Since the release of the renegotiated Double Taxation Agreement (DTA) between South Africa and Mauritius, there has been speculation as to whether Mauritius will still be a viable investor’s destination into South Africa and Africa.

The new DTA was signed on 17 May 2013 and will come into force in January 2015. The most significant changes in the new DTA concern the treatment of dual residency as well as the withholding tax rates on dividends, interest and royalties. Changes have also been made to the capital gains Article and the exchange of information provisions.

Uncertainty around tax residency
The change which has received the most attention is the tie-breaker clause which sets out the test to be applied to determine which jurisdiction will have sole taxing rights over a company which is tax resident in both jurisdictions (i.e. dual residency). The revised DTA provides that in the case of the dual residency of a company, its tax residence will be decided by the two contracting states. If an agreement cannot be reached, the entity will not be entitled to benefits under the treaty. Under the current DTA, the tie-breaker clause provides that a company will be treated as being tax resident solely where it has its place of effective management.

The general consensus is that the move away from the place of effective management test will create uncertainty, especially where a conclusive agreement cannot be reached by the two states. At this stage the South African Revenue Services (SARS) has provided no further indication of the parameters to be applied in resolving the issue of dual residency.
Clearly, the South African test of tax residency will still depend on where the entity has its place of effective management. Currently, in terms of Interpretation Note 6 issued by SARS in 2002, SARS states that a company's place of effective management is the place where the day-to-day operational decisions of the business are made. SARS contends that the place of effective management differs from the place of shareholder control or control by the board of directors.

A discussion paper was issued by SARS in 2011 which indicates their interpretation of the term will now be more in line with the OECD’s recommended approach. It seems, therefore, that SARS will in the future be focusing more on where the actual decision-making takes place and where the senior executives who are responsible for operational strategies and policies are located.

The senior executives will include those who:
- Develop or formulate key operational and commercial strategies and policies regardless of where these policies are formally approved; and
- Ensure that these strategies and policies are carried out.

In contrast, the Mauritius Revenue Authorities (MUR) has confirmed the place of incorporation or central management and control will continue to be used for purposes of determining tax residency. This is an easier test to meet. Accordingly, it is clear that the parameters used by SARS and the MUR for testing effective management will differ substantially. It is, therefore, not inconceivable that a disagreement could arise between the two contracting states.

Should this happen, the entity will not be entitled to rely on the DTA at all. One impact would be that withholding taxes payable on dividends, interest and royalties remitted from South Africa would not be reduced under the DTA.

SARS has stated that the change made to the tie-breaker clause on dual residency in the new DTA is in line with the standard test provided for in the OECD Model Convention. The OECD Model Convention provides for dual residency to be resolved by way of effective management or by a ‘mutual agreement’ procedure. In relation to the mutual agreement procedure, paragraph 24.1 of the commentary to article 4(3) of the OECD model convention reads as follows:

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

There are clear differences between the recommended wording as set out above to that used in the new DTA. The first sentence in Article 4(3) of the new DTA does not mention any factors that should be taken into account by the contracting states when determining the residency. Furthermore, the Article states that the competent authorities will decide the mode of the application of the DTA to the entity. It may, therefore, be difficult for the taxpayer to challenge the decision and it is not clear how this can be done.

A concern was also raised that the dual residency Article could result in double taxation. However, the rebate of foreign taxes as set out in the South African and Mauritius Income Tax Acts should provide relief subject to the various requirements being met.

Going forward, significant substance should be added to Mauritius structures so that there is no doubt as to the place of effective management of these entities. Agreements which outsource core activities to South African persons (related or unrelated) should be avoided. The outsourcing of significant back office functions to South Africa should also be revisited. Strategic policies for the Mauritian entities and offshore groups should be developed outside South Africa and preferably in Mauritius. It will not be sufficient to merely implement the strategies and policies by way of Board meetings and resolutions in Mauritius. In addition to this, the authority and skill level of the Mauritian employees should be revisited to ensure they are the driving force of the policies for the Mauritian operations.

