of the phrase "connected persons" lies within the phrase "affected transaction," which is referred to in subsection (2). Subsection (2) clearly provides that the arm's length principle only applies to affected transactions, which is defined in subsection (1) as follows:

"(1) For the purposes of this section –

"affected transaction" means any transaction, operation, scheme, agreement or understanding where –

(a) that transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into […] between […]

(aa) a person that is a resident; and

(bb) any other person that is not a resident;

…

and those persons are connected persons in relation to one another; and

(b) any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length." [own emphasis]

As is illustrated above, if an affected transaction exists as defined by subsection (1), then subsection (2) (that is, the provision that effectively provides for the arm's length principle) finds application. In other words, subsection (1) is the door to the application of subsection (2) (that is, the arm's length principle).

Subsection (1) only applies when there is an international transaction between connected persons. There are therefore two legs required to open the door to the arm's length principle; it must be an international transaction and that transaction must be between connected parties. If the transaction is not between connected parties, then that transaction cannot constitute an affected transaction and, by virtue thereof, cannot be subjected to the arm's length principle.

Given that the definition of an "affected transaction" uses the words "directly or indirectly," it can be deduced that a transaction may not escape the scope of the "affected transaction" definition *per se* if an independent person has been interposed in the affected transaction between two or more connected persons.

3.2.3 Analysis of the definition of a connected person

The definition of a connected person as per section 1 of the Income Tax Act provides as follows:

"Connected person" means –

(a) in relation to a natural person –

(i) any relative; and

(ii) any trust (other than a portfolio of a collective investment scheme) of which such natural person or such relative is a beneficiary;

(b) in relation to a trust (other than a portfolio of a collective investment scheme) –

(i) any beneficiary of such trust; and

(ii) any connected person in relation to such beneficiary;

(bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme), any other person who is a connected person in relation to such trust;

(c) in relation to a member of any partnership or foreign partnership –

(i) any other member; and

(ii) any connected person in relation to any member of such partnership or foreign partnership;

(d) in relation to a company –

(i) any other company that would be part of the same group of companies as that company if the expression 'at least 70 per cent of the equity shares in' in paragraphs (a) and (b) of the definition of 'group of companies'[130] in this section were replaced by the expression 'more than 50 per cent of the equity shares or voting rights in'

(ii) …

(iii) …

---

[130] Section 1 of the Income Tax Act defines a "group of companies" as two or more companies in which one company (hereinafter referred to as the "controlling group company") directly or indirectly holds shares in at least one other company (hereinafter referred to as the controlled group company), to the extent that –

(a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

(b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company

(iv) any person, other than a company as defined in section 1 of the Companies Act that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of –

(aa) the equity shares in the company; or

(bb) the voting rights in the company;

(v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, **and no holder of shares holds the majority voting rights in the company;**[131]

(vA) any other company if such other company is managed or controlled by –

(aa) any person who or which is a connected person in relation to such company; or

(bb) any person who or which is a connected person in relation to a person contemplated in item (aa); and

(cc) any other close corporation or company which is a connected person in relation to –

(i) any member contemplated in item (aa); or

(ii) the relative or trust contemplated in item (bb); and

(e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme in securities." [own emphasis]

Although paragraph (e) only appears at the end of the definition, it is important to highlight the effect of paragraph (e) of the definition. Paragraph (e) essentially provides that if, for example, X is defined as a connected person in relation to Y, then Y is also a connected person in relation to X. In other words, both parties are mutually connected persons in relation to each other. So if the definition of a connected person in relation to, for example, a company, provides that a natural person with 20% shareholding is connected to a company, then that company is mutually also a connected person in relation to that natural person by virtue of paragraph (e).[132]

[131] Section 31(4) of The Income Tax Act provides that the phrase "and no holder of shares holds the majority voting rights in the company" contained in the definition of connected person is to be disregarded for purposes of determining whether a connected person relationship exists in respect of the granting of financial assistance, intellectual property or knowledge.

[132] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 31 <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-67%20-%20IN67%20Connected%20Persons.pdf> (accessed 24-04-2020).

It is clear that section 1 provides for distinct definitions of a connected person in relation to each different type of person as defined by the Act, as well as in relation to a partnership. Although the definition is split into separate paragraphs for all types of persons and partnerships, one must still read the definition in its entirety to establish all possible connected person relationships. This point is best illustrated by discussing the definition of a connected person in relation to natural persons.

3.2.3.1 In relation to a natural person

One is defined as being connected to a natural person if one is a "relative" of that natural person. A relative, according to section 1 of the Income Tax Act, is defined as:

- one's spouse;
- anybody related to one within three degrees of consanguinity;
- the spouse of anybody related to one within three degrees of consanguinity;
- anybody related to one's spouse within three degrees of consanguinity; or
- the spouse of anybody related to one's spouse within 3 degrees of consanguinity.[133]

In addition to a relative, a connected person in relation to a natural person also includes any trust that the natural person in question, or that natural person's relative, is a beneficiary of.

Although the definition only lists a relative and certain trusts as constituting connected persons in relation to a natural person, these are not the only types of persons that can be connected to a natural person, because of paragraph (e) of the definition.[134]

When one reads paragraph (d)(iv), which states *inter alia* that any person that holds at least 20% equity shares or voting rights in a company is connected to that company, together with paragraph (e), the definition provides that a company can also be a connected person in relation to a natural person.

A company can also be regarded as a connected person in relation to a natural person by virtue of paragraph (bA), which also has an influence on who can constitute

[133] Def of "relative" in s 1 of the Income Tax Act.
[134] AP de Koker & RC Williams *Silke on South African income tax* (2018) 1.18.

a connected person in relation to a natural person. This paragraph essentially provides that all connected persons in relation to a particular trust are also connected persons in relation to each other. This means that if a trust and a company are connected by virtue of the applicability of paragraph (d)(iv) [that is, the trust holds at least 20% shareholding in the company] read with paragraph (e), then all of the beneficiaries of that trust will also be regarded as connected persons in relation to that company (and *vice versa*).

3.2.3.2 In relation to a trust

Paragraph (b) provides that a **beneficiary** of a trust will constitute a connected person in relation to that trust. Secondly, any connected person of that beneficiary[135] will also be a connected person in relation to the trust. Should the beneficiary of the trust be a natural person, then any connected person in relation to that natural person (as discussed above) will also be connected to the trust. Should the beneficiary be a company, then any person connected to that company will also be connected to the trust (connected persons in relation to a company is addressed below).

3.2.3.3 In relation to a member of any partnership

Paragraph (c) provides that a connected person in relation to a partner of a partnership is any other partner of the partnership (X), as well as any connected persons in relation to X. This paragraph of the definition is relatively straightforward, however, the definition of a connected person can get somewhat convoluted and stretched when one reads paragraph (c)(ii) together with paragraph (bA), as will be discussed later in this chapter.

3.2.3.4 In relation to a company

3.2.3.4.1 Individuals and trusts – (d)(iv)

An individual or a trust will be regarded as a connected person in relation to a company if such individual or trust individually (or jointly with such person's connected

[135] Regarding a beneficiary that is a natural person, see the above paragraph dealing with connected persons in relation to a natural person for further information.

persons) holds, directly or indirectly, at least 20% of the equity shares or voting rights in the tested company.

3.2.3.4.2 Companies: Groups – (d)(i)

The first person to be defined as a connected person in relation to a company is any other company that forms part of the same group of companies as defined.[136] The definition of a group of companies, however, is altered when read with paragraph (d)(i).[137] A group of companies in this context is therefore defined as two or more companies where at least 50% of the equity shares or voting rights in each subsidiary company is held directly by the parent company, or held by one or more other subsidiary company, or is held in combination by the parent company and its subsidiaries. Put differently, "B will be regarded as a connected person in relation to A if a controlling group company (that is, a parent company) holds more than 50% of the equity share capital of each A and B."[138] A and B will also be connected.[139]

The wording of the definition of a group of companies seems to indicate that one must add the shares and voting rights held by the parent company and the subsidiary companies to determine whether or not the 50% threshold is met. Such an interpretation is consistent with the SARS Interpretation Note 67 (issue 4), which provides that "the calculation is not based on the determination of an effective percentage interest."[140] For example, consider a hypothetical set of facts where a parent company holds 66.67% equity and voting rights in a subsidiary company. If the

---

[136] Section 1 of the Income Tax Act defines a "group of companies" as "two or more companies in which one company (the 'controlling group company') directly or indirectly holds shares in at least one other company (the 'controlled group company'), to the extent that –

(a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

(b) the controlling group company directly holds at least 70 percent of the equity shares in at least one controlled group company;"

[137] The phrase "at least 70 percent of the equity shares" in the definition of "group of companies" is to be repealed and replaced by the phrase "more than 50 percent of the equity share or voting rights".

[138] De Koker & Williams *Silke* 1.18.

[139] 1.18.

[140] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 16.

parent company directly holds 25% in company X and the subsidiary company directly holds 30% in company X, then in terms of subsection (d)(i) of the connected person definition, company X will constitute a connected person by virtue of forming part of the parent company and subsidiary company's group of companies. This is because the parent and subsidiary company together hold 55% in company X, which exceeds the threshold of the "group of companies" definition for purposes of the "connected person" definition. The fact that the parent company directly holds 45% shareholding in company X is irrelevant for purposes of determining whether company X is a group company for purposes of establishing whether the connected person definition has been triggered.

3. 2. 3. 4. 3 Equity shares – (d)(v)

Paragraph (d)(v) also defines a company as a connected person in relation to any other company that holds at least 20% of the equity shares[141] or voting rights in the tested company <u>and no holder of shares holds the majority voting rights in the company</u>.[142] One of the two most pertinent issues to note on this point is that section 31 of the Income Tax Act provides that, for the purposes of section 31, the wording underlined above, which appears in paragraph (d)(v) of the definition of a connected person, is to be disregarded where the tested transaction consists of the granting of financial assistance or intellectual property as defined in section 23I(1), or knowledge.[143] The second point to note is that in determining the 20% threshold, only direct shareholding is to be considered.[144]

---

[141] Section 1 defines an equity share as any share in a company, excluding any share that, neither as respects dividends nor as respects return of capital, carries any right to participate beyond a specified amount in a distribution. Put differently, as long as a shareholder's right to participate in dividend or capital distributions, the share will constitute an equity share.

[142] Section 31(4) of the Income Tax Act provides that the phrase "and no holder of shares holds the majority voting rights in the company" contained in the definition of connected person is to be disregarded for purposes of determining whether a connected person relationship exists in respect of the granting of financial assistance, intellectual property or knowledge.

[143] According to page 34 of the SARS Explanatory Memorandum to Taxation Law Amendment Bill 2007, the reason for the reduced threshold for the scope of the connected person definition in relation to financial assistance or IP transactions is because these transactions have been identified as being at higher risk of being used from tax avoidance purposes.

[144] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 26.

3.2.3.4.4 Companies: Managed or controlled – (d)(vA)

Additionally, subparagraph (vA)(aa) provides that a company ("Y") is a connected person in relation to another company ("X") if Y is managed or controlled by a connected person in relation to X. Company Y is therefore connected to company X if company Y is managed or controlled by:

- a "holder" (that is; individual or trust) with 20% shareholding in company X;
- a trust if company X is a trust beneficiary;
- any connected person in relation to a trust that company X is also connected to;
- a group company in relation to company X; or
- another company with 20% shareholding in company X to the extent that no other holder of shares holds the majority voting rights in company X.

Lastly, subparagraph (vA)(bb) provides that company Y is a connected person in relation to company X if a connected person in relation to company X's connected person manages or controls company Y. This subparagraph can be put in the following simple terms:

> "X is a connected person in relation to Company A
> Y manages or controls Company B
> Y is a connected person in relation to X
> Company B is therefore a connected person in relation to Company A"[145]

This subparagraph extends the connected person net to companies that are managed or controlled by persons that are connected to each other. For example, two relatives (X and Y) are the sole shareholders and directors of their own respective companies (A and B). According to subparagraph (vA)(bb), A and B are connected persons in relation to each other.

---

[145] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 28.

3. 2. 3. 4. 5 The meaning of "managed or controlled"

In *ITC 1741*,[146] the court considered the meaning of "connected person" as per section 12C(6)(a)(i) of the Income Tax Act as it was at that time. The definition provided that "a connected person in relation to a company includes any other company if both such companies are **controlled** or owned directly or indirectly by the same persons."[147]

Although not exactly the same as the current definition, the current definition also refers to a connected person in relation to a company as being another company that is **controlled** by a connected person of that first-mentioned company. Although the old definition of a connected person has since been amended, I am of the view that the term "controlled" was used in the same context as the current definition of a connected person (being that the action of control was indicative of a connected person relationship). Therefore, it is submitted that any judgments dealing with the meaning of the term "controlled" as per the old definition of a connected person are still of relevance today.

In *ITC 1741*, company X and company Y were not commonly owned. The only question that the court was therefore left to consider was whether the same persons controlled X and Y. In this matter, each company had its own board of directors. Despite company X and company Y having their own respective boards, in substance control of company X was exercised by company X's board of directors (with the exclusion of Mr C who, despite being a director, did not have any power). On the other hand, although the board of directors of company Y had the legal ability to control company Y, it was not, in fact, controlling the company. "Mr C was a domineering presence who effectively made all the decisions and informed everyone afterwards. He controlled the company (that is; company Y) and the input from fellow directors, if any, was limited to that of a consulting nature."[148]

After considering the case of *S v Pouroulis*,[149] the court came to the conclusion that, in the absence of a statutory definition of "control" (or any other contradictory indicators), the ordinary meaning is to be ascribed to the term "control". On this point,

---

[146] 65 SATC 106.

[147] As the sections read in 1992.

[148] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 32.

[149] 1993 4 SA 575 (W).

the court concluded that control refers to *de facto* control, in other words, factual control rather than some form of control in the legal sense. One must, therefore, establish how the entity in question is controlled, as well as how this method of control is effectively exercised.[150] In practice, the business and affairs of a company must be managed by or under the direction of its board.[151] However, establishing who has *de facto* control of an entity will need to be decided on a case by case basis, based on the relevant facts.

As mentioned earlier, in *ITC 1741* the court held that, despite company Y having its own board of directors that were able to control the company, Mr C was effectively in control of company Y since Mr C made all the decisions and informed the board thereafter.[152] From this case, it can be deduced that effective control will give rise to a *de facto* control relationship, regardless of whether or not the person exercising effective control has control in the legal sense. Put differently, where a person has *carte blanche* to run a company, the company will be *de facto* controlled by that person.[153]

For example, a CEO of two different companies may not have control over the two different companies in a legal sense, given that the CEO holds less than a controlling share of equity or voting rights in both companies, and is not the sole board member of the companies. Nevertheless, if the CEO is a domineering presence that effectively makes all the decisions of both companies, then such CEO will be in *de facto* control over both companies.

Considering the broad scope of *de facto* control, it seems more likely than not that any minority shareholder may even potentially be the person that effectively makes all the decisions of the company, thereby resulting in that company being *de facto* controlled by that particular minority shareholder (regardless of whether the quantitative threshold of 20% for individuals or 50% for group companies, in equity shares or voting rights is met). An example of how a minority shareholder may exercise *de facto* control is if that shareholder has the majority voting rights at a specific

[150] *ITC 1054* 26 SATC 260 263, *Estate Kootcher v CIR* 1941 AD 256 301.
[151] Section 66 of the Companies Act 71 of 2008.
[152] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 29.
[153] SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 29.

shareholders meeting where certain decisions are made regarding the acquisition or disposal of assets, or to incur a liability.

Some professionals in practice are of the view that control is wide enough to include exclusive distribution rights or offtake arrangements. In cases where this is the extent of the relationship, it is respectfully submitted that such contracting parties cannot constitute a connected person by virtue of *de facto* control. This submission is based on the premise that the person entering into an agreement with the company does not factually have *carte blanche* to run the company. Of course, such commercial arrangement may influence the persons that run the company, however, that does not result in the "influencer" running the company (and thereby being in *de facto* control thereof). The person who runs the company cannot be said to have relinquished itself from running the company and having given the "influencer" *carte blanche* to run the company. The company's actions remain the result of the actions of the person who runs the company, not the person who influences that person who runs the company. The same can be said about creditors of a company; they may influence the person who runs the company by way of contractual rights entitling the lender to restrict the decisions of the borrower, but that does not *per se* give rise to the creditor running the company. Academics have also opined that mere economic dominance or dependence deriving from commercial relationships originating from *de facto* situations should not be confused with control.[154]

On the other hand, where a company gives an independent creditor (by way of an amendment to the document regulating that borrowing company)[155] the power to veto any decisions pertaining to the company's capital expenditure or acquisitions, the incurral of further debt or any other material arrangement, it could be argued that such powers conferred upon the creditor in terms of the document regulating that borrowing company gives rise to a *de facto* controlling relationship in the narrow sense.

