EXPLANATORY MEMORANDUM

ON THE DOUBLE TAXATION AGREEMENT

BETWEEN

THE REPUBLIC OF SOUTH AFRICA

AND

THE GOVERNMENT OF MALAYSIA

It is the practice in most countries for income tax to be imposed both on the world-wide income derived by residents of the country and on income derived by non-residents which arises in the country. The effect of such a system is that income derived by a resident of one country from a source in another country is subjected to tax in both countries. As this position clearly discourages foreign investment, it is normal for countries which have trade relations to conclude double taxation agreements. Such agreements commonly provide that income of a particular nature will either be taxable in only one of the countries, or may be taxed in both countries with one of them allowing a credit for the tax imposed by the other.

The Agreement concluded with Malaysia closely follows the OECD Model. In the explanation which follows, the general principles of each Article of the Agreement are set out.

The entire text has been made gender neutral.

Preamble

The Preamble records that the object of the Agreement is to avoid double taxation and prevent fiscal evasion.

Article 1

Persons Covered

The Agreement is made applicable to persons who are residents of one or both of the Contracting States. This means, *inter alia*, that a citizen of one of the States who is resident in a third State will not enjoy the benefits of the Agreement, apart from the non-discrimination provisions.

Article 2

Taxes Covered

Paragraphs 1 and 2 of this Article provide that the Agreement will apply to all taxes on income imposed by the two States irrespective of the manner in which they are levied.

Paragraph 3 lists the existing taxes imposed by each State and paragraph 4 provides that the Agreement will also apply to substantially similar taxes which are imposed by either State after the date of signature of the Agreement.

Paragraph 5 provides for notification of any significant changes made to the taxation laws of the Contracting States.

Article 3

General Definitions

This Article defines various expressions which are used in the body of the Agreement. Several of these definitions are self-evident and are not further explained.

The definition of "South Africa" includes not only the sovereign territory but also those areas outside its territorial sea over which it may exercise jurisdiction in accordance with international law, for example in relation to the exploitation of natural resources.

"Person" is defined to include an individual, a company and any other body of persons that is treated as an entity for tax purposes. The underlined words are of particular relevance to partnerships. Partnerships are not regarded as taxable entities in South Africa or Malaysia, rather, the income of a partnership is taxed in the hands of the partners. Accordingly, should a partnership consisting of a Malaysian resident and a resident of a third State derive income in South Africa, only the Malaysian resident will be entitled to the benefits of the Agreement on his/her share of the partnership income.

"International traffic" is defined as any transport by ship or aircraft operated by an enterprise of a Contracting State, except where the ship or aircraft is operated solely between places in the other State. Special provisions are contained in Article 8 for the taxation of international traffic. The effect of the exclusion mentioned above is that should a Malaysian company operate a purely domestic airline operation within South Africa, that operation will not fall to be dealt with under Article 8, but rather under Article 7 which deals with business profits in general. This provision is intended to place that operation on the same footing as South African domestic airlines.

Paragraph 2 follows the OECD Model in providing that expressions not defined in the Agreement bear the meaning that they have under the domestic taxation laws of the States at the time of application of the Agreement. Any meaning under the taxation laws will take precedence over a meaning under other laws of the State.

Article 4

Resident

The concept of "resident of a Contracting State" is used throughout the Agreement and is of importance in three cases:

(a) in determining the Agreement's personal scope of application as set out in Article 1;

(b) in solving cases where double taxation arises because of dual residence;

(c) in solving cases where double taxation arises as a consequence of taxation in the State of residence and in the State in which the income arose, the State of source.

This Article defines the meaning of the term and further solves cases of dual residence.

In paragraph 1, the term "resident of a Contracting State" is defined. The definition refers to the concept of residence adopted in the domestic law of each of the Contracting States. As criteria for taxation as a resident, domicile, residence, place of management or any other criterion of a similar nature are used in the definition.

The term "resident" also includes specific reference to the State itself.

Paragraph 2 provides solutions to the cases where individuals are residents of both Contracting States and sets out a step by step method of finally deciding which State has a preferent right in claiming the individual as its resident.

