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Mauritius Global Business Update 30

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**

We bring to you further clarificatory comments with regard to certain articles of the DTA and MOU. ***You are however, strongly recommended to seek specific advice before acting on any information contained in this update.***

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1. Introduction

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

2. Changes to the DTA - Article 4 of the DTA - The Dual Residence conundrum

2.1. Article 4 of the DTA now contains a tie-breaker test by way of a mutual agreement procedure ("MAP") known as the "Competent Authority Procedure" 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. 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").

2.2.1. The factors that MRA and SARS have mutually agreed to consider as per the MoU 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.

2.3. With reference to bullet point c) above which deals with day-to-day management, we draw attention to the fact that the draft Interpretation Note 6 (IN 6) with respect to POEM recently issued by SARS states that:

i. Operational management generally concerns the oversight of the day-to-day business operations and activities of a company; and

ii. Operational management decisions are generally of limited relevance in determining a company's POEM and must be distinguished from the key management and commercial decisions.

2.3.1. IN6 states that a company's POEM is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD's commentary on the term "place of effective management".

2.3.2. We submit therefore that given that day-to-day management is no longer considered a POEM determining criteria by SARS, non compliance with bullet point 2.2.1 c) would not be fatal to a company's POEM determination, provided that the key management and commercial decisions are taken in Mauritius.

2.4. In our opinion, three issues are material in relation to the MoU, namely:

2.4.1. Does the MoU have any force of law?

2.4.2. Whether ALL the factors listed in the MoU should be complied with to determine POEM? and

2.4.3. Whether compliance with the factors is sufficient to prove POEM in either of the Contracting States i.e Mauritius or South Africa?

2.4.1 **Does the MoU have any force of law?**

a) While it is a fact that the MoU does not have the same force of law as a Protocol or a full fledged tax treaty which are binding on both Contracting States party thereto, the mere fact that the MoU has been signed by the two Competent Authorities in question does carry persuasive weight that they intend, in good faith, to honor the MOU;

b) However, the extent of the force of law held by the MoU can only be determined by a Court of law.

2.4.2 **Whether ALL the factors listed in the MoU should be complied with to determine POEM?**

a) OECD Commentary on the Model Tax Convention (MTC) on which the SA - MRU DTA is based is the best source of guidance on the practical application of the articles of the MTC. OECD Commentary 24 explains that "All relevant facts and circumstances must be examined to determine the place of effective management."

b) OECD Commentary 24.1 explains that "cases of dual residence of persons who are not individuals are relatively rare and should be dealt with on a case-by-case basis" and further explains that Competent authorities having to apply such a provision to determine the residence of a legal person for purposes of the Convention would be expected to take account of various factors (GWMS: such as the factors listed in the MoU).

c) In our opinion, to be on the safe side, a tax payer should strive to meet as many conditions of the MoU as possible and relevant to its activities. However, the MAP is not a tick the box procedure and circumstances of each case are relevant. Nevertheless, non compliance with conditions which may not be entirely relevant to a taxpayer's circumstances may not necessarily be fatal. For example, a passive holding company cannot be expected to meet both the headquarter and the place where CEO carries his activities conditions because such companies are usually SPVs and their activities do not warrant them having headquarters and senior officers like CEOs.

d) A taxpayer should realistically take cognisance of the fact that MAP is more likely to be initiated by the South African Competent Authority than the Mauritius one. It is therefore advisable that POEM as contemplated in IN6 be also complied with, as much as possible and where relevant.

2.4.3 **Whether compliance with the factors is sufficient to prove POEM in either of the Contracting States i.e Mauritius or South Africa?**

a) The preamble to the MoU states that the Competent Authorities of Mauritius and South Africa have "reached the following understanding in relation to the factors to be considered when endeavouring to settle the question of dual residence."

b) A taxpayer is therefore legitimately entitled to rely on such official and public understanding in relation to the MoU factors, in good faith, to settle a question of dual residence i.e to ensure that POEM does in fact exist in one of the two States.