Although the SARS' interpretation note discusses the term "managed" separately to the term "controlled", and states that the term "managed" is very broad, the

[154] Dwarkasing *Associated Enterprises* 237.

[155] The question whether amending the document regulating that borrowing company to cater for the lender in such manner is a question of company law, which falls outside the scope of this dissertation. To the extent that the document regulating that borrowing company remains unchanged, and the lender relies on a contractual right instead, then such a lender relationship will arguably not constitute *de facto* control in the narrow sense.

interpretation note gives the impression that the term "managed" also generally requires one to look at the board level of the company. The difference between the two terms may perhaps be that management is of a lower bar or threshold than control, in other words, mere participation in the management functions at board level (rather than control at board level) may suffice.

3.2.3.5 In relation to a close corporation ("CC")

Subparagraph (d)(vi) contains the definition of a connected person in relation to a CC, which has also been divided into three subparagraphs.

Subparagraph (d)(vi)(aa) provides that a connected person in relation to a CC is any member of that CC.

Subparagraph (bb) is essentially divisible in the sense that it provides for two types of parties that are defined as a connected person in relation to a CC. First, it provides that any relative of a member is connected to the CC. Second, it provides that any trust that is a connected person in relation to a member is connected to the CC.

Subparagraph (cc) of the definition provides that a connected person in relation to a CC also includes any other CC or company that is connected person in relation to a member of the CC, or that is connected to a trust which is connected to a member of the CC.

Subparagraph (cc)(ii) is also divisible. The second part of the subsection has been discussed above (that is; any CC or company that is a connected person in relation to a trust that is connected to a member). The first part provides that any CC or company ("Y") that is a connected person in relation to a relative of a member of the CC ("X") is a connected person in relation to that CC (X).

Subparagraphs (bb), (cc)(i) and the second part of (cc)(ii) essentially provide that a connected person in relation to a member is a connected person to the CC. Although these subparagraphs do not provide so entirely because they do not mention partners of a partnership, subparagraph (c)(ii) provides that any connected person in relation to a partner is connected to any other partner. If one partner is a member of a CC, then such CC is connected to that partner. By virtue of this subparagraph, read with paragraph (e), a CC is connected to a partner of any member from the CC. I, therefore, submit that it is correct to say that a connected person in relation to a CC includes any connected person in relation to a member of that CC.

3.2.3.6 In relation to a connected person of a trust

Paragraph (bA) to the definition is somewhat unique in the sense that it defines two persons as being connected to one another if both persons are connected to a mutual trust. This part of the definition appears relatively broad because it seems to cater for particular cases where no direct relationship exists between the parties. For example, a trust that was formed to benefit Black Economic Empowerment ("BEE") shareholders may have numerous beneficiaries. Two of the beneficiaries (X and Y), who are unrelated to one another, are each the sole shareholder of his or her own company. According to paragraph (bA), these two companies will be regarded as connected persons in relation to each other, which is not generally provided for under paragraph (d). This broad paragraph may be seen as giving rise to harsh results in cases where X and Y are not acquainted with one another (ie; where X and Y are at arm's length) and their companies begin trading with one another.

Paragraph (bA) clearly gives rise to a broad definition of the term connected person. This is evident if one reads paragraph (c)(ii) together with paragraph (bA), which is best illustrated by way of an example:

- A and B are partners of a partnership that provides professional services. This means that A and B are connected persons to one another in terms of paragraph (c)(i).
- B is married to C. This means that B and C are connected persons in terms of paragraph (a)(i).
- C is a beneficiary of Trust Y. C and Y are therefore connected in terms of paragraph (b)(i), and B and Y are connected in terms of paragraph (b)(ii).
- Company X is also a beneficiary of Trust Y. X is therefore connected to Y in terms of paragraph (b)(i).
- Trust Y holds 20% of the equity shares and voting rights in Company Z and no holder of shares holds the majority voting rights. Y is therefore connected to Z in terms of paragraph (d)(v).
- A is therefore connected to X, as well as Z, in terms of paragraph (c)(ii) read with (bA).

Although such broad definitions may be beneficial when utilised for anti-avoidance provisions, it may give rise to detrimental consequences to unknowing parties transacting with each other (and unknowing third parties utilising data from such transaction for benchmarking purposes) when used for transfer pricing purposes. The example above illustrates this point well. If A were to enter into a transaction with X or Z, then such transactions would not be considered to be of an arm's length nature. This would mean that the pricing data from such transactions would not be able to be utilised as an internal comparable by either party, nor would a third party be able to utilise such data for benchmarking purposes, and the transactions would be subject to section 31 of the Act, provided that the international element is also present. These consequences would arise regardless of whether or not A even knew of Y's existence and of Y's connection to B, X and Z.

As is evident from the above, this paragraph creates a considerably wide definition of a connected person. On the face of it, it would seem that the connection that gives rise to a connected party relationship in terms of this paragraph could be considerably extensive. The connections may even be so stretched that one may even question whether parties that meet the definition of a connected person in terms of this paragraph are not in the substance of an arm's length to one another.

3.2.3.7 In relation to transactions in respect of the granting of financial assistance, intellectual property or knowledge

Section 31(4) of The Income Tax Act provides that the phrase "and no holder of shares holds the majority voting rights in the company" contained in subparagraph (d)(v) of the definition of "connected person" is to be disregarded for purposes of determining whether a connected person relationship exists in respect of the granting of financial assistance, intellectual property or knowledge. One issue that requires clarification is whether this reduced threshold for the applicability of the arm's length principle in terms of section 31 of the Income Tax Act will only be in respect of financial assistance, intellectual property or granting of knowledge transactions, or whether the reduced threshold will apply to all transactions in cases where at least one of the transactions pertain to the granting of financial assistance, intellectual property of knowledge. Lermer and Van Rhyn have previously stated that "in line with the global trend of tax authorities to vigilantly scrutinize [*inter alia*] royalty payments from a transfer pricing perspective, the National Treasury and SARS are actively endeavouring to discourage 'abusive' schemes involving [*inter alia*] intellectual property."[156] Lermer and Van Rhyn go on to conclude that it is for this purpose that the scope of the transfer pricing legislation relating to *inter alia* intellectual property transactions was extended.[157] Lermer and Van Rhyn state that the extended scope is only intended to apply in the context of the transactions that have been identified as requiring further discouragement due to such transactions being considered to be enabling "abusive" schemes.[158] The extension of the scope of section 31 will therefore not apply to all a person's transactions if that person has entered into a transaction pertaining to financial assistance, intellectual property or granting of knowledge. The scope of section 31 of the Income Tax Act will therefore not be extended to that person's other transactions that do not consist of financial assistance, intellectual property or granting of knowledge.

3.2.3.8 Amendment to section 31

On 15 January 2020, the Tax Law Amendment Act 34 of 2019 was promulgated. This Amendment Act amended *inter alia* the definition of "affected transaction" in section 31 of the Income Tax Act. The amendment was initially meant to commence on 1 January 2021, however, it has been proposed in the Tax Law Amendment Bill of 2020 that this date be delayed to 1 January 2022.

The Amendment Act amended the "affected transaction" definition by substituting the phrase "**and those persons are connected persons in relation to one another"** with the phrase "**and those persons are connected persons <u>or associated enterprises</u> in relation to one another."**[159]

---

[156] J van Rhyn & D Lermer "Recent transfer pricing developments" (2008) 5 *International Transfer Pricing Journal* 230.

[157] 230.

[158] 230.

[159] SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 41 <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2020-01%20-%20Explanatory%20Memorandum%20on%20the%20TLAB%20of%202019.pdf> (accessed 20-04-2020).

The Explanatory Memorandum to the Bill that ultimately derived into the Amendment Act provides the following reason for the inclusion of the term "associated enterprises" to the "affected transaction" definition.

> "Both the OECD and UN use the concept of "associated enterprises" when applying the arm's length principle, […] On the other hand, South Africa still uses the concept of "connected persons" when applying the arm's length principle. The fact that South Africa does not have or use the concept of associated enterprises when applying the arm's length principle presents a challenge in application of the transfer pricing rules in respect of transactions between "associated enterprises" that are not regarded connected persons."[160]

The Explanatory Memorandum goes on to provide that:

> "[i]n order to address this anomaly, it is proposed that changes be made in section 31 of the Act so that the scope of the transfer pricing rules be extended to also include transactions between persons that are not connected persons, but that are "associated enterprises" as described in Article 9(1) of the MTC on Income and on Capital of the OECD."[161]

The fundamental point that needs to be addressed is that the Explanatory Memorandum suggests that the term "associated enterprise" is broader than the term "connected person". Given the low shareholding or voting rights threshold of 20% that is provided for by the connected person definition, it is argued later in chapter 3.2.4 read together with chapter 4.6 that it is unlikely that the term "associated enterprise" is broader than the term "connected person". Consequently, it appears that SARS' explanation for the amendment to section 31 of the Income Tax Act is flawed.

Lastly, SARS explains the reason for the effective date of the amendment being delayed until 1 January 2021, stating that "[i]n order to give SARS and taxpayers more time to consider the interpretation of the term "associated enterprise", it is proposed that the effective date of this provision be postponed by a year, from 1 January 2020

---

[160] SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 41.

[161] SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 42.

to 1 January 2021."[162] It has been proposed in the Tax Law Amendment Bill of 2020 that this date be delayed until 1 January 2022.

Based on the discussion above regarding SARS' flawed reasoning for amending section 31 of the Income Tax Act, it appears that SARS is under the erroneous impression that the term "associated enterprise" is broader than the term "connected person." Given that the term "associated enterprise" is not broader than the term "connected person,"[163] the amendment to section 31 of the Income Tax Act will in all likelihood have no effect on the scope of the application of the arm's length principle contained in section 31 of the Income Tax Act.

This amendment will also not mitigate the possibility of economic double taxation arising in cases where the non-SA party to the transaction is resident in a contracting state that SA does not have a DTA with, because both contracting states will still be applying a unilateral approach (which may differ to that taken by the other relevant contracting state) to determining the applicability of the arm's length principle.

3.2.4 Concluding remarks on the South African definition of a connected person

One can see that, although the definition of a connected person, as per section 1 of the Income Tax Act, provides for separate definitions of a connected person in relation to each different type of person as defined by the Act (as well as in relation to a partnership), the definition should be read as a whole. One would be left with an incomplete definition if one were to read only portions of the definition in isolation. For example, paragraph (a) does not list a company as a possible connected person in relation to a natural person. However, paragraph (d)(iv) read with paragraph (e), do. It is therefore crucial that one always reads the definition in its entirety. Another clear takeaway that needs to be noted is that a connected person is very widely defined, to the point where parties may not even be aware of an existing connected person relationship. The implication is that parties may be unaware that they are connected parties and that their transactions need to conform with the arm's length principle. In

[162] SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 42.

[163] The reasons for concluding that the term "associated enterprise" is narrower than the term "connected person" is deduced from the analysis of the interpretation of the two terms under chapters 4 and 3 respectively.

such instance, however, the parties most likely did transact with each other on an arm's length basis. The more onerous consequence of the broad definition of a connected person is the compliance obligations that arise from entering into an affected transaction.

3.3 India

Unlike SA, India does utilise the term "associated enterprise" in its domestic legislation.

3.3.1 Domestic trigger for a possible transfer pricing adjustment

Section 92(1) read with section 92B of the Indian Income Tax Act 43 of 1961 provides for the trigger of a possible transfer pricing adjustment. Section 92(1) provides that "any income arising from an international transaction shall be computed having regard to the arm's length price." The definition of an international transaction is found in section 92B, which provides *inter alia* that an "international transaction" is a transaction between at least two "associated enterprises".

When read together, these sections clearly indicate that the term "associated enterprise" is utilised to govern the application of transfer pricing legislation.

3.3.2 Domestic definition of associated enterprise

The domestic definition will be provided below, which will be followed by a brief analysis thereof. Section 92A of the Indian Act defines an associated enterprise as follows:

> "(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise—
>
> (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
>
> (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed."

Subsection (1) of the definition appears extremely broad as it provides that all persons that participate in the control, management, or the capital of a company are an associated enterprise in relation to that company. It also expressly provides that two entities will be associated with each other in situations where the same person participates in both those entities' capital, management, or control.

The level of participation in the capital required for an associated enterprise to exist is not mentioned in subsection (1). Subsection (2) of the Act, however, seems to provide clarity on this point. The relevant portion provides as follows:

> "For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises."

The phrase "*for the purpose of subsection (1)*" shows that subsection (2) sets the parameters, such as degree of participation in capital, or management, which must be met in order for an associated enterprise to exist.[164] This is also of assistance in giving context to what constitutes "control," since the term is not defined in the Act.

As regards the level of participation in capital that is required, subsection (a) provides that the level of participation in capital required for an associated enterprise relationship to exist is 26%. On the other hand, subsection (l) provides that an enterprise only needs a 10% interest in a firm in order for that enterprise to constitute an associated enterprise in relation to that firm (that is, a partnership).[165]

In regards to the degree of participation in management that is required, subparagraph (e) indicates that one enterprise is connected to another if more than half of the board of directors, or at least one executive director of an enterprise is appointed by that first-mentioned enterprise. Furthermore, subparagraph (f) provides that two enterprises are associated with one another if a mutual person appoints half

[164] CBDT Circular 14 of 2001 – New legislation to curb tax avoidance by abuse of transfer pricing – Appendix C.
[165] Section 2 of the Partnership Act 9 of 1932.

of their board of directors or appoints at least one executive director for both enterprises.

3.3.3 Domestic relevance of the term "control"

I am of the view that subsections (c),[166] (d),[167] (g)[168] and (h)[169] are indicative of dependency. Since subsection (2) is to give context to subsection (1), it seems as though the only logical conclusion one can reach, by process of elimination, is that subsections (c), (d), (g) and (h) may be contextualising what constitutes control.

Subsections (j) and (k) essentially provide that two enterprises are associated to each other if they are both controlled by the same individual(s), or by the same Hindu family share, or one enterprise is controlled by an individual and the other is controlled by that individual's relative. These two subsections also certainly belong to the "control" category. It is unfortunate, however, that they do not give context to what constitutes "control".

Subsection (m) provides that two enterprises are associated with one another if any relationship of mutual interest, as may be prescribed, exists between them. I am of the view that subsection (m) can only be regarded as a "catch-all" subsection, which does not give context to management, control or the necessary participation in capital needed to trigger an associated enterprise.

Additionally, subsection (i)[170] also does not appear to contextualise management, control, or the level of participation in capital required for an associated enterprise

---

[166] Subsection (c) provides that an enterprise is associated to another if that first-mentioned enterprise extends a loan of at least 51 per cent of the other enterprise's book value.

[167] Subsection (d) provides that two enterprises are associated to each other if one enterprise guarantees at least 10 per cent of the other enterprise's total borrowings.

[168] Subsection (g) provides that two enterprises are associated to each other if the manufacture of goods carried out by one enterprise is wholly dependent on the IP of the other enterprise.

[169] Subsection (h) provides that two enterprises are associated to each other if at least 90 per cent of the materials required for the manufacture of goods by one enterprise are supplied by the other enterprise.

[170] Subsection (i) provides that two enterprises are associated to each other if the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise.

relationship to exist. It may therefore arguably also be considered an additional "catch-all" subsection.

3.3.4 Comparative analysis in relation to South Africa

The first difference one notices is that, unlike SA, India does not divide the definition in such a way that it defines an associated person in relation to different types of legal persons (including partnerships).

One of the most notable differences between the Indian definition of an associated enterprise and SA's definition of a connected person is that SA's definition does not contain provisions similar to India's "dependency" provisions (which could arguably fall within the ambit of "influencers" as referred to in the South African section of this chapter).

The two most important differences that need to be highlighted are, firstly, that the level of participation required by a company in India (that is, 26%) is less than what is required for a connected person relationship to exist in SA (that is, more than 50%, to the extent that the arrangement does not pertain to financial assistance or IP).[171] Secondly, India includes certain forms of *de facto* control in the broad sense[172] in their definition, while SA arguably interprets "control" as *de facto* control in the narrow sense.

3.4 United Kingdom

As is the case with SA, the UK does not utilise the term "associated enterprise" in its domestic legislation. Instead, the UK's primary transfer pricing legislation requires a "participation condition" to be met in order for any transfer pricing provisions to be triggered.

[171] An exception to this "more than 50 percent" participation requirement would be instances where no holder of shares holds the majority voting rights. In such instance, the "more than 50 percent" participation requirement is reduced to 20%.

