EXPLANATORY MEMORANDUM

ON THE DOUBLE TAXATION CONVENTION

BETWEEN

THE REPUBLIC OF SOUTH AFRICA

AND

THE REPUBLIC OF CHILE

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 conventions. Such conventions 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 Convention concluded with Chile closely follows the OECD Model. In the explanation which follows, the general principles of each Article of the Convention are set out.

The entire text has been made gender neutral.

Preamble

The Preamble records that the object of the Convention is to avoid double taxation and prevent fiscal evasion with respect to taxes on income and on capital.

Article 1

Persons Covered

The Convention is made applicable to persons who are residents of one or both of the Contracting States except as otherwise stated. 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 Convention, apart from the non-discrimination provisions.

Article 2

Taxes Covered

Paragraphs 1 and 2 of this Article provide that the Convention will apply to all taxes on income and on capital 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 Convention will also apply to identical or substantially similar taxes and to taxes on capital which are subsequently imposed by either State.

Article 3

General Definitions

This Article defines various expressions which are used in the body of the Convention. 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 <u>that is treated as an entity for tax purposes.</u> The underlined words are of particular relevance to partnerships. Partnerships are not regarded as taxable entities in South A frica, rather, the income of a partnership is taxed in the hands of the partners. Accordingly, should a partnership consisting of a Chilean resident and a resident of a third State derive income in South Africa, only the Chilean resident will be entitled to the benefits of the Convention 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 when 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 Chilean 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 Convention bear the meaning that they have under the domestic taxation laws of the States at the time of application of the provisions of the Convention. 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 Convention and is of importance in three cases:

(a) in determining the Convention'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, place of incorporation 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 the right to claim the individual as its resident.

Paragraph 3 provides that an item of income, profit or gain derived through a fiscally transparent person will be considered to be derived by a resident of a Contracting State if that item of income, profit or gain is taxable under the taxation laws of that State as the income, profit or gain of such resident.

Paragraph 4 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 shall by mutual agreement decide which State will have the sole right to claim the company or body of persons as its resident. The paragraph further provides that in the absence of such an agreement between the competent authorities, the person will be denied benefits under the Convention.

Article 5

Permanent Establishment

One of the goals of the Convention is to determine the right of a Contracting State to tax the business 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, subject to the provisions of paragraph 1.

Paragraph 3(a) provides expressly that a building site or construction, assembly or installation project will constitute a permanent establishment only if it continues for a period of more than six months. Supervisory activities carried on in a Contracting State in connection with such site or project will also constitute a permanent establishment if they continue for more than six 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 or other personnel engaged by that enterprise for such purpose 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.

Paragraph 3(c) introduces provisions dealing with the income from professional services or other activities of an independent nature by an individual and specifies that a permanent establishment will exist if the individual is present in that 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 be deemed not to exist if the enterprise only carries on the various activities set out therein. The Contracting State in which these activities take place will in any event not have any, or negligible profits, to tax 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 has the power to conclude contracts in the name of the enterprise.

Paragraph 6 deems an insurance enterprise, except in regard to reinsurance, to have a permanent establishment in the other Contracting State if it collects premiums in that territory or insures risks situated therein, through a person other than an independent agent.

Paragraph 7 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 and that conditions of a commercial or financial nature are not made or imposed that would differ from those generally agreed to by independent agents.

Paragraph 8 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. 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 which establishes somewhat different rules for the treatment of business profits.

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 only 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 such as management fees are excluded.

Paragraph 4 provides for profits attributable to a permanent establishment to be determined on the basis of apportionment if this method is customary in a Contracting State. However, the proviso specifies that the result of this method should still be in accordance 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 profit from such purchase transaction.

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 Convention. Paragraph 7 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 Chile are taxable only in South Africa.

Paragraph 2 specifies that the expression "operation of ships or aircraft" by an enterprise includes, charter or rental on a bareboat basis of ships or aircraft, the rental of containers and related equipment, provided such activities are connected to the operation by the enterprise of ships or aircraft in international traffic.

Paragraph 3 makes the above rules also applicable where the business is conducted through a pool, a joint business 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 to be 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 oblige 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 on the non-resident shareholder and the State of residence in which the dividends are received has an unlimited taxing right.

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

(a) the tax is limited to 5% of the gross dividend where the shareholder is a company which holds directly at least 25 per cent of the capital of the company

paying the 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) in all other cases the rate of tax is limited to 15 per cent of the gross amount of the dividends.

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.

The mode of application of these limitations shall be settled by the competent authorities of the two States.

Tax on the profits of the company will not be affected by this paragraph.

