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Mauritius Global Business Update 18

REVISION OF THE AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME BETWEEN REPUBLIC OF MAURITIUS ("MAURITIUS") AND THE REPUBLIC OF SOUTH AFRICA ("SOUTH AFRICA") ("DTA")

The 1996 DTA was renegotiated and signed on 17 May 2013. The new tax agreement ***is not yet in force*** *and the existing provisions are likely to stand good for quite some time yet. The new DTA will need to be ratified by the Mauritian and South African parliaments. Along with other industry operators, the Association of Trusts & Management Companies, of which GWMS is the current President, has sought clarification on aspects of the revisions from the Ministry of Finance of Mauritius. It is very probable that Mauritius will seek clarifications from South Africa. It is therefore very likely that the revised DTA may be ratified much after 2015.*

We bring to you our comments with regard to the salient features of the revised DTA.

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1. Introduction

1.1. Despite certain changes to the DTA, as discussed below, for many investors currently making use of Mauritian-based structures, it should be "business as usual".

2. Dual Residence

2.1. Current DTA

2.1.1. Article 4 of the current DTA contains a tie-breaker test to determine in which country persons other than individuals i.e. a juristic person, should be considered tax resident for DTA purposes. The place of effective management (POEM) is a major determinant for this test. This test is to be replaced with a mutual agreement procedure known as the "Competent Authority Procedure" between the competent authorities in the revised DTA.

2.2. Revised DTA

2.2.1. The "Competent Authority Procedure" is sanctioned as acceptable, although not recommended, by the Organisation for Economic Development ("OECD"). DTAs worldwide are generally based on the OECD or United Nation model.

2.2.2. OECD recommends that the following non exhaustive factors be considered by the Competent Authorities of the countries involved (“CA”) , in making their determination:

Place where Board meetings are held	Place where the accounting records are kept
Place where the CEO/senior executives operate from	Place where the headquarters are located
Governing law of the juristic person	Whether the determination by the CA carries the risk of an improper use of the provisions of the DTA

2.2.3. Assuming that the CAs follow OECD’s recommendations as set out above, their analysis is likely to yield a very similar result to any current analysis carried out under the place of effective management tie-breaker test.

2.2.4. We draw your attention to the fact that the new approach under the "Competent Authority Procedure” is not new to South Africa. It is currently to be found in 13 of South Africa’s existing DTAs, including, in the African context, South Africa’s treaties with Botswana, Nigeria and Uganda. It is also found elsewhere in the world, for example in the UK's treaties with US, Canada and the Netherlands.

2.2.5. GWMS draws utmost attention to the following critical considerations:

2.2.6. The change to the "Competent Authority Procedure” may indeed cause concern in certain cases however such cases should be the exception rather than the rule.

2.2.7. The "Competent Authority Procedure” makes it even more critical to ensure that the place of effective management (“POEM”) is in Mauritius. GWMS has previously recommended suggested measures to enhance substance (i.e. POEM) in Mauritius. Please revisit, review and implement as much as possible.

2.2.8. A taxpayer should henceforth be more aware than before of the dangers of unintentionally locating effective management of any Mauritian incorporated company in South Africa.

2.2.9. Failure to do so may subject a taxpayer to the uncertainty and administrative burden of the Competent Authority procedure or to file tax returns in two different countries or lose the benefits of any DTA relief the taxpayer may currently be enjoying.

2.2.10. The risks associated with cases relating to 'dual residence' or insufficient POEM in Mauritius could be further mitigated through the shifting of regional global headquarter administration to Mauritius. This is a NEW product recently which is available in Mauritius. GWMS will be pleased to apprise you of this new development.

3. South African withholding tax on dividends, interest and royalties

3.1. Current DTA

3.1.1. The DTA reduces to 5% the flat South African withholding tax rate of 15% applicable to dividends paid by a South African company to its Mauritius shareholder company.

3.1.2. The DTA reduces to 0% the flat South African withholding tax rate of 15% applicable to interest, from a South African source, paid by a South African company to a Mauritius.

3.1.3. The DTA reduces to 0% the flat South African withholding tax rate of 12%/15% applicable to royalty, from a South African source, paid by a South African company to a Mauritius company provided the royalty is beneficially owned by the Mauritius company.

