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MINIMISING TAXES FOR SOUTH AFRICAN COMPANIES INVESTING INTO AFRICA USING MAURITIUS AS GATEWAY

by

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ABSTRACT

MINIMISING TAXES FOR SOUTH AFRICAN COMPANIES INVESTING INTO AFRICA USING MAURITIUS AS GATEWAY

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Investors constantly seek to secure business ventures and structures that will provide them with the most tax-efficient consequences by utilising loopholes in tax legislation and exploiting them within the legal requirements. With the recent growing interest in the undeveloped markets in Africa, many South African companies aim to invest into Africa in a tax-efficient manner. Mauritius, being a low tax jurisdiction and having a favourable tax treaty network with a large number of African countries, is an attractive choice for South African companies wishing to set up a platform for investing into Africa. The aim of this study was to address the shortcomings of efficient tax planning and the approach to invest into Africa using Mauritius as gateway for South African resident companies. The study focused on the tax implications of an offshore trust and offshore company incorporated in Mauritius for tax-efficient investing in order to minimise taxes. Therefore this study did not focus on using Mauritius for tax evasion purposes and a qualitative approach was applied, using a hypothetical case study to determine the most tax-efficient organisational structure for minimising taxes. The findings of the study revealed that, on a balance of case law and tax legislation, a tax-minimising organisational structure is largely influenced by its residency status and South Africa's control foreign company (CFC) legislation. Residency for an offshore trust and offshore company will be at the place where it is effectively managed. The findings revealed that the tax consequences are similar for an offshore trust and offshore company in Mauritius legislation. However, the hypothetical case study revealed that the impact of the CFC legislation can have negative consequences for a structure where only an offshore company is used, and therefore the ideal tax-minimising structure will be where a South African company uses a combination of an offshore trust and offshore company in Mauritius in order to avoid the possibility of CFC legislation having an impact on such a structure.

KEY WORDS:

Offshore trust

Offshore company

Mauritius

Resident

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OPSOMMING

MINIMALISERING VAN BELASTING VIR SUID-AFRIKAANSE MAATSKAPPYE WAT IN AFRIKA WIL BELÊ DEUR MAURITIUS AS POORTTE GEBRUIK

deur

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Beleggers soek voortdurend sakeondernemings en strukture wat hulle van die mees belasting doeltreffende opbrengtse sal voorsien deur die ontginning van wetlike skuiwergate binne die belasting wetgewing. Met die onlangse toenemende belangstelling in die onontginde Afrika markte is daar heelwat Suid-Afrikaanse maatskappye wat op 'n belasting doeltreffende wyse in Arika wil belê. Mauritius is ’n laebelasting-jursidiksie en het ’n netwerk van gunstige dubbelbelasting-ooreenkomste met ’n groot aantal Afrika lande. Dit maak Mauritius ’n aantreklike keuse vir Suid-Afrikaanse maatskappye om dit as ’n poort te gebruik om in Afrika te belê. Die doel van hierdie studie was om vir Suid-Afrikaanse maatskappye die tekortkominge uit te wys van doeltreffende belastingbeplanning en die benadering om in Afrika te belê deur Mauritius as tussenganger te gebruik. Die studie het gekonsentreer op die belasting implikasies van ’n buitelandse trust en buitelandse maatskappy wat vir doeleindes van belasting minimalisering in belasting doeltreffende beleggings in Mauritius geïnkorporeer kan word. Hierdie studie is dus nie gefokus op die gebruik van Mauritius vir belastingontduiking nie en daar is 'n kwalitatiewe benadering gevolg en gebruik gemaak van ’n hipotetiese gevallestudie om die mees belasting doeltreffende struktuur vir die vermindering van belasting te bepaal. Die studie het ná oorweging van regsuitspraak en belasting wetgewing aan die lig gebring dat die belasting vermindering van die organisatoriese struktuur grootliks deur sy inwoner status beïnvloed word. Inwoner status van ’n buitelandse trust en buitelandse maatskappy sal die plek wees van waar dit effektief bestuur word. Die bevindinge toon verder dat in terme van Mauritius-wetgewing die belasting implikasies dieselfde is vir ’n buitelandse trust as wat dit vir ’n buitelandse maatskappy is. Die hipotetiese gevallestudie het egter getoon dat die impak van die wetgewing aangaande Suid-Afrikaanse beheerde-buitelandse maatskappye (BBM)

negatiewe gevolge kan hê op ’n belegging struktuur waar slegs ’n buitelandse maatskappy gebruik word. Die ideale belastingvermindering-struktuur sal dus wees waar ’n Suid-Afrikaanse maatskappy ’n trust skep in Mauritius en daar deur die moontlike impak vermy wat die BBM-wetgewing op so ’n struktuur kan hê.

SLEUTELWOORDE
Buitelandse trust
Buitelandse maatskappy
Mauritius
Inwoner

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Jean Baptiste Colbert (French economist and Minister of Finance under King Louis XIV of France, 1619–1683) explained tax planning to be the following: “The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.”

Investors constantly seek to secure business ventures and organisational structures that will provide them with the most tax-efficient consequences by utilising loopholes in the tax legislation and exploiting them within the legal requirements. The age of Africa has dawned as South Africa has recently become a member of the joined cooperative mechanism of large emerging economies called BRICS (Brazil, Russia, India, China and South Africa). BRICS is an acronym given by Goldman Sachs for the abovementioned emerging economies. These developing countries have been identified as large emerging economies and it is speculated that these economies will be the pinnacle of the world economy by 2050 (Goldman Sachs, 2003:2).

It is estimated that by 2015 foreign direct investment into Africa will reach US$150 billion (Ernst and Young, 2011:5); bringing the realisation that investors will want to exploit the most tax-efficient manner of investing into Africa. As such, more and more South African companies are seeking to exploit these opportunities by investing into these undeveloped markets. For this purpose Mauritius is seen as a hub of choice as Mauritius has a low tax jurisdiction and substantial network of treaties and double taxation agreements that have been concluded with a large number of African countries.

The majority of the material available to investors focuses on the establishment of an offshore company in Mauritius as a vehicle or organisational structure (Stephan Spamer & Dylan Buttrick 2011:6). There seems to be a lack of innovative literature in respect of tax-

efficient organisational structures with regards to the possibility of using an offshore trust or a combination of an offshore trust and an offshore company in Mauritius specifically for South African companies.

1.2 PROBLEM STATEMENT

The problem statement that this study investigates can be articulated as follows: **What is the best structure to use for South African companies to effectively minimise taxes when investing into Africa using Mauritius as gateway?**

1.3 PURPOSE STATEMENT

The aim of this study is to address the shortcomings in efficient tax planning and the approach to invest into Africa using Mauritius as gateway for South African resident companies. In pursuit of the most tax-efficient organisational structure for such investments, the study focused on the tax implications of offshore companies and offshore trusts within the context of South African and Mauritian tax legislation.

1.4 RESEARCH OBJECTIVES

In the quest of addressing the problem statement the following research objectives were formulated:

(1) The study aims to identify how residency is determined in accordance with South African and Mauritian tax legislation. This is an important consideration as the residency status of an organisational structure affects the jurisdiction in which the organisational structure will be liable for taxes. Therefore the residency can result in an organisational structure being taxed in a higher tax jurisdiction than originally intended.

(2) The study aims to identify the key attributes of an offshore trust and how these elements affect the residency status of the offshore trust.

(3) The study aims to determine which type of trust would be best to use in a tax-minimising scheme.

(4) The study aims to identify the key elements of an offshore company and how these elements affect the residency status of the offshore company.

(5) The study aims to assess the impact of Section 9D of the South African Income Tax Act 58 of 1962 (referred to as "the Act" hereafter) and the double taxation agreement between South Africa and Mauritius with regard to a tax-minimising structure.

(6) The study aims to apply the theory to a practical case study and thus determine the best tax-minimising organisational structure.

(7) The study aims to identify aspects that require further research.

1.5 IMPORTANCE AND BENEFITS OF THE STUDY

This study makes a contribution to the decisions faced by South African companies when looking to invest into Africa via Mauritius in the most tax-efficient manner.

In essence this study provides South African companies with a possible structure that is tax efficient for investing into Africa via Mauritius. The cost of tax is always an important factor to consider when an investment is made. This study provides practical solutions for South African companies making investments into the undeveloped markets in Africa from a tax perspective.

1.6 DELIMITATIONS AND ASSUMPTIONS

The study has numerous delimitations and assumptions. The delimitations of the study relate to the context in which it was performed, relationships, theoretical and historical perspectives of the study. Assumption is defined as "a condition that is taken for granted, without which the research project would be pointless" (Leedy & Ormrod, 2005:5).The delimitations explain to the reader what the study focused on and what fell outside the scope of the study (Hofstee, 2006:87).

1.6.1 DELIMITATIONS

The application of the South African and Mauritian legislation (which formed the basis of this study) to the hypothetical case study raises concerns regarding the limitations and bias of the study. It is complicated to simplify the outcomes of the study using a case study (Yin, 2009:38). The assumptions and delimitations of this study are detailed below.

Because of the difficultly of generalising the outcomes of the study it does not aim to address all possible tax-minimising organisational structures or scenarios. The study does, however, provide some practical insight into which factors have an impact on a tax-minimising organisational structure. The study explores the principles of the South African and Mauritian tax legislation as well as the double taxation agreement between South Africa and Mauritius. Therefore the outcomes must be considered and interpreted in the context in which they were used in this study. This needs consideration in order to determine the relevance of these principles and how these principles can be applied to other tax-minimising organisational structures where the details and circumstances are different.

The following delimitations have been identified:

- The study focused only on offshore trusts and offshore companies incorporated in Mauritius as these are the common vehicles available to South African resident companies under the Global Business Licence Category 1 provided by Mauritius (OECD, 2011:12).Other structures, such as partnerships, joint ventures and any other incorporated entities, were not considered in this study.
- The study is concerned with the tax impact of making direct foreign investment into Africa via Mauritius and not with the tax impact of direct foreign investment into Africa.
- The study focused on minimising taxes when investing into Africa via Mauritius, which is limited to the application of the relevant tax regulations and case law in both Mauritius and South Africa. Therefore other requirements and costs, such as incorporation costs, incorporation regulations and transfer pricing as well as security exchange controls were not considered in this study.

- The study is limited to investing into Africa via Mauritius by South African resident companies with the aim to conduct and operate a business in African countries. The study's literature review was focused on the tax implications of an offshore trust and offshore company incorporated in Mauritius for tax-efficient investing for tax-minimising (avoidance) purposes. Therefore this study did not focus on using Mauritius for tax evasion purposes.
- This study acknowledges the existence of legislation affecting cross-border investment such as transfer pricing, anti-avoidance provisions and exchange control regulations, amongst others, but does not discuss these rulings and their consequences in detail.

1.6.2 ASSUMPTIONS

This study made the following assumptions:

- The definition of "person" in the South African Income Tax Act states that "any trust" is defined as a "person" for purposes of domestic income and capital gains tax. Therefore this study assumed that the term "offshore trust" is included in the definition of a "person" for tax treaty purposes.
- A trust can be taxed on its undistributed income and therefore is not entirely considered to be a fiscal transparent entity (Olivier & Honiball, 2008: 284). Therefore this study assumed that for the DTA between South Africa and Mauritius the trust can be a regarded as resident of one of the contracting states.
- This study assumed that the Mauritian tax burden is significantly lower than that of South Africa. The effective tax rate for a Global Business Licence Category 1 is 3% (flat rate of 15% less 80% of the 15% as a deemed tax credit on foreign income). South Africa's effective tax rate for companies is 28%. In addition, South Africa levies 15% withholding taxes on dividends compared to no withholding taxes on dividends in Mauritius (Stephan Spamer & Dylan Buttrick 2011:6).
- This study further assumed that the South African resident company will correctly adhere to the relevant countries' legislation and other requirements for setting up an effective offshore organisational structure in Mauritius in order to obtain the tax benefits. These requirements are discussed later in this study. If there is not adhered

to the aforementioned requirements it could result in the trust or company being taxed in South Africa and consequently not obtaining the tax benefits of Mauritius.

- The DTA between South Africa and Mauritius was published in the *Government Gazette* 18111, dated 02/07/1997. This study accepts that the DTA is part of South African domestic law and enjoys no special treatment above the Act.

1.7 DEFINITION OF KEY TERMS

Abbreviations used in this document are included in Table 1 below:

Table 1: Abbreviations used in this document

Abbreviation	Meaning
BRICS	Brazil, Russia, India, China and South Africa
CFC	Controlled foreign company
CGT	Capital gains tax
DFI	Direct foreign investment
DTA	Double taxation agreement
E-commerce	Electronic commerce
GBL1	Global Business Licence Category 1
GBL2	Global Business Licence Category 2
IHC	Intermediary holding companies
MRA	Mauritius Revenue Authority
MTA	Mauritian Trusts Act 2001
OECD	Organisation for Economic Co-operation and Development
PCC	Protected cell companies
SARS	South African Revenue Services
TPCA	Trust Property Control Act 57 of 1998

The key terms for the purpose of this research are defined below. The definitions are predominantly based on a South African perspective as the study focused on the tax implications for South African resident companies.

Contracting states: This refers to those states that are parties to a DTA (Olivier & Honiball, 2008:572). It is important to note that for the purpose of this research the contracting states will refer to South Africa and Mauritius collectively.

Company: In terms of Section 1 of the Companies Act No 71 of 2008 a company means a juristic person incorporated in terms of the Companies Act. A foreign company is described in the Companies Act as an entity incorporated outside the republic irrespective of whether it is carrying on trade within the republic. Also refer to the definition of an "offshore company".

Dividend(s): The term dividend used in this study bears the same meaning as the term "dividend" defined in the double taxation agreement between South Africa and Mauritius. This term is defined as "income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident" (Olivier & Honiball, 2008:167).

Double taxation: This refers to income that is subject to taxation both in the country of residence (due to the residence-based tax system) as well as the country in which the taxable transaction took place (due to a source system) (Koekemoer, 2010:552).

