The University of the Western Cape

Faculty of Law

The income tax resident status of internet-based companies: when is South Africa their place of effective management?

A mini-thesis submitted in partial fulfilment of the requirements for the LLM degree (with major in taxation law) in the Department of Mercantile & Labour Law

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Commencement Date: February 2022

Completion Date: November 2023

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ACKNOWLEDGEMENTS

First and foremost, I would like to thank my Lord and Saviour, Jesus Christ for giving me the strength throughout my LLM journey.

I would like to thank my mother, Annie Naidoo and my late father, Floyd Nathaniel for inspiring me and for giving me the best opportunities to help me achieve my dreams. I would like to thank my brother, Cameron Nathaniel for his contribution in assisting me in deciding on my research topic.

I am grateful to my supervisors, Prof. Fareed Moosa and Dr. Etienne Olivier for the mentorship and direction that they provided me throughout my LLM journey. I am indebted to my supervisors for their constant support and guidance. I would like to acknowledge their constructive contributions to my thesis.

Finally, I would like to thank the Faculty of Law at the University of the Western Cape for the LLM Growth Bursary and for giving me the opportunity to further my studies.

ABSTRACT

In terms of the Income Tax Act 58 of 1962 ('ITA'), taxpayers are liable to tax in the Republic of South Africa ('SA') on their worldwide revenue if they satisfy the test for residency within the meaning of the term 'resident' in s 1 of the ITA. Companies and other juristic taxpayers are 'resident' for income tax purposes in relation to a particular year of assessment if, for example, its 'place of effective management' is located in SA for that period. A key problem associated with the term 'place of effective management' which affects its application in practice, is that it is undefined in the ITA. Therefore, its meaning is open to interpretation and, possible, manipulation. The precise meaning of 'place of effective management' is particularly relevant to electronic commerce on the world wide web carried on by internet-based companies. To address the problem arising from the uncertainty of the scope and ambit of the term 'place of effective management' for ITA purposes, this thesis provides a comprehensive analysis of this term and its probable meaning in the context of the ITA.

Using a comparative analysis approach, the current legal framework in SA is examined alongside international best practices and standards. It is argued that the place in which internet-based companies are effectively managed should be linked to the place in which particular internet service providers are located. This, so it is argued, will go a considerable way to ensure that internet-based companies do not erode SAs tax base by escaping the income tax net altogether. In so doing, this thesis hypothesises an answer to the vexed question of when internet-based companies have their 'place of effective management' in SA so as to qualify as tax resident for ITA purposes. This thesis concludes that there exists a need for SA to update the ITA so that it adequately addresses the complexities arising from digital business models and apparent loopholes in the ITA. In the final chapter, certain recommendations are made which, it is submitted, carries the potential, if implemented as intended, to achieve a fair and equitable taxation of internet-based companies earning income sourced in SA.

KEYWORDS

The following is a list of key words / terms / expressions used in this thesis:

- E-commerce
- Income tax
- Internet-based company
- Juristic person
- Place of effective management
- Resident
- Source

ACRONYMS AND/OR ABBREVIATIONS

In this thesis, the acronyms and/or abbreviations mentioned below shall relate to the statutes, journals and terms indicated here.

- ATO – Australian Taxation Office
- EU – European Union
- IRS – Internal Revenue Service
- ITA – Income Tax Act 58 of 1962 (as amended)
- LJ – Law Journal
- PER/PELJ - Potchefstroomse Elektroniese Regsblad/Potchefstroom Electronic Law Journal
- SA – Republic of South Africa
- SAFLII – Southern African Legal Information Institute
- SALJ – South African Law Journal
- SA Merc LJ – South African Mercantile Law Journal
- SARS – South African Revenue Service
- SCA – Supreme Court of Appeal
- TAA – Tax Administration Act 28 of 2011 (as amended)
- THRHR - Tydskrif vir hedendaagse Romeins-Hollandse reg
- USA – United States of America

CHAPTER 1: INTRODUCTION

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1. CHAPTER 1: INTRODUCTION

1.1. Background to the Study

An 'internet company' can loosely be defined as an organisation that presents itself to the general public primarily via a website.[1] The term 'internet company' may also refer to a service provider that offers access to the internet.[2] Although most companies have a website no matter what the nature of their business, the term 'internet company' implies that the predominant way customers obtain products or services from such entity is through an online platform.[3] The question of the tax residency of a company operating in the online environment is important in a modern day, tech savvy South Africa ('SA'). It is especially relevant for internet-based companies operating in SA (for eg, Amazon, Takealot.com, and Facebook). It is important to understand how the online environment is being used by internet-based companies to generate turnover. To understand how companies of this nature earn income in an online environment, the concept of electronic commerce ('e-commerce') is crucial.

E-commerce can be defined as:

> 'The use of electronic networks to exchange information, products, services and payments for commercial and communication purposes between individuals (consumers) and businesses, between businesses themselves, between individuals themselves, within government or between the public and government and, last, between business and government.'[4]

This definition encompasses a wide array of business activities that are conducted electronically and conveys the notion that e-commerce is more comprehensive than simply purchasing goods and services electronically.[5] This definition of e-commerce is important

[1] Internet Company available at *https://www.pcmag.com/encyclopedia/term/internet-company* (accessed 28 December 2022).
[2] Internet Company available at *https://www.pcmag.com/encyclopedia/term/internet-company* (accessed 28 December 2022).
[3] Internet Company available at *https://www.pcmag.com/encyclopedia/term/internet-company* (accessed 28 December 2022). A partnership (whether general or limited) is treated as fiscally transparent for income tax purposes in SA. In *Chipkin Natal (Pty) Ltd v CSARS* 2005 (5) SA 566 (SCA) 574, it was held that, for purposes of the ITA, the income of a partnership will be determined; amounts exempt from tax will be deducted; each partner's share of the income will then be calculated; and each partner will then be entitled to that partner's portion of any deduction or allowance in respect of that partner's share to produce that partner's taxable income derived from the partnership. It is, therefore, the partners and not the partnership itself that are subject to tax under the ITA. As a result, reference in this thesis to 'internet-based companies' shall only encompass a company or a trust registered as such, unless the context indicates otherwise.
[4] Department of Communications, '*Green Paper on e-Commerce'* (November 2000) 16 (hereafter *Green Paper on e-Commerce* 2000).
[5] *Green Paper on e-Commerce* 2000 16.

because it indicates that e-commerce is broader in scope than the mere exchange of goods online. In terms of this meaning of 'e-commerce', companies (such as Facebook and Youtube) which earn income through advertising and not necessarily from the sale of products, are also encompassed. As a result, a discussion on e-commerce is equally applicable to internet-based companies earning revenue by making use of the internet.

According to a report by the United Nations Conference on Trade and Development, the impact of the Covid-19 pandemic has led to an increase in global e-commerce sales by 4% and has jumped to USD26.7 trillion.[6] This large increase indicates how reliant the world has become on the internet, especially during difficult times. It is evident that the use of the online environment is rapidly increasing. One possible reason for this, it is submitted, is that people may regard the internet as a safer and more convenient method to transact, and the internet may have benefitted the ordinary person and businesses that are considering creative ways to profit from the heavy traffic on the internet.

Companies may profit from the use of the internet in a variety of ways. These include, selling products online, advertising and providing services online. Internet-based companies generate revenue through online sales, financial transaction fees, paid advertising, cloud services, and a host of other business lines.[7] The global community, including SA, is steering towards a more tech-based society and have become more dependent on such internet-based companies. The emergence of artificial intelligence in recent times is a clear indicator hereof.

Although the use of internet-based companies provides benefits for users, there are challenges that are associated with such companies. One challenge, which will be the main focus of this thesis, is the income taxation of internet-based companies. There is a legitimate concern that the development of the internet may have the effect of shrinking the tax base and, hence, reducing fiscal revenue.[8] The reasons behind these concerns are, on the one hand, the difficulties inherent in defining jurisdiction in the online environment; and, on the other hand, the problem of administration and enforcement.[9] These difficulties should not create a loophole that allows companies earning an income in the online environment to escape the tax net. Rules

[6] United Nations Conference on Trade and Development, '*Estimates of Global E-Commerce 2019 And Preliminary Assessment of Covid-19 Impact On Online Retail Report'* (2020) UNCTAD Technical Notes on ICT for Development 4.
[7] World's Top 10 Internet Companies available at *https://www.investopedia.com/articles/personal-finance/030415/worlds-top-10-internet-companies.asp* (accessed 28 December 2022).
[8] *Green Paper on e-Commerce* 2000 36.
[9] *Green Paper on e-Commerce* 2000 36.

have to be developed to ensure that businesses operating in the online space are not able to manipulate their operation in a way that places them beyond the reach of the Income Tax Act[10], since doing so would undermine tax collection and the South African government's ability to meet its obligations to its citizenry. In addressing these problems, and in developing an income taxation legal framework, it is important to ensure that the taxing systems are fair, predictable, and do not distort the conduct of business.[11]

Countries in the European Union ('EU'), such as Austria, Ireland and France, levy income tax on companies on the basis of its tax residency.[12] This emphasis on residence for income tax purposes means that there is less emphasis on income taxation based on the source of earnings.[13] Therefore, internet-based companies, such as, Google and Amazon, can exploit and manipulate the rules for residence by taking advantage of the weak source rules. If structured properly, this may well lead to its income, or a significant portion thereof, being taxed nowhere.

When determining the residence of companies for income tax purposes in SA, the starting point is s 1 of the ITA. In relation to juristic persons, s 1 defines 'resident' as follows:

> 'any person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation'

This definition provides, in essence, for two main tests as regards residency for a juristic taxpayer. The first is that an income taxpayer in any form other than a natural person (such as, a trust, close corporation, or a company) shall be resident in SA if, viewed objectively, it is incorporated or established anywhere in the territory of SA. This is a formal test which is based on documents, and the actual filing of documents with the relevant registering authority.[14]

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[10] Act 58 of 1962

[11] *Green Paper on e-Commerce* 2000 36.

[12] EYGM *Worldwide Personal Tax and Immigration Guide* (2020-2021) available at *https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/tax-guides/2021/ey-worldwide-personal-tax-and-immigration-guide-4-february-2021.pdf#page=1434?download* (accessed 24 February 2022).

[13] In *CIR v Lever Brothers & Unilever Ltd* 1946 AD 453 449 - 450, it was held that the source of income is the originating cause of the income which is the work a taxpayer does to earn the income, or it may be a business carried on by the taxpayer, or it may involve the employment of a taxpayer's capital, or a combination of any of these factors. In terms of the definition of 'gross income' in s 1 of the ITA, non-resident taxpayers are liable to pay income tax on revenue income sourced from within SA.

[14] The basis of income taxation in SA and the concept of 'residence' will be discussed in chapter 2 of this thesis.

The second test for the residency of a juristic taxpayer is that it will be regarded as a resident in SA in relation to a particular year of assessment[15] if its place of effective management is located in SA for that period. This is a substance over form test and it examines the actual factual circumstances to determine whether the company operates in the country where it claims to be resident.[16]

The term, 'place of effective management' remains undefined in the ITA. As a result, its meaning will have to be determined by conducting an interpretation thereof.[17] A South African case law survey reveals that there is only one reported judgment which has dealt with its meaning, namely *Oceanic Trust Co Ltd NO v CSARS* (hereafter *Oceanic Trust*).[18] It is, therefore, important to consider international law while recognising that context remains important.[19] Furthermore, it must be noted that s 233 of the Constitution of the Republic of South Africa, 1996 ('Constitution') provides that:

> 'When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.'[20]

Commentary on the Organisation for Economic Co-operation and Development ('OECD') MTC[21] indicates that 'place of effective management' is the place where key management and commercial decisions of a company are made. This does not mean that every country will follow that interpretation, as there are different interpretations of place of effective management. It is, therefore, important, in a South African context to interpret the meaning of

[15] Section 1 of the ITA defines 'year of assessment' as any year or other period in respect of which any tax or duty leviable under the ITA is chargeable, and any reference in the ITA to any year of assessment ending the last or the twenty-eighth or the twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company or a portfolio of a collective investment scheme in securities be construed as a reference to any financial year of that company or portfolio ending during the calendar year in question.
[16] De Koker AP & Williams RC *Silke on South African Income Tax* (2021) (online version) SA: LexisNexis 5 (hereafter *Silke on South African Income Tax* (2021)).
[17] See *First National Bank of Southern Africa Ltd t/a Wesbank v CSARS* 2002 (4) SA 768 (CC) and *Metcash Trading Limited v CSARS* 2001 (1) SA 1109 (CC) for a discussion on the interpretation of fiscal statutes. Refer to chapter 3 of this thesis for a discussion on the interpretation of fiscal statutes.
[18] 74 SATC 127. The *Oceanic Trust* case will be discussed in chapter 2 of this thesis.
[19] For a discussion on how South African courts approach the use of international law, see Tladi D 'Interpretation and international law in South African courts: the Supreme Court of Appeal and the Al Bashir saga" (2016) 16 *African Journal of Human Rights* 310 – 338.
[20] Refer to chapter 2 of this thesis for a discussion on the position in the UK relating to the meaning of 'place of effective management'.
[21] OECD 'Commentaries on the Articles of the Model Tax Convention' *Commentary on Article 4 Concerning the Definition of Resident* (2010) available at *https://www.oecd.org/berlin/publikationen/43324465.pdf* (accessed 12 June 2022).

'place of effective management' in a way that aligns with constitutional values.[22] This is a transformative approach to interpretation. To this end, the values of fairness, equity, and equality will be promoted by interpreting and applying 'place of effective management' to internet-based companies. They ought to shoulder their fair share of the tax burden. It would be unfair towards other taxpayers to allow internet-based companies to generate income within SA and not pay tax thereon through such taxpayers being able to manipulate the tax system.

To the extent that internet-based companies may be entitled to structure themselves in such a way that they are tax efficient, a discussion around the right of taxpayers to plan their own affairs is important because internet-based companies ought to be brought within the letter of the law so that they do not exploit this right to the detriment of the fiscus. Even though companies may exercise this right, it is subject to limitations and internet-based companies cannot use this right in a way that impermissibly leads to tax savings. If internet-based companies manage themselves in a way that legitimately results in them escaping the net of 'place of effective management', such management would be permissible and result in them not being 'resident' for income tax purposes. To the extent that directors or shareholders plan the management affairs of an internet-based company in a way that impermissibly leads to SA not being the place of effective management, such tax planning should not lead to any tax saving and the company ought to be declared as resident.

In *CSARS v NWK*[23] (hereafter *NWK*), the Supreme Court of Appeal held that,

> 'if the purpose of the transaction is only to achieve an object that allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated. And the mere fact that the parties do perform in terms of the contract does not show that it is not simulated: the charade of performance is generally meant to give credence to their simulation.'[24]

The effect of this judgement is that, if the transaction is undertaken solely for tax-saving reasons, and there is no commercial substance, it could be set aside; even though the parties might truly have intended that the agreement should have effect according to its terms. According to Moosa,

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[22] In *Corpclo 2290 CC t/a U-Care v Registrar of Banks* 2013 1 All SA 127 (SCA) para 20, it was held that the requirement in s 39(2) of the Constitution means that every piece of legislation must be construed in a manner that promotes the spirit, purport and objects of the Bill of Rights, which means that '(a)ll statutes must be interpreted through the prism of the Bill or Rights'.
[23] 73 SATC 55.
[24] *NWK* para 55.

> 'The judgment reflects a marked shift towards a stricter approach to the evaluation of contracts designed to create a tax benefit. Its effect is so pervasive that it extends to all transactions concluded in the ordinary course of carrying on a trade, including contracts of employment.'[25]

Moosa further states that the court failed to indicate whether, in relation to the objective of securing a tax advantage, the business reason must be a dominant purpose. The basis on which the commercial substance of a contract must be decided on a case-by-case basis and a transaction will pass the commercial rationality test if it is commercially expedient or facilitates the carrying on of the taxpayer's trade.[26] As a final caution, Moosa stated that,

> 'The doctrine of stare decisis will enable C: SARS to utilize the principles crystallized in the NWK case *supra* as a weapon in its arsenal to combat the tax consequences flowing from a contract which it perceives not to be in the best interests of the fiscus. These principles apply to all pre-existing, otherwise tax-effective, contracts. Taxpayers ought therefore to review all such affected transactions and revise same to the extent now permissible in law.'[27]

The court indicated that tax evasion is impermissible and, if a transaction is simulated, it may amount to tax evasion. However, the court also stated that,

> 'it is trite that a taxpayer may organize his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective. But there is something wrong with dressing up or disguising a transaction to make it appear to be something that it is not, especially if that has the purpose of tax evasion, or the avoidance of a peremptory rule of law.'[28]

The SCAs approach in *NWK* in relation to simulation and its requirement of 'commercial reason' shows remarkable overlap with the 'business purpose' test found in the United States of America ('USA').[29] In *Gregory v Helvering* (hereafter *Gregory*)[30] it was held that the taxpayer's corporate 'reorganisation' completely lacked any business purpose and the tax relief in respect of same was bluntly denied. In *CIR v Transport Trading & Terminal Corp.*[31] the court held that 'business purpose' as described in *Gregory* has a much wider scope, and it

[25] Moosa F '*C: SARS v NWK Ltd* a tax planning sham(e)?' (2012) 27(3) *Insurance and Tax Journal* 3 (hereafter Moosa F (2012)).
[26] Moosa F (2012) 3.
[27] Moosa F (2012) 3.
[28] *NWK* para 42.
[29] Van der Walt J 'NWK case casting shadows' (2011) Moneyweb's *TAX BREAKS* 8 (hereafter Van der Walt (2011)).
[30] (1935) 293 U.S. 465 US SC 293.
[31] 176 F2nd 570 (2nd Cir. 1949) 572.

means that in constructing words of a tax statute which describe commercial or industrial transactions, it refers to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation.

