A COMPARATIVE ANALYSIS OF THE TAXATION OF DIVIDENDS BETWEEN SOUTH AFRICA AND MAURITIUS

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ABSTRACT:

The aim of this dissertation was to determine whether there was any benefit to shareholders (corporate or individuals) in utilising offshore structures in Mauritius to minimise their ultimate dividends tax liability. Due to multiple factors, including the lack of prolific secondary sources in Mauritius, the dissertation was written, for the most part, from a South African perspective. In undertaking this study, a comprehensive review of dividends tax was undertaken (excluding dividends in specie and dividends from listed companies) under South African law, Mauritian law and the tax treaty that is effective between the two jurisdictions. A brief analysis of the Agreement between the Government of the Republic of South Africa and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, which is set to become effective on 1 January 2016 was also undertaken. In each chapter, a review was performed, analysis was made and practical examples were given in order to give the reader a better understanding of the practical application of the analysis. Comparisons were made using different commonly used entities such as companies (including Global Business License 1 and 2 companies) trusts, foreign trusts and also individuals. The dissertation provided examples of each of these types of entities in order to show the effectiveness of utilising Mauritius' low tax rates and generous provisions in the tax treaty between South Africa and Mauritius. The study revealed that, without making any comments on the cost of setting up offshore structures, offshore structures could in certain circumstances, if properly structured, substantially reduce a shareholders dividends tax liability. The study did however also reveal that such structures would have to be legitimate foreign business enterprises to avoid the complex anti-avoidance provisions provided in the South African Income Tax Act No 58 of 1962 such as the controlled foreign company provisions which, in certain circumstances, attribute the net income of the offshore company to the shareholder(s). The dissertation described certain important principles which would need to be complied with by the shareholder and the foreign entity concerned, in order to avoid the pitfalls associated with such structures, including the very important place of effective management tests. The dissertation therefore had a positive result and could benefit any high net worth individual or company seeking to minimise its dividends tax burden.

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1 CHAPTER 1 – INTRODUCTION

1.1 Introduction

From high net worth individuals to local and foreign companies, taxpayers will always be looking for ways to minimise their tax burden.[1] In order to achieve this tax practitioners have devised complex tax efficient structures with the end result being that the taxpayer pays less tax.

The strategies used by tax practitioners include the use of various types of legal entities which are taxed at different rates, to employing a group structure which has both local and off-shore entities and which take advantage of the tax laws and treaties of different jurisdictions, to a mix of the two strategies. Many high net worth individuals and other legal entities choose to utilise the tax laws of Mauritius in order to minimise their tax burdens.

Tax practitioners need to determine the best structure for the taxpayer's specific requirements in order to ensure any distribution from one entity to another, and to the ultimate shareholder, is subject to the least amount of tax. It is therefore important to know how dividends are taxed in the hands of different entities, and how different jurisdictions regulate the levying of such taxes, to ensure this aim is achieved.

Distributions are, for tax purposes, made by way of dividends and are useful in that they can be used to shift assets between entities (through a dividend in specie), or can be used to distribute profits to shareholders. Dividends are unique to companies[2] and are used widely as a method of distribution of assets and profits.

Due to the usefulness of dividends this dissertation will explore the taxation of dividends in the hands of different entities. Given the high prevalence of high net worth individuals seeking tax relief in Mauritius this exploration will cover the tax treatment of dividends in South Africa and Mauritius. The analysis of the Double Taxation Agreement between South Africa and

[1] I Wilson 'Techniques in international tax planning' (2004) 18 Tax Planning Corporate and Personal 1.
[2] Income Tax Act No. 58 of 1962, section 1.

Mauritius[3] (DTA) will focus on how dividends are treated in terms of the DTA. Finally, a comparison will be made of the tax treatment of dividends in the hands of the different entities in South Africa, Mauritius and in terms of the DTA in order to determine the efficacy of the utilisation of certain corporate structures between the two jurisdictions.

This dissertation will therefore use sources such as tax planning journals, guides issued by SARS on Dividends Tax,[4] the Income Tax Act No. 58 of 1962 (ITA)(for the taxation of dividends in South Africa) case law (where applicable), the Income Tax Act 1995 for Mauritius (MITA) and the DTA.

1.2 Statement of Purpose

The purpose of this dissertation will be to provide a synopsis of the way in which dividends are taxed in the hands of different entities in South Africa, Mauritius and through the DTA and to compare the differences between them in order to determine the efficacy of the utilisation of certain corporate structures between the two jurisdictions.

1.3 Rationale

In practice there are many high net worth individuals and corporates that organise their tax affairs in order to minimise the taxation of the distribution of profits and assets of their businesses. This can include elaborate structures[5] which utilise cross-border or international structures or merely taking advantage of certain types of entities which enjoy different rates of taxation than other entities, such as trusts versus companies.

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[3] The Agreement between the Government of the Republic of South Africa and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.

[4] South Africa Revenue Service 'Comprehensive Guide to Dividends Tax' 23 February 2015 available at http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G19%20-%20Comprehensive%20Guide%20to%20Dividends%20Tax%20-%20External%20Guide.pdf, last accessed on 4 November 2015.

[5] 'Nando's using secretive tax have trust to avoid inheritance tax bills' The Guardian 10 July 2014, available at http://www.theguardian.com/business/2014/jul/10/nandos-using-secretive-tax-haven-trust-avoid-inheritance-tax-bills, accessed on 4 November 2015.

There are many countries which are considered tax havens,[6] however many opt to take advantage of the tax laws in Mauritius and as such, this dissertation will consolidate information in order to aid tax practitioners in planning a more efficient tax structure with a specific focus on the taxation of dividends in different types of legal entities in and between South Africa and Mauritius. Further to this consolidation, the dissertation will determine whether there is any real benefit to employing such arrangements.

1.4 Research Questions

1. How are dividends taxed in the hands of certain entities in South Africa?
2. How are dividends taxed in the hands of certain entities in Mauritius?
3. How does the 1996 DTA effect the taxation of dividends in both South Africa and Mauritius?
4. What is the difference between the new Double Taxation Agreement entered into between South Africa and Mauritius, and the 1996 Double Taxation Agreement, if any, in relation to how dividends are taxed?
5. Are multinational structures making use of Mauritius actually effective when attempting to minimise the tax liability of different entities in relation to dividends (simply put, is it worth it)?

1.5 Methodology

This dissertation will compare the taxation of dividends in the hands of various entities in South Africa, Mauritius and in terms of the DTA. The research methodology used will therefore be a comparative approach, drawing comparisons firstly between the two jurisdictions and secondly between the two jurisdictions in the light of the DTA. The theory that will be used will be one of positivism as the dissertation will not question the correctness of the law, but merely whether

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[6] J Ware and P Roper 'The attack on the tax havens' December 2000 The Insurance and Tax Journal available at http://www.mylexisnexis.co.za/Index.aspx?permalink=RGVjZW1iZXIgMsAwMCAtIFRoZSBhdHRhY2sgb24gdGhlIHRheCBoYXZlbnMkNDc4NTA1JDckTGlicmFyeSRKRCRMaWJyYXJ5, last accessed on 20 November 2015.

having an offshore structure based in Mauritius does actually lower the dividends tax liability of various entities. The research will be conducted through an analysis of legislation, case law, journal articles, textbooks and the DTA itself.

1.6 Literature Review

1.6.1 Introduction

There are extensive writings on how dividends are taxed in South Africa. From textbooks to articles and explanatory notes, the topic is well covered. With regard to Mauritius, the topic is covered with summaries written by practitioners, however, as highlighted in chapter 3, there is a distinct lack of authoritative academic texts emanating from the Mauritian perspective. With that being said however, the popularity of Mauritius as a low tax jurisdiction for high net worth individuals and multinational corporates to minimise their tax liability, is great and as such a comparison between South Africa and Mauritius, specifically in the way each jurisdiction taxes dividends, will be a valuable exercise in determining the feasibility and efficacy of certain tax structures.

1.6.2 South Africa

The primary source for the dissertation and the legislation responsible for the taxation of dividends in the hands of different entities in South Africa is the ITA.

In the South African context there exists an extremely comprehensive guide issued by the South African Revenue Service (SARS) on dividends tax.[7] The guide starts with the introduction of the new dividends tax regime and how it replaced secondary tax on companies. It then moves further and describes the various definitions related to dividends tax. It then explains how dividends tax works, who is liable for the payment of dividends tax and provides an in-depth discussion of when it is due. A very methodical approach is taken in setting out the law, by breaking up each element of the plethora of relevant sections of the ITA and describing in detail how SARS, based on case law and other methods of interpretation, interprets the various

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[7] SARS 'Comprehensive Guide to Dividends Tax' 23 February 2015 available at http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G19%20-%20Comprehensive%20Guide%20to%20Dividends%20Tax%20-%20External%20Guide.pdf, last accessed on 4 November 2015.

provisions. The tax treatment of dividends in terms of the OECD Model Tax Convention on Income and on Capital is then briefly touched on. The focus of the guide is not on international tax and the treatment of dividends tax in different jurisdictions.

The guide that SARS has drafted regarding dividends tax has been invaluable as a reference point for the tax treatment of dividends from the South African perspective, however, it is not all encompassing and as such this dissertation will make use of further sources in order to ensure that the coverage of the topic is comprehensive.

The definition of a dividend is thoroughly examined by R. De Swardt,[8] who starts by explaining practically what a dividend is and then works through the different elements of the definition. Other high level overviews[9] are available and provide a good overall understanding to the way in which dividends tax actually works,[10] including a brief introduction to Double Taxation Agreements, but these are not extensive nor do they specifically address the application of dividends tax between South Africa and Mauritius.

The sources above do not address the way in which certain specific entities are taxed on dividends. There are, however, a host of articles which do address how specific entities are taxed, for example Professor E. Brincker penned a short article to answer the question on when trusts are liable for dividends tax.[11] The article is short and explanatory but does not make use of proper references to the ITA. Prof E. Brincker highlights the importance of whether the dividends have vested in the beneficiaries or not, and explains the possibility of the dividends losing their nature as dividends.

[8] R De Swardt 'Definition of 'dividend'' in M Stiglingh (ed). …et al. Silke: South African Income Tax: LexisNexis, (2014) 557-564.
[9] For example, N Church 'Double Taxation Agreement between South Africa and Mauritius' 10 October 2013, available at http://www.thesait.org.za/news/142092/Double-Taxation-Agreement-Between-South-Africa-And-Mauritius.htm, last accessed on 25 November 2015; and KPMG 'Mauritius – South Africa Double Taxation Agreement' available at https://www.kpmg.com/MU/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG%20Tax%20Alert%20-%20Highligts%20of%20Mauritius%20-%20South%20Africa%20Treaty.pdf, last accessed on 25 November 2015.
[10] E Retief 'The provisions of dividend tax' (2012) Feb/Mar The Tax Professional 6-7.
[11] E Brincker 'When is a trust liable for dividends tax? SARS clarifies the matter' (2012) 317 Tax Breaks Newsletter 7.

When dealing with trusts that own shares, the concept of beneficial ownership arises and this was addressed in a Binding Private Ruling[12] issued by SARS. The Binding Private Ruling was discussed by Ntombela[13] who explains that the beneficial owner of the shares in question did not have to be the actual shareholder of those shares. The article, although very fact specific, is a good example to highlight the distinction between a beneficial owner of shares and a shareholder of those shares.

As with the taxation of dividends on trusts, there are also many sources of information highlighting how other legal entities are taxed on dividends. There is however no consolidated source of information which then also goes on to compare the situation in South Africa with Mauritius.

1.6.3 Mauritius

The primary source of information in terms of Mauritius is the MITA,[14] read with the Income Tax (Foreign Tax Credit) Regulations 1996[15] (where applicable). As the focus of the dissertation will be the taxation of dividends tax in the hands of different legal entities, the corporate tax provisions will be applicable. The Mauritius Revenue Authority (MRA) has set out a very simplistic summary of its corporate tax regime,[16] however it is by no means extensive.

An article[17] by Dr T. Legwaila reviews the corporate tax provisions for holding companies implemented by Mauritius with the intention of making foreign investment more attractive. The focus of the article is to provide a brief exposé on the corporate tax regime in Mauritius and of various corporate tax benefits for different types of corporate entities, highlighting why Mauritius is so popular amongst multinational companies. In this article Legwaila examines

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[12] SARS 'Binding Private Ruling: BPR 129' available at http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BPR-2012-129%20-%20Beneficial%20Owner%20Dividends.pdf, last accessed on 4 November 2015.
[13] N Ntombela 'Dividends withholding tax implications' (2013) 13(4) Without Prejudice 76.
[14] Available at http://www.mra.mu/download/ITA1995-180615.pdf, last accessed on 4 November 2015.
[15] Available at http://www.mra.mu/download/Regulations_foreignTaxCredit_GN_55_2011.pdf, last accessed on 4 November 2015.
[16] Available at http://www.mra.mu/index.php/business-corporation/corporate-tax, last accessed on 4 November 2015.
[17] T Legwaila 'The Tax Treatment of Holding Companies in Mauritius: Lessons for South Africa' (2011) 23 SA Merc LJ 1-15.

what South Africa could do in order to attract 'headquarter companies' to South Africa. The article discusses these entities, the requirements which need to be complied with by them and the way in which they are taxed. The article's focus is, however, not on dividends tax, but rather the taxation of corporates within Mauritian law. It does touch on aspects of dividends tax, but is by no means focussed or comprehensive in this regard. The article is useful as it explains the compliance requirements in order to take advantage of the beneficial tax laws as they relate to holding companies and, by implication, the taxation of dividends in the hands of these holding companies in Mauritius.

KPMG, PWC and Deloitte have all published guides which provide a detailed overview of the different taxes in Mauritius.[18] Whilst these guides are of great value as an initial source, they do not provide a full breakdown of how dividends are taxed in the hands of different legal entities, but rather give a general rule for the tax treatment of dividends in Mauritius.