Double taxation agreement: A double taxation agreement, which is an international treaty concluded between two states to determine the incidence of tax in and the application of tax laws by each state with the object of avoiding double taxation (Olivier & Honiball, 2008:573). For the purpose of this research the double taxation agreement will specifically refer to the double taxation agreement between South Africa and Mauritius as concluded in the *Government Gazette* 18111 of02/07/1997.

Global Business Licence 1: This refers to Category 1 Global Business Licence issued under the Financial Services Act of Mauritius. This licence may be issued to a company, partnership or trust. This licence provides legal segregation of assets attributable to each company and allows the company, partnership or trust access to Mauritius's favourable tax treaty networks (OECD, 2011:18).

Global Business Licence 2: Category 2 Global Business Licence issued under the Financial Services Act of Mauritius. This licence can only be granted to a Mauritian private company. This licence disallows the conduct of business with Mauritian residents and is considered a non-resident for tax purposes in Mauritius (OECD, 2011:21).

Intermediary holding company: This refers to a holding company that is generally located outside South Africa, interposed between a South African resident shareholder and its subsidiaries situated in foreign jurisdictions (Olivier & Honiball, 2008:576).

Offshore trust: An offshore trust is defined by Olivier and Honiball (2008:578) as a trust resident outside the tax jurisdiction of the resident investor, often used when referring to tax haven trusts.

Offshore company: An offshore company is defined by Olivier and Honiball (2008:578) as a company resident outside the tax jurisdiction of the resident investor, often used when referring to tax haven companies. A “foreign company” is defined in Section 1 of the Income Tax Act no 58 of 1962 as any company that is not resident in South Africa. It should be noted here that if the company is deemed to be a resident of another country it will be treated as a non-resident in terms of an applicable tax treaty entered into by South Africa. In the context of this research the offshore companies refer to companies incorporated in Mauritius by South African residents.

Resident: This refers to a person who has sufficiently close connections to a country to be liable to tax on their worldwide income (Olivier & Honiball, 2008:579). A resident other than a natural person is defined in Section 1 of the Income Tax Act no 58 of 1962 as a “person which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic”. For the purpose of this research tax residency will be determined from a South African perspective in terms of Interpretation Note 6 of the South African Revenue Services which determines that “place of effective management” determines residency.

Tax avoidance: This involves the use of lawful means to arrange one's affairs to defer and avoid or reduce a tax burden. This is done through the use of loopholes within the legal parameters in the tax and other legislation (Olivier, 1997:725).

Tax evasion: This involves the use of illegal and dishonest means by tax payers to reduce their tax burden (CIR v Conhage (Pty) Ltd 1999 4 SA 1149 (SCA)).

Tax haven: This is commonly referred to as a jurisdiction that allows measures to avoid taxes, normally for high-tax countries (Oguttu, 2007: 18).

Trust: This is an arrangement allowed under the laws of "common law" jurisdictions for the holding of property by a person (trustee) transferred from a person (settlor) for the benefit of the persons (beneficiaries) (Olivier & Honiball, 2008:581). Oguttu (2007:310) describes the attributes of a trust as a contract whereby a donor donates or transfers property to a trustee or trustees in terms of a trust deed for the benefit of other persons (beneficiaries) or the accomplishment of a special purpose whereby the trustees are responsible for the management of the trust in accordance with the trust deed.

1.8 RESEARCH DESIGN

1.8.1 Research approach

A qualitative research approach was used in this study to evaluate the most efficient tax-minimising organisational structure for South African resident companies looking to invest into Africa via Mauritius. A qualitative research approach was followed as the data available was in the form of words, sentences and paragraphs which form the fundamentals of a qualitative research approach. The study also made use of the application of legislation and selected case law to provide a better understanding and interpretation than would be provided by a quantitative research approach (Leedy & Ormrod, 2005:133).

1.8.2 Research design

A literature review was used in this study to ascertain the impact of key factors affecting a tax-minimising organisational structure. The study then applied these factors to a hypothetical case study in order to explore whether an offshore trust, offshore company or a combination of both would be the ideal vehicle to use in a tax-minimising scheme.

This study required detail knowledge in order to determine a tax-minimising organisational structure for South African companies investing into Africa via Mauritius. The literature review was applied to a case study to test the hypothesis from the literature review for these principles to be applied to other or similar cases.

1.9 CHAPTER OUTLINE

Chapters 2 to 5 provide a literature review and analysis of the key concepts that would have an impact on an efficient tax-minimising organisational structure. Based on this review, a purposive approach is applied to obtain an in-depth understanding of how these concepts affect an efficient tax-minimising organisational structure. Chapter 6 provides the application of the key concepts, defined and analysed in chapters 2 to 5 with regard to a hypothetical case study in order to assess whether an offshore trust, offshore company or a combination of both would be ideal for the use in a tax-minimising structure. Chapter 7 contains a summation of the research outcomes and points out areas that need further research in the South African legislation.

CHAPTER 2

DEFINITION OF RESIDENT

2.1 INTRODUCTION

This study was done to determine which organisational structure a South African resident company should use to invest into Africa via Mauritius in order to effectively minimise taxes. The study therefore predominantly focused on the tax effects of an offshore company versus the use of an offshore trust or a combination of both.

A critical aspect in determining the most tax-efficient organisational structure is to evaluate the residency status of both an offshore trust and an offshore company as South African residents are taxed on their worldwide income and not on source-based income. A South African resident would prefer to be taxed in Mauritius, which has a lower tax jurisdiction when compared to South Africa. Factors affecting residency of an organisational structure in terms of South African income tax legislation as well as international guidelines were considered in this study. The DTA between South Africa and Mauritius and its impact on the residency status of the proposed organisational structure was also evaluated in this study.

The structure of this literature review has been set out as follows. Firstly, an evaluation of previous research performed on this specific topic is provided. This is followed by a review of the definition of “resident” in the income tax legislation of both South Africa and Mauritius, as well as the impact of international guidelines on the interpretation of the definition of “resident”.

This is followed by a review of the key attributes of a trust and company and an assessment of their respective tax consequences. In closing, the DTA between South Africa and Mauritius and its tax consequences for each organisational structure is analysed, as well as its impact on determining residency for each organisational structure.

2.2 PREVIOUS RESEARCH

An extensive search of leading electronic journal databases and journals, including Google Scholar, Proquest, the *South African Law Journal*, The South African Institute of Tax Practitioners and Sabinet, suggests that limited academic research has been done on the comparison between an offshore trust's tax efficiency and the tax efficiency of an offshore company established in Mauritius for the purpose of investing into Africa by South African resident companies. There are numerous factors that have an impact on the tax efficiency of an offshore trust and offshore company established in Mauritius.

These factors are as follows:

- Definition of "resident", as this impacts the jurisdiction in which the organisational structure will be taxed (refer to Section 2.3 – 2.3.3).
- The attributes of an offshore trust and how these attributes affect a tax-efficient structure (refer to Chapter 3).
- The attributes of an offshore company and how these attributes affect a tax-efficient structure (refer to Chapter 4).

Numerous studies have been done on the above concepts and what follows is the literature review with regard to these concepts and how they affect a tax-efficient organisational structure established in Mauritius.

The most important concept is the definition of a resident as this affects the jurisdiction in which the organisational structure will be liable to tax. What follows is a literature review on the definition of a resident and factors affecting residency.

2.3 DEFINITION OF A RESIDENT

South Africa's tax system is based on the residence basis of taxation, which means that the country in which the person is resident has the right to tax that person's worldwide income (Olivier & Honiball, 2008:60). Therefore when a South African resident is looking to set up a structure in Mauritius, for the purpose of investing into Africa, the organisational

structure would preferably have to be one which is deemed to be a non-resident of South Africa. The reason for this is that South African residents are taxed at a much higher rate than residents of Mauritius, as illustrated later in the case study (refer to Chapter 7).

The ideal structure will therefore be where the South African resident obtains the benefits of investing into Africa, but paying taxes in Mauritius. Since it is envisaged that an organisational structure will be set up offshore from South Africa in Mauritius it can only be liable to tax in South Africa when it is deemed to be a resident in South Africa. This means that the definition of “resident” and the application thereof require careful consideration.

2.3.1 Definition of ‘resident’: South African legislation and OECD

A resident other than a natural person is defined in Section 1 of the Act as a “person which is incorporated, established or formed in the Republic or which has it place of effective management in the Republic”. The definition further stipulates that “any person who or which is deemed to be exclusively a resident of another country for the purpose of the application of any double tax convention will not be a resident”.

From the above it is clear that the Act poses two tests to determine residency. Firstly, if it is found that the company or trust is incorporated, established or formed in South Africa, the “place of effective management” becomes irrelevant (save in so far as it is applicable in determining the company or trust’s residence in terms of any DTA). Secondly, if the company or trust is incorporated, established or formed outside of South Africa it can only be deemed a resident in South Africa if its “place of effective management” is found to be in South Africa (Du Plessis, 2009:329).

2.3.2 “Place of effective management"

The term “place of effective management” has only been introduced to the Act in recent years along with the definition of “resident” (Du Plessis, 2009:334). No clear definition of “place of effective management” is given in the Act.

There has been some inconsistency with regard to the interpretation of the term "place of effective management" in the past. The meaning has, however, been clarified by SARS in Interpretation Note 6 of 26 March 2002. In this interpretation note the place of effective management is where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meet. Management by these directors or senior managers refers to the execution and implementation of policies and strategy decisions made by the board of directors. In addition, it refers to the place of implementation of the entity's overall vision and objectives. Management structures, reporting lines and responsibilities vary from entity to entity depending on the requirements of the entity, and no hard and fast rules exist. It is therefore not possible to lay down absolute guidelines in this regard.

From the above it is clear that SARS's view of the term "place of effective management" is the place where the regular day-to-day operations are carried out by the directors or senior managers. Therefore the place of effective management is the place where management's decisions are implemented (Du Plessis, 2009:335). Taking the above into consideration, depending on the facts, a company may have more than one place of effective management. No guidance is provided by the OECD or SARS's Interpretation Note 6 on how to allocate weight to a set of facts in order to determine one place of effective management (Oguttu, 2007:89).

It would seem that SARS only had companies in mind for the description of "place of effective management", which created a scenario that taxpayers have the responsibility to translate SARS's view to trusts (Du Plessis, 2009:337).

Until recently, there has been no case law in South Arica that considered the meaning of "place of effective management". On 13 June 2011, judgement was delivered by the Western Cape High Court in a matter between Oceanic Trust Co Ltd and the Commissioner for the SARS (*The Oceanic Trust Co. Ltd NO v The Commissioner for the South African Revenue Services*. Western Cape High Court Case No 22556/09).

The facts of the case are listed briefly as follows:

- The applicant (Oceanic Trust) is a company registered and incorporated under the company laws of Mauritius. The applicant is the sole trustee of a trust, Specialised Insurance Solutions (Mauritius) (refer to as "SISM" hereafter), which was established and registered in Mauritius. The applicant in this case, Oceanic Trust, acted in its capacity as the trustee of SISM.
- SISM conducted business as captive reinsurer to mCubed Life Limited (referred to as "mCubed Life" hereafter). The premiums of the reinsurance policies were transferred to SISM and constituted assets that were invested by SISM in South Africa and elsewhere in a variety of investments. SISM utilised an asset manager in South Africa to manage its South African assets.
- SARS issued an assessment letter to SISM. One of the bases of the assessment was that SISM was a South African resident because it had its place of effective management in South Africa. SISM approached the High Court to issue a declaratory order declaring that it was not a resident of South Africa.
- SISM argued that its management decisions would have been taken by its sole trustee (ie Oceanic Trust) and that such decisions would have been made in Mauritius. Reliance was placed on a recent UK decision in *Commissioner of Her Majesty's Revenue and Customs v Smallwood and Anor* [2010] EWCA Civ 778.

Referring to the relevant facts of the Smallwood case, the High Court made the following statements regarding the place of effective management:

- The place of effective management is in substance the place where key management and commercial decisions, that are necessary for the conduct of the entity's business, are made.
- The place of effective management will typically be the place where the most senior group of persons (eg a board of directors) make its decisions, where the policies and procedures that will govern the entity as a whole are determined.
- However, no definite rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management of an entity.
- It would seem that in certain circumstances there may be more than one place of management, but it is clear from the above that at a point in time there can only be one place of effective management.

It was acknowledged by the Court that the place of effective management, for persons other than natural persons, is in substance the place where the most senior group of persons make the decisions that are necessary for the conduct of a person's business, and therefore it is deemed to carry the most weight in determining the place of effective management within South African legislation.

The Court's decision corresponds with the commentary of the OECD on the discussion of "place of effective management". Where a person other than a natural person is resident in both contracting states of a DTA, the tie breaker according to Article 4 of the OECD Model Tax Convention is based on "place of effective management". According to paragraph 24 of the OECD Commentary on Article 4, the meaning of place of effective management is as follows: "The place of effective management 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. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

In their Interpretation Note 6, SARS determines that the place of effective management must be based on factual circumstances. SARS acknowledge in their Interpretation Note 6 that no hard and fast rules exist in order to determine the place of effective management. It would seem that SARS gives preference towards the day-to-day management concept for a person other than an individual. This is not entirely in line with OECD's view of place of effective management.

In summary, as explained above, there are distinct differences between SARS's interpretation of "place of effective management" and that of the OECD. SARS's view is that the "place of effective management" is where day-to-day operations are carried out by the directors or most senior management. The OECD's interpretation, which would therefore also be applicable to the interpretation of the DTA, is that the place of effective management is where the board of directors or senior management meet and key policies and strategy decisions are made.

The judgement in the *Oceanic* case (South African case law) on the term "place of effective management" corresponds with the commentary of the OECD, which in turn places doubt on the view that SARS has regarding the definition of "place of effective management". It is accepted that each case will be assessed based on its facts and circumstances. Based on the recent judgement in the *Oceanic* case, however, the place of effective management for South African legislation purposes seems to be the place where key management and commercial decisions are taken in order for a person other than an individual to conduct its business.

For the purpose of this study it is assumed that the South African resident company will either establish or form a company or trust in Mauritius. This study has therefore focused predominantly on the impact of the term "place of effective management" as this will form the basis of a tie-breaker provision in the event of dual residency in terms of Article 4 of the DTA.