NWK and the apparent enthusiasm with which it is being applied in SA could be indicative that the newly introduced 'commercial reason' requirement might be taking SA towards some convergence with the 'business purpose' test as applied in the US. To be on the safe side requires that there should always be a demonstrable non-fiscal financial, business, or economic driver for any transaction.[32]

It is clear that a taxpayer is entitled to plan its financial affairs in a way that is tax efficient to the extent that it is lawful. Taxpayers are entitled to structure transactions in such a manner so as to reduce or eliminate a tax liability, provided such structuring is both *bona fide* and factually genuine from a commercial standpoint.[33] Courts do not have the mandate to unjustifiably widen the net of tax liability.[34] While an internet-based company can plan its affairs in a way that leads to them not being tax resident in SA, such companies cannot use this right to plan their affairs in a way that impermissibly leads to tax savings. To the extent that internet-based companies manage themselves in a way that legitimately results in them escaping the net of 'place of effective management', such management would be permissible and result in them not being 'resident' for income tax purposes. However, in such instances, the internet-based companies may be held liable on the basis of source of income.[35] As a result, a discussion on source of income is crucial in the context of this study.

According to Wallis, when dealing with a statute, context does not involve guesswork as to the intention of the legislature, but a reasoned assessment of the broad purpose underlying its enactment.[36] It is considered that the interpretation of a provision in a statute must be considered through the prism of the Bill of Rights. The rule of law, a founding value entrenched in the Constitution, entails, *inter alia*, that taxpayers must respect and comply with tax laws.[37] Based on the principle of legality within the rule of law, no tax is due or payable at the whim

[32] Van der Walt (2011) 8.
[33] Krebs M '*An analysis of the CSARS V NWK case and the effect on the substance over form doctrine'* (unpublished LLM thesis, University of Pretoria, 2015) 51 (hereafter Krebs (2015)).
[34] Krebs (2015) 51.
[35] Refer to chapter 2 of this thesis for a discussion on source of income.
[36] Wallis MA 'Interpretation before and after *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA)' (2019) 22 *PER/PELJ* 17.
[37] Moosa F 'Value-conscious interpretation of taxing provisions using *ubuntu*: An appropriate decolonised interpretive approach?' (2018) 76 *SA Merc LJ* 73 (hereafter Moosa F (2018)).

of a tax collector.[38] The imposition of a tax, and liability for its payment, must originate from the clear wording of a taxing statute. This position is rooted in the rule of law requiring verbal precision in all, including fiscal, enactments, because nothing that is not stated is to be read in.[39] On the one hand, a provision may be construed narrowly to impose a less burdensome duty on an affected taxpayer, while on the other hand, it may be construed widely to impose a more onerous financial obligation.[40] In such instances as to the extent to which a taxpayer is liable ('the interpretive dilemma'), the taxing provision must be construed using the rules and techniques of statutory interpretation.[41]

Section 39(2) of the Constitution provides:

> 'When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights'.[42]

If applied, s 39(2) will promote a result that best advances the realisation of the Bill of Rights transformative objects, namely, by requiring a taxpayer to pay, for communal benefit, the highest permissible amount of tax under an ambiguous provision.[43]

According to Moosa:

> 'The Constitution aims to create a transformed society in which every person is fully and equally protected by, and benefits from, the rights in the BoR, all of which serve as a safe and stable foundation for the substantive law. Revenue from taxation capacitates the state in achieving broad-based social transformation. …[U]nless taxes are paid and effectively administered, the government will not be functionally stable or financially able to fulfil its constitutional mandate. Ambiguous taxing provisions create practical problems in tax collection in that they enable taxpayers to contend, on the basis of the contra fiscum rule, that they ought to pay the least permissible amount of tax.'[44]

In determining whether 'place of effective management' should include internet-based companies in SA or not, consideration must be given to the constitutional values and balanced against the potential limitation of taxpayer rights. When considering the rights of taxpayers, it

[38] Moosa F (2018) 73.
[39] Moosa F (2018) 73.
[40] Moosa F (2018) 74.
[41] Moosa F (2018) 74.
[42] Moosa F (2018) 89.
[43] Moosa F (2018) 89.
[44] Moosa F (2018) 89.

is important to note that tax law operates within a broader legal framework.[45] The Constitution, its norms, values and democratic principles, are in the frontline of the defence and advancement of taxpayer rights.[46] Human rights and taxpayer rights bear some correlation to each other.[47] This is so because certain human rights are included as fundamental rights in the Bill of Rights which are enjoyed by taxpayers.[48] Taxpayer rights, on the one hand, insulate taxpayers and protect their legitimate interests.[49] On the other hand, taxpayer rights provide a healthy balance by keeping in check otherwise unlimited power in the hands of bureaucratic tax officials.[50] According to Moosa:

> 'Human rights are "inalienable entitlements of human beings", juristic (such as companies, trusts, and close corporations) entities cannot be holders or beneficiaries thereof. Since taxpayers include juristic persons, the general classification of 'taxpayer rights' as human rights would be problematic.'

Since 'place of effective management' is only relevant in the context of residency for juristic persons, it is clear that the rights of internet-based companies cannot be treated in the same manner as human rights as contemplated in the Bill of Rights. In order for taxpayer rights to be made meaningful on a practical level, judicial officers and SARS officials must give full force and effect thereto by fulfilling their constitutional duties and, in a sense, act in partnership in upholding, respecting and protecting taxpayer rights and by displaying a fervent commitment to honouring these pivotal obligations.[51] In the course of doing so, the classification of taxpayer rights is of secondary importance.[52] There is no denying that juristic taxpayers have rights, such as the right to plan their tax affairs. However, these rights are not rigid and may be limited in circumstances that require a greater cause.

In considering whether 'place of effective management' should include internet-based companies, consideration must be given to s 39(2) of the Constitution. An interpretation which contradicts a right contained in the Bill of Rights cannot promote the spirit, purport, and objects

[45] Moosa F 'Are taxpayer rights classifiable as human rights?' (2017) 32(4) *Insurance and Tax Journal* 24 (hereafter Moosa F (2017)).
[46] Moosa F (2017) 25.
[47] Moosa F (2017) 25.
[48] Moosa F (2017) 25.
[49] Moosa F (2017) 25.
[50] Moosa F (2017) 25.
[51] Moosa F (2017) 25.
[52] Moosa F (2017) 25.

of the Bill of Rights unless it is limited in accordance with s 36(1) of the Constitution.[53] As discussed above, taxpayers' rights in relation to juristic persons are not classified as 'human rights' and must be given secondary importance. It is, therefore, submitted that where an interpretation of 'place of effective management' which includes internet-based companies is capable of promoting a constitutional value, such interpretation should be adopted. This is due to the fact that there are no 'higher' considerations that are required, than the Constitution.

Public finance is vital for enabling effective governance, maintaining law and order, promoting peace and prosperity, facilitating there construction and redevelopment of national infrastructure, and providing access to social goods (such as education and social security).[54] Efficient and effective tax administration is an essential pillar of a modern, democratic state.[55] By including internet-based companies in a possible definition of 'place of effective management', it appears that a public interest will be advanced. Section 195(1) of the Constitution requires efficiency in public administration, of which tax administration forms an integral part.[56] SARS is therefore required to fulfil the Constitution's underlying goals. It may be argued that it is unfair to current juristic taxpayers that are held liable, while internet-based companies are able to manipulate tax laws and therefore escape liability. It appears that the only difference, which is relevant to taxation, between internet-based companies and 'other' companies is the nature of the business.

It is submitted that the nature of a business should not be the deciding factor in holding a company liable, rather tax laws, which are to be applied equally. This view is consistent with constitutional values and promotes fairness and equality. It may be argued that 'place of effective management' is not defined in the ITA and therefore, the ITA does not expressly provide that 'place of effective management' includes internet-based companies. Any view along these lines is not compelling enough to outweigh the public interests. By excluding internet-based companies from taxation on the basis of residence, SARS will be deprived of large amounts of revenue which could be used for the advancement of SA.

[53] Section 36(1) of the Constitution provides that the rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including, (*a*) the nature of the right; (*b*) the importance of the purpose of the limitation; (*c*) the nature and extent of the limitation; (*d*) the relation between the limitation and its purpose; and (*e*) less restrictive means to achieve the purpose.
[54] Moosa F (2017) 16.
[55] Moosa F (2017) 16.
[56] Moosa F (2017) 16.

The difficulties in defining the nature of internet-based companies must also be appreciated. With the rapid advancements in technology, one cannot determine the nature of companies in the years to come. Therefore, it is submitted that a definition of 'place of effective management' should not close the door shut. Rather, the term 'place of effective management' should be constantly interpreted to keep up with the changes in technology and advance constitutional values. Therefore, it is important for SARS to determine 'place of effective management' on a case-by-case basis.

There is no harm in SARS holding internet-based companies accountable as such companies may later challenge the decision by SARS. This is consistent with the 'pay-now-argue-later' rule that was endorsed in *Metcash Trading Limited v CSARS*[57] This further supports the view that SARS will not be infringing any constitutional rights by holding internet-based companies liable to taxation in SA, in the event that a court finds a specific internet-based company to not be liable on the basis of residency.

1.2. Problem statement and aims of the research

The preamble to the Tax Administration Act[58] ('TAA') provides that the TAA was enacted to provide for the effective and efficient collection of tax by the South African Revenue Service ('SARS'). Section 2 of the South African Revenue Service Act[59] ('SARS Act') provides that SARS is established as an organ of state within the public administration, but as an institution outside the public service. Section 3 of the SARS Act further provides that SARS' objective is the efficient and effective collection of revenue. With the emergence of the internet, this duty imposed on SARS becomes increasingly difficult and the rules may easily be manipulated by internet-based companies to escape tax liability.

One aspect that creates an opportunity for such companies to escape the tax net is the 'place of effective management' criterion. The main problem associated with the term is that it is undefined and, therefore, open to interpretation and possible manipulation in practice. This thesis aims to provide a comprehensive analysis of the meaning of 'place of effective management' in the context of the term 'resident' contained in s 1 of the ITA with a view to hypothesising a meaning that can effectively ensure that internet-based companies do not escape the income tax net. This thesis further aims to determine the criterion which apply when

[57] 2001 (1) SA 1109 (CC).
[58] Act 28 of 2011.
[59] Act 34 of 1997.

determining whether such companies are liable to income taxation in SA and if so, then this thesis aims to provide practical steps for ensuring compliance.

It has become clear that the emergence of internet-based companies creates a problem for the SARS as a result of the term, 'place of effective' management being undefined in the ITA. The problem lies in the fact that the ITA does not determine the place in which an internet-based company is effectively managed.[60] This lack of certainty creates fertile ground which, if left unattended, will allow such companies to manipulate the tax rules so that they effectively avoid a liability for tax altogether.

One of the problems that exist due to ITA not defining 'place of effective management', is that where internet-based companies operate on the internet through a server, often located in a place different to that where the company employees are working, how does one determine where the company is effectively managed? If a company avoids day-to-day management in a specific location through the use of the internet, then, in terms of the SARS' approach[61], the place of effective management will be where the business operations are actually carried out.[62]

For internet-based companies, it will be easy for its directors to manipulate the place of effective management by conducting business operations and activities from various locations.[63] This type of avoidance does exist, as is evidenced by the need for specific anti-avoidance legislation and the quest for alternative criteria for determining the residence of a company for ITA purposes.[64]

The so-called 'Double Irish' structure offers a simple illustration of how the affairs of a company can be manoeuvred in such a manner as to circumvent the tax residency laws of a country. Under this formerly available structure, one Irish subsidiary ('IRL1') would be an Irish-registered company selling products to non-US locations from Ireland.[65] A second Irish subsidiary ('IRL2') would hold intangible assets and charge the IRL1 royalties, thereby shifting

[60] Van der Merwe *BA* 'The Phrase 'place of effective management': Effectively Explained?' (2006) 18 *SA Merc LJ* 128 (hereafter Van der Merwe BA (2006)).
[61] SARS Interpretation Note 6 (Issue 3) 2023.
[62] Oguttu AW & Van der Merwe B 'Electronic Commerce: Challenging the Income Tax Base?' (2005) 17 *SA Merc LJ* 311 (hereafter Oguttu AW & Van der Merwe B (2005)).
[63] Oguttu AW & Van der Merwe B (2005) 311.
[64] Oguttu AW & Van der Merwe B (2005) 311.
[65] Nakayama K & Perry V 'Residence-Based Taxation: A History and Current Issues' in Corporate Income Taxes under Pressure: Why Reform Is Needed and How It Could Be Designed (2021) *International Monetary Fund* 113 available at *https://www.elibrary.imf.org/view/books/071/28329-9781513511771-en/ch007.xml* (accessed on 14 June 2022).

most profits to IRL2.[66] Therefore, IRL2 would be registered in Ireland but managed and controlled from a low-or no-tax jurisdiction.

The Irish tax code considered IRL2 to be a resident of the low-tax jurisdiction (based upon the Irish 'managed and controlled' test), but the US tax code considered IRL2 to be an Irish company (based on the place of incorporation or registration test).[67] Neither jurisdiction therefore taxed the income of IRL2, as neither viewed it as legally resident within its jurisdiction. In 2015, Ireland closed this avenue of tax minimisation by changing the definition of tax residence to include not only entities that are effectively managed in Ireland but also those incorporated there.[68]

The 'Double Irish' structure provides an example of how important it is to prevent companies from avoiding tax through the manipulation of rules. It is therefore important to understand and predict the ways in which companies will creatively manipulate the rules to avoid paying tax. As a result, this thesis will discuss how the term 'place of effective management' can be properly interpreted so as to avoid the manipulation of place of residence for tax purposes by companies.

1.3. Research Question

Based on the preceding discussions, the primary focus of this thesis will be to hypothesise an answer to the following question: are internet-based companies in the sense explained in paragraph 1.1 which provides services or goods to consumers based in SA, 'resident' in SA for income tax purposes on the basis that their 'place of effective management' is within the Republic of SA as envisaged by the ITA?

To answer the research question formulated above involves investigating certain sub-enquiries which will also be explored in this study, namely: (i) what is the meaning of 'place of effective management' for income tax purposes? and (ii) what criteria are to be considered when determining the tax residency of a company which operates exclusively in an online ecosystem?

[66] Nakayama K & Perry V (2021) 113.
[67] Nakayama K & Perry V (2021) 113.
[68] Nakayama K & Perry V (2021) 113.

1.4. Significance of the Study

There is no single, internationally mandated meaning of the expression 'place of effective management', nor does the ITA define it. The OECD has provided guidance by stating that the place of effective management is 'the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made', which will ordinarily be the place where the most senior person or group of persons makes its decisions.[69] Due to the lack of legal certainty regarding the meaning of 'place of effective management', it is important to consider case law which may provide guidance in interpreting the term.

In *Oceanic Trust*, the court applied the place of effective management test. The court stated that the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entities business are in substance made.[70] The court further stated that all of the relevant facts and circumstances must be examined in determining the place of effective management.[71] The court in this case relied on *Commissioner for Her Majesty's Revenue and Customs v Smallwood and Anor*[72] (hereinafter referred to as *Smallwood*) to apply the test for place of effective management. This case is relevant because s 233 of the Constitution provides that legislation must be interpreted in a way that is consistent with international law. It is important to note that the court had applied the test in *obiter* and therefore the application of this test does not provide definitive authority on the meaning and application of the term 'place of effective management'.[73] The court held that it did not have jurisdiction to decide on a question of fact.[74] There is, therefore, no authority regarding the test for place of effective management in SA, however the remarks made in this case could assist researchers in interpreting the term.

In *Smallwood*,[75] the court held that determining the place of effective management required the court to determine where, based on the facts presented, the real top level of management or realistic, positive management of the taxpayer, a trust, was exercised.[76] Although this case dealt

[69] OECD Model Tax Convention on Income and on Capital (2008) 77.
[70] *Oceanic Trust* para 54.
[71] *Oceanic Trust* para 54.
[72] De Matos C 'The place of effective management criterion for determining the tax residence of persons other than natural persons: *Oceanic Trust Co Ltd NO v Commissioner for South African Revenue Service*' (2015) 132 *SALJ* 42 (hereafter De Matos C (2015)).
[73] De Matos C (2015) 42.
[74] 74 SATC 127 para 68.
[75] [2010] EWCA Civ 778.
[76] *Silke on South African Income Tax* (2021) 5.

with the determination of the place of effective management in the context of a trust, the court's decision is useful in that the principles are relevant, with some modification, to companies.[77] The court found that there was a distinction between the scheme of management (which constituted the key management and commercial decisions) and day-to-day management exercised by the trustees from time to time with the former determining the place of effective management.[78]

A company may have more than one place of management, but it can only have one place of effective management at any one time. If a company's key management and commercial decisions affecting its business as a whole are made at a single location, that location will be its place of effective management.[79] However, if those decisions are made at more than one location, the company's place of effective management will be the location where those decisions are primarily or predominantly made. Although, this case dealt with trusts, it may be relevant and useful to apply to companies.[80]

The significance of this study lies in the fact that the definition of 'place of effective management' has not been authoritatively decided by any South African court. In *Oceanic Trust*, the court discussed the meaning of 'place of effective management' in the *obiter dictum.*[81] The court interpreted 'place of effective management' to mean, the place where key management and commercial decisions that necessary for the conduct of the entities business are in substance made.[82] This has provided assistance with the interpretation of the 'place of effective management'. However, the court's decision is not binding but has persuasive authority.[83]

Furthermore, the interpretation provided by the court does not cater for the problems associated with the taxation of internet-based companies discussed above. An example of an issue that was not addressed by the court, is that it is possible business to be conducted in SA, while the key management and commercial decisions are made in another country[84]. As a result, this

[77] *Silke on South African Income Tax* (2021) 5.
[78] *Silke on South African Income Tax* (2021) 5.
[79] *Silke on South African Income Tax* (2021) 5.
[80] *Silke on South African Income Tax* (2021) 5.
[81] De Matos C (2015) 41.
[82] *Oceanic Trust* para 54.
[83] De Matos C (2015) 42.
[84] Oguttu AW & Van der Merwe B (2005) 311.

thesis will critically analyse the interpretation by the court in *Oceanic Trust* and identify the shortcomings of the interpretation in a modern, tech savvy SA.

In addition, this thesis provides an interpretation which will broadly cater for internet-based companies. This thesis can, therefore, assist researchers as well as the courts in clarifying the position regarding 'place of effective management'. Furthermore, the subject matter of this thesis has not been decided by a court in SA. Therefore, it carries the potential to be significant in the field of taxation.