Paragraph 3 deals with companies and other bodies of persons who are not individuals but who are residents of both States and specifies that in these cases the competent authorities will settle the question by mutual agreement.

Article 5

Permanent Establishment

One of the main goals of the Agreement is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State which arise through a permanent establishment situated in the first-mentioned State. The Article defines what is to be regarded as a permanent establishment.

Paragraph 1 gives a general definition of a “permanent establishment” as being a fixed place of business through which the business of an enterprise is carried on.

Paragraph 2 contains a list, which is not exhaustive, of what is regarded to be a permanent establishment.

Paragraph 3(a) provides expressly that a building site or construction, installation or assembly project will constitute a permanent establishment only if it lasts for more than twelve months. Supervisory activities carried on in a Contracting State in connection with such a site or project will also constitute a permanent establishment if they last for more than twelve months and irrespective of the fact that the enterprise carrying on such activities has no fixed place of business in that State.

Paragraph 3(b) introduces provisions dealing with the furnishing of services through employees of an enterprise and specifies that a permanent establishment will be deemed to exist, despite there being no fixed place of business, if such services are rendered in a State for a period or periods exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

A number of preparatory or auxiliary activities which are treated as exceptions to the general definition laid down in paragraph 1 are set out in paragraph 4. The paragraph specifies that the term “permanent establishment” will not include the various activities set out therein and the Contracting State in which these activities take place will consequently not be able to tax any profits which might arise if these are the only activities which occur.

Paragraph 5 sets out the generally accepted principle that an enterprise will be treated as having a permanent establishment in a Contracting State if it carries on business in that State through an agent situated in that State, provided that the agent is not of an independent status and provided that such agent:

(a) has the power to conclude contracts in the name of the enterprise and provided that the activities are activities other than those mentioned in paragraph 4; or
(b) maintains a stock of goods in that State in respect of which orders are regularly obtained and excluded.

Paragraph 6 deals with the situation where an enterprise carries on business through an independent agent in the other Contracting State and provides that no permanent establishment will be deemed to exist if the activities are carried on through such an agent who is acting in the normal course of business.

Paragraph 7 sets out the principle that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that for tax purposes a subsidiary company constitutes an independent legal entity and will be taxed in its State of residence on its own profits.

Article 6

Income from Immovable Property

Paragraph 1 provides that income from immovable property may be taxed in the State in which the property is situated. Income from agriculture and forestry is specifically included in this rule.

Paragraph 2 establishes the general rule that what constitutes fixed property will be decided under the law of the State in which the property is situated. Nevertheless, property accessory to fixed property and livestock and equipment used in agriculture and forestry are specifically included. So too are usufructs and payments for the right to extract minerals and other natural resources.

Paragraph 3 makes it clear that the rule established in paragraph 1 applies irrespective of the manner in which the property is exploited.

Paragraph 4 provides that the provisions of paragraphs 1 and 3 also apply to income derived from fixed property owned by an enterprise or which is used for the performance of independent personal services. In the absence of this provision, it might be argued that this income should be dealt with in terms of the provisions of Article 7 or 15, which establish somewhat different rules for the treatment of businesses profits and independent personal services.

Article 7

Business Profits

This Article deals with the taxation of business profits and is to be read together with Article 5 as it uses the test of “permanent establishment” in determining where such profits are to be taxed.

Paragraph 1 specifies that the profits of an enterprise which is a resident of a Contracting State are taxable in that State unless it carries on business in the other Contracting State through a permanent establishment situated in that other State in which case that other State may tax the profits which are attributable to that permanent establishment.

Paragraph 2 deals with the allocation of profits to a permanent establishment and specifies that the profits which are to be attributed to the permanent establishment are those which it would have made if it had been dealing with entirely separate enterprises under arms-length conditions and not with its head office.

Paragraph 3 recognises the fact that in calculating the profits of a permanent establishment, allowance must be made for certain expenses, wherever incurred, which were incurred for the purposes of the permanent establishment. For example, if the head office incurs general administrative expenses it is most likely that a portion of those expenses was in fact incurred on behalf of the permanent establishment and it will therefore be necessary to allocate that portion of the expenses to the permanent establishment in determining its profits. The emphasis here is on the fact that the expenses must have been actually incurred - notional charges are excluded, for example, management fees.