In respect of the place of effective management, the criterion varies from the OECD commentary to SARS's view in Interpretation Note 6. However, in the light of the recent judgement in the *Oceanic* case, it is clear that the courts in South Africa have adopted a similar view to the OECD regarding the meaning of the term "place of effective management". It can therefore be argued that the place of effective management will be the place where key management and commercial decisions are taken (Du Plessis, 2009:343). This view is in contrast with the views of Olivier and Honiball (2008:285), which are of the opinion that the place of effective management of a trust will be where the day-to-day management decisions are taken and implemented.

In *AM Moola Group Ltd v C: SARS* 65 SATC 414 the Supreme Court of Appeal held that where a conflict exists between domestic law and an international trade agreement, the domestic law prevails. In contrast to this, in *Secretary for Inland Revenue v Downing* 1975 (4) SA 518 (A), the use of the OECD's commentary as a guide to interpreting international tax terms used in South African DTAs was recognised (Du Plessis, 2009:335). The meaning of "place of effective management" as per the OECD commentary can therefore be used by the courts in South African legislation in order to determine the place of effective management of an organisational structure. The *AM Moola* case stands, but is

arguably not correct. In addition, it is widely accepted that SARS's interpretation notes and practice notes are the interpretation of SARS with regard to relevant provisions and that they do not have the force of law (Stiglingh et al, 2011: 11).

In the author's opinion, the definition of "place of effective management" will therefore bear the same meaning as the "place of effective management" as described by the OECD. The reason for this is that the Act does not define "place of effective management". In accordance with the *Downing* case, the courts can use the OECD commentary in interpreting international tax terms. In recent case law–the *Oceanic* case–the South African courts had a similar understanding of "place of effective management" to the OCED.

Based on the above it would seem that the view similar to that of the OECD commentary will carry more weight in determining the "place of effective management" than the view of SARS.

A brief overview will be discussed in the following section in respect of residency in accordance with Mauritian legislation.

2.3.3 Definition of "resident": Mauritian legislation

The Income Tax Act 1995 of the MRA defines a Mauritian resident company as "a company which is incorporated in Mauritius or which has its central management and control in Mauritius".

In addition to the above, the residence of a trust is determined by the Income Tax Act 1995 of the MRA as "a trust which is administrated in Mauritius and a majority of the trustees are resident in Mauritius or where the settlor of the trust was resident in Mauritius at the time the instrument creating the trust was executed".

Non-citizens are allowed to create a trust in Mauritius and be the beneficiaries. Mauritius does recognise foreign trusts and as a consequence foreign trusts are enforceable in Mauritius (OECD, 2011:29). In accordance with the Mauritian general tax system, the

corporate taxation concepts apply to companies and entities deemed to be companies for tax purposes which include trusts. Therefore it is accepted that the central management and control rule that is used to determine the residency status of companies in Mauritius would apply for determining the residency status of foreign trusts (OECD, 2011:12).

From the above it is clear that by adopting the principles of the domestic income tax legislation for both South Africa and Mauritius the residency status of a trust and company can be determined based on the jurisdiction where these entities are controlled.

It should be noted that Article 4 of the DTA between South Africa and Mauritius refers to the tie-breaker in respect of determining residency as the place where the person, other than a natural person, is effectively managed. Therefore for the purpose of this research the focus will be on the term “place of effective management” and not on “control and managed”.

2.4 CONCLUSION

The residency status of an organisational structure is determined with reference to the “place of effective management”. From the above it is clear that there are different views of the interpretation of “place of effective management” and that there are no hard and fast rules to determine the “place of effective management”.

From a South African perspective, taking into consideration the recent *Oceanic* case, it would seem that the courts in South Africa have accepted and acknowledged that the “place of effective management” will be where the key policies and strategy decisions are made by the board of directors or senior management in order to conduct a person’s business. This study has accepted this view, but tax payers should note that the “place of effective management” will be assessed on a case-by-case basis.

Having determined the meaning and impact of “place of effective management”, it is now necessary to discuss the key attributes of an offshore trust and offshore company in order

to assess the factors that have an impact on the “place of effective management”, which in turn affects residency of each as well as their respective tax consequences.

CHAPTER 3

THE OFFSHORE TRUST

3.1 INTRODUCTION

A trust is a legal concept that has its origins in medieval English law. It is included in the definition of a "person" in the Income Tax Act 58 of 1962 (referred to as "the Act" hereafter). A trust is therefore liable to tax (Stiglingh et al, 2011: 754).

It was estimated in 2000 that about 60% of the world's transactions took place offshore and that 40% of these transactions occurred via trusts. This would effectively imply that 24% of the world's wealth lies within offshore trusts (Oguttu, 2007:307). This underlines the importance of realising the popularity of the offshore trust in the last decade as well as its associated tax consequences. In order to assess the tax consequences of an offshore trust it is important to consider the residency status of a trust and who carries the liability of paying the taxes: the trust, the trustees or the beneficiaries?

Before the above can be analysed, certain definitions and key aspects of a trust will be discussed. Different types of trusts will then be analysed followed by an application of the key aspects to trusts in order to determine a trusts residency status. It should be noted here that the tax consequences of an offshore trust is discussed in detail in Chapter 5.

3.1.1 The definition of a trust

The TPCA defines a trust as "the arrangement through which ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

(a) to another person, the trustee, in whole or in part, to be administrated or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act No 66 of 1965)".

A trust is defined in the Act as "any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under the deed of trust or by agreement or under the will of a deceased person".

In *Deedat & Others v The Master of the Supreme Court & Others*; 1995 (2) SA 377 (AD) at 383E – F it was held that a trust exists when the creator or founder of the trust has handed over or is bound to hand over to another the control of property which is to be administrated by the other party (normally the trustees or administrator) for the benefit of some person other than a trustee. The case makes it clear that a trust is an agreement whereby the donor or founder transfers property to a trustee or administrator in terms of a trust deed or a trust instrument. The trustees are required to administrate the property in accordance with the deed or instrument for the benefit of someone else. The above definition is in line with the definition of a trust in terms of the TPCA as well as the definition of a trust in the Act.

In terms of Section 3 of the MTA a trust exists where a person (known as a "trustee") holds or has vested in him, or is deemed to hold or have vested in him, property of which he is not the owner in his own right, with a fiduciary obligation to hold, use or dispose of it for the benefit of any other person (a "beneficiary") whether or not yet ascertained or in existence.

The Hague Convention on the law applicable to trusts and their recognition refers to a trust in Article 2 when a legal relationship is created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary, person or for a specified purpose. The provisions of this Convention are

accepted internationally even though South Africa is not part of this convention (Cameron et al 2002:5). The features and concepts of a trust, as described above, in the South African and Mauritian law conforms to the definition of a trust in this convention.

From the above it is clear that the parties to a trust can be categorised as the following: founder (donor), trustees (administrators) and the beneficiaries. Following is a literature review on the roles each party play in a trust and how it affects the "place of effective management" in order to determine the residency status of a trust.

3.1.2 Parties to a trust: trustees

For the purpose of this study it is of critical importance to evaluate which party to the trust is responsible for the management of the trust, as residency of a trust is determined with reference to the place of effective management.

In *Land and Agricultural Bank of South Africa v Parker & Others* 2005 (2) SA 77 (SCA) the court acknowledged the significance of separating control or ownership from enjoyment. The court further acknowledged that the duties imposed on trustees or administrators and the standard of care expected from trustees or administrators derives from this principle. The court acknowledged and accepted that the trustees or administrators exercise control over the trust assets for the benefit of the beneficiaries or special purpose as set out in the trust deed or instrument.

In support of the above, Section 9 of the TPCA states that a trustee shall in the performance of his or her duties and in execution of his or her powers act with care, diligence and ability which can reasonably be expected of a person who manages the affairs of another. This is also in line with the description of a trust and the duties of a trustee under Section 3 of the MTA.

Beneficiaries are those parties to a trust who are the beneficial owners of the trust assets, and the conduct of the trustees, as well as the founder, will be to the benefit of the beneficiaries (Oguttu, 2007:313).

It can therefore be expected that the trustees are regarded as the persons responsible for the "management" of a trust, even though the trustees are required to deal with the trust assets in a specific manner by way of the trust deed or trust instrument (Oguttu, 2007:311–312).This is a key aspect to consider when the residency status of a trust is assessed.

What follows is a literature review on the residency status of trusts in terms of South African and Mauritian legislation as well as the impact of "place of effective management" on the assessment of the residency status of a trust.

3.1.3 Residency status of an offshore trust

A full discussion of the "time of establishment" or "place of formation" falls outside the scope of this study; only brief reference will be made to these concepts and the impact thereof on the residency status of a trust. For the purpose of the remainder of the study it is assumed that the trust is formed in Mauritius by a South African resident company. A trust can thus only be taxable in South Africa if it has its place of effective management in South Africa.

It is accepted that a trust is a taxable entity in South Africa in accordance with South African tax legislation. However, if a trust is found not to be a resident within the jurisdiction of South Africa the trust income cannot be taxed in South Africa unless it makes distributions to resident (in South Africa) beneficiaries (Oguttu, 2007:308). In the event that a trust is deemed to be effectively managed in South Africa, South Africa may apply the residence basis of taxation and the undistributed income in the trust may be taxed in South Africa.

A critical aspect to consider with regard to offshore trusts is whether the trust can be regarded as a resident under South African income tax legislation. It is important to note here that even though a trust is accepted to be a person for income tax purposes the trust is not an individual and is not incorporated. A trust will only be deemed a resident for South African tax purposes if the trust is formed in South Africa or if the trust's "place of effective management" is deemed to be in South Africa (Olivier & Honiball, 2008:285).

In respect of the place of residency of a trust it is also not determined by where the trust deed was drafted (Olivier & Honiball, 2008:285). *Inter vivos* trusts are formed by way of contract; therefore the laws applicable to the formation of contracts have an impact on where and when these trusts are formed. A trust would normally be formed where the founder is informed of acceptance by the trustee; where there is more than one trustee it is accepted that the trust will be formed upon the acceptance of the last trustee. It is emphasised that a trust is not formed or established by lodging the trust deed at the Master's office. (Du Plessis, 2009: 342–343). These formation rules can be easily manipulated for the purpose of tax planning. For the purpose of this study emphasis will be placed on trusts that are established or formed in Mauritius under the MTA and not in South Africa as the focus of the study was to assess the tax efficiency of the use of an offshore trust by South African resident companies. Therefore the offshore trust, assessed in this study, can only be a deemed South African resident based on its "place of effective management".

In the assessment of the "place of effective management" of a trust the residency status of the beneficiaries becomes irrelevant as the beneficiaries do not take part in the key decisions of the trust and are therefore not considered to be part of the management of the trust. This will hold true even if a beneficiary has a vested right in the trust assets as the beneficiary does not become the owner of the relevant trust assets. The trustees are still the owners of the trust assets and as such are still responsible for making key decisions on the trust assets (Du Plessis, 2009:340). It is therefore clear that the trustees are responsible for the management of a trust even though they are required to manage the assets in accordance with a trust deed or instrument. There may also be circumstances where key decisions may be made by someone other than the trustees, as illustrated in the *Smallwood* case, which can cause the place of effective management to be where the person, other than the trustee, makes those key decisions. This will be the case where the person, other than the trustee, can influence the decisions of the trustee, as in the *Smallwood* case.

With reference to paragraph 2.3.2, the "place of effective management" of a trust will be determined on a case-by-case basis and the facts and circumstances of each case will

have to be assessed. Notwithstanding the above, if clear evidence can be provided that the trustees of the trust make their key management and commercial decisions offshore in Mauritius, the trust will have to be deemed to be a non-resident for South African income tax purposes.

There are many kinds of different trusts that can be formed. It is important to have an understanding of the various types of trusts available and which ones are ideal for tax-minimising (avoidance) purposes.

3.1.4 Types of trusts

The classification of a trust is influenced by:

- the way the trusts were created; or
- based on the manner in which the rights of the beneficiaries to the ownership of the trust assets are treated.

When a trust is classified from the viewpoint of how it was created then it could fall into one of two categories, namely the testamentary trust or the inter vivo trust. When a trust is classified from the viewpoint of beneficiaries' rights to the ownership of the trust assets the trust could fall into one of three main categories, namely "bewind" trusts, vested trusts and discretionary trusts (Oguttu, 2007:314). The above classifications of a trust can have an impact on its residency status based on the time and place of formation or the manner in which the trust will be managed by the trustees. What follows is a brief literature review on the different types of trusts.

3.1.4.1 Testamentary trust

A "testamentary trust" is a trust created in terms of a will, whereby the deceased person leaves his estate to a trustee, who is responsible for managing the estate on behalf of the beneficiaries (Oguttu, 2007:315). For the purpose of this study a testamentary trust will not be considered as this trust pertains to individuals and cannot be established by South African resident companies.

3.1.4.2 *Inter vivos* trust

An *inter vivos* trust is a trust that is established or formed during the lifetime of the founder (Olivier & Honiball, 2008:267). The founder will transfer some of the founder's assets to a trustee or trustees who in turn are responsible for dealing with the assets on behalf of the beneficiaries (Oguttu, 2007:315). The trust, based on the rights of the beneficiaries to the ownership of the income or capital of the trust, could be classified either as a "bewind" trust, vested trust or discretionary trust (Oguttu, 2007:315). Each of these trusts are considered and discussed hereafter in order to ascertain which type of trust is the better one to use in a tax-minimising scheme.

3.1.4.3 Bewind trust

A bewind trust has the effect that the trust property vests with the beneficiary and only the administration and control over the trust assets vests with the trustees (Oguttu, 2007:316). Based on the above, it is clear that the founder cannot easily manipulate the trust in order to gain income tax advantages. For the purpose of this study the "bewind" trust was therefore not considered for tax planning purposes.