In addition, this thesis will focus on a comparative study with the laws of Australia, Switzerland and the USA which will provide a unique perspective at interpreting the term 'place of effective management' and ultimately ensuring that internet-based companies are held liable to taxation in SA.[85] For this reason too, this thesis has the potential to make a meaningful contribution to its subject area.

1.5. Research Methodology

This thesis is a desktop study. An analysis has been done that focusses on primary sources dealing with 'place of effective management' in the context of the term 'resident'. The primary sources included relevant South African statutes, policies, regulations as well as international instruments (such as resolutions, treaties and conventions). This thesis also relied on international and national legislative provisions, which lays the foundation for the argument that will follow throughout this thesis. Through the use of secondary sources, such as textbooks, journal articles, commentaries and internet sources, this thesis critically analyses published literature and theoretical substance, which, in turn, guides the research topic towards, it is submitted, coherent and intellectually sound findings and recommendations in the final chapter.

1.6. Chapter Outline

Chapter 1: Introduction

This chapter is an introductory chapter. It provides the background of the study and discusses the research question, significance of study as well as provides the chapter outline.

[85] A comparative study will be undertaken in chapter 3.

Chapter 2: The South African Tax System

This chapter will discuss the term 'gross income' in the context of the ITA. Further discussions will be held on 'source' of income and the definition of 'resident' for income tax purposes, with a particular emphasis on the term 'place of effective management' and how it has been interpreted and applied in South Africa.

Chapter 3: Comparative Analysis

This chapter will discuss the laws in Australia which relate to 'central management and control' and the laws in the USA which ensures that internet-based companies are held liable to taxation for conducting e-commerce transactions. The position in Switzerland regarding place of effective management is further discussed as the Swiss Supreme Court has stated that a legal entity's place of effective management is where its economic and effective interests are focused[86]. This analysis may provide assistance in addressing the issues discussed in chapter 1.

Chapter 4: A possible meaning of 'place of effective management'

This chapter will discuss the fundamental principles of legal interpretation which will be relevant to how the term 'place of effective management' and a practical application shall follow with a view to ensuring that internet-based companies do not escape the income tax net.

Chapter 5: Conclusion and Recommendations

This chapter contains the conclusion and the recommendations with regard to SARS rendering internet-based companies in SA liable to taxation. The chapter further provides a brief summary of the findings in each chapter and draws some recommendations from the international law framework.

[86] Prager Dreifuss, 'Tax domicile of legal entities – not always so clear' (2020) available at *https://www.prager-dreifuss.com/en/news/tax-domicile-of-legal-entities-%E2%80%93-not-always-so-clear-687* (accessed on 10 June 2022).

CHAPTER 2: THE SOUTH AFRICAN TAX SYSTEM

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2. CHAPTER 2: THE SOUTH AFRICAN TAX SYSTEM

2.1. Introduction

In terms of SAs mainly residence-based income tax system, persons qualifying as 'resident' are taxed on their worldwide income.[87] Any such person is a 'taxpayer' within the meaning of this term in s 151 of the TAA[88] from whom the SARS is obliged to collect income tax. In terms of s 169 of the TAA, any tax due for collection under the ITA is a debt owing to the SARS for the benefit of the National Revenue Fund.

To lay the basis for the discussion to follow in chapter 3 of this thesis on the meaning of the term 'place of effective management' within the realm of 'resident' for juristic persons, it is important to first discuss the system of income taxation provided in the ITA. The ITA sets out a series of steps to be followed in calculating a taxpayer's 'taxable income'. The ITA, in s 1, outlines the concepts of 'taxable income', 'income' and 'gross income'. These statutory terms form the foundation on which tax liability is calculated.[89] Taxable income starts with a determination of gross income; then certain items 'exempt' from taxation under s 10 of the ITA are subtracted from 'gross income, thereby creating a sum referred to as 'income'. The latter sum can then be reduced by way of the subtraction of allowable deductions catered for in the ITA (such as, deductions permitted under the so-called general deduction formula in s 11(a) read with s 23(g)).[90] The sum then remaining is referred to as 'taxable income' of which a percentage is taken as tax payable to SARS.[91]

The point of departure for determining a person's 'taxable income' is determining that person's 'gross income'.[92] If a person does not have gross income, no normal tax can be levied on that person.[93] In terms of s 1 of the ITA:

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[87] S 1 of the ITA.

[88] S 151 of the TAA defines a taxpayer as a (a) person chargeable to tax; (b) representative taxpayer; (c) withholding agent; (d) responsible third party; or (e) person who is the subject of a request to provide assistance under an international tax agreement.

[89] SA Tax Guide 'SA Income Tax' available at *https://www.sataxguide.co.za/sa-income-tax/* (accessed on 10 December 2022).

[90] See the following cases with regard to the general deduction formula: *Port Elizabeth Electric Tramway Co Ltd v CIR* 8 SATC 13 16; *Sub-Nigel Ltd v CIR* 15 SATC 381 389, ITC 1058 26H SATC 305 at 307 (all on earlier versions of the relevant provisions of the ITA); *Stone v SIR* 36 SATC 117 125; ITC 1267 (1977) 39 SATC 146 148; *SIR v Crane* 39 SATC 191 192-196; ITC 1327 43 SATC 47 48–9; *Borstlap v SBI* 43 SATC 195 203.

[91] Investopedia 'Gross Income vs Earned Income: What's the Difference?' available at *https://www.investopedia.com/ask/answers/011915/what-difference-between-gross-income-and-earned-income.asp* (accessed on 10 December 2022).

[92] Croome B 'Tax Law: An Introduction' (2013) 27 (hereafter Croome (2013)).

[93] Croome (2013) 27.

'gross income', in relation to any year or period of assessment, means-

(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,

during such year or period of assessment, excluding receipts or accruals of a capital nature…'

From this definition of 'gross income', it is clear that 'gross income' consists of the total amount in cash or otherwise received by or accrued to or in favour of such person excluding receipts or accruals of a capital nature. The definition of 'gross income' makes a clear distinction between SA residents and non-residents. With regard to residents, 'gross income' includes all amounts regardless of whether they originate from SA or not. With regard to non-residents, 'gross income' is limited to amounts from a source which originates from SA. To sufficiently understand the SA income tax system, the concepts of 'in cash or otherwise', 'received by or accrued to' and 'receipts or accruals of a capital nature' will need to be discussed. This discussion will be undertaken in this chapter.

It is clear from the definition of 'gross income' that there are, generally, two main bases which underlie liability for taxation on income in SA, namely, residence and source.[94] Residence is the test of tax liability, for the reason that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters that person.[95] Source of income, on the other hand, rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient may reside.[96]

To the extent that internet-based companies plan their affairs in a way that leads to them not being resident in SA, a discussion will need to be held on how such companies can be held

[94] Clegg D & Stretch R *Income Tax in South Africa* (2022) (online version) 1 (hereafter *Clegg: Income Tax in South Africa* (2022)).
[95] *Clegg: Income Tax in South Africa* (2022) 1.
[96] *Clegg: Income Tax in South Africa* (2022) 1.

liable to taxation in SA on the basis of source of income. As a result, this chapter will also discuss how 'gross income' is computed for both resident and non-resident taxpayers.

2.2. 'In cash or otherwise'

In *WH Lategan v CIR*,[97] it was held that gross income, although expressed as an amount in the definition, need not be an actual amount in money but may constitute every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.[98] In *CIR v Delfos*[99] the court confirmed the principle that:

> 'tax is to be assessed in money on all receipts and the pairs having a money value. If it is something which is not money's worth or cannot be turned into money, it is not to be regarded as income.'[100]

In some cases, this principle was interpreted to mean that, where a benefit could not be turned into money, such a benefit could not constitute an amount 'in cash or otherwise'.[101] An amount may be in cash or otherwise, but a non-cash receipt or accrual must have an ascertainable money value to be gross income. An asset not having a money's worth or which cannot be converted into money cannot be regarded as income.[102] However, the Supreme Court of Appeal laid any uncertainty to rest in *CSARS v Brummeria Renaissance (Pty) Ltd*[103] (hereafter referred to as *Brummeria*), where the court explained that:

> 'the question whether a receipt or accrual in a form other than money has a money value is the primary question and the question whether such receipt or accrual can be turned into money is but one of the ways in which it can be determined whether or not this is the case; in other words, it does not follow that if a receipt or an accrual cannot be turned into money, it has no money value. The test is objective, not subjective,'[104]

In *Brummeria,* the taxpayer was a developer of retirement villages. Instead of selling occupancy rights (so-called 'life rights'), the taxpayer (instead) obtained an interest-free loan from a potential occupant, and in return granted such a lender the right of lifelong occupation of a unit. The taxpayer was obliged to pay back the loan to the occupant upon cancellation of the

[97] 2 SATC 16.
[98] 2 SATC 16 19.
[99] 6 SATC 92.
[100] 6 SATC 92 21.
[101] Croome (2013) 66.
[102] *CIR v Butcher Bros* 1945 AD 301 318.
[103] 69 SATC 205.
[104] *Brummeria* para 15.

agreement or upon the occupant's death. The court had to decide whether the taxpayer's right to use the loan capital free of any interest constituted an 'amount' for purposes of gross income. It was held that the right to retain and use the borrowed funds interest-free was a valuable right with a money value and the fact that such a right could not be ceded or alienated (and therefore not turned into money) did not negate such value. As a consequence, the court held that the Commissioner of SARS was correct in valuing the benefit acquired by the taxpayer (the interest-free loans) and including such amount in the taxpayer's gross income. It must be noted that the Commissioner of SARS bears the burden of proof to show on a balance of probabilities that some amount has accrued to or has been received by a taxpayer.

The rise of cryptocurrencies (a new type of financial product powered by blockchain technology) has led to some revenue authorities, such as the Internal Revenue Service ('IRS') in the USA having to develop a new approach to collecting tax revenues on online transactions.[105] A cryptocurrency is any form of currency that exists digitally or virtually and uses cryptography to secure transactions.[106] Cryptocurrencies do not have a central issuing or regulating authority, instead using a decentralized system to record transactions and issue new units.[107] The fact that cryptocurrencies are used to purchase goods and services as well as for investment and trading purposes has led to some confusion regarding the proper tax treatment of this new financial technology.

By way of example, in 2014, the IRS issued a policy statement that shed some light on the federal taxation of virtual currencies.[108] In this statement, the IRS explained that cryptocurrencies may be used for the purchase and sale of goods.[109] Some cryptocurrencies may also be converted into dollar and as a result of these cryptocurrencies being convertible, the IRS concluded that these types of virtual currency profits should be taxed as property rather than income.[110] Therefore, profits made from either investing in or accepting payments in these forms of cryptocurrencies are taxed according to the capital gains tax rates. This means that every convertible cryptocurrency transaction, whether made as a payment for goods or services

[105] The laws of the USA relating to the taxation of internet-based companies is discussed in chapter 4 of this thesis for comparative purposes. See chapter 4 of this thesis for an explanation as to why the laws of the USA may be relevant to the taxation of internet-based companies from a South African perspective.
[106] Cryptocurrency explained with pros and cons for investment available at *https://www.investopedia.com/terms/c/cryptocurrency.asp* (accessed on 3 January 2023).
[107] Cryptocurrency explained with pros and cons for investment available at *https://www.investopedia.com/terms/c/cryptocurrency.asp* (accessed on 3 January 2023).
[108] Internal Revenue Service Notice 2014 – 21.
[109] Internal Revenue Service Notice 2014 – 21 at 1.
[110] Internal Revenue Service Notice 2014 – 21 at 2.

or as a revenue-generating investment is a taxable transaction that must be reported to the IRS.[111] This tax treatment of virtual currencies serves as a mere example and does not describe the position in SA.

For the sake of brevity, this thesis will not provide a detailed discussion on cryptocurrencies. Rather, the reference made to cryptocurrencies serves as a mere example of how the USA treats the taxation of cryptocurrencies. Although the IRS taxes payments in the form of cryptocurrencies according to capital gains tax rates, an internet-based company that operates in SA, and that accepts payment of goods or services by way of cryptocurrency may be considered to be receiving an amount 'in cash or otherwise' in accordance with the case law principles set out above.

According to Moosa, for purposes of the ITA, cryptocurrencies are incorporeal property with a comparable value in real currency.[112] Moosa argues that the reason for this is that such cryptocurrencies give rise to certain protectable proprietary rights, namely, (i) the rights exist digitally in cyberspace; (ii) the rights have value to their users; (iii) the rights are capable of being owned as cyberproperty; (iv) the rights can be transferred electronically by a possessor of a unique public-private cryptography protected keypair, and (v) the rights can be proved by entries in a digital ledger that records the historical chain of ownership transfers.[113] As such, if cryptocurrency is received or accrued as a revenue asset, its value in South African Rands on the date of such receipt or accrual, whichever occurs first, is subject to inclusion in the recipient taxpayer's gross income under the ITA.[114] Therefore, it is submitted that cryptocurrencies in SA, like the USA may constitute income tax. This is an example which highlights the importance of the concept of 'gross income' in the ITA.

2.3. 'Received by or accrued to'

The reference in the definition of the term 'gross income' in s 1 of the ITA to the total amount 'received by or accrued to or in favour of' a person during a particular year or period of assessment makes it clear that the definition applies both to 'receipts' and to 'accruals'. It is not profits but (gross) receipts and accruals of a non-capital nature and not merely the profit

[111] Law Shelf Educational Media 'Taxation in E-Commerce - Module 4 of 5' available at https://lawshelf.com/videocoursesmoduleview/taxation-in-e-commerce-module-4-of-5 (accessed 19 December 2022) (hereafter *Taxation in E-Commerce (2022)*) para 20.
[112] Moosa F 'Cryptocurrencies: do they qualify as "gross income?"' (2019) 44(1) *Journal for Juridical Science* 10.
[113] Moosa F 'Cryptocurrencies: do they qualify as "gross income?"' (2019) 44(1) *Journal for Juridical Science* 29.
[114] Moosa F 'Cryptocurrencies: do they qualify as "gross income?"' (2019) 44(1) *Journal for Juridical Science* 31.

component of those receipts and accruals that are included in gross income.[115] No liability for tax arises unless there has been a receipt or accrual, and, in the absence of special provisions, when a person neither receives anything nor has anything accrued to him, there can be no amount to be included in his gross income.[116]

The concept 'received by or accrued to' is not defined in the ITA and the meaning of the words must therefore be sought in case law. The general rule is that no liability for tax can arise when there is no receipt or accrual, although in certain instances the ITA does subject a person to tax on amounts that have not been received by and have not accrued to him.[117] It may often occur that an amount accrues to a taxpayer in the same tax period that he or she receives it, in which case the amount would only be included in the taxpayer's gross income once.[118] Where an amount accrues in one tax period, but it is received in another, it could never have been intended that income tax should be paid twice over.[119] In *SIR v Silverglen Investments (Pty) Ltd*[120] it was held that where a taxpayer disclosed an amount that accrued to him in a period of assessment, SARS cannot elect to rather tax the amount in a subsequent tax period (during which it had been received by the taxpayer).[121] In *Ochberg v CIR*,[122] the court held that the question whether the taxpayer had benefited from a transaction was irrelevant.[123] What is important, however, is that the receipt by or accrual to the taxpayer must be on his own behalf and for his own benefit for it to be included in gross income.[124]

2.3.1 Meaning of 'received by'

In *Geldenhuys v CIR*[125] it was held that the words 'received by' indicate that the taxpayer should have received the amount 'on his own behalf and for his own benefit'.[126] It is clear, therefore, that a person cannot be liable to tax on amounts received by him for the benefit of another.[127] Furthermore, any amount received with a corresponding obligation to return cannot

[115] *Silke on South African Income Tax* (2021) para 2.1A.
[116] *Silke on South African Income Tax* (2021) para 2.1A.
[117] Croome (2013) 67.
[118] Croome (2013) 67.
[119] *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 52 SATC 9 19.
[120] 30 SATC 199.
[121] 30 SATC 199 208.
[122] 5 SATC 93.
[123] 5 SATC 93 97.
[124] *CSARS v Cape Consumers (Pty) Ltd* 61 SATC 91 94.
[125] 14 SATC 419.
[126] 14 SATC 419 430.
[127] *Income Tax in South Africa* (2022) para 4.12.

constitute gross income.[128] It follows that, where a person receives an amount as an agent or trustee, such an amount would not form part of the gross income of that agent or trustee.[129]

The courts have applied various approaches in determining whether a person has received an amount for his or her own benefit. In cases dealing with receipts other than receipts derived in an illegal manner, the courts have invariably adopted an objective approach by enquiring whether a person was objectively entitled to receive an amount for own benefit.[130] In other cases (and especially in cases concerning the receipt of income derived from illegal activities) the courts predominantly (but not exclusively) applied a subjective approach.[131]

2.3.2 Meaning of 'accrued to'

Two meanings were originally attached to the term 'accrued to'. It was argued that an amount accrues to someone either as soon as a claim arises in his favour (that is, when he becomes entitled to claim payment), or when it is due and payable.[132] The 'due and payable' interpretation was, however, rejected by the Appellate Division in *CIR v People's Stores (Walvis Bay) (Pty) Ltd*[133] (hereafter *People's Stores)*. In *People's Stores*, the court held that these two principles were inseparably linked and that in the result, the right to receive future payments had to be valued at the end of the year of assessment having regard to its lack of immediate enforceability, that is, the discounted future value.[134] Notwithstanding this, the future income must be brought to account at the face value of the accrual, irrespective of when the amount is payable. The court held that the correct interpretation was that of 'entitled to'.[135]

As a result of the decision in *People's Stores*, it is now specifically provided that where a taxpayer has become entitled to an amount which is payable on a date after the last day of the year of assessment, the total amount is nevertheless deemed to have accrued to him during such year of assessment.[136] In other words, it is not the present value of the future amount that must

[128] *Income Tax in South Africa* (2022) para 4.12.
[129] Croome (2013) 68.
[130] See *Brookes Lemos Ltd v CIR* 14 SATC 295; *Greases (SA) Ltd v CIR* 17 SATC 358; *CIR v Genn & Co (Pty) Ltd* 20 SATC 113; *CIR v Witwatersrand Association of Racing Clubs* 23 SATC 380; *SIR v Smant* 35 SATC 1; *CSARS v Cape Consumers (Pty) Ltd* 61 SATC 91.
[131] See *COT v G* 1981 (4) SA 167 (ZA); *MP Finance Group CC (in liquidation) v CSARS* 69 SATC 141.
[132] See *Lategan v CIR* 2 SATC 16; *CIR v Delfos* 6 SATC 92.
[133] 52 SATC 9.
[134] *People's Stores* 24.
[135] *People's Stores* 10.
[136] *Clegg: Income Tax in South Africa* (2022) para 4.12.

be included in income, but the face value of the amount which had accrued during the year of assessment.[137]

2.4. 'Receipts or accruals of a capital nature'

The general definition of gross income excludes receipts and accruals of a capital nature, However, this does not mean that all capital receipts or accruals are excluded from constituting gross income, in that certain receipts (whether of a capital nature or not) are specifically included in the concept of gross income, such as an amount received by a natural person as compensation for the imposition of a restraint of trade.[138]

Although capital accruals have been subjected to income tax since 2001 (albeit under the provisions of the Eighth Schedule to the ITA, which provides for the levying of capital gains tax), the distinction between income and capital is still of significance because capital gains are taxed at a lower effective rate.[139]

Generally speaking, when an amount qualifies as a receipt or an accrual of a capital nature (and is therefore excluded from the gross income of the taxpayer), then the next step would be to establish whether any capital gains tax implications would ensue.[140] Should the amount, however, fall within the taxpayer's gross income (and therefore be classified as an amount of a revenue nature), then capital gains tax would not also be payable in respect thereof.[141]

The concept of 'of a capital nature' is not defined in the ITA. As a result, the judiciary has developed certain guidelines over the years in an attempt to provide clarity as to the distinction between what constitutes an amount of an 'income' (or revenue) nature on the one hand, and an amount of a 'capital' nature on the other.