[172] Reference to de facto control in the broad sense is a misnomer in the sense that it does not refer to real control. Instead, it refers to mere economic dominance or dependence deriving from commercial relationships originating from de facto situations. For the sake of brevity, this dissertation will refer to this concept as de facto control in the broad sense.

3.4.1 Trigger for the applicability of transfer pricing adjustment

Section 147(3) and (5) of the Taxation (International and Other Provisions) Act of 2010 ("TIOPA") are the domestic subsections that provide for the applicability of the arm's length principle. In other words, these provisions provide that the profits and/or losses of the contracting parties are to be calculated for tax purposes as if the contract was entered into at an arm's length.

Subsections (2) and (4) provide the requirements for the applicability of subsections (3) and (5), which are twofold. First, the "basic pre-condition" must be met. Second, the transaction must give rise to a potential UK tax advantage.

The definition of the "basic pre-condition" is found in subsection (1), which is defined as follows:

> "(a) provision ("the actual provision") has been made or imposed as between any two persons ("the affected persons") by means of a transaction or series of transactions,
> (b) the participation condition is met (see section 148),
> (c) the actual provision is not within subsection (7) (oil transactions), and
> (d) the actual provision differs from the provision ("the arm's length provision") which would have been made as between independent enterprises."

It appears that the term is somewhat of a misnomer in the sense that there are four pre-conditions (not merely one pre-condition). The most important of which, for purposes of this study, is the "participation condition". This is because if this condition is not met then it is meaningless to examine whether or not the pre-conditions of (a) and (d) were met. In other words, meeting the participation condition is the essential trigger that can cause the domino effect of opening the door to the arm's length principle (that is; subsections (3) and (5)) via their respective triggers (that is; subsections (2) and (4)).

3.4.2 Definition of "participation condition"

Section 148 of TIOPA defines the participation condition as follows:

> "(1) For the purposes of section 147(1)(b), the participation condition is met if—
> (a) condition A is met in relation to the actual provision so far as the actual provision is provision relating to financing arrangements, and
> (b) condition B is met in relation to the actual provision so far as the actual provision is not provision relating to financing arrangements.

(2) Condition A is that, at the time of the making or imposition of the actual provision or within the period of six months beginning with the day on which the actual provision was made or imposed—
   (a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or
   (b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(3) Condition B is that, at the time of the making or imposition of the actual provision—
   (a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or
   (b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(4) In this section "financing arrangements" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

(5) For the interpretation of subsections (2) and (3) see sections 157 to 163."

3.4.2.1 Analysis of section 148 (the participation condition)

One can see that section 148 is divided into two parts. One part caters for "financial arrangements", and the other part caters for arrangements that are not financial arrangements ("general arrangements"). The condition that needs to be met in order for the participation condition to be met for both arrangements is relatively similar,[173] which is that "one of the affected persons was directly or indirectly participating in the management, control or capital of the other,"[174] or a mutual person(s) directly or indirectly participated in the management, control or capital of both affected persons.[175] The participation condition and the OECD MTC definition of an associated enterprise appear very similar, which may ultimately mean that one may be able to glean from the definition of the participating condition in order to gain insight into interpreting the OECD MTC definition of an associated enterprise.[176]

[173] The only material difference is that the condition must be met at the time of the provision being entered into when pertaining to general arrangements, whereas the condition can be met at any time within 6 months of the provision being entered into when pertaining to financial arrangements.

[174] Sections 148(2)(a) and 148(3)(a) of the TIOPA.

[175] Section 148(2)(b) and 148(3)(b).

[176] See chapter 4 of this dissertation for further details on interpreting the OECD MTC definition of an associated enterprise.

3.4.3 Provision

The "participation condition" definition refers to "provisions," which is undefined. According to HMRC's Commentary,[177] the term is synonymous to the phrase "conditions made or imposed", as can be found in Article 9 of the OECD MTC. HMRC's Commentary emphasises that such an interpretation is consistent with the entirety of the Act, which requires this part of the Act to be interpreted following OECD principles.[178]

3.4.3.1 Provisions between affected persons in cases where an independent party is interposed in the transaction

It appears that the provision does not necessarily have to be entered into directly with the affected persons that are under common control in order for the transaction to fall within the scope of the participation condition. Further guidance on this point can be found in the case of *DSG Retail Ltd v HMRC*,[179] which dealt with reinsurance arrangements for extended warranties on household electronic goods. The DSG Group would utilise its UK resident group entities ("the UK group entities") to sell extended warranties to customers in the UK. The UK group entities would then obtain insurance cover on the extended warranties, which would be covered by an independent third party ("ASL"). ASL would then reinsure the risk on those extended warranties with another entity that was part of the DSG Group ("DISL"), which was a resident of the Isle of Man.

Although there were no transactions that took place directly between the associated entities, "the various entities knew that the different agreements would all take effect together, …[and] were … interdependent."[180] Put differently, "[t]he contract with the 'fronter' would not have been entered into unless the 'fronter' would reinsure with the connected company."[181] This case therefore clearly shows that a provision may exist between two affected persons even where an independent third party has been

[177] INTM 412050: Transfer pricing: legislation: rules: meaning of "provision" and "transaction" <https://library.croneri.co.uk/cch_uk/irm/intm-intm412050> (accessed 06-09-2020).
[178] Section 164 of TIOPA.
[179] [2009] STC (SCD) 397.
[180] INTM412050: Transfer pricing: legislation: rules: meaning of "provision" and "transaction".
[181] INTM412050: Transfer pricing: legislation: rules: meaning of "provision" and "transaction".

interposed in-between the affected persons' transaction in the aim of facilitating the avoidance of the transaction falling within the net of a "provision," thereby circumventing the application of the UK's transfer pricing legislation.

3.4.4 Domestic relevance of the term "control"

The participation condition requires that "one of the affected persons was directly or indirectly participating in the management, control or capital of the other." Control is, therefore, a fundamental requirement to trigger a possible transfer pricing adjustment.

The terms "capital" and "management" seem relatively trite and are therefore not addressed further. The term "control", on the other hand, requires further analysis in order to digest its meaning.

3.4.4.1 Control

TIOPA, fortunately, defines the term under section 217, which cross-references the term "control" as contained in section 1124 of the Corporation Tax Act 2010. Section 1124 provides the following:

> "(2) In relation to a body corporate ("company A"), "control" means the power of a person ("P") to secure—
>
> (a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or
>
> (b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate,
>
> that the affairs of company A are conducted in accordance with P's wishes.
>
> (3) In relation to a partnership, "control" means the right to a share of more than half the assets, or of more than half the income, of the partnership."

The form of control envisioned by subsection (2)(a) of the definition appears to be limited to control in the form of shareholding or management. There does not, however, appear to be a limitation in subsection (2)(b) as to what form of control must exist but rather the method of its inception (that is; as a result of any powers conferred by the articles of association or other document regulating that company). Any form of control arising from such documents mentioned in subsection (2)(b) will, therefore, trigger the control definition. An example of a form of control arising in such manner other than control in the form of management, albeit controversial, may be where a company borrows funds from a lender, to the extent that such funding is subject to the lender being given the power to approve or deny any financial proposals[182] made by the board of the borrowing company in terms of the document regulating that borrowing company.[183]

Subsection (3) exclusively caters for partnerships and appears to provide that any partner of that partnership that is entitled to more than half the share of the partnership is considered to control that partnership.

3.4.4.2 Degree of participation required

Sections 157 to 163 define what constitutes <u>participation</u> in the management, control or capital.[184] These sections therefore describe the level, or degree, of participation, required. Additionally, HMRC's Commentary notes that these sections also "set out rules that attribute rights and powers to a person when considering whether that person controls a company or partnership."[185]

Section 157 defines direct participation as follows:

> "(2) a person is directly participating in the management, control or capital of another person at a particular time if (and only if) that other person is at that time –
> (a) a body corporate or a firm, and
> (b) controlled by the first person."

This subsection may possibly shed light on the entire issue that this dissertation addresses (that is; what does "participation in management, capital or control" mean), because the UK legislation actually defines the phrase "participating in the

---

[182] Such as any decisions pertaining to the company's capital expenditure or acquisitions, the incurral of further debt or any other material arrangement.

[183] The question whether amending the document regulating that borrowing company to cater for the lender in such manner is a question of company law, which falls outside the scope of this dissertation. To the extent that the document regulating that borrowing company remains unchanged, and the lender relies on a contractual right instead, then such a lender relationship will arguably not constitute *de facto* control in the narrow sense.

[184] INTM412060: Transfer pricing: legislation: rules: participation in the management, control or capital of a person available <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412060> (accessed 06-09-2020).

[185] INTM412060: Transfer pricing: legislation: rules: participation in the management, control or capital of a person.

management, control or capital," which is the exact phrase that is used in Article 9 of the OECD MTC.

What is clear from section 157(2) is that in order for one to constitute an associated enterprise in relation to a company, the level of participation required in the management or capital of such company must be to such extent that one controls that company (that is, when one has the power to secure that the affairs of the company are conducted in accordance with one's wishes). The power to secure that the company is conducted in accordance with one's wishes would generally require one to hold more than 50% participation in management, or of the share capital (together with an equivalent percentage of voting rights).

Although not crucial to this dissertation, it appears that the domestic definition of control, read together with section 157 (which defines direct participation) appears to give rise to some redundancies. The definition of control provides that control exists when a person has the power to secure that the affairs of the company in question are conducted in accordance with that person's wishes, either by means of the <u>holding of shares</u>, or as a result of any powers conferred by the articles of association or other document regulating that company (which is generally, but not always, power in the form of <u>management</u> via the board of directors). The definition of control contained in section 1124(2) of the Corporation Tax Act of 2010 therefore already appears to contain a participation requirement both in the form of shareholding or in management (or some other form of control arising from such documents mentioned in subsection (2)(b)).

The similarity between the wording of Article 9 of the OECD MTC and the UK transfer pricing legislation is indicative of an identical intention. Considering this, it seems appropriate to glean from the interpretive aids (such as the definition of direct participation) when interpreting the meaning of Article 9. In summary, it seems that an argument could be made that the phrase "participate directly … in the management, … or capital of an enterprise" should be interpreted in a manner similar to section 157(2)(b) of TIOPA (that is; direct participation in management or capital is to mean participation in management or capital to such extent that the participant has control over that entity). This argument is further elaborated on in chapter 4 of this dissertation.

Section 158 explains how one must read the definition of indirect participation. It provides, firstly, that, for the purposes of sections 148(2)(a) and (3)(a) (that is, the requirement that one of the affected persons was controlling the other), indirect participation exists if section 159, 160 or 161 provides for it. Secondly, it provides that for the purposes of sections 148(2)(b) and (3)(b) (that is; the alternative requirement that the same person(s) control both affected persons), indirect participation exists if section 159, 160 or 162 provides for it. Sections 159 and 160, therefore, apply to both requirements, while section 161 and 162 only apply to one alternative requirement.

3.4.4.3 Attribution rules (section 159)

Section 159(2) appears to provide that certain rights are to be attributed to a person when determining whether or not that person controls another person. Subsection (3) goes on to list the rights that are to be attributed to that person. Subsections (3)(a) and (b) attribute future rights that a person is entitled or will become entitled to acquire. Subsection (d) attributes rights of a person's connected persons to that person, and subsection (e) takes the attribution rules a step further by attributing the rights to a person that would be attributed to that person's connected person under subsections (a) and (b). Lastly, subsection (c) attributes the rights of a third party, as per subsection (4), to a person. According to HMRC's Commentary, the rights and powers under subsection (4) that are to be attributed to a person generally belong to a third party, but may need to be exercised on behalf of or for the benefit of that person.[186]

3.4.4.4 Indirect participation (section 160)

Section 160 provides that one is indirectly participating in the management or capital of another person if one is "one of a number of **major participants** in that other person's enterprise."

Subsection (3) goes on to define a major participant as follows:

> "(3) For the purposes of this section, a person ("A") is a **major participant** in another person's enterprise at a particular time if at that time—
> (a) that other person ("the subordinate") is a body corporate or firm, and
> (b) the 40% test is met in the case of each of two persons—
> (i) who, taken together, control the subordinate, and
> (ii) of whom one is A."

[186] INTM412060: Transfer pricing: legislation: rules: participation in the management, control or capital of a person.

Subsection (3)(a) seems to indicate that the subordinate must either be a company or a partnership. Furthermore, subsection (3)(b) requires the 40% test to be met in order for one to be considered to be a major participant.

Subsection (4) appears to be the actual subsection that defines when the 40% test has been met. This section provides as follows:

> "(4) For the purposes of this section, the 40% test is met in the case of each of two persons wherever each of them has interests, rights and powers representing at least 40% of the holdings, rights and powers in respect of which the pair of them fall to be taken as controlling the subordinate."

According to the Commentary on section 160 of TIOPA,[187] two requirements must be met in order to satisfy the 40% test. First, the two persons must control the company or partnership. Second, each person must hold at least 40% interest in the company or partnership.

Section 160 also provides for attribution rules.

> "(5) For the purposes of this section—
>
> (a) the question whether a person is controlled by any two or more persons taken together, and
>
> (b) any question whether the 40% test is met in the case of a person who is one of two persons, is to be determined after attributing to each of the persons all the rights and powers which would be attributed by section 159(2) to a person were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of another person.
>
> (6) References in this section—
>
> (a) to rights and powers of a person, or
>
> (b) to rights and powers which a person is or will become entitled to acquire, include references to rights or powers which are exercisable by that person, or (when acquired by that person) will be exercisable, only jointly with one or more other persons."

3.4.4.5 Indirect participation in relation to financing cases (section 161)

Section 161(2) of TIOPA provides as follows:

> "A person ("P") is indirectly participating in the management, control or capital of another ("A") at the time of the making or imposition of the actual provision if—

[187] Explanatory Notes: Taxation (International and Other Provisions) Act 2010 60.

(a) the actual provision relates, to any extent, to financing arrangements for A,
(b) A is a body corporate or firm,
(c) P and other persons acted together in relation to the financing arrangements, and
(d) P would be taken to have control of A if, at any relevant time, there were attributed to P the rights and powers of each of the other persons mentioned in paragraph (c)."

Section 161 appears to extend the scope of the participation condition to cover a person ("P") that acted together with other persons to enter into a finance arrangement with a tested party, to the extent that P would have control over the tested party if the rights and powers of the other persons were attributed to P.

3.4.5 Comparison to South Africa

The UK definition does not provide different requirements for the participation condition to be met in respect of different forms of legal persons.

The most significant aspect to highlight is that the UK focuses on control through shareholding or management, whereas SA includes additional *de facto* forms of control. It appears that the UK also includes other forms of control, but such other forms of control are limited to powers (which give rise to the control) conferred by the articles of association or other document regulating that company. Unlike SA, the UK does not appear to consider *de facto* control in the narrow sense to constitute control.

3.5 United States

3.5.1 Trigger for the applicability of a transfer pricing adjustment

The primary transfer pricing legislation in the US is S482 of the Internal Revenue Code, which provides as follows:

"in any case of two or more organizations, trades, or businesses (whether or not incorporated , whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses …"[188]

[188] Section 482 goes on to provide that "In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer

Upon reading this section, it appears that one can view this section in three parts, the first being a trigger for the application of the second part. The trigger that needs to be met is that there needs to be at least two organisations that are directly or indirectly owned or controlled by the same interests. Once this trigger has been met, then the second part of section 482 can be accessed, which entitles the Internal Revenue Service ("IRS") to make a transfer pricing adjustment. This second part, however, is subject to the parameters of the third part, which is that an adjustment may only be made if the Secretary has concluded that such adjustment is necessary to either prevent tax evasion or to clearly reflect the income of any such organisations. Regulation 1.482.1(b) makes it abundantly clear that when establishing the true income of such organisation, "the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer."[189]

3.5.2 Relevance of the term "control"

Control is required over an organisation in order for a transfer pricing adjustment to apply. Regulation 1.482-1(i)(4)[190] provides that "it is the reality of the control that is decisive, not its form or the mode of its existence." Furthermore, the regulation provides that there is a presumption of control if profits have been shifted arbitrarily.

Academics have previously opined that the US domestic definition of control is defined as *de facto* control.[191] The decisive factor in establishing whether control exists, according to academics, is whether a person, in fact, can dictate the price of a particular transaction.[192]

It seems relatively trite that the basis of control may well be routed in the form of shareholding or control of voting rights. Obviously, one may, therefore, obtain control

---

or license shall be commensurate with the income attributable to the intangible." Section 482 appears to provide special rules pertaining to the transferring or licensing of intangible property. Although one must be cognisant of such special rules, these special rules fall outside the scope of this dissertation and therefore will not be included in the analysis herein.