Paragraph 4 provides that nothing in this Article shall prohibit a Contracting State from enforcing its domestic law to determine the tax liability of a person. This will also be applicable in cases where insufficient information is available or is inadequate to determine such liability. The laws so applied, as far as is practical to do so, should be consistent with the principles of this Article.

Paragraph 5 deals with the situation where a permanent establishment which, although carrying on other business, also carries on purchasing for its head office. The paragraph provides that the profits which are attributed to the permanent establishment cannot be increased by the addition of a notional figure for profits from such purchases which are actually earned by the head office.

Paragraph 6 stipulates that the method of allocation of profits to the permanent establishment should not be changed merely for the reason that a different method may result in more profit becoming taxable in the State of residence of the permanent establishment. This also establishes a degree of certainty regarding the tax treatment to be expected in the State in which the permanent establishment is situated.

It is possible that the term “profits” could include other items of income which are dealt with in other Articles of the Agreement. Paragraph 6 stipulates that the preceding provisions of Article 7 shall not affect the provisions of such other Articles. An example of this is where profits include interest which is dealt with separately under Article 11.

Article 8

Shipping and Air Transport

Paragraph 1 provides that profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic are taxable only in that State. Thus, for example, profits derived by South African Airways from its flights into and out of airports in Malaysia are taxable only in South Africa.

Paragraph 2 specifies that profits derived from the rental on a bare boat basis of ships or aircraft used in international traffic as well as the use or rental of containers which are incidental to the profits mentioned in paragraph 1, are also taxable in accordance with Article 8. It should be noted that where such income is not incidental to international traffic operations, but rather constitutes an independent business in its own right, it will fall to be dealt with under either Article 7 or Article 15 as business income.

Paragraph 3 makes the above rules also applicable where the business is conducted through a pool, a joint business venture or an international operating agency.

Article 9

Associated Enterprises

This Article deals with associated enterprises and in paragraph 1 provides that a Contracting State may recalculate the profits of the enterprises if they have created conditions between themselves which would not be created by enterprises dealing at arms-length with each other. This paragraph is effective in dealing with the effects of transfer pricing between associated enterprises. The concept of what is regarded as being an associated enterprise is also set out in this paragraph.

The recalculation of profits envisaged in paragraph 1 may of course result in double taxation if, for example, one of the Contracting States increases the profits of its enterprise, and subjects the increased amount to tax, although such increased amount may already have been subjected to tax in the hands of its associated enterprise in the other Contracting State.

The provisions of paragraph 2 allow that other State to make a corresponding adjustment to the profits of the associated enterprise and, in so doing, avoid double taxation. It should be noted that the paragraph provides for consultation between the States in deciding on such adjustment.

Article 10

Dividends

Paragraphs 1 and 2 of this Article provide for the common international tax treatment of cross-border dividends, in terms of which the State in which the dividends are declared may impose a limited withholding tax and the State in which the dividends are received may impose full tax.

The limitation on withholding tax rates in the source State imposed by paragraph 2 is as follows:

(a) where the shareholder is a company which holds at least 25 per cent of the capital of the company declaring the dividend, the tax is limited to 5 per cent of the gross dividend. This limitation is intended to encourage substantial (i.e. at least 25 per cent) investment by companies in one State in subsidiaries in the other State;

(b) where the minimum holding of 25 per cent is not met (i.e. portfolio share investments) the rate of tax is limited to 10 per cent.

Both the above limitations apply only if the registered shareholder is also the beneficial holder, i.e. the limitation does not apply to nominee shareholders.

Paragraph 3 contains the standard definition of what constitutes a dividend.

Paragraph 4 provides that this Article will not apply in cases where a resident of one State carries on business in the other State through a permanent establishment or fixed base situated therein and derives dividends from shares the holding of which is effectively connected with the permanent establishment or fixed base. For example, if a South African company carrying on a manufacturing business through a permanent establishment in Malaysia were to purchase the shares of a Malaysian company which supplies it with raw materials, the dividends derived by the South African company on those shares could be taxed in Malaysia as part of the business profits of the permanent establishment.