3.2. Revised DTA

3.2.1. The rate of tax for dividends **remains unchanged at 5%** when a minimum shareholding of 10% of capital is met. We draw your attention to the fact that the revised DTA **reduces** the default rate under the current DTA **from 15% to 10%** for distributions from South Africa to Mauritius to persons other than a beneficial owner who holds 10% of the share capital of the company.

3.2.2. The reduction to 0% in respect of interest paid to a Mauritius company **remains intact** in the new tax treaty for interest on debt instruments listed on a stock exchange like the JSE.

3.2.2.1. All other types of interest will be subject to a maximum source rate of tax of 10% (previously 0%).

3.2.2.2. South Africa is set to introduce an interest withholding tax of 15% in 2014 on all SA source interest payments to non-residents. The new DTA will **reduce** the rate from 15% to 10% in respect of Mauritius companies.

3.2.2.3. The DTA **reduces to 5%** (previously 0%) the flat South African withholding tax rate of 12%/15% applicable to any royalty, from a South African source, paid by a South African company to a Mauritius company provided the royalty is beneficially owned by the Mauritius company.

4. Capital Gains Tax

4.1. Current DTA

4.1.1. The DTA provides that capital gains from the disposal of movable property like shares will be taxable in the country of residence of the alienator. This means that the capital gains that arises from a sale of shares in a South African company by a Mauritius company is only taxable in Mauritius where capital gains are currently tax exempt.

4.1.2. Capital gains that arise from an alienation or transfer of an immovable property in South Africa held by a Mauritian company may also avoid South African CGT in South Africa.

4.2. Revised DTA

4.2.1. The DTA leaves **unchanged** the mode of taxation of capital gains on movable property.

4.2.2. The new DTA gives the right to South Africa to tax any capital gains that arise from the sale of shares in a South African company that is “property rich” i.e. where the shares derive more than 50% of their value from immovable property situated in South Africa. This provision applies to immovable property in both Mauritius and South Africa.

5. Tax Sparing Clause

5.1. Current DTA

5.1.1. The DTA grants tax sparing credits on a reciprocal basis for investment in either South Africa or in Mauritius. In effect, a South African resident is allowed a notional tax credit for Mauritian tax at the standard rate of 15% even though the actual Mauritian tax paid may at the incentive rate of 3%.

5.1.2. This clause is beneficial where a South African company holds and effectively manages and controls, from South Africa, a Mauritius company which has a GBL1 licence. In this case, the income of the Mauritius company may be taxable in South Africa. South Africa would grant a foreign credit for taxes paid in Mauritius. In the absence of the tax sparing clause, the foreign credit would only be limited to the actual tax paid in Mauritius i.e. 3%. However, the DTA operates to enable the South African company to benefit from the tax sparing clause i.e. the foreign tax credit granted by South Africa is then based on a Mauritius standard tax rate of 15% thus the incentive tax rate of 3% is ignored.

5.2. Revised DTA

5.2.1. Under the new tax treaty, the tax sparing relief will only be available for investment into South Africa by Mauritian residents.

6. Permanent Establishment

6.1. Current DTA

6.1.1. The term permanent establishment (PE) includes a building site or construction, installation or assembly project or connected supervisory activities ONLY if these last more than 9 months.

6.2. Revised DTA

6.2.1. The 9 months period is increased to 12 months. If the threshold is met, profits attributable to the PE will be taxed in the source state.

6.2.2. The Article on PE has been **expanded** to include the "furnishing of services through employees… or other personnel" as well as "the performance of professional services or other activities of an independent character" where such activities continue within a contracting state i.e. either South Africa or Mauritius for more than 6 months in the aggregate in a fiscal year. In such case, such profits derived from services rendered will be taxed in the source State.

6.2.3. South Africa proposes to introduce in 2014 a withholding tax on service fees. Under the DTA, where the period during which the services are rendered does not exceed the 6 month threshold, South Africa will not be able to levy the withholding tax on fees paid to Mauritius.

7. Conclusion

The revised DTA will only come into operation if and when it is ratified. The impact of the changes will concern mainly South African capital gains tax where Mauritius companies hold South African based investments in the mining or property sectors (“property rich companies”) and the South African withholding tax impact on Mauritian financing or IP licensing entities that derive interest or royalty income from South Africa. Despite the changes, the revised DTA will still be beneficial to Mauritius companies as it will still mitigate the withholding tax on dividends, interest and royalty. Capital gains on alienation of shares (other than property rich companies) will still accrue to Mauritius companies.

It is however critical that POEM of Mauritius companies remain unambiguously in Mauritius.

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