[189] Treas Reg § 1.482 (1)(b).

[190] Treas Reg §1.482-1(i)(4).

[191] J Wittendorff *Transfer pricing and the arm's length principle in international tax law* (2010) 65.

[192] 65; Tax Management Transfer Pricing Report 8 (1999) 289.

though holding more than 50% shareholding or voting rights in a person. Although the holding of more than 50% shareholding or voting rights would generally be indicative of one having control over another person, Wittendorf points out this will not be the case if the person is actually controlled by other interests.[193] Furthermore, Wittendorf also points out what some may consider obvious in an era of shareholder apathy, being that one can also factually control another person even if one only holds a minority shareholding in that person.[194]

An interesting point to note is that control may be considered to exist even where an independent third party has been interposed in-between two or more controlled persons (as in the UK case of *DSG v HMRC*).[195] A transaction between two controlled persons will, therefore, still fall within the scope of section 482 irrespective of whether or not an independent person has been interposed in the transaction.[196]

3.5.3 Comparison with South Africa

The US definition does not provide different requirements for the participation condition to be met in respect of different forms of legal persons.

The US transfer pricing legislation caters for cases where an intermediary has been interposed in-between the associated parties. This is consistent with the position in SA, the UK as well as India.

The US defines control as *de facto* control. Unlike SA, the US does this by simply providing for a general qualitative definition of control. SA, on the other hand, mostly provides specific quantitative definitions for a connected person in relation to a specific type of person. The South African definition of a connected person, however, also includes a person that controls another person. The SARS Interpretation Note 67 provides that control is undefined and is to be given its ordinary meaning, which is *de facto* control. The domestic meaning that has been ascribed to the term "control" in SA is therefore relatively similar to that in the US.

[193] Wittendorf *Transfer pricing* 65.
[194] 65.
[195] Internal Revenue Bulletin 2002-44 (04-11-2002) <https://www.irs.gov/pub/irs-irbs/irb02-44.pdf> (accessed 14-06-2020) 766.
[196] 766.

3.6 Conclusion

Although one can see from the above that the proliferation of unilateral measures has resulted in some inconsistencies in the domestic approaches to determining what transactions should fall within the net of the domestic transfer pricing legislation, there are also a number of similarities amongst the various domestic approaches. The inconsistencies in the domestic approaches can initially be identified from the fact that different terminology is utilised by different states, albeit that the differing terminologies seem to aim to cater for the same thing (being connectivity to another). India uses the term "associated enterprise," which is *inter alia* defined as a person that participates in the control, management, or the capital of a company. In the UK, the "participation condition" must be met, which requires one of the affected persons to be directly or indirectly participating in the management, control or capital of the other. In the United States, a transfer pricing adjustment may be made if at least two organisations are owned or controlled by the same interests. Lastly, in SA, the contracting parties need to be a connected person (which includes parties that are managed or controlled by another, as well as various participation requirements pertaining to capital), or (as of January 2021 (or 2022, if the draft amendment in terms of Clause 78 of the Taxation Laws Amendment Bill 2020 is accepted)) an associated enterprise in relation to each other.

The obvious similarities in the various domestic approaches is that they all include some form of interest in the management, capital or control of an entity. On the other hand, the most important differences that need to be mentioned are the differences in the level of participation required in capital or management, and differences in interpretation of what constitutes control amongst the above-mentioned states (being *de jure* control, *de facto* control in the narrow sense, and *de facto* control in the broad sense that includes various open market arrangements).

Regarding the level of participation required, direct participation is defined in the UK as participation in capital or management to the extent that one has control. The level of participation required is therefore generally more than 50% in capital (together with voting rights) or management. In the United States it is the reality of the control that is decisive, not its form or the mode of its existence. More than 50% participation in capital would therefore also generally be required in the United States. This general position may, however, arguably not apply in instances where it can be proven that there are apathetic shareholders or board members that have resulted in a person obtaining control with less than 50% participation in capital or management. In India, the participation requirement is 26% shareholding, which is considerably less than what is generally required in the above-mentioned states.

South African domestic legislation imposes a participation requirement of 20% if no other holder of shares holds the majority voting rights. Alternatively, the participation requirement is more than 50%, to the extent that the arrangement does not pertain to financial assistance or IP (in which case the participation requirement is 20%). In addition to the participation requirement, entities that are managed or controlled by a person are connected to such person. The analysis above found that control is interpreted as *de facto* control in SA, which again means that the general participation requirement could arguably not limit the existence of a connected person relationship (particularly where it can be proven that there are apathetic shareholders that have resulted in a person obtaining control of certain decisions at a shareholders meeting with less than 50% participation in capital).

Regarding the similarities and differences in interpretation of what constitutes control, direct participation is defined in the UK as participation in capital or management to the extent that one has control. This is generally referred to as *de jure* control. The UK, however, also considers a person to control a company if, as a result of any powers conferred by the articles of association or other document regulating that company, the company is conducted in accordance with that person's wishes.

Control is also defined in the US domestic legislation. Unlike the UK, however, the definition of control is based on an open-ended concept of *de facto* control. What is evident from the United States' domestic legislation is that it is not the form of control that is material, but rather it is the reality of control that is decisive.

Although control is not expressly defined by India's domestic legislation, Indian domestic legislation does specifically stipulate that the relationships listed therein are indicative of a controlled relationship existing. These listed relationships generally provide for *de jure* control and *de facto* control in the broad sense that includes a closed list of open market arrangements.

The South African domestic law definition of a connected person also refers to the term "control," which the South African courts have held means *de facto* control.[197] However, it is submitted that the form of *de facto* control referred to in Interpretation Note 67, as well as in the court cases referred to therein, is narrower than the types of relationships that India considers to give rise to *de facto* control. This submission is based on the fact that SA's interpretation of *de facto* control considers whether there is in substance control via management (which is in all likelihood aimed at including entities that try to artificially avoid the associated enterprise or connected person definition as being controlled by another entity). The connected person definition, however, also appears to be broad enough to possibly include persons that can control a company by virtue of some form of the power conferred by that company's memorandum of incorporation or some other document governing the company (as is the case in the UK, and arguably also the US). An example may include the power given by a company to an independent creditor (by way of an amendment to the document regulating that borrowing company)[198] to veto any decisions pertaining to the company's capital expenditure or disposals, or the incurral of further debt or any other material arrangement.

The above analysis clearly illustrates that the above-mentioned states do not all impose an identical participation level required to give rise to association, nor do they all interpret the term "control" identically domestically. Regarding the latter, the predominant interpretations are *de jure* control and *de facto* control, and *de facto* control also appears to be capable of being interpreted in a narrow manner as well as a broad manner. The narrow interpretation appears to aim at regarding entities that are in substance controlled by another via management or in terms of a legal agreement or a document that governs the decision-making powers of a company such as a memorandum of incorporation, while the broad interpretation appears to include certain commercial relationships that may give rise to one entity being

[197] *S v Pouroulis* 1993 4 S A 575 (W); *ITC 1741* 65 SATC 106; SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS*.

[198] The question whether amending the document regulating that borrowing company to cater for the lender in such manner is a question of company law, which falls outside the scope of this dissertation. To the extent that the document regulating that borrowing company remains unchanged, and the lender relies on a contractual right instead, then such a lender relationship will arguably not constitute *de facto* control in the narrow sense.

commercially dependent on the other. This may well give rise to uncertainty when interpreting the term "control" in a DTA, which the following chapter will aim to address.

CHAPTER 4: CRITICAL ANALYSIS OF THE TWO PREDOMINANT (AND OPPOSING) VIEWS ON INTERPRETING ARTICLE 9

4.1 Introduction

Generally, Article 9 of the OECD MTC provides that contracting states may rewrite the accounts of an entity if, due to the special relationship between the entities, the accounts do not show the true taxable profit arising in that state.[199]

Article 9(1) of the OECD MTC provides as follows:

> "Where
>
> a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
>
> b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
>
> and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

Article 9 of the OECD MTC is titled "Article 9: Associated Enterprises," and the content of Article 9(1) defines this term. Article 9 therefore effectively provides for two instances in which an associated enterprise relationship may exist. First, in cases where one enterprise participates in the management, control or capital of another enterprise. Second, where the same mutual person(s) participate in the management, control or capital of both enterprises.

It must be noted that the terms "management", "control" and "capital" are expressed as distinct terms that are not synonymous with each other. In other words, "control is presented as something other than 'participation in the management' or 'participation in the capital'."[200] Since participation in either management, control or capital can give rise to an associated enterprise relationship, one must comprehend what these terms mean. The words contained in the phrase "participates directly … in the management,

---

[199] OECD *Commentary on Article 9* para 2.

[200] G Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 40 <http://online.ibfd.org.ez.sun.ac.za/document/tp_intro> (accessed 14-06-2020).

control or capital", however, are not defined in the OECD MTC. Accordingly, the words contained in this phrase fall within the ambit of Article 3(2) of the OECD MTC, which deals with undefined terms and must be applied to these terms.

Article 3(2) provides as follows:

> "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

As discussed below, some academics are of the view that the words contained in the phrase "participates directly … in the management, control or capital" are to take the meaning of its domestic definition of the state applying the DTA. Others, however, argue that the context requires otherwise.

The reasons why certainty over this point is required are twofold. The first reason is that corresponding adjustments can only be made if, according to the Commentary on Article 9, the other state agrees with the primary transfer pricing adjustment in principle.[201] This point is also made in the OECD TPG, which provides that the state from which a corresponding adjustment is requested should comply with this request only if that state "considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length".[202] The second reason why certainty over this point is required is due to the fact that the definition or meaning of the term "control" may be fundamental in determining whether certain transactional data between two particular entities constitutes uncontrolled comparable pricing data, which is a vital form of data that may be used by entities to justify the arm's length nature of their transfer price.

The purpose of this chapter is, therefore, to seek clarity on the meaning of the phrase "participates directly … in the management, control or capital". This will be done by briefly considering the rules governing the interpretation of DTAs, which will be followed by a short discussion on some of the difficulties surrounding the application of Article 3(2), as well as an analysis of the opposing views on interpreting

[201] OECD *Commentary on Article 9* para 6.

[202] Para 4.17 OECD TPG.

Article 9. The preceding chapters hereto have clarified two major points that one needs to comprehend before dealing with this question. The first being clarifying the relationship between DTAs and domestic legislation, and the second being establishing that different states do, in fact, have differing definitions for the phrase "participates directly … in the management, control or capital".

4.2 The Vienna Convention on the Law of Treaties

Articles 31 and 32 of the Vienna Convention contains the primary rules of interpreting international treaties (including DTAs),[203] which has been largely accepted to constitute a codification of pre-existing customary international law.[204] According to section 232 of the Constitution, customary international law generally constitutes law in SA. Articles 31 and 32 of the Vienna Convention are therefore enforceable in SA,[205] even though SA is not a signatory to the Vienna Convention at the time of writing this dissertation. The content of these respective articles, as well as their impact, therefore, need to be considered.

4.2.1 Article 31 of the Vienna Convention

This article provides as follows:

"Article 31 GENERAL RULE OF INTERPRETATION

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

[203] EC Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership" in Article 10 of the OECD Model Tax Convention on Income and Capital in the context of conduit company treaty shopping*. LLD dissertation, University of Pretoria (2017) 101. M Sada Garibay "An analysis of the case law on Article 3(2) of the OECD Model (2010)" (2011) 65 *Bulletin for International Taxation*.

[204] U Linderfalk & M Hilling "The use of OECD Commentaries as interpretative aids – The static/ambulatory–approaches debate considered from the perspective of international law" (2015) *Nordic Tax Journal* 34, 36; P Baker *Double taxation conventions* 3 ed (2019) para E.03.

[205] *Krok v C:SARS* 2015 6 SA 317 (SCA) para 27 and s 232 of the Constitution. See also Du Plessis (2012) *SA Merc LJ* 41.

(a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
(b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:
(a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
(c) Any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended."

Article 31(1) clearly provides that the "ordinary meaning" of a DTA term is to be established by considering its context and the purpose of that DTA. Put differently, one must apply the ordinary meaning to an undefined treaty term, given its context and the purpose of the treaty (which may be expressed in the preamble of the DTA).[206] It is therefore apparent that an interpretation which achieves the object of the DTA should be favoured above one which does not.[207]

Since the ordinary meaning of an undefined term is to be determined with consideration of the context and purpose of the DTA, "[i]n context, a technical meaning may become the ordinary meaning. This is particularly true in the context of tax treaties where tax expressions frequently have a meaning that is different from the ordinary meaning of the words."[208] This argument is also contained in the Commentary to the Vienna Convention, which provides that "technical or special use of the term normally appears from the context and the technical or special meaning becomes, as it were, the ordinary meaning in the particular context."[209] Relying on the research conducted

---

[206] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 109.

[207] *COT v Aktiebolaget Tetra Pak* 1966 28 SATC 217.

[208] A Jones "Treaty interpretation" in R Vann (ed) *Global tax treaty commentaries* (2015) para 3.4.11

[209] Para 17 of the Commentary to the Vienna Convention. Jansen van Rensburg suggests that the Commentary does not support this view, but instead indicates that special meanings will fall within the ambit of Article 31(4).

by Linderfalk, Jansen van Rensburg concludes that "'the ordinary meaning' in Article 31(1) includes technical meanings that are usually used in the particular context."[210]

There is, however, a view amongst some academics that such preference for context over the literal meaning of a term is not permissible to establish the ordinary meaning of a term, but instead can only be permitted to establish the special meaning of a word in terms of Article 31(4)[211] (which provides that a special meaning may be ascribed to the term if it is established that the parties to the treaty in question so intended).

The meaning of an undefined term contained in a DTA cannot be determined without regard to its context and the purpose of the DTA in question.[212] Consequently, Jansen Van Rensburg argues that either a "nuanced"[213] or "contextual"[214] approach should be applied when interpreting the content of a DTA,[215] and appears to suggest that South African courts will in all likelihood apply a contextual approach.[216] One, therefore, needs to be able to identify the relevant context when establishing the meaning of an undefined term that is contained in a DTA.

4.2.2 Context for purposes of establishing the ordinary meaning in terms of Article 31(1)

As mentioned above, Article 31(1) refers to the ordinary meaning of terms in the context and in light of the purpose of the DTA. Jansen van Rensburg notes that the dominant view appears to be that the context, for purposes of establishing the ordinary

---

[210] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 106 referring to Linderfalk & Hilling (2015) *Nordic Tax Journal* 44.

[211] DA Ward et al *The interpretation of income tax treaties with particular reference to the commentaries on the OECD Model* (2005) 19, 21 and 26-27.

[212] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 102.

[213] A nuanced approach requires the context and purpose of the treaty to be considered, but that can never override the clear meaning of the text.

[214] A contextual approach allows one to interpret the meaning of the words in the light of the context and purpose.

[215] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 114.

[216] 227-228.

meaning in terms of Article 31(1), is to be determined concerning the material referred to in Article 31(2) and (3).[217]

Article 31(2) identifies a closed list of items that may constitute the context when determining the ordinary meaning of a term. This includes the entire text of the relevant treaty, as well as agreements and instruments that relate to the relevant treaty that was accepted by all the relevant parties in connection with the conclusion of the treaty. This would in all likelihood include the preamble to a DTA, which typically provides the purpose of the DTA.

Article 31(3) further provides a closed list of content that may be taken into consideration for purposes of establishing the ordinary meaning of the term in accordance with its context and purpose. Article 31(3) allows one to consider any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions, any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation, as well as any relevant rules of international law applicable in the relations between the parties.

4.2.3 Supplementary means of interpretation: Article 32

Article 32 provides as follows:

> "Article 32 SUPPLEMENTARY MEANS OF INTERPRETATION
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
> (a) Leaves the meaning ambiguous or obscure; or
> (b) Leads to a result which is manifestly absurd or unreasonable."

Article 32, therefore, entitles a person to supplementary means of interpreting an undefined treaty term. The applicability of Article 32 is limited to, *inter alia*, instances where the application of Article 31 results in the undefined term being given a meaning that gives rise to an absurdity, obscurity or ambiguity. Such conditions resulting in the applicability of Article 32 are broad.

---

[217] 108 referring to Avery Jones "Treaty interpretation" in *Global tax treaty commentaries* para 3.4.10.

Unlike Article 31(2) and (3), Article 32 does not provide a closed list of material that may be considered when interpreting an undefined term in accordance with Article 32.[218] An argument can, therefore, be made that the Commentary to the OECD MTC may be considered,[219][220] as well as historical research[221] when interpreting an undefined term in a DTA in terms of Article 32 of the Vienna Convention.

