Revisiting Mauritius/South Africa Double Tax Avoidance Treaty

Kamal Hawabhay
Global Wealth Management Solutions Ltd, Mauritius

In his Budget 2003-2004 (the "Budget"), the South African Finance Minister Trevor Manuel proposed an amnesty process with regards to South African resident taxpayers who have *illegal* offshore money. The amnesty will cover all income tax and exchange control taxes, penalties, interest charges and civil convictions up until February 28, 2003, in exchange for the payment of a small fine of 5 percent for all foreign assets that are repatriated to South Africa and a one-time exchange control levy of 10 percent for all foreign assets remaining offshore.

The Commissioner of the South African Revenue Service, Pravin Gordhan, has been reported as saying that SARS will make full use of the *Exchange of Information* article of the Double Tax Treaties that South Africa has concluded with several countries to track down defaulting taxpayers.

The amnesty proposed by the Minister has understandably made headlines in most of the major newspapers in South Africa. South Africans have a long tradition of keeping money offshore, for many reasons, as acknowledged by the Minister. South Africans have been urged to make the amnesty process a success and this has sometimes been so forceful that it has predictably made most people with funds offshore nervous, even those with legal offshore funds!

At the outset, it is worth reiterating, if need be, that it is perfectly legal for one to arrange one's affairs in the best possible way in order to minimise tax liability and this includes considering legal offshore structuring of one's affairs and business.

This paper addresses some aspects of legally using Mauritius, better known as a tropical paradise island, but now more widely known as a business structuring jurisdiction of international repute and discusses certain confidentiality aspects.

Mauritius is an independent and sovereign nation strategically located in the Indian Ocean and has earned a solid reputation as a world class international financial services hub, providing operational security and commercial flexibility to investors. Mauritius offers a unique blend of very innovative, flexible and value added features which will no doubt appeal to a wide range of global investment vehicles:

- Modern, innovative and user-friendly legislation;
- Internationally recognised standards of regulatory practices;
- Well diversified economy with a growth rate averaging 5 percent for the past 20 years;
- Political stability guaranteed by Parliamentary democracy;
- Connected to the SAFE fibre optic network;
- Pool of highly qualified professionals bilingual in English and French;
- Favourable fiscal policies;
- Growing network of double Tax Treaties.

Mauritius has focused the development of its Global Business (previously known as offshore) centre on the use of its growing network of double taxation treaties for structuring investment abroad. So far Mauritius has ratified 26 treaties and is party to a series of treaties under negotiation. The treaties currently in force are with Belgium, Botswana, Cyprus, France, Germany, India, Indonesia, Italy, Kuwait, Luxembourg, Madagascar, Malaysia, Mozambique, Namibia, Nepal, Oman, Pakistan, People's Republic of China, Singapore, South Africa, Sri Lanka, Sweden, Thailand, United Kingdom and Zimbabwe.

I. The Treaty

Mauritius concluded, on July 5, 1996, a comprehensive double tax avoidance treaty with South Africa (the "Treaty") covering the Mauritius Income Tax and South African Normal Tax and Secondary Tax on companies. The Treaty was ratified on June 20, 1997.

An important change in the Budget relates to the henceforth non-taxability of foreign dividends. The Minister announced that to encourage the inflow of corporate offshore group profits, dividends declared by foreign subsidiaries to SA companies will no longer be subject to SA tax where the SA company holds a "meaningful interest" in the foreign subsidiary. These foreign dividends will also enable the SA recipient companies to obtain a foreign exchange control credit so that these amounts can, subject to approval, be remitted from SA. This therefore means that dividend paid by offshore companies to South African companies will now not be taxed.

It has also been reported that the National Treasury is considering extending the removal of the tax on foreign dividend to individuals as well, such that individuals or those who are majority shareholders in offshore companies might also not be taxed on dividends declared by those companies.

Interest and royalties are exempt from withholding tax in the source country provided beneficially owned by the recipient. South Africa does not impose a withholding tax on payment of interest to non-residents.