Paragraph 5 deals with the limitation of the right of one of the States to impose tax on dividends declared by, or the undistributed profits of, a company which is a resident of the other State. One situation in which tax may be imposed, is where the shareholding is effectively connected with a permanent establishment or a fixed base situated in that other State, as mentioned in relation to paragraph 4 above.

The second situation can best be explained through an example of a Malaysian company which carries on business through a branch in South Africa. The paragraph provides that South Africa may not impose tax on the dividends declared by the Malaysian company, even though its profits are partly derived in South Africa, except in so far as the dividends are received by South African resident shareholders.

Article 11

Interest

This Article deals with the taxation of income in the form of interest.

Paragraph 1 specifies that interest which arises in a Contracting State and is paid to a resident of the other Contracting State may be taxed in the State of residence.

Paragraph 2 gives a right of taxation to the source State but limits the amount of tax to 10 per cent of the gross amount of the interest provided that the beneficial owner of the interest is a resident of the other Contracting State.

Paragraph 3 sets out a number of circumstances in which interest shall be exempt from tax in the source State, such taxation being allowed by paragraph 2.

Paragraph 4 defines what is meant by the term “Government” and also includes statutory bodies engaged in governmental functions as well as the two Central Banks.

Paragraph 5 contains the standard definition of what is to be regarded as interest.

Paragraph 6 specifies that if the beneficial owner of interest carries on business in the Contracting State in which the interest arises through a permanent establishment or a fixed base situated in that State, the interest may be taxed in that State if the debt in respect of which the interest is paid is connected to that permanent establishment or fixed base. The provisions of Article 11 will not apply to such interest but rather the provisions in Article 7 in the case of a permanent establishment or Article 14 in the case of a fixed base. This paragraph is similar to paragraph 4 of Article 10 dealing with dividends.

Paragraph 7 lays down the principle that the State of source of the interest is the State of which the payer of the interest is a resident. It also provides for an exception to this rule in the case of interest-bearing loans which have an economic link with a permanent establishment or a fixed base operated in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of the permanent establishment or fixed base and the interest is borne by such permanent establishment or fixed base, the paragraph specifies that the source of the interest is the Contracting State in which the permanent establishment or fixed base is situated.

The purpose of paragraph 8 is to restrict the operation of the provisions of this Article with regard to the taxation of interest in cases where there is a special relationship between the beneficial owner of the interest and the payer or between both of them and a third party. If, in the presence of this relationship, the interest paid exceeds the interest which would have been paid in the absence of such a relationship, the provisions of this Article will not apply to the amount of the interest which is considered to be excessive and such excessive amount will remain taxable in accordance with the laws of both Contracting States. The limitation placed on the source State under paragraph 2 will in such circumstances be negated in respect of the excessive amount. This is an anti-avoidance provision.

Article 12

Royalties

This Article deals with royalties and paragraph 1 provides that royalties which arise in a Contracting State and are paid to a resident of the other Contracting State may be taxed in the State of residence.

Paragraph 2 gives a right of taxation to the source State but limits the amount of tax to 5 per cent pf the gross amount of the royalties provided that the beneficial owner of the royalties is a resident of the other Contracting State.

Paragraph 3 defines which payments will constitute royalties for purposes of the Article. It includes amounts normally understood as royalties, such as patents, copyrights, trade marks, etc, and also includes payments for the use of, or right to use, industrial, commercial or scientific experience (know-how). Payments for the use of, or right to use, industrial, commercial or scientific equipment are also included. Payments of this nature are mostly dealt with under Article 7 which deals with business income.

Paragraph 4 provides that the provisions of paragraphs 1 and 2 will not apply if the beneficial owner of the royalties carries on business or performs independent personal services in the State in which the royalties arise through a permanent establishment or fixed base and the royalties are effectively connected with that permanent establishment or fixed base. In this case, the royalties are in effect regarded as part of the business profits of the permanent establishment or fixed base and may be taxed by the source State. This paragraph is similar to paragraph 4 of Article 10 dealing with dividends and paragraph 6 of Article 11 dealing with interest.