Regarding the former, the UK courts in *Re the Trevor Smallwood Trust; Smallwood v HMRC*[222] held that the Commentaries may reflect the intention of the parties of the relevant DTA.[223] The court in *ITC 1878*[224] also held that the Commentaries are perceived as a tool that promotes the aim of common and uniform interpretation. Various case law from India has also recognised the importance of interpreting DTAs in accordance with the intention of the signatories,[225] including *Deputy Commissioner of Income Tax v. Metchem Canada Inc*, which held that the Commentaries apply to the extent that the parties had not expressly indicated a different intention.[226] The US judgment in *National Westminster Bank plc v. United States of America* (2008) also confirmed the obligation to interpret the provisions of a DTA in a way that gives effect to the intention of the signatories. Therefore, although not law, the Commentaries

---

218 Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 112.

219 Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* para 3.11.4.

220 Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 112.

221 108 referring to JA Becerra *Interpretation and Application of Tax Treaties in North America* (2007) 121.

222 [2008] STC (SCD).

223 *Re the Trevor Smallwood Trust; Smallwood v HMRC* [2008] STC (SCD) 629 para 98. See also *Sun Life Assurance co of Canada v Pearson [1986] STC 335 CA*.

224 *ITC 1878* (2015) 77 SATC 349 para 15.

225 *UAE Exchange Centre Ltd v. Union of India*, WP(C) 14869/2004, Tax Treaty Case L. IBFD, in P. Baker, 11 Intl. Tax L. Rpt. 4, 714-733 (2009); *Hindalco Industries Ltd v. Assistant Commissioner of Income Tax*, ITA 3772 and 3774/Mum/1996, 1588/Mum/1997 and 409 to 411/1999, Tax Treaty Case L. IBFD, in P. Baker, 8 Intl. Tax L. Rpt. 1, 1-26 (2005); and IN: HC, 19 Dec. 2008, *Clifford Chance (United Kingdom) v. Deputy Commissioner of Income Tax*, Appeal 181 of 2002 and 182 of 2002, Tax Treaty Case L. IBFD, in P. Baker, 11 ITLR 3, 585-598 (2009).

226 *Deputy Commissioner of Income Tax v Metchem Canada Inc* (2005).

arguably constitute material that may be considered in interpreting the terms contained in the relevant DTA.[227]

4.3 Ancillary consideration when interpreting DTAs

Although not provided for by the Vienna Convention, the goals of common and uniform interpretation also need to be mentioned before addressing the remainder of this dissertation. These goals seem to stem from the fact that a DTA gives rise to the reciprocal allocation of taxing rights, "which encourages contracting states to seek a common interpretation of treaty terms (the 'goal of common interpretation')".[228] Furthermore, the international character of DTAs is indicative that their content should be interpreted uniformly across all states that apply the wording of that DTA.[229] Jansen van Rensburg has expressed that "DTAs that are modelled on the OECD MTC would be an example of treaties that lend themselves to such a uniform interpretation."[230]

The pursuit of the goals of common and uniform interpretation would in all likelihood result in undefined terms contained in a DTA to be interpreted consistently by the relevant contracting states. Jansen van Rensburg has mentioned that this implies that DTA terms should be interpreted in such manner that an autonomous meaning,[231] as opposed to a domestic meaning, should be ascribed to the undefined DTA term.[232] It is respectfully submitted that, given that the opposite of an autonomous meaning would be a domestic meaning, an autonomous meaning would arguably derive from the context and purpose of the DTA provision in question (that is; a source other than domestic law).

[227] There are opposing views as to whether the Commentaries fall within the ambit of Article 31(1) or Article 32. This distinction has been noted as immaterial in relation to this dissertation and has therefore not been addressed further.

[228] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 98.

[229] Baker *Double Taxation Conventions* paras E-26 – E-28.

[230] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 99.

[231] With reference to *Schwarz on Tax Treaties* para 12-300, Van Rensburg suggests that Schwarz seems to equate the term with the "international fiscal meaning".

[232] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 100.

The goals of common and uniform interpretation also seem to find support from section 232 of the Constitution. Section 232 of the Constitution provides that "Customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament."[233] Olivier and Honiball state that, based on section 232 of the Constitution, "to the extent that there are OECD guidelines on the interpretation of the concept [in question] … as utilized in tax treaties worldwide, South African courts would take cognizance of such guidelines … to interpret the meaning in the context of a tax treaty."[234]

4.4 Applying Article 3(2)

Article 3(2) requires one to apply a contracting states' domestic definition of a term that is undefined in the convention. However, where the context requires otherwise, then domestic definitions are not to be applied. The following text will discuss some of the difficulties surrounding the application of Article 3(2), as well as an analysis of the opposing views on interpreting Article 9.

4.4.1 What constitutes context?

With reference to the work of Avery Jones,[235] Baker,[236] as well as Rust,[237] Jansen van Rensburg submits that the "context" referred to in Article 3(2) includes all listed materials contained in Article 31 of the Vienna Convention, and arguably also includes the materials referred to under Article 32 of the Vienna Convention.[238] Rust expresses that "the 'context' concept should nevertheless be interpreted as broadly as possible."[239] Rust then goes on to provide examples of material that would constitute context, which includes the text of the treaty, supplementary instruments thereto, the object and purpose of the provision, the relevant provisions of the two national legal

[233] Section 232 of the Constitution.
[234] Olivier & Honiball *International Tax* 42.
[235] Avery Jones et al (1984) *BTR* 104.
[236] Baker *Double Taxation Conventions* para E.20
[237] Rust "Article 3(2)" in *Klaus Vogel* 212 m.nr. 123
[238] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 286.
[239] Rust "Article 3(2)" in *Klaus Vogel* 212.

systems, as well as the OECD MTC Commentary.[240] As for what constitutes the "context", Lang states that it not only encompasses the entire OECD MTC, "but also the preparatory work of the OECD Model such as the Commentary."[241] Paragraph 6 of the OECD Commentary on Article 9 provides that a corresponding transfer pricing adjustment is only due if the state that is being requested to make a corresponding adjustment considers the initial primary adjustment made by the other state to be justified in principle as well as the amount.[242] This point is also made in the OECD TPG, which also provides context relating to Article 9 of the OECD MTC.[243]

In the pursuit of context for Article 9 of the OECD MTC, Dwarkasing considers the historical development of Article 9 of the MTC. One of the bodies of work referred to by Dwarkasing is Article 5 of the 1933 Report,[244] which is the predecessor to the OECD MTC. According to Dwarkasing, "the term 'participation in "control"' is not meant to be an independent criterion for association, but the term is a substitute for the term 'dominating' used in Art. 5 of the 1933 Report".[245]

4. 4. 2 When does context require otherwise

Jansen van Rensburg identifies two existing views as to when the context requires otherwise for purposes of Article 3(2) of the OECD MTC. The first being that the domestic meaning of a term should only be applied as a last resort.[246] Promoters of this view generally rely on the goal of common and uniform interpretation as support for this argument, which would possibly be hindered if domestic meanings were

---

[240] 212.

[241] Lang *Introduction to the Law of Double Taxation Conventions* para 94.

[242] OECD *Commentary on Article 9* para 6.

[243] Paragraph 4.17 of the OECD TPG provides that the state from which a corresponding adjustment is requested should comply with this request only if that state "considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length."

[244] League of Nations *Report of the Fiscal Committee to the Council* 5.

[245] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 13

[246] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 287.

ascribed to undefined DTA terms.[247] The second view identified by Jansen van Rensburg is that the domestic meaning is to be preferred and can only be avoided to the extent that there are reasonably strong arguments to the contrary.[248] This view is supported by Rust, who previously stated that "an interpretation contrary to the meaning a term has under domestic law must constitute an exception."[249]

South African case law has also indicated that the domestic meaning of an undefined DTA term will be utilised by a South African court, unless it is clear from the context that the domestic meaning should not be utilised. This was the finding of the Appellate Division in *Baldwins (South Africa) Ltd v CIR*,[250] wherein the court considered in what instance the context would require one to deviate from the domestic definition of an undefined DTA term. The court appears to suggest that the weight of the context would need to be strong in order for a court to deviate from the domestic meaning of a term.[251]

Although not settled, there is a view amongst some academics that the above-mentioned judgment was not deviated from in the more recent judgment of Commissioner for the *South African Revenue Service v Tradehold Ltd*.[252] This argument is premised on the conclusion that the court applied the domestic meaning to an undefined DTA term, which is based on the fact that the court only referred to domestic law when interpreting the undefined DTA term.[253] However, the court makes reference to the existence of "international tax language," which Du Plessis argues suggests that the domestic definition was not ascribed as the meaning of the undefined DTA term.[254]

Rust expresses that "context will for instance require an interpretation different from domestic law if the domestic law meaning would render parts of the treaty

[247] 287.
[248] 287 referring to Rust "Article 3(2)" in *Klaus Vogel* 212 m.nr. 123 notes that "weighty arguments" should be put forward if the domestic meaning is not used.
[249] Rust "Article 3(2)" in *Klaus Vogel* 212.
[250] *Baldwins (South Africa) Ltd v CIR* 1961 24 SATC 270.
[251] *Baldwins* 281.
[252] *CSARS v Tradehold Ltd* 2013 4 SA 184 (SCA).
[253] Jansen van Rensburg *A South African perspective on the meaning of "beneficial ownership"* 284.
[254] Du Plessis *Critical issues regarding the OECD Model Tax Convention* 134-135

inapplicable".[255] Rust also states that in instances "… where an interpretation in light of domestic law … leads to … double non-taxation, then there are already strong arguments for a contextual interpretation provided that a contextual interpretation helps to avoid such undesirable results."[256] It seems reasonable to conclude that this argument would remain valid in cases where an interpretation in light of domestic law will not alleviate economic double taxation, particularly since the argument is based on the DTA provision achieving its purpose (and the purpose of Article 9(2) is to avoid economic double taxation from arising, as discussed below).

According to Dwarkasing, the phrase "unless the context requires otherwise" as found in Article 3(2) of the OECD MTC "refers to situations where a reference to an interpretation according to domestic law fails to provide a clear solution to the particular tax issue."[257] Put differently, Dwarkasing argues that the context requires otherwise when the application of the domestic meaning of the undefined DTA term will not result in the provision achieving its purpose. On this point, Dwarkasing submits that the purpose of Article 9(2) of the OECD MTC is to prevent economic double taxation.[258] In other words, the particular tax issue that requires a solution is the issue of economic double taxation, and where an interpretation of a treaty term is following the domestic interpretation of such term but yet the issue of economic double taxation remains unresolved, then this is indicative of the context requiring otherwise and for the treaty term to be interpreted without solely relying on domestic interpretations.

4.5 Article 9

4.5.1 Applying the meaning of a term in accordance with the law of the State applying the convention (Cottani's view)

According to Cottani, "Article 9(1) … is not self-supporting, in that it depends on the domestic law of the various treaty partners for its interpretation and clarification."[259]

---

[255] Rust "Article 3(2)" in *Klaus Vogel* 213.
[256] 213.
[257] Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* 9
[258] [258] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 5.
[259] Cottani "Transfer Pricing, Topical Analyses" (2016) *IBFD* 42.

Cottani seems to make this assertion due to none of the terms contained in the phrase "participation in management, control or capital" being defined by the OECD MTC and hence falling within the scope of Article 3(2) of the OECD MTC. Cottani then goes on to conclude that participation in "management, control or capital" "will have the meaning as determined under the domestic tax law of the country applying the convention, unless the context requires otherwise."[260] Cottani does not, however, appear to consider the context of Article 9 as requiring otherwise. Cottani's view, therefore, seems to conclude that the terms contained in the phrase "participation in management, control or capital" are to be defined as per the domestic definition of a contracting state. Other academics have also supported Cottani's view.[261]

It will be recalled that the OECD Commentary on corresponding transfer pricing adjustments provides that a contracting state is only required to make a corresponding transfer pricing adjustment if it agrees with the primary adjustment in principle.[262] Considering this, the consequence of applying Cottani's view is that countries may, in some cases, refuse to provide taxpayers with relief from economic double taxation through the form of a corresponding transfer pricing adjustment. Relief in the form of a corresponding transfer pricing adjustment may be refused where the contracting state disagrees with the primary transfer pricing adjustment in principle. When applying Cottani's view, there is a risk that a corresponding transfer pricing adjustment may be refused because of the contracting state disagreeing with the primary transfer pricing adjustment due to the contracting state having a narrower domestic definition of the terms contained in the phrase "participation in the management, control or capital." This risk is particularly high where one contracting state interprets control as *de jure* control, or as *de facto* control in the narrow sense, whilst the other contracting state interprets control as *de facto* control in the broad sense. The risk is also high where the contracting states apply different participation thresholds to participation in management or capital that is required for an associated enterprise relationship to exist. This is because the contracting state that is requested to make a corresponding

[260] Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 42.
[261] H Hamaekers "introduction to transfer pricing" in H Hamaekers, MH Collins & WA Comello (eds) *The tax treatment of transfer pricing* (2008) 1.
[262] See introduction to Chapter 4 of this dissertation, as well as OECD MTC Commentary on Article 9, paragraph 6.

transfer pricing adjustment must agree with the primary adjustment in principle, otherwise, it is not required to make a corresponding adjustment.

The following practical example illustrates the possibility of Article 9 providing no relief from economic double taxation if Cottani's view were to be applied. This example requires one to assume that company A, which is a tax resident of Country A, has been subjected to a primary transfer pricing adjustment by the revenue authorities in Country A. The primary transfer pricing adjustment that company A has been subjected to arose since, according to the domestic laws of Country A, company A meets Country A's shareholding participation requirement to be an associated enterprise in relation to company B. Hence, companies A and B are considered to be associated enterprises in relation to one another in terms of the domestic law of Country A. The revenue authorities of Country A may, therefore, apply their domestic law to make a primary transfer pricing adjustment if it establishes that company A and B's transactions with each other were not arm's length in nature.

Since a primary transfer pricing adjustment is to be made domestically in Country A, company B will in all likelihood attempt to apply Article 9(2) of the DTA to obtain relief from economic double taxation. The terms in the phrase "participation in capital" in the DTA would, therefore, be defined in terms of the domestic legislation of Country B since Country B is the country "applying the convention."[263] Country B's domestic legislation, however, does not consider company A and B to be associated to one another. The consequence of Country B not regarding company A and B to be associated enterprises under the domestic law of Country B, is that Country B can legitimately claim not to be required by Article 9 of the tax treaty with Country A to make the corresponding adjustment. This is because the transaction adjusted by Country A is not considered to be a "controlled transaction" under Article 9(1) of the applicable treaty as construed under the legislation of Country B.[264]

The above example clearly illustrates that if a corresponding state has a narrower interpretation of the phrase "participates directly … in the management, capital or control" than the state that made the initial primary transfer pricing adjustment, then the corresponding state applying the DTA is not required to make a corresponding adjustment in terms of the DTA since the corresponding state will not agree with the

[263] Article 3(2) of the OECD MTC.
[264] Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 41

primary adjustment in principle. This interpretation, therefore, does not alleviate the possibility of economic double taxation from arising, which would support an interpretation that does not rely on the domestic meaning.

4.5.1.1 Cottani's qualification statement

Although Cottani does not consider the context of Article 9 and whether it requires otherwise, Cottani does go on to highlight that "unavoidably, purely open-market situations will be covered by formulas covering *de facto* control,"[265] for example where a supplier of materials for manufacturing is almost exclusively supplying a company that utilises those materials for their manufacturing operations. Cottani notes, however, that paragraph 2 of the Commentary to Article 9 provides that transfer pricing adjustments may not be made in the case of normal open-market commercial terms.[266] He relies on this part of the Commentary as authority to conclude that DTAs containing an article similar to Article 9(1) and (2) of the OECD MTC "permits an adjustment only in cases where double taxation would arise as a result of the adjustment, generally only in shareholding (including voting rights and interests in partnerships) and managerial relationships."[267]

So although Cottani concludes that the meaning of participation in "management, control or capital" is to be defined as per the domestic laws, Cottani qualifies this by appearing to suggest that certain forms of *de facto* control (ie, the broad interpretation of *de facto* control) are to be excluded from the applicability of Article 9. Further support for this view can be found in Vogel's Commentary, wherein Kofler expresses the following:

> "[E]conomic control based on a market position is not to be considered 'control' falling within Article 9 OECD and UN MC. Indeed, it is not Article 9 OECD and UN MC's purpose to interfere with the pricing between competing business interests, which is inevitably based on the relative strength and bargaining power of the truncation participants. This means that such market-based relationships (e.g., between a monopolist and customers, between two enterprises, one which is economically dependent on intangibles, goods or services of

[265] Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 51.
[266] 52.
[267] 52.

the other, or because of a creditor relationship) do not fall under Article 9 OECD and UN MC."[268]

Although Cottani's view does resolve some of the issues that may arise from differing interpretations of the term "control" by relying on the Commentary to the MTC, this does not address the opposing thresholds that states have on the amount of participation required in management or capital for an associated enterprise to exist.