In *CIR v Visser* (hereafter *Visser*)[142], it was stated that 'income is what "capital" produces, or is something in the nature of fruit as opposed to principal or tree'.[143] According to this approach, income is produced as a result of the employment of capital such as interest (income)

[137] *Clegg: Income Tax in South Africa* (2022) para 4.12.
[138] Croome (2013) 82.
[139] Croome (2013) 83.
[140] Croome (2013) 83.
[141] Croome (2013) 83.
[142] 8 SATC 271.
[143] *Visser* 276.

derived from money in the bank (capital).[144] This tree-and-fruit test, however, cannot always be used to characterise an amount as revenue or capital.[145]

In *Pyott v CIR*[146] it was held that an amount should be classified as either 'income' or 'capital' in nature there being no 'half-way house' in between). Apportionment is, however, possible where one amount (having regard to its *quid pro quo*) contains both an income element and an element of a capital nature.[147] In *Tuck v CIR* (hereafter *Tuck*)[148] the taxpayer was the managing director of a pharmaceutical company who had received certain shares in terms of a management incentive plan. The court held that the shares were partly attributable to a restraint of trade term (and therefore capital in nature) and partly attributable to services rendered (and therefore income in nature). The court remarked that,

> '[it] could hardly have been the intention of the legislature that in such circumstances the receipt be regarded wholly as an income receipt, to the disadvantage of the taxpayer, or wholly as a capital receipt, to the detriment of the *fiscus*.'[149]

It is important to note that, should a capital or revenue dispute between a taxpayer and SARS end up in court, the taxpayer will bear the onus to prove that, on a balance of probabilities, the amount is not of an income nature.[150] Although the capital amount would still be subject to income tax as a capital gain inclusion, s 102 of the TAA is relevant because the amount would not be taxable as gross income.

In *CIR v Pick 'n Pay Employee Share Purchase Trust* (hereafter *Pick 'n Pay*)[151] it was held that there is, unfortunately, no single infallible test to apply for determining whether a receipt or an accrual is of a capital nature.[152] There are a variety of tests for determining whether or not a particular receipt is one of a revenue or capital nature and they are laid down as guidelines only.[153] In ITC 1450[154] the court stated the following,

[144] Croome (2013) 83.
[145] Croome (2013) 83.
[146] 13 SATC 121.
[147] Croome (2013) 84.
[148] 50 SATC 98.
[149] *Tuck* 115.
[150] See s 102 of the TAA.
[151] 54 SATC 271.
[152] *Pick 'n Pay* 276.
[153] *Pick 'n Pay* 279.
[154] 51 SATC 70 (N).

> 'But when all is said and done, whatever guideline one chooses to follow, one should not be led to a result in one's classification of a receipt as income or capital which is, as I have had occasion previously to remark, contrary to sound commercial and good sense.'[155]

In some instances (and especially in the context of a business), the courts have referred to the distinction between 'fixed capital' and 'floating capital'.[156] In *CIR v George Forest Timber Co Ltd*[157], the court held that,

> 'Capital, it should be remembered, might be either fixed or floating. The substantial difference was that floating capital was consumed and disappeared in the very process of production, while fixed capital did not; though it produced fresh wealth it remained intact. …Ordinary merchandise in the hands of a trader would be floating capital. Its use involved its disappearance and the money obtained for it was received as part of the ordinary revenue of the business. It could never have been intended that money received by a merchant in the course and as the result of his trading should not form part of this gross income. The proceeds of fixed capital stood in a different position. The sale of such capital would generally speaking represent a mere realisation which ought from its nature to be excluded, and which the section intended to exclude from the calculation of income.'[158]

The issue whether the proceeds constitute a receipt of a revenue or a capital nature is especially problematic because the mere realisation of a profit by the taxpayer does not cause the proceeds to be classified as revenue in nature.[159] In *CIR v Stott*[160], the principle that a taxpayer has the right to realise a capital asset to his or her best advantage was highlighted.[161] The test employed by the judiciary to establish whether the proceeds are revenue or capital in nature is the test of 'intention'.[162] What has to be established is whether the taxpayer intended to resell the asset disposed of at a profit through a scheme of profit-making or whether the taxpayer merely intended to realise an investment.[163]

The starting point of an enquiry into the intention of a taxpayer at the time of the realisation of an asset is to determine what the intention of that taxpayer was at the time of the initial

[155] 51 SATC 70 (N) 76.
[156] Croome (2013) 85.
[157] 1 SATC 163.
[158] 1 SATC 163 23-24.
[159] Croome (2013) 85.
[160] 3 SATC 253.
[161] 3 SATC 253 261.
[162] Croome (2013) 85.
[163] Croome (2013) 86.

acquisition of that particular asset.[164] Secondly, it has to be established whether the taxpayer has changed his or her intention (with respect to that asset) during the whole period that the asset was held.[165] Lastly, it has to be established what the intention of the taxpayer was at the time of the disposal of the asset.[166]

In view of the fact that the intention of a taxpayer established through his or her own evidence (his *ipse dixit*) would be subjective (and could be manipulated), the courts will test his or her subjective thoughts against the background of objective factors.[167] External or surrounding circumstances which are taken into account by the courts are very important in the determining of the taxpayer's intention and in deciding whether or not the taxpayer succeeded in discharging his burden of proof.[168]

In the event where a taxpayer has alternative intentions (to deal with an asset), effect will generally be given to the taxpayer's dominant intention, but only if the alternative intention is entirely secondary.[169] However, where a taxpayer envisages making a profit with regard to an asset in one of two ways (and the one is not secondary to the other), then the preferred manner will not constitute a dominant intention. The court will consider the proceeds to be of a revenue nature.[170]

With regard to the intention of a company, the general rule is that the intention of a company is determined with reference to the intention of its directors, the idea being that the directors are in control of the affairs of the company.[171] This may be derived from the formal acts of the directors for example, resolutions and minutes of meetings) and those of the company (for example, the objects clause in its memorandum of association of the memorandum of incorporation), the oral evidence of the directors or other objective factors.[172]

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[164] Croome (2013) 86.
[165] Croome (2013) 86.
[166] Croome (2013) 86.
[167] Croome (2013) 86.
[168] See Griessel R 'The Nature of the Proceeds Derived from the Sale of an Asset for the Purposes of Income Tax' (1997) 9 *SA Merc L.J.* 144 for a discussion on the significant factors considered by the courts. Some of the factors discussed include the (i) activities of the taxpayer in relation to the asset in question; (ii) the way in which the transaction is financed; (iii) length of time for which the asset is held; (iv) frequency of transactions; and (v) way in which an asset is sold. The above list is not exhaustive and it must be borne in mind that there are many other factors which a court may consider. It must further be born in mind that no single one of these factors and circumstances will necessarily be decisive. All these factors or circumstances, including the taxpayer's evidence, are considered as a whole when a decision by a court is taken
[169] *COT v Levy* 18 SATC 127 135-136.
[170] Croome (2013) 87.
[171] *SIR v Trust Bank of Africa Ltd* 37 SATC 87 105.
[172] Croome (2013) 87.

Traditionally the activities of the shareholders of a company (except in their capacity as directors) are irrelevant in establishing the intention of a company. However, in *Elandsheuwel Farming (Edms) Bpk v SBI*[173] (hereafter *Elandsheuwel*), the court stated that,

> 'It must be remembered that the dealings of a juristic person are controlled by human beings, and that they are the brain and ten fingers thereof.'

Elandsheuwel established that change in shareholding may certainly be relevant to the enquiry of a company's intention.[174]

2.5. Source of income

The principles relating to source of income are crucial in the context of taxation of internet-based companies. It is submitted that it is more likely that internet-based companies will be held liable to taxation on the basis of 'source' rather than 'residence'. This is due to the fact that, in recent decades, the rise of the digital economy has drastically changed the way the world does business and this may increase the flow of cross-border transactions. Business can now be conducted without regard to geographical boundaries and limitations and organisations have the ability to conduct business by making use of mobile and sophisticated software in SA without having a significant physical presence in the country.[175] There is a general move globally to align taxation with economic substance and value creation and there is an increased focus on source-based taxation.[176] As a result, the principles relating to source of income in SA will be discussed below.

The ITA does not provide a definition of the term 'source'. According to Silke, the reason for the term 'source' being undefined in the ITA is that, 'it is not possible to comprehensively define the qualities that determine the source of income'.[177] Although source is undefined in the ITA, there is a significant body of case law setting out principles for determining the source of income, although such case law is subject to the provisions of s 9. In *CIR v Lever Brothers & Unilever* Ltd[178] (hereafter *Lever Brothers*), the court dealt with the test of a natural source of an amount. Before considering case law, it is important to consider whether the income in

[173] 39 SATC 163 174.
[174] Croome (2013) 88.
[175] Flynn B *Evaluation of the "source" rules as contained in section 9 of the South African Income Tax Act as relating to software in the context of the Digital Economy* (unpublished M Com (Taxation) thesis, University of Cape Town, 2014) 5 (hereafter Flynn B (2014)).
[176] Flynn B (2014) 5 5.
[177] *Silke on South African Income Tax* (2021) 14.
[178] 1946 AD 453.

question falls within any s 9(2) deemed source provision under the ITA. If the income in question does fall within the scope of s 9(2) of the ITA, then it is deemed to be sourced in SA for purposes of non-resident taxpayers.

Instead of providing a broad definition of source that applies to all categories of income, s 9(2) of the ITA has identified streams of income that is automatically subject to income tax. All other streams of income are therefore subject to case law. The deeming provisions contained in s 9(2) of the ITA provides for instances in which income is automatically deemed to be sourced in SA. In the event that the income in question does not fall within the ambit of s 9(2) of the ITA, the question that then arises is, how is the source of income determined? In *Lever Brothers*, Watermeyer CJ held that,

> 'the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income … this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them.'[179]

Furthermore, in *Essential Sterolin Products v CIR*[180] (hereafter *Essential Sterolin*), the court noted that the originating cause and the location of that originating cause must be determined for purposes of determining source.[181] The court further held that, all of the relevant factors must be weighed up to find the dominant, main, substantial, or real cause of the receipt.[182] In *First National Bank of Southern Africa Ltd v CSARS*[183] (hereafter *First National Bank*), the Supreme Court of Appeal considered whether interest under the particular circumstances had been received from a source within SA. The court affirmed the legal principles applied in *Essential Sterolin* and *Lever Brothers*.[184]

Based on *Essential Sterolin* and *First National Bank,* it appears that the following general principles can, and should be applied to determine whether or not an amount was received from a source within SA, namely, (i) in determining the source of an amount, the first step is to determine what is the originating cause of the income and when that has been determined, the second step is to locate it; (ii) in seeking the originating cause and the location of the source of income one must have regard to the overall factual matrix of the circumstances; (iii) against

[179] *Lever Bros* 461.
[180] 1993 (4) SA 859 (A).
[181] *Essential Sterolin* para 23.
[182] *Essential Sterolin* para 24.
[183] 64 SATC 245.
[184] *First National Bank* para 12.

this factual matrix, the originating cause of a particular receipt may not necessarily all occur in the same place and may occur in different countries, in which case, the dominant, or main or substantial or real and basic cause of the accrual of income must be determined; and (iv) one should not lose sight of the fact that ascertaining the actual source of a given income is a practical, hard matter of fact where it may be necessary to adopt a common sense approach.[185]

A case law analysis shows that the determination of the source of income based upon these principles depends, first, on the ability to distinguish between different types of income, and, secondly, on the geographical location of a taxpayer's activities. E-commerce affects both factors.[186] This indicates the challenges associated with the taxation of internet-based companies and highlights how difficult it may be for internet-based companies to be held liable to taxation on the basis of 'place of effective management'. It is, therefore, important for SARS to apply the principles relating to source in instances where internet-based companies plan their affairs in ways that make them non-resident.

Since the primary subject of this thesis is 'place of effective management' in relation to tax residency under the ITA, it is important to first consider whether there is an appropriate interpretation of 'place of effective management' capable of being the basis on which a particular internet-based company can be held liable to income taxation in SA. Only in instances, where internet-based companies plan their affairs in a way that leads to them not being resident in SA, such companies may be liable to income taxation on the basis of source. Accordingly, a discussion on the SA concept of resident and more specifically, 'place of effective management' will follow.

2.6. Residence of a company in SA

Historically, income tax legislation in SA did not contain a definition of resident.[187] A variety of specific terms were previously used in the case of companies, including management and/or control, 'domestic company', 'external company' and 'South African company' were used in different situations where a degree of SA presence or residence was a requirement.[188] However, in 2002, the definition of 'resident' was introduced into the ITA which ensured that a company

[185] De Koker AP & Lewis A *Silke on International Tax* (2021) (online version) 2 (hereafter *Silke on International Tax* (2021)).
[186] Oguttu AW & Van der Merwe B (2005) 311.
[187] *Income Tax in South Africa* (2022) 3.
[188] *Income Tax in South Africa* (2022) 3.

is for all purposes of the ITA treated consistently as far as residence is concerned.[189] The definitions of 'domestic company', 'external company' and 'South African company' have, therefore, become obsolete.[190] Reference is now made comprehensively to 'resident' for both individuals and artificial persons, including companies.[191]

As shown in chapter 1 of this thesis, a juristic taxpayer will be resident in SA for ITA purposes if it is incorporated, established or formed in SA, or if its 'place of effective management' is located anywhere in SA. A juristic taxpayer will also be regarded as a 'resident' in SA in relation to a particular year of assessment if its 'place of effective management' is located in SA for that period. This is a substance over form test, and it entails an examination of the factual circumstances to determine whether the company or other juristic person operates in SA or the country where it claims to be resident.[192]

It is necessary to have the differing criteria catered for in the ITA for the tax residency of a juristic taxpayer because a juristic person (such as, a company or trust) could be registered or incorporated in one country but operate in the jurisdiction of another.[193] The place of registration and incorporation is, therefore, easy to determine and easy to manipulate.

With regards to the registration test, if a juristic entity is registered in SA, the entity will be liable to pay income tax on the basis of residence.[194] If a juristic entity is not linked to SA by way of its registration, it may be liable to income taxation in SA if it has its 'place of effective management' in SA for a particular tax year.[195] In cases where the juristic taxpayer is exposed to the possibility of double taxation across different tax jurisdictions, the issue will be resolved with reference to whether a Double Taxation Agreement (DTA) exists between SA and the other jurisdiction.[196] If not, then the taxpayer would be liable for income taxation in both countries. If a DTA exists, then its provisions will regulate the incidence of taxation.[197]

[189] National Treasury *South African National Treasury Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002* (2002) 12.
[190] National Treasury *South African National Treasury Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002* (2002) 12.
[191] *Income Tax in South Africa* (2022) 3.
[192] *Silke on South African Income Tax* (2021) 1.
[193] *Silke on South African Income Tax* (2021) 5.
[194] Olivier L *International Tax: A South African Perspective* (2011) 24.
[195] Olivier L *International Tax: A South African Perspective* (2011) 24.
[196] *Silke on South African Income Tax* (2021) 1.
[197] *Silke on South African Income Tax* (2021) 1.

In *CSARS v Tradehold Ltd,*[198] the court held that the provisions of DTAs will prevail over South African legislation.[199] The reason for this decision was that DTAs effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries.[200] They achieve the objective of s 108 of the ITA[201], generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state or, in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances.[202] DTAs may provide guidance in interpreting the 'place of effective management' in a particular case. It is of interest, in the context of DTAs concluded by SA with other countries, that they are replete with references to the 'place of effective management'.[203] One may, accordingly, conclude that the concept bears the same meaning in the ITA as it does in these agreements.[204] On a practical level, the starting point when determining the 'place of effective management' in a particular case may be to consider any applicable DTA. This illustrates the importance of DTAs in determining the tax liability of internet-based companies.