While there is a lot of information available there is no one consolidated source, nor is there a source which compares the taxation of all the different Mauritian legal entities with their South African counterparts. The further issue, as touched on above, and as will be explained in Chapter 3, is that there is no comprehensive guide issued by the MRA, nor is there any authoritative text from which to seek answers.

1.6.4 The Double Taxation Agreement

The third primary piece of legislation that the dissertation will focus on will be the DTA.[19] For the purposes of the dissertation article 10 of the DTA will be the focus, as it is the article which deals specifically with dividends. South Africa renegotiated the DTA with Mauritius and, as discussed in chapter 4, this revised DTA recently came into force (although it is currently not in effect until 1 January 2016). The dissertation will therefore include an investigation into any changes in the new DTA (Revised DTA), and how such changes will change the way dividends are taxed between the two jurisdictions, if at all.

[18] I have restricted my focus to the guide published by KPMG to prevent repetition; KPMG 'Mauritius Fiscal Guide 2014/15' available at http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2014-15%20Fiscal%20Guides/MAURITIUS-Fiscal%20Guide-2014.pdf, last accessed on 4 November 2015.

[19] Available at http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2012-09%20-%20DTA%20Mauritius%20GG%2018111.pdf, last accessed on 4 November 2015.

The OECD Commentary on the Articles of the Model Tax Convention[20] (OECD Commentary) discusses and interprets the provisions of its model tax treaties article by article. It is useful where the treaty between two states is based on the OECD model, which is the case between South Africa and Mauritius.[21] The OECD Commentary first seeks to make the distinction between profits earned by partners who are actively participating in a business, and the shareholder who receives distributed profits from a company (i.e. 'dividends'). It then goes on to explain the meaning and workings of each paragraph of the Model Convention. The issue that arises with the OECD Commentary, is that, in order to understand how the DTA actually effects the taxation of dividends in the hands of different legal entities, one has to have a working knowledge of how the two contracting states actually tax the dividends. It is therefore imperative to have an understanding of how dividends are taxed in both states in order to properly apply or interpret the provisions of the DTA. Consequently the OECD Commentary will be useful in respect of both the DTA and the Revised DTA.

KPMG has released a synopsis[22] of the Revised DTA between South Africa and Mauritius. It provides a comprehensive overview of the Revised DTA, but does not specifically address how dividends are taxed in the hands of specific legal entities. There are other sources which describe briefly the effect of the Revised DTA, however a comparison between the DTA and the Revised DTA will be useful to determine whether such changes effect the taxation of dividends in the hands of different legal entities.

1.7 Conclusion

Whilst there is extensive information on the taxation of dividends in both South Africa and in Mauritius, there is no single consolidated source of information which compares these two jurisdictions in relation to the DTA or the Revised DTA, to assess whether creating multinational structures between the two jurisdictions does minimise the tax burden of the taxpayer, specifically in relation to the taxation of dividends.

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[20] OECD 'OECD Commentary on the Articles of the Model Tax Convention' available at http://www.oecd.org/berlin/publikationen/43324465.pdf, accessed on 4 November 2015.

[21] PWC 'Tax Alert - New Tax Treaty between Mauritius and South Africa' 27 May 2013, available at https://www.pwc.co.za/en/assets/pdf/tax-alert-27-may-2013.pdf, accessed on 4 November 2015.

[22] KPMG 'South Africa – Mauritius DTA: Key features of the new treaty' 17 July 2013 available at http://www.sablog.kpmg.co.za/2013/07/south-africa-mauritius-dta-key-features-of-the-new-treaty/, accessed on 4 November 2015.

In the next chapter, the taxation of dividends in South Africa will be discussed. This discussion will cover the various definitions contained in the ITA and will move on to the way in which dividends are actually taxed and dealt with by the various sections in the ITA which govern the taxation dividends. The chapter will then conclude by including a few specific examples of how dividends are taxed in the hands of certain South African entities.

It must be noted from the start that, dividends distributed from listed companies and distributions that constitute dividends in specie fall outside of the scope of this dissertation.

2 CHAPTER 2 – SOUTH AFRICA

2.1 Introduction

In this chapter I investigate what constitutes a dividend in terms of South African dividends tax. I unpack the various provisions of the ITA to determine what dividends tax actually is, how dividends are taxed in South Africa and in terms of what specific provisions are they taxed. I investigate who is taxed, at what rate and when the liability actually arises in respect of dividends tax.

There will not, as discussed above in section 1.7,[23] be an investigation into dividends tax in respect of dividends in specie, other than possibly commenting on it as the need arises, nor will the provisions relating to the taxation of dividends of listed companies or headquarter companies be dealt with.

Finally, after having examined the general provisions relating to dividends tax, select entities will be used in examples in order to establish how they are taxed, including individuals, companies and how the taxation of dividends are handled in respect of trusts.

2.2 Definition

In terms of section 1 of the ITA a 'dividend' is defined as:

> *any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied—*
>
> > *(a) by way of a distribution made by; or*
> >
> > *(b) as consideration for the acquisition of any share in,*
>
> *that company, but does not include any amount so transferred or applied to the extent that the amount so transferred or applied—*
>
> > > *(i) results in a reduction of contributed tax capital of the company;*
> > >
> > > *(ii) constitutes shares in the company; or*
> > >
> > > *(iii) constitutes an acquisition by the company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of*

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[23] Discussed at above at 1.7 under the heading 'Conclusion'.

> *paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.84 of section 5 of the JSE Limited Listings Requirements*;

The definition of a dividend is therefore quite broad. Before proceeding further there are a few concepts that need to be investigated first.

The first of these concepts is 'contributed tax capital' (CTC) which has a rather broad definition and is dealt with extensively by SARS.[24] Whilst a full analysis of CTC is beyond the scope of this dissertation, it is, for the purposes of this dissertation, relevant to know that CTC is a tax specific concept and, in essence, CTC constitutes the amounts contributed to a company for the issue of a specific class of shares in that company.[25]

Therefore a dividend is a distribution made by a company to the extent that the distribution does not constitute CTC. This is important to note as dividends tax is only applicable insofar as the distribution constitutes a dividend.[26]

Central to the concept of a dividend is a company, which is defined in section 1 of the ITA as:

> *'company' includes—*
>
> *(a) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or*
>
> *(b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or*
>
> *(c) any co-operative; or*

[24] SARS 'Comprehensive Guide to Dividends Tax' 2015 at page 11 to page 24, available at http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G19%20-%20Comprehensive%20Guide%20to%20Dividends%20Tax%20-%20External%20Guide.pdf, last accessed on 4 November 2015.
[25] Idem at page 10.
[26] Ibid.

(d) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or

(e) any—

(i). . . . . .

(ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or

(iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1 (x) of the JSE Limited Listing Requirements; or

(f) a close corporation,

The term distribution, is not defined in the ITA, however it is defined in the Companies Act, No. 71 of 2008 (Companies Act). This, therefore, is the definition which is accepted and used by SARS.[27] A distribution, for the sake of completeness, is defined in section 1 of the Companies Act as:

'distribution' means a direct or indirect—

(a) transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one or more holders of any of the shares, or to the holder of a beneficial interest in any such shares, of that company or of another company within the same group of companies, whether—

(i) in the form of a dividend;

(ii) as a payment in lieu of a capitalisation share, as contemplated in section 47;

[27] Ibid.

(iii) as consideration for the acquisition—

(aa) by the company of any of its shares, as contemplated in section 48; or

(bb) by any company within the same group of companies, of any shares of a company within that group of companies; or

(iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164 (19);

(b) incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies; or

(c) forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders of any of the shares of that company or of another company within the same group of companies;

but does not include any such action taken upon the final liquidation of the company;

The main provisions dealing with the taxation of dividends in South Africa are found in section 64 of the ITA. Section 64D contains further definitions applicable to dividends tax and here we find a further definition of dividends:

'dividend' means any dividend or foreign dividend as defined in section 1 that is—

(a) paid by a company that is a resident; or

(b) paid by a foreign company—

(i) if the share in respect of which that foreign dividend is paid is a listed share; and

(ii) to the extent that that foreign dividend does not consist of a distribution of an asset in specie;

Whereas the first definition of dividend found in section 1 of the ITA includes only residential companies, here, foreign companies are brought into the tax net in relation only to distribution of assets in specie and in respect of foreign dividends paid in relation to listed shares.

In order to ascertain how dividends are taxed in the hands of different entities in South Africa, it is important to break up the definition of dividends into its different elements. The elements which make up a dividend are:[28]

1. an amount;

2. which is transferred or applied by a company that is a resident;

3. for the benefit or on behalf of any person;

4. in respect of any share in that company.

Each will be examined in turn.

2.3 Amount

An amount can be cash or corporeal or incorporeal property[29] with a monetary value,[30] but does not necessarily have to be capable of being converted into money.[31]

In respect of dividends, if a company, by way of distribution, transfers cash to a shareholder, this would be referred to as a dividend, however if the company transfers an asset (be it corporeal or incorporeal), the distribution will be referred to as a dividend in specie.[32]

For the purposes of tax, and in this case dividends tax, an asset which is distributed by means of a dividend in specie is valued at its market value.[33]

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[28] Idem at page 24.
[29] *WH Lategan v Commissioner for Inland Revenue* 1926 CPD 203.
[30] *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2)(SA 353 (A).
[31] *Commissioner for South African Revenue Service v Brummeria Renaissance (Pty) Ltd & others* 2007 (6) SA 601 (SCA).
[32] SARS Comprehensive Guide to Dividends Tax, page 25.
[33] ITA, section 64E(3)(b); SARS Comprehensive Guide to Dividends Tax, page 24; SARS Comprehensive Guide to Dividends Tax at paragraph 3.3.2, page 62.

2.4 Transferred or Applied by a Company that is a Resident

SARS states that a 'transfer' is the transfer of ownership and that 'applied' includes payment on behalf of a shareholder in respect of a debt owed by that shareholder, or even the provision of a service to a shareholder.[34]

As described above in section 2.2,[35] although the definition of dividend in section 1 of the ITA includes only residents, that definition is extended to foreign companies in very limited circumstances.

2.5 For the Benefit or on Behalf of any Person

Two elements exist here.

Regarding the first element, a dividend needs to be for the benefit of a person. SARS[36] gives the example of a person who receives a dividend or where a dividend accrues to a person (analogous to the meaning of the word 'benefit' used for a receipt. That is, in order to receive an amount, a person must receive it on his behalf and for his benefit).[37]

Regarding the second element, SARS[38] explains the 'on behalf' provision as being where a company transfers a dividend on behalf of a shareholder in respect of a debt owed by the shareholder to that person.

2.6 In Respect of any Share in that Company

The term 'share' is defined in section 1 of the ITA as meaning '*in relation to any company, any unit into which the proprietary interest in that company is divided*'.

The dividend therefore has to be paid as a result of an obligation placed on the company through a 'causal relationship' between the company and the person receiving the dividend.[39] SARS

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[34] SARS Comprehensive Guide to Dividends Tax, page 25.
[35] Discussed above at 2.2 under the heading 'Definition' where the further definitions of 'dividends' (as provided for in section 64D of the ITA) are discussed.
[36] SARS Comprehensive Guide to Dividends Tax, page 26.
[37] The concept of beneficial receipt of an amount was confirmed in the case of *Geldenhuys v Commissioner for Inland Revenue* 1947 (3) SA 256 (C).
[38] SARS Comprehensive Guide to Dividends Tax, page 26.
[39] Ibid.

draws the analogy that the terms 'in respect of' and 'by virtue of' in respect paragraph (c) of the gross income definition bear the same meaning and that they connote a causal relationship.[40]

In essence, but for the shares in that company which a person holds, he would not be entitled to, or would not have received that amount in question. He therefore receives the amount because he holds shares in that company. Put differently, the effective cause of the receipt or accrual of a dividend is the share that the person holds. If an amount is transferred to a person for any reason other than holding a share (for example due to services being rendered) he does not receive a dividend.[41]

2.7 What Creates the Liability for Dividends Tax

Section 64EA of the ITA creates the liability to pay dividends tax, but makes that liability subject to section 64J(7) which is a transitional section dealing with Secondary Tax on Companies and as such, is outside the scope of this dissertation.

In terms of section 64EA:

1. a beneficial owner is liable for dividends tax in respect of a dividend received, to the extent that the dividend which he received does not constitute a dividend in specie;[42] and

2. the resident company which declares and pays a dividend will be liable for the dividends tax in relation to that dividend to the extent which the dividend constitutes a dividend in specie.[43]

2.8 When does the Liability for Dividends Tax Arise

The rate of tax and the timing provision for dividends tax is provided for in section 64E(1) of the ITA which states that:

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[40] SARS draws the analogy from *Stevens v Commissioner for South African Revenue Service* 2007 (2) SA 554 (SCA) in SARS Comprehensive Guide to Dividends Tax, page 26.
[41] SARS Comprehensive Guide to Dividends Tax, page 26.
[42] ITA, section 64EA(a).
[43] Idem at section 64EA(b).

Subject to paragraph 3 of the Tenth Schedule, there must be levied for the benefit of the National Revenue Fund a tax, to be known as the dividends tax, calculated at the rate of 15 per cent of the amount of any dividend paid by any company other than a headquarter company.

Section 64E(2) then provides when dividends are deemed to be paid:

For the purposes of this Part, a dividend must, to the extent that the dividend—

(a) does not consist of a distribution of an asset in specie and is declared by a company that is—

(i) a listed company, be deemed to be paid on the date on which the dividend is paid; or

(ii) not a listed company, be deemed to be paid on the earlier of the date on which the dividend is paid or becomes due and payable; or

(b) consists of a distribution of an asset in specie, be deemed to be paid on the earlier of the date on which the dividend is paid or becomes due and payable.

The liability for dividends tax arises when the dividend is paid.[44] The question then revolves around investigating when a dividend can be said to have been paid in instances when it may not be particularly obvious (for example in a share buy-back).