3.1.4.4 Vested trust

In general terms a vested trust refers to a trust in which the beneficiaries have vested rights to the income or capital; therefore the trustees have no discretion as to whether to distribute the income or not (Olivier & Honiball, 2008:267). A vested trust has the effect that the beneficiaries have an unconditional claim against the trustees for delivery of income or capital to which the beneficiaries are entitled (Du Plessis, 2009:328). The impact of this type of trust is that the income or capital vests with or accrues to the beneficiary upon happening of a specific event and therefore the trustees are largely limited to only administrating the income or the capital for the beneficiary, even though the ownership of the trust assets remains with the trustees. A vested trust is therefore not considered to be ideal for a tax-efficient structure as an event needs to occur before the income accrues and the trustees are not allowed to deal with the assets using their own discretion and therefore limit the trustee's capability in performing tax planning. Based on

the above a vested trust was not included in the study as the trustees are limited in their rights from a tax planning point of view. Therefore it is argued that the tax benefits associated with this type of offshore trust are limited.

3.1.4.5 Discretionary trust

A discretionary trust refers to a trust where the distribution of income and capital to the beneficiaries are conditional and uncertain. The distribution of the income and capital is at the discretion of the trustees (Olivier & Honiball, 2008:267). It should be noted that the beneficiaries of a discretionary trust do not have vested rights in the income or capital of the trust, which makes this type of trust ideal for tax avoidance (Oguttu, 2007:318). The beneficiaries will only become entitled to the income and capital once it has been distributed to the beneficiaries by the trustees. The advantage of this is that the trustees are given the opportunity to establish when the trust income and capital can or will vest with the beneficiaries. This provides the trustees with the ability and opportunity to control the trust income and capital with tax avoidance in mind. For the purpose of this study it is submitted that a discretionary trust is ideal for a tax-minimising scheme.

There are various types of offshore trusts that a South African resident company can utilise for various different types of goals. A full discussion of the various types of offshore trusts falls outside the scope of this study; the important factor of the type of trust used was discussed briefly. It is submitted that a discretionary trust is the ideal trust to use in a tax-minimising scheme, and it does not matter if the offshore trust is an asset protection trust or purpose trusts, etc.

Another special feature exists for South African residents looking to make use of an offshore trust that can enable the South African resident to manipulate an offshore trust in order to obtain tax advantages. This special feature is called a “letter of wishes” (Oguttu, 2007:324).

3.1.5 Letter of wishes

The establishment of an offshore trust is usually accompanied by a “letter of wishes". This is an instrument used by the settlor or founder outside of the trust deed where the founder or settlor would indicate to the trustees how they should exercise some of their powers. This creates the opportunity for the founder to request the trustees to carry out activities that are not in line with the trust deed, which can result in the avoidance of tax (Oguttu, 2007:325). The trustees are not unavoidably bound to the letter of wishes and the trustees are still responsible for exercising control based on their discretion and in line with the trust deed.

The remaining literature review considers the impact of the Mauritian legislation on the establishment of an offshore trust by a South African company in Mauritius.

3.1.6 Mauritian legislation: trusts

An offshore trust is essentially an entity which breaks the chain of legal ownership between the donor and his former assets (Ginsberg, 1997:43) and this creates the opportunity to set up a tax-efficient structure to avoid home-country taxes.

It is possible to form a trust in Mauritius under the MTA (OECD, 2011:29). Non-citizens are allowed to create trusts under the MTA and are also allowed to be beneficiaries in terms of Section 8(3) and (4) of the MTA.

A trust may hold a GBL1 licence, but not a GBL2 licence (OECD, 2011:30). As of June 2010, 216 tax resident trusts are registered with the MRA (OECD, 2011:30).

A trust can be formed in Mauritius under the MTA. The different types of trusts available are protective trusts, purpose trusts and charitable trusts. Non-citizens can create a trust in Mauritius and be the beneficiaries. A trust may hold a GBL1 licence, but not a GBL2 licence. The tax consequences of a GBL1 are discussed in detail later in this study. According to the MRA a trust is deemed to be a resident if it is administered in Mauritius

and a majority of the trustees are resident in Mauritius, or if the settler of the trust was resident in Mauritius when the trust was created (OECD, 2011:29).

This is important to assess when dealing with an offshore trust, whether formed in Mauritius or not, as the residency of the trust is not easily determined or proven. This is not just a matter of law but of fact and can potentially have a significant impact in determining the tax consequences of the establishment of an offshore trust.

3.2 CONCLUSION

A discretionary trust is the type of trust that offers the trustees the ability and opportunity to perform tax planning with tax minimising (avoidance) in mind. South African residents are allowed to register trusts in Mauritius in accordance with the MTA. In addition, the trust registered in Mauritius will be able to hold a GBL1 licence, which will give the trust access to a Mauritius-favourable tax treaty network. In addition, the settlor or founder could make use of a "letter of wishes" in order to obtain further tax-planning benefits.

With reference to the above and paragraph 2.3.2, the "place of effective management" of a trust will be where the trustees meet and where the key decisions regarding the policies and strategy of the trust are made. Therefore the residency status of the trustees, beneficiaries as well as the settler or founder becomes irrelevant in determining the residency status of a trust.

The ideal trust for tax-minimising opportunities will therefore be a discretionary trust, formed in Mauritius and managed by the trustees from Mauritius. In order to determine the most tax-efficient organisational structure, the features of an offshore trust need to be compared to the key attributes of an offshore company. What follows is a literature review of offshore companies.

CHAPTER 4

THE OFFSHORE COMPANY

4.1 INTRODUCTION

This study analysed the characteristics of an offshore company and the manner in which an offshore company can be utilised in an organisational structure to minimise taxes. It is, once again, of great importance to assess the residency status of a company as this has an impact on where the company is liable for taxes.

For the purpose of this study it is important to assume that a South African resident company will want to make use of an offshore company in Mauritius only if the offshore company is taxed in Mauritius at a lower tax rate than that of South Africa. Refer to Chapter 5 for a detailed discussion on the tax consequences of an offshore company established in Mauritius.

In this regard the next part of the literature review will consider the South African and Mauritian legislative requirements for an offshore company, residency status of the offshore company as well as the impact of the taxes raised by the revenue authorities of the respective contracting states.

4.1.1 South African legislation

In terms of Section 1 of the Companies Act No71 of 2008 (referred to as the Companies Act hereafter) a company refers to a juristic person incorporated in terms of the Companies Act. A foreign company is described in the Companies Act as an entity incorporated outside the republic, irrespective of whether it is carrying on trade within the republic.

As stated earlier, this study focused on the incorporation of an offshore company which is defined in the Companies Act as a “foreign company”. The study is limited to the treatment of an offshore company in terms of the Act and will not consider the other regulatory

requirements in terms of the Companies Act or any other Act which does not affect the offshore company's tax burden. If a company is incorporated in South Africa it will automatically be regarded as a resident of South Africa in terms of the Act.

In terms of Section 1 of the Act, the definition of a company includes any association, corporation or company incorporated under the law of any other country apart from South Africa. The Act therefore recognises offshore companies as companies for tax purposes (Oguttu, 2007:54).

In this study it was envisaged that the South African resident company will set up a subsidiary or base company in Mauritius. The purpose of the base company or subsidiary is to conduct business in Africa via Mauritius. The base company is regarded as the holder of the legal title to the right on the foreign income that belongs to the parent company, which may be registered outside the country where the base company is registered. This implies that the base company is entitled to the foreign income within the foreign tax jurisdiction, which means that the foreign income of a base company is not subject to the domestic tax legislation of the parent company since it is incorporated in a foreign jurisdiction and as such is recognised as a separate juridical entity (Arnold & McIntyre, 2002:87). This is applicable for most tax systems, but in terms of South African tax legislation companies are taxed based on their "residence" basis, which implies that the company is taxed on its worldwide income.

The residence status of an offshore company therefore plays a critical role in terms of its liability to pay taxes. The following is a discussion on the factors that could have an impact on the determination of the residency of a company.

4.1.2 Residence status of an offshore company

Since this study dealt with South African resident companies investing into Africa via Mauritius it is imperative that consideration be given to the definition of "resident" in terms of the Act in respect of companies. The definition of "resident" must also be considered in the context of double taxation agreements in accordance with the OECD commentary as

the DTA between South Africa and Mauritius has a significant impact on the most tax-efficient structure.

The Act in Section 1 divides “resident” into two categories, namely: natural persons, known as individuals, and persons other than natural persons. This study only focuses on the part of the definition that pertains to persons other than natural persons. In accordance with the definition a person other than a natural person is considered to be a “resident” of South Africa if it is incorporated, established or formed in the Republic of South Africa or if it has a place of effective management in South Africa. When a company is incorporated in South Africa it will automatically be regarded as a South African resident. The purpose of this study is to determine an efficient tax-minimising organisational structure. Ideally the most efficient structure will be where the company is liable to tax in a lower tax jurisdiction, in this case Mauritius. Therefore a full discussion on incorporated companies in South Africa falls outside the scope of this study and the focus will be on companies incorporated in Mauritius. Remaining is the key consideration that if the company is effectively managed in South Africa it will be deemed to be a resident in South Africa.

For DTA purposes, Article 4 of the DTA between South Africa and Mauritius determines that in order to determine a person’s residency status, the domestic law of South Africa and Mauritius has to be used and applied to the person’s circumstances (Olivier & Honiball, 2008:67). It may happen that a person is a tax resident in both contracting states based on the application of the domestic law principles of the respective contracting states. This is referred to as dual residency (Olivier & Honiball, 2008:69). Article 4, paragraph 3 of the DTA between South Africa and Mauritius provides guidelines in respect of a tie-breaker where a person other than an individual has dual residency. The tie-breaker rule determines that a person other than an individual will be regarded to be a resident in the contracting state where it is effectively managed. The impact of the DTA between South Africa and Mauritius is discussed in more detail later in this study.

It is therefore important to consider the factors that will affect the place of effective management of a company.

4.1.3 Place of effective management

As discussed earlier, the “place of effective management” will be the place where key management and commercial decisions that are necessary for the conduct of the entity’s business are in substance made.

It can be concluded, at this stage, that the application of the “place of effective management” is difficult and may vary from situation to situation. As a result of the recent decision reached in the *Oceanic* case, the South African courts hold a similar view as prescribed by the OECD. It would seem that the “place of effective management” for companies will be where the board of directors or the most senior group of people make the key management and commercial decisions. This will have to be assessed on a case-by-case basis as there is no clear set of rules to follow in the determination of the “place of effective management”.

Once determined that a foreign company is not a resident of South Africa cognisance must be taken of Section 9D of the Act. The purpose of Section 9D is to prevent the avoidance of tax on investment income and all other foreign income including capital gains tax (Olivier & Honiball, 2008:430). Section 9D of the Act deals with the CFC rules and will need careful attention in setting up a tax-efficient structure for investing into Africa via Mauritius. The next part of the literature review focused on the CFC rules.

4.1.4 Section 9D: CFC rules

Section 9D is an anti-avoidance measure with its primary objective to prevent South African residents’ foreign income not being taxed in South Africa (Olivier & Honiball, 2008:436). When dealing with foreign direct investments the international literature makes a distinction between direct and portfolio investment. Direct investment refers to where an investor has a large enough interest in a company to influence the operations of the company, whereas portfolio investment refers to circumstances where an investor has little or no influence (Vann, 1998:768). This study focused on the “direct investment” term and it is in this context that the rules of CFC legislation are relevant.

The definition of a foreign company (offshore company) in Section 9D(1) of the Act reads as follows: "... any association, corporation, company, arrangement or scheme contemplated in paragraph (a), (b), (e) or (f) of the definition of company in Section (1), which is not a resident". It is clear from this definition that the foreign entity must be a company and must not be a resident in South Africa for income tax purposes. Once again the term resident under South African domestic law is determined with reference to "place of effective management". It should further be noted that the above definition does not apply to a foreign trust (offshore trust); in other words the CFC rules can only be applied to foreign companies as the trust is excluded from the definition (Olivier & Honiball, 2008:432–433).

The implication of Section 9D of the Act is that a foreign company is deemed to be a South African resident and as such income from foreign sources will fall within the ambit of the South African tax net. In essence Section 9D(2) implies that a South African resident who holds more than 50% of the participation rights in a foreign company which is a non-resident is required to include on a proportional basis net income earned by the foreign company based on the South African resident's ownership percentage. It is important to note that if a foreign company is deemed to be a resident in South Africa by means of having its effective place of management in South Africa, the CFC rules cannot apply as the foreign company will be taxed on its worldwide income (Olivier & Honiball, 2008:430–431).

Section 9D of the Act determines that the net income of the foreign company is calculated with reference to the Act. Therefore the amounts that would have been included under the definition of gross income (had the foreign company been a South African resident) will be included in the foreign company's taxable income calculation. Similarly, deduction of expenses and allowances not allowed under the Act will not be allowed in the foreign company's taxable income regardless of the foreign country's tax legislation.

Section 9D(9) of the Act provides certain "exemptions" or "exclusions". For the purpose of this study the "foreign business establishment" exemption was discussed as this is the exemption most likely to be applied in setting up a tax avoidance structure by South African residents. This study recognises that this exemption is one of the most complicated

sections in the Act, and therefore a detailed analysis and discussion thereof falls outside the scope of this study. The definition "foreign business establishment" broadly resembles the definition of "permanent establishment" contained in the DTA between South Africa and Mauritius (Olivier & Honiball, 2008:448).

Section 9D(1) of the Act defines a "foreign business establishment'" as "a place of business with an office, shop, factory, warehouse, or other structure that was used or will continue to be used by the controlled foreign company for a period of at least one year, whereby the business of the company is carried on, and where the place of business is suitably equipped with on-site managerial and operational management and employees of the CFC inter alia are required to render services on a full-time basis for purposes of conducting the primary operations of that business..." (Olivier & Honiball, 2008:448). It is clear that there must be economic substance to the CFC in a country other than South Africa in order to qualify for the exemption. Similar aspects are contained in the definition of a "permanent establishment".

The DTA between South Africa and Mauritius defines a "permanent establishment" as a fixed place of business through which the business of the enterprise is carried on wholly or partly. The term "permanent establishment" includes a place of management and therefore the fixed place of management is regarded as sufficient to constitute a permanent establishment. The impact of the DTA between South Africa and Mauritius is discussed in more detail later in this study.

A critical difference between the term "foreign business establishment" and "permanent establishment" is that a fixed place of management is sufficient to be regarded as a permanent establishment for tax treaty purposes, whereas it will not be sufficient for a foreign business establishment. Circumstances or scenarios could therefore arise where there is a conflict between the two definitions and consideration must be given to which definition will take preference.