However, if the entity concerned is to be treated exclusively as a resident of another country for purposes of a DTA between that country and SA, then that entity will also be treated as non-resident in SA for purposes of all provisions of the ITA.[205] The purpose of this provision is to avoid certain anomalies which might arise, where an entity could be treated as 'dual resident'.[206]

It has become clear that it is possible for companies to manipulate their circumstances so as to escape the tax residency net. Countries may, therefore, conclude a DTA with a provision that specifically considers what should happen if there is no place of effective management in a

[198] 2013 4 SA 184 (SCA).
[199] 2013 4 SA 184 (SCA) para 17. For a discussion on the rules governing the interpretation of DTAs, see Moosa F 'Interpreting a double taxation agreement' (2012) 26 *Tax Planning: Corporate and Personal* 118.
[200] 2013 4 SA 184 (SCA) para 17.
[201] Section 108(1) of the ITA provides that '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.' Section 108(2) of the ITA further provides that 'as soon as may be after the approval by Parliament of any such agreement, as contemplated in s 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.'.
[202] 2013 4 SA 184 (SCA) para 17.
[203] *Silke on South African Income Tax* (2021) 3.
[204] *Silke on South African Income Tax* (2021) 3.
[205] *Income Tax in South Africa* (2022) 3.
[206] *Income Tax in South Africa* (2022) 3.

specific instance. For example, the 2015 DTA concluded between Germany and Australia provides that in the event that they cannot find the place of effective management based on domestic rules or based on an agreement between both countries, the residence of the company will be wherever it has the most significant economic links.[207]

In order to ascertain the tax liability of internet-based companies, the 'place of effective management' of such companies will need to be considered. Although the meaning of the term 'place of effective management' has not been analysed in detail by the courts in SA, the High Court has acknowledged that the place of effective management of a person, other than a natural person, is the place where key management and commercial decisions that are necessary for the conduct of a person's business are in substance made.[208] This view is in line with the Commentary of the OECD MTC[209] on place of effective management.

According to OECD, the place of effective management means the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made.[210] This changed in 2017. Article 4 (3) of the new OECD Articles of the Model Convention with respect to taxes on income and on capital ('OECD MTC') provides as follows:

> 'Where…a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors.…'

Article 4 (3) indicates that the OECD has resolved not to make any decision as to which country will have the right to tax a company based on a competing right of two countries. It is going to be a political decision that is not founded purely in law. This means that developing countries

[207] Australian Government: Department of Foreign Affairs and Trade, 'Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance' (2015) available at *http://www.austlii.edu.au/au/other/dfat/treaties/ATS/2016/23.pdf* (accessed 12 June 2022) 7.
[208] *Oceanic Trust* para 54.
[209] OECD 'Commentaries on the Articles of the Model Tax Convention' *Commentary on Article 4 Concerning the Definition of Resident* (2010) available at *https://www.oecd.org/berlin/publikationen/43324465.pdf* (accessed 12 June 2022).
[210] OECD, 'OECD Articles of the Model Convention with Respect to Taxes on Income and on Capital' (2003) available at *https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2003_mtc_cond-2003-en* (accessed 16 November 2021).

will be forced to negotiate even though they do not necessarily have the expertise to undertake such negotiations.

In *Oceanic Trust*, the taxpayer applied to court for a declaratory order that it was not tax resident in SA, on the basis that it did not conduct business in SA. The applicant, a company registered and incorporated in Mauritius, was the sole trustee of the trust. The applicant relied on the test used in the UK case of *Smallwood* to substantiate its application for a declaratory order. In *Smallwood*, the court held that, in order to determine the place of effective management of a trust, the court had to establish where the real top level of management of the taxpayer was exercised. The court distinguished between the place where key management and commercial decisions of the trust were made (which is important for the purposes of determining the place of effective management) and the place where the day-to-day management of the trust is exercised by the trustees (which does not necessarily affect where the place of effective management is).

In *Oceanic Trust*, the court stated that all of the relevant facts and circumstances must be examined in determining the place of effective management. *Smallwood* is relevant because s 233 of the Constitution provides that legislation must be interpreted in a way that is consistent with international law. With reference to *Smallwood*, the court held that, the place of effective management will ordinarily be the place where the most senior group of persons (e.g. a board of directors) makes its decisions, where the actions to be taken by the entity as a whole are determined.[211] It was further held that, no definite rule can be given and all relevant facts and circumstances must be considered to determine the place of effective management of an entity; and although there may be more than one place of management, there may only be one place of effective management at any one time.[212]

According to the House of Lords in *De Beers Consolidated Mines, Ltd v Howes*[213] (hereafter *De Beers*), the question was whether the residence of a particular company was in the UK or SA. The court noted that when determining the residence of a company, it is a question of fact.[214]. The court held that the residence of a company will be determined based on where the central management and control of the company is located.[215]

[211] *Oceanic Trust* para 54.
[212] *Oceanic Trust* para 54.
[213] [1907] UKHL 626.
[214] *De Beers* 627.
[215] *De Beers* 627.

In *Wood & Anor v Holden (HM Inspector of Taxes)*[216] (hereafter *Holden*) the court recognised that it is possible for someone other than the constitutionally authorised bodies to make key strategic management decisions.[217] This is important for this thesis because South Africa's test of place of effective management in terms of our domestic legislation is linked to the test in the UK which is the central management of control.

SARS issued an interpretation note in 2023 in relation to 'place of effective management' ('IN 6 (Issue 3)'), which provides that, since the term 'place of effective management' is not defined in the ITA, the ordinary meaning must be ascribed to the phrase, taking into account international precedent and interpretation.[218] As stated in chapter 1, there is no binding authority in respect of the meaning of 'place of effective management'. Consideration must therefore be given to any materials that may be useful in attributing meaning to the term

According to the Commentary on the OECD MTC, the 'place of effective management' of a company is the place where key management and commercial decisions are made.[219] It is clear that the opinion of the court in *Oceanic Trust* is aligned with the OECD. There appears to be a common thread amongst the interpretations by the various courts in *Oceanic Trust* and the UK cases of *Smallwood*, *Holden* and *De Beers* mentioned above. This thread relates to the concept of 'central management and control'. The analysis to be conducted in chapter 3 of this thesis may identify and highlight (if applicable) any issues that may arise from this concept of 'management and control' (i.e. decisions of the board of directors and shareholders of a company). Pursuant to this analysis, a proposal will be submitted for an alternative concept which could be useful to interpreting 'place of effective management' in the context of internet-based companies.

With regard to IN 6 (Issue 3), it appears that SARS has tried to interpret 'place of effective management' as broadly as possible so as to capture as many companies as possible in the income tax net. SARS purports that IN 6 (Issue 3) is in line with the OECD principles and guidelines for the determination of the 'place of effective management' when used as a tie-breaker rule in a DTA. However, the pragmatic attempt by IN 6 (Issue 3) at recognising regular,

[216] [2006] BTC 208.
[217] *Holden* para 27.
[218] IN 6 (Issue 3) 3. Refer to a chapter 3 of this thesis for a detailed discussion on SARS' interpretation of 'place of effective management'.
[219] OECD 'Commentaries on the Articles of the Model Tax Convention' *Commentary on Article 4 Concerning the Definition of Resident* (2010) available at *https://www.oecd.org/berlin/publikationen/43324465.pdf* (accessed 12 June 2022).

day-to-day management by directors and senior managers as the preferred level of effective management differs from the OECD approach.[220] As discussed in chapter 1 of this thesis, the *obiter* in *Oceanic Trust* is not binding in relation to the meaning of 'place of effective management' in SA, rather is holds persuasive value.

However, the question relating to the meaning of 'place of effective management' has not been raised by an SA court apart from *Oceanic Trust*. As such, it is submitted that, the *obiter* in *Oceanic Trust*, although not binding, holds weight in the development of the term 'place of effective management'. The role of the *obiter* in *Oceanic Trust* and its relevance in determining a possible meaning for 'place of effective management' of social media companies in SA will be discussed in the later chapters of this thesis.

According to Van der Merwe, when interpreting the phrase in the context of the ITA, the alternative approach by SARS, as discussed in previous versions of IN 6 (Issue 3) and which currently features in IN 6 Issue 3), is not considered settled in SA law, and consequently may have a limited effect as an interpretational aid due to the possible persuasive influence of a conflicting international opinion.[221] Furthermore, SA courts may find the OECD interpretation to be 'unreasonable', based upon our legislature's clear indication that it intends to move away from a concept of overriding central control by deleting references to 'central management and control' from the ITA.[222] Such a finding could result in the allocation of different meanings to the same phrase, depending on whether the context is domestic or international.[223] It is clear, that SA courts will have a hard time interpreting the term 'place of effective management', however, it is submitted that one comprehensive definition of the term is not the solution, rather, it should be dealt with on a case by case basis. In this thesis, the main subject is internet-based companies and it will need to be determined whether such companies may have its 'place of effective management in SA'.

2.7. Conclusion

This chapter shows that, despite the right of taxpayers (such as, internet-based companies) to organise their tax affairs in such a way as to pay as little tax as possible, the effect of *NWK* is that SARS has been provided with a weapon to counter questionable tax arrangements. As

[220] Van der Merwe BA (2006) 137.
[221] Van der Merwe BA (2006) 137. See chapter 3 of this thesis for a discussion on the interpretive value of IN 6 (Issue 3) with reference to the decision in *Marshall NO v CSARS* 2019 (6) SA 246 (CC).
[222] Van der Merwe BA (2006) 137.
[223] Van der Merwe BA (2006) 137.

discussed in chapter 1 of this thesis, *NWK* dealt a blow to the common law right of internet-based companies to structure their affairs in way that is tax effective for their purposes. This chapter shows further that in instances where internet-based companies plan their affairs in a way that leads to them not being tax 'resident' in SA, such companies may yet be liable to income taxation in SA on the basis of source of income.

In addition, this chapter set out the principles applicable to 'gross income' in the context of the ITA. This has laid the foundation for understanding the term 'place of effective management' in context and gives background for the chapters to follow. Further inroads may be made through an interpretation of 'place of effective management' which would further minimise the opportunity for internet-based companies to structure their operational affairs in such a manner as to escape the income tax net, whether altogether or in a significant way. This is dealt with in chapter 3 below.

Before discussing the principles of interpretation and a possible, alternative interpretation of 'place of effective management', it is appropriate to draw on the relevant laws of foreign countries which may be implemented in SA to assist SARS collecting taxes from internet-based companies. This is discussed in the next chapter.

CHAPTER 3: A POSSIBLE MEANING OF PLACE OF EFFECTIVE MANAGEMENT

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3. CHAPTER 3: A POSSIBLE MEANING OF PLACE OF EFFECTIVE MANAGEMENT

3.1. Introduction

As discussed in chapter 1 of this thesis, the main objective of this thesis is to determine whether an internet-based company is considered 'resident' in SA for income tax purposes on the basis that its 'place of effective management' is within the Republic of SA as envisaged by the ITA. Chapter 1 of this thesis further discussed that the term 'place of effective management' is undefined in the ITA and no meaning has been ascribed thereto by the courts. As a result, and as mentioned in chapter 2 of this thesis, the interpretation of the term 'place of effective management' is a key component of the aims and objectives of this study. A discussion on the fundamental principles of legal interpretation is therefore crucial to the study and will need to be applied in order to achieve the aims and objectives of this study.

It is possible that when Parliament included the concept of 'place of effective management' as a determining factor for a juristic person to be subject to income taxation in SA, they envisaged the rise of e-commerce transactions. It could be argued that, on the one hand, Parliament struggled to formulate a definition of 'place of effective management' and chose not to define the term. On the other hand, it is also possible that they did not envisage the rise of e-commerce transactions and did not define 'place of effective management' because they did not think it was important enough to have a definition. These possibilities are speculative and whichever possibility is true, does not change that fact that the term 'place of effective management' is undefined and that this is a problem for the fiscus. Due to the lack of meaning and scope being ascribed to 'place of effective management', it is important to consider whether 'place of effective management' is capable of applying to internet-based companies. This will require an analysis of the principles of legal interpretation to determine whether it is justified in terms of the Constitution to hold them liable should they meet certain 'criteria'.

Lastly, a discussion will be undertaken on the criteria which ought to be used in order for an internet-based company to be held liable to taxation on their worldwide income in SA on the basis of 'place of effective management'. This will involve ascribing a possible meaning to the term which is both practical and constitutional.

3.2. Principles of interpretation

In *Glen Anil Development Corporation Ltd v SIR,*[224] it was stated that, there is little reason why the interpretation of fiscal legislation should be subjected to special treatment which is not applicable in the interpretation of other legislation.[225] This indicates that the rules of statutory interpretation that apply to general statutes also apply to tax legislation. However, the interpretation of statutes is often a difficult task, and the rules of construction, which range from a literal analysis of the wording to one based on the aims and context of the legislation, have historically not been consistently applied.[226]

Greater cohesion has been achieved through a series of judgements in the Supreme Court of Appeal between 2010 and 2020,[227] the most influential of which is *Natal Joint Municipal Pension Fund v Endumeni Municipality* (hereafter *Endumeni*).[228] To understand the current, accepted principles of legal interpretation it is important to consider the brief history leading up to the current approach. This will help provide greater context later on in this chapter when the current principles are applied. The traditional view has been that in the interpretation of tax legislation, in contrast to other legislation, the court must adhere strictly to the words of the particular statute and that deviation from a literal interpretation should not readily occur.[229] The judgments in *CIR v George Forest Timber Co Ltd*[230] and *CIR v Simpson*[231] are especially relevant since it was in these two judgments that the above approach was taken over from English judgments.[232] In *CIR v George Forest Timber Co Ltd*, it was held that if there is an equitable construction, such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.[233]

In *CIR v Simpson* it was held that:

> '[i]n construing the definition regard must be had to the cardinal rule laid down by Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* (1921 1 KB 64 at 71) and approved by Simon VC in *Canadian Eagle Oil Co Ltd v The King* (1946 AC 119 at 140). That

[224] 37 SATC 334.
[225] 37 SATC 334 para 334.
[226] *Income Tax in South Africa* (2021) 2.
[227] *Income Tax in South Africa* (2021) 2.
[228] 2012 (4) SA 593 (SCA).
[229] *Income Tax in South Africa* (2021) 2.
[230] 1924 AD 516.
[231] 1949 (4) SA 678 (A).
[232] *Income Tax in South Africa* (2021) 2.
[233] 1924 AD 531.

> rule was as follows: "(It simply means that) in a taxing act one has to look merely at what is clearly said. *There is no room for any intendment*. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used".'[234]

These judgements create the impression that as far as the interpretation of tax legislation is concerned, courts must adhere strictly to the literal words contained in a statute rather than an approach from the point of view of intention and that a departure from literal interpretation never occurs.[235] In summary, statutory interpretation in SA previously required the courts to do four things, namely:

a) Find the literal meaning of a word. This may be done by looking at the meaning it has in the dictionary and using the common law canons of construction to determine the most likely operation of a word or phrase;
b) If the literal meaning is absurd, vague or ambiguous, we may depart from that meaning;
c) But when we depart from the literal meaning we have to give the word a meaning intended by the legislature;
d) The meaning intended by the legislature can be determined only by a limited context, that is, by what Parliament actually said in the rest of the enactment in other sections, titles, preambles, margins, headings and so on. One may not imaginatively reconstruct the will of Parliament by wondering how it would reasonably interpret a particular word.[236]

The current approach to statutory interpretation preferred by SA courts is set out in *Endumeni*. The Constitutional Court has endorsed *Endumeni* on numerous occasions, such as, in *KwaZulu*

[234] 1949 (4) SA 695 (A). See *R Koster & Son (Pty) Ltd & Another v CIR* 1985 (2) SA 831 (A), where there was a departure from this literal approach to statutory interpretation. The court held that in construing a provision of an Act of Parliament the plain meaning of its language must be adopted unless it leads to some absurdity, inconsistency, hardship or anomaly which from a consideration of the enactment as a whole a court of law is satisfied the Legislature could not have intended. See *Bhyat v Commissioner for Immigration* 1932 AD 129, where the court held that the 'cardinal rule of construction of a statute', '…is to endeavour to arrive at the intention of the lawgiver from the language employed in the enactment ... in construing a provision of an Act of Parliament the plain meaning of its language must be adopted unless it leads to some absurdity, inconsistency, hardship or anomaly which from a consideration of the enactment as a whole a court of law is satisfied the Legislature could not have intended.

[235] *Income Tax in South Africa* (2021) 2.

[236] Perumalsamy K 'The Life and Times of Textualism in South Africa' (2019) 22 *PER/PELJ* 6.

Natal Joint Liaison Committee v MEC Department of Education, KwaZulu Natal,[237] where the court held that the principles applicable to interpreting written documents are now settled.[238]

In *Endumeni*, Wallis JA held that:

> 'Interpretation is the process of attributing meaning to the words used in a document, … having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible … results or undermines the apparent purpose of the document. … [B]e alert to, and guard against, the temptation to substitute what [you] regard as reasonable [or] sensible for the words actually used [for] to do so is to cross the divide between interpretation and [divination]. … The 'inevitable point of departure is the language … itself', read in context and having regard to [its] purpose … and the background to the preparation and production of [this] document.'[239]

In *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Others*[240], Ngcobo J held that,

> 'The Constitution is now the supreme law in our country. It is therefore the starting point in interpreting any legislation. Indeed, every court "must promote the spirit, purport and objects of the bill of rights" when interpreting any legislation. That is the command of section 39(2)'.

The primary principles of legal interpretation in SA have been described in *Corpclo 2290 CC t/a U-Care v Registrar of Banks*[241] as follows:

> 'It is a primary rule of statutory construction that words in a statute must be given their ordinary grammatical meaning in the light of their context, where 'context' includes the language of the rest of the statute, the matter of the statute, its apparent scope and purpose, and, within limits, its background. When interpreting the words in as statute, the court must, from the outset, consider the language and the context together. This must be done even when

[237] 2013 4 SA 262 (CC).
[238] 2013 4 SA 262 (CC) para 128.
[239] *Endumeni* para 18.
[240] 2004 (4) SA 490 (CC) para 72.
[241] [2013] 1 All SA 127 (SCA).

