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# TAX AND EXCHANGE CONTROL ALERT

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*One of the most exciting endeavours of the OECD/G20 BEPS Project is the progress being made on BEPS Action 15 – the Development of a Multilateral Instrument to Implement Tax Treaty related BEPS Measures.*

The European migrant crisis has reached catastrophic proportions. In 2015 more than a million migrants and refugees from Syria, Afghanistan, Iraq and other Asian and African countries fled from war and conflict, to Europe. The European Union (EU) is struggling to cope with the influx, which has caused schisms in the EU over how best to deal with resettlement of these displaced persons. Some European jurisdictions have been willing to accept asylum seekers while others have responded by increasing funding for border patrol operations in the Mediterranean and re-introducing border controls within the Schengen Area.

The EU's single market was dealt a blow in June of this year when the United Kingdom (UK) voted to exit the EU (Brexit). Article 50 of the Treaty on the EU, which governs the withdrawal process, has never been activated before and while the UK appears to be angling for a more gradual exit through an informal process of negotiation; the remaining EU jurisdictions are eager to get the formal process underway, no doubt for fear, among other things, of political contagion. Uncertainty reigns as pundits try to predict how Brexit will play out.

The campaign of United States (US) presidential candidate, Donald Trump, has caused division in the US and even within his own Republican party.

Political extremism, violence and division continue unabated across the globe, and the world appears to have run mad.

All the more commendable then is the momentum sustained by the inter-jurisdictional collaboration required to implement the OECD/G20 BEPS Project, which seeks to eliminate opportunities for cross-border tax avoidance and evasion while effectively and efficiently preventing double taxation.

These endeavours are critical to the establishment of a robust international tax system capable of supporting economic growth and a resilient global economy.

More than 100 countries and jurisdictions, including South Africa, are now collaborating to achieve cross-border equity and integrity between tax systems and much effort is being exerted to achieve fiscal transparency and tax capacity building programmes, particularly for developing countries.

For me, one of the most exciting endeavours of the OECD/G20 BEPS Project, particularly when juxtaposed with the accelerating disintegration of any semblance of unified global action for good; is the progress being made on BEPS Action 15 – the Development of a Multilateral Instrument to Implement Tax Treaty related BEPS Measures.

Several OECD/G20 BEPS Project recommendations are to be implemented through amendments to double taxation agreements (DTAs). If undertaken on a DTA-by-DTA basis, the sheer volume of DTAs in effect would make the process arduous and



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*In May 2015 an Ad Hoc Group comprising 96 countries, together with a number of non-State jurisdictions and international organisations participating as observers, was established with the objective of developing a multilateral instrument to modify existing DTAs in order to swiftly implement the tax treaty measures developed during the course of the OECD/G20 BEPS Project.*



protracted. Recognising the need for an efficient and effective mechanism to implement the DTA-related measures resulting from the BEPS Project, Action 15 of the BEPS Action Plan called for the development of a multilateral instrument.

Public international law and tax experts analysed the possibility of developing a multilateral instrument to allow countries to amend their DTAs to implement the DTA-related BEPS recommendations and concluded that such a multilateral instrument was not only feasible but desirable.

In May 2015 an Ad Hoc Group comprising 96 countries all participating on equal footing, including South Africa, together with a number of non-State jurisdictions and international organisations participating as observers, was established with the objective of developing a multilateral instrument to modify existing DTAs in order to swiftly implement the tax treaty measures developed during the course of the OECD/G20 BEPS Project. The aim of the Ad Hoc Group is to conclude its work and open the multilateral instrument for signature by 31 December 2016.

1. The tax treaty provisions to be implemented through the multilateral instrument include:

1.1 The provisions developed under BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch

Arrangements) to amend the OECD Model Tax Convention (MTC) with a view to ensuring that hybrid instruments and hybrid entities (including dual-resident entities) are not used to obtain undue DTA benefits; more specifically:

1.1.1 the revision of Article 1 (Persons Covered) of the OECD MTC to address fiscally transparent entities. Hybrid entities are entities classified differently for tax purposes in two or more jurisdictions. In consequence of the divergent classifications, one jurisdiction may treat the hybrid entity as fiscally transparent or non-taxable (eg a partnership for South African tax purposes) while the other jurisdiction may treat it as a non-transparent taxable entity (eg a company). When a particular entity is afforded varying tax treatment in different jurisdictions, either double taxation or double non-taxation may arise; and

1.1.2 measures to address issues with the application of and interaction with domestic law of the exemption method to relieve double taxation (Article 23A of the OECD MTC).