For the purposes of dividends tax then, where a distribution is not a distribution of an asset in specie and where the company is not a listed company, a dividend is deemed to be paid on the earlier of the date it is paid, or the date it becomes due and payable.[45]

In order to determine which date is the earlier of the two dates, the interpretation of the term 'payable' is instructive.

Haupt[46] submits that the phrase 'becomes payable' is not '*the date that the obligation arises to pay the dividend in the future (the date of accrual), but is the date that the actual payment is supposed to be made*'.

[44] Idem at section 64E(1).
[45] Idem at section 64E(2)(ii).
[46] P Haupt Notes on South African Income Tax (2013) 412.

Silke[47] states that: '*paid*' must be '*contrasted with "payable", which connotes dies venit, namely the day upon which payment is required to be made*'. The learned author goes on to say, '*the date on which a dividend is paid does not necessarily coincide with the date on which the obligation to pay the dividend is incurred or the right to the dividend accrues (dies cedit)*'.

The views above are endorsed by SARS[48] where the following is stated, '*an amount may be due under a contract (dies cedit) but not payable (dies venit). An amount will only be payable when the time for payment arrives. For an amount to be "due and payable" the amount must not only be owing, but a person must have the right to claim payment for it*'.

This would, for example, become an issue where a company bought back its own shares by way of agreement with a particular shareholder (a share buy-back), and by agreement paid the shareholder by way of instalments. Whilst the agreement would be that the shares would be transferred on the effective date of the agreement, the actual consideration paid may take place in different years of assessment in terms of that instalment sale. Thus, a dividends tax event would then take place on each payment of consideration (that is on the payment of each tranche).

2.9 Who is Taxed – The Beneficial Owner/Recipient

The term beneficial owner is defined in section 64D of the ITA as meaning '*the person entitled to the benefit of the dividend attaching to a share*'.

SARS issued a binding private ruling[49] (BPR) that dealt with beneficial ownership. The thrust of the BPR was that the applicant company (which sought the ruling) declared and paid dividends to its shareholders. Some of those shareholders were employee scheme trusts. Where, for certain reasons, the trusts had not allocated shares to employees, the applicant company was resolved by the trustees to be the income beneficiary of the dividends. SARS

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[47] AP de Koker & RC Williams Ch9 of Silke on South African Income Tax (online version) at paragraph 9.38, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggOSBwYXIgOS4zOCQ0Nzk4ODYkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.

[48] SARS Comprehensive Guide to Dividends Tax, page 60.

[49] SARS 'Binding Private Ruling: BPR 129' available at http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BPR-2012-129%20-%20Beneficial%20Owner%20Dividends.pdf last accessed on 4 November 2015.

held that in terms of s 64F(a) the applicant company, which was the recipient of its own shares, was exempt from dividends withholding tax. This effectively means that the beneficial owner does not have to be the owner of the shares, as in this instance where the trust held the shares and they were not allocated to anyone, but the benefit of the shares (the dividends) were distributed to the company by resolution and as such the company would be deemed to be the beneficial owner. That is the beneficial owner of the shares is not necessarily the actual owner of the shares.

The Appellate Division[50] made the distinction between a beneficial owner of shares and the registered owner of shares. Essentially, in the case where an agent may be the registered owner of shares in respect of the share register of the company, the company in question will recognise that agent as the registered shareholder. However, the principal and not the agent will be the beneficial owner of the shares, and will therefore be the person who receives the distribution (or at least to whom the amount accrues) and as such will be the one who is liable for dividends tax.[51]

SARS[52] refers to a British case: *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*[53] which in turn referred to a prior British case: *Her Majesty the Queen v Prévost Car Inc*[54] which held that the person who receives the dividends for his own use and enjoyment, and who assumes the risk and the control of the dividend is the beneficial owner of the dividends. This is analogous then to our test for a receipt in respect of gross income.[55]

Finally SARS[56] makes reference to a third British case: *Prévost Car Inc. v Her Majesty the Queen*[57] which held that, amongst other things, the beneficial owner of the share is the person who '*enjoys and assumes the attributes of ownership*' in respect of those shares, and that it will only meet the requirements as set out in the *Prévost* case if that person has the right to control the item (shares) without question.

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[50] As it then was, now the Supreme Court of Appeal (refer to footnote 51 below).
[51] *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A); SARS Comprehensive Guide to Dividends Tax, page 38.
[52] SARS Comprehensive Guide to Dividends Tax, page 38.
[53] 2009 FCA 57, [2010] 2 F.C.R. 65.
[54] (2008) TCC 231.
[55] The test for receipt was set out in *Geldenhuys v Commissioner for Inland Revenue* 1947 (3) SA 256 (C).
[56] SARS Comprehensive Guide to Dividends Tax, page 38.
[57] *Velcro Canada Inc. v Her Majesty the Queen* (2012) TCC 57.

2.10 How are Dividends Taxed and at What Rate

As above, section 64E(1) of the ITA levies a tax on dividends at a rate of 15 per cent.

The mechanics of how the tax is actually paid is contained in section 64G. In essence a company that makes a distribution must withhold 15 per cent, in terms of section 64E of the ITA, except where that distribution constitutes a dividend in specie,[58] or where the dividend is not subject to dividends tax, as a result of the existence of an STC credit.[59]

The company must not withhold the dividends tax from the payment of a dividend where the beneficial owner has informed the company, by way of declaration in the form prescribed by the Commissioner, that the dividend is exempt from dividends tax in terms of section 64F.[60] In instances like this the beneficial owner must give a written undertaking to inform the company in writing, in the form prescribed by the Commissioner, if that position changes.[61] Such declarations need to be made within a time determined by the company, or by the date of the payment of the dividend. Further, the company making the distribution must not withhold dividends tax in respect of a beneficial owner, which is a company that forms part of the same group of companies,[62] and where the payment is made to a regulated intermediary.[63]

The ITA provides that where the beneficial owner has provided the company with a declaration that the dividend is subject to a lesser rate of tax due to an agreement for the avoidance of double taxation and has given an undertaking that it (the beneficial owner) will inform the company if those circumstances change (or the beneficial owner changes) then the company must withhold that lesser rate of dividends tax in respect of those dividends.[64]

Dividends tax is therefore, subject to the above conditions being met, a withholding tax, which the beneficial owner is liable for, but the company paying has the obligation to hold back and pay over to SARS.

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[58] ITA, section 64G(1)(a).
[59] Idem at section 64G(1)(b) .
[60] Idem at section 64G(2)(aa).
[61] Idem at section 64G(2)(bb).
[62] A group of companies is defined in section 41 of the ITA.
[63] ITA, section 64G(2)(c). This aspect is beyond the scope of this dissertation.
[64] Idem at section 64G(3).

2.11 Exemptions

2.11.1 Section 10(1)(k) – Exemption from Gross Income

The first exemption in respect of dividends is found in section 10(1)(k)(i) of the ITA which, subject to many conditions, excludes dividends from being included in a person's gross income. The reason for this is to ensure that dividends are not subject to double taxation as they are, as explained above, subject to dividends tax.

While outside the scope of this dissertation, the conditions contained in section 10(1)(k) of the ITA speak to various anti-avoidance measures relating to dividends.[65]

2.11.2 Section 64F

Section 64F exempts a payment of a dividend from dividends tax where the beneficial owner is a resident company, the Government (in all three spheres),[66] a public benefit organisation approved by the Commissioner in terms of section 30(3) of the ITA, a trust in terms of section 37A of the ITA, an institution, board or body in terms of section 10(1)(cA), a fund in terms of section 10(1)(d)(i) and (ii) or a person in terms of section 10(1)(t), or a shareholder of a registered microbusiness[67] (in terms of the Sixth Schedule to the ITA).

Section 64F also excludes a non-resident (where he is the residential owner) from having to pay dividends in respect of dividends received from foreign companies. In such instances the dividend must comply with paragraph (b) of the definition of dividend, as defined in section 64D, in that it must be in respect of a listed share and to the extent that the dividend is not a dividend in specie.[68]

Section 64F then exempts the payment of a dividend from dividends tax where the beneficial owner is a portfolio of a collective investment scheme in securities, where the dividend is income in the hands of that person,[69] a fidelity or indemnity fund in terms of section 10(1)(d)(iii)

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[65] SARS Comprehensive Guide to Dividends Tax, page 16.
[66] The three spheres of Government are local, provincial and national levels.
[67] The aggregate amount of dividends paid by a microbusiness to its shareholders during a year of assessment cannot exceed R200 000 in terms of section 64F(1)(h) of the ITA.
[68] ITA, section 64F(1)(j).
[69] If that person was already subject to STC (and to the extent that the dividend was already subject to STC).

of the ITA, and a dividend that was paid by a real estate investment trust (REIT)[70] or controlled company in specific circumstances.[71]

2.12 The Payment and Recovery of Dividends Tax

Section 64K of the ITA ties up the actual payment of the tax. It provides that the beneficial owner, who is liable for dividends tax, must pay the tax on the last day of the month following the month in which he received the dividend. That is subject to anyone else paying the liability on his behalf.[72] This same provision is repeated for companies[73] and for any person who was obliged to withhold the tax.[74]

If a person receives a dividend which is exempt from dividends tax in terms of section 64F, or the dividends tax in respect of a distribution has already been paid, then that person must just submit a return in respect of that dividend to the Commissioner by the last day of the month following the month in which that person received the dividend.[75]

Where a person, in terms of section 64G(3) or 64H(3) has withheld dividends tax which is subject to a reduced rate, that person must submit the declaration which it received in respect of those sections to the Commissioner.[76] Finally, if dividends tax is not paid timeously, it will be subject to interest.[77] There are many other provisions, outside of the scope of this dissertation, dealing with payment and the administration and penalties incurred for failure to pay dividends tax timeously.[78]

2.13 Prevention of or Relief from Double Taxation

2.13.1 Section 108

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[70] A REIT is a type of Investment Company which is defined in Section 1 of the ITA.
[71] ITA, sections 64F(1)(k) – 64F(2).
[72] Idem at section 64K(1)(a).
[73] Idem at section 64K(1)(b).
[74] Idem at section 64K(1)(c).
[75] Idem at section 64K(1)(d).
[76] Idem at section 64K(4).
[77] Idem at section 64K(6).
[78] For example the Tax Administration Act, No 28 of 2011, section 157, which makes a withholding agent (that is the person who actually declared and paid the dividend) personally liable for the dividends tax in certain circumstances. This example is discussed further in SARS Comprehensive Guide to Dividends Tax, page 138 .

Section 108 of the ITA empowers the National Executive (the Government of South Africa) to enter into agreements with other countries that prevent, mitigate or discontinue the levying of tax. This is therefore an empowering provision which allows South African to enter into tax treaties with other countries.[79]

2.14 Binding General Ruling 9

SARS released a binding general ruling (BGR),[80] the purpose of which was to declare what it thought constituted tax on income, or what it terms substantially similar taxes in respect of tax treaties, which South Africa has entered into. The BGR elaborates specifically on the nature of the STC regime and the new dividends tax regime. The issue which the BGR sought to address was whether dividends tax was covered by the tax treaties entered into by South Africa where, at the time the relevant tax treaty was entered into, South Africa had an STC regime and not a dividends tax regime.

Dividends tax is specifically included in a list of taxes on income that will qualify for relief under a tax treaty with South Africa.[81] The BGR does discuss the STC regime, which was subsequently replaced by the dividends tax regime which came into effect on 1 April 2012.

The concept of a dividend is discussed[82] and the distinction is made between what SARS terms as a 'cash dividend' and a dividend in specie. SARS states that a cash dividend falls within the dividends article of a tax treaty entered into with South Africa, and as such, a non-resident shareholder would therefore be able to take advantage of a lower rate of dividends tax where such lower rate is applicable. In this regard it is important to note that a reduction in the rate of dividends withholding tax does depend on the specific treaty in question to determine what the rate is, as different tax treaties will have different rates. This will however be discussed later.[83]

The BGR raises the question of whether dividends tax is covered by the tax treaties which South Africa enters into, even though it may not actually be named as a covered tax. In order to

[79] SARS Comprehensive Guide to Dividends Tax, page 109.
[80] Binding General Ruling (Income Tax): No. 9 (Issue 2), South African Revenue Service, available at http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BGR-2012-09%20-%20Taxes%20income%20RSA%20Tax%20Treaties.pdf last accessed on 4 November 2015.
[81] Idem at paragraph 3.1.
[82] Idem at paragraph 3.3.
[83] This will be discussed below in Chapter 4, with specific reference to the DTA.

answer this question the BGR[84] discusses both article 2 of the OECD Model Tax Convention on Income and on Capital (OECD Model) and the United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model).

The OECD Model and the UN Model are similar in the sense that they include both income and capital into the tax net, regardless of how they are levied in the contracting states.

SARS quotes the OECD's commentary in respect of Article 2 of the OECD Model. The commentary in this regard states that the taxes are made up of '*taxes on total income and on elements of income…*'[85] to which SARS submits that, '*Dividends tax is a tax on an element of income*'.[86]

SARS submits that despite the same wording not always being present in a tax treaty, they will nevertheless contain similar provisions thereto[87] and as such, dividends tax will be drawn into the taxes which are included into the treaty.

SARS gives the example of the wording 'identical or substantially similar taxes' and states that this test is to be applied to the listed taxes of both of the countries which enter into the tax treaty. The reason this is specifically important is that when certain treaties were entered into, dividends tax did not exist,[88] as such it was important and remains important where treaties have not been updated, to ensure that dividends tax actually falls under the various tax treaties. As such, SARS states that the relevant Contracting States have been notified of the move away from STC and the introduction of the dividends tax regime, and that this type of tax is covered by the taxes included in the treaties.