> the words to be interpreted are clear and unambiguous. In addition, s 39(2) of the Constitution requires that every piece of legislation must be construed in a manner that promotes the 'spirit, purport and objects of the Bill of Rights,' ie '(a)ll statutes must be interpreted through the prism of the Bill or Rights'. This must be done whatever the nature of the legislation. But looking through the prism of the Constitution does not open the door to changing the clear meaning of the statute. If the clear meaning conflicts with the Bill of Rights, the remedy is to strike it down. And it must always be borne in mind that s 39(2) postulates that the interpretation which is proposed is one which would demonstrably promote an identifiable value enshrined in the Bill of Rights and also one of which the legislation is reasonably capable. In seeking to give meaning to the words of a statute the court will also give effect to the object or purpose of the legislation but this cannot change the meaning of words which are only capable of one meaning.'[242]

Constitutional and statutory interpretation is not a free-wheeling (or free-floating), haphazard exercise.[243] It is a question of law that involves first considering the 'the content and sweep of the ethos expressed in the structure of the Constitution' and thereafter striking a fair balance between conflicting considerations reflected in the text being interpreted within its context, having regard to all relevant internal and external interpretive aids.[244]

According to Moosa:

> '…statutory provisions cannot be peered at with blinkers on. They are to be read and understood in their proper 'context'. … neither the Constitution nor any statute means whatever an interpreter wishes it to mean. Interpreters must act as informed, open-minded, thoughtful and objective observers sensitive to SA's complex social, financial and economic realities. They must guard against succumbing to the influences of their own personal intellectual and moral preconceptions. Interpreters must give effect to a meaning for a word that is contextually and linguistically justifiable and legally sound.'[245]

It is important for a taxpayer to know their tax resident status in SA, as the difference between a resident and a non-resident is that a resident will have a greater financial obligation as opposed to a non-resident.[246] It is therefore important to determine whether an internet-based

[242] [2013] 1 All SA 127 (SCA) para 20.
[243] Moosa F *The 1996 Constitution and the Tax Administration Act 28 of 2011: Balancing efficient and effective tax administration with taxpayers' rights* (unpublished LLD thesis, University of the Western Cape, 2016) 58 (hereafter Moosa (2016)).
[244] Moosa (2016) 59.
[245] Moosa (2016) 59.
[246] See discussion on 'gross income' above in chapter 2 of this thesis.

company has its 'place of effective management' in SA or not. It is clear that 'place of effective management' is subject to statutory interpretation. On the one hand, if it is construed narrowly to impose a less burdensome duty on an internet-based company in SA, it may be unfair to other taxpayers. On the other hand, if it is construed widely to impose a more onerous financial obligation on such internet-based companies, the question will be whether the imposition of such tax originates from the clear wording of a taxing statute.

This chapter will make use of the principles of interpretation discussed above to ascribe a possible meaning for the term 'place of effective management'. This exercise will be undertaken by having regard to the relevant internal and external interpretive aids and will give effect to a meaning for 'place of effective management' that is contextually and linguistically justifiable, and legally sound. In order to achieve this, regard will be given to the language used in the ITA, read in context and having regard to the purpose and the background in which the term 'place of effective management' is used. Furthermore, consideration will be given to s 39(2) of the Constitution, and the interpretation which will be proposed, will be one that promotes an identifiable value enshrined in the Bill of Rights and also one of which the ITA is reasonably capable. This exercise will involve an analysis of the most relevant writings that deal with the term 'place of effective management' and will draw on the various possible meanings postulated by authors, researchers and presiding officers.

3.3. Possible meaning of 'place of effective management' in SA

As discussed in chapter 2 of this thesis, SARS issued IN 6 (Issue 3) to attempt to interpret 'place of effective management' as broadly as possible so as to capture as many companies as possible in the income tax net. It was also discussed that IN 6 (Issue 3) may have persuasive value in ascribing a meaning to the term 'place of effective management'. In considering IN 6 (Issue 3), it is important to note the status of interpretation notes in SA. In *Marshall NO v CSARS*,[247] the court stated the following in relation to interpretation notes:

> 'Missing from this reformulation is any explicit mention of the further fundamental contextual change, that from legislative supremacy to constitutional democracy. Why should a unilateral practise of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified, where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties.

[247] 2019 6 SA 246 (CC) para 10.

> In those circumstances, it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided.'

This provides clarification as to the status of interpretation notes in SA and more specific to this context, IN 6 (Issue 3). However, this does not mean that interpretation notes have no significance. It is submitted that in circumstances where there is very little material available to attribute meaning to a statutory provision, an interpretation note issued by SARS should be considered if it aligns with constitutional values and international laws. Furthermore, in *C: SARS v Bosch and Another*[248], it was held that:

> '…in any marginal question of statutory interpretation, evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation is admissible and may be relevant to tip the balance in favour of that interpretation. This is entirely consistent with the approach to statutory interpretation that examines the words in context and seeks to determine the meaning that should reasonably be placed upon those words. The conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision in question'.[249]

It is submitted that IN 6 (Issue 3) may still be useful in attributing meaning to the term 'place of effective management'. It must be noted that, in light of the decision in *Marshall NO v CSARS*, IN 6 (Issue 3) must be used cautiously by our courts and not as a binding authority.

SARS confirms in IN 6 (Issue 3), that a company may have more than one place of management but it can only have one place of effective management at any one time.[250] The place of effective management will be at the place where key management and commercial decisions affecting its business are primarily or predominantly made.[251] This approach is consistent with the OECD's approach.

In determining a single dominant 'place of effective management', SARS provides for certain facts and circumstances that need to be considered. The determination looks at where the key management and commercial decisions are regularly and predominantly made. According to SARS, definitive rules cannot be laid down in determining the place of effective management

[248] 2015 (2) SA 174 (SCA).
[249] 2015 (2) SA 174 (SCA) para 17.
[250] IN 6 (Issue 3) 16.
[251] IN 6 (Issue 3) 6.

and all relevant facts and circumstances must be examined on a case-by-case basis.[252] A company's place of effective management must be determined by ascertaining who makes the key management and commercial decisions for the conduct of the company's business as a whole.[253] Once this determination has been made, it is necessary to determine where those decisions are in substance actually made.[254] Some of the facts and circumstances that should be considered on a case-by-case basis according to SARS will be discussed below and will be important for purposes of ascribing a meaning to the term 'place of effective management'.

The place where a company's head office[255] is located (i.e. the place where a company's senior management and support staff are predominantly located) is often representative of the place where key company decisions are made and forms an important consideration in determining where the place of effective management is located.[256] It is important to note that SARS acknowledges that there may be some situations in which senior management is so decentralised that determining the company's head office with a reasonable degree of certainty is not possible. This could be true in the case of internet-based companies. Consequently, in these situations, the location of a company's head office would be of less relevance in determining that company's place of effective management.[257] This will assist in the interpretation of 'place of effective management' as this thesis is concerned with internet-based companies that are likely to be decentralised.

According to SARS, where a company's board has chosen to delegate some or all of its authority to a committee, the location where the members of the committee are based will be considered in establishing the 'place of effective management'.[258] Furthermore, the location where the company's board meets and makes decisions may be indicative of a company's place of effective management, depending on the role of the board in the key management and commercial decisions of the company but states that there it should not be assumed that the

[252] IN 6 (Issue 3) 7.
[253] IN 6 (Issue 3) 7.
[254] IN 6 (Issue 3) 7.
[255] Section 9I of the ITA provides that a 'headquarter company' is a company that is resident in SA. The term 'head office' as used by SARS and the term 'headquarter company' as defined in the ITA, appear to be different concepts. The reason for this is that, on the one hand, it is a prerequisite in the ITA for a 'headquarter company' to be resident in SA, and on the other hand, SARS uses the term 'head office' to assist in attributing a meaning to the term 'place of effective management', which in turn may determine whether a company is resident in SA or not. See discussion in chapter 2 on residence. See *CSARS v Coronation Investment Management SA (Pty) Ltd* 85 SATC 413 .
[256] IN 6 (Issue 3) 7.
[257] IN 6 (Issue 3) 9.
[258] IN 6 (Issue 3) 8.

place of effective management of a company is where the board meets.[259] Where a board has *de facto* delegated authority to senior management and merely routinely ratifies decisions that have been made, the place of effective management will ordinarily be where those senior managers are located.[260]

With advances in telecommunications, information technology, global travel and modern business practices, the physical location of a board meeting may not be where the key management and commercial decisions are in substance being made. Therefore, no undue focus should be placed on the location of board meetings without considering the facts and circumstances such as who was physically present and who joined via video-conference.[261] Section 74(1) of the Companies Act (hereafter *Companies Act)*[262] provides the following:

> 'Except to the extent that the Memorandum of Incorporation of a company provides otherwise, a decision that could be voted on at a meeting of the board of that company may instead be adopted by written consent of a majority of the directors, given in person, or by electronic communication, provided that each director has received notice of the matter to be decided.'

A decision made by way of written resolution in this manner by the board of directors will have the same effect as if it had been approved by voting at a meeting.[263] It is possible (and probable) that companies (i.e. the board of directors acting on behalf of companies) make decisions by way of written resolution on a day-to-day basis for the sake of efficiency. Where the board of directors of a company adopt a written board resolution, such resolution may contain a counterpart resolution in terms of which the directors resolve that the resolutions contained in the document may be executed in counterparts, each of which when so executed shall be deemed to be an original, and all of which shall together constitute one and the same document. Adopting such resolutions provides the board directors the flexibility of managing a company from any location in the world with relative ease.

However, it must be borne in mind that s 1 of the Companies Act provides that a company is a juristic person incorporated in terms of the Companies Act. As such, s 74 of the Companies Act only applies to companies that have passed the incorporation test discussed in chapter 1 of

[259] IN 6 (Issue 3) 9.
[260] IN 6 (Issue 3) 10.
[261] IN 6 (Issue 3) 8.
[262] Act 71 of 2008.
[263] Section 74(2) of the Companies Act.

this thesis and, therefore, companies that are already considered 'resident' in terms of the ITA. Company legislation in foreign jurisdictions may, however, contain similar provisions to s 74 of the Companies Act.[264] It is submitted that with the ability of directors to adopt written resolutions from any location in the world, the place at which meetings of the board of directors are held should not be given much importance in determining whether a company has its 'place of effective management' at such location. It is further submitted, that by placing undue focus on such location, companies would find ways to manipulate their 'place of effective management' much easier. Therefore, other factors will have to be considered in ascribing a meaning to the term 'place of effective management'.

In addition to the loopholes contained in company law, technology now allows directors, living in different states to convene a board meeting through telephone conferencing, video conferencing and through communication via email. Therefore, the directors (or any senior managers) are not meeting in one specific location to make high level decisions and, therefore, more than one 'place of effective management' exists at any given point in time. However, because more than one 'place of effective management' is not allowed, each jurisdiction from which the directors are located and sit and make decisions is referred to as a 'place of management'. It will be very difficult if not impossible for one to point out which 'place of management' is the 'place of effective management'.[265]

Some decisions are reserved for the shareholders of a company, but such decisions generally affect the existence of the company rather than its business and are therefore not relevant in determining the place of effective management.[266] However, shareholder involvement can influence the place of effective management where a shareholder may usurp the powers of the directors of a company.[267] This situation normally arises where there is only one shareholder.

[264] A few examples of such laws are s 163 of the Companies Act 992 of 2019 (Ghanaian Companies Act), s 250(2) of the Companies Act 28 of 2004 (Namibian Companies Act), s 248A of the Corporations Act 2001 (Australian Corporations Act).
[265] Styane T *Place of Effective Management – A comparison between the South African domestic tax concept and the International tax concept* (unpublished LLM thesis, University of Cape Town, 2010) 31.
[266] SARS IN 6 (Issue 3) 12. Section 60 of the Companies Act provides, *inter alia*, that a resolution that could be voted on at a shareholders meeting may instead be submitted for consideration to the shareholders entitled to exercise voting rights in relation to the resolution. It is submitted that a similar discussion that was held on s 74 of the Companies Act (written resolutions of directors of a company) above will apply to s 60 of the Companies Act (written resolutions of shareholders of a company). As such, it is submitted that the location of the shareholders of a company do not hold much relevance in determining the 'place of effective management of such company'.
[267] SARS IN 6 (Issue 3) 12.

The relevance of operational management decisions (i.e. oversight of day-to-day business operations) is generally limited in determining the place of effective management and should be distinguished from the key management and commercial decisions (i.e. broader strategic and policy decisions).[268] Where support functions are centralised, the managers in charge of those support functions are generally not directly involved in making key management and commercial decisions that affect the company's business as a whole. Accordingly, the location where the support services are located is generally of limited relevance in determining the place of effective management of a company.[269]

According to Meyerowitz:

> 'place of effective management is normally the place where the directors meet on the company business, which may differ from the place where a company carries on business or is managed by staff and directors individually and not as a board. Where the company has executive directors, the facts may reveal that the company is effectively managed where such directors, in contrast to the board of directors as a whole, conduct the company business'.[270]

Ntombela states that in seeking to ascertain the place of effective management of a company, phrases such as 'central management and control' and 'effective management' can provide guidance.[271] However, the place of effective management can include, but is not restricted to, the place where management and administration are performed on a day-to-day basis, unlike the concept 'central management and control', which refers only to the place where the superior policy and strategic decisions are made.[272]

Although the interpretations mentioned above attempt to provide possible meanings of 'place of effective management', these interpretations do not cater for internet-based companies able to manipulate the rules to escape the tax net. For an interpretation of 'place of effective management' to be meaningful and beneficial in practice, consideration must be given to the effect of technology and the rapid developments of internet-based companies. According to van der Merwe:

[268] SARS IN 6 (Issue 3) 14.
[269] SARS IN 6 (Issue 3) 15.
[270] Meyerowitz D *Meyerowitz on Income Tax 1998/1999* (2000) 104.
[271] Ntombela NN *'Effective Management – The South African court's interpretation compared to OECD principles'* (unpublished LLM thesis, University of Pretoria, 2014) 48 (hereafter Ntombela NN (2014)).
[272] Ntombela NN (2014) 48.

> 'The adequacy of effective management as a tie-breaker rule based upon the location of superior management decision making has been questioned…. [M]odern companies are increasingly run and managed divisionally rather than through the legal entities in which the divisions are formed. This has resulted in an organisational network spread across different countries.'[273]

Van der Merwe further explains that due to modern technology, management has become much more mobile and traditional place of effective management may rotate. Van der Merwe has identified the problem that technology has made it possible to manage a company without the need for a group of persons to be physically located or to meet in one place and it is therefore difficult to pin effective management down to one constant location, and double or multiple residences or even non-residences may be the result.[274]

It is clear that technology has created problems in ascertaining the 'place of effective management' of a company. Although Van der Merwe explains that the problem is that the term, 'place of effective management' is not given a meaning which ensures that internet-based companies are unable to escape tax liability.

Furthermore, Jonker states that the interpretation and meaning of the place of effective management still has a far way to go in SA.[275] Not only does the term remain open to manipulation, but no definitive interpretation is given by SARS.[276] Jonker adds that the location of place of effective management has various tax implications and is accompanied with an additional administrative burden if located in a different location as the country of incorporation.[277] It would only be fair to conclude that if SARS wants to prevent the manipulation of place of effective management and protect its tax base, clear guidance needs to be given as to how this very important and influential terms need to be interpreted and applied.[278] It can be inferred that Jonker believes that interpretation is crucial to the issue relating to tax liability on internet-based companies. The issue of internet-based companies manipulating tax rules is a common problem which has been identified by various authors. However, Jonker has not provided a possible interpretation of 'place of effective management'.

[273] Van der Merwe BA (2006) 124.
[274] Van der Merwe BA (2006) 124-125.
[275] Jonker J *'"Place of Effective Management" – A South African perspective'* (unpublished LLM thesis, University of Pretoria, 2012) 72 (hereafter Jonker J (2012)).
[276] Jonker J (2012) 72.
[277] Jonker J (2012) 72.
[278] Jonker J (2012) 72.

The e-commerce challenges to a country's jurisdiction to tax are linked to the enforcement problems resulting from the use of new technologies. The ability to collect taxes is based on the identification and location of taxpayers, the identification and verification of taxable transactions, the ability to establish a link between taxpayers and their taxable transactions, and the ability to enforce payment. E-commerce transactions not only obscure the identity and location of the buyers and sellers who participate in internet-based transactions, but often make these aspects irrelevant. Anonymity is a unique feature central to e-commerce transactions. An internet address domain name only shows who is responsible for maintaining that address and provides no link to the computer, its user, or even the location of the computer. The use of electronic money and digital cash enhances anonymity, leads to virtually undetectable transactions and conceals the identities of the contracting parties. Identification of possible taxpayers in SA is driven mainly through the identification of taxable transactions.

Interpretation of statutes deals with the body of rules and principles which are used to construct the correct meaning of legislative provisions to be applied in practical situations.[279] Since all taxes are imposed by statute, all questions of tax are ultimately ones that involve the interpretation and application of the statute.[280] The common thread that runs across the interpretations postulated by the various authors of 'place of effective management' as well as the court in the *Oceanic Trust*[281], is that the 'place of effective management' of a company is the place where, the key management and commercial decisions of a company are regularly and predominantly made. This understanding is not binding in SA and therefore still subject to interpretation by SA courts. As discussed above, the location at which the board of directors should have very limited influence at the very best, in determining the 'place of effective management' of a company.

In the event that a court has to decide on the meaning of 'place of effective management', the question is whether this current interpretation will be sufficient in holding taxpayers liable or if an alternative interpretation should be adopted, considering the rapid growth of e-commerce transactions by internet-based companies. The answer to this question, it is submitted, is that no. Such definition is inadequate and has possible loopholes. It is further submitted that it is not possible to formulate a 'one size fits all' definition of 'place of effective management' that

[279] De Ville J 'Meaning and Statutory Interpretation' (1999) 62 *THRHR* 374.
[280] Jones JA, Harris P & Oliver D *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley* (2008) 8.
[281] See discussion on *Oceanic Trust* above in chapter 2 of this thesis.

fits perfectly in allowing SARS to hold companies liable to income tax at all times. Rather, it is submitted, that the definition of 'place of effective management' needs to constantly be reviewed through the prism of the Bill of Rights and shall continue to develop over time. It has been discussed in chapter 1 of this thesis, that holding internet-based companies liable to income tax will ensure a more equitable South African society.

