

Tax Alert

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SA court decision on SA permanent establishment of US consulting firm

A recent Tax Court judgment is one of SA's first disputes on the treaty concept of "permanent establishment". The court held in May 2015 that a US advisory firm's extended presence in SA, to deliver consulting services to a SA client, constituted a permanent establishment.

The facts

The appellants were two US-resident entities (limited liability companies or "LLCs"), which are part of a global advisory group specialising in the airline industry. The dispute in question related to a consulting contract that the LLCs had with a SA client.

In terms of the consulting contract, the advisory services were delivered in SA —at the client's premises— over a 16-month period between February 2007 and May 2008. In total, 17 of the LLCs' employees were made available on the project, three of who formed the "core" of the team and were present in SA on a rotational basis, with the other employees being sent to SA only as required. In carrying out the consulting activities, the physical "engine room" (as described by one of the witnesses) of the consulting work was the client's boardroom, i.e. the consultants were generally based in the boardroom despite also occasionally needing to work with the client's staff in other parts of the client's premises. The consultants did not work in the boardroom after hours or on weekends.

The judgment refers to an amount, being the subject of the tax dispute, of around ZAR64M (although it is not clear whether this refers to the gross income amount or just the taxable income portion). Part of this was accrued during the period when the services were actually rendered (2007 and 2008) and the

balance accrued in 2009 as a "success fee" once the impact of the advisory work had been witnessed in the client's financial results.

The dispute

At issue were the provisions of the double tax agreement ("DTA") between SA and the US, and specifically the question of what constitutes a permanent establishment ("PE"). The SA Revenue Service ("SARS") sought to tax the LLCs on their SA consulting income, and relied specifically on the assertions that:

- the consulting income constituted business profits attributable to a SA PE of the LLCs (as contemplated in Art 7(1) of the DTA); and
- the LLCs had a PE in SA on the basis that:
 - the consulting work was caught by the specific inclusion for services in the PE definition (as contemplated in Art 5(2)(k) of the DTA) since the tenure of the consulting activities in SA exceeded 183 days in the tax year; and that
 - in the alternative, in any event, the client's boardroom constituted a fixed place of business of the LLCs (as contemplated in Art 5(1)).

Against that, the LLCs argued that the client's premises did not fulfill the "fixed place of business" requirement and thus the general PE definition

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(5(1)) did not apply. Furthermore, they argued that the services-special-inclusion (5(2)(k)) could not apply because it was subject to the prerequisite that the general “fixed place of business” condition must also be fulfilled.

The judgment

The Tax Court held that the services-special-inclusion (5(2)(k)) is not dependent on the existence of a general fixed place of business and, therefore, the rendering of the services under the consultancy contract —on its own— constituted a PE. That said, the court also held that, even if a “fixed place of business” was a prerequisite, the general, ongoing and exclusive access that the consultants had to the client’s boardroom did indeed constitute a fixed place of business through which the LLCs’ business was (partly) carried on. As such, the boardroom itself was in any event a PE.

The takeaway

This primary focus of this case was on a specific inclusion in the US-SA DTA for consulting services rendered over an extended period (i.e. in excess of 183 days) and, in finding in favour of the SARS, the judgment was not particularly ground-breaking. However, the case also considers the more general question of whether the premises of a service

provider’s client can represent a “fixed place of business” (and thus a PE) of that service provider — and, on these specific facts, the court held that the SA client’s boardroom was indeed a SA PE of the US consultants.

The case should be viewed in the context of the concern that the SARS has with respect to services rendered by non-residents in SA and the increased scrutiny being placed on such arrangements, including through the withholding tax on service fees and the proposed reportable arrangement for services rendered by non-residents in SA.

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