Importantly SARS states that the relevant competent authorities from the Contracting States were informed that dividends tax is similar to STC, and that it is therefore considered to be a

[84] BGR 9, starting at page 4.
[85] OECD 'OECD Commentaries on the Articles of the Model Tax Convention', page 75, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.
[86] BGR 9, page 4.
[87] Ibid.
[88]For example the DTA entered into between South Africa and Mauritius in 1996 which will be dealt with in chapter 4 of this dissertation.

tax which is substantially similar to the taxes which are covered by Article 2 of the tax treaties which are entered into with South Africa.[89]

2.15 General Effect of a Tax Treaty on Companies

The effect of the BGR, as discussed above in section 2.14,[90] is that where a resident company of South Africa makes a distribution to a non-resident, that distribution may (to the extent that the distribution does not constitute a dividend in specie) be subject to a reduced rate of tax through a relevant tax treaty. Exactly what that rate would be would be determined by the relevant tax treaty. This is applicable if the non-resident has made the declaration and undertakings which are contained in section 64G[91] of the ITA and section 64H[92] of the ITA as discussed above in section 2.12.[93]

In general, for a non-resident company which receives dividends from a company which is resident in South Africa, to take advantage of a tax treaty which their country of residence has entered into with South Africa, it would need to own between 10 and 25 per cent of the authorised and issued shares of that resident company. Therefore, if for example a non-resident company owned less than 10 per cent, that not resident company would generally not be able to take advantage of a lower withholding rate on dividends tax.[94] This would however be dependent on the specific tax treaty in question.

2.16 Controlled Foreign Companies

For the purposes of taxation in South Africa, if a South African resident owns shares in a non-resident company, which for the purposes of this dissertation might be a Mauritian company,

[89] BGR 9, page 5.
[90] Discussed above at 2.14 under the heading 'Binding General Ruling 9'.
[91] Discussed above at 2.10 under the heading 'How are Dividends Taxed and at What Rate'.
[92] This section deals with regulated intermediaries, which is a defined term. Regulated intermediaries are defined in section 64D of the ITA and can simplistically be thought of as a third party entity which makes investments for and on behalf of investors.
[93] Discussed above at 2.12 under the heading 'The Payment and Recovery of Dividends Tax'; SARS Comprehensive Guide to Dividends Tax, page 109.
[94] SARS Comprehensive Guide to Dividends Tax, page 109.

then the tax consequences will depend on whether it can be said that the Mauritian company is a controlled foreign company (CFC) of the South African resident.[95]

In essence a proportional amount of the net income and capital gains of a CFC are attributed to its South African shareholder(s).[96] A CFC is defined as a 'foreign company'[97] where more than 50 per cent of the total participation rights[98] or more than 50 per cent of the total voting rights in that foreign company are held directly or indirectly by one or more persons, who are residents in South Africa.

If the Mauritian company is a CFC of the South African resident then one must consider if the Mauritian company constitutes a foreign business establishment (FBE)[99] in terms of the ITA. A FBE effectively negates the CFC rules, that is, to the extent that a CFC is a FBE, the income must not be taken into account in calculating the net income attributable to the South African shareholder(s).[100] A FBE is, in a nutshell, the place of substance where the business of the Mauritian company is carried on in Mauritius.

2.17 Foreign Dividends

A foreign dividend is a defined term in the ITA.[101] It is an '*amount which is paid or payable by a foreign company in respect of a share in that foreign company*'. Effectively it is a dividend which is paid by a foreign company.[102] A foreign company is defined as a non-resident company.[103]

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[95] ITA, section 9D, defines and makes provision for CFCs. A full discussion is outside of the scope of this dissertation but it is important to note the provision exists.
[96] AP de Koker & RC Williams Ch4 of Silke on South African Income Tax (online version) at paragraph 4.79A, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggNCBwYXIgNC43OUEkNDc5MzEyJDckTGlicmFyeSRKRCRMaWJyYXJ5, last accessed on 6 November 2015.
[97] Foreign company is defined in the ITA, section 9D, and means a non-resident company.
[98] Participation rights are defined in the ITA, section 9D, and are effectively the right to participate in the profits and capital of the company. M Honiball & L Olivier 'The Taxation of Trusts in South Africa' (2009) 105.
[99] ITA, section 9D(1), also defines and provides for foreign business establishments.
[100] AP de Koker & RC Williams Ch5 of Silke on South African Income Tax (online version) at paragraph 5.47, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggNSBwYXIgNS40NyQzMTA2ODAwJDckTGlicmFyeSRKRCRMaWJyYXJ5, last accessed on 6 November 2015.
[101] ITA, section 1(1).
[102] SARS Comprehensive Guide to Dividends Tax, page 33.
[103] ITA, section 1(1).

Foreign dividends may be exempt from normal tax under the South African system of taxation where that foreign dividend meets certain requirements set out in section 10B(2) of the ITA. However, where that foreign dividend is not exempt from tax under section 10B(2) of the ITA, it will be subject to a maximum rate of tax of 15 per cent.[104]

The exemptions listed under section 10B(2) of the ITA for foreign dividends which have been received by or accrued to a person include:

1. where that person holds at least 10 per cent of the total equity shares and the total voting rights in the foreign company which declared the foreign dividend (this is called the participation exemption);[105]

2. where the person receiving the foreign dividend is itself a foreign company and the two foreign companies are resident in the same country;[106]

3. where, and to the extent that the foreign dividend does not exceed the amounts which are included in the resident taxpayer's income in terms of section 9D[107] of the ITA from the payment of a dividend from that foreign company as a result of an indirect shareholding in that foreign company;[108] and

4. where and to the extent that a dividend from a listed company does not constitute a dividend in specie (distributed to a person)[109] and to the extent that a dividend from a listed company constitutes a dividend in specie (distributed to a company).[110]

2.18 Rebate in Respect of Foreign Taxes on Dividends

Section 64N of the ITA contains provisions which are specific to dividends which do not consist of a dividend in specie, and which dividend is paid by a foreign company to a resident in respect

[104] SARS Comprehensive Guide to Dividends Tax, page 7.
[105] ITA, section 10B(2)(a); SARS Comprehensive Guide to Dividends Tax, page 6.
[106] ITA, section 10B(2)(b).
[107] The section deals with controlled foreign companies.
[108] ITA, section 10B(2)(c).
[109] Idem at section 10B(2)(d).
[110] Idem at section 10B(2)(e).

of a share which is listed share on the Johannesburg Stock Exchange. This is mentioned merely for the sake of completeness, but as it deals with listed shares it is beyond the scope of this dissertation. Suffice to say that the beneficial owner of such a share will be able to deduct from his dividends tax liability in respect of that foreign dividend, a rebate equal to the amount of foreign tax he paid on the receipt of that foreign dividend.

2.19 Taxation of Dividends in the Hands of Different Entities - Specific Examples

For the most part a full discussion on each type of entity is beyond the scope of this dissertation. To enable the reader to better understand how dividends are taxed in the hands of different entities, brief mention is therefore made, where applicable, regarding the mechanics of these entities. Examples of this will include both resident and foreign trusts.

The principles of the taxation of dividends will not be fully discussed here, as they have already been covered above in this chapter. What follows is a set of examples that can usefully compare South Africa and Mauritius, in respect of the taxation of dividends.

2.19.1 Resident trusts

The main provision dealing with the taxation of trusts is contained in section 25B of the ITA. Section 25B of the ITA is subject to section 7 of the ITA which is essentially a deeming provision. If section 7 of the ITA applies, the income (and therefore tax liability in respect of that income, including dividends tax) is deemed back to a certain person (for example the donor of assets to a trust) rather than to the trust, or to the beneficiaries of the trust. If section 7 of the ITA does not apply then section 25B(1) of the ITA either deems income to the trust or to the beneficiary of the trust, depending on whether the income has vested to the beneficiary or not.

A trust may be a discretionary trust, where the trust deed gives the trustees a discretion with respect to the trust income and trust capital of the trust. In such a case the income is therefore deemed (assuming section 7 of the ITA does not apply) to be that of the trust and as such the trust will be liable for the tax.[111]A trust may also be a vesting trust, where the trust deed sets

[111] Idem at section 25B(1).

out that a specific asset vests in a certain beneficiary. Such vesting may occur before the actual receipt thereof by the beneficiary (essentially an accrual), and the beneficiary will be taxed accordingly.[112] In the case of a discretionary trust, where a trustee has exercised his discretion and as a result an asset (income or capital) has vested to the beneficiary, that beneficiary will be taxed as having received the asset in question.[113]

Whilst a trust is taxed at a different rate to other taxpayers, in respect of dividends, the rate is fixed (subject to the exemptions discussed above or reductions in terms of a DTA) at 15 per cent.[114] Therefore, if a trust receives a dividend and pays it to the beneficiary in the same year of assessment, the beneficiary will be liable (subject to the withholding rules of dividends tax) for the 15 per cent tax.

Where a trust receives a dividend and does not make a distribution in that year of assessment, nor does the dividend vest in a beneficiary by reason of the trust deed or the exercise of a discretion of a trustee, the trust will be liable for the dividends tax.

Where a beneficiary receives a dividend through a trust, it is done by way of the 'conduit pipe' principle. In the case of *Armstrong v Commissioner for Inland Revenue*[115] the Appellate Division held that dividends that had been paid to a trust and distributed to a beneficiary did not lose the exemption which applied to such dividends and was found in section 10(1)(k) of the Income Tax Act, No. 40 of 1925 (as it was then known). This therefore meant that the nature or characteristics of the income received by the trust was not lost, and was passed onto the beneficiary, who was allowed to take advantages of the exemptions in respect of that income.[116] The Appellate Division held that the trust could not increase or decrease the amount of tax which was due in relation to the amount of income (the dividend) derived by the beneficial owner from the company simply by the intervention of the trust between the company paying the dividend and the beneficial owner who received the dividend (in whose hands the

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[112] Ibid.
[113] Idem at section 25B(2).
[114] Idem at section 64E.
[115] *Armstrong v Commissioner for Inland Revenue* 1938 AD 343; 10 SATC 1.
[116] K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.25, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjI1JDQ5MDA0MjgkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.

dividend was exempt) and that the trust was a mere 'conduit pipe' of the income to the ultimate beneficiary.[117]

The Appellate Division in *Secretary for Inland Revenue v Rosen*[118] confirmed that income which flows through a trust to the beneficiaries of that trust retains its identity, provided that the income accrues to the beneficiary in the same year of assessment in which it accrued to the trust.[119] It is therefore important, in order to ensure dividends are still dividends, and taxed as such in the hands of the beneficiaries, that the distribution is made, or at the very least that the dividends vest in the beneficiaries in the same year in which it is paid to, or accrues to the trust. If a trust keeps the dividend and does not distribute the dividend in the same year of assessment, the dividend will lose its characteristic as a dividend when it is ultimately distributed to the beneficiary.

As in the case of a resident individual, the section 10(1)(k) exemption will apply to the trust (if it is taxed) or the beneficiary (if the dividend has been passed through) and will therefore be excluded from their gross income.

2.19.2 Foreign trusts

A foreign trust is a trust that is a non-resident for the purposes of the ITA. South Africa has a resident based system of taxation, however if a taxpayer is not a resident, the taxpayer may still be liable for tax on income if the source of that income is from South Africa or deemed to be from a South African source.[120] The test for residency is set out in the definition of a 'resident'[121] in the ITA but further analysis is beyond the scope of this dissertation.

As a foreign trust is a trust, the same concepts applicable to resident trusts are applicable to foreign trusts. That is, only if the income from a South African source has not vested to a

[117] 10 SATC 1, page 6.
[118] *Secretary for Inland Revenue v Rosen* 1971 (1) SA 173 (A); 32 SATC 249.
[119] K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.25, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjI1JDQ5MDA0MjgkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.
[120] Idem at paragraph 12.34.
[121] ITA, section 1, at paragraph (b) of the definition of 'resident'.

beneficiary in that year of assessment, and if section 7 of the ITA is not applicable, will the income be taxed in the hands of the foreign trust.[122]

In respect of foreign income, foreign trusts are taxed on the distribution of that income to South African resident beneficiaries in terms of section 25B(2A) of the ITA.[123] If the foreign trust earns foreign income and never distributes it to a resident beneficiary, then such income will never be taxed in South Africa (unless the provisions of section 7 of the ITA deem the income back to the resident donor).[124]

Section 25B(2A) of the ITA provides that any resident who has acquired a vested right in the capital ('retained or accumulated income')[125] of a foreign trust in a particular year of assessment, must include that amount as income in that year of assessment. The amount which vested to the beneficiary will only be included in the beneficiary's income if:

1. that capital amount arose from receipts or accruals of that trust which would have constituted income in the hands of the trust; and
2. if that trust had been a resident in South Africa, in any previous year of assessment that the beneficiary had a contingent right to that amount;[126] and
3. the amount has not already been subject to tax in South Africa.[127]

If the beneficiary of the foreign trust is a resident in South Africa, the beneficiary will be liable for tax on the vesting of any right in respect of dividends which the foreign trust would have been liable for, if that trust had been a resident in any previous year of assessment that the

[122] K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.34, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjI1JDQ5MDA0MjgkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.
[123] ITA, section 25B(2A); K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.34, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjM0JDYxNDMzMTUkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.
[124] K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.34, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjM0JDYxNDMzMTUkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.
[125] Ibid.
[126] ITA, section 25(2A)(a).
[127] Idem at section 25(2A)(b).

beneficiary had a contingent right to those dividends.[128] The nature and characteristic of the income (in this case the income is dividends) would be kept. Section 25B(2A) of the ITA is essentially an extension of the conduit principle discussed above in 2.19,[129] but instead of only applying to income passed through the trust in the same year of assessment, section 25B(2A) applies for any subsequent year of assessment in respect of foreign trusts and resident beneficiaries.[130] It must be noted here that foreign dividends will be taxed in terms of the applicable section of the ITA,[131] whereas local dividends would be taxed (if not already taxed in the hands of the trust for whatever reason) in terms of the dividend specific provisions as discussed in chapter 2 of this dissertation.

