9 NOVEMBER 2018

TAX & EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

NO TAX ON INTEREST? RULING PERTAINING TO DTA BETWEEN SOUTH AFRICA AND BRAZIL

On 24 July 2006, the Convention between the Government of the Republic of South Africa and the Government of the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (DTA), came into force. The DTA, similar to other such double tax agreements, determines the taxing rights of each country where a resident of one contracting state earns income from a source in the other contracting state.

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On 4 July 2018, the South African Revenue Service (SARS) issued Binding Private Ruling 307 (BPR 307), which deals with relief from double taxation of interest in terms of the DTA.

Facts and proposed transaction

The applicant, a South African resident company, proposes to enter into trades in respect of bonds issued by the Brazilian government (bonds). The applicant will:

- enter into a purchase and resell agreement with international counterparties in terms of which it will acquire bonds from the counterparties and will agree to sell back the bonds to the counterparties on specified dates and for specified prices which will each include an interest component; and
- acquire bonds in the market without any associated resell arrangements.

The applicant may in either case receive interest from the Brazilian government as issuer of the bonds during the term of the transaction. The interest that the applicant will receive is not subject to tax in Brazil.

In respect of the purchase and resell agreement, the applicant will pay the counterparties so-called manufactured payments calculated with reference to the interest it will receive while holding each bond. The applicant will recognise the purchase and resell agreements and the bonds at fair value in profit or loss in terms of International Financial Reporting Standard 9. BPR 307 further states that s24JB(2) of the Income Tax Act, No 58 of 1962 (Act) will apply to the instruments.

Applicable legal provisions

In terms of article 11(4)(b) of the DTA, subject to article 11(4)(a), interest from securities, bonds or debentures issued by the Government of a Contracting State, a political subdivision thereof or any agency (including a financial institution) wholly owned by that Government or a political subdivision thereof shall be taxable only in that State.

Article 11(4)(a) of the DTA states that interest arising in a Contracting State and derived and beneficially owned by the Government of the other Contracting State, a political subdivision thereof, the Central Bank or any agency (including a financial institution) wholly owned by that Government or a political subdivision thereof, shall be exempt from tax in the first-mentioned State.

Section 24JB of the Act applies to "covered persons". According to s24JB, the definition of a "covered person" includes

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Although it is not specifically dealt with in BPR 307, it appears that where article 11(4)(b) of the DTA applies, the source rules in s9(2)(b) of the Act do not apply.

the South African Reserve Bank, banks as defined in s1 of the Banks Act, No 94 of 1990, long-term insurers as defined in s1 of the Long-Term Insurance Act, No 52 of 1998 and short-term insurers as defined in s1 of the Short-Term Insurance Act, No 53 of 1998.

Ruling

SARS ruled in BPR 307 that article 11(4)(b) of the DTA grants exclusive taxing rights to Brazil in respect of the interest that the applicant will receive on the bonds, meaning that the interest will not be taxable in South Africa.

SARS added an additional note in BPR 307 stating that its ruling does not cover the application or interpretation of any general or specific anti-avoidance provision or doctrine and does not pronounce on the deductibility of any expenditure incurred by the applicant in relation to the transactions.

Comment

In terms of s9(2)(b) of the Act, if an amount constitutes "interest" as defined in s24J of the Act, the interest is deemed to be received or accrue from a South African source if:

- it is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or
- it is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement.

Although it is not specifically dealt with in BPR 307, it appears that where article 11(4)(b) of the DTA applies, the source rules in s9(2)(b) of the Act do not apply.

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Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory & Controversy for 2018.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

Ludwig Smith has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2018.

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