If a company avoids day-to-day management in a specific location through the use of modern technology, then, in terms of the SARS' approach, the place of effective management will be where the business operations are actually carried out.[282] This will generally not be too difficult to locate where the company is involved in the manufacture or sale of tangible goods, unless business activities, or parts or phases of such activities, are conducted across the globe. However, when the company deals in intangible goods and services, it will be easier to manipulate the place of effective management by conducting business operations and activities from various locations. [283]

When an enterprise conducts its business through a website that is hosted on the server of an internet service provider ('ISP'), such hosting arrangement does not result in the server and its location being controlled by and being at the disposal of the enterprise.[284] The enterprise does not have a physical presence at the location of the server since the website through which it operates is not a tangible, fixed place of business.[285] However, if the enterprise owns or leases and operates the server on which the website is stored and used, then the place where that server is located could be regarded as a fixed place as the server and its location is at the enterprise's disposal.[286] Even if the enterprise has a server at its disposal, the server must be 'fixed' at some location. In other words, the server has to be located at a certain place for a sufficient period.[287]

In terms of article 5(5) of the OECD Model, a dependent agent is a person that habitually acts on behalf of an enterprise and has the authority to conclude contracts in its name in another contracting state. Of particular interest in an e-commerce environment, is the question whether an ISP may be considered to be a dependent agent due to its hosting of the website of a specific enterprise through servers owned and operated by the ISP. According to the OECD

[282] Oguttu AW & Van der Merwe B *Electronic Commerce: Challenging the Income Tax Base*? 17 (2005) *SA Merc LJ* 311 (hereafter Oguttu (2005)).
[283] Oguttu (2005) 311.
[284] Oguttu (2005) 311.
[285] Oguttu (2005) 311.
[286] Oguttu (2005) 311.
[287] Oguttu (2005) 311.

Commentary, the ISP will not constitute a dependent agent of the enterprise to which the web site belongs because it does not normally have authority to conclude contracts on behalf of this enterprise. ISPs are normally independent agents acting in the ordinary course of their own businesses which entails hosting web sites of many different enterprises. It appears from the above that an ISP and a web site are not dependent agents and will consequently not provide taxing authority.[288]

Notwithstanding, the OECDs position on ISPs and dependant agents, it is possible to argue that an ISP is a dependant agent and as a result, an internet-based company will be effectively managed at the location in which the ISP is located. This argument may seem far-fetched considering the OECDs position, however, it should be noted that the OECDs position is not binding and therefore, alternative interpretations may be considered. It is argued that in the case of internet-based companies (i.e. companies that rely on the internet to conduct its business)[289], the location of ISPs should be considered when taxing such companies. It is submitted that, in respect of internet-based companies, SA should adopt an approach which links the location of an ISP to the 'place of effective management'. In order to argue for this submission, minor additions will be required by Parliament. There is a need to create a centrally managed portal where ISPs can register, detail their country of origin, identify their 'place of effective management', and register as VAT vendors in the countries where they intend to sell their services and digitally delivered products.[290] This would be a streamlined process that allows the use of technology to manage a technologically intensive process.[291]

Registering international internet-based companies in every local jurisdiction in which they operate in order to establish physical presence, implies de-virtualisation of a virtual system. In a world where businesses operate in more than 100 countries from one location, it may be rather ridiculous to require these businesses to create a physical presence in each of these 100 countries.[292] Therefore, an effectively designed portal linked to local jurisdictions should be able to inform the foreign electronic service provider, which products are subject to tax and how much the tax due would be. Foreign electronic service providers could therefore add a new jurisdiction to their registration record at the click of a button when they receive a new

[288] Oguttu (2005) 311.
[289] See chapter 1 of this thesis for a discussion on internet-based companies.
[290] Kondo T *Legal and economic uncertainties clouding digital taxation: unpacking and addressing the issues* (unpublished LLM thesis, University of the Western Cape, 2010) 83 (hereafter Kondo (2010)).
[291] Kondo (2010) 83.
[292] Kondo (2010) 83.

customer. It is important that we remain adaptable to change, and not respond to new challenges with old solutions, but rather see challenges as prospects for innovation and ingenuity.[293]

Therefore, it is submitted that the term 'place of effective management' in respect of internet-based companies, should include the place in which particular ISPs are located, being the place in which such companies are effectively managed. This will be supported by a centrally managed portal on which ISPs can register. By making use of the ISPs, internet-based companies may be required to give an undertaking that they are subject to the 'place of effective management' of the particular ISP. Furthermore, this approach will indicate the location in which an internet-based company is effectively managed despite directors and being located in different parts of the world. This interpretation will ensure that SARS holds internet-based companies liable to taxation and will simultaneously ensure that internet-based companies are paying the required tax for certain transactions without manipulating tax laws.

3.4. Conclusion

The digital revolution has changed the economic reality in SA. Now, many of the activities that used to bring consumers to physical locations are performed entirely online. This has forced the government to grapple with the growing presence of e-commerce in consumer and business finance. As a result, the laws regulating e-commerce transactions need to be developed over time. It is evident that the current approach in SA to interpreting the term 'place of effective management' is flawed. A discussion has been held above on possibly including ISPs in the determination of 'place of effective management' of companies. This proposed meaning seeks to cater for increase in internet-based companies and is in line with the principles of legal interpretation discussed above. In light of this discussion, it is now important to consider foreign laws which may be useful to ensuring that internet-based companies do not manipulate tax laws in SA and are held liable to income tax in SA. This is discussed in the next chapter.

[293] Kondo (2010) 83.

CHAPTER 4: COMPARATIVE ANALYSIS

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4. CHAPTER 4: COMPARATIVE ANALYSIS

4.1. Introduction

It is clear that there is a lack of certainty as to the meaning of 'place of effective management' in SA. In chapter 2, it was discussed that the meaning of 'place of effective management' will therefore have to be extracted by applying the principles of legal interpretation and a possible meaning was postulated. To assist in the interpretation of the 'place of effective management', the laws of foreign countries will be considered to assist SARS in collecting income tax from internet-based companies. In *H v Fetal Assessment Centre* (hereafter *Fetal Assessment Centre*)[294], it was held that foreign law may be used as a tool in assisting the court in coming to decisions on the issues before it.[295]

The court, in *H v Fetal Assessment Centre*, further stated the following in relation to using foreign law to assist in interpreting legislation:

> '(a) Foreign law is a useful aid in approaching constitutional problems in South African jurisprudence. South African courts may, but are under no obligation to, have regard to it.
>
> (b) In having regard to foreign law, courts must be cognisant both of the historical context out of which our Constitution was born and our present social, political and economic context.
>
> (c) The similarities and differences between the constitutional dispensation in other jurisdictions and our Constitution must be evaluated. Jurisprudence from countries not under a system of constitutional supremacy and jurisdictions with very different constitutions will not be as valuable as the jurisprudence of countries founded on a system of constitutional supremacy and with a constitution similar to ours.
>
> (d) Any doctrines, precedents and arguments in the foreign jurisprudence must be viewed through the prism of the Bill of Rights and our constitutional values.'[296]

The usefulness of foreign sources is, naturally, subject to limits. They are to be approached with due caution. This is because foreign precedent cannot, without more, be transplanted wholesale onto the domestic scene of a sovereign nation. In other words, allowance must always be made for a local context, the language and subject matter of the law-text being construed, and any other relevant consideration relating to local conditions that may affect the

[294] 2015 (2) SA 193 (CC).
[295] *Fetal Assessment Centre* para 28.
[296] *Fetal Assessment Centre* para 31.

application of a right or duty, or the operationalisation of a statutory provision in one country as opposed to a foreign State.[297]

In this chapter, the Australian concept of 'resident' will be discussed. Undertaking such a discussion may provide clarity on 'residence' from a South African perspective and more specifically, 'place of effective management'. Australia is used for comparative purposes because courts in SA rely on Australian jurisprudence, particularly in the sphere of taxation because of the similarity between provisions enacted in tax statutes.[298]

The USA does not employ the concept of corporate 'residency' based on the seat of management. Instead, in the USA, how a company is taxed is generally based on its place of incorporation, and not where it is managed or controlled.[299] Although the laws in the USA do not provide for a concept such as 'place of effective management', there are laws within the USA which provide for the taxation of e-commerce activity. It would be useful to consider such laws from a SA perspective to assist SARS in holding internet-based companies subject to income taxation in SA. In considering such laws, the laws will have to be viewed through the prism of the Bill of Rights and South African constitutional values to align with the decision in *H v Fetal Assessment Centre*.

It is submitted that such USA laws may be useful in holding internet-based companies in SA liable to income taxation. The reason for this submission is that the Supremacy Clause of the U.S. Constitution establishes that the federal constitution, and federal law generally, take precedence over state laws, and even state constitutions.[300] It prohibits states from interfering with the federal government's exercise of its constitutional powers, and from assuming any functions that are exclusively entrusted to the federal government.[301] This aligns with the *H v Fetal Assessment Centre* decision since s 2 of the Constitution provides that the Constitution is the supreme law of SA, law or conduct inconsistent with it is invalid, and the obligations

[297] Moosa F 'A Comparison Between the Modalities of Interpreting Tax Legislation Applied in South Africa and Australia' (2018) 25 *Revenue Law Journal* 2.
[298] See Moosa F 'A Comparison Between the Modalities of Interpreting Tax Legislation Applied in South Africa and Australia' (2018) 25 *Revenue Law Journal* 2. In *Richards Bay Iron & Titanium (Pty) Ltd v CIR* 1996 (1) SA 311 (A) para 19, the court held that 'in Australia, … [the] system of taxation has much in common with our own in its eschewal of the assessment of tax on the profits or gains of a business in accordance with undiluted accounting principles and practices, and its preference for the assessment of tax upon the excess of assessable income over allowable deductions…'. See also *CSARS v Foskor (Pty) Ltd* [2010] 3 All SA 594 (SCA).
[299] Lexology (2021) *Spotlight: tax residence and fiscal domicile in USA* available at Spotlight: tax residence and fiscal domicile in USA - Lexology (accessed on 3 January 2023).
[300] The United States Constitution Article VI, Paragraph 2 (hereafter *U.S Constitution*).
[301] U.S Constitution Article VI, Paragraph 2.

imposed by it must be fulfilled. As such, both the USA and SA are under systems of constitutional supremacy. Furthermore, the USA was selected for comparative purposes because like South Africa, the USA has a residence-based income tax regime.[302] Also, the USA tax authorities have provided some concrete guidelines in relation to the income taxation of cryptocurrency denominated transactions.[303] This is relevant because the aim of this thesis relates to the taxation of social media companies in SA, being companies that rely on the internet to conduct business. As such, these USA guidelines are useful for comparative purposes.

The applicable laws of Switzerland provide for the taxation of companies if their 'place of effective management' is located in Switzerland. According to Article 3 of the Federal Constitution of the Swiss Confederation of 18 April 1999 (hereafter the *Swiss Constitution*), 'the Cantons are sovereign except to the extent that their sovereignty is limited by the Federal Constitution. They exercise all rights that are not vested in the Confederation.' Like SA and the USA, the Swiss Constitution also provides for constitutional supremacy and this, therefore, align. with the decision in *H v Fetal Assessment Centre*.

Since the tax laws of Switzerland and SA make use of the term 'place of effective management' for purposes of determining residency of a taxpayer, a discussion on the applicable laws of Switzerland will be held to determine whether its concept of 'place of effective management' differs from the SA concept of 'place of effective management'. It would be useful to consider the approach adopted by Switzerland and apply such approach in SA to address the shortcomings of the SA position in respect of 'place of effective management'.

This chapter will discuss the relevant laws of Australia, USA and Switzerland which relate to e-commerce and 'place of effective management'.

4.2. Australia

The terms resident and resident of Australia are defined in s 6(1) of the Income Tax Assessment Act[304] ('ITAA'). In terms of that definition, a company which has been incorporated in Australia is a resident of Australia for taxation purposes. The company is a resident of Australia for taxation purposes because it is incorporated in Australia. A company that is incorporated in

[302] Moosa F 'Cryptocurrencies: do they qualify as "gross income?"' (2019) 44(1) *Journal for Juridical Science* 14.
[303] As discussed in chapter 2 above.
[304] Act 1936. See discussion on 'gross income' above in chapter 2 of this thesis.

Australia continues to be an Australian resident for taxation purposes even if the company is also a resident of another country for taxation purposes. The operation of the relevant Convention is considered below. The definition of resident in the ITAA further provides that a company that is not incorporated in Australia, is still resident if, it carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia. This contains some similarity to SAs concept of 'place of effective management'.

Like SA, the assessable income of a company that is a resident of Australia for taxation purposes will generally include all the company's ordinary and statutory income from all sources, in or out of Australia.[305] In 2018, Australia ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 2018 ('MLI'). The MLI is a multilateral treaty that enables jurisdictions to swiftly modify their bilateral tax treaties to implement measures designed to better address multinational tax avoidance. Article 4 of the MLI deals specifically with residency and provides that where a company is a resident of both Australia and the other country for taxation purposes, the company is deemed to be a resident only of the country in which its place of effective management is situated.

For the purposes of Article 4 of the MLI, the place of effective management of a company is the place where the key management and commercial decisions regarding the company's operations are made. According to the commentary on Article 4 contained in the OECD Model Tax Convention on Income and on Capital, the 'place of effective management' test is very similar to the test of 'central management and control'.

Following the High Court decision in *Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation*[306], the Australian Taxation Office ('ATO') released a public ruling on the central management and control test of residency. The meaning of 'central management and control' was set out in Taxation Ruling[307] ('TR 2018/5'). In terms of TR 2018/5, central management and control refers to the control and direction of a company's operations.[308] It does not refer to a physical location in which the control and direction of a company is located, and may ultimately be exercised in more than on

[305] Income Tax Assessment Act 1997, s 995 – 1(1).
[306] [2016] HCA 45; 2016 ATC 20-589.
[307] TR 2018/5
[308] TR 2018/5 para 10.

location.[309] The key element in the control and direction of a company's operations is that making of high-level decisions that set the company's general policies, and determine the direction of its operations and the type of transactions it will enter.[310]

The control and direction of a company is different from the day-to-day conduct and management of its activities and operations. The day-to-day conduct and management of a company's activities and operations is not ordinarily an act of central management and control. Nor is the management of day-to-day activities under the authority and supervision of higher-level managers or controllers.

The Commissioner of the ATO held that the day-to-day conduct and management of a company's operations might be an exercise of central management and control in circumstances where they are effectively the same. For example, for a small passive investment company with a very small number of investments, the decisions to make, hold and dispose of those investments, would be both the day-to-day management and the central management and control of the company.

Exercising central management and control of a company in Australia can involve:

- 'setting investment and operational policy including:
  - setting the policy on disposal of trading stock, and/or the use and development of capital assets
  - deciding to buy and sell significant assets of the company
- appointing company officers and agents and granting them power to carry on the company's business (and the revocation of such appointments and powers)
- overseeing and controlling those appointed to carry out the day-to-day business of the company, and
- matters of finance, including determining how profits are used and the declaration of dividends.'[311]

It is important to note that TR 2018/5 is not binding in Australia, but rather sets out the Commissioner's view on how to apply the central management and control test of company residency in Australia.[312] However, if a taxpayer relies on TR 2018/5, the Commissioner of the ATO must apply the law to a taxpayer in the way set out in TR 2018/5 (unless the

[309] TR 2018/5 para 10.
[310] TR 2018/5 para 11.
[311] TR 2018/5 para 16.
[312] TR 2018/5 para 1.

Commissioner is satisfied that the ruling is incorrect and disadvantages the taxpayer, in which case the law may be applied to the taxpayer in a way that is more favourable for it, provided the Commissioner is not prevented from doing so by a time limit imposed by the law).[313] A taxpayer will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by TR 2018/5 if it turns out that it does not correctly state how the relevant provision applies to the taxpayer.[314] For this reason, TR 2018/5 holds much weight in Australia and can be very useful from a taxpayer's point of view.

As mentioned above, Australia is used for comparative purposes because of the similarity between provisions enacted in tax statutes in SA and Australia. It is clear that Australia makes use of a 'central management and control' test when determining residency of a juristic taxpayer. In Australia, one of the factors that are used in deciding the location of 'central management and control' is the place where high-level decisions that set the company's general policies are made. This is similar in some respects to the *obiter* in *Oceanic Trust*, being the place where a company's key commercial decisions are made. For the reasons submitted in chapter 3 of this thesis, the decision in *Oceanic Trust* is inadequate in determining 'place of effective management' of a company. Therefore, it is submitted, that although Australian law is similar to SA law in some respects, such laws are inadequate in assisting SARS and SA courts in ascribing meaning to 'place of effective management'. For this reason, the laws of the USA and Switzerland will be discussed below to determine whether such laws may be applied in SA to hold internet-based companies liable to income taxation. It is submitted that such laws may be more relevant than the Australian laws discussed above.

4.3. USA

When internet businesses first entered the mainstream in the 1990s, few people were able to predict the transformational impact e-commerce would have on the economy in the USA. As a result, lawmakers in the USA developed rules for the e-commerce industry that ensure both continued development and effective regulation of this increasingly important market.[315] This is particularly true in the development of e-commerce tax laws, which have shifted focus from

[313] Australian Taxation Office 'Taxation Ruling TR 2018/5' available at *https://www.ato.gov.au/law/view/document?docid=TXR/TR20185/NAT/ATO/00001* (accessed on 20 September 2023).
[314] Australian Taxation Office 'Taxation Ruling TR 2018/5' available at *https://www.ato.gov.au/law/view/document?docid=TXR/TR20185/NAT/ATO/00001* (accessed on 20 September 2023).
[315] *Taxation in E-Commerce (2022)* para 1.

facilitating growth in e-commerce markets to ensuring that online businesses contribute their fair share of revenues to the public coffers.[316]

As e-commerce was first establishing itself in the USA, lawmakers wanted to make sure that this promising new market had the opportunity to grow without unnecessarily burdensome regulation and taxation. To this end, the Internet Tax Freedom Act of 1998 was passed.[317] The Internet Tax Freedom Act of 1998 imposed a three-year moratorium on duplicate or discriminatory taxes levied on e-commerce activities and also precluded state and local governments from taxing internet access, a policy which was made permanent with the enactment of the Trade Facilitation and Trade Enforcement Act of 2015.[318]

Protective tax policies for e-commerce transactions originate from the Commerce Clause in the Constitution of the USA.[319] The Supreme Court in the USA has interpreted the Commerce Clause to prevent the states from passing laws that have the effect of discriminating against certain activities in interstate commerce.[320] This prohibition has been applied by federal legislation to online businesses through the Internet Tax Freedom Act's ban on discriminatory e-commerce taxes, which prevents state and local governments from imposing taxes on electronic transactions that are higher than they would be for identical activities performed at brick-and-mortar businesses.[321]

The Internet Tax Freedom Act of 1998 was passed during a time where there was not sufficient e-commerce taxation. This conservative approach was largely due to the Supreme Court's interpretation of how the Commerce Clause applies to taxation in e-commerce in *Quill Corporation v. North Dakota*[322] (hereafter *Quill*). *Quill* required that e-commerce companies have a physical presence or a business nexus to a state before that state would be allowed to tax their activities.[323] Therefore, under *Quill*, states could not collect sales tax from purchases that state residents made from out-of-state companies.[324] However, the *Quill* precedent has been discarded in favour of a more liberal e-commerce tax policy.