An example of where this paragraph would apply would be a Malaysian company with a permanent office in South Africa through which it sold franchise rights for the use of its product brand. South Africa would in this case be entitled to tax the franchise payments received by the Malaysian company.

Paragraph 5 lays down the principle that the State of source of the royalties is the State of which the payer of the royalties is a resident. It also provides for an exception to this rule in the case of royalties which have an economic link with a permanent establishment or a fixed base operated in the other Contracting State by the payer of the royalties. If the liability to pay the royalties was incurred by the permanent establishment or a fixed base and the royalties are borne by such establishment or fixed base, the paragraph specifies that the source of the royalties is the Contracting State in which the permanent establishment or fixed base is situated.

Paragraph 6 contains an anti-transfer pricing provision. Where the payer and recipient of a royalty are connected persons and the royalty is excessive, the source State may tax the portion which is excessive according to its laws – in other words, the limitation set out in paragraph 2 would only apply to the portion of the royalty which meets the arms-length test.

Article 13

Fees for Technical Services

This Article deals with technical fees and paragraph 1 provides that such fees which arise in a Contracting State and are paid to a resident of the other Contracting State may be taxed in the State of residence but also in the source State. The amount of tax in the source State is limited to 5 per cent of the gross amount of the technical fees, provided that the recipient is subject to tax on the fees in the State of residence. If this condition is not met there is no limit placed on source State taxation.

Paragraph 2 defines which payments will constitute technical fees for purposes of the Article. It includes payments for services of a technical, managerial or consultancy nature.

Paragraph 3 provides that the provisions of paragraph 1 will not apply if the recipient of the fees carries on business in the State in which the fees arise through a permanent establishment or fixed base situated therein and the fees are effectively connected with that permanent establishment or fixed base. In this case, the fees are in effect regarded as part of the business profits of the permanent establishment or fixed base and may be taxed as business profits by the source State. This paragraph is similar to paragraph 3 of Article 10 dealing with dividends and paragraph 6 of Article 11 dealing with interest.

An example of where this paragraph would apply would be a Malaysian company with a permanent office in South Africa through which it provided consultancy services to South African clients. South Africa would in this case be entitled to tax the fees received by the Malaysian company as part of the business profits of the permanent establishment.

Paragraph 4 lays down the principle that the State of source of the technical fees is the State of which the payer of the fees is a resident. It also provides for an exception to this rule in the case of fees which have an economic link with a permanent establishment or fixed base operated in the other Contracting State by the payer of the fees. If the obligation to pay the fees was incurred by the permanent establishment or fixed base and the fees are borne by such permanent establishment or fixed base, the paragraph specifies that the source of the fees is the Contracting State in which the permanent establishment or fixed base is situated.

Paragraph 5 contains an anti-transfer pricing provision. Where the payer and recipient of fees are connected persons and the fees are excessive, the source State may tax the portion which is excessive according to its laws – in other words, the limitation set out in paragraph 1 would only apply to the portion of the fees which meets the arms-length test.

Article 14

Capital Gains

The Article deals with the taxation of capital gains and covers all kinds of taxes which are imposed on such gains.

Paragraph 1 specifies that the right to tax gains derived from the alienation of immovable property is also given to the Contracting State in which the property is situated although the alienator may be a resident of the other Contracting State.

Paragraph 2 deals with the alienation of movable property which forms part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State. It provides that gains from the alienation of such property may also be taxed in the State in which such permanent establishment or fixed base is situated and also includes gains from the alienation of the permanent establishment or fixed base as such.

Paragraph 3 provides that gains from the alienation of ships or aircraft operated in international traffic and movable property related to the operation of such ships or aircraft are taxable only in the State in which the enterprise is resident. This follows the principle laid down in Article 8 with regard to the taxation of the business profits of such an enterprise.

Paragraph 4 specifies that gains made from the alienation of shares in a company, the property of which consists, directly or indirectly principally of immovable property are taxable in the State in which they are situated. This follows the normal taxing principle in this Article.

Paragraph 5 specifies that gains from the alienation of any property not covered by the preceding paragraphs of this Article may only be taxed in the State of residence of the alienator.