Currently there is no clear universal answer on this matter, nor are there many international cases (Legwaila, 2010:99). The position in South Africa is currently that an interpretation of Section 9D of the Act in the context of the tax treaty between South Africa

and Mauritius indicates a conflict between the relevant provisions. The South African Constitution represents the supreme law and all South African law and international agreements must conform to the provisions of the South African Constitution. Section 9D of the Income Tax Act and the treaty provisions under South African law therefore has equal status (Olivier & Honiball, 2008:479).

Oguttu (2009:105) submits that the manner in which a domestic court will resolve a conflict between CFC legislation and a tax treaty depends on whether the CFC legislation will take preference above the DTA. The CFC legislation may also not be applied if the tax treaty does not contain a safeguarding clause that expressly authorises that the CFC legislation may be applied (Oguttu, 2009:105). Specific to this study is where a South African resident company makes use of a subsidiary incorporated in Mauritius. The current CFC legislation in terms of Section 9D of the Act contradicts the principle that a subsidiary is a separate legal entity. Oguttu argues that tax treaties based on the OECD Model Tax Convention uphold the principle that a corporation is treated separately from its shareholders as a taxpayer (Oguttu, 2009:75). The DTA between South Africa and Mauritius is established based on the OECD Model. It can therefore be argued that a foreign company incorporated by a South African resident company as a subsidiary will only be liable for tax in South Africa on the income generated in South Africa, given that there is an absence of effective management in South Africa.

Nevertheless, the CFC legislation in the Act ignores the principle that a foreign subsidiary is deemed to be a separate legal entity. Instead it determines that the shareholders –in this study the South African resident company –are liable for tax on their pro rata share of the foreign income.

Currently there is no clear guidance on how the conflict between CFC legislation and a country’s tax treaties can be resolved (Oguttu, 2009:87). The South African Constitution represents the supreme law and all South African law and international agreements must conform to the provisions of the South African Constitution, therefore the treaty provisions and Section 9D of the Act have equal status under South African law. It cannot be generally accepted that the treaty provisions will automatically override the domestic legislation (Olivier & Honiball, 2008:479). Currently the conflict between Section 9D and

tax treaty provisions remains unresolved and it is submitted that the court will assess each case based on its own set of circumstances and facts.

It is further submitted that there are two ways in which certainty in this regard can be obtained in South Africa:

- Firstly, the tax treaties of South Africa must include specific CFC rules and clauses.
- Secondly, the domestic legislation (Section 9D) could be amended to state that in the case of conflict between Section 9D and a tax treaty the CFC legislation will override the tax treaty (Olivier & Honiball, 2008:481).

A full discussion of the aspects of conflict between Section 9D of the Act and the DTA between South Africa and Mauritius falls outside the scope of this study. In conclusion it is important to note here that CFC legislation is not applicable on foreign trusts and is only applicable to foreign companies. The effect of Section 9D of the Act is that the foreign company's (offshore company established in Mauritius) net income as calculated under the principles of the Act will be included in the South African shareholders taxable income and as such will be liable to tax in South Africa and can therefore result in the shareholder being subject to double tax. The conflict between Section 9D and the DTA provisions currently remains unresolved, and therefore when setting up an organisational structure the South African resident company should assess in detail the impact of Section 9D on the offshore company.

4.1.5 Mauritian legislation

In this study the implications of Mauritian tax and other legal requirements were investigated (refer to Chapter 5).In order to conduct business in Mauritius, Mauritius provides two licences under the Financial Services Act of Mauritius, namely category 1 Global Business Licence (GBL1) and category 2 Global Business Licence (GBL2).

A GBL1 may be a company, partnership or a trust. A GBL2 may only be limited by shares or by guarantee, or limited by both shares and guarantee. At the end of 2009, Mauritius had 10 250 GBL1s and 18 548 GBL2s (OECD, 2011:17). A GBL1 is deemed to be a resident corporation which carries on business outside Mauritius. A prerequisite for the

Commissioner of the MRA granting this licence is that the business conducted by the GBL1 corporation is or will be managed from Mauritius. It is important to note that GBL1 corporations will qualify for the Mauritian tax treaty benefits (OECD, 2011:20).

The problem that arises with the incorporation of a GBL1 company in Mauritius by a South African company is the possibility that a GBL1 company could be regarded as a South African resident. This is based on the possibility that a GBL1 company could be effectively managed in South Africa. In such a case a GBL1 company will have to pay taxes in South Africa as South African residents are taxed on worldwide income and not only on income from a South African source. In the latter case, tax efficiency of the structure or business venture will be lost as South Africa has a much higher tax rate than Mauritius in respect of corporate taxes, capital gains taxes as well as dividend-withholding taxes. In terms of the double taxation agreement between South Africa and Mauritius the company is liable for tax in the country of residence. This research specifically evaluates the impact of effective management and consideration will be given to the necessary requirements of a GBL1 company to be recognised as non-resident of South Africa.

A GBL2 can only be granted to a Mauritian private company incorporated under the Companies Act of Mauritius. A GBL2 involves certain restrictions, one of which is that a GBL2 corporation cannot conduct business with persons resident in Mauritius, nor can it have any dealings in Mauritian currency. A GBL2 is considered to be a non-resident for tax purposes and as a result thereof will not be able to obtain benefits from the Mauritian tax treaty network (OECD, 2011:20).

In this study the emphasis, when dealing with an offshore company, was therefore placed on GBL1 corporations as the GBL2 does not provide any benefits in terms of the tax treaty networks of Mauritius. In accordance with the MRA, a company's residence in Mauritius is based on either its incorporation in Mauritius or its central management and control being in Mauritius (Deloitte, 2012). Similarly, residents in Mauritius are taxed on their worldwide income and non-residents are only taxed on their source income from Mauritius. It should further be noted that Mauritius does not have a CFC regime (Legwaila, 2011:213). In this research it is important to assess and evaluate the residency of the offshore company as

the residency of the company ultimately determines its tax jurisdiction in terms of the DTA between South Africa and Mauritius. South Africa bears a higher tax rate than Mauritius.

According to Mauritian legislation the residence test must satisfy the following six requirements (Legwaila, 2011:204):

- The company must have at least two resident directors in Mauritius.
- The board meetings of the company must be chaired and initiated from Mauritius; it should be noted that it is not required that the meeting be held in Mauritius.
- The company is required to open a local bank account in Mauritius and the company's funds must flow through this account.
- The registered office of the company must be situated in Mauritius and the statutory documents should be kept on site.
- The qualified secretary of the company must be a resident in Mauritius.
- The company must appoint a local auditor.

The above requirements are mentioned as it is critical for a company to comply with the requirements in order to obtain and maintain the GBL1, which in turn will provide the company with a Tax Residence Certificate. Even though this is an important aspect of the GBL1 it is proposed that this study does not further investigate these matters and it will be assumed that these requirements are met when evaluating a GBL1 tax structure.

4.2 CONCLUSION

According to Mauritian legislation non-residents can either use a trust or a company under the GBL1 licence to conduct business in Mauritius. A company incorporated in Mauritius is deemed to be a resident of Mauritius in respect of Mauritian tax legislation. However, if it is found that the Mauritian-incorporated company is effectively managed from South Africa the offshore company could be deemed to be a resident in South Africa. This is in line with the DTA between South Africa and Mauritius. When an offshore company is therefore used in a structure to minimise taxes the company should be effectively managed in Mauritius in order to ensure that the company is deemed to be a resident of Mauritius in terms of the DTA between South Africa and Mauritius.

The effect and application of the DTA is discussed in the next chapter. This is followed by an assessment of the tax consequences of a GBL1 licence as well as the applicable South African taxes on the various different organisational structures.

CHAPTER 5

DTA BETWEEN SOUTH AFRICA AND MAURITIUS AND TAX CONCERNS

5.1 INTRODUCTION

The international tax arena is affected and to a certain extent governed by DTAs. The main objective of a DTA is to eliminate or avoid double taxation and as such provide relief to the tax payer participating in international trade.

When a tax payer is looking to set up an effective organisational structure to minimise taxes there is no doubt that a DTA will play a significant part in setting up the organisational structure. The DTA determines which country has the right to tax a person's income. The DTA also determines how certain income should be taxed and when withholding taxes will be applicable.

This chapter includes a discussion on the status of treaties in South Africa. This is followed by a discussion on the various taxes applicable on a GBL1 corporation as well as a discussion and assessment of the impact of the DTA on various incomes.

5.2 DOUBLE TAX AGREEMENTS (DTAs)

It is important to consider the status of the DTA within the legislation of South Africa as the study focused on tax efficiency for South African resident companies. In accordance with Section 231 of the Constitution of the Republic of South Africa No 108 of 1996it is important to note that a double taxation agreement is classified as an international agreement (Olivier & Honiball, 2008:32). Section 108(2) of the Act determines that a DTA becomes part of domestic law once it has been accepted and published in the *Government Gazette*. This view was supported in ITC 1544: SATC 456 at 460 where the court held that the effect of Section 108(2) of the Act is to provide relief in situations where the Act imposes tax and where the provisions of a DTA provides exemption to a person. The court further held that the tax imposed by the Act will not be payable in so far as the

DTA provides relief to that person, provided that the DTA has been proclaimed and therefore enjoys a statutory status. It is therefore clear that a treaty ranks equally with the Act as provided in terms of Section 231 of the Constitution of the Republic of South Africa No 108 of 1996 (Olivier & Honiball, 2008:38).

An important aspect of the DTA is that it determines the jurisdictions to tax. Through the DTA the contracting states agree to share the tax costs of double tax avoidance (Rohatgi, 2002: 2–3). The jurisdiction to tax has a critical impact on a tax-minimising organisational structure because if Mauritius has the right to tax, the tax rate is significantly lower compared to when the said right would be awarded to South Africa. Based on Article 4 of the DTA between South Africa and Mauritius a person, other than a natural person, can only be a resident in one of the contracting states. In order to determine residency of the person specific reference is made to the "place of effective management". The term "place of effective management" has been discussed in detail earlier in this study. Once residency is determined it is important to establish how the shareholders or owners of the foreign company will eventually obtain the benefit from the tax-minimising organisational structure and what impact the DTA has on the benefit.

From the above it has been established that the DTA between South Africa and Mauritius enjoys equal status with the Act. The DTA determines which country has the right to tax and therefore the impact of the DTA on tax imposed by Mauritius and South Africa should be assessed. In order to assess the impact of the DTA the fundamentals of certain tax aspects should first be discussed.

What follow is a discussion on the tax implications of a GBL1 corporation and a discussion on other tax aspects with regard to the Act.

5.3 TAX TREATMENT OF A GBL1 CORPORATION

It is important to analyse the Mauritian general tax system and the impact thereof on the GBL1 corporations. The normal corporate income tax rate is currently at 15% and there is

no tax on wealth in Mauritius (OECD, 2011:12). Furthermore, as discussed earlier, both an offshore trust and offshore company formed and established in Mauritius can hold a GBL1.

Resident companies are taxable on their Mauritian-source income as well as all foreign income, whether remitted or not. The benefit that the Mauritian tax system offers is that a credit is allowed for foreign tax on the foreign source income of a resident of Mauritius against the Mauritius tax liability. Where a GBL1 does not present written evidence to the MRA showing the amount of foreign tax charged, the amount of foreign tax is presumed to be equal to 80% of the Mauritian tax, reducing the effective tax rate on the foreign income to 3% (OECD, 2011:12). This would imply that effectively only 20% of the foreign income of a GBL1 corporation will be subject to a 15% tax rate. Mauritius also has neither withholding taxes on dividends nor any other dividends tax. Mauritian domestic legislation does not levy any capital gains taxes (OCED, 2011:13).

It is also important to note that the corporate taxation concepts apply to companies and entities deemed to be companies for tax purposes and this will therefore include trusts (OECD, 2011:12).

The remaining part of this chapter focused on the DTA between South Africa and Mauritius and its effect on the investment decision and impact on the taxes payable on different types of income.

5.4 TYPES OF INCOME IN TERMS OF THE DTA

The manner in which the shareholders of the South African resident company obtain the benefit from the tax-efficient organisational structure needs to be considered carefully. For the purpose of the tax-minimising organisational structure it is important to distinguish between the tax implications for the shareholders of the South African resident company and the company itself.

Shareholders, whether they are natural persons or persons other than natural persons, will generally obtain their benefit from a company in the form of dividends. Where a trust is a

shareholder the dividends received by the trust will ultimately vest with the beneficiaries due to the conduit principle applicable to a trust. In turn, the company will be taxed on its business profits. The DTA between South Africa and Mauritius addresses both of these income streams.

5.4.1.1 Dividend income and related tax consequences

Article 10 paragraph 1 of the DTA between South Africa and Mauritius reads as follows: “Dividends paid by a company which is resident of a Contracting State to a resident of the other Contracting State may be taxed in the other State.” This would imply that in accordance with the DTA dividends paid by a company in Mauritius to South African residents may be taxed in South Africa (Olivier & Honiball, 2008:167).

Article 10, paragraph 2 of the DTA further stipulates the following: “... such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State...” The effect of this is that where the offshore company, which is resident in Mauritius, declares a dividend to its beneficial owners who are residents of South Africa, the shareholders might be taxed in accordance with the domestic laws of Mauritius as well. The tax levied may not exceed 5% of the dividend amount where the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends. In other cases the tax levied on dividends should not exceed 15% (Olivier & Honiball, 2008:167). The current domestic laws of Mauritius stipulate that there is no withholding tax or income taxes on the distribution of dividends; the dividends distributed from Mauritian source companies to the South African residents will therefore be exempt from any tax in Mauritius (OECD, 2011:12).

South African residents are taxed on their worldwide income. Foreign dividends are specifically included in paragraph (k) of the definition of “gross income” in the Act. South African residents are therefore liable to tax on their foreign dividends. A foreign dividend is defined in Section 1 of the Act as “any amount paid by a foreign company” (Stiglingh et al, 2012: 100). South African residents that receive foreign dividends from a Mauritian company will be taxable in South Africa, but there are certain exemptions applicable to

foreign dividends that are contained in Section 10B(2) of the Act (before 1 April 2012 foreign dividends were exempt under Section 10(1)(k)(ii)).