[316] *Taxation in E-Commerce (2022)* para 2.
[317] Internet Tax Freedom Act, Pub. L. 105-277 (1998).
[318] Facilitation and Trade Enforcement Act, Pub. L. 114-125 (2016).
[319] *Taxation in E-Commerce (2022)* para 5.
[320] *Taxation in E-Commerce (2022)* para 5.
[321] Stupak J 'The Internet Tax Freedom Act: In Brief' (2016) 1, 3, *U.S. Congressional Research Service* 3.
[322] 504 U.S. (1992) 298, 311.
[323] 504 U.S. (1992) 298, 311.
[324] 504 U.S. (1992) 298, 311.

Another reason the federal government was slow to warm up to the idea of allowing state and local governments to tax e-commerce transactions was the practical concern of how difficult it would be for online companies to comply with the tax policies of every state to which they shipped.[325] E-commerce companies face the potentially daunting task of complying with dozens, if not hundreds, of tax policies from every jurisdiction in which they have customers. These jurisdictions vary with respect to what e-commerce activities are taxable, the applicable sales tax rate and when and how often sellers must file tax returns. Effective compliance would be extremely burdensome, and when *Quill* was heard back in the early 1990s the Supreme Court applied the precedent from *National Bellas Hess v. Department of Revenue*[326], which held that the complexity of requiring out-of-state sellers to comply with sales tax requirements of every customer's jurisdiction would be an unconstitutional burden on e-commerce companies' abilities to engage in interstate commerce.

However, in 2018, *Quill* was overturned by a landmark decision in *South Dakota v. Wayfair, Inc.* (hereafter *Wayfair*).[327] *Wayfair* involved a South Dakota law that imposed sales taxes on out-of-state vendors providing goods to state residents. The law included several exemptions and safe harbour terms designed to protect small e-commerce companies from undue burdens associated with out-of-state taxation.[328]

South Dakota began enforcing its tax policy against major e-commerce retailers active in the state, including Overstock.com, Newegg, and Wayfair. The court struck down the law under the Supreme Court's precedent in *Quill*.[329] In reviewing the case, the Supreme Court determined that the changes that have occurred in the e-commerce markets over the past two decades necessitated a departure from the outdated precedent set forth in *Quill*.[330] The technical challenges associated with state and local sales tax compliance have declined substantially due to e-filing and the plethora of bookkeeping and tax preparation software on the market today.[331] As a result, compliance is no longer a burden on interstate commerce.[332]

While some concerns remain regarding the long-term impacts *Wayfair* will have on e-commerce activity, the Supreme Court clarified that permissible state and local sales tax laws

[325] *Taxation in E-Commerce (2022)* para 8.
[326] 386 U.S. 753, 759-60 (1967).
[327] 201 L. Ed. 2d 403, 410, 421-22 (2018).
[328] 201 L. Ed. 2d 403, 410, 421-22 (2018) 23.
[329] 585 U. S. (2018) 3.
[330] 585 U. S. (2018) 8.
[331] 585 U. S. (2018) 6.
[332] 585 U. S. (2018) 6.

must be designed to prevent unnecessary burdens on interstate commerce.[333] For example, the South Dakota law under review included a safe harbour provision for small e-commerce retailers, a prohibition on retroactive taxation and a set of clear, uniform, and simple methods that companies can follow to ensure compliance with the law.[334] Therefore, *Wayfair* did not simply unleash the floodgates of taxation on e-commerce retailers. Rather, the ruling allows state and local governments to tax e-commerce sales only when the applicable tax rules are designed for simple compliance and do not improperly burden commerce.

Online auctions have become increasingly common since e-commerce giant eBay first launched in 1995.[335] Often, the entities selling goods in online auctions are laypeople who do not think they have to report this income on their tax returns. However, proceeds from nearly any auction whether online or physical are taxable in the USA unless the circumstances merit specific exemption.[336] Depending on the way the online auction is carried out, this may include individual income tax, business income tax, self-employment tax and/or excise taxes like sales and use taxes.[337] Any entity that sells goods through online auctions as a regular business activity or hobby must report its profits to the Internal Revenue Service (IRS) on its tax return.[338]

Credit card companies and third-party financial networks (such as, PayPal, and Venmo) must abide by the reporting requirements found in s 6050W of the Internal Revenue Code.[339] Credit card and third-party payment companies are legally required to document and report the gross amounts paid to individuals and companies who have performed more than 200 transactions totalling USD 20,000 or more across their payment networks.[340]

Before *Wayfair*, states were restricted from requiring e-commerce sites to collect sales tax unless the online seller had a physical presence or identifiable nexus in the jurisdiction. However, this prior policy was established in 1992, when e-commerce was still in its infancy.[341] Over time, this approach has put online sellers at an unfair advantage over local businesses required to pay state and local taxes. As e-commerce grew into an increasingly common

[333] 585 U. S. (2018) 12.
[334] *Taxation in E-Commerce (2022)* para 12.
[335] *Taxation in E-Commerce (2022)* para 15.
[336] *Taxation in E-Commerce (2022)* para 15.
[337] *Taxation in E-Commerce (2022)* para 15.
[338] *Taxation in E-Commerce (2022)* para 15.
[339] Internal Revenue Code of 1986.
[340] *Taxation in E-Commerce (2022)* para 23.
[341] *Taxation in E-Commerce (2022)* para 23.

method of making retail purchases, this unfair advantage grew into a significant policy concern. As a result, the Supreme Court expanded state and local authority to levy taxes against online retailers.[342]

From a South African perspective, the decision laid down in *Wayfair* could be applied by the legislature with regard to e-commerce transactions. In that case, the court recognised the increase of e-commerce as well as the need for companies that profit from e-commerce transactions to be brought within the tax net. This will ensure that internet-based companies are taxed on e-commerce transactions and therefore not escape the tax net as a result of outdated and ambiguous laws. From a practical standpoint, the *Wayfair* decision will increase the cost of retail e-commerce transactions.

However, this is unlikely to dampen the substantial growth that has occurred in e-commerce in recent years.[343] Much of this is due to the increasing role of e-commerce in the daily lives of citizens. It is submitted that Parliament could benefit by considering the *Wayfair* decision and laying out a specific set of rules which govern the taxation of internet-based companies. Whether the concept of 'place of effective management' will be incorporated in such laws, will depend on whether internet-based companies are capable of being held liable to income taxation on the basis of 'place of effective management'. This will be discussed in chapter 4.

4.4. Switzerland

Switzerland is a federal republic consisting of 26 cantons. The federal government, cantons and communes are entitled to levy taxes and therefore corporate income and personal income taxes are levied on all three levels.[344] Corporate entities in Switzerland are viewed as having legal personality and are treated as separate taxpayers. As such they are subject to corporate income and annual capital tax (net wealth tax for corporations) as well as withholding tax, stamp tax and value added tax.[345] According to the tax laws of Switzerland, an entity is resident for tax purposes if its legal domicile (registered office) or place of effective management is located in Switzerland.[346] For resident taxpayers, corporate income tax is in principle levied on worldwide income.[347]

[342] *Taxation in E-Commerce (2022)* para 23.
[343] Law Shelf Educational Media 'Taxation in E-Commerce - Module 4 of 5' para 24.
[344] The Law Reviews 'The Inward Investment and International Taxation Review' pg 398.
[345] The Law Reviews 'The Inward Investment and International Taxation Review' pg 398.
[346] Article 50 of the Federal Act on Direct Federal Taxation 642.11 (1990).
[347] The Law Reviews 'The Inward Investment and International Taxation Review' pg 403.

If an entity is incorporated outside Switzerland, it may nevertheless be a Swiss resident entity for tax purposes if its place of effective management is in Switzerland.[348] According to the OECD, this means the place where important decisions of the company are taken. Whether an entity is subject to corporate income tax and capital tax is based on the respective evidence regarding the effective management in each individual circumstance. Therefore, if the manager of a company resides in the country in which the company has its legal domicile, but in fact merely follows the instructions of a Swiss shareholder, the Swiss tax authorities may consider the company to be a Swiss resident. For entities other than companies, the same rules apply as for companies.[349]

According to the jurisprudence of the Swiss Supreme Court, a legal entity's 'place of effective management' is where its economic and effective interests are focused.[350] In the Swiss case of *AG v Cantonal Tax Office Zurich*[351], the court held that the main tax domicile of legal persons should be located where the real, actual centre of their economic existence is located and not at the arbitrarily chosen formal seat.[352] The decisive question is therefore, where the usual business is run, in line with the entity's business purpose. The term 'effective management' refers to the place where key management decisions which are necessary for the conduct of the entity's business are made in substance.[353]

Effective management needs to be distinguished from mere administrative tasks on the one hand and from activities carried out by the most senior persons on the other, as long as these are limited to controlling the effective management and making fundamental decisions only.[354] The place where the board of directors' meetings are held is of minor importance only. Equally, the places, where general assemblies are held or the shareholders reside are not decisive.[355] Nevertheless, the residency of the person who is in charge of the effective management can

[348] Article 54 of the Federal Act on Direct Federal Taxation 642.11 (1990).
[349] OECD 'Switzerland -Information on residency for tax purposes' available at Switzerland-Residency.pdf (oecd.org) (accessed on 18 December 2022).
[350] See *AG v Cantonal Tax Office Zurich* 2C_627/2017.
[351] 2C_627/2017.
[352] 2C_627/2017 para 2.3.2.
[353] Prager Dreifuss, 'Tax domicile of legal entities – not always so clear' (2020) available at *https://www.prager-dreifuss.com/en/news/tax-domicile-of-legal-entities-%E2%80%93-not-always-so-clear-687* (accessed on 10 June 2022).
[354] 2C_627/2017 para 2.2. See judgements 2C_1086/2012, 2C_1087/2012 of 16 May 2013 at 2.2 in: StE 2013 B 11.1 no. 24; 2A.321/2003 of 4 December 2003 at 3.1 in: ASA 75 p. 294, StE 2005 B 71.31 no. 1).
[355] Prager Dreifuss, 'Tax domicile of legal entities – not always so clear' (2020) available at *https://www.prager-dreifuss.com/en/news/tax-domicile-of-legal-entities-%E2%80%93-not-always-so-clear-687* (accessed on 10 June 2022).

play an important role, if the effective management is essentially performed by one person in various places, without the legal entity having a fixed place of business or its own staff.[356]

If the cantonal tax authorities do not succeed in demonstrating that an entity's place of effective management is in their canton, it can still claim a right to limited taxation based on an economic link.[357] From a SA perspective, this reference to limited taxation appears to be very similar to the SA concept of source. It is clear that there are similarities that exist between the Swiss tax system and the SA tax system. In the event that the SA government wishes to adopt any of the Swiss tax laws, implementation will be made easier as a result of the similarities that currently exist. It is important to consider why SA should adopt any Swiss laws and the answer is that there is a need for the SA government to ensure that the tax system is fair and equitable. Goals such as increased revenue mobilization, sustainable growth, and reduced compliance costs will need to be balanced with ensuring that the tax system is fair and equitable.[358] The Swiss laws relating to 'place of effective management' can guide SA courts in interpretating the 'place of effective management' of an internet-based company. It is submitted that SA should seek to follow a similar approach to determine the 'place of effective management' of an internet-based company and that an economic link should hold more weight in making a determination.

4.5. Conclusion

This chapter discussed the laws of Australia which relate to the taxation of juristic persons. With reference to the discussion held in chapter 3 of this thesis, it was submitted that such Australian laws hold little relevance in assisting SARS and SA courts in holding internet-based companies liable to income taxation in SA. The internet revolution has given rise to several new ways to buy and sell things online, as well as new technologies designed specifically for the processing of electronic payments. These include online auctions, secure credit card transactions and the new wave of virtual or 'crypto' currency and related financial services.[359]

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[356] Prager Dreifuss, 'Tax domicile of legal entities – not always so clear' (2020) available at *https://www.prager-dreifuss.com/en/news/tax-domicile-of-legal-entities-%E2%80%93-not-always-so-clear-687* (accessed on 10 June 2022).

[357] 2C_627/2017 para 2.3.6.

[358] The World Bank 'Taxes and Government Revenue' available at *https://www.worldbank.org/en/topic/taxes-and-government-revenue#1* (accessed on 5 January 2023). According to the Tax Foundation, the Swiss tax system ranks 4th best in the world. This ranking was determined by analysing the legislation of countries and identifying strengths and weaknesses of the legislation. A neutral tax law seeks to collect the most revenue with the least economic distortions. See Immigrant Invest 'Where is the most tax-friendly environment for business and living in 2021' available at *https://immigrantinvest.com/insider/international-tax-competitiveness-index-en/* (accessed on 5 January 2023).

[359] Law Shelf Educational Media 'Taxation in E-Commerce - Module 4 of 5' para 14.

Each of these activities are subject to taxation under USA local laws. The laws discussed above in respect of Switzerland may be useful in assisting SARS define 'place of effective management' in a way that not only aligns with international law, but follows modern trends and holds internet-based companies liable to taxation in SA.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

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5. CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

SARS has a duty under the TAA to ensure the effective and efficient collection of tax in SA. With the emergence of the internet, this duty imposed on SARS becomes increasingly difficult and the rules may easily be manipulated by internet-based companies to escape tax liability. One of the factors that makes this duty difficult for SARS to perform its functions in terms of the TAA, is that the term 'place of effective management' is undefined in the ITA. This makes it difficult for SARS to determine residency of a taxpayer and, therefore, difficult to determine whether the rules relating to 'residence' or 'source' should apply.

To address the problem arising from the uncertainty of the scope and ambit of the term 'place of effective management' for ITA purposes, this thesis sought to answer the question of whether internet-based companies which provide services or goods to consumers based in SA, are 'resident' in SA for income tax purposes on the basis that their 'place of effective management' is within the Republic of SA as envisaged by the ITA. Chapter 1 of this thesis discussed that this enquiry is the important as the term 'place of effective management' is undefined in the ITA. Chapter 1 of this thesis further discussed the consequences of the term 'place of effective management' being undefined, namely, that internet-based companies may manipulate tax laws to escape income tax liability in SA. Lastly, chapter 1 of this thesis discussed the significance of the study undertaken with regard to the 'place of effective management' of internet-based companies, and that SA courts have not addressed this issue.

To answer the question raised in chapter 1 of this thesis, chapter 2 of this thesis laid the foundation by discussing the income tax system in SA. The meaning of 'gross income' was discussed within the context of the ITA, and the rules relating to residence and source were further discussed in the context of the definition of 'gross income' in the ITA. Chapter 2 highlighted the fact that that in instances where internet-based companies plan their affairs in a way that leads to them not being tax 'resident' in SA, such internet-based companies may still be held liable to income taxation in SA on the basis of source of income.

Chapters 3 and 4 provided a comprehensive analysis of the term and its probable meaning in the context of the ITA. Using a comparative analysis approach, the current legal framework in SA, as discussed in chapter 2 of this thesis, was examined alongside international best practices and standards. It is argued that the place in which internet-based companies are effectively

managed should be linked to the place in which particular internet service providers are located. This should form part of the criteria to be used in determining 'place of effective management' of an internet-based company. This, so it is argued, will go a considerable way to ensure that internet-based companies do not erode SAs tax base by escaping the income tax net altogether. This thesis concludes that there exists a need for SA to update the ITA so that it adequately addresses the complexities arising from digital business models and apparent loopholes in the ITA. Certain recommendations are made below which, it is submitted, carries the potential, if implemented as intended, to achieve a fair and equitable taxation of internet-based companies earning income sourced in SA.

5.2. Recommendations

As shown above in chapter 4 of this thesis, courts in SA should be guided by the laws of the USA and Switzerland when making any determination on the taxation of internet-based companies. As discussed in chapter 4 of this thesis, in *Wayfair*, the court recognised that the technical challenges associated with state and local sales tax compliance have declined substantially due to e-filing and the plethora of bookkeeping and tax preparation software on the market today. The *Wayfair* decision recognised the increase of e-commerce as well as the need for companies that profit from e-commerce transactions to be brought within the tax net. It is submitted that Parliament should consider adopting such laws which recognises the increase of e-commerce activity and provides for a system which ensures that internet-based companies are held liable to taxation on their e-commerce activities. On a practical level, it is recommended that, in order to achieve this, Parliament includes a provision in the TAA which provides for a government body to be created, which will work closely with SARS, to be responsible for creating a centrally managed portal on which ISPs can register. This managed portal ought to be linked to local jurisdictions and should be able to inform the foreign electronic service provider as to which products are subject to tax and how much the tax due would be. By making use of the ISPs, internet-based companies may be required to give an undertaking that they are subject to the 'place of effective management' of the particular ISP.

Furthermore, when interpreting the term 'place of effective management' on a case-by-case basis, courts should carefully consider the relevance of the decision in *Oceanic Trust*. For the reasons set out in chapter 3 of this thesis, it is submitted that an interpretation of the term 'place of effective management' which relies on the place at which the key commercial decisions of a company are made is inadequate. As discussed in chapter 4 of this thesis, the Swiss case law

provides that the 'place of effective management' of a company is where its economic and effective interests are focused. It is recommended that Parliament should insert a definition of 'place of effective management' in s 1 of the ITA. This definition should provide, that the 'place of effective management' of a company means the place where its economic and effective interests are focused or any other place determined by a competent court taking into account the place in which the particular ISPs for that relevant company are located.

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