For the sake of completeness, paragraph 80(3) of the Eighth Schedule to the ITA taxes resident beneficiaries on capitalised capital gains distributed from the foreign trust, in the same way which section 25B(2A) of the ITA taxes capitalised income in the hands of resident beneficiaries, who receive distributions subject to the criteria discussed above in section 2.19.[132]

The actual taxation of the foreign trust would only occur if that non-resident trust was actually resident in South Africa (i.e. the foreign trust was effectively managed in South Africa), or that foreign trust was deemed, in terms of a DTA, to be resident in South Africa (through the permanent establishment provisions contained in the DTA).[133]

2.19.3 Resident individuals

The exemption found in section 10(1)(k) of the ITA exempts dividends from being included into the individual's gross income. The individual, being the beneficial owner, is then taxed on the receipt or accrual of dividends at a rate of 15 per cent, to the extent that the dividends are

[128] M Honiball & L Olivier 'The Taxation of Trusts in South Africa' (2009) 76 – 79.
[129] Discussed above at 2.19.1 under the heading 'Resident Trusts'.
[130] M Honiball & L Olivier 'The Taxation of Trusts in South Africa' (2009) 76 – 79.
[131] ITA, section 10B.
[132] The criteria are similar to those discussed for section 25B(2A) of the ITA under the same section and heading, that is 2.19.3 'Foreign Trusts'. This topic is not strictly relevant, however a discussion can be found at K Stark & M Stiglingh Ch 12 of Silke on South African Income Tax (online version) at paragraph 12.34, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=Q2ggMTIgcGFyIDEyLjM0JDYxNDMzMTUkNyRMaWJyYXJ5JEpEJExpYnJhcnk, last accessed on 6 November 2015.
[133] The concept of effective management and permanent establishments will be discussed in Chapter 4 of this dissertation and will therefore not be discussed here.

not dividends in specie. The dividends tax, in respect of the dividend paid, is withheld by the company paying the dividend.

Regardless of the obligation to withhold dividends tax, the liability to pay the tax remains with the beneficial owner (the individual). This is obviously subject to the provisions mentioned above.[134]

There is therefore, subject to what is said later in this dissertation, scope for improvement of this rate of taxation because it is possible for an individual shareholder to take advantage of the various provisions of the DTA, and thereby reduce this rate of taxation from 15 per cent to a lower percentage.

2.19.4 Resident companies

Resident companies are exempt from including dividends in their gross income.[135] Resident companies are also specifically exempt from paying dividends tax in respect of dividends paid to them.[136]

Whilst the above is self-explanatory, the consequences for tax planning are important, as the dividends will only be taxed in the hands of the ultimate beneficiary (if at all).[137] This means that a complex group structure of companies will not prejudice the ultimate shareholder of the holding company, by being taxed through each shareholder company in the group.

2.20 Conclusion

This chapter has explored the various provisions in the ITA dealing with the taxation of dividends in South Africa, including how they are taxed, who is liable for the tax and a the various exemptions provided in relation to dividends tax. The examples cited show how dividends are taxed in the hands of various entities in South Africa.

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[134] Whilst the onus is on the withholding agent to pay over the dividends tax, and in this regard the withholding agent can be held personally liable, the ultimate obligation to pay the tax lies with the beneficial owner.
[135] ITA, section 10(1)(k).
[136] Idem at section 64F; discussed above at 2.11.2 under heading 'Section 64F'.
[137] If the ultimate shareholder was, for example, a resident company, it would not be subject to dividends tax nor would the dividend be included in that resident company's gross income.

The next chapter will explore how dividends are taxed in Mauritius generally and more specifically an analysis is undertaken of how dividends are taxed in the hands of various entities. The final chapter will then undertake, after a discussion of the provisions of the DTA, a comparison between South Africa and Mauritius, with regard to their taxation of dividends in the hands of various entities.

3 CHAPTER 3 – MAURITIUS

3.1 Introduction

Whilst this dissertation compares[138] the way in which dividends are taxed in South Africa and Mauritius, this dissertation seeks to make the comparison from a South African perspective rather than a purely objective perspective. Further to this, the commentaries and secondary sources for the way in which dividends are taxed in Mauritius are less prolific. Consequently the analysis of the Mauritian tax regime will not be as in-depth as that presented for South Africa.

One can separate the way Mauritius taxes its taxpayers into two distinct categories. The first category is for corporates and the second category is for individuals. It must be noted here that Mauritius does not have any authoritative secondary sources of information as South Africa does in relation to tax and specifically dividends tax. The only sources are therefore the MITA and the various articles and summaries which can be found on various practitioners' websites.[139]

Notwithstanding this limitation, this chapter will seek to provide an overview of Mauritian tax law in order to properly answer the main research question of this dissertation.

A broad approach will therefore be taken in order to analyse the differences in the way dividends are taxed in the hands of different entities, and further to compare this with the South African tax regime in order to come to a final conclusion on the efficacy of utilising offshore structures to minimise a shareholder's tax liability (whether that shareholder is an individual or a corporate entity).

3.2 Main Taxing Statute

The main taxing statute in Mauritius is the MITA.[140] The MITA governs the liability to pay tax, personal taxation and corporate taxation.[141]

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[138] It must be noted that it would be beyond the scope of this dissertation to make a full comparison of the law between the two countries due to the word limitation.

[139] PWC's tax summary is quite extensive, covering a range of different tax topics for Mauritius. A quick discussion on dividends taxes can be found on their 'withholding taxes' section at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Withholding-taxes# last accessed on 4 November 2015; EY has a summary for Mauritius tax which can be found at http://www.ey.com/GL/en/Services/Tax/Worldwide-Corporate-Tax-Guide---XMLQS?preview&XmlUrl=/ec1mages/taxguides/WCTG-2015/WCTG-MU.xml last accessed on 4 November 2015.

[140] Available at http://www.mra.mu/download/ITA1995-180615.pdf, last accessed on 4 November 2015.

[141] Each of these form their own distinct parts in the MITA, for example the liability to pay tax falls under part II, personal taxation falls under part II and Corporate Taxation falls under part III of the MITA.

3.3 General Principles – Corporate Taxation

As with South Africa, a company, which is resident in Mauritius, will be liable for tax on its worldwide income, and a non-resident company will be taxed, subject to an applicable tax treaty, on its income that has its source in Mauritius.[142] In general, corporations are subject to a flat rate of tax of 15 per cent on their net income,[143] and all corporate bodies, such as companies which are incorporated in Mauritius (subject to certain exceptions)[144] are subject to income tax.[145]

With regard to foreign income, Mauritius makes use of a credit system that essentially gives a credit to the taxpayer where that taxpayer has already paid tax in another jurisdiction on that foreign income.[146] Foreign corporations which carry on business in Mauritius are only subject to tax on the income that they derive from Mauritius.[147]

There are different rates for different types of corporations. The following corporations are taxed on income before any distributions at the following rates:

1. Global Business Category 1 (GBL1) companies[148] and offshore trusts are taxed at a flat rate of 15 per cent. However GBL1 companies are entitled to a foreign tax credit which is the higher of 80 per cent of the tax for which they are liable in terms of Mauritius tax law, or the actual tax which they had to pay in another jurisdiction in respect of foreign income. Essentially this means that GBL1 companies have a maximum effective tax rate of 3 per cent;[149]

[142] PWC, 'Taxes on corporate income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Taxes-on-corporate-income, last accessed on 4 November 2015.
[143] Ibid.
[144] An example would be GBL2 companies which are mentioned below under the same section 3.3 under the heading 'General Principles – Corporate Taxation' and briefly discussed below at section 3.4.2 under the heading 'Mauritius GBL2 companies'.
[145] PWC, 'Taxes on corporate income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Taxes-on-corporate-income, last accessed on 4 November 2015.
[146] Ibid.
[147] Ibid.
[148] Global Business Licences (1 and 2) are issued under the Financial Services Act 2007 (as amended).
[149] MRA, 'Credit for foreign tax paid', available at http://www.mra.mu/index.php/taxes-duties/international-aspect, last accessed on 4 November 2015; PWC, 'Taxes on corporate income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Taxes-on-corporate-income,last accessed on 4 November 2015.

2. Global Business Category 2 (GBL2) companies are exempt from tax in Mauritius;[150] and

3. all other resident companies are taxed at a flat rate of 15 per cent.[151]

In order for a corporate entity to be considered a resident in Mauritius, that corporate entity must have been incorporated in Mauritius or the corporation must be centrally managed or controlled in Mauritius.[152] Unlike South Africa, there are no CFC rules in the Mauritius taxation legislation.[153]

3.4 Types of Corporations

As already stated, in Mauritius different types of entities are taxed at different rates and subject to their own specific requirements. There are normal resident companies, GBL1 companies, GBL2 companies, trusts and foreign trusts. Whilst the requirements for each is beyond the scope of this dissertation, it is important to note that, for example, the GBL1 companies and GBL2 companies do have very specific requirements which need to be met in order to make use of their legislated advantages.[154]

3.4.1 Mauritius GBL1 companies

Mauritius GBL1 companies are, for tax purposes, resident companies of Mauritius holding a Category 1 Global Business License.[155] Unlike GBL2 companies, GBL1 companies may make use of the Mauritius' extensive DTA network. A GBL1 company has an effective income tax

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[150] PWC, 'Taxes on corporate income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts .nsf/ID/Mauritius-Corporate-Taxes-on-corporate-income, last accessed on 4 November 2015.
[151] Ibid.
[152] MITA, section 73(1)(b); for a general explanation thereof see PWC 'Corporate – Corporate residence', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Corporate-residence, last accessed on 4 November 2015.
[153] PWC, 'Corporate – Group taxation' available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Group-taxation, last accessed on 4 November 2015.
[154] PWC 'Corporate – Tax credits and incentives', available at http://taxsummaries.pwc.com /uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Tax-credits-and-incentives, last accessed on 4 November 2015.
[155] S Spamer & D Buttrick, 20 November 2011, 'Investing into Africa directly or via Mauritius – the contestable choice' http://www.moneyweb.co.za/archive/ investing-into-africa-directly-or-via-mauritius-t/ last accessed on 4 November 2015.

rate of 3 per cent and importantly there is no withholding tax on dividends which are paid/payable by a GBL1 company to its non-resident shareholders.[156] The effective rate of 3 per cent is in respect of any trading with non-residents, however if the GBL1 company trades with a Mauritian resident, it will be taxed at 15 per cent.[157]

3.4.2 Mauritius GBL2 companies

Mauritius GBL2 companies are, for tax purposes, non-resident companies which are set up for trading and investment purposes and which hold a Category 2 Global Business License.[158] These GBL2 companies are also exempt from income tax and are non-residents for the purposes of any tax treaties.[159]

3.4.3 Offshore trusts

Offshore trusts in Mauritius are set up in terms of the Trusts Act 2001.[160] They are taxed in the same manner as GBL1 and GBL2 companies.[161] Section 46 of MITA governs the taxation of trusts, where the settlor of the trust is a non-resident or where the settlor holds a category 1 Global Business Licence or a category 2 Global Business Licence, or even another trust which qualifies under the section. The beneficiaries of the trust also need to be non-residents or an entity which holds either a category 1 Global Business Licence or a category 2 Global Business Licence, or a purpose[162] trust, whose purpose must be carried out outside of Mauritius.[163]

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[156] Ibid.
[157] PWC 'Corporate – Tax credits and incentives', available at http://taxsummaries.pwc.com /uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Tax-credits-and-incentives, last accessed on 4 November 2015.
[158] S Spamer & D Buttrick, 20 November 2011, 'Investing into Africa directly or via Mauritius – the contestable choice' http://www.moneyweb.co.za/archive/ investing-into-africa-directly-or-via-mauritius-t/ last accessed on 4 November 2015.
[159] PWC, 'Taxes on corporate income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts .nsf/ID/Mauritius-Corporate-Taxes-on-corporate-income, last accessed on 4 November 2015.
[160] Lowtax.net 'Mauritius: Types of Company – Trusts', available at http://www.lowtax.net/information/mauritius/mauritius-trusts.html, last accessed on 4 November 2015.
[161] Lowtax.net 'Mauritius: Offshore Legal and Tax Regimes – Tax Treatment of Offshore Operations', available at http://www.lowtax.net/information/mauritius/mauritius-tax-treatment-of-offshore-operations.html, last accessed on 4 November 2015.
[162] In terms of the Trusts Act 2001.
[163] MITA, section 46(2).

If an offshore trust meets the requirements of section 46 of MITA then it will be taxed at the rate which is set out in the first schedule to MITA. However, if that trust has submitted a declaration to the relevant authority, in terms of section 46(3) of MITA and within a specific time period, the trust will then be exempt from income tax in that income year.

Interestingly, any distribution made by an offshore trust to its beneficiaries is deemed to be a dividend to the beneficiary.[164] This means that an amount that is distributed by an offshore trust to its non-resident beneficiary will be exempt from income tax in Mauritius.[165]

If an offshore trust received income from a source outside of Mauritius, it will be allowed a foreign tax credit on that income. If however an offshore trust does not produce proof that the income has already been taxed in a foreign jurisdiction, then the amount of foreign tax will be presumed to be equal to 80 per cent of the Mauritius tax which is chargeable in respect of that income.[166]

3.5 Dividends Tax

Dividends paid by certain companies are, in terms of Sub-Part B of Part II of the MITA, exempt from income tax. Resident companies and non-resident companies are exempt from being taxed on dividends, where those dividends have been received from a resident Mauritian company.[167]

Any resident company, which is not a GBL1 company, and which receives dividends from a non-resident company is liable for a flat 15 per cent tax thereon. This is however subject to any credit given to the resident company, where the dividends were subject to foreign tax.[168] Where

[164] Idem at section 46(4).
[165] Lowtax.net ‘Mauritius: Offshore Legal and Tax Regimes – Tax Treatment of Offshore Operations’, available at http://www.lowtax.net/information/mauritius/mauritius-tax-treatment-of-offshore-operations.html, last accessed on 4 November 2015.
[166] Ibid.
[167] Paragraph 1(a) of Sub-Part B of Part II of the second schedule to the MITA; MRA, ‘Companies holding category 2 global business licence’, available at http://www.mra.mu/index.php/taxes-duties/international-aspect, last accessed on 4 November 2015; PWC, ‘Corporate – Income determination’, available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Income-determination last accessed on 4 November 2015.
[168] PWC, ‘Corporate – Income determination’, available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Individual-Income-determination, last accessed on 4 November 2015.

a GBL1 company receives a dividend from a non-resident company, it will be subject to tax at an effective rate of 3 per cent.[169]

Where a company holding a Global Business Licence is paid a dividend (or other distribution) by another company holding a Global Business Licence, that dividend will be exempt from income tax.[170]

3.6 Foreign Dividends

If a Mauritian resident company owns a minimum of 5 per cent of a foreign company, then that Mauritian resident company may utilise tax credits in respect of foreign dividends that it received. These tax credits are then used to offset the tax which would have been payable in Mauritius on those foreign dividends. That is, since the source company (the company paying the dividend) paid tax on the underlying profit in the source state, the Mauritian resident company receiving the dividend may claim a tax credit against the payment of the dividend.[171]

It is important to note that where a foreign subsidiary pays dividends to a resident Mauritian parent company, the parent company will be liable for tax on those dividends, regardless of whether or not the resident Mauritian company actually receives those dividends.[172] Therefore, the Mauritian company will be taxed if the dividends accrue to it.