These exemptions, briefly, are as follows:

- Section 10B(2)(a) of the Act: This section allows an exemption on foreign dividends if the person receiving the foreign dividend holds at least 10% of the total shares or voting rights in the company declaring the dividend. It is important to note here that this exemption will not apply where the person receiving the dividend is deemed to be a CFC and the dividend amount declared was not taken into account in calculating the CFC’s net income.
- Section 10B(2)(b) of the Act: This section determines that a foreign dividend received by a company is exempt if the foreign dividend is received from another company which is deemed to be a resident of the same country of the person receiving the dividend.
- Section 10B(2)(c) of the Act: This section determines that a foreign dividend received by a person is exempt to the extent that the foreign dividend received is not more than the aggregate amounts included in the person’s income in any year of assessment with regard to amounts included as per CFC legislation (Section 9(D) of the Act).
- Section 10B(2)(d) of the Act: This section states that a foreign dividend received from a listed share will be exempt. Listed shares refer to shares listed on the Johannesburg Stock Exchange.
- Section 10B(3) of the Act: This section determines that a foreign dividend may qualify for a ratio exemption in the event that the foreign dividend did not qualify for any other foreign dividend exemptions, as discussed above. The portion that will be exempt is calculated based on a ratio. The ratio is prescribed as follows:
    - For natural persons, estates and special trusts the exempt portion will be calculated as 25/40 times the non-exempt foreign dividends.
    - For companies, trusts or any persons other than those mentioned above the exempt portion will be calculated as 13/28 times the non-exempt foreign dividends.

Depending on the structure utilised, foreign dividends paid by a Mauritian resident company to South African residents may be exempt from tax in South Africa. It has been established above that dividends declared in Mauritius bear no tax consequences from a Mauritian tax perspective and as such the foreign dividends received by South African residents may be completely free of tax in a certain organisational structure (refer to Chapter 6 for the case study of an analysis of the tax consequences of foreign dividends).

Dividends are generally declared and paid out of business profits of the companies declaring the dividends. The right to tax business profits is also dealt with in the DTA between South Africa and Mauritius.

5.4.1.2 Business profits

Article 7 of the DTA between South Africa and Mauritius reads as follows: "... profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment." The concept of a permanent establishment has been discussed earlier in this study.

The profits of an offshore company or trust which carried on business through a permanent establishment in Mauritius shall therefore only be taxable in Mauritius in accordance with the DTA between South Africa and Mauritius. This will have the result that the business profits are only taxed at 15% or in certain circumstances (where foreign income is generated by the foreign company or trust) at 3%.

It is clear that the DTA between South Africa and Mauritius contains favourable conditions for a tax-minimising organisational structure if set up correctly. Business profits could possibly be taxed at 3% and there is no tax implication of dividends in Mauritius. The South African resident will only be taxed on the foreign dividend when the dividend is accrued to the resident and if it is not exempt in terms of Section 10B of the Act.

Chapter 3 contains a detailed analysis which assesses the impact of the DTA on the tax-minimising organisational structure.

5.5 CONCLUSION

In conclusion of the literature review (chapters 2 to5). The Mauritian tax system is one of the most attractive in the world. The effective corporate income tax of 15% is one of the lowest in the world compared to most other African countries. In some instances an effective tax rate of 3% can be obtained through the use of a GBL1-incorporated company or trust.

The combination of the tax-sparing clause in the DTAs between Mauritian and other countries gives the GBL1 structure a major competitive advantage over other structures on the African continent.

This study has identified the best organisational structure to use under the GBL1 category which will ensure a South African resident company's access to the Mauritian tax treaty networks as well as the lower tax rate. The study mostly focused on theoretical resources and included a hypothetical case study chapter (refer to Chapter 6) where the different organisational structures were evaluated with reference to the findings in chapters 2 to 5.

CHAPTER 6

CASE STUDY

6.1 INTRODUCTION

“The avoidance of taxes is the only intellectual pursuit that still carries any reward.” (John Maynard Keynes)

The key objective of the study is to determine the most tax-efficient structure for South African residents investing into Africa using Mauritius as gateway. Whilst the focus of chapters2 to 5was on a review of literature on the key factors affecting such a tax-minimising organisational structure, in this chapter the key factors are applied to a case study in order to determine the practical implications of these key factors to such a structure.

This chapter aims to contribute to the base of knowledge that is available to determine a tax-efficient organisational structure for South African resident companies investing into Africa via Mauritius. In this chapter the key factors affecting such a structure are applied to a hypothetical case study. The chapter concludes on how these key factors affect a tax-efficient organisational structure in order to determine the most tax-efficient organisational structure.

6.2 CASE STUDY

A practical scenario was used in this section to analyse the impact on the tax implications for the various different organisational structures. The analysis was done in order to determine which organisational structure can be best utilised to minimise the tax burden for South African residents that want to invest into Africa via Mauritius.

The scenario is based on an actual, well-established, privately owned South African resident company (referred to as "SACo" hereafter) operating in the property industry. SACo's directors are of the opinion that the global future growth will be in Africa, and therefore a platform must be established in a low tax jurisdiction such as Mauritius. The result is that different organisational structures were explored in this study in order to establish which organisational structure will provide the shareholders of SACo with the best tax-minimising structure via Mauritius.

The specific details of the case study are as follows:

- SACo has three South African resident shareholders, who are also the directors of SACo. All the shareholders are natural persons and considered to be South African residents for tax purposes.
- The directors want to set up a platform in Mauritius, which is considered to have a low tax jurisdiction and which is a gateway to Africa due to its favourable tax treaty network with a large number of countries in Africa.
- SACo wants to make investments into Africa through its platform in Mauritius and consequently the income derived on the investments must be subject to minimal taxes.
- SACo will make investments in established funds or companies in the African countries.
- This study is specific in nature and is based on an organisational structure for making investments into African countries via Mauritius. The case study will therefore focus predominantly on the tax implications on interest, dividend income and gains from the disposal of shares or investment.
- For the purpose of the case study SACo wants to invest in a property company in Mozambique via its Mauritius organisational structure.

The options available to SACo in setting up a platform are the following organisational structures:

- Incorporate a company in Mauritius (MAUCo), which in turn will hold the shares in the Mozambique Company (MOCo).
- Establish an offshore trust in Mauritius, which will hold the shares in the MOCo.

- A combination of the above where the offshore trust in Mauritius will hold the shares in MAUCo, which in turn will hold the shares in MOCo.

Following is a discussion of the key factors affecting the tax efficiency of the above options. Following the discussion is an analysis of the tax implications of each of the structures.

6.2.1 Incorporation of a company in Mauritius

In this scenario SACo will use an offshore company incorporated in Mauritius, MAUCo. SACo will hold the entire issued shares in MAUCo. The directors of SACo will also be the directors of MAUCo. The following key factors that would have an impact on the efficiency of the tax structure are analysed in detail below.

6.2.1.1 Type of offshore company

SACo will be allowed to incorporate MAUCo in Mauritius as a private company in accordance with the Companies Act 2001 of Mauritius. MAUCo will only be utilised as a platform to expand into the rest of Africa and in this specific case study for investment into Mozambique in MOCo.

SACo will make its investments into Africa via MAUCo. Companies carrying on offshore (from Mauritius) activities are required to be licensed in accordance with the Financial Services Act (OECD, 2011:17). MAUCo will be required to register as a GBL1 under the Financial Services Act. Under the GBL1 licence, MAUCo will have access to the benefits provided by the tax treaty network of Mauritius. For the purpose of this case study only the GBL1 licence will be analysed as the GBL2 does not provide any tax benefit in respect of the tax treaty network.

MAUCo registered under a GBL1 is subject to a flat tax rate of 15% on both its Mauritius-source income and foreign-source income (remitted to Mauritius or not). It should be noted that a GBL1 is allowed to claim a tax credit for foreign taxes on the foreign-source income of the GBL1 against the Mauritian tax liability. Furthermore, the Mauritian tax legislation

determines that the foreign tax is presumed to be 80% of the Mauritian tax liability, reducing the effective tax rate on foreign income to 3% in Mauritius. In addition, dividends paid by a resident company in Mauritius are exempt from income tax in the hands of its shareholders, whether resident or not. As such there is no withholding tax on dividends paid to shareholders of Mauritian companies (OECD, 2011:12).

It is important to note here that the above will only be relevant if MAUCo is deemed to be a resident in Mauritius. A company is deemed to be a resident in Mauritius if the company is registered in Mauritius or has its "place of effective management" in Mauritius in accordance with the DTA between South Africa and Mauritius. In this scenario it is expected that MAUCo will be incorporated in Mauritius, and therefore the factor that needs to be analysed further is the effect of the "place of effective management". This needs further consideration because in the event that MAUCo is deemed to be effectively managed in South Africa, MAUCo will be liable to tax in South Africa as it will be regarded as a South African resident. As a result MAUCo, and subsequently its shareholders, will not be able to effectively utilise the benefits of the low tax jurisdiction of Mauritius as MAUCo will be taxed at the applicable South African tax rate which is much higher than that of Mauritius.

6.2.1.2 "Place of effective management" of the offshore company

It is clear that the impact of the "place of effective management" is a critical factor in order to determine the most tax-efficient organisational structure. If MAUCo, which was incorporated by SACo in Mauritius, is found to be a resident of South Africa, MAUCo will be liable to tax in South Africa at a much higher rate than in Mauritius.

As discussed before, the "place of effective management" is the place where key management and commercial decisions that are necessary for the conduct of the enterprise's business are in substance made. From a company's perspective this will be the place where the board of directors normally meet. It is clear from the *Oceanic* case that there is no hard and fast rule to determine the place of effective management and that each case will be assessed individually, taking into consideration its facts and circumstances. It is important to make reference here that the court did not make

reference to the requirements of SARS's Interpretation Note 6 in the *Oceanic* case. It could therefore be argued that the courts in South Africa will follow more of an OECD approach than the SARS Interpretation Note 6 approach.

Taking the above factors into consideration, it is recommended that the directors of MAUCo should hold their directors' meetings in Mauritius on a frequent basis. The directors need to ensure that adequate minutes of meetings are kept or that they have any other relevant support to provide proof that MAUCo is effectively managed from Mauritius. This will serve as proof that the key management and commercial decisions necessary to conduct the enterprise's business are made in Mauritius. The place where these decisions are implemented or where the day-to-day management of MAUCo occurs is irrelevant. It is compulsory to appoint two local resident directors in Mauritius in order to gain access to the tax treaty networks. The company must have a registered address in Mauritius and the accounting records should be kept and maintained from the registered office in Mauritius. MAUCo must in addition to the above appoint a management company, administrator, secretary and auditor in Mauritius. All these factors will contribute to MAUCo being effectively managed from Mauritius.

From the above it is clear that the residency status of MAUCo is not dependent on the residency of either its shareholders or its directors. Once it is established that MAUCo has its place of effective management in Mauritius it will be deemed to be a resident of Mauritius and not of South Africa.

It is important to note here that the shares of MAUCo will either be held by the three shareholders of SACo or by SACo itself. The result is that MAUCo can be considered as a CFC for South African tax purposes. It is therefore important to consider the impact of Section 9D of the Act on MAUCo and its South African shareholders from a South African tax perspective.

6.2.1.3 Section 9D of the Act

MAUCo in this study might be subject to the requirements and implications of Section 9D of the Act as MAUCo is a foreign company which is not a resident or deemed resident of South Africa.

Section 9D of the Act defines a CFC as any foreign company where more than 50% of the total participation or voting rights of the CFC is held by residents. Section 9D(1) defines participation rights as the “right to participate in decisions of a company in relation to the shares held in that company”.

From the above definition and application thereof it is clear that MAUCo falls within the ambit of Section 9D as all the shares in MAUCo are held by South African residents, either by the individual shareholders of SACo or SACo itself.

The implications of MAUCo being classified as a CFC is that the net income at the end of the foreign tax year is calculated and included in the South African resident’s (in this case the shareholders of SACo or SACo itself) income at the end of the South African year of assessment. As such the net income of MAUCo will have to be calculated and included in the shareholders of SACo or SACo’s income at the end of SACo’s year of assessment. The net income of MAUCo, which is included in the South African resident shareholders’ income, will therefore be subject to tax in South Africa at a corporate tax rate of 28%.

The application of Section 9D of the Act would be excluded when there is a foreign business establishment in Mauritius. If it can be proven that MAUCo meets all the requirements of a foreign business establishment MAUCo will fall outside the ambit of Section 9D of the Act. In order to qualify for the exemption under the term “foreign business establishment” MAUCo will need to set up an office in Mauritius for at least a period of one year. The office must be suitably equipped for running the operations of that business –this will include on-site managerial and operational employees which are required to render services on a full time basis. If MAUCo is not properly structured to meet these requirements it can and most likely will not be deemed to be a foreign business establishment. It is most likely that in this scenario MAUCo will not be able to comply with

these requirements as MAUCo is only used as an investment vehicle into the rest of Africa, specifically in MOCo, and will not be trading full time in Mauritius.

However, in accordance with the term “permanent establishment” of the DTA between South Africa and Mauritius, MAUCo will be deemed to be a permanent establishment for the reason that it has its place of effective management in Mauritius and the term “permanent establishment” indicates that a fixed place of management is sufficient to be regarded as a permanent establishment. The above differences in the terms result in a conflict between the tax treaty provisions and domestic tax legislation of South Africa. It is unclear how this conflict will be resolved and it is submitted that the courts will make a decision based on each individual case, taking the facts and circumstances of each case into consideration.

Therefore, even if MAUCo is deemed to be a resident in Mauritius, there is always a risk that MAUCo might be regarded as a CFC for South African tax purposes. This will have a significant impact on the tax implications of MAUCo as MAUCo’s net income will be calculated according to the South African tax legislation, which includes worldwide income. In addition to the aforementioned, the net income will be included in the South African shareholder’s taxable income at a much higher rate than the effective tax rate of 3% that is provided by Mauritian legislation. What follows is a quantum analysis of the above structure.