However the payment of royalties to non-residents will attract a withholding tax of 12 percent unless the royalty is paid to a non resident person such as a properly structured Category 1 Global Business Licence (see below) Mauritius resident company. In this case, only a Mauritius tax liability will crystallise at an effective tax rate of 3 percent.

Capital gains on movable property not forming part of the property of a Permanent Establishment are subject to tax in the contracting state where situated. Capital gains on disposal of other assets including shares are taxable only where the seller is resident. Mauritius does not tax capital gains at present.

II. Tax Sparing

Article 23(2) of the Treaty contains a very useful tax sparing provision. The tax sparing article allows a tax credit for Mauritian tax, at the standard Mauritian tax rate of 25 percent, against the South African tax liability at the tax rate of 30 percent In other words, any notional incentive tax rate which might be prevailing in Mauritius (currently an incentive tax rate of 15 percent applies to Global Business (offshore) companies) is ignored to the benefit of the standard corporate Mauritius tax rate of 25 percent. Thus the South African resident retains the benefit of the incentive rate obtained in Mauritius.

Typically, the benefit of the tax sparing article may be accessed by a South African company registering either as an independent company or branch with a Category 1 Global Business Licence in Mauritius. This entity will be taxed at 15 percent reduced by the automatic deemed foreign tax credit to an effective tax rate of 3 percent.

In the event that a Category 1 Global Business Licence company (see below) registered in Mauritius is a Controlled Foreign Company for the purposes of the SA Income Tax Act, the tax sparing provision protects the South African resident from paying a higher rate of tax than the incentive rate applicable in Mauritius and only marginally higher than the effective tax rate of 3 percent.

III. Major Changes in the Mauritius Financial Services Sector

On December 1, 2001, ground breaking legislation was introduced replacing the Mauritius Companies Act 1984, and replacing the Mauritius Offshore Business Activities Authority ("MOBAA") with a modern and world standard regulatory body, the Financial Services Commission ("FSC"). As a result, Mauritius now has a new Companies Act 2001, Financial Services Development Act 2001 ("FSD Act") and Trust Act 2001.

Consequently, the nomenclatures "Offshore" has now been replaced by "Global Business", "Offshore Company" by "Category 1 Global Business Licence Company", "International Company" – which is the Mauritius version of the International Business Companies existing in jurisdictions such as Jersey, Guernsey and Isle of Man, among others, – by "Category 2 Global Business Licence Company" and finally "Offshore Trust" is now referred to simply as a Trust.

The new Companies Act 2001 brings within the same ambit both the domestic companies and companies in the previously ring fenced offshore sector. Both sectors are therefore now regulated by the same statutory regime, subject to certain special provisions which recognises the specificities of the Global Business companies. The combined effect of the introduction of the FSD Act with the Companies Act 2001 has been to more effectively protect the consumer of financial services through improved regulation.

It should be noted that Mauritius is not black listed by the OECD and other world watchdog organisations. Mauritius is fully committed to the international fight against money laundering, drug trafficking, terrorist financing and activities and has introduced/overhauled appropriate legislations last year.

IV. Qualified Global Business Activities

The specified activities listed in the FDA Act 2001 are:

Category 1 Global Business Licence companies	
Aircraft financing and leasing	Consultancy services
Employment services	Financial services
Assets management	ICT services
Funds management	Operational headquarters
Insurance	Pension funds
Logistics, Licensing and franchising or marketing	Shipping Trading and ship management

Category 2 Global Business Licence companies	
Passive Investment Holding	Marketing
Trading: non-financial	Shipping
Non financial consultancy	Logistics
ICT services	Other, as approved by the FSC

V. Disclosure of Information

The disclosure of corporate details of a Mauritian company holding a Category 1 Global Business Licence ("GBL1") or a Category 2 Global Business Licence ("GBL2") is restricted by law to a large extent.

The FSD Act empowers the FSC to request any information and to be shown all such records and documents as deemed necessary, in order to ensure compliance with the FSD Act and other relevant acts and provides that the Chief Executive of the FSC may make such inquiries and inspection in relation to the conduct of business in the financial services sector, as he may reasonably require.