3.7 Withholding Taxes

Companies with a GBL1 or GBL2 license are not subject to withholding tax on payments to non-residents, where those non-residents do not carry on business in Mauritius.[173] There is no withholding tax on dividends that are received from Mauritian resident companies.[174]

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[169] Ibid.
[170] Paragraph 2 of Sub-Part B of Part II of the second schedule to the MITA.
[171] PWC 'Corporate – Tax credits and incentives', available at http://taxsummaries.pwc.com /uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Tax-credits-and-incentives, last accessed on 4 November 2015.
[172] PWC, 'Corporate – Income determination', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Individual-Income-determination, last accessed on 4 November 2015.
[173] PWC, 'Corporate – Withholding taxes', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Withholding-taxes, last accessed on 4 November 2015.
[174] Ibid.

Other withholding rates are dependent on the tax treaty between Mauritius and that other contracting state.[175]

3.8 General Principles – Taxation of Individuals

This dissertation focuses on the efficacy of South Africans electing to structure their tax affairs by utilising Mauritian entities. While a full discussion of Mauritian resident individual's tax implications is beyond the scope of this dissertation, for the sake of completeness I highlight a few pertinent issues.

Individuals resident in Mauritius are subject to a flat rate of taxation of 15 per cent.[176] As is the case in South Africa, residents and non-residents are taxed on all income received from a source within Mauritius. Furthermore, residents of Mauritius are taxed on their worldwide income.[177] Interestingly however, other than income derived from rendering employment duties, income that is derived from a source outside of Mauritius is only subject to tax in Mauritius to the extent that it is actually received in Mauritius.[178]

If a Mauritian individual resident pays tax in respect of foreign income, that resident may claim a foreign tax credit against its Mauritian tax liability.[179]An individual resident or non-resident will not pay tax on dividends received from a resident Mauritian company, however they will pay tax on foreign dividends received, subject to the provisions regarding the receipt of foreign dividends.[180]

3.9 Specific Examples

3.9.1 Individuals

[175] Ibid.
[176] MRA, 'Tax Rates on Chargeable Income: Individuals', available at http://www.mra.mu/index.php/taxes-duties/personal-taxation, last accessed on 4 November 2015; PWC, 'Individual – Taxes on personal income', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Individual-Taxes-on-personal-income, last accessed on 4 November 2015.
[177] PWC, 'Individual – Residence', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Individual-Residence, last accessed on 4 November 2015.
[178] Ibid.
[179] PWC, 'Individual – Other tax credits and incentives', available at http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Individual-Other-tax-credits-and-incentives, last accessed on 4 November 2015.
[180] Offtax.com 'Dividends' available at http://www.offtax.com/countries/mauritius/mauritius-tax-system.php, last accessed on 4 November 2015.

An individual who receives a dividend from a Mauritian resident company will not be liable for tax on that dividend.[181] Further, as there is no withholding tax, the company paying the dividend will not pay the liability for that resident either. In South Africa, a South African resident individual who receives a dividend (or where a dividend accrues to that individual) from a South African resident company would be liable to pay dividends tax on those dividends and the company paying the dividend would be obligated to withhold the dividends tax, and pay it directly to SARS on behalf of the individual.

An individual receiving a dividend from South Africa will however be liable for 15 per cent withholding tax in South Africa, and 15 per cent tax in Mauritius. However the individual will be able to show the MRA that it has paid the foreign withholding tax in South Africa and as such will not pay tax on the receipt of the dividends in Mauritius. This effect of the tax treaty between South Africa and Mauritius is discussed further in Chapter 4.

3.9.2 Mauritian company shareholder of another Mauritian company

A Mauritian company will not be liable for any tax on receipt of dividends from other Mauritian companies. This is beneficial as it allows the flow of dividends up through a group of companies, without the dividends being taxed by each recipient company as the dividends flow through the group.

3.9.3 Mauritian shareholder company of a South African company

There are various types of Mauritian companies and dividends may be taxed differently depending on what type of company the Mauritian shareholder company is. Some examples illustrate how the taxable effect might be felt in Mauritius.[182]

A normal Mauritian resident company will pay 15 per cent tax on dividend income received from a South African company in Mauritius. This amount can be reduced by any tax credit the Mauritian resident company receives for paying tax in South African, and/or any reduction the

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[181] MITA, section 1(a) of Sub-Part B of Part II.

[182] These examples do not explore how the dividend would be taxed in South Africa (the first half of the transaction) - full examples will be included in Chapter 5.

Mauritian resident company may be granted under the tax treaty between South Africa and Mauritius.

A GBL1 company would pay an effective maximum rate of 3 per cent on receipt of dividends from a South African company.[183] While a GBL2 company would not pay any tax in Mauritius on the receipt of a dividend from a South African Company.

3.10 Conclusion

From this general overview of the taxation of dividends and the taxation of certain corporate entities and individuals in Mauritius, it can be concluded that Mauritius has a particularly low rate of tax in general. Moreover Mauritius does not differentiate the taxation of dividends from the taxation of other forms of income, other than where it may be exempted from tax.

Over and above the generally low rate of tax, Mauritius does make use of certain other types of companies (the Global Business Licence companies). While these unique companies are subject to very definitive restrictions and requirements, they benefit from having, as the examples have illustrated, very low to no tax imposed on them.

In the chapter that follows the tax treaty between South Africa and Mauritius will be analysed in order to determine how the flow of dividends between the two countries is taxed. Examples will illustrate any advantage that may be available to companies and shareholders as a result of this tax treaty.[184]

[183] A full example using a GBL1 company will be made in Chapter 5.
[184] Currently the DTA.

4 CHAPTER 4 – DOUBLE TAXATION AGREEMENT

4.1 Introduction and General Aspects

Double taxation agreements are tax treaties that are entered into between two contracting states. These tax treaties govern how various enterprises from the resident state are taxed in the source state. They cover various issues, including reciprocal assistance in the administration of taxes and the collection of those taxes under the domestic laws of both contracting states.[185] Double taxation agreements are entered into between two contracting states to ensure, amongst other things, that a taxpayer is not subjected to double taxation (i.e. that the taxpayer is not taxed in both states on the same income). The DTA will be discussed in this chapter, however it is important to note upfront that the DTA is in effect between South Africa and Mauritius, and it does affect dividends tax. This is important because, as was discussed above in section 2.14[186] and which will be discussed below in section 4.2,[187] dividends tax did not exist at the time that the DTA came into effect.

There are generally two models of double taxation agreements. That is, the OECD Model and the UN Model.

4.2 1996 DTA between South Africa and Mauritius

The DTA between South Africa and Mauritius was entered into in 1996 and came into force in South Africa on 20 June 1997.[188] Whilst a discussion on the entire DTA is outside of the scope of this dissertation, a few articles do impact upon the taxation of dividends.

In terms of article 1, the DTA applies to residents of one or both of the Contracting States, and applies to the types of income stipulated in article 2 of the DTA. According to article 2(3)(b)(ii), and article 2(4) STC and taxes of a substantially similar nature are included in the taxes to which the DTA will apply to in respect of South Africa. The DTA therefore also applies to dividends as discussed above at section 2.14 under the heading 'Binding General Ruling 9'.[189] This is

[185] AP de Koker & E Brincker, Ch 12 'Silke on International Tax' (online version) at paragraph 12.2, available at http://www.mylexisnexis.co.za/Index.aspx?permalink=SVNpbGtlIENoIDEyLjIoNikkNDA1ODQ4NCQ3JExpYnJhcnkkSkQkTGlicmFyeQ, last accessed on 6 November 2015.

[186] This is discussed above in section 2.14 under the heading 'Binding General Ruling 9'.

[187] This is discussed below in section 4.2 under the heading '1996 DTA between South Africa and Mauritius'.

[188] SARS 'Summary of all Treaties for the Avoidance of Double Taxation' available at http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20-%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf, last accessed on 4 November 2015.

[189] SARS 'Binding General Ruling (Income Tax): No. 9' (Issue 2), available at http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BGR-2012-09%20-%20Taxes%20income%20RSA%20Tax%20Treaties.pdf last accessed on 4 November 2015.

significant because the new system of dividends tax only came into effect in South Africa in 2012, and therefore was not effective as a tax in South Africa when the DTA was concluded and came into force.

In article 3 the DTA sets out some general definitions, including who the Contracting States are, while article 4 describes who 'residents' are and contains a test to determine which individuals are resident and which legal persons other than individuals are resident.[190]

The test for an individual (natural person) is to be found in Article 4(2), and the test for a legal person other than an individual is found in Article 4(3). In determining an individual's residence article 4(2) lists some pertinent factors which consist of a series of tests; if the one test does not apply the next factor is tested. These tests include where the resident's permanent home is, or where his vital interests are, where his habitual abode is, where he is a national and finally, if none of the aforementioned tests are indicative of his residence, the Contracting States may settle the question by mutual agreement between themselves.

Article 4(3) states that where a person other than an individual is a resident of both Contracting States, then that person is deemed to be a resident of the State in which its 'place of effective management' is situated. This is an important concept and will be discussed below in section 4.5.[191]

Article 5 elaborates on the concept of permanent establishments and contains a list of which activities shall be included in the term. A permanent establishment is a concept that is created in double taxation agreements and outlines the activities that an enterprise of a resident state must conduct in the source state, before the profits that are generated from those activities can be taxed in the source state.

On 15 May 2015, the Tax Court in Johannesburg handed down judgment in the case of *ITC 1878.*[192] In this case, the Tax Court had to determine whether an American company, an

[190] Whilst a full discussion on the various tests are beyond the scope of this dissertation, it is important to discuss the key concepts.
[191] Discussed below at 4.5 under the heading 'Place of Effective Management'.
[192] *Income Tax Case No* 1878 77 SATC 349 *(referred to as AB LLC and BD Holdings LLC v Commissioner for South African Revenue Service* (15 May 2015, case number 13276) when the case was unreported).

advisory group for the airline industry, had created a permanent establishment in South Africa.[193] There were two relevant provisions relied on in terms of the double taxation agreement between South Africa and the United States of America:

1. article 5(1) which stated '*for the purposes of this convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on*'; and

2. article 5(2)(k) stated that the term permanent establishment '*includes especially*' '*the furnishing of services including consultancy services within a contracting state by an enterprise through employees or other personnel engaged by the enterprise for such purposes, but only if activities of that nature continue (for the same or connected project) within that state for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the taxable year concerned*'.

The company taxpayer (the appellant) in this case argued that a permanent establishment needed to be created first before looking at the provisions of article 5(2)(k). SARS argued that if the appellant fell within article 5(2)(k) that a permanent establishment then existed, and that it was not necessary to comply with the provisions of article 5(1). The court agreed with SARS and held that the words '*includes especially*' meant activities that will constitute a permanent establishment.

Further to the court's interpretation of the words '*includes especially*' the court analysed the commentary published by the OECD (Commentary)[194] on its Model Convention with Respect to Taxes on Income and On Capital (Model Tax Treaty).[195] While the Commentary differed on the treatment of the articles, the Model Tax Treaty did not include a provision like article 5(2)(k)

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[193] For a brief explanation of the case see - Dr B Croome, 'Tax Consequences of Foreign Companies Rendering Services in South Africa' 9 June 2015, available at http://www.taxtalk.co.za/tax-consequences-of-foreign-companies-rendering-services-in-south-africa/ last accessed on 4 November 2015.

[194] OECD 'Commentaries on the Articles of the Model Tax Convention', starting at page 186, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.

[195] Available at http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf, last accessed on 4 November 2015.

and as such the court opted to follow the technical explanation[196] of the treaty between the United States of America and South Africa, which effectively provided that article 5(2)(k) was not to be treated in the same manner as the rest of 5(2) and did not rely on section 5(1).

The court then looked at the number of days the appellant's employees were in South Africa and held that they met the time requirements in terms of article 5(2)(k), and that a permanent establishment had been created. The court also held that the appellant had a fixed base in the boardroom of its client in South Africa, while providing services to its client and it therefore also complied with the requirement of article 5(1), regardless of whether or not article 5(2)(k) applied. The court held that the non-resident appellant was liable for tax here in SA on the services rendered to its South African client as it had created a permanent establishment.

Whilst the wording of the current DTA is different to that of the double taxation agreement in the above case, they are similar enough to make the note that if any of the activities in article 5(2) are being undertaken by an enterprise, that they may be deemed to be a permanent establishment, regardless of whether or not the enterprise has a 'fixed place of business through which the business of the enterprise is wholly or partly carried on'. That is, at least in terms of South African case law it would then seem that an enterprise does not have to actually comply with the definition of a permanent establishment as set out in article 5(1), but just has to comply with one of the activities in article 5(2) to constitute a permanent establishment. Whilst there is no provision like article 5(2)(k) in the DTA, nor is there a similar technical explanation for the DTA, it must be noted that the court used the technical explanation as additional evidence to its interpretation of the permanent establishment articles and as such, an enterprise would be safer if it ensures that it does not fall in either article 5(1) or article 5(2) to ensure it does not create a permanent establishment.