6.2.1.4 Quantum analysis

Assume the following for the purpose of this case study:

- MAUCo received dividends of US$100 000 and interest of US$50 000 from its investment in MOCo. This was the only foreign income remitted from the MOCo to MAUCo. The effect of foreign currency translation falls outside the scope of this case study. Therefore the US$ currency is used for consistency purposes in the case study.
- MAUCo in turn declared and paid dividends to its shareholders out of the remaining profits and paid interest to SACo of US$50 000 in the year of assessment. For the purpose of this quantum analysis the shareholders will be deemed to be SACo.

- The tax implications of these amounts between MOCo and MAUCo are disregarded for the purpose of this case study. This study was done to assess the options available for South African residents using Mauritius as gateway for investing into Africa. The tax implications between Mauritius and Mozambique therefore fall outside the scope of this case study.
- It should also be noted that the tax implications between Mauritius and Mozambique will be the same for a company registered in Mauritius (MAUCo) holding the shares in MOCo or an offshore trust established in Mauritius holding the shares in MOCo. Both these organisational structures are allowed to hold a GBL1 and as such are taxed in the same manner. The only difference in each scenario is therefore the tax implications that the structure has for SACo.

The tax implications of the above scenario for the South African resident shareholders of MAUCo were analysed as follows. In the analysis below two scenarios are analysed. In scenario 1 MAUCo is not regarded as a CFC for South African tax purposes. In scenario 2 MAUCo is regarded as a CFC for South African tax purposes.

Table 2: Analysis of tax consequences for offshore company structure

Description	Notes	Scenario 1 (US$)	Scenario 2 (US$)
MAUCo gross income:			
- Foreign dividend received		100 000	100 000
- Interest received on loan		50 000	50 000
Less: Interest paid to SACo		(50 000)	(50 000)
Chargeable income	1	**100 000**	**100 000**
Tax on chargeable income at 3%	2	(3 000)	(3 000)
Profit after tax available for dividends		**97 000**	**97 000**
Dividends declared to SACo		97 000	97 000
Withholding taxes in Mauritius:			
- Interest paid	3	0	0
- Dividends paid	3	0	0
Amounts received by SACo			
- Dividends received	4	97 000	97 000
- Interest received	4	50 000	50 000
Tax implications in South Africa			
Tax on foreign interest received	5	(14 000)	(14 000)

Tax on foreign dividends	**6a,6b**	0	0
CFC tax implications	**7**	Not applicable	(25 000)
Net cash flow	**8**	**133 000**	**108 000**

Notes	
1	According to the Income Tax Act 1995 of the MRA a person's (companies and trusts) chargeable income in Mauritius is calculated as follows: Gross income less allowable deductions. Included in gross income are foreign dividends received as well as the foreign interest in accordance with paragraph 10 of the Income tax Act 1995 of the MRA. The interest paid to SACo will be allowed as allowable deduction.
2	The interest received and foreign dividends are subject to tax at 15%. MAUCo, however, can claim deemed foreign tax credit of 80% of tax payable, therefore resulting in an effective tax rate of 3%. In certain circumstances the tax rate can be reduced to nil if foreign withholding taxes were applicable (OECD, 2011:13). For the purpose of the case study it will be accepted that the effective tax rate is 3%.
3	Interest paid to a non-resident (in this case SACo) who is not carrying on a business in Mauritius is exempt from tax if the interest is paid out of foreign income (in this case interest received from MOCo) by a GBL1 entity (PKF, 2012:2). Mauritius does not levy any withholding taxes on dividends (OECD, 2011:13).
4	Foreign dividends received are included in gross income for South African tax purposes. This is in accordance with paragraph (k) of the definition of gross income in Section 1 of the Act. In accordance with Article 11 of the DTA between South Africa and Mauritius the interest is taxable in the state where the beneficial owner is resident. The interest received by SACo will therefore be liable to tax in South Africa and will therefore be included in the gross income. In addition, SACo is a resident in South Africa and therefore SACo is liable to tax on its worldwide income.
5	SACo is deemed to be a resident in South Africa and therefore no exemption will be allowed on foreign interest in respect of Section 10(1)(h) of the Act. The foreign interest is taxable in full at the corporate tax rate of 28%. Also see Note 4 on Article 11 of the DTA between South Africa and Mauritius. According to Section 10(1)(i) exemption on foreign interest will also not be applicable because SACo is not a natural person.
6a	The foreign dividend received by SACo by MAUCo will be exempt in terms of Section 10B(2)(a) of the Act. SACo holds 100% of the shares in MAUCo, which is more than the prescribed 10% in Section 10B(2)(a).
6b	MAUCo is regarded to be a CFC in scenario 2 above. Exemption in Section 10B(2)(a) will therefore not apply to the foreign dividend received. Section 10B(2)(c) determines

	that the foreign dividend will, however, be exempt to the extent that the foreign dividend does not exceed the aggregate of the amount included in SACo's taxable income in the year of assessment in terms of Section 9D of the Act. Section 10B(3) provides relief on foreign dividends for the part of the foreign dividends that were not exempt. For a company the exemption is calculated as 13/28. In this scenario the full portion of the foreign dividend will be exempt under Section 10B(2)(c) as the foreign dividend (US$97 000) does not exceed the net income amount (US$100 000) included under Section 9D of the Act in SACo's taxable income.
7	Section 9D(2A) determines that the net income of a CFC is calculated on the same basis as South African resident companies. The net income is included in SACo's taxable income in accordance with its participation rights, which in this case is 100%. US$100 000 is therefore included in SACo's taxable income, which is 100% of the net income of MAUCo, calculated in terms of South African tax legislation. The US$100 000 will be taxed at the corporate tax rate of 28% in South Africa, which means that tax amounting toUS$28 000 will be paid to SARS. SACo will, however, be able to claim a Section6quatrebate in terms of the Act on the foreign taxes paid. In this case the US$3 000 can be claimed in full. Therefore the total tax paid in scenario 2 in respect of the CFC net income amountstoUS$25 000.
8	The net cash flow is calculated as follows: Foreign interest received of US$50 000 plus foreign dividend received of US$97 000, less the relevant taxes included in each scenario. It is assumed for this purpose that the interest as well as the dividends was paid in cash.

In the above scenarios the sale of shares in MOCo was not considered. It should be noted here that there are no capital gains taxes in Mauritius (PKF, 2012:1). Any capital gains that are therefore attracted from the disposal of shares in MAUCo will not be taxed in Mauritius. These capital gains will, however, be included in the taxable income under Section 9D of the Act in the event that MAUCo is regarded to be a CFC.

6.2.1.5 Conclusion

Two scenarios were considered in the above quantum analysis. It was noted from the analysis that more taxes were paid by the South African residents where the offshore company was treated as a CFC. It is therefore critical to analyse the impact of Section 9D when an organisational structure is set up in Mauritius to minimise taxes.

The use of an offshore trust will now be investigated.

6.2.2 Establish an offshore trust in Mauritius

For the purpose of this scenario it is accepted that a discretionary trust is the best trust to use for tax-minimising (avoidance) purposes. This is according to the earlier discussion of the types of trusts. Non-residents of Mauritius can establish a trust in Mauritius and can also be the beneficiaries of the trust. In this scenario SACo will set up a foreign trust in Mauritius. SACo will be the sole beneficiary of the offshore trust (referred to as "Trust A" hereafter). The directors of SACo are also the trustees of Trust A along with a Mauritian resident trustee as required by the MTA. A trust is allowed to hold a GBL1 licence in Mauritius and consequently is taxed in the same manner as offshore company holding a GBL1 licence (OECD, 2011:30).

The corporate taxation principles in Mauritius that would normally be applicable to companies are also applicable to entities that are deemed to be companies such as trusts for the purpose of taxation in Mauritius (OECD, 2011:12).

The same effective tax rate that will apply to the offshore company established in Mauritius would therefore apply to the offshore trust registered in Mauritius. Resident trusts in Mauritius are liable to tax on income derived from Mauritian source or foreign source. In addition to the above a resident trust in Mauritius that holds a GBL1 licence is required to file information, including particulars of the beneficial owners with the Mauritius Financial Services Commission (referred to as "the FSC" hereafter) (OECD, 2011:30). The fact that the resident trust, which is the holder of a GBL1 licence, must by law disclose information with regard to the beneficial owners to the FSC makes this scenario less attractive for tax avoidance (or legally minimising taxes). It is also important to consider the residency status of an offshore trust as this can have an impact on where the trust will be liable to tax.

In Mauritius a trust is regarded as a resident if established in Mauritius. However, it has also been established that a trust is a person for tax purposes in respect of South African tax legislation. Trust A will therefore be subject to the provisions of the DTA between

South Africa and Mauritius. In accordance with Article 4 of the DTA between South Africa and Mauritius the residency status of the trust (a person other than a natural person) is determined based on "place of effective management". The same rules that would apply for determination of the "place of effective management" for an offshore company would apply for an offshore trust. As a result the "place of effective management" for Trust A will be where the key management and commercial decisions regarding the trust's business are made. The trustees are ultimately responsible for the management of the trust assets and as such are in control of the trust. Therefore the place of effective management will be where the trustees meet to make these decisions. Once again, based on the *Oceanic* case, there are no clear rules for this and each case will be assessed individually taking its facts and circumstances into consideration. It is clear that the residence status of the trustees and the beneficiaries are not the determining factors for the residency of a trust. SACO's residence and the residence of the trustees of the trust are therefore irrelevant in determining the trust's residency status.

Trust A is required by the MTA to have a registered address in Mauritius and the accounting records should be kept and maintained from the registered office in Mauritius. Trust A must in addition to the above appoint a management company, administrator, secretary and auditor in Mauritius. All these factors will contribute to Trust A being effectively managed from Mauritius.

Since the trust is treated as a company in Mauritius the distributions made to the beneficiaries will not be subject to any withholding taxes. The problem that may however arise is that the income will be distributed as income to the beneficiaries and not as dividends. As such when Trust A distributes the income made by the trust to its beneficiary, SACo, the income will be regarded as foreign income due to the conduit principle of trusts. Company A will have no exemption on the foreign income as it will not be deemed to be a foreign dividend and as such the income will be subject to income taxes at a rate of 28% in South Africa when the income is distributed. A benefit of this structure is that the tax liability can be deferred until a time that the income has been declared to the beneficiaries.

Since a trust is treated as a company in Mauritius, consideration must be given to the effect of Section 9D of the Act on Trust A.

6.2.2.1 Section 9D implications on the offshore trust

A trust is usually not regarded to be a CFC due to the fact that in the majority of times a trust is not an incorporated entity under the laws of the relevant foreign jurisdiction. However, where an offshore trust is regarded as a company under the Mauritian law in which it was formed the South African CFC legislation can apply as the trust is regarded as a company under the Mauritian laws.

Section 1 of the Act includes the following in the definition of the term “foreign company”: “...any arrangement or scheme carried on outside the Republic in pursuance of which members of the public are invited or permitted to invest in a portfolio of a collective investment scheme, where two or more investors contribute to and hold a participatory interest in a portfolio of the scheme through shares...” This definition makes it clear that a “foreign company” refers to unit or mutual trusts. This has the effect that the normal discretionary offshore trust will fall outside the definition of a foreign company and as such Trust A cannot be subject to the CFC legislation (Olivier & Honiball, 2008:432).

The use of only an offshore trust (Trust A in this scenario) appears not to be the best vehicle to use in a tax avoidance scheme to legally minimise taxes due to the following:

- The beneficial owner information must be disclosed to the FSC.
- The income distributed to the beneficiaries will retain its nature as foreign income and as a result will be subject to tax at a rate of 28% (which is the effective tax rate for a company in South Africa).

What follows is an analysis of the case study where an offshore trust was used instead of an offshore company.

6.2.2.2 Quantum analysis

From the above it is clear that Trust A will have similar tax consequences as MAUCo in the first scenario where MAUCo was deemed not to be a CFC. The net cash flow in this scenario will therefore also be US$133 000.

If the foreign dividend does not vest within 12months from the date when it was initially received or accrued to Trust A the foreign dividend will lose its identity. The impact of this is that the foreign dividend will then be regarded as foreign income when it vests with SACo. As a result the amount, that was the foreign dividend, will now be regarded as foreign income, which will attract taxes at a rate of 28%. In this case it will have the exact same effect as when MAUCo was regarded as a CFC, meaning that the net cash flow will be US$108 000.

6.2.2.3 Conclusion

From the above it is clear that the use of an offshore trust does seem to provide relief from the CFC legislation. The downside, however, is that the foreign dividends need to vest with the beneficiaries of the trust 12months after receipt or accrual thereof by the offshore trust. This in turn defiles the purpose of having a discretionary trust for tax-minimising purposes as the foreign dividends need to vest and therefore limit the trustees' use of discretion to do tax planning.

What follows is an analysis of an organisational structure where an offshore company and offshore trust are used in combination to ensure that taxes are minimised effectively.

6.2.3 Combination of an offshore trust and offshore company

In this scenario SACo will establish a discretionary offshore trust in Mauritius (referred to as "Trust A" hereafter). SACo will be the beneficiary of Trust A (the settlor of a trust established in Mauritius can also be the beneficiary in accordance with the MTA). The trustees of Trust A will be the shareholders of SACo (who are also the directors of SACo), along with the appointed management company in Mauritius as well as a resident trustee.

Trust A will in turn hold all the shares in an offshore company incorporated in Mauritius (referred to as "MAUCo" hereafter). MAUCo will then hold the GBL1 licence.

The benefits of the above structure are as follows:

- The trust/company combination provides a strong confidentiality barrier regarding the disclosure of information pertaining to beneficial ownership of the trust's beneficiaries. Since Trust A is not the holder of the GBL1 licence it is not required to disclose any information in respect of the beneficiaries of Trust A, which is ideal for tax avoidance purposes.
- Trust A is not deemed to be a resident of South Africa for South African income tax purposes as its "place of effective management" is deemed to be in Mauritius.
- MAUCo is not subject to CFC legislation, as the voting or participation rights are held by the offshore trust (Trust A) which is not deemed to be a resident of South Africa for income tax purposes.
- In addition to the above, MAUCo is deemed to be effectively managed in Mauritius for the same reasons as discussed before. The company is therefore not deemed to be a resident of South Africa and as a result the offshore company will be liable to tax at an effective tax rate of 3% in Mauritius on its foreign income.
- MAUCo will in turn declare dividends to its shareholders, which is Trust A in this scenario. These dividends are not subject to income tax or any withholding taxes in Mauritius. As such the distributions made to the shareholders from the offshore company to the trusts are tax free.
- Trust A will in turn distribute the foreign dividends received to its beneficiary, SACo, based on the discretion of the trustees. It should, however, be noted that the settlor of the trust can make use of a letter of wishes. This is a letter that will be addressed to the trustees and the trustees can decide whether or not to respond to the letter of wishes. The letter of wishes does not constitute control or effective management.