The second observation that needs to be made pertains to how Cottani argues that *de facto* control is to be excluded, which on the face of it may appear contradictory to his view that the terms contained in the phrase "participation in the management, control or capital" are to be defined as per the domestic definition. In other words, on the one hand, Cottani seems to argue that the term "control" is to be defined in terms of domestic legislation. However, on the other hand, Cottani seems to be suggesting that the context, in this case, requires otherwise (due to the Commentary to the MTC) and therefore the domestic definitions are to be limited. So despite Cottani arguing that domestic definitions are to be used, and hence allowing for economic double taxation to arise, he appears to refute his own argument by saying that the Commentary excludes *de facto* control in the broad sense (and therefore that the context requires a deviation from the domestic definition).

If, however, Cottani is arguing that only the term "control" is to be ascribed a meaning without reference to domestic law due to the context of that term stemming from the Commentary, then Cottani's qualification statement does not undermine his argument, but instead suggests that Cottani's argument that domestic law meanings are to be used only applies to the terms contained in the phrase "participates in management or capital".

[268] Kofler "Article 9. Associated Enterprises" in *Klaus Vogel on double taxation conventions* 635. See also Art 9 at m.no. 38; Wittendorff *Transfer pricing* 218–221; L de Broe *International tax planning and prevention of abuse* (2008) 515.

4.5.1.2 Some thoughts on whether economic double taxation can be avoided by determining which single respective contracting state's domestic interpretation is to be applied in terms of Article 3(2) – The "new approach"

Assuming that Cottani's view is to be applied in practice, the following paragraph considers whether economic double taxation could be avoided by only applying the domestic meaning of one contracting state to the phrase "participation in management, control or capital".

Some academics have expressed that "[w]hile in the past an interpretation in light of domestic law could lead to double taxation …, this problem is now resolved by the new approach."[269] The so-called "new approach" seems to stem from the wording contained in Article 23 A and B of the OECD MTC, which is intended to eliminate juridical double taxation from arising due to qualification conflicts.

This view that the "new approach" eliminates double taxation from arising due to the existence of differing definitions of undefined DTA terms is evident from Rust's statements in Vogel's Commentary, wherein Rust states that "[i]f the particular preconditions of a distributive rule are at issue, different qualifications may lead to double taxation not being avoided …."[270] Rust then refers to the views developed by the International Tax Group that was chaired by J.F Avery Jones. According to this view, which was developed in consideration of Article 23 of the OECD MTC, the contracting state in which the person is resident must interpret the undefined term in accordance with the domestic interpretation of the contracting state in which the income was sourced.[271] Such an interpretation of the application of Article 23 results in juridical double taxation being avoided.

As will be recalled from paragraph 4.5.1 of this chapter, economic double taxation may arise in the case of a transfer pricing adjustment in instances where the two contracting states have differing interpretations of the phrase "participates directly … in the management, control or capital." When considering whether the "new approach" will be applicable for purposes of enforcing a corresponding state to provide a

---

[269] Rust "Article 3(2) OECD and UN MC" in *Klaus Vogel on double taxation conventions* 216.
[270] 209.
[271] JF Avery Jones "The "one true meaning" of a tax treaty" (2001) *Bulletin – Tax Treaty Monitor, International Bureau of Fiscal Documentation* 220.

corresponding transfer pricing adjustment, the first thing that comes to mind is the irreconcilable difference between the new approach and the OECD Commentary on Article 9 providing that a contracting state is not obliged to provide a corresponding adjustment to the extent that such contracting state disagrees with the primary adjustment in principle. Lang also acknowledges that the corresponding state will not make a corresponding transfer pricing adjustment where the corresponding state holds a diverging opinion regarding the applicability of a DTA provision identical to Article 9(1) of the OECD MTC.[272]

The second issue that needs to be considered is the fact that the new approach requires the DTA to be interpreted in accordance with the view of the contracting state in which the income was sourced. This is arguably an arbitrary method of preventing economic double taxation from arising as a result of transfer pricing adjustments because the arm's length principle is not a distributive rule (and the source of the income is irrelevant to whether the arm's length principle has been followed). This submission is arguably further supported by the fact that the primary transfer pricing adjustment may even be an adjustment made to an expense as opposed to income, therefore there may not even be income (or a source of income) to consider. This further supports the argument that the "new approach" does not solve the issue of economic double taxation in cases regarding the computation of income.[273] The new approach may therefore arguably have to be adapted, to the extent that it is to apply to Article 9 so that the DTA is interpreted in accordance with the State that made the initial primary adjustment. Such an approach would result in the avoidance of economic double taxation from arising because multinational groups that have been subjected to an initial transfer pricing adjustment will then automatically be entitled to a corresponding adjustment (regardless of whether the contracting state that is requested to make the corresponding adjustment disagrees with the initial adjustment in principle due to it having a narrower interpretation of the phrase "participation in management, control or capital").

It should further be borne in mind that Article 23 uses the words "which may be taxed in the other Contracting State". Article 9(2), on the other hand, does not use

[272] M Lang "Qualification conflicts" in R Van (ed) *Global tax treaty commentaries* 3.

[273] Avery Jones (2001) *Bulletin – Tax Treaty Monitor, International Bureau of Fiscal Documentation* 221.

those words, which, arguably, further supports the view that the "New approach" does not apply to Article 9.

4.5.1.3 Administrative considerations pertaining to corresponding adjustments

According to the OECD Commentary on Article 9, there is no specified method by which corresponding transfer pricing adjustments are to be made. The Commentary, therefore, suggests that the method to provide a corresponding adjustment is left open for contracting states to agree on. [274] The Commentary then goes on to provide two possible methods of giving effect to a corresponding transfer pricing adjustment in a case where enterprise X's taxable income has been adjusted upwards (thereby ultimately resulting in its associated enterprise, enterprise Y, being deemed to have over-stated its taxable income). One of these proposed methods is to re-open enterprise Y's tax assessment and to reduce its taxable income accordingly.[275]

The other method mentioned in the Commentary, on the other hand, requires one to view enterprise Y's income as having been taxed twice (that is; once in its resident state, and once in the resident state of its associated enterprise – enterprise X). This would result in the applicability of Article 23 of the OECD MTC, to the extent that such identical provision is contained in an applicable DTA. This means that the "double-taxed profits" of enterprise Y should be treated in the hands of enterprise Y (which is a resident of State B) as if they may be taxed in State A (which is the resident state of enterprise Y's relevant associated enterprise, enterprise X).

Applying this secondary method to giving effect to a corresponding adjustment would undoubtedly also prevent economic double taxation from arising. Whether all contracting states will be willing to apply this method, however, remains to be seen. Contracting states may be unwilling to provide corresponding adjustments that result in a loss to the fiscus. Contracting states may well, therefore, decide to argue that this latter method is incompatible with Article 9 because Article 9 is not a provision that distributes taxing rights, but instead, the purpose of Article 9 is to adjust the profits of two associated enterprises that have entered into an arrangement on a non-arm's length basis. It is therefore arguably untenable to conclude that it is enterprise Y's income that is taxed both in its resident state as well as in the resident state of its

[274] OECD *Commentary on Article 28* para 7.
[275] OECD *Commentary on Article 28* para 7.

associated enterprise (enterprise X). It is enterprise X's income, not enterprise Y's income, that is being taxed in enterprise X's residence state. This means that enterprise Y's income is not taxable in two states, but instead, it is a different entity's income that is taxable in the other state. Article 23 may therefore not apply in cases where Article 9 is applicable. The first-mentioned method of obtaining a corresponding adjustment would arguably, therefore, need to be relied on by the taxpayer to be alleviated from economic double taxation.

4.5.2 Application of Article 3(2) in relation to Article 9 where it is accepted that the context requires otherwise (Dwarkasing's view)

Dwarkasing agrees with Cottani that the party seeking to obtain a corresponding transfer pricing adjustment, after a contracting state made a primary transfer pricing adjustment in terms of that state's domestic laws, will need to request such adjustment to be made as per an applicable DTA.[276] Dwarkasing also agrees with the view taken by Cottani regarding the fact that the terms contained in the phrase "participation in management, control or capital" are undefined and therefore fall within the ambit of Article 3(2).[277]

Unlike Cottani, however, Dwarkasing does not argue that the terms contained in the phrase "participation in management, control or capital" are to be defined by the domestic definition of the relevant contracting state(s). Instead, Dwarkasing argues that the context requires otherwise. (Dwarkasing's reasons for this conclusion are elaborated on in the paragraph below.) The application of an autonomous meaning to an undefined term in cases regarding computation of income has previously been supported by academics.[278] Dwarkasing goes on to state that since DTAs effectively limit the applicability of a contracting states' domestic laws, "broader concepts of

---

[276] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 2.

[277] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 10.

[278] Avery Jones (2001) *Bulletin – Tax Treaty Monitor, International Bureau of Fiscal Documentation* 221.

associated enterprises will be overruled by the narrower concept of associated enterprises of the appropriate tax treaty."[279]

Regarding what constitutes "context", Article 31(1) of the Vienna Convention on the Law of Treaties (1969) provides that "context" includes the text, the preamble to the tax treaty and annexes.[280]

Dwarkasing argues that "the concept of associated enterprises under Article 9 of the OECD Model is based on a dominating or controlling participation in capital or management."[281] He refers to Article 5 of the 1933 Report by the League of Nations' Fiscal Committee,[282] which is the predecessor to Article 9 of the OED MTC and initially introduced the arm's length principle.[283] Article 5 read as follows:

> "When an enterprise of one contracting State has a dominant participation in the management or capital of an enterprise of another contracting State, or when both enterprises are owned or controlled by the same interests, and as the result of such situation there exists, in their commercial or financial relations, conditions different from those which would have been made between independent enterprises, any item of profit or loss which should normally have appeared in the accounts of one enterprise, but which has been, in this manner, diverted to the other enterprise, shall be entered in the accounts of such former enterprise, subject to the rights of appeal allowed under the law of the State of such enterprise."

Dwarkasing argues that the term "participation in control" is not meant to be an independent trigger for association, but rather the term is a substitute for the term "dominant" as was used in Article 5 of the 1933 Report.[284] Therefore, Dwarkasing submits that the concept of associated enterprises is a concept based on *de jure* control that follows from company law. The view that the concept of associated enterprises under Article 9 covers *de facto* control in the broad sense should therefore, Dwarkasing argues, be rejected.[285]

---

[279] Dwarkasing *Associated enterprises* 570.
[280] Article 31(1) of the Vienna Convention.
[281] Dwarkasing *Associated enterprises* 570.
[282] League of Nations *Report of the Fiscal Committee to the Council* 5.
[283] 77.
[284] League of Nations *Report of the Fiscal Committee to the Council* 5.
[285] 567.

4.5.3 Similarities and differences between Dwarkasing's view and the UK domestic law

One cannot ignore the obvious similarities between Dwarkasing's view and the domestic position of the UK. The latter bears the greatest similarity to the OECD MTC's wording of the states that are assessed in this dissertation. As has been discussed in chapter 3 of this dissertation, the level of participation required in management or capital in order to trigger the associated enterprise definition is to such extent that the affairs of the enterprise are conducted in accordance with the person in question's wishes. This may arguably further support Dwarkasing's view and would provide much-needed certainty and uniformity to the application of Article 9 (particularly concerning the level of participation required in management or capital).

There is, however, no consensus between the UK's domestic law and Dwarkasing's view as to whether the term "control" constitutes an independent trigger for association. As will be recalled from chapter 3, I argue that the UK does, in fact, consider the term "control" as a distinct trigger for association. Dwarkasing, however, does not.[286]

It will also be recalled from chapter 3 that the United States, India and SA's domestic laws all contain the term "control", which is defined to include *de facto* control in all these states. Considering that all these above-mentioned states interpret "control" as a stand-alone criteria that may give rise to an associated enterprise relationship, an argument could be made that this consistent approach by the above-mentioned states in interpreting "control" constitutes context indicating that these states may have intended for the term "control" to be a separate trigger for association (which would include a form of *de facto* control). The Commentary makes it apparent, however, that *de facto* control in the broad sense ought not to trigger the application of Article 9.[287]

Considering the above, it appears that support for Dwarkasing's view that an autonomous meaning should be applied to the phrase "participation in management, control or capital" should be supported. That being said, Avery Jones has previously

---

[286] [286] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 12.

[287] OECD *Commentary on Article 9* para 2 provides that transfer pricing adjustments may not be made in the case of normal open-market commercial terms.

pointed out the possibility "for courts in each of the treaty countries to come to different decisions on what each considers to be the 'one true meaning' of the treaty."[288]

4.6 Conclusion

Cottani appears to be of the view that one must interpret the terms in the phrase "participates on the management or capital" in accordance with the domestic law of the state applying the treaty, which according to Cottani is the state in which one is seeking a corresponding transfer pricing adjustment for the sake of relief from economic double taxation. Regarding the interpretation of the term "control," the domestic law is limited in terms of the interpretation of Article 9 as envisioned by the Commentary thereto (which provides that transfer pricing adjustments may not be made in the case of normal open-market commercial terms).[289] Cottani relies on this part of the Commentary as authority to conclude that DTAs containing an article similar to Article 9(1) and (2) of the OECD MTC "permits an adjustment only in cases where double taxation would arise as a result of the adjustment, generally only in shareholding and managerial relationships."[290] This suggests that Cottani does not consider control to include *de facto* control in the broad sense. His approach initially seems contradictory in the sense that he does not exclusively favour either the domestic law of the contracting states or the context of Article 9 (in the form of the Commentary thereto). If, however, Cottani is arguing that only the term "control" is to be ascribed a meaning without reference to domestic law due to the context of that term stemming from the Commentary, then Cottani's qualification statement does not contradict his initial argument relying on domestic law, but instead suggests that Cottani's argument that domestic law meanings are to be used only applies to the terms contained in the phrase "participates in management or capital".

Dwarkasing, on the other hand, is of the view that the context requires otherwise than relying on the domestic meaning of the undefined terms.[291] After referring to the

---

[288] Avery Jones (2001) *Bulletin – Tax Treaty Monitor, International Bureau of Fiscal Documentation* 222.
[289] Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 52.
[290] 52.
[291] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 10.

context of Article 9 in the form of a historical analysis thereof, Dwarkasing concludes that the term "participation in control" is not meant to be an independent trigger for association, but rather the term is a substitute for the term "dominant".[292] Therefore, Dwarkasing submits that the concept of associated enterprises is a concept based on *de jure* control that follows from company law.

The author hereof respectfully submits that the OECD MTC Commentary on Article 9 (providing that a corresponding primary transfer pricing adjustment is only required if the other state agrees in principle with the initial adjustment), together with the purpose of the OECD MTC (to avoid economic double taxation from arising) supports the argument that the context requires undefined terms in Article 9 to be interpreted otherwise (ie, not in accordance with the domestic meaning of the Contracting State applying the convention).

This view is further supported by the OECD's Commentary providing that normal open-market commercial arrangements should not trigger an adjustment. It could be argued that this Commentary adds context to the term "control", requiring broad interpretations of the term (which consider normal commercial relationships to constitute control) to be disregarded.

Considering the historical context of Article 9, together with the purpose thereof, the view that direct participation in management or capital is to be interpreted as meaning that a person requires a dominant level of participation in management or capital to be associated ought to be favoured. Such a view would resolve economic double taxation from arising without the need for further amendments to DTAs.

When considering the domestic laws of the UK, the United States, India and SA, it appears that all of these states make use of the word "control" in their domestic tax laws (which consists of *de facto* control in the narrow sense, except for India which interprets *de facto* control in the broad sense). This may also constitute context for purposes of Article 3(2). This particular context may arguably suggest that contracting states did, in fact, intend for the term "control" to be a distinct trigger for association. The Commentary to Article 9 must also be considered for purposes of context when applying Article 3(2). The Commentary expresses that transfer pricing adjustments

[292] [292] R Dwarkasing "Comments on the revised Discussion Draft on Transfer Pricing Aspects of Intangibles" (27-09-2013) *OECD* <https://www.oecd.org/ctp/transfer-pricing/dwarkasing-maastricht-university.pdf> (accessed 01-09-2020) 12/

may not be made in the case of normal open-market commercial terms,[293] which can arguably be considered to mean that *de facto* control in the broad sense does not constitute "control". It seems apparent that Cottani supports this view.

