The new South Africa-Mauritius DTA or the battle for the gateway to Africa

Now that the new DTA between South Africa and Mauritius has been ratified by both states and the MOU regarding the much discussed element of dual residency signed, the stage is set for a match between the two jurisdictions as to which will come out as the preferred source of African FDI. Both countries boast a vast number of worldwide DTAs and both figure prominently in international standings as platforms for conducting African business.

Mauritius has demonstrated as is the case with India, its capability in terms of providing a secure, stable and well-regulated jurisdiction where it is competing with the likes of Singapore for the top spot in terms of FDI source. The rise of Africa has come at a time when Mauritius has been seeking to diversify its service offering. With its geographical and cultural proximity with the continent and the added benefit of the Indian experience, it has naturally set itself up as one of the preferred domiciles for African capital.

On the South African side, recommendations of the Katz Commission in 1997 saw the formation of headquarter companies (HQC) located in South Africa. It was argued that this would be advantageous to its economy by encouraging local investors to expand outside its borders and encouraging foreign investors to expand into Africa via South Africa. Several tax proposals regarding HQCS were introduced into the South African tax system and came into effect in 2011. The outcome was a regime free of controlled foreign company and thin capitalisation rules as well as exchange controls and withholding taxes which the South African authorities hoped would provide an alternative to the Mauritian GBL1 company.

In the midst of all this is the Double Taxation Agreement ('DTA') issue between the two countries. The 1996 DTA ('Current Treaty'), effective up to 31 December 2015 has seen Mauritius come out as preferred platform for South African multinationals to aid their regional expansion. To a lesser extent, Mauritius has also been used as conduit for South African inbound FDI.

Under the Current Treaty, a Mauritian tax resident company holding shares in a South African subsidiary will not be subject to capital gains tax on the disposal of such shares, despite the fact that the South African subsidiary holds immovable property and the sale of the shares indirectly constitutes a sale of that immovable property. Under the New Treaty, Mauritian companies holding shares in South African subsidiaries, the shares of which derive more than 50% of their value from immovable property, may now be taxed in South Africa on the gains arising from a disposal of those shares.

A further important change is the provision for withholding tax on interest and royalties. Under the Current Treaty, interest and royalties paid by South African subsidiaries to their Mauritian holding company would only be subject to tax in Mauritius, provided that the Mauritian company is the beneficial owner. The New Treaty makes provision for South Africa to withhold tax on interest and royalty payments made by South African subsidiaries to a Mauritian holding company. However, tax on interest will be limited to 10% and tax on royalties to 5%.

In respect of dividends, the Current Treaty provides that South Africa can only tax dividends at a

maximum rate of 5% where the Mauritian company holds at least 10% of the shares in the South African subsidiary. In all other cases the maximum rate is 15%. The New Treaty also provides for a maximum rate of 5% where the Mauritian company holds at least 10% of the shares in the South African subsidiary, but the maximum rate for all other cases has been reduced to 10%.

More importantly, the Current Treaty provides that where a company is a tax resident of both Mauritius and South Africa in terms of each country's domestic law, that company will for purposes of the treaty be regarded as only being resident in the country in which that company has its place of effective management.

The New Treaty, signed in May 2013 and effective 1 January 2016, provides that where a company is a resident of both states, "the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and determine the mode of application of the Agreement to such person". It further also provides that in 'the absence of such agreement such person shall be considered to be outside the scope of the Agreement'.

The problem that arises is that a Mauritian incorporated company could find itself no longer tax resident of Mauritius, for treaty purposes, but a tax resident of South Africa, should Mauritius and South Africa agree on it. If no agreement be reached between Mauritius and South Africa, the treaty will simply not apply, and the company, as a dual resident, will be subject to tax in both South Africa and Mauritius.

Until May 2015 was a lack of clarity as to what principles would be applied by the SARS and MRA in coming to such an agreement. The term 'place of effective management' is not defined in the South African tax code and must be ascribed its ordinary meaning, taking into account international precedence and interpretation with SARS emphasizing that 'it does not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it.

It concludes that a company's place of effective management 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 which is consistent with the OECD's commentary on the term.

While 'a company may have more than one place of management, it can only have one place of effective management at any one time,' it adds. 'There are normally multiple facts that need to be taken into account, often involving multiple locations, and from those facts and locations it is therefore necessary to determine a single dominant place where effective management is located.'

It transpired that the lack of definitive rules in determining the place of effective management could shed a lot of uncertainty over the applicability of the New Treaty. This led the competent authorities to enter into a Memorandum of Understanding ('MOU') which spells out the determining factors in reaching their decision. These factors include the place where the entity's board meetings are held, where the chief executive officer and other senior executives usually carry on their activities, where the entity's headquarters are located and any such other factors that may be identified and agreed upon by the Competent Authorities.

The Mauritius GBL1 has since its establishment been required under Mauritian law to inter-alia have at least 2 directors from Mauritius who should be present at all board meetings and to maintain its records in Mauritius. Effective 1 January 2015, additional substance requirements have been imposed on the GBL1 which is now required to either have an office and employ staff on a full-time basis or resolve disputes arising out of the constitution by way of arbitration in Mauritius or have a yearly expenditure which can be reasonably expected from any similar corporation which is controlled and managed from Mauritius among other criteria. Over time, the GBL1 has been aligning its substance requirements with internationally acceptable standards and principles.

Ahead of the MOU, some industry players had already taken steps to ensure that the GBL1 goes beyond its statutory requirements of ensuring that ‘management and control’ is exercised in Mauritius to having its ‘place of effective management’ located in the island jurisdiction, a move which is seen to complete the vehicle’s evolutive process. From a Mauritian financial centre perspective the GBL1’s evolution happens to be in line with the new international taxation landscape taking shape after the OECD BEPS report.

The clarity brought about by the MOU has come as a relief for the South African investment community which has been actively using Mauritius as a platform to support its regional expansion across Africa. Going forward, we can only see the growing trend of South African multinationals electing domicile in Mauritius to accelerate and it very much seems to be growing business as usual for Mauritius.

Bio of author

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