In addition, the original shareholders of SACo will only be liable to tax in South Africa once the trust income or dividends received by the trust are distributed or have vested to the beneficiaries of the trusts (which are the original shareholders of SACo). The beneficiary of Trust A, which is SACo, will be able to claim the ratio exemption on foreign dividends

under Section 10B(3) of the Act. The exempt portion will be calculated based on a 13/28 ratio for persons other than natural persons. No exemption can be claimed under Section 10B(2)(a) by SACo as the participation rights in MAUCo are held by Trust A, which is a non-resident for South African tax purposes.

6.2.3.1 Quantum analysis

Using the same information as in paragraph 6.2.1.4 above, the following analysis was done with regard to a combination of an offshore trust and offshore company.

Table 3: Tax implications for combined structure

Description	Notes	Combined structure (US$)
MAUCo gross income:		
- Foreign dividend received		100 000
- Interest received on loan		50 000
Less: Interest paid to SACo		(50 000)
Chargeable income	**1**	**100 000**
Tax on chargeable income at 3%	**2**	(3 000)
Profit after tax available for dividends		**97 000**
Dividends declared to Trust A		97 000
Withholding taxes in Mauritius:		
- Interest paid	**3**	0
- Dividends paid	**3**	0
Amounts received by SACo		
- Dividends received	**4**	0
- Interest received	**4**	50 000
Tax implications in South Africa		
Tax on foreign interest received	**5**	(14 000)
Tax on foreign dividends	**6**	0
CFC tax implications	**7**	Not applicable
Net cash flow to SACo	**8**	**36 000**
Net cash flow to Trust A	**8**	**97 000**
Total net cash flow in this scenario		**133 000**
Notes		

1	According to the Income Tax Act 1995 of the MRA a person's (companies and trusts) chargeable income in Mauritius is calculated as follows: gross income less allowable deductions. Included in gross income are foreign dividends received as well as the foreign interest in accordance with paragraph 10 of the Income Tax Act 1995 of the MRA. The interest paid to SACo will be allowed as allowable deduction.
2	The interest received and foreign dividends are subject to tax at 15%. MAUCo, however, can claim deemed foreign tax credit of 80% of tax payable, therefore resulting in an effective tax rate of 3%. In certain circumstances the tax rate can be reduced to nil if there were foreign withholding taxes applicable (OECD, 2011:13). For the purpose of the case study it will be accepted that the effective tax rate is 3% for illustration purposes.
3	Interest paid to a non-resident (in this case SACo) who is not carrying on a business in Mauritius is exempt from tax if the interest is paid out of foreign income (in this case interest received from MOCo) by a GBL1 entity (PKF, 2012:2). Mauritius does not levy any withholding taxes on dividends (OECD, 2011:13).
4	In this scenario the dividends received by Trust A from MAUCo were not remitted to SACo, and therefore there is no foreign dividend exemption applicable to this scenario. In accordance with Article 11 of the DTA between South Africa and Mauritius the interest is taxable in the state where the beneficial owner is resident. The interest received by SACo will therefore be liable to tax in South Africa and will be included in the gross income. In addition, SACo is a resident in South Africa and is therefore liable to tax on its worldwide income.
5	SACo is deemed to be a resident in South Africa and therefore no exemption will be allowed on foreign interest in respect of Section 10(1)(h) of the Act. The foreign interest is taxable in full at the corporate tax rate of 28%. Also see Note 4 on Article 11 of the DTA between South Africa and Mauritius. According to Section 10(1)(i) exemption on foreign interest will also not be applicable because SACo is not a natural person.
6	Dividends paid by resident companies are exempt from any withholding taxes as well as income taxes. When the dividend is therefore received by Trust A it will be exempt from any income taxes as Trust A is deemed to be a resident in Mauritius (OCED, 2011:12).
7	Section 9D of the Act is not applicable in this scenario, as discussed earlier in this case study.
8	The net cash flow is calculated as follows: SACo received foreign interest of US$50 000 less the relevant taxes in this scenario. Trust A received a foreign dividend of US$97 000. It is assumed for this purpose that the interest as well as the dividends was paid in cash.

	It is important to note here that the dividend received by Trust A from MAUCo was not remitted to nor did it vest in SACo. If this was the case, the foreign dividend would have been included in the taxable income of SACo (who is the beneficiary of Trust A). SACo would only have been able to claim a portion exemption under Section 10(B)(3). The exemption would have been US$97 000 x 13/28 = US$45 035, which means that US$51 965 would have been taxed at 28%. Should this have been the case then the net cash flow would have been US$36 000 on the interest and US$82 450 on the foreign dividend, which equals a net cash flow of US$118 450.

6.2.3.2 Conclusion

From the above analysis it is clear that a combination of an offshore trust and offshore company is an ideal organisational structure for minimising taxes. It seems that the complex structure provides relief on CFC legislation. In addition to the complex structure the “place of effective management” can be manipulated to the extent that it is considered to be in Mauritius.

It should, however, be noted here that the distribution of the foreign dividend received by the offshore trust to its South African beneficiaries can have negative tax consequences. It is likely, however, that the funds are retained in the trust offshore due to the complex control regulations imposed in South Africa compared to the non-existing control regulations in Mauritius (PKF, 2012:5).

6.3 CONCLUSION

From the above it is clear that for tax-minimising purposes as well as tax-planning purposes the protection of the beneficial ownership information is important. The “place of effective management” plays a critical role in the setup of an organisational structure to minimise taxes. In addition, the impact of CFC legislation can also have a significant impact on minimising taxes. The ideal organisational structure will be where the impact or possible impact of the CFC legislation can be eliminated.

Taking the above into consideration, it would seem that the best organisational structure will be where a combination of an offshore trust and an offshore company is used and

where the foreign dividends received from the offshore company established in Mauritius is retained in the offshore trust offshore from South Africa. The reason would seem that this structure can be better manipulated in order to achieve better tax avoidance results in order to effectively minimise taxes.

CHAPTER 7

CONCLUSION

7.1 INTRODUCTION

The desire for investors to legally avoid taxes has been a concern throughout the ages. The investor has a right to arrange his/her affairs in a way that minimises taxes whilst ensuring that the investor complies with the relevant regulatory requirements. This study aimed to provide guidance to South African resident companies that want to invest into Africa on how Mauritius can be used effectively to minimise taxes. The impetus of the study originated from a study of available literature on how offshore companies and offshore trusts can be used in determining a tax-avoidance structure for the investor.

The problem statement to be answered by this study was defined as "What is the best structure to use to effectively minimise taxes for South African residents investing into Africa using Mauritius as gateway?"

In addressing this problem statement the following research objectives (paragraph 1.4) were formulated:

(1) The research wishes to identify how residency is determined in accordance with South African and Mauritian tax legislation. This is an important consideration as the residency status of an organisational structure affects jurisdiction in which the organisational structure will be liable for taxes. The residency can therefore result in an organisational structure being taxed in higher tax jurisdiction than originally intended.

(2) The research wishes to identify the key attributes of an offshore trust and how these elements affect the residency status of the offshore trust.

(3) The research wishes to determine which type of trust can be best used in a tax-minimising scheme.

(4) The research wishes to identify the key elements of an offshore company and how these elements affect the residency status of the offshore company.

(5) The research wishes to assess the impact of Section 9D of the Act and the DTA between South Africa and Mauritius on a tax-minimising structure.

(6) The research wishes to apply the theory to a practical case study and thus determine the best tax-avoidance structure.

(7) The research wishes to recommend aspects that need further research.

This chapter concludes with the findings in respect of each research objective.

7.2 ACHIEVEMENT OF RESEARCH OBJECTIVES

In order to achieve the research objective of this study a literature review approach was followed to gain a detailed understanding of the factors that have an impact on a tax-minimising organisational structure. The literature review was followed by applying these factors to a hypothetical case study in order to determine the best tax-minimising organisational structure for South African resident companies looking to invest into Africa via Mauritius.

7.2.1 The research wishes to determine how residency is determined in accordance with South African and Mauritian tax legislation.

The literature review in Chapter 2 revealed that in South Africa the residency of a person other than a natural person will be determined based on its "place of effective management". It further revealed that the "place of effective management" will be where the key management and commercial decisions are made in order for the entity to conduct its business. However, no hard and fast rules exist and the place of effective management will be assessed on a case-by-case basis.

7.2.2 The research wishes to identify the key attributes of an offshore trust and how these elements affect the residency status of the offshore trust.

The literature review revealed that the residency of an offshore trust will be where the trust is effectively managed by the trustees and the residency of its beneficiaries, trustees or settlor becomes irrelevant in determining the residency status of the trust. There is no hard

and fast rule to determine the place of effective management and this will be determined on a case-by-case basis.

7.2.3 The research wishes to identify which type of trust would be the best to use in a tax-minimising scheme.

The literature review revealed that the best type of trust to use for tax avoidance purposes is a discretionary trust. The reason is that it allows the trustees to arrange the tax affairs of the trust in order to obtain the best tax position for the trust and its beneficiaries.

7.2.4 The research wishes to identify the key attributes of an offshore company and how these attributes affect the residency status of the offshore company.

The literature review revealed that a company's residence is determined based on its "place of effective management". The definition "place of effective management" bears the same meaning for a company as for a trust. The board of directors are generally those charged with the responsibility to manage the company and are required to make key decisions in respect of the company's conduct. It is therefore submitted that the place of effective management will be the place where these decisions are made and not necessarily where they are implemented.

7.2.5 The research wishes to assess the impact of Section 9D of the Act and the impact of the DTA between South Africa and Mauritius on a tax-minimising structure.

The literature review revealed that Section 9D of the Act can have a significant impact on the tax consequences for an offshore company where South African residents hold more than 50% of the participation (voting) rights. In the event that Section 9D is applicable the net profits, in relation to the percentage voting rights held by South African residents, of the offshore company is liable to tax in South Africa at a rate of 28%, compared to an effective tax rate of 3% in Mauritius. Section 9D could impact a tax avoidance structure

negatively. As a result, the use of an offshore company becomes less attractive due to the possible application of Section 9D of the Act.

The DTA between South Africa and Mauritius determines that the country of residence has the right to tax, unless there is a fixed place of business in the source country, which will give the source country the right to tax. In accordance with the DTA between South Africa and Mauritius the residency of a person other than a natural person is determined with reference to "place of effective management". The literature review indicated that dividends declared in Mauritius bear no tax consequences in Mauritius in accordance with its domestic tax legislation. Furthermore, the DTA provides that the business profits are only taxable in Mauritius if they are attributable to a permanent establishment and therefore the foreign company or trust will be liable to tax at a lower rate than the tax rate of South Africa.

7.2.6 The research wishes to apply the theory to a practical case study and thus determine the best tax avoidance structure.

The case study identified various benefits and disadvantages for each of the proposed structures (offshore company, offshore trust or a combination of both). It was found that through proper structuring the objective to avoid taxes legitimately can be met.

Based on the findings on the literature review in chapters 2 to 5 and the application of the literature review to a case study in Chapter 6, it can be concluded that the research objectives have been met. It can be concluded that the research problem has been adequately addressed through the accomplishment of the research objectives.

7.3. CONCLUSION

Taking various factors, qualitative and quantitative, into consideration this study has found that the ideal tax-minimising organisational structure for South African resident companies investing into Africa via Mauritius will be a combination of an offshore trust and an offshore company. It is envisaged that the discretionary offshore trust will be the main shareholders of the offshore company established in Mauritius. The offshore company will have to

establish a "permanent establishment" in Mauritius in order to ensure that the business profits are only taxable in Mauritius at an effective tax rate of 3%. In addition, the "place of effective management" for both the offshore company and offshore trusts should also be in Mauritius and this can be achieved through various means, as outlined in Chapter 3. The effect of this will be that both the offshore trust and offshore company are deemed to be residents of Mauritius and are as such liable to tax in Mauritius at a tax rate of 3%, which is significantly lower than the tax rate of South Africa (28% for companies and 40% for trusts).

Another aspect of using a combination is that the dividends received by the offshore trust from the offshore company are free from tax as Mauritius has no income tax or withholding taxes on dividends. In addition, the beneficiaries, South African residents, will only be taxed on the foreign dividends once the dividends vest in the beneficiaries. Since the trust is a discretionary trust the vesting of the foreign dividends can be deferred until a later point in time. In addition, the offshore trust, being resident in Mauritius, is taxed in a similar fashion as the offshore company. Furthermore, the CFC rules have no impact on this structure as the offshore trust, which is a non-resident of South Africa, is the main shareholder of the offshore company and CFC legislation does not apply to offshore trusts.

In conclusion, it would seem that the more complex the structure the better it is for tax avoidance purposes.

7.3 TOPICS FOR FUTURE RESEARCH

This study has identified the following potential topics for future research:

- A study could be performed in order to assess how the conflict between the CFC rules contained in Section 9D of the Act and the provisions contained in double taxation agreements can be resolved. This may be useful in order to ensure that there is no loop hole to exploit in this conflict.
- A study could be performed on the implication of Section 9D of the Act on offshore trusts where offshore trusts are treated as companies in foreign countries. It should be noted that trusts in South Africa are not deemed to be companies and as such fall outside the scope of Section 9D of the Act. However, where offshore trusts are

treated as companies in foreign countries, it might well be that Section 9D of the Act could have an impact on the offshore trust. The study could further assess how the income would be attributed to South African residents as there are no shareholders and Section 9D specifically refers to shareholders. This is currently another loophole that is exploited in tax avoidance schemes.

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