Based on the above, it appears that there are at least two possible solutions to eliminating economic double taxation from arising as a result of a primary transfer pricing adjustment. The first being for contracting states to agree to an autonomous or universal definition of associated enterprise (which would arguably require consensus amongst both contracting states that the context of Article 9 requires otherwise than to interpret the terms therein in accordance with the domestic law of a particular Contracting State). The alternative would be for contracting states to apply the modified "new approach" (that is; the DTA is to be interpreted in accordance with the Contracting State applying the DTA), which would arguably require contracting states to ignore the existing paragraph 6 of the Commentary on Article 9 of the OECD MTC (which provides that a corresponding state is not obliged to make a corresponding transfer pricing adjustment if it disagrees with the initial transfer pricing adjustment).

On the other hand, where not all contracting states agree to apply the modified "new approach" by ignoring the existing paragraph 6 of the Commentary on Article 9 of the OECD MTC, taxpayers will have no option but to argue that Article 3(2) of the applicable DTA, together with the context of Article 9 of the applicable DTA, requires one to interpret the phrase "participates in management, control or capital" in accordance with the context of Article 9 (as opposed to in accordance with any particular Contracting State's domestic law).

The application of an autonomous meaning to the undefined terms, in my view, would theoretically provide increased conformity amongst all contracting states, particularly given that some states interpret control as *de facto* control in the narrow sense whilst others interpret it in the broad sense (which I am of the view is inconsistent with the context of Article 9, particularly the Commentary thereto stating that normal open-market conditions are not covered by the arms-length principle). However, given the increased pressure on almost every fiscus worldwide, together with the fact that the revenue authority of a Contracting State that is asked to make a corresponding adjustment would lose out on tax revenue if it were to adhere to such request, revenue authorities are unlikely to concede to such argument in practice

[293] Cottani "Transfer pricing, topical analyses" (2016) *IBFD* 52.

(leaving the decision to be decided by way of a Mutual Agreement Procedure, which has been criticised for being a challenging dispute resolution forum in Africa).[294] Considering the increased risk of an adversarial interaction between the taxpayer and the revenue authority of the Contracting State being requested to make a corresponding adjustment, it would seem that relying on the first above-mentioned method (that is; for contracting states to agree to an autonomous or universal definition of associated enterprise) may result in fewer disputes pertaining to economic double taxation from arising.

Regardless of whether the relevant contracting states decide to ignore the existing paragraph 6 of the Commentary on Article 9 of the OECD MTC, the context of Article 9 of the OECD MTC (particularly in the form of the Commentary thereto) requires the contracting states to interpret the term "control" in such manner that it does not include normal open market relationships. The term "control" therefore constitutes *de facto* control in the narrow sense.

[294] AW Oguttu "Resolving treaty disputes: The challenges of mutual agreement procedures with a special focus on issues for developing countries in Africa" (2016) 70 *Bull Intl Taxn* (accessed 06-09-2020).

CHAPTER 5: CONCLUSION

5.1 Introduction

As mentioned in the introductory chapter hereof, the general purpose of this dissertation is to establish how to interpret the phrase "participat[ion] … in the management, control or capital" under an article of a DTA (which mirrors Article 9 of the OECD MTC), which is central to establishing whether an "associate enterprise" exist, from a South African perspective. The understanding of this phrase has become particularly pertinent in SA after the amendment to the "affected transaction" definition to include cross-border transactions entered into between associated enterprises. However, despite SA's amendment, the effective date of the amendment was postponed to a year after the amendment was effected. [295] The reason for this delay was due to uncertainty in interpreting the term associated enterprise.[296]

This dissertation specifically examines two distinct ways of interpreting the relevant phrase. One being an interpretation that, due to the fact that the OECD MTC does not define the terms contained in the phrase "participates in the management, control or capital," relies on an article of a DTA (which mirrors Article 3(2) of the OECD MTC) to interpret the undefined terms in accordance with domestic legislation. The second being whether the context provides otherwise and therefore requires one not to follow the domestic legislation's definition of an associated enterprise, and rather interpret the undefined terms in accordance with the context.

In addition to comprehending how to interpret the content of Article 9, which requires one to apply Article 3(2), the relationship between DTAs (with provisions identical to Article 9 of the OECD MTC) and domestic transfer pricing laws require consideration to understand what legal impact such a DTA provision has on taxpayers.

5.2 Preliminary point regarding the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019

Interestingly, the Explanatory Memorandum to the amendment states the following:

[295] SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 42. And it is proposed that the effected date be postponed even further [Clause 78 of the Taxation Laws Amendment Bill, 2020].
[296] 41.

> "The fact that South Africa does not have or use the concept of associated enterprises when applying the arm's length principle presents a challenge in application of the transfer pricing rules in respect of transactions between "associated enterprises" that are not regarded connected persons."[297]

Based on the content of the Explanatory Memorandum, it seems that some professionals are of the view that the term "associated enterprise" is broader than the term "connected person". Based on the findings of this dissertation, it is unlikely for this to ever be the case, regardless of whether one interprets the term "associated enterprise" in accordance with one of the contracting states' domestic law (as proposed by Cottani), or whether one interprets the terms autonomously without reference to a contracting state's domestic law (as proposed by Dwarkasing). One conceivable scenario in which this may arise is if one were to apply Cottani's view, and the term "associated enterprise" were interpreted in accordance with India's domestic law (because India defines "control" as including a closed list of general open-market relationships, such as *inter alia* a supplier dependency relationship).[298] However, even Cottani concedes that the Commentary to the OECD MTC provides that normal open market conditions (which arguably can include a supplier dependency relationship) ought not to be considered to be a transaction between associated enterprises. The only indefensible way that the term "associated enterprise" could possibly be broader than the term "connected person" is if one follows Cottani's approach, and the contracting state whose domestic law is relied on to interpret the term "associated enterprise" contains a lower participation threshold for an associated enterprise relationship to exist. Given that the connected person's share participation requirement is, in some instances, 20%, it seems unlikely for this to ever be the case.

5.3 The relationship between domestic legislation and double taxation agreements

Since both of the two distinct methods of interpretation that are considered by this dissertation (that is, interpreting the undefined terms in question in accordance with domestic law, or alternatively applying an autonomous interpretation) rely on the

---

[297] 42

[298] Section 92A of the Indian Income Tax Act 43 of 1961.

interpretation of a DTA, it is material for one to first grasp an understanding of what legal effect a DTA has domestically, particularly in instances where a DTA conflicts with domestic legislation.

After having analysed the prevailing legislation, Commentary and case law from SA, the USA, the UK and India, it appears that two general methods to address conflict between DTAs and domestic legislation exist. The first being that a state can provide for rules that provide that one rule prevails over another (the *lex superior derogate inferiori* rule), such as in the UK. The second general method identified in this analysis is the ordinary principles of legislative interpretation, particularly the *lex specialis derogat legi generali* rule (such as in SA and India). Although the United States utilises domestic legislation to address conflicts between DTAs and domestic legislation, the content of that legislation stems from ordinary principles of legislative interpretation. Unlike SA and India, however, the United States does not apply the *lex specialis* rule. Instead, the United States applies the *posterior derogate priori* rule. Later-enacted domestic legislation can, therefore, supersede existing DTAs in the United States. The United States is therefore different from SA, India and the UK in the sense that the United States does not give preference to a DTA over domestic legislation *per se*. Instead, the United States enforces the later-enacted provision, whether or not from a DTA or domestic legislation.

From a South African perspective, the only legal basis for a transfer pricing adjustment is in terms of the application of section 31 of the Income Tax Act. The impact of the *lex specialis derogat legi generali* rule in relation to section 31 of the Income Tax Act and a DTA provision identical to Article 9 of the OECD MTC is that such DTA provision restricts the application of section 31 of the Income Tax Act. This restriction is in the form of a prohibition of a transfer pricing adjustment in instances where the transaction in question falls outside the ambit of a DTA provision identical to Article 9 of the OECD MTC. Where such transaction is not between associated enterprises as per Article 9 of the OECD MTC, a transfer pricing adjustment would not be allowed. A further noteworthy point to mention relating to the impact of the *lex specialis derogat legi generali* rule in relation to section 31 of the Income Tax Act and a DTA provision identical to Article 9 of the OECD MTC is that any amendment to section 31 of the Income Tax Act resulting in a broadening of the scope of a transfer pricing adjustment would have no impact. This is due to the fact that the applicability of section 31 of the Income Tax Act is limited by a DTA provision identical to Article 9 of the OECD MTC.[299]

5.4 Differing domestic definitions of the term "associated enterprise" (or terms *in lieu* thereof)

Before dealing with how to correctly interpret the term "associated enterprise," one needs to be aware of the fact that different states have differing definitions for the phrase "participates directly … in the management, control or capital" (or a comparable phrase).

Based on chapter 3 of this dissertation, one can see that the proliferation of unilateral measures has resulted in some inconsistencies in the domestic approaches to determining what transactions should fall within the net of the domestic transfer pricing legislation. However, there are also a number of similarities amongst the various domestic approaches. The inconsistencies in the domestic approaches can initially be identified from the fact that different terminology is utilised by different states, albeit that the differing terminologies seem to aim to cater for the same thing (being connectivity to another). India uses the term "associated enterprise," which is *inter alia* defined as a person that participates in the control, management, or the capital of a company. In the UK, the "participation condition" must be met, which requires one of the affected persons to be directly or indirectly participating in the management, control or capital of the other. In the United States, a transfer pricing adjustment may be made if at least two organisations are owned or controlled by the same interests. Lastly, in SA, the contracting parties need to be connected persons (which includes parties that are managed or controlled by another, as well as various participation requirements pertaining to capital), or (as of January 2021 (or 2022, if the draft amendment in terms of Clause 78 of the Taxation Laws Amendment Bill 2020 is accepted)) an associated enterprise in relation to each other.

The evident similarities in the various domestic approaches is that they all include some form of interest in the management, capital or control of an entity. On the other hand, the most important differences that need to be mentioned are the differences in the level of participation required in capital or management, and differences in

---

[299] Kofler "Article 9. Associated Enterprises" in *Klaus Vogel on double taxation conventions* 601.

interpretation of what constitutes control amongst the above-mentioned states (being *de jure* control, *de facto* control in the narrow sense, and *de facto* control in the broad sense that includes various open market arrangements).

Regarding the level of participation required, direct participation is defined in the UK as participation in capital or management to the extent that one has control. The level of participation required is therefore generally more than 50% in capital (together with voting rights) or management. In the United States, it is the reality of the control that is decisive, not its form or the mode of its existence. More than 50% participation would therefore generally also be required in the United States. This general position may arguably not apply in instances where it can be proven that there are apathetic shareholders or board members that have resulted in a person obtaining control with less than 50% participation in capital or management. South African domestic legislation imposes a participation requirement of 20% if no other holder of shares holds the majority voting rights. Alternatively, the participation requirement is more than 50%, to the extent that the arrangement does not pertain to financial assistance or IP (in which case the participation requirement is 20%). In India, the participation requirement is 26% shareholding, which is considerably less than what is generally required in the UK and the United States.

Regarding "control", the differing approaches of interpretation were identified. First, forms of *de jure* control that are limited to control in the form of shareholding or management or control stemming from a document governing a company (such as a memorandum of incorporation), which is applied by states such as the UK. Secondly, *de facto* control that is based on an open-ended concept of control in reality, as applied by states such as the USA. Finally, an interpretation of control that covers a broad interpretation of *de facto* control that includes certain open market arrangements, as applied by states such as India.

Regarding the differences in interpretation of what constitutes control, direct participation is defined in the UK as participation in capital or management to the extent that one has control. This is generally referred to as *de jure* control. The UK, however, also considers a person to control a company if, as a result of any powers conferred by the articles of association or other document regulating that company, the company is conducted in accordance with that person's wishes.

Control is also defined in the US domestic legislation. Unlike the UK, however, the definition of control is based on an open-ended concept of *de facto* control. What is evident from the United States' domestic legislation is that it is not the form of control that is material, but rather it is the reality of control that is decisive.

Although control is not expressly defined by India's domestic legislation, Indian domestic legislation does specifically stipulate that the relationships listed therein are indicative of a controlled relationship existing. These listed relationships generally provide for *de jure* control and *de facto* control in the broad sense that includes open market arrangements.

The South African domestic law definition of a connected person also refers to the term "control," which the South African courts have held means *de facto* control.[300] However, it is submitted that the form of *de facto* control referred to in Interpretation Note 67, as well as in the court cases referred to therein, is narrower than the types of relationships that India considers to give rise to *de facto* control. This submission is based on the fact that SA's interpretation of *de facto* control considers whether there is in substance control via management. The connected person definition, however, also appears to be broad enough to possibly include persons that can control a company by virtue of some form of power conferred by that company's memorandum of incorporation or some other document governing the company (as is the case in the UK, and arguably also the US). An example may include the power given by a company to an independent creditor (by way of an amendment to the document regulating that borrowing company) to veto any decisions pertaining to the company's capital expenditure or acquisitions, or the incurral of further debt or any other material arrangement.

The above analysis clearly illustrates that the above-mentioned states do not all impose an identical participation level required to give rise to association, nor do they all interpret the term "control" identically domestically. Regarding the latter, the two predominant interpretations are *de jure* control and *de facto* control, and *de facto* control also appears to be capable of being interpreted in a narrow manner as well as a broad manner that includes certain open market arrangements. The narrow interpretation appears to aim at regarding entities that are in substance controlled by another via management, while the broad interpretation appears to include certain commercial relationships that may give rise to one entity being commercially

[300] *S v Pouroulis* 1993 4 S A 575 (W); *ITC 1741* 65 SATC 106; SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS*.

dependent on the other. This may well give rise to uncertainty when interpreting the term “control” in a DTA, which was addressed in chapter 4 of this dissertation.

5.5 Findings from the critical analysis of the two predominant (and opposing) views on interpreting Article 9

The first of the two predominant views on interpreting Article 9 considered in this dissertation requires that one must interpret the term “associated enterprise” in accordance with the domestic law of the state applying the treaty, which according to Cottani is the state in which one is seeking a corresponding transfer pricing adjustment for the sake of relief from economic double taxation. The domestic law, however, is limited in terms of the interpretation of Article 9 as envisioned by the Commentary thereto (which provides that transfer pricing adjustments may not be made in the case of normal open market commercial terms).[301] Cottani relies on this part of the Commentary as authority to conclude that DTAs containing an article similar to Article 9(1) and (2) of the OECD MTC “permits an adjustment only in cases where double taxation would arise as a result of the adjustment, generally only in shareholding and managerial relationships.”[302] This suggests that Cottani does not consider control to include *de facto* control in the broad sense. Cottani’s approach, however, does not currently always result in the avoidance of economic double taxation, nor does it answer the question as to what level of participation in capital is required to trigger an associated enterprise relationship. His approach is also contradictory in the sense that he does not exclusively favour either an interpretation in accordance with the domestic law of the contracting states or the context of Article 9 (in the form of the Commentary thereto).

Dwarkasing, on the other hand, is of the view that the context requires otherwise than relying on the domestic meaning of the undefined terms. After referring to the context of Article 9 in the form of a historical analysis thereof, Dwarkasing concludes that the phrase “participation in control” is not meant to be an independent trigger for association, but rather that the term is a substitute for the term “dominant”. Therefore, Dwarkasing submits that the concept of associated enterprises is a concept based on *de jure* control that follows from company law.[303]

---

[301] Cottani “Transfer pricing, topical analyses” (2016) *IBFD* 52.
[302] 52.
[303] Dwarkasing *Associated enterprises* 570.

The author hereof respectfully submits that the OECD MTC Commentary on Article 9 (providing that a corresponding primary transfer price ("TP") adjustment is only required if the other state agrees in principle with the initial adjustment), together with the purpose of the OECD MTC (to avoid economic double taxation from arising) supports the argument that the context requires undefined terms in Article 9 to be interpreted otherwise (that is, not in accordance with the domestic meaning of the contracting state applying the convention). This view is further supported by the OECD's Commentary providing that normal open market commercial arrangements should not trigger an adjustment. It could be argued that this Commentary adds context to the term "control", requiring broad interpretations of the term (which consider normal commercial relationships to constitute control) to be disregarded.

Considering the historical context of Article 9, together with the purpose thereof, direct participation in management or capital ought to be interpreted as meaning that a person requires a dominant level of participation in management or capital in order to be associated. Furthermore, considering the domestic laws of the UK, the United States, India and SA, it appears that all of these states make use of the word "control" in their domestic tax laws as a stand-alone requirement. This may also constitute context for purposes of Article 3(2). This particular context may arguably suggest that contracting states did in fact intend for the term "control" to be a distinct trigger for association, and that a form of *de facto* control would constitute "control". The Commentary to Article 9 must also be considered for purposes of context when applying Article 3(2). The Commentary expresses that transfer pricing adjustments may not be made in the case of normal open market commercial terms,[304] which can arguably be considered to mean that *de facto* control in the broad sense does not constitute "control". The form of *de facto* control that is to fall within the ambit of the term "associated enterprise" should therefore be limited to *de facto* control in the narrow sense.

