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Mauritius Global Business Update 29

1. THE RENOGOTIATED 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"); &

2. THE RELATED MEMORANDUM OF UNDERSTANDING (MoU) CLARIFYING THE MAP

The 1996 DTA was renegotiated and signed by South Africa on 17 May 2013. Mauritius has in May 2015 signed and ratified both the DTA and the MoU. The Mauritius Revenue Authority ("MRA") and the South African Revenue Service ("SARS") are the Competent Authorities("CAs") and parties to the MoU which they signed on 22 May 2015. The new DTA has been gazetted in Mauritius on 27 May 2015. In terms of Article 28 of the DTA, the date of entry into force of the DTA is 1 January 2016. Point 4 of the MoU states that its date of entry into force is linked to the DTA.

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

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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 when there is a case of dual residence. The place of effective management (POEM) is a major determinant for this test.

2.2. Revised DTA

2.2.1. The POEM test is now replaced with a mutual agreement procedure ("MAP") known as the "Competent Authority Procedure" between the competent authorities in the revised DTA.

2.2.2. The MoU sets out the factors that the CAs will consider when endeavouring to settle the question of dual residence. The MoU therefore removes to a large extent the opaqueness surrounding the application of the MAP thereby restoring certainty to a large extent. These factors revolve around determining the place of effective management ("POEM").

2.2.3. The factors that MRA and SARS have mutually agreed to consider are:

a) Where the meetings of the entity's board of directors or equivalent body are usually held;
b) Where the CEO and other senior executives usually carry on their activities;
c) Where the senior day-to-day management of the entity is carried on;
d) where the entity's headquarters are located;
e) Which country's laws govern the legal status of the entity;
f) Where the accounting records are kept;
g) Any other factors listed in paragraph 24.1 of the 2014 OECD Commentary (Article 4 paragraph 3) as amended by the OECD/BEPS Action 6 final report; and
h) Any such other factors that may be identified and agreed upon by the Competent Authorities in determining the residency of the entity.

2.2.4. With respect to factor f) above, it is worthwhile to note that paragraph 21 of the 2014 OECD Commentary (Article 4 paragraph 3) states "It may be rare in practice for a company etc to be subject to tax as a resident in more than one state";

2.2.5. Paragraph 24 of the said OECD Commentary clarifies that POEM is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. **GWMS: Client should ensure that key management and commercial decisions are made in Mauritius.**

2.2.5.1. Note that factors a) to f) above are straight lifts of the factors identified in paragraph 24.1 of the 2014 OECD Commentary (Article 4 paragraph 3) with respect to POEM;

2.2.5.2. The only other factor identified in the said paragraph 24.1 is "whether determining that the entity is a resident of one of the Contracting States but not of the other for the purpose of the convention would carry the risk of an improper use of the provisions of the convention etc."

2.2.6. Assuming that the CAs diligently apply the MoU factors, as set out above, their analysis is likely to yield a very similar result to any current analysis carried out under the POEM tie-breaker test.

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

2.2.8. 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.

2.2.9. The "Competent Authority Procedure" makes it even more critical to ensure that POEM be in Mauritius. GWMS routinely recommends suggested measures to enhance substance (i.e. POEM) in Mauritius. Please contact us for details.

2.2.10. 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.

2.2.11. 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.

2.2.12. 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.

3. SARS's stance with respect to POEM

3.1. **A change for the better! - Draft Interpretation Note 6 (IN 6)**

3.1.1. SARS recently (beginning 2015 & due date for comments in respect of this IN6 is 31 July 2015) issued a draft Interpretation Note 6 (IN 6) in which its interpretation of POEM is radically changed, **for the better**, bringing relief to taxpayers involved in cross border activities!

3.1.2. SARS, formerly under PN 6 (see below), placed emphasis on the place where an entity is managed on a day-to-day basis by the directors or senior management, irrespective of where the overriding control is exercised or where the board of directors meet.