Article 15

Independent Personal Services

Paragraph 1 provides the general rule that independent personal services derived by a resident of a State may be taxed only in that State. The other (source) State is entitled to impose tax only if;

(a) the person performing the services has a fixed base regularly available to him in that State, and then it may tax only the income attributable to that fixed base;

(b) the person is present in that State for more than an aggregate of 183 days in any twelve-month period commencing or ending in the fiscal year concerned, in which case the income attributable to those services in that State may be taxed in that State.

Paragraph 2 defines professional services but the definition is not exhaustive.

Article 16

Dependent Personal Services

Paragraph 1 lays down the principle that remuneration in respect of an employment is taxable in the State of residence of the employee unless the services in respect thereof are rendered in the other Contracting State, in which case the remuneration arising from the services rendered in the other State may also be taxed in that other State.

Paragraph 2 limits the right of taxation of the State in which the services are rendered (the source State) in that remuneration for services rendered in that State is taxable only in the State of residence if the following conditions are met:

(a) the employee is present in the source State for a period or periods not exceeding 183 days in any twelve-month period; and

(b) the employer who pays the remuneration, or on whose behalf the remuneration is paid, is not a resident of the source State; and

(c) the relevant remuneration is not borne by a permanent establishment or fixed base which the employer has in the source State.

It is important to note that all three requirements must be met before the provisions of the paragraph operate.

Paragraph 3 deals with remuneration derived by employees in respect of employment aboard a ship or aircraft operated in international traffic and specifies that such remuneration may be taxed in the State of residence of the operator of such ship or aircraft.

Article 17

Directors' Fees

The Article provides that directors' fees may be taxed by the State in which the company concerned is resident. It does not, however, prevent the director from also being taxed on those fees in the director's State of residence.

Article 18

Entertainers and Sportspersons

In terms of paragraph 1 the income derived by entertainers and sportspersons may be taxed in the Contracting State in which their activities are exercised.

Paragraph 2 expands the principle laid down in paragraph 1 in that it specifies that in cases where income in respect of the activities of entertainers and sportspersons accrues to some other person rather than the entertainer or sportsperson, such income may still be taxed in the Contracting State in which such activities are exercised. This paragraph covers the frequent situation in which a professional sportsperson forms a company and competes in a sporting event in another country not in a personal capacity, but rather as an employee of the person's company. Because the sportsperson's activities in the country continue for a very short period and do not constitute a permanent establishment, neither the sportsperson nor the company would under the normal provisions of the Agreement be taxable in that country.

In cases where the activities of entertainers or sportspersons in a Contracting State are supported wholly or mainly out of public funds of the other State, paragraph 3 specifies that any income derived from those activities in the first-mentioned State will be exempt from tax.

Article 19

Pensions and Annuities

Paragraph 1 provides that pensions and other similar remuneration as well as annuities may be taxed in the State in which they arise. The State of residence may also tax but must then give a credit for the source State tax.

Paragraph 2 contains the standard definition of "annuity".

Article 20

Government Service

Paragraph 1(a) provides that remuneration paid to an individual for services rendered (other than pensions) to a Contracting State, a political subdivision or a local authority or statutory body thereof in the excercise of governmental functions, is taxable only in that State.

However, subparagraph 1(b) provides that such remuneration is taxable only in the other Contracting State if the services are rendered in that other State by a resident who is also a national of that other State or did not become resident of the other State with the express purpose of rendering the services. An example of this is a South African national, normally resident in South Africa, who is employed by the High Commission of Malaysia. Such person would be taxable in South Africa even though the person's salary is paid by Malaysia.

Paragraph 2 provides that the same principle which applies to remuneration, as set out in paragraph 1, also applies to pensions paid by a Contracting State, a political subdivision, a local authority or a statutory body thereof in the exercise of governmental functions.

Paragraph 3 specifies that the provisions of paragraphs 1 and 2 will not apply in respect of remuneration or pensions paid by a Contracting State, a political subdivision, a local authority or a statutory body thereof in respect of services rendered in relation to any business carried on by that Contracting State, political subdivision, local authority or statutory body thereof. In such circumstances, the provisions of Articles 16, 17, 18 and 19 dealing with remuneration and pensions other than of a public nature will apply.