The FSD Act also requires the personnel of the FSC, including the Chief Executive and the Board to maintain the confidentiality of any matter which comes before them in regard to GBL1s and GBL2s, their shareholders and beneficial owners.

Accordingly, no personnel of the FSC can disclose to any court, tribunal, committee of inquiry or other authority in Mauritius or elsewhere, any information relating to GBL1s and GBL2s without a court order.

It is pertinent to note that Section 33(6) of the FDA Act enables a Mauritius Court to make an order for disclosure or production of any confidential information in relation to a GBL1 or GBL2 strictly only on the application of the Mauritius Director of Public Prosecutions, and on proof beyond reasonable doubt that the confidential information is *bona fide* required for the purpose of any enquiry or trial into or relating to the trafficking of narcotics and dangerous drugs, arms trafficking or money laundering under the Financial Intelligence and Anti-Money Laundering Act 2002. The Registrar of Companies also has a duty to report any such matter to the FSC.

Of note here, is the fact that Section 33(6) of the FSD Act falls short of including tax matters within the ambit of this section.

Of course, the FSD Act provides that its provisions are without prejudice to the obligations of Mauritius under any international treaty, convention or agreement.

It is interesting to note the Finance Act 2002 amendment of Section 33(7) of the FDA Act which now enables disclosure by the FSC of information under condition of confidentiality for the sole purpose of exercising its supervisory functions in relation to a financial institution carrying out any services or business activities as defined in the FDA Act. Such disclosure may only be made to the Bank of Mauritius and to any other institution which performs in a foreign country functions similar to those of the FSC under this Act. This clearly places the bar away from any income tax authority of any country and disclosure is strictly linked to supervision activities.

It is the wide held view in Mauritius, backed by recent events, that the Exchange *of Information* provisions of tax treaties concluded by Mauritius may not be invoked lightly by foreign tax authorities in order to prevent witch hunts which may irremediably damage Mauritius excellent reputation as a financial services centre.

As an illustration, the elite South African Scorpion police unit had no problem, during 2002, to obtain a Mauritius Court order to further their investigations, in relation to the arms deal scandal that rocked the South African political establishment and government, into the normally out-of-bound plush offices of the appointed management company acting as registered offices of the Mauritius companies allegedly involved in the scandal and the homes of the directors of the connected Mauritius companies. On the other hand, the FSC after having conducted its own internal investigations turned down several requests by the Securities and Exchange Board of India (SEBI) to have access to the books of some Global Business (offshore) companies which were suspected of being involved in several major stock exchange scams in India. It appeared from Mauritius newspapers reports that the FSC politely but firmly disallowed SEBI's requests because of the lack of solid, persuasive and tangible evidence.

Finally, one should note that there is no public access (save to the shareholders, directors, agent, appointed management company or other authorised officer of the company) to the records maintained by the appointed management company and by the Registrar of Companies in regard to GBL1s and GBL2s.

Minister Trevor Manuel has indeed taken bold and laudable steps in his tax reforms, to date, to curb illegal fund transfers offshore and to mitigate sophisticated tax evading schemes using tainted offshore jurisdictions. However, it is equally true that the use of overseas financial centres, of international repute, to mitigate one's tax liability is perfectly legal. Furthermore, and perhaps more importantly, with the advent of globalisation, using such international financial centres often makes perfectly good commercial sense. The favourable Treaty combined with a world class regulatory framework which provides enhanced protection and legitimate but not unconditional confidentiality to the consumer of financial services, together with innovative tax incentives still makes Mauritius an ideal location for structuring business and investments into and out of South Africa, especially in SADC countries in view of SA's liberalised exchange control rules for investment in those countries and even beyond.

Kamal Hawabhay*, B.Comm (UDW), Dip Acc (UDW), CA (SA) is Managing Director of Global Wealth Management Solutions Ltd, a management company, based in Mauritius, and licenced by the Mauritius Financial Services Commission.(info@globalwealth-ms.com).*

Acknowledgement:Tax Planning International Review