Having said this, the place of effective management is already a significant exposure in terms of the current DTA. SARS is actively challenging Mauritian entities with ties to South Africa and adopting a restrictive interpretation regarding issues such as outsourcing of obligations and activities back to South Africa.

The new provisions, therefore, do not impose any additional risk in this regard. However, the uncertainty around what factors will be used in determining the place of effective management, and how the decision may be challenged, is certainly new.

In summary, therefore, as long as adequate substance is added to the operations in Mauritius, Mauritius will still remain a useful holding company jurisdiction for investment into South Africa and Africa, despite the provisions of the new DTA.
Funding considerations
Another factor which should be borne in mind is that the new DTA has increased the withholding tax rate on interest from 0% to 10%.

As the domestic tax regime of Mauritius does not provide for withholding taxes, the increased rate would only be an issue in respect of interest flows from South Africa to Mauritius. The new DTA will, therefore, have an adverse effect on funding structures from Mauritius into South Africa. As the effective date of the DTA will be January 2015 - which coincides with the proposed introduction of the South African withholding tax of 15% on interest - there is still time to restructure the funding arrangements depending on commerciality requirements. Until then there should be no withholding tax on interest payments from South Africa. Funding structures into Africa remain viable depending on the withholding tax rates in a particular jurisdiction and whether these are reduced under a DTA.

Capital gains on immovable property implications
Mauritius has been an established investment route into property-rich structures, including mining operations, in South Africa. The change to the capital gains Article in the new DTA will effectively put an end to the benefits derived from these investment structures.

In terms of the South African Income Tax Act, non-residents will only be subject to capital gains tax (CGT) if the non-resident disposes of an asset attributable to a permanent establishment in South Africa or sells immovable property situated in South Africa or an interest in immovable property. Immovable property includes land as well as mining and prospecting rights. An ‘interest in immovable property’ is defined to include a direct or indirect interest of at least 20% held by a person (together with a connected person in relation to that person) in the equity share capital of a company, where 80% or more of market value of the company at the time of disposal is attributable directly or indirectly to immovable property situated in South Africa.

Currently, the existing DTA provides relief from South African CGT on the sale of shares by a Mauritian entity in an immovable property company situated in South Africa. In terms of the new DTA, the CGT exemption will no longer be available where more than 50% of the shares derive their value directly or indirectly from immovable property. This will clearly impact on those structures that have used Mauritius as a holding company jurisdiction for the investment into property-rich entities in South Africa.

Other changes
The dividends tax of 15% will be reduced to 10% where less than 10% of the capital in the company declaring the dividend is held. The dividends tax remains at 5% where at least 10% of the capital of the company paying the dividend is held. Royalty withholding tax which is currently 0% under the DTA will be increased to 5%.

In order to benefit under the existing and the new DTA, it is necessary that the recipient of the dividend, interest and royalty income is the beneficial owner of the income stream. This is an important consideration and should be investigated, particularly in respect of Mauritius structures which have limited substance and back-to-back arrangements with other group entities. Factors to prove beneficial ownership include, for example, the taking on of risks (such as contractual, credit and forex risks) as well as the ability to deal with the income without any contractual obligation to remit the income or pay it to another entity. This will soon become a focus area of SARS once the withholding tax regime is fully operational.

The new DTA contains exchange of information provisions, which grant SARS the right to request information regardless of whether the other contracting state has any interest in such information. SARS will, however, still have to request information in accordance with the agreed procedures such as lodging specific requests with the competent authority in Mauritius.

In conclusion, Mauritius remains a viable investment structure both into South Africa and Africa. However, the cost of establishing the requisite substance to ensure effective management is in Mauritius will have to be weighed against the benefits derived under the DTA. Mauritian funding structures and the investment into property-rich companies will, however, no longer be beneficial and should be reconsidered before the introduction of the new DTA.