I. This legitimate entitlement has a basis in law and arises from the centuries old "doctrine of legitimate expectation" which originates from English law and is now part of international customary law through wide usage;

II. The doctrine is based on the principles of natural justice and fairness and seeks to prevent authorities from abusing power. Courts apply the doctrine on grounds of judicial review and apply the ethics of fairness and reasonableness to the situation where a person has an expectation or interest in a public body retaining a longstanding practice or keeping a promise.

c) Accordingly, if the factors of the MoU are complied with, a taxpayer is entitled to expect that the Competent Authority of either country will not act against him.

d) The doctrine of legitimate expectation however applies to the MoU factors only to the extent that they are not contrary to international law. Some of the factors stated in the MoU may not be regarded as being widely accepted international law in relation to POEM, such as the day-to-day management factor which used to be a South Africa specific POEM factor and the place where accounting records are kept which is a Mauritius centric POEM factor.

e) Despite the apparent contradiction between some of the MoU factors and internationally accepted POEM factors, it is submitted that a taxpayer who complies with international law relating to POEM (instead of any of the MoU factors that may not have international acceptance) should be successful in avoiding a dual residence problem.

f) It is recognised by OECD (and IN6 as well) that a company may have more than one place of management but it can only have one POEM at any one time. The location where those key management and commercial decisions are primarily or predominantly made will determine the POEM. Accordingly, the fact that certain minor day-to-day management may sporadically occur in South Africa need not necessarily be fatal to the taxpayer.

g) It is very likely that a dual residency challenge is most likely to come from SARS rather than from the Mauritius Competent Authority. We recommend that in case a taxpayer is unsure that his POEM is in Mauritius, then it is advisable that he obtains a legal opinion that his company's POEM is not in South Africa at an early stage instead of engaging in a MAP which can be a very time consuming, costly and tortuous procedure. GWMS is able to refer to you to appropriate advisors with specialist POEM expertise.

2.5. The MAP

2.5.1. It should be noted that SARS is not entitled to raise an assessment at will. It is required to undergo a formal inquiry procedure in a first instance. The procedure to be followed by SARS is codified in the Tax Administration Act 2011 ("TAA");

2.5.2. As soon as a taxpayer is notified that SARS is inquiring into raising an assessment under a MAP, we recommend that the taxpayer should adopt a resolutely proactive stance and his strategy should be aimed at obtaining and remaining in control of the audit /assessment procedure. This means, through an expert legal advisor, reminding SARS of the taxpayer's rights which include the right to request SARS to provide him the grounds on which SARS is raising an assessment. It is preferable that this step be followed as soon as the taxpayer is informed of the raising of the assessment to attempt a resolution before the matter reaches the Courts.

2.5.3. Under S 42 of TAA, the taxpayer is entitled to request SARS to provide him with a report indicating the stage of completion of the inquiry. In practice, a letter of findings is issued by SARS;

2.5.4. Following a review of the letter of findings, the taxpayer may argue that the findings are not accurate and initiate an emergency complaint procedure which is filed with the Tax Ombud in South Africa, as provided by the TAA or apply to a South African High Court prior to the issue of the assessment;

a) The Tax Ombud is expected to provide taxpayers with a cost-effective mechanism to address administrative difficulties, which operate in addition to the existing mechanisms to do so.

b) The Tax Ombud has a duty to review and address a complaint laid by a taxpayer and resolve a dispute using informal, fair and cost effective measures. This method of resolution is intended to be a simple and affordable remedy to taxpayers who have legitimate complaints that relate to administrative matters, poor service or the failure by SARS to observe taxpayer rights.

2.5.5. The taxpayer may thus avail of judicial procedures to withhold payment of taxes until a court decision is not obtained.

2.5.6. It is strongly recommended for taxpayers to be proactive and assume control of an inquiry to better protect his rights. This can be achieved by entering, from the beginning of an audit, into a letter of engagement with SARS which clearly states SARS responsibilities under the South African Constitution, TAA and other relevant laws.

a) Failure to do so is very likely to place the taxpayer in a very disadvantageous situation.

3. Changes to the DTA - Article 14 (Independent Personal Services)

3.1. Art 14 has been removed completely from the DTA. This is in line with OECD Model Tax Convention which did away with Art 14 in its model treaties since 2000.

3.2. This Article concerns mainly professionals such as accountants, lawyers, architects, physicians etc who often travels to either Mauritius or South Africa to perform professional services.

3.3. The old Art 14 enabled the income of such professionals generated in the other state to be taxed only in their state of residence unless they have a fixed base in the state where the services are provided.

3.4. Such cross border income now falls under Art 5 (PE) and if there is a PE, the taxing rights of such income is settled by Art 7 (business profits).

3.5. Professionals resident in either Mauritius or South Africa who often travel between the two countries to provide their professional services generally avail themselves of an arrangement with a colleague or firm in the other state which enables them to use their office for their work.

The old fixed base criteria in the now withdrawn Art14 could cause the office, in certain circumstances, to be a fixed base leading to the creation of a PE and the taxation of the income in that state.

3.6. Under the new Art 5 (3) (c), the fixed base criteria is replaced by period or periods exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

3.6.1. In our opinion, this new requirement is a more objective test which can be more readily planned around to ensure professional income is only taxed in the state of residence of the professional.