Article 21

Students, Apprentices and Business Trainees

In terms of this Article, students, apprentices and business trainees who are residents of one State but are undergoing education or training in the other State, will not be taxed in the last-mentioned State on payments received for the purposes of:

(a) their maintenance, education, study, research or training, if those payments are received from outside that State;

(b) any grant, allowance or award as set out in the Article;

Article 22

Other Income

This Article deals with the treatment of income which is not dealt with in other Articles of the Agreement and specifies in paragraph 1 that such items of income will be taxable only in the State of residence of the recipient thereof.

Paragraph 2 reintroduces the principle established in paragraph 3 of Article 10 dealing with dividends and paragraph 6 of Article 11 dealing with interest that if such income is connected to a permanent establishment or a fixed base which a resident of a Contracting State has in the other Contracting State, then such income may be included in the profits which are attributable to the permanent establishment or fixed base as envisaged in Article 7 or Article 15, as the case may be, and taxed in that other Contracting State.

Paragraph 3 specifies that, notwithstanding the provisions of paragraphs 1 and 2, the source State also retains a taxing right in respect of other income.

Article 23

Elimination of Double Taxation

The provisions of this Article are designed to allow for the actual mechanisms required for the elimination of double taxation. In subparagraph (a) the position with regard to the manner in which Malaysia will provide relief in cases of double taxation of its residents is set out while the South African position with regard to its residents is set out in subparagraph (b). Both States use the credit method of relief. Malaysia will also allow the underlying tax paid by a company on the profits out of which a dividend is paid as a credit in cases where the shareholding is at least 25 per cent.

Article 24

Non-discrimination

Paragraph 1 provides that a State may not impose upon nationals of the other State any tax or requirement connected therewith which is other or more burdensome than that which it imposes on its own nationals in the same circumstances. The underlined words above are crucial to understanding the effect of this paragraph. By way of example, if Malaysia imposed a withholding tax (NRST) on dividends paid to non-residents, but did not impose a similar tax on residents NRST would be paid by South African shareholders but not by Malaysian shareholders. Nevertheless, this tax does not contravene the provisions of this paragraph, because the shareholders are not in the same circumstances, as they are resident in different States. A Malaysian national taking up residence in South Africa would also become liable for NRST and the discrimination is thus on the basis of residence and not nationality. This is permitted. This Agreement does not extend the provisions of this Article to nationals who are resident in a third State as Malaysia would not agree to such an inclusion.

Paragraph 2 provides that where an enterprise of one State has a permanent establishment in the other State, that permanent establishment shall not be less favourably taxed than enterprises of the home State which carry on similar activities.

Paragraph 3 prevents a State from giving less favourable taxation treatment to foreign-held enterprises than it gives to locally-held enterprises. The paragraph deals only with the taxation of the enterprise – it is still permissible, as discussed in relation to paragraph 1 above, to impose a different tax regime on the owners of the enterprise.

Paragraph 4 provides that interest, royalties, technical fees and other disbursements paid by non-residents deriving income in a State are to be allowed as a deduction by that State in the same manner as that State grants those deductions to residents. It is provided, however, that this paragraph does not override Articles 9(1), 11(9) 12(6) or 13(5), which allow a State to make adjustments in cases where excessive payments are made because of a special relationship between payer and recipient.

An exception is made in paragraph 5 in the case of personal allowances, reliefs and reductions on account of civil status or family responsibilities. An example of such an allowance or relief would be the child rebates previously granted by South Africa. These reliefs may be withheld from non-residents.

Paragraph 6 states that nothing in this Article shall prevent South Africa from imposing a tax on the profits attributable to a permanent establishment in South Africa, of a company resident in Malaysia, at a rate which does not exceed the rate of normal tax by more than five percentage points.

The Agreement generally applies only to the taxes listed in Article 2 and paragraph 7 provides that the non-discrimination provisions of this Article will apply only to such taxes.

Article 25

Mutual Agreement Procedure

This Article institutes a mutual agreement procedure for difficulties arising out of the application of the Agreement. In paragraphs 1 and 2 it provides that the competent authorities of the Contracting States shall endeavour by mutual agreement to solve the situation of taxpayers subjected to taxation not in accordance with the provisions of the Agreement.