Article 10 is the most relevant provision from the DTA for the purposes of this dissertation as it deals specifically with dividends. This will be discussed in its own in section 4.3 below.[197]

[196] 'Department of the Treasury Technical Explanation of the Convention between the United States of America and the Republic of South Africa for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income and Capital Gains', available at http://www.irs.gov/pub/irs-trty/safrtech.pdf, last accessed on 4 November 2015.
[197] Discussed below at 4.3 under the heading 'Article 10 of the Double Taxation Agreement'.

Finally, article 23 of the DTA provides for the elimination of double taxation. Essentially it provides that the enterprise will have credits (in the case of Mauritius) or deductions (in the case of South Africa) against the tax due in its resident state, where it has paid tax in the other contracting state (source state) in respect of profits made in that source state.

4.3 Article 10 of the Double Taxation Agreement

Article 10(1), which deals with the treatment of dividends, starts out by allowing dividends being paid by a company which is a resident of one of the contracting states (the source state) to a resident of the other contracting state (the resident state) to be taxed in that other state (the resident state). Therefore, if a South African resident company pays a dividend to a shareholder resident in Mauritius, Mauritius may tax that dividend (subject to the rules which follow and subject to any other local laws of taxation).

Article 10(2) then states that the dividend referred to in article 10(1) may also be taxed in the contracting state where the company which paid the dividend is resident (the source state). Article 10(2) continues by creating the rule that if the recipient of the dividend (in the resident state) is the beneficial owner of the dividend, that the tax charged to the beneficial owner cannot exceed 5 per cent of the gross amount of the dividends if that beneficial owner is a company which holds at least 10 per cent of the capital of the company which paid the dividends.[198] If however the beneficial owner does not comply with the above, then the tax on the dividend cannot exceed 15 per cent.[199]

The DTA then, in article 10(3), provides that the term dividend means income from shares or the participation in profits of the company (it specifically excludes debt claims). It includes other corporate rights, which rights are taxed in the same manner as income from shares by the contracting state, where the company who is making the distribution is resident (that is the source state).

Article 10(4) provides that where the beneficial owner (that is resident in the resident state) is found to be a permanent establishment (in the source state), or performs independent personal

[198] DTA, article 10(2)(a).
[199] Idem at article 10(2)(b).

services from a fixed base within the source state, and the holding of the shares from which the dividend payment is made, is made in respect of that permanent establishment or the fixed base, then either article 7 or article 14 will apply and the provisions of article 10(1) and article 10(2) will not apply.

Article 7 deals with business profits and article 14 deals with independent personal services. A brief description has been included merely to show the result of a permanent establishment or fixed base being established in the source state in terms of article 10(4) above.

Article 7 provides that the profits of an enterprise resident in the resident state will only be taxable in that resident state unless it carries on business in the sources state through a permanent establishment. If the enterprise is found to be a permanent establishment then the profits will only be taxable in the source state to the extent that they are attributable to the permanent establishment.[200]

Article 7 then creates a fiction which separates the permanent establishment from the enterprise and attributes the profits accordingly,[201] allowing for deductions against expenditure for a permanent establishment[202] and allowing a contracting state to tax the apportionment contained in article 7(2), as it would be in that contracting state (as long as the apportionment is in terms of the DTA).[203] The article then provides that the profits of the permanent establishment will not just be attributed to it just because that permanent establishment has purchased goods or merchandise for the enterprise,[204] and that the methodology in determining the profits which are to be attributed to the permanent establishment must be consistent in each year unless there is a 'good and sufficient reason' not to.[205] Finally, article 7(7) provides that where the profits of the enterprise include items of income which are dealt with elsewhere in the DTA, then the other articles of the DTA take precedence.

Article 14 provides that a resident of a contracting state which provides services (professional services or services of an independent character) will be taxed on income derived from those

[200] Idem at article 7(1).
[201] Idem at article 7(2).
[202] Idem at article 7(3).
[203] Idem at article 7(4).
[204] Idem at article 7(5).
[205] Idem at article 7(6).

services only in that resident state, unless he has a fixed base in the source state which is regularly available to him in that source state for the purpose of performing those services. If he does have a fixed base, then he may be taxed in the source state on the income derived from those services, but only to the extent that the income is able to be attributed to that fixed base.[206]

Article 14(2) continues by including specific services into the meaning of 'professional services'.[207]

Article 10(5) provides that, where a company which is a resident in the resident state derives a profit or income from the source state, the beneficial owner in the source state cannot be taxed on the dividends which are paid by the company. This is except in so far as such dividends are paid to a resident of the source state or where and to the extent that the shareholding in respect of which the dividend is paid is connected with a permanent establishment or fixed base which is situated in that source state. It provides further that the source state cannot tax the company's undistributed profits, even if the dividends which are paid, or those undistributed profits consist of (to whatever extent) profits or income that arose in that source state.

4.4 Applicable OECD Commentary on Article 10

Whilst article 10 of the DTA may seem somewhat straightforward in its application, it is important to review the Commentary[208] on the Model Tax Treaty[209] in order to carefully analyse the provisions of article 10 of the DTA. The Commentary is extensive, and as with all the articles contained in the Model Tax Treaty, the Commentary provides an explanation paragraph by paragraph.

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[206] Idem at article 14(1).

[207] The services include independent scientific, educational or teaching activities and includes independent activities of certain professionals such as physicians, lawyers, engineers, architects, dentists and accountants.

[208] OECD 'OECD Commentaries on the Articles of the Model Tax Convention', starting at page 186, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.

[209] Available at http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf, last accessed on 4 November 2015.

The Commentary begins by explaining what dividends are, what entities can distribute dividends and that the shareholder is a separate entity from the company and can only be taxed on those distributions actually made to him.[210]

The DTA, and specifically article 10 is very similar to the Model Tax Treaty with only a few minor changes. As this dissertation is not a discussion on double taxation agreements in general, the likeness and differences are not within the scope of this dissertation. However with that being said a few noteworthy points will be made:

1. The Commentary makes a point that the word paid in article 10(1) has a very wide meaning due to the concept of 'payment' meaning the fulfilment of an obligation by a company to put funds at the disposal of the shareholder in terms of a contract or a custom. This is an interesting definition as the concept of placing funds at the disposal of the shareholder does not necessarily mean that the funds have been received by the shareholder. It therefore seems to suggest that the term 'paid' means a receipt or accrual of the dividends (in South African terminology).[211]

2. Article 10 is quite restricted in its application as it only deals with dividends which are paid by a company which is a resident of one of the contracting states, to a resident of another contracting state.[212] It makes it clear that there may be other more complicated scenarios where the article will simply not be applicable (i.e. it is not an all-encompassing provision for dividends).

3. The term beneficial owner is not narrow and technical; it is used in a wider and practical sense. It is important to note that the Commentary explains that an agent, receiving on behalf of someone else, will not be the beneficial owner and as such cannot be taxed on receipt thereof. This is, as discussed above in section 2.9, the same as the position in South Africa.[213]

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[210] OECD 'OECD Commentaries on the Articles of the Model Tax Convention' at page 186, available at www.oecd.org/berlin/publikationen/43324465.pdf last accessed on 4 November 2015.
[211] Idem at paragraph 7 on page 187.
[212] Idem at paragraph 8 on page 187.
[213] Discussed above at 2.9 under the heading 'Who is Taxed - The Beneficial Owner/Recipient' wherein the BPR was discussed; For a discussion on the topic, in relation to OECD based tax treaties, see also OECD 'OECD Commentaries on the Articles of the Model Tax Convention', paragraph 12.1 on page 187 and 188 of the, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.

4. The Commentary continues and explains that a beneficial owner cannot include a 'conduit company' or '*a conduit for another person who in fact receives the benefit of the income concerned… cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which renter it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties*'.[214] This is an important interpretation as it fully correlates with the South African interpretation in the BPR discussed above in section 2.9[215] and ensures that there should therefore be consistent treatment of these 'conduit' entities[216] in the various jurisdictions which use treaties based on the Model Tax Treaty, and specifically South Africa and Mauritius. This means for tax planning purposes the taxation of the beneficial owner is seemingly settled law.

5. In terms of article 10(3) the Commentary states that dividends carry different meanings in its different member states and as such the term 'dividends' cannot be defined and therefore it is defined with reference to a non-exhaustive list of examples which are commonly found in its member states' laws. It goes further and states that it is not possible to define dividends separately from domestic law definitions as there are too many differences in each states' company laws and tax laws.[217] This is a good thing as if it were not open to the contracting states to use their own definition of a dividend, there may be uncertainty and inconsistency in tax planning between the domestic taxation of dividends in each contracting state and the treatment thereof in terms of the DTA.

4.5 Place of Effective Management

An enterprise's place of effective management (POEM) is an important concept in South Africa as well as in terms of the DTA. The reason for this, in the South African context, is that it forms

[214] OECD 'OECD Commentaries on the Articles of the Model Tax Convention', paragraph 12.1 on page 187 and 188, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.
[215] Discussed above at 2.9 under the heading 'Who is Taxed - The Beneficial Owner/Recipient'.
[216] Such as trusts, where the trusts are the holder of the shares and distributes the dividends to the beneficiaries.
[217] OECD 'OECD Commentaries on the Articles of the Model Tax Convention', paragraph 12.1 on page 187 and 188, available at www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 4 November 2015.

part of the definition of a residence of a person that is not a natural person. In the context of the DTA it is important for the same reason in that, where a person other than a natural person is a resident of both Mauritius and South Africa, the test to determine which state that person is deemed to be a resident of, for the purposes of taxation, is the POEM test.

The Commentary discusses the fact that it is not appropriate to give weight to the jurisdiction where a company is actually registered and therefore the proper enquiry is where the company is actually managed. The Commentary explains that the POEM is '*the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made*.'[218] In order to determine whether this is actually the case, all the facts need to be taken into consideration in order to make the determination. Importantly, however, the Commentary makes the point that a company can only have one POEM at any one time.[219]

In 2002 SARS issued Interpretation Note No. 6 (IN 6) which discussed the POEM concept as it pertained to the test for residence for persons other than natural persons for the purposes of s1 of the ITA.[220] IN 6 referred to the fact that the terms 'effective management' or 'effectively managed' were used by various countries around the world and also by the OECD. However, IN 6 makes the point that the meaning is not universal and each country attaches its own meaning to the words.[221] IN 6 then states that POEM is not a shareholder function, but rather where the company is managed on a day-to-day basis, regardless of where the overriding control of the company is actually exercised or even where the board of directors meets. It states that these functions could even be carried on in different places and as such it is where the business operations of the company are actually carried out or conducted, and whilst no definitive rule exists in this regard, in order to determine the POEM of the company, all the facts which are relevant to the enquiry need to be taken in to account. IN 6 lists various non-exhaustive factors that need to be taken into account. Importantly, from a South African perspective, IN 6 states a company will not be a controlled foreign entity for the purposes of

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[218] Idem at paragraph 24 on page 88 and 89.
[219] Ibid.
[220] SARS 'Interpretation Note No. 6 Resident: Place of Effective Management (Persons other than Natural Persons)'26 March 2002, available at http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-06%20-%20Resident%20Place%20Effective%20Management.pdf, last accessed on 4 November 2015.
[221] Idem at page 2.

section 9D of the ITA if its POEM is in South Africa (this is because it would therefore be considered a resident for the purposes of the ITA).

In 2011, the Western Cape High Court handed down judgment in a case[222] where the applicant, who was seeking declaratory relief, was a trust which had been established and registered in Mauritius. One of the issues was whether the trust was to be regarded as a resident in South Africa as a result of having its POEM in South Africa. The court held that it could not pronounce on the issue, as the issue was one of fact and not law and that the Tax Court would be in the more appropriate position to decide on the issue with it being able to hear all of the facts.

The court did however traverse the issues to be dealt with in determining an entity's POEM. It did this by discussing and extracting the principles of a recent case which was heard in the UK.[223] The judge stated that:

> *In my view, the key features of Smallwood relating to the POEM of an entity relevant to this case, are:*
>
> 1. *The POEM is the place where key management and commercial decisions that are necessary for the conduct of the entities business are in substance made;*
> 2. *The POEM will ordinarily be the place where the most senior group of persons (for example a board of directors) makes its decision, where the actions to be taken by the entity as a whole are determined;*
> 3. *However, no definite rule can be given and all relevant facts and circumstances must be examined to determine the POEM of an entity;*
> 4. *There may be more than one place of management, but only one POEM at any one time;…*[224]

The judgment therefore gives an understanding of the important elements that the courts will consider when determining an enterprise's POEM.[225]

[222] *Oceanic Trust Co. Ltd N.O v Commissioner for South African Revenue Service* 22556/09 (2011).
[223] *Commissioner for Her Majesty's Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778.
[224] *Oceanic Trust Co. Ltd N.O v Commissioner for South African Revenue Service* 22556/09 (2011) at pages 30 and 31.
[225] Ernst & Young 'International Tax Issue 147- November/ December 2011 2012- Place of effective Management'

SARS has, after international developments and the *Oceanic Trust Case*, revisited the POEM concept in its discussion paper on IN 6[226] (Discussion Paper). The Discussion Paper reviews the criticisms of the current IN 6 and discusses the Commentary and the international views on POEM. Essentially it moves away from the view that POEM is where the day-to-day running of the company is performed (despite where the overriding control may be) and moves toward the Commentary's view that POEM is where the key management and commercial decisions of the company are made.[227] SARS confirmed this view in the second issue of Interpretation Note No. 6.[228]

4.6 The Revised DTA

The 1996 DTA was renegotiated and signed on 17 May 2013 in Maputo (I have referred to this as the Revised DTA above and throughout this dissertation).[229] This Revised DTA was, however, not initially ratified.