4. Changes to the DTA - Article 25 (Exchange of information (EOI))

4.1. The Mauritius Competent Authority has confirmed that they will not entertain any fishing expeditions in line with the international standards of transparency and exchange of information for tax purposes of the Global Forum on Transparency and Exchange of Information for Tax Purposes. Fishing expeditions are not authorised under these international standards.

4.2. The Mauritian Income Tax Act does not require any notification to the taxpayer that he/she is the subject of a request for information. However, in practice, when the information is not already at the disposal of the tax authorities or the Financial Services Commission, the Mauritius Competent Authority systematically sends a request for information to the person concerned, indicating that the information is sought for EOI purposes. When the person concerned is not resident in Mauritius, the information is sought from any relevant third party that may be in possession of the information.

4.3. The “Procedure Manual on Exchange of Information” of the Mauritius Competent Authority states that there is no legal requirement for prior notification of the taxpayer (section 5). The Manual further states that such notification should not be given when accessing third party information if the treaty partner requests that the taxpayer should not be informed of the request or in other cases where a notification is likely to unduly delay the exchange of information with the treaty partner.

4.4. However, where a taxpayer is aware of such EOI request, we recommend the following:

4.4.1. Determine if it is a valid request emanating from a duly appointed representative of the Competent Authority of the other Contracting State. For example, any officer of SARS merely by virtue of being a SARS officer is not entitled to issue an EOI request. ;

4.4.2. At the commencement of the procedure, It is strongly recommended that the taxpayer be proactive and assume control of the procedure to better protect his rights. This can be achieved by entering, from the beginning, into a formal letter of engagement with SARS which clearly states SARS responsibilities under the South African Constitution, TAA and the Promotion of Administrative Justice Act (PAJA). PAJA provides, in essence at section 3 (1), (2) and section 5(1) and (2) that tax administrative actions that materially and adversely affect taxpayer rights must, in the absence of exceptions provided for in PAJA, adhere to certain fairness requirements.

4.4.3. The letter of engagement is a request for SARS to explain the scope, extent and purpose of the EOI request including its basis, the setting up of parameters upfront, to request confidentiality of any information provided and to ascertain that the EOI request is not vague such that the language of the EOI request should enable the taxpayer to ascertain clearly the purpose of such request.

4.4.4. The letter of engagement should also contain a request to SARS to confirm whether they have exhausted all channels of obtaining the information they require in South Africa before requesting any information from Mauritius.

5. Application of POEM factors to investment holding companies (IHC)

5.1. An analysis of the extent to which POEM factors are applicable to an IHC hinges on the activity of the IHC;

5.2. An IHC, by its very nature, is rather passive in nature. So as much substance as possible and as are typical of running such an IHC should be carried out in Mauritius. Assuming that no activity of the IHC is carried out outside of Mauritius, then one or two board meetings held in Mauritius, accounts done and kept in Mauritius, audit in Mauritius i.e the management and control factors typical of Mauritius along with the relevant MoU factors should be sufficient.

5.3. The draft Interpretation Note 6 issued recently by SARS for consultation highlights situations where POEM may hinge on the behaviour of shareholder (s) of a holding company which may shift POEM to the location of the shareholders. The following are highlighted:

5.3.1. where a shareholder may effectively usurp the powers of the directors of the IHC;

5.3.2. where there are multiple shareholders and those shareholders are either connected persons in relation to each other or are acting in concert to influence the board actions of the IHC;

5.3.3. Note that if the board considers what the shareholder has recommended and independently makes its own decision, this would not constitute usurpation even if the decision made by the board is in line with the shareholder's recommendation.

6. Property rich companies

6.1. 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.

6.2. In our opinion, where the shares of a Mauritius company holding a property rich South African company is sold to a non South African buyer, there should be no South Africa capital gains tax consequence.

7. Conclusion

As stated in IN6, SARS takes the view that POEM must be supported by the facts. A company bears the onus of proof on the issue of POEM and should retain the necessary evidence to support the view taken. GWMS cannot but strongly emphasise that as much substance as possible must be built in the Mauritius operations of a Mauritius company.

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

Regarding the changes, other than Art 4, in the DTA, our opinion remains unchanged that the revised DTA is more friendly towards South Africans setting up base in Mauritius.

With the revised DTA, Mauritius GBL1 entities that are structured properly and that have their POEM in Mauritius are bound to gather more sail!

While zero taxation is indeed part of a bygone era, the DTA changes are still quite favourable and in certain cases are even better than the old DTA.

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About us

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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.

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