Considering the broad scope of *de facto* control in the narrow sense, it seems more likely than not that any minority shareholder may even potentially be the person that effectively makes all the decisions of the company, thereby resulting in that company being *de facto* controlled by that particular minority shareholder (regardless of whether a different shareholder holds the majority in equity shares or voting rights). An example

[304] OECD *Commentary on Article 9* para 6.

of how a minority shareholder may exercise *de facto* control is if that shareholder has the majority voting rights at a specific shareholders meeting where certain decisions are made regarding the acquisition or disposal of assets, or to incur a liability.

Some professionals in practice are of the view that control is wide enough to include exclusive distribution rights or offtake arrangements. In cases where this is the extent of the relationship, it is respectfully submitted that such contracting parties cannot constitute a connected person by virtue of *de facto* control. This submission is based on the premise that the person entering into an agreement with the company does not factually have *carte blanche* to run the company. Of course, such commercial arrangement may influence the persons that run the company, however, that does not result in the "influencer" running the company (and thereby being in *de facto* control thereof in the narrow sense). The person who runs the company cannot be said to have relinquished itself from running the company and having given the "influencer" *carte blanche* to run the company. The company's actions remain the result of the actions of the person who runs the company, not the person who influences that person who runs the company. The same can be said about creditors of a company; they may influence the person who runs the company by way of contractual rights entitling the lender to restrict the decisions of the borrower, but that does not *per se* give rise to the creditor running the company. Academics have also opined that mere economic dominance or dependence deriving from commercial relationships originating from *de facto* situations should not be confused with control.[305]

On the other hand, where a company gives an independent creditor (by way of an amendment to the document regulating that borrowing company)[306] the power to veto any decisions pertaining to the company's capital expenditure or acquisitions, the incurral of further debt or any other material arrangement, it could be argued that such powers conferred upon the creditor in terms of the document regulating that borrowing company gives rise to a *de facto* controlling relationship in the narrow sense.

---

[305] Dwarkasing *Associated Enterprises* 237.

[306] The question whether amending the document regulating that borrowing company to cater for the lender in such manner is a question of company law, which falls outside the scope of this dissertation. To the extent that the document regulating that borrowing company remains unchanged, and the lender relies on a contractual right instead, then such a lender relationship will arguably not constitute *de facto* control in the narrow sense.

Based on the above, it appears that there are at least two possible solutions to eliminating economic double taxation from arising as a result of a primary transfer pricing adjustment. The first being for contracting states to agree to an autonomous or universal definition of an associated enterprise (which would arguably require consensus amongst all contracting states that the context of Article 9 requires otherwise than to interpret the terms therein in accordance with the domestic law of a particular contracting state). The alternative would be for contracting states to apply the modified “new approach” (that is; the DTA is to be interpreted in accordance with the Contracting State applying the DTA), which would arguably require contracting states to ignore the existing paragraph 6 of the Commentary on Article 9 of the OECD MTC (which provides that a corresponding state is not obliged to make a corresponding transfer pricing adjustment if it disagrees with the initial transfer pricing adjustment). The author is of the view that the first option should be preferred.

BIBLIOGRAPHY

Books and book chapters:

Avi-Yonah RS "Tax treaty overrides: A qualified defence of U.S. practice" in *Tax treaties and domestic law* (2006), Amsterdam: IBFD Publications.

Baker P *Double taxation conventions* 3 ed (2019), United Kingdom: Sweet & Maxwell.

Becerra JA *Interpretation and application of tax treaties in North America* (2007), Amsterdam: IBFD Publications.

De Broe L *International tax planning and prevention of abuse* (2008), Amsterdam: IBFD Publications.

De Koker AP & Williams RC *Silke on South African income tax* (2018), Durban: LexisNexis.

Dugard J International law: A South African perspective 4 ed (2011), Cape Town: Juta & Co. Ltd.

Eden L "Taxes, transfer pricing and the multinational enterprise" in AM Rugman & TL Brewer (eds) *The Oxford handbook of international business* (2001), Oxford: Oxford University Press.

Fiscal Association *Cahiers Volume 101B: The notion of tax and the elimination of international double taxation or double non-taxation* (2016), The Hague: International Fiscal Association.

Hamaekers H "Introduction to transfer pricing" in H Hamaekers, MH Collins & WA Comello (eds) *The Tax Treatment of Transfer Pricing* (2008), Amsterdam: International Bureau of Fiscal Documentation.

IFA Cahiers 2016 volume 101B 862.

Infanti AC "United States" in G Maisto (ed) *Tax treaties and domestic law: Volume 2 in EC and international tax law series* (2006), Amsterdam: IBFD Publications.

Jones A "Treaty interpretation" in R Vann (ed) *Global tax treaty commentaries* (2015), Online: IBFD Publications.

Kofler G "Article 9. Associated enterprises" in E Reimer & A Rust (eds) *Klaus Vogel on double taxation convention*s (2015), The Netherlands: Wolters Kluwer.

Lang M "Qualification conflicts" in R Van (ed) *Global tax treaty commentaries* (2015), Online: IBFD Publications.

Lang M *Introduction to the law of double taxation conventions* 2 ed (2013), IBFD and Linde.

OECD "Commentary on Article 9: Concerning the taxation of associated enterprises," in *Model Tax Convention on Income and on Capital* (Full Version) 10 ed (2017), Paris: OECD Publishing.

OECD *Committee on fiscal affairs tax treaty override* (1989), Paris: OECD Publishing.

OECD *Committee on fiscal affairs*. *Report of the OECD Committee on Fiscal Affairs on transfer pricing and multinational enterprises* (1979), Paris: OECD Publishing.

OECD *Model Tax Convention on Income and on Capital* (Full Version) I and II 10 ed (2017), Paris: OECD Publishing.

OECD *Transfer pricing guidelines for multinational enterprises and tax administrations* (2017), Paris: OECD Publishing.

Olivier L & Honiball M *International tax: A South African perspective* 4 ed (2008), South Africa: Siber Ink.

Rogers-Glabush J IBFD *International tax glossary* 6 ed (2009), Amsterdam: IBFD Publications.

Roxan I "United Kingdom" in G Maisto (ed) *Tax treaties and domestic law* (2006), Amsterdam: IBFD Publications.

Rust A *"Article 3(2)" in Klaus Vogel on double taxation conventions* 3 ed (1997), The Netherlands: Wolters Kluwer.

Schwarz J *Schwarz on tax treaties* (2013), CCH.

Vogel K "The domestic law perspective" in G Maisto (ed) *Tax treaties and domestic law* (2006), Amsterdam: IBFD Publications.

Vogel K Klaus *Vogel on double taxation conventions* 3 ed (1997), The Netherlands: Wolters Kluwer.

Ward DA *The interpretation of income tax treaties with particular reference to the commentaries on the OECD Model* (2005), Canada: International Fiscal Association.

Wittendorff J *Transfer pricing and the arm's length principle in international tax law* (2010), The Netherlands: Wolters Kluwer.

Journal articles:

Akehurst M "The hierarchy of the sources of international law" (1976) 47 *British Yearbook of International Law* 273-285.

Avery Jones JF "The "one true meaning" of a tax treaty" (2001) *Bulletin – Tax Treaty Monitor, International Bureau of Fiscal Documentation* 220-224.

Du Plessis I "Some thoughts on the interpretation of tax treaties in South Africa" (2012) 24 *South African Mercantile Law Journal* 31-52.

Dwarkasing R "The concept of associated enterprises" (2013) 41 *Intertax* 412-429.

Ferreira G & Ferreira-Snyman A "The incorporation of public international law into municipal law and regional law against the background of the dichotomy between monism and dualism" (2014) 17 *Potchefstroom Electronic Law Journal* 1470-1496.

Gutuza T "Tax treaties, the Income Tax Act and the Constitution – Trump or reconcile?" (2016) 3 *South African Mercantile Law Journal* 480-507.

Iwasawa Y "The doctrine of self-executing treaties in the United States: A critical analysis" (1985-1986) 26 *Virginia Journal of International Law* 626-692.

Linderfalk U & Hilling M "The use of OECD Commentaries as interpretative aids – The static/ambulatory–approaches debate considered from the perspective of international law" (2015) 10 *Nordic Tax Journal* 195-205.

Oguttu AW "Resolving treaty disputes: The challenges of mutual agreement procedures with a special focus on issues for developing countries in Africa" (2016) 40 *South African Yearbook of International Law* 160-201.

Sada M Garibay "An analysis of the case law on Article 3(2) of the OECD Model (2010)" (2011) 65 *Bulletin for International Taxation*.

Van Rhyn J & Lermer D "Recent transfer pricing developments" (2008) 5 *International Transfer Pricing Journal* (2008) 230-232.

Vogel K "Double tax treaties and their interpretation" (1986) 4 *International Tax & Business Lawyer* 1-85.

Dissertations:

Du Plessis I *A South African perspective on some critical issues regarding the OECD model tax convention on income and on capital, with special emphasis on its application to trusts*. LLD dissertation, Stellenbosch University (2014).

Dwarkasing RSJ *Associated enterprises: A concept essential for the application of the arm's length principle and transfer pricing*. LLD dissertation, Tilburg University (2011).

Jansen van Rensburg EC *A South African perspective on the meaning of "beneficial ownership" in Article 10 of the OECD Model Tax Convention on Income and Capital in the context of conduit company treaty shopping*. LLD dissertation, University of Pretoria (2017).

Legislation:

Constitution of the Republic of South Africa, 1996.

Constitution of the United States of America (Amend XXVII).

Income and Corporation Tax Act of 1988.

Income Tax Act 58 of 1962.

Indian Income Tax Act 43 of 1961.

Internal Revenue Code ("26 US Code") § 7852.

Internal Revenue Code and the Indian Income Tax Act of 2001.

Partnership Act 9 of 1932.

Taxation (International and Other Provisions) Act of 2010.

Treas Reg § 1.482 (1)(b).

Treas Reg §1.482-1(i)(4).

Case law:

4 Posadas v National City Bank 296 US 497, 503 (1936).

Baldwins (South Africa) Ltd v CIR 1961 24 SATC 270.

Chotabhai v Union Government (Minister of Justice) & Registrar of Asiatics 1911 AD 13.

CIT v VR.S.R.M. Firm 208 ITR 400.

CIT v. Torquoise Investment and Finance Ltd (2006) 202 CTR MP 395, 2008 299 ITR 143 MP.

Clifford Chance (United Kingdom) v. Deputy Commissioner of Income Tax (2001 and 2008).

Commissioner for the South African Revenue Service v Tradehold Ltd 2012 3 All SA 15 (SCA).

Commissioner, South African Revenue Service v Van Kets 2012 3 SA 399 (WCC).

COT v Aktiebolaget Tetra Pak 1966 28 SATC 217.

CSARS v Tradehold Ltd 2013 4 SA 184 (SCA).

Deputy Commissioner of Income Tax v. Metchem Canada Inc (2005).

DSG Retail Ltd v HMRC [2009] STC (SCD) 397.

Estate Kootcher v CIR 1941 AD 256, 11 SATC 298.

Fugro Engineers BV v. Assistant Commissioner of Income Tax, Assistant Commissioner of Income Tax v. Fugro Engineers BV (2008).

Gentiruco AG v Firestone SA (Pty) Ltd 1972 1 SA 589 (A).

Glenister v President of the Republic of South Africa 2011 3 SA 347 (CC).

Hindalco Industries Ltd v. Assistant Commissioner of Income Tax (2005).

ITC 1054 26 SATC 260.

ITC 1878 (2015) 77 SATC 349.

Jolly Jeorge Verghese & Anr v The Bank of Cochin AIR 1980 SC 470.

Krok v C:SARS 2015 6 SA 317 (SCA).

Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 4 SA 593 (SCA).

New Modderfontein Gold Mining Co v Tvl Provincial Administration 1919 AD 367 397.

R v Sutherland 1961 2 SA 806 (A) 815B.

Re the Trevor Smallwood Trust; Smallwood v HMRC [2008] STC (SCD) 629.

S Rep No 110-17 (2008).

S v Hattingh 1978 2 SA 826 (A) 829A-G.

S v Pouroulis 1993 4 SA 575 (W).

South African Revenue Service v Van Kets 2012 3 SA 399 (WCC).

Sun Life Assurance co of Canada v Pearson [1986] STC 335 CA.

UAE Exchange Centre Ltd v. Union of India (2009).

Whitney v Robertson 124 US 190 (1888).

SARS and tax-related documentation:

SARS "Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019" (21-01-2020) *SARS* 41 <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2020-01%20-%20Explanatory%20Memorandum%20on%20the%20TLAB%20of%202019.pdf>.

Explanatory Notes: Taxation (International and Other Provisions) Act 2010.

Senate Report 100-445, 100th Cong., 2nd Sess., Tit. I, XII H 1 (Relationship with Treaties), explaining Sec. 112 (aa) of S. 2238 (IRC Sec. 7852).

SARS "Interpretation Note 67 (issue 4)" (28-01-2020) *SARS* 31 <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-67%20-%20IN67%20Connected%20Persons.pdf>.

International instrument:

Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331.

Internet sources:

Agarwal SK "Implementation of International Law in India: Role of Judiciary" (14-06-2010) *SSRN* <https://ssrn.com/abstract=1864489>.

CBDT Circular 14 of 2001 – New legislation to curb tax avoidance by abuse of transfer pricing – Appendix C.

Cottani G "Transfer pricing, topical analyses" (2016) IBFD 40 <http://online.ibfd.org.ez.sun.ac.za/document/tp_intro>.

Cottani G "Transfer pricing" (2014) IBFD Topical Analysis <https://www.africataxjournal.com/wp-content/uploads/2018/04/An-Overview-of-Transfer-Pricing-by-IBFD-1.pdf>.

De ePietro C "Tax treaty override and the need for coordination between legal systems: Safeguarding the effectiveness of international law" (2015) 77 World Tax Journal <https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Pay-per-view_wtj_2015_01_int_3.pdf>.

Government of India: Income Tax Department "Circular No. 333 Double Taxation Relief & Transfer Pricing" (02-04-1982) *Government of India* <https://www.incometaxindia.gov.in/_layouts/15/dit/pages/viewer.aspx?path=http://www.incometaxindia.gov.in/communications/circular/910110000000000699.htm&k=&opt=&isdlg=0&path=http://www.incometaxindia.gov.in/communications/circular/910110000000000699.htm&k=&opt=&isdlg=0>.

Government of India: Income Tax Department "Circular No. 789 Clarification regarding taxation of income from dividends and capital gains under the Indo-Mauritius Double Tax Avoidance Convention (DTAC)" (13-04-2000) Government of India <https://www.incometaxindia.gov.in/Communications/Circular/910110000000000483.htm>.

HMRC "INTM267626: Foreign banks trading in the UK through permanent establishments: Interaction of double tax agreements with UK domestic law" (09-0-2016) Gov.uk <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm267626>.

Internal Revenue Service "Internal Revenue Bulletin 2002-44" (04-11-2002) <https://www.irs.gov/pub/irs-irbs/irb02-44.pdf>

INTM 412050: Transfer pricing: legislation: rules: meaning of "provision" and "transaction" available at <https://library.croneri.co.uk/cch_uk/irm/intm-intm412050>.

INTM412060: Transfer pricing: legislation: rules: participation in the management, control or capital of a person <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412060>.

Langston R "Back to basics: Double tax treaties" (18-04-2012) The Tax Journal <https://www.taxjournal.com/articles/double-tax-treaties-44911>.

League of Nations *Report of the Fiscal Committee to the Council*, Fourth Session, Doc No C.399.M.204.1933.II.A (Geneva: League of Nations 1933) <https://biblio-archive.unog.ch/Dateien/CouncilMSD/C-399-M-204-1933-II-A_EN.pdf>.

Narayan A & Mala B "Tax Treaty Override: A Detailed Study" (undated) SAPR Law Blog 32 <http://www.saprlaw.com/taxblog/tax_treaty_override-A_detailed_study.pdf>.

Spearman T "Transfer pricing rules for South African domestic intergroup transactions" (23-05-2013) SAIT News & Press: Transfer Pricing & International Tax <http://www.thesait.org.za/news/126410/Transfer-pricing-rules-for-South-African-domestic-intergroup-transactions.htm>.