In paragraph 3, it authorises the competent authorities of the two States to resolve by mutual agreement any problems relating to the interpretation or application of the Agreement, and, furthermore, to consult together for the elimination of double taxation in cases not provided for in the Agreement.

Finally, for practical purposes, paragraph 4 authorises the competent authorities to communicate directly with each other for the purpose of reaching mutual agreement in respect of any of these matters.

Article 26

Exchange of Information

Paragraph 1 provides that the States shall exchange such information as may be required both for carrying out the provisions of the Agreement and for applying the domestic taxation laws of the States. Information obtained by a State under this provision must be treated with the same degree of secrecy as applies to information obtained under the domestic laws of that State. In addition to this general stipulation on secrecy, it is specifically provided that information obtained under this Article may be disclosed only to persons or authorities involved in the administration of the taxes covered by the Agreement, and that those persons and authorities shall use the information only for the purposes of such administration.

In terms of paragraph 2, the preceding provisions will not impose on a State the obligation:

(a) to do anything which is contrary to the laws or administrative practice of either State;
(b) to supply information which is not obtainable under the laws of either State or in the normal course of the administration of either State;
(c) to supply information which discloses any business secret, or information the disclosure of which is contrary to public policy.

Article 27

Members of Diplomatic Missions and Consular Posts

The Article ensures that members of diplomatic missions and consular posts are not deprived of any right which is accorded to them under international law or special agreements between Contracting States. In effect this normally means that the remuneration which they receive from their State of residence while they are stationed in the other Contracting State is not subjected to tax in that other State.

Article 28

Entry into Force

Paragraph 1 provides that the Contracting States shall notify each other in writing, through the diplomatic channel, once the legal procedures required in each country for the bringing into force of the Agreement have been completed. The Agreement will then enter into force on the date of receipt of the later of these notifications.

Paragraph 2 also specifies the date on which the provisions will begin to operate, in both States on or after the first day of January next following the date of entry into force of the Agreement. However, in the case of Malaysia, in respect of petroleum income tax, the provisions will begin to operate on or after the first day of January of the second calendar year following the date of entry into force of the Agreement.

Article 29

Termination

Paragraph 1 provides that the Agreement shall operate for a minimum period of five years after which it may be terminated by giving written notice of termination not later than 30 June of any calendar year.

The Agreement will then cease to operate from 1 January in the calendar year following such notice on the basis set out in paragraph 2. However, in the case of Malaysia, in respect of petroleum income tax, the Agreement will cease to operate on or after the first day of January of the second calendar year following the year in which the notice of termination is given.

PROTOCOL

Paragraph (i) in the Protocol to the Agreement take account of the fact that South Africa currently exempt dividends declared by non-resident companies from tax where the participation by the South African shareholder is more than twenty five per cent. Should South Africa withdraw this exemption, then it shall advise the competent authority in Malaysia accordingly with a view to the renegotiation of the provisions of paragraph (a) of Article 23 to include tax sparing provisions.

Paragraph (ii) of the Protocol provides that the fact that Malaysia is entitled to refuse to allow interest, royalties, fees for technical services and other disbursements which are paid to non-residents as a deduction to its residents if there has been a failure to withhold tax from such payments will not constitute discrimination as envisaged in paragraph 4 of Article 23. The South African view is that this is not discrimination as envisaged in Article 23 and the paragraph merely confirms this.

Subparagraph (iii) of the Protocol provides that the provisions of the Agreement will not be available in respect of offshore business activities under the Labuan Offshore Business Activity Tax Act of 1990, which is regarded as being a tax haven.

General

Attached are the opinions from the State Law Advisers of the Departments of Foreign Affairs and Justice.

The entire Agreement becomes part of the law of South Africa and is entered into in terms of section 108 of the Income Tax Act, 1962 (Act No 58 of 1962), read in conjunction with section 231(4) of the Constitution of the Republic of South Africa, 1996 (Act No 108 of 1996).

Financial Implications

There are no direct financial costs under the Agreement for the State.