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*DTA benefits will be denied unless granting the benefits will align with the object and purposes of the provisions of the relevant DTA.*



1.2 Provisions developed under BEPS Action 6 (Preventing the granting of DTA benefits in inappropriate circumstances), as follows:

1.2.1 the minimum standard to counter treaty shopping through the introduction of an express statement in DTAs that the common intention of the relevant Contracting States is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, while clarifying that DTAs do not restrict Contracting States' rights to tax their own residents, hence providing some flexibility in the implementation of the minimum standard to accommodate adaptation to each country's specific circumstances and negotiated DTAs;

1.2.2 a general anti-avoidance rule providing that if the principal purpose of a transaction or arrangement is to obtain DTA benefits, such benefits will be denied unless granting the benefits will align with the object and purposes of the provisions of the relevant DTA; and

1.2.3 specific anti-abuse rules pertaining to:

1.2.3.1 certain dividend transfer transactions intended to artificially lower withholding taxes payable on dividends;

1.2.3.2 transactions involving immovable property holding companies, which seek to circumvent the application of DTA provisions that allow for source taxation of the proceeds from the sale of shares that derive their value predominantly from immovable property located in the source jurisdiction;

1.2.3.3 situations of dual-resident entities; and

1.2.3.4 treaty shopping employing third-jurisdiction permanent establishments (PEs), which results in non-taxation or preferential tax treatment of the PE's income.

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*The provisions developed under BEPS Action 7 prevent the Artificial Avoidance of PE status.*



1.3 The provisions developed under BEPS Action 7 (Preventing the Artificial Avoidance of PE status) which include:

1.3.1 measures to address

*commissionaire* arrangements (whereby a person sells products in a given State in its own name but on behalf of a foreign enterprise that is the owner of the products; in consequence of which the foreign enterprise is able to sell its products in a State without having a PE to which such sales may be attributed for tax purposes; and since the person concluding the sales does not own the products that it sells, it cannot be taxed on the profits derived from such sales, rendering it taxable only on the remuneration that it receives for its services (usually in the form of a commission)) and similar strategies;

1.3.2 modifications to the specific activity exemptions excluded from the definition of a PE under Article 5(4) of the OECD MTC coupled with the introduction of an anti-fragmentation rule; and

1.3.3 measures to address the splitting-up of contracts to exploit the exception in Article 5(3) of the OECD MTC, which

provides that a building site, construction or installation project only constitutes a PE if it endures for more than 12 months.

1.4 Work done under BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) including best practices and measures established as minimum standards (eg to ensure that DTA-related obligations related to the Mutual Agreement Procedure (MAP) are fully implemented in good faith and that MAP cases are resolved in a timely manner, ideally within 24 months of the commencement of the MAP; to ensure the implementation of administrative processes that promote the prevention and timely resolution of DTA-related disputes; and to ensure eligible taxpayers' accessibility to MAP, including in transfer pricing cases etc.), in particular:

1.4.1 amendments to paragraphs 1 – 3 of Article 25 (MAP) of the OECD MTC, which paragraphs provide for MAP as an additional remedy (over and above anything which may be available at domestic law) in the case of a person's justified grievance at being taxed by one or both of the Contracting States to a DTA in a manner inconsistent with the provisions of the MTC; and



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*Having overcome far greater obstacles to reach this point, the Ad Hoc Group is forging ahead with the formulation of the multilateral instrument, undeterred by these technical issues.*



1.4.2 provision for MAP to apply in cases contemplated under Article 9(2) of the OECD MTC when adjustments are made under a DTA by one Contracting State to the taxation of profits of an associated enterprise, the profits of which have already been taxed in the other Contracting State, allowing for the competent authorities of relevant Contracting States to remedy the double taxation precipitated by such adjustment on a semi open-ended basis.

1.5 The MAP is of fundamental importance to the proper application and interpretation of DTAs. Action 14 aims to strengthen the efficacy of the MAP with a view to ensuring timely dispute resolution. It is encouraging that several countries have declared their commitment to provide for mandatory binding MAP arbitration as a mechanism to guarantee that DTA-related disputes will be resolved within a specified time frame in consequence of which an optional provision on mandatory binding MAP arbitration is being developed as part of the negotiation of the multilateral instrument.

A number of technical issues arise in the course of developing a multilateral instrument to modify DTAs, including, but not limited to, ensuring compatibility between the provisions of the multilateral instrument and the existing DTA network; ensuring consistent application and interpretation of the DTA-related BEPS outputs across the diverse range of DTAs by issuing a supporting explanatory statement or commentary in conjunction with the multilateral instrument; and ensuring the accurate modification of DTAs in multiple authentic languages. The multilateral instrument is being negotiated in English and French but will be employed to modify DTAs in several other authentic languages.

