SA's double tax agreement with Mauritius amended

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12 Aug 2013

The double tax agreement between Mauritius and South Africa, which came into force in 1997 has been renegotiated. There are three main amendments to the 1997 double tax agreement: the resident article has been amended, the allocation of taxing rights in relation to immovable property assets has been renegotiated, and the interest article has been amended.

In terms of the 1997 double tax agreement, it is necessary to determine whether a company is resident in Mauritius or South Africa.

Where a company is considered to be both a resident of Mauritius, in terms of Mauritian domestic tax law and a resident of South Africa, in terms of South African domestic tax law, it is necessary to have reference to the tie-breaker test set out in Article 4(3) of the 1997 double tax agreement.

This tie-breaker provision states that where a company is a resident of both countries it shall be deemed to be a resident of the state in which its place of effective management is situated.

Tie-breaker

In this regard, there has been some suggestion that, in applying this tie-breaker test, it is necessary to make reference to the OECD Commentary. In terms of the OECD Commentary, the true decision-makers of a company must be identified. They may or may not be members of the board of directors and the place where such person(s) make the key management decisions (as opposed to the place where decisions are merely formally resolved) should constitute the place of effective management of the company.

However, it is not clear that, in applying the tie-breaker test, the OECD Commentary would be followed. Instead, South Africa could arguably apply its domestic tax law in determining whether a company has its "place of effective management" in South Africa or Mauritius.

In this regard, SARS's interpretation of "place of effective management" emphasises the place where important decisions are implemented, as well as the place where certain day-to-day management functions are carried out. It also looks at the place where decisions are taken which relate to the development or formulation of key operational or commercial strategies and policies, and where implementation of these strategies and policies takes place.

If, after applying the tie-breaker test, it is still not clear whether a company is "effectively managed" in South Africa or Mauritius, the parties may then resort to the mutual-agreement procedure set out in the 1997 double tax agreement.

Renegotiated double tax agreement

Article 4 of the renegotiated double tax agreement states that "a company will constitute a resident of a contracting state if it is liable for tax by reason of its domicile, residence, place of management or any other criterion of a similar nature"

This means that, as in the case of the 1997 double tax agreement, both South Africa and Mauritius must determine whether a company is resident of Mauritius or South Africa by applying their respective domestic tax law concepts.

In respect of a Mauritian incorporated company, Mauritius will apply its place of incorporation or central management and control test in order to determine whether that entity is tax-resident in Mauritius as a matter of Mauritian domestic tax law.

South Africa will apply its concept of "effective management" in determining whether, as a matter of South African domestic tax law, the company is tax-resident in South Africa.

Article 4 of the renegotiated double tax agreement, however, does not have a tie-breaker test. Instead, in cases of dual residence in respect of a company, the competent authorities of Mauritius and South Africa must, by mutual agreement, settle this issue and determine in which jurisdiction the company is resident.

This replicates the position under the 1997 double tax agreement on the basis that, when applying the tie-breaker test set out in the 1997 double tax agreement, South Africa may apply its domestic law concept of place of effective management.

It therefore seems that the absence of a tie-breaker test in the renegotiated double tax agreement may not make a significant difference in the determination of the tax residence of a company.

In respect of both the 1997 double tax agreement and the renegotiated double tax agreement, it should be ensured that the "effective management" of a company (as understood under South African tax law) is not based in South Africa.

Immovable property

Article 13 of the renegotiated double tax agreement, which deals with capital gains, has inserted a provision that states: "Gains derived by a resident of a contracting state from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other contracting state may be taxed in that other state."

Where a Mauritian company holds shares in a South African company and the South African company holds immovable property, a sale of the shares in the South African company by the Mauritian company may be taxed in South Africa.

However, a double tax agreement may not impose additional tax liabilities to those which exist under domestic tax law. Therefore, the capital gain will be taxable only if it falls within the provisions of paragraph 2 of the Eighth Schedule to the Income Tax Act. Paragraph 2 states that "immovable property situated in South Africa held by a non-resident, or any interest or right of whatever nature of that person to or in immovable property situated in South Africa, is subject to capital gains tax"

An interest in immovable property includes ordinary shares held by a person in a company if 80% or more of the market value of those shares is attributable to immovable property, and in the case of a company, it holds at least 20% of the ordinary shares in that entity.

In terms of the interest withholding tax, Article 11 of the renegotiated double tax agreement provides South Africa with the right to tax interest arising in South Africa and paid to a beneficial owner in Mauritius at a rate of 10% of the gross amount of such interest. The 1997 double tax agreement did not allow South Africa any taxing rights in these circumstances.

The renegotiated double tax agreement is, therefore, preparing for the introduction of interest withholding tax, which will be levied at the rate of 15% on cross-border interest flows.

Source: The Times via I-Net Bridge

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