THE NEW DOUBLE TAX AGREEMENT BETWEEN SOUTH AFRICA AND MAURITIUS – WHAT IS THE EFFECT ON BUSINESS?

(by Aneria Bouwer, a director in the Bowman Gilfillan tax team)

The news[1] of the revised double tax agreement between South Africa and Mauritius ("the new DTA") on Monday, 27 May, rang alarm bells for both Mauritian companies investing into South Africa as well as for South African companies expanding offshore via Mauritius.

What are these changes and how will they impact on the use of Mauritian companies for investment by non-residents into South Africa, or for foreign investment by South Africans?

The main changes to the DTA relate to dual residence for persons other than individuals, withholding taxes (interest, dividends and royalties) and capital gains.

Dual residence for persons other than individuals

In terms of the current (1996) DTA, where a person other than an individual (e.g. a company) is tax resident in both Mauritius and South Africa, the person will be deemed to be a resident of the state in which its place of effective management is situated. A South African incorporated company which is effectively managed in Mauritius, would thus in terms of the current tiebreaker, deemed to be tax resident in Mauritius and not in South Africa. South Africa would therefore lose its "taxing rights" which apparently does not sit well with SARS.

The new dual-residence tie-breaker does not refer to effective management, but provides that the competent authorities of the two states must *"by mutual agreement endeavour to settle the question"* and determine how the DTA will apply to such person.

This is a very unusual tiebreaker and will create substantial uncertainty for companies faced with the dual-residence conundrum. They would have to rely on the tax authorities in the two countries to not only reach agreement on this issue, but to do so in an expeditious manner to avoid leaving the taxpayer dangling in mid-air. Should the two authorities not be able to reach agreement, the taxpayer will not be entitled to rely on the DTA.

As a result, at least one article on the new DTA warned taxpayers to be "wary of" Mauritian structures. However, this specific issue only arises in the context of dual resident taxpayers other than individuals. A Mauritian incorporated company which is effectively managed in Mauritius will thus not be subject to the new dual residence-tiebreaker and the same applies to a South African incorporated company which is effectively managed in South Africa.

Nothing has thus really changed for most Mauritian incorporated companies – they should (as is also currently the case) take care to ensure that they will indeed be effectively managed in Mauritius.

[1] The new DTA is not yet available on the South African Revenue Service (SARS) website, as it has not yet been ratified and published in a Government Gazette. However, the new DTA is already available in other parts of the world. It is anticipated that, if duly ratified during 2014, the new DTA will come into effect on 1 January 2015.

Withholding taxes

Interest: The current DTA provides for the country of residence of the recipient of interest to have the taxing rights if such recipient is the beneficial owner of the interest. A Mauritian lender would thus not be subject to the new South African withholding tax on interest (once it comes into effect) if the Mauritian lender is the beneficial owner of the interest. However, the new DTA does not provide for an exemption but instead caps the tax on interest which may be imposed by the source country, to 10% of the gross amount of the interest.

In the above example, South Africa will be entitled to impose a 10% withholding tax on interest paid to the Mauritian lender. Any loans from a Mauritian lender would thus need to be reconsidered to determine the impact of the South African withholding tax on interest.

Mauritius does not currently impose a withholding tax on interest paid by so-called GBL1 or GBL2 companies. South African lenders to Mauritian borrowers would thus as a general rule not be negatively affected by the amendment of the interest article, while Mauritian lenders to South African borrowers would on the other hand be prejudiced.

Dividends: The amendment of the article dealing with dividends constitutes one tiny little silver lining: In terms of the current DTA, the South African withholding tax on dividends will be reduced to 5% if the beneficial owner is a Mauritian company which holds at least 10% of the capital of the company paying the dividends, while in all other instances, the dividends tax may not exceed 15%. The fall-back position has now been amended to reduce the maximum dividends tax rate to 10%.

Royalties: The current exemption from royalties withholding tax has been replaced with a 5% maximum rate.

Capital gains

The current DTA provides protection against South African capital gains tax ("CGT") for a Mauritian company owning shares in a South African company holding immovable property. However, the capital gains article of the new DTA now specifically provides that a country may tax gains derived from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in such country.

Is this the end of the road for Mauritian holding companies?

There is no doubt that the new DTA will put Mauritian companies in a less beneficial position vis-à-vis South Africa as is currently the case. This is so specifically in the context of dual-resident companies, loans to South African borrowers and investment in companies owning immovable property in South Africa. However, this does not necessarily mean that the use of Mauritian companies is no longer beneficial in international structures.

Ironically, the amendments are not that negative for South African companies using Mauritius as a gateway for foreign investments. It does however make Mauritius less attractive as a portal for investment into South Africa, as it will no longer provide 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.

Does this mean that foreigners would be better off investing directly into South Africa? No, not necessarily – the withholding tax rates provided for in the new DTA are still lower than the normal South African withholding tax rates. Of course, a headquarter company enjoys exemptions from these withholding taxes, but a headquarter company cannot be used for investment into South Africa. Foreign investors would thus still be better off investing into South Africa via Mauritius, or they could look for another suitable jurisdiction to act as holding company jurisdiction for investment into Africa, including South Africa.

Bowman Gilfillan has offices in South Africa, Tanzania, Uganda and Kenya.