Having overcome far greater obstacles to reach this point, the Ad Hoc Group is forging ahead with the formulation of the multilateral instrument, undeterred by these technical issues.

When the multilateral instrument is opened for signature later this year, it will signify a milestone for public international law and tax law. The attainment of inter-jurisdictional collaboration on such a grand scale is cause for celebration, particularly when viewed in contradistinction with the current state of global divisiveness.

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*Lisa Brunton*

# FURTHER WELCOME TAX INCENTIVES ANNOUNCED FOR RENEWABLE ENERGY SECTOR

*The Explanatory Memorandum to the Draft TLAB 2016 states that large scale renewable energy projects are currently not sufficiently catered for.*

*Government proposes that provision is made for further specific tax deductions to encompass the supporting capital infrastructure for large renewable energy projects.*



Renewable energy is seen as the long term future to the planet's energy demands as a result of the increasing effects of climate change due to the long term use of fossil fuels. South Africa, in particular, has certain obligations as a party to the United Nations Framework Convention on Climate Change (UNFCCC) to ensure the reduction of greenhouse gas emissions and to incentivise investments in low carbon, clean energy. In addition to the environmental factors, South Africa's load shedding and insufficient power supply has resulted in a further demand for the greater procurement and use of renewable energy.

However, renewable energy projects and initial set up costs are expensive. As a result, government has introduced many tax incentives in the renewable energy sector. Some of the incentives or mechanisms which have been introduced are focused on reducing carbon emissions, including the still to be introduced carbon tax. Other incentives are focused on energy efficiency such as the industrial policy projects' additional allowance contained in s12I of the Income Tax Act, No 58 of 1962 (Act), the energy efficiency savings' allowance contained in s12L, as well as the production of renewable energy and fuels' allowance contained in s12B.

The Draft Taxation Laws Amendment Bill, 2016 (Draft TLAB 2016) intends introducing the latest renewable energy incentive. The Explanatory Memorandum to the Draft TLAB 2016 states that large scale renewable energy projects are currently not sufficiently catered for "due to the capital intensive nature of the supporting infrastructure whose tax treatment would need to be specifically targeted". In particular, ancillary capital expenditures that indirectly support renewable energy

production, such as the construction of necessary fences and roads close to renewable energy farms do not qualify for any deductions under the Act. The lack of sufficient tax deductions for such auxiliary outlays is, according to the industry, one of the major restrictions on the feasibility of such projects.

Government therefore proposes that provision is made for further specific tax deductions to encompass the supporting capital infrastructure for large renewable energy projects. The proposal is limited to renewable energy projects exceeding 5MW and above. The reason for this appears twofold, firstly projects within the 5MW to 50MW band are barely economically viable and this will hopefully boost such projects' viability. Secondly, all renewable energy projects approved under the Renewable Energy Independent Power Producers Procurement Programme of the Department of Energy exceed at least 5MW.

The proposal includes provision for a deduction of pre-trade expenditure in much the same way as s11A of the Act to the extent that the capital expense is actually incurred prior to the

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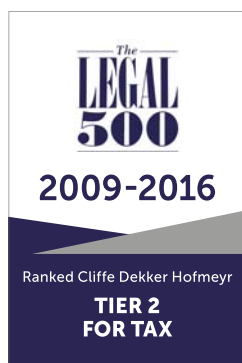
*While the increase of renewable energy tax incentives is most certainly welcome, it remains to be seen whether the recent round of proposed amendments will have a positive effect on the uptake of large renewable energy projects.*



commencement of and in preparation of carrying on that trade and where it has not been allowed as a deduction previously in the current or any previous year of assessment. The new intended s12U of the Act also provides for an anti-avoidance mechanism, in that any supporting infrastructure capital expenditure that exceeds the income in any year of assessment be ring fenced to the specific trade of the production of renewable energy. The proposed amendment is due to apply to large renewable energy projects undertaken during any year of assessment commencing on or after 1 April 2016.

While the increase of renewable energy tax incentives is most certainly welcome, it remains to be seen whether the recent round of proposed amendments will have a positive effect on the uptake of large renewable energy projects. An additional tax deduction in a similar form as the additional 50% research and development tax deduction has, despite calls from the industry, not been forthcoming. Nevertheless such an amendment may have a much larger impact on the feasibility of sorely needed large scale renewable energy projects.

*Jerome Brink*





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