3.1.3. South African Courts have almost consistently endeavoured to determine POEM of an entity with reference to settled and widely accepted international jurisprudence in lieu of supporting SARS' PN 6 (see below) based interpretation of the POEM concept. The 2011 High Court case of Oceanic Trust Co Ltd NO v SARS seems to have succeeded in pushing SARS to revise its earlier views.

3.1.4. In terms of IN 6, POEM of an entity is the place where key management and commercial decisions that are necessary for its business as a whole, are in substance made. This revised view is now consistent with international jurisprudence and OECD and has also been adopted in the MoU – see bullet point 2.2.5 above.

3.1.5. SARS will now attach more weight to the location of decision-making, as opposed to the location of implementation. **GWMS: This is a very much welcomed shift by SARS and a key consideration for entities that operate in Mauritius.**

3.2. **Current but soon to be replaced Practice Note 6 of 2002 ("PN 6")**

3.2.1. PN 6 identifies several factors as determinants of POEM. These may be regrouped in the following categories:

a) Policy making by Directors Strategic management (strategic management)
b) Execution and implementation of policy by senior management and directors (operational management)
c) Day-to-day business activities carried out.

3.2.2. PN 6 has long has been subject to widespread criticism in South Africa mainly because it differs substantially from the approach followed by the OECD which has international appeal and is followed by Courts internationally. PN 6 also suffers from terminology inconsistency among others.

4. Changes to the DTA - Article 5 (Permanent Establishment)

4.1. Art 5(3) - Building site or construction, installation or assembly project or connected supervisory activities is now a PE only if the site, project or activity lasts for a period of 12 months (previously 9 months). **GWMS: This is a favourable change relative to the 1996 DTA.**

4.2. A new Art 5(3) - Furnishing of services through employees […] or other personnel the performance of professional services or other activities of an independent character for more than 183 days in the aggregate in a fiscal year.

5. Changes to the DTA-South African withholding tax on dividends, interest and royalties

5.1. Current DTA

5.1.1. 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.

5.1.2. 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.

5.1.3. 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. **GWMS: This is a favourable change relative to the 1996 DTA.**

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 has introduced an interest withholding tax of 15% in 2015 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 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%.

5.2. 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 in terms of Art 22(2).

6. Article 25 (Exchange of information)

6.1. Art 25 allows for more comprehensive exchange of information and a Contracting State cannot refuse to supply the information simply because the information is held by a bank, other financial institution, nominee, person acting as agent or in a fiduciary capacity.

6.2. Art 25 also provides for assistance to the respective Competent Authorities in the collection of taxes along the lines of the OECD Model Agreement.

7. Conclusion

In our view, the changes are more of a hindrance to inward businesses/investments into South Africa than to the outward ones. In our view, the amendments are thus paradoxically and definitely quite favourable for South African companies using Mauritius as a gateway for foreign investments/businesses.

For South Africa inbound investments/business however, there will not be complete protection against the South African interest and royalty withholding taxes and against CGT on the disposal of shares in a company owning South African immovable property.

The withholding tax rates on dividends, interest and royalty provided for in the new DTA are still lower than the prevailing South African withholding tax rates. Foreign investors would thus still be better off investing into South Africa via Mauritius.

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.

About us

GWMS is an experienced Management Company incorporated in Mauritius and licensed by the Financial Services Commission to provide Global Business services to businesses worldwide. One of the core competencies and activity of GWMS is the provision of a full range of Fund Administration services to offshore funds set up in Mauritius or elsewhere.

The board of GWMS comprises mainly of Chartered Accountants of calibre and experience in diverse sectors encompassing accounting, audit, management, global business, international and local taxation among others. GWMS is able to handle back office work as well. Our staff comprises a mix of fully qualified accountants, near qualified accountants, law graduates and administrative clerks.

More information is available on www.globalwealth-ms.com

International network

GWMS is the sole member for Mauritius GMN International (www.gmni.com), an association of legally independent accounting firms. Formed in the 1970s, GMNI is a well-established association of quality professional accounting firms which provide accountancy, audit, tax advisory and business consultancy services to businesses worldwide – with the same care and skill you find locally. GWMS's clients can thus benefit from cutting edge international tax advice through our GMNI linkage along with having a global reach.

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