It is further provided that the provisions of paragraph 2 shall not limit the application of the Additional Tax payable under Chilean Income Tax Act as long as the First Category Tax is fully deductible in computing the amount of Additional Tax. Non-domiciled and non-resident persons are subject to a 35 per cent withholding of Additional Tax on distributions or remittances, with a 16 per cent credit being granted in respect of the First Category Tax.

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 and derives dividends from shares the holding of which is effectively connected with that permanent establishment. In other words, the holding must be part of the business assets of the permanent establishment. The source State is therefore not limited in its taxing rights which are then exercised under the provisions of Article 7 of the Convention.

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, as mentioned in relation to paragraph 4 above.

The second situation can best be explained through an example of a Chilean 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 Chilean 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.

Paragraph 6 provides that the provisions of Article 10 will not apply if the right giving rise to the dividend was created or assigned mainly for the purpose of taking advantage of the Article by means of that creation or assignment. This is an anti-avoidance provision.

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 as well but limits the amount of tax to 5 per cent of the gross amount of interest derived from loans granted by banks and insurance companies, interest derived from bonds or securities that are regularly and substantially traded on a recognised securities market, as well as interest derived from a sale on credit paid by the purchaser of machinery and equipment to a beneficial owner that is the seller of the machinery and equipment. In all other cases the limit is 15 per cent of the gross amount of the interest.

Paragraph 3 contains the standard definition of what is to be regarded as interest.

Paragraph 4 specifies that if the beneficial owner of the interest carries on business in the Contracting State in which the interest arises through a permanent establishment 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. The provisions of Article 11 will not apply to such interest but rather the provisions in Article 7. This paragraph is similar to paragraph 4 of Article 10 dealing with dividends.

Paragraph 5 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 operated in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of the permanent establishment and the interest is borne by such permanent establishment, the paragraph specifies that the source of the interest is the Contracting State in which the permanent establishment is situated.

The purpose of paragraph 6 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.

Paragraph 7 stipulates that there will be no relief granted under this Article if the interest arising was due to a scheme created to take advantage of this Article. This is an anti-avoidance provision and is in line with the provisions in Article 10(6) and Article 12(7).

Article 12

Royalties

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 royalties arise may impose a limited withholding tax on the non-resident shareholder and the State of residence in which the royalty payment is received has an unlimited taxing right.

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

(a) 5 per cent of the gross amount of the royalties for the use of, or the right to use, any industrial, commercial or scientific equipment;
(b) 10% per cent of the gross amount of the royalties in all other cases

The competent authorities of the Contracting States shall settle the mode of application of this limitation by mutual agreement.

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). Information concerning, industrial, commercial or scientific experience is also included.

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

An example of where this paragraph would apply would be a Chilean 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 Chilean company.

Paragraph 5 is a deeming provision which establishes the source of royalties by laying 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 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 and the royalties are borne by such permanent establishment, the paragraph specifies that the source of the royalties is the Contracting State in which the permanent establishment is situated.

Paragraph 6 contains an anti-abuse provision in respect of transfer pricing. 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.

Paragraph 7 provides that the provisions of Article 12 will not apply if the rights giving rise to the royalties were created or assigned mainly for the purpose of taking

advantage of the Article by means of that creation or assignment. This is an anti-avoidance provision.

Article 13

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 is situated and includes such gains arising from the alienation of the permanent establishment as such and the enterprise as a whole.

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 of which the alienator 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 arising from the alienation of shares or other rights representing the capital of a company, or comparable interests or rights in any other person that is a resident of the other Contracting State, may be taxed in that other State.

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

Article 14

Income from Employment

Paragraph 1 lays down the principle that salaries, wages and other remuneration in respect of an employment is taxable only 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 all met:

(a) the recipient 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 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 it specifies that such remuneration may be taxed in the State of residence of the operator of such ship or aircraft.

Article 15

Directors' Fees

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

Article 16

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 that company. As 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 Convention be taxable in that country.

Article 17

Pensions

Paragraph 1 provides that pensions 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 provides that alimony and other maintenance payments paid to a resident of a State by a resident of the other State is taxable only in the State of residence of the recipient of such alimony or other maintenance payments. However, paragraph 2 further provides that alimony and other maintenance payments shall, to the extent that it is not allowable as a relief from tax to the payer thereof, be taxable only in the State in which the payer is resident. This provision has been inserted at the request of Chile, although neither Chile nor South Africa tax alimony payments in the hands of the recipient thereof neither do they allow it as a

deduction in the hands of the payer thereof.

Article 18

Government Service

Subparagraph 1(a) provides that salaries, wages and other remuneration (other than a pension), which is paid by a Contracting State, a political subdivision or a local authority thereof to an individual for services rendered, is taxable only in that State.