The Revised DTA was published in the Government Gazette on 17 June 2015. In terms of this published notice the Revised DTA came into force on 28 May 2015.[230] In terms of Article 28 of the Revised DTA, the Revised DTA will come into effect on the first day of January following its entry into force. Accordingly, the Revised DTA, and specifically article 10 of the Revised DTA, which governs the taxation of dividends, will come into effect on 1 January

http://www.saica.co.za/integritax/2011/2012._Place_of_effective_management.htm, last accessed on 4 November 2015.

226 SARS 'Discussion Paper on Interpretation Note 6: Place of Effective Management' available at http://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2011-02%20-%20Discussion%20Paper%20POEM%20on%20IN6.pdf, last accessed on 4 November 2015.

227 BDO South Africa, 30 April 2015 'SARS' Draft Interpretation note on 'Place of Effective Management' available at http://www.taxtalk.co.za/sars-draft-interpretation-note-on-place-of-effective-management, last accessed on 4 November 2015.

228 SARS 'Interpretation Note No. 6 (Issue 2) 'Resident: Place of Effective Management (Persons other than Natural Persons)' 3 November 2015, paragraph 4.1 on page 4, available at http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-006%20-%20IN%206%20Issue%202%20place%20of%20effective%20management%20companies.pdf last accessed on 5 November 2015. This second issue of Interpretation Note No. 6 confirmed the view SARS held in the discussion paper on IN 6. The second issue of Interpretation Note No. 6 was released on 3 November 2015.

229 SARS 'Summary of all Treaties for the Avoidance of Double Taxation' available at http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20-%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf, last accessed on 4 November 2015.

230 According notice published in the government gazette, page 1, available at http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2015-02%20-%20DTA%20Mauritius%20GG%2038862.pdf, last accessed on 4 November 2015.

2016. The effective date of the Revised DTA is the same for both Mauritius and South Africa.[231]

There are quite a few changes in the Revised DTA, however only changes that are relevant for the purposes of this dissertation will be discussed.

4.7 The Differences between the DTA and the Revised DTA

The first difference pertains to the determination of a resident in terms of article 4(3) which moves away from the POEM test. On 22 May 2015 the Mauritius Revenue Authority and the South African Revenue Service entered into a Memorandum of Understanding concerning 'The application of the provision of article 4(3) of the Agreement between the Government of the Republic of Mauritius and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income signed on 17 May 2013 in Maputo'[232] (MOU).

The purpose of the MOU[233] is to clarify the procedure to be followed by the competent authorities in order to give effect to article 4(3) of the Revised DTA. That is, whilst the current test where a company is resident in both Mauritius and South Africa is the application of the POEM test. The Revised DTA refers to a mutual agreement procedure, which is known as the competent authority procedure.[234]

The Commentary states that some authorities believe that it is rare for a company to be resident in two places at the same time and as such should be decided on a case by case basis by agreement between the two competent authorities (which are defined terms in the MOU as being the South African Revenue Service for South Africa and the Mauritius Revenue Authority

[231] Revised DTA, article 28, governs the effective date for the Revised DTA for both Mauritius and South Africa and can be available at http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2015-02%20-%20DTA%20Mauritius%20GG%2038862.pdf, last accessed on 4 November 2015.
[232] MOU, page 1, available at http://www.mra.mu/download/MOUSAMay2015.pdf, last accessed on 4 November 2015.
[233] Mauritius signed and ratified the Revised DTA and the MOU in May of 2015. In terms of article 4 of the MOU, it will come into force on the same date on which the Revised DTA becomes effective.
[234] Global Wealth Management Solutions Ltd 'Mauritius Global Business Update 29' available at http://www.gmni.com/images/News/Mauritius_SATaxTreaty0515.pdf, last accessed on 4 November 2015.

for Mauritius).[235] The Commentary lists factors which should be taken into account in this test and this includes '*where the meetings of its board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc.*'[236]

The MOU lists the factors that the competent authorities must take into account and which specifically incorporates the factors listed in the Commentary. The list of factors is not however exhaustive as in article 2(h) of the MOU, it is stated that the competent authorities may take into account any other factor that may be identified by them to determine the residency of the person.[237]

In essence then POEM is important (for the purposes of taxation) to determine residence in terms of both the ITA and the DTA, however, whilst it may not be as important in terms of the Revised DTA as residence will rather be determined by mutual agreement, it is submitted that the POEM test would probably still be the most effective test and the contracting states will, in all likelihood, implement the POEM test in assessing residence of a company or trust which may be physically resident in both states.

A further difference between the DTA and the Revised DTA is the effective withholding rate of dividends in certain circumstances. As discussed above in section 4.3,[238] the withholding rate in terms of article 10 of the DTA reduces the dividends tax liability in terms of the ITA from 15 per cent to 5 per cent for dividends paid by a South African company to a Mauritian Shareholder company where that Mauritian Shareholder company owns 10 per cent or more of

[235] MOU, page 2, available at http://www.mra.mu/download/MOUSAMay2015.pdf, last accessed on 4 November 2015.

[236] OECD Commentaries on the Articles of the Model Tax Convention, available at www.oecd.org/berlin/publikationen/43324465.pdf, paragraph 24.1 on page 89, last accessed on 4 November 2015.

[237] MOU, page 2, available at http://www.mra.mu/download/MOUSAMay2015.pdf, last accessed on 4 November 2015.

[238] Discussed above at 4.3 under the heading 'Article 10 of the Double Taxation Agreement'.

the capital of the South African company and 15 per cent in every other case. The Revised DTA keeps the requirements for the 5 per cent reduction in the rate of withholding tax, however it reduces the percentage from 15 per cent to 10 per cent in every other case. Therefore, whilst currently a shareholder (which is not a company, or is a company but owns less than 10 per cent of the capital of the South African company) residing in Mauritius gets taxed at the same 15 per cent rate on the dividends as its South African resident counterparts, it will, from January 2016 onward, only be taxed at 10 per cent.

4.8 Specific Examples

Some examples serve to illustrate how South Africans, seeking to minimise their tax liability in terms of the DTA, can make use of the DTA (or Revised DTA).

4.8.1 South African company with a Mauritian shareholder company

If a Mauritian shareholder is a company, holding 10 per cent or more in the capital of the South African company, then, when the South African company makes a distribution the Mauritian Shareholder will only be taxed at 5 per cent by South Africa. This example however assumes that the Mauritian shareholder is not a Controlled Foreign Company in terms of section 9D of the ITA, nor is it considered a permanent establishment in South Africa.

It must be noted that a South African resident company that receives a dividend from another South African resident company is exempt from dividends tax. The point here however will be where the Mauritian company makes its distribution to its shareholders, it should be done in terms of the Mauritian tax regime and not at the 15 per cent that a South African resident would be taxed on (in terms of the rate of tax for dividends withholding tax in terms of the ITA).

4.8.2 South African company with Mauritian resident

In the case of a shareholder who is a Mauritian resident, but is not a company owning 10 per cent or more of the South African company making the distribution, then currently the shareholder will be taxed at a rate of 15 per cent on that dividend (the same as a South African resident would in terms of the ITA).

However, from January 2016 the Revised DTA will replace the DTA and as such, the same shareholder will be taxed at 10 per cent on the dividends distributed to it. Therefore the same shareholder will be in a better position than a South African resident would be.

4.9 Conclusion

In terms of the DTA and more specifically the Revised DTA, it is obvious that there are definitely advantages of having a Mauritian resident receiving dividends from a South African company.

To ensure that a South African, who is structuring his tax affairs in such a way as to take advantage of the DTA, successfully takes advantage of the DTA or the Revised DTA (from January 2016) that South African needs to ensure that he does not set up a structure in Mauritius which is seen to be a permanent establishment in South Africa, a controlled foreign company in South Africa (assuming the entity set up in Mauritius is a company) or that the POEM is actually found to be in South Africa. Effectively, the entity in Mauritius needs to actually be managed from Mauritius in substance and form.

5 CHAPTER 5 – COMPARISON AND CONCLUSION

5.1 Introduction

In conclusion dividends are taxed differently in the hands of different entities in South Africa and the way in which shareholders would be taxed on those same dividends differs if the dividends flowed through an entity in Mauritius. The efficacy of utilising offshore structures to minimise a person's dividends[239] tax liability in South Africa through the DTA is subject to influence from several factors as can be illustrated by the examples below.

5.2 Specific Examples

5.2.1 South African shareholder using GBL1 company

To use an example to show the effectiveness of an offshore structure which includes a GBL1 company, if a South African resident owned 10 per cent or more of a GBL1 company (to gain the foreign dividend participation exemption),[240] but did not fall foul of the CFC provisions in the ITA, that is, the GBL1 company was not a CFC in relation to the South African shareholder (and therefore the income and capital gains of the company was not attributed to the shareholder), then, assuming the place of effective management of the GBL1 company was in Mauritius, if the GBL1 company distributed a dividend, the GBL1 company would first be taxed at a rate of 3 per cent on its income (in comparison to a flat rate of 28 per cent of South African Companies, and a maximum marginal rate of 41 per cent[241] for the individual South African shareholder).[242]There is no withholding tax in Mauritius on a dividend payment by a GBL1 company to its non-resident shareholder. As the South African resident is a non-resident for the purposes of tax in Mauritius, he would not be subject to tax on that dividend in Mauritius.

In South Africa, the distribution received would constitute a foreign dividend. As the shareholder owns more than 10 per cent of the total equity shares in the Mauritian GBL1

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[239] As has already been stated, this dissertation does not seek to analyse how dividends in specie are taxed, or even dividends distributed from listed companies. It seeks to analyse the tax on dividends distributed by private companies only.

[240] ITA, section 10B(2)(a); SARS Comprehensive Guide to Dividends Tax, page 6; discussed above at 2.17 under the heading 'Foreign Dividends'.

[241] For the 2016 tax year.

[242] See CFC provisions discussed above at 2.16 under the heading 'Controlled Foreign Companies', if the GBL1 company is a CFC in relation to a South African shareholder who is a natural person, that natural person would be taxed up to his maximum marginal rate of taxation (depending on the amount of income and capital gains made by the company in relation to his shareholding).

company, he is exempt from paying normal tax on that foreign dividend due to the participation exemption.

5.2.2 South African shareholder

There are an infinite number of examples that could be explained, however as this dissertation compares the taxation of dividends from a South African perspective, it is important to have an example that would have proper, real world application to South African companies and shareholders. As such, in this example a South African company (company A) declares and pays a dividends to its sole shareholder, a non-resident company (company B) which was incorporated in, and is resident in Mauritius.

In terms of section 64G(1) company A withholds 15 per cent of the dividend paid to company B. However the withholding rate of 15 per cent can be reduced, in terms of section 64G(3), if a declaration and undertaking has been provided to company A by the beneficial owner (company B). Company A will therefore only have to withhold 5 per cent of the value of the dividend (in terms of article 10(2)(a) of the DTA).

If the sole shareholder of company B is an individual resident in South Africa then, in terms of section 10B(2)(a) of the ITA (the participation exemption), the payment of the foreign dividend will be exempt from normal tax in the hands of that resident shareholder.

This will however be subject to the CFC and FBE provisions above. That is, the income of the company B will be attributable to the shareholder (as the CFC requirements are met), however if the shareholder can ensure that the company meets the requirements of a FBE, then the CFC provisions will not apply.

Therefore, in this example, assuming the shareholder can ensure that company B is a FBE, the total dividends tax liability from the payment of the dividend by company A, to the ultimate payment to the shareholder would only be 5 per cent.

It must be noted however that in order to actually constitute a FBE, company B would have to have substance and not merely be a sham in order to reduce the ultimate tax liability of the shareholder. The important point however, is that if proper structures are set up, there will be a reduction in the dividends tax liability.

5.3 Conclusion

As one can see, there are many advantages to having a structure that incorporates entities registered in Mauritius, especially with regard to the receipt of dividends. This is subject to many factors however and tax practitioners and planners need to ensure that all the relevant criteria are met in order to properly and legally reduce a taxpayer's tax liability.

The use of offshore structures in Mauritius does then, as seen in the examples above, have the capability of reducing a South African shareholder's dividends tax liability. There are many effective and efficient ways of achieving this purpose, depending on where the source of the income, from which the dividends are distributed, is actually derived from.

There are many anti-avoidance measures in the ITA which negate the reduction measures which are discussed above in section 2.16.[243] However, if a South African shareholder sets up proper, legitimate structures, and not just sham structures with the sole purpose of reducing his tax liability, then he may make use of these reduction measures[244] which will if done correctly, effectively reduce his dividends tax liability.

The answer then to the main research question is yes, multinational structures which make use of Mauritius can be effective when attempting to minimise the tax liability of different entities in relation to dividends, simply put it is worth incorporating such structures if done correctly.

[243] For example the controlled foreign company provisions in the ITA discussed above at 2.16 under the heading 'Controlled Foreign Companies'.

[244] For example, where a Foreign Business Establishment is established (discussed above at 2.16 under the heading 'Controlled Foreign Companies') then the provisions of article 10 of the DTA (discussed above at 4.3 under the heading 'Article 10 of the Double Taxation Agreement') may be utilised and a proper reduction in the rate of dividends tax may be achieved.

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7. LIST OF ACRONYMS UTILISED IN THIS DISSERTATION

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UNIVERSITY OF KWAZULU-NATAL
INYUVESI YAKWAZULU-NATALI

19 November 2015

Mr Daniel Peter Derek Robb (203517126)
School of Law
Howard College Campus

Dear Mr Robb,

Protocol reference number: HSS/0547/015M
Project title: A comparative analysis of the taxation of dividends between South Africa and Mauritius

Approval Notification – Amendment Application

This letter serves to notify you that your application and request for an amendment received on 16 November 2015 has now been approved as follows:

- Change in Supervisor

Any alterations to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form; Title of the Project, Location of the Study must be reviewed and approved through an amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

Best wishes for the successful completion of your research protocol.

Yours faithfully

....

Dr Shenuka Singh (Chair)

/ms

Cc Supervisor: Mr Chris Schembri and Dr Shannon Bosch
Cc Academic Leader Research: Dr Shannon Bosch
Cc School Administrator: Mr Pradeep Ramsewak

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