However, subparagraph 1(b) provides that such salaries, wages and other similar remuneration are 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 Chilean Embassy. Such person would be taxable in South Africa even though the person's salary is paid by the Chile.

Paragraph 2 provides that the provisions of paragraphs 1 and 2 will not apply in respect of salaries, wages, pensions and other similar remuneration paid by a Contracting State, a political subdivision or a local authority thereof in respect of services rendered in relation to any business carried on by them. In such circumstances, the provisions of Articles 14, 15 and 16 dealing with remuneration other than of a public nature will apply.

Article 19

Students

In terms of this Article, students or business apprentices who are residents of one State but are present in the other State solely for the purpose of undergoing education or training, will not be taxed in that other State on payments received for the purposes of their maintenance, education or training, if those payments are received from outside that other State.

Article 20

Other Income

This Article deals with the treatment of income which is not dealt with in other Articles of the Convention 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 4 of Article 10 dealing with dividends and paragraph 4 of Article 11 dealing with interest that if such income is connected to a permanent establishment 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 as envisaged in Article 7 and taxed in that other Contracting State.

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

Article 21

Capital

The Article deals with the taxation of capital.

Paragraph 1 specifies that the right to tax capital represented by 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 capital represented by movable property which forms part of the business property of a permanent establishment which a resident of a Contracting State has in the other Contracting State. It provides that such capital may be taxed in the State in which such permanent establishment is situated.

Paragraph 3 provides that capital represented by ships and aircraft operated in international traffic, and by movable property pertaining to such operation, are taxable only in the State of which the enterprise operating such ships or aircraft is resident.

Paragraph 4 specifies that capital not covered by the preceding paragraphs of this Article shall only be taxable in the State of residence of the owner.

Article 22

Avoidance 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 1(a) the position with regard to the manner in which Chile will provide relief in cases of double taxation of its residents is set out while subparagraph 1(b) enables Chile to retain the right to take into consideration the amount of income or capital exempted in Chile, when determining the rate of tax to be imposed on the remainder of the income or capital.

The South African position with regard to the manner of relief to its residents is set out in paragraph 2.

Both States use the credit method of relief.

Article 23

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 Chile 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 Chilean 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 Chilean 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.

The paragraph extends the application of the non-discrimination provisions to all nationals of either of the States who are resident in a third State.

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.

An exception is made in paragraph 3 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 4 provides that interest, royalties and other disbursements paid to 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(6) and 12(6), which allow a State to make adjustments in cases where excessive payments are made because of a special relationship between payer and recipient. These provisions will apply equally to debts of an enterprise for the purpose of determining taxable capital.

Paragraph 5 prevents a State from giving less favourable taxation treatment to companies owned by non-residents than it gives to companies owned by residents. The paragraph deals only with the taxation of the company – it is still permissible, as discussed in relation to paragraph 1 above, to impose a different tax regime on the owners of the company.

The Convention generally applies only to the taxes listed in Article 2 and paragraph 6 provides that the non-discrimination provisions of this Article will apply only to such taxes.

Article 24

Mutual Agreement Procedure

This Article institutes a mutual agreement procedure for difficulties arising out of the application of the Convention.

If, due to the actions of one or both of the Contracting States, a resident of one of the Contracting States considers that taxation which is not in accordance with the provisions of the Convention has been imposed, paragraph 1 enables such resident of a Contracting State to present a case to the competent authority of that State. This may be done irrespective of remedies provided by domestic legislation. The taxpayer must notify the competent authority within 3 years of the notification of the action which results in such incorrect taxation.

Paragraph 2 stipulates that the competent authority, considering the objection to be justified and unable to arrive at a satisfactory solution shall, in an endeavour to avoid incorrect taxation, consult with the competent authority of the other Contracting State.

In paragraph 3, the competent authorities of the two States are authorised to resolve by mutual agreement any problems relating to the interpretation or application of the Convention.

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

Article 25

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 Convention 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 Convention, and that those persons and authorities shall use the information only for the purposes of such administration.

Thus, should South Africa obtain tax information relating to a resident of a third State who is liable for Kenyan tax, it may make that information available to Kenya. The exchange extends to residents of a third State.

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 and 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.

In terms of paragraph 3 a Contracting State is obliged to exchange information even in cases where the requested information is not needed by that State for domestic tax purposes.

Article 26

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 27

Miscellaneous Rules

Paragraph 1 provides that, notwithstanding the provisions of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that disputes between them as to whether a measure relating to a tax to which any provision of this Convention applies, falls within the scope of Convention may be brought before the Council for Trade in Services only with the consent of the Contracting States. Paragraph 1 further provides that the competent authorities of the two States are authorised to resolve by mutual agreement any problems relating to the interpretation of this paragraph or should no agreement be reached under the mutual agreement procedures, pursuant to any other procedure which both Contracting States may agree to.

Paragraph 2 provides that the provisions of the Convention must not be interpreted to restrict Chile from imposing on pooled investment accounts or funds under the Foreign Capital Investment Fund legislation a tax at a flat rate on its remittances from such accounts or funds in respect of investments in assets situated in Chile. The Foreign Capital Investment Fund is regulated by special law in Chile, namely, Law Nº 18.657. It is the entity formed by contributions made from outside Chile by persons for investment in publicly offered securities and is required to be administered by a resident of Chile.

Paragraph 3 once again takes account of Chilean legislation and states that nothing in the Convention will affect the application of the existing provisions of the Foreign Investment Statute (DL 600) as they are in force at the time of signature of the Convention or may from time to time be amended without changing the general principle thereof.

Paragraph 4 provides that where pension plan contributions are paid by or on behalf of an individual who is a resident of a Contracting State, to a pension plan in the other Contracting State which is recognised for tax purposes in that other State, then the first-mentioned State shall, during a period not exceeding in the aggregate 60 months, treat those contributions in the same way for tax purposes as it would treat contributions paid to a pension plan recognised for tax purposes in that first-mentioned State, provided that such individual contributed to that pension plan for a period which ended immediately before the individual became a resident of the first-mentioned State and the competent authority of that State agrees that the pension plan corresponds to a pension plan which is recognised for tax purposes in that first-mentioned State. The paragraph further provides that a pension plan created under a public social security system would be included for purposes of this paragraph.

Paragraph 5 states that nothing in the Convention will prevent Chile from imposing tax on the profits attributable to a permanent establishment situated in Chile, of a resident in South Africa, both the First Category Tax and the Additional Tax, but only if the First Category Tax is deductible in computing the Additional Tax.

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

Article 28

Entry into Force

Paragraph 1 stipulates that the Contracting States will notify each other, through the diplomatic channel, once the legal procedures required in each country for completion of their domestic requirements for entry into force of the Convention have been fulfilled. The Convention will then enter into force on the date of receipt of the later of these notifications.

Paragraph 2 specifies the date on which the provisions will begin to operate in both States:

(a) In Chile, in respect of taxes on income obtained and amounts paid, credited to an account, put at the disposal or accounted as an expense, on or after the first day of January in the calendar year next following the date of entry into force of the Convention.

(b) In the case of South Africa, this will be on the first day of January in the calendar year next following the date of entry into force of the Convention with regard to taxes withheld at source as well as other taxes, for taxable years beginning on or after such date.

Article 29

Termination

Paragraph 1 provides that the Convention 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 Convention will then cease to operate from 1 January in the calendar year following such notice on the basis set out in paragraph 2.

PROTOCOL

Paragraph 1 of the Protocol provides that the competent authorities of the Contracting States will jointly decide on the methods of implementing the terms, operation and application of the Convention to ensure that the purpose of the Convention, namely, to avoid double taxation and prevent fiscal evasion, continues and further, to amend the Convention by way of Protocols when necessary.

Paragraph 2 of the Protocol provides that for purposes of determining the duration of activities under paragraph 3 of Article 5, the period during which the activities are carried on in a Contracting State by an enterprise associated with another enterprise within the meaning of Article 9 will, if the activities of the associated enterprises are identical or substantially the same, be aggregated with the period during which the activities are carried on by the enterprise.

Paragraph 3 of the Protocol states that the provisions of paragraph 3 of Article 7 regarding the attribution of expenses to the permanent establishment will be in accordance with the laws of the Contracting State in which the permanent establishment is situated. This is merely a clarification of how allowable expenses are in any case dealt with.

Paragraph 4 of the Protocol provides that the Chilean forms set out in the Chilean Circular 17 of 2004 is compatible with the Convention in regard to the requirement of residence for entitlement to the benefits of the Convention. Any change of residence certificates will be settled by mutual agreement by the competent authorities.

Paragraph 5 of the Protocol provides that the income referred to in paragraph 1 of Article 16 which is derived by an entertainer or sportsperson from any personal activity exercised in the other State, will include any other income which is related to that person's fame as an entertainer or sportsperson.

Paragraph 6 of the Protocol provides that the term "pensions" will include any payments made by a pension scheme recognised for tax purposes by the Contracting State in which the pension arises to a scheme member or beneficiary in accordance with a scheme's rules. Lump sum payments are, for example, included in the term "pensions".