

## TR 111

### Facts

A Ltd (the "Fund") and B Ltd ("Associate Fund") constitute limited liability partnerships which were set up under the laws of Guernsey. The Fund and the Associate Fund invest in parallel in terms of a co-investment agreement between them. The limited partners of the Fund and Associate Fund comprise various South African and non-South African resident entities. The limited partners of the Fund are not M group entities, i.e they are third party investors. The limited partners of the Associate Fund are C Limited, an employee trust and various employees.

The general partner of both the Fund and the Associate Fund is D Ltd, a company which is 100% owned by C Ltd, a wholly owned subsidiary of E, a company listed on the London Stock Exchange.

### Capital Structure

**It is proposed that a company, G be incorporated in South Africa and capitalized as follows:**

- The Fund will hold one ordinary voting share.
- Pursuant to the alternative investment clause in the partnership agreement of the Fund /Associate Fund;
- all the Fund's South African resident limited partners (third party investors) will invest directly in a specific class of non-redeemable preferred shares (A Pref Shares) in G;
- the Fund's non-South African resident limited partners (third party investors) will, through an intermediary company (H) incorporated and tax resident in Guernsey, invest in A Pref Shares in G;
- the Associate Fund will through H indirectly invest in a second specific class of non-redeemable preferred shares (B Pref Shares) in G;
- D Ltd will, through H, indirectly invest in a third specific class of non- redeemable preferred shares (C Pref Shares) in G

**The A, B and C Pref Shares will have the following terms:**

- the shares will be bought back by G after 8 years. This represents the term of G's underlying investment. In addition, the holder will have the right to require G to buy back the shares and;
- dividends will be paid with reference to a formula of which the interest received by G on its underlying investment, i.e the loan, will be issued to each of the A,B and C Preference Shares. It is anticipated that the borrower of the loan from G will pay interest quarterly and, accordingly, G will pay preferred dividends on a quarterly basis as well. The terms of the A, B and C Preference Shares will require that dividends be paid in accordance with the formula referred to above. As such the directors would not have discretion as to whether to declare dividends on the A,B and C Preference Shares;

- The price at which the shares will be bought back will be the sum of the subscription price and any dividends which were due but remained unpaid (i.e accrued dividends) at date of buy-back. The holder therefore has a contractual right through the buy-back arrangement to dividends from G;
- for accounting purposes, the Preference Shares will be reflected as a liability on the balance sheet of G, and any preference share dividends which are declared and paid will be accounted for in the income statement of the issuer as a finance cost.

### **Activities of G**

G will utilize the funding so raised to advance an interest bearing loan to a third party South African resident. The loan will have a floating interest rate between 15 - 29% for the first two years, and thereafter it will become a fixed rate. The loan will be repaid in 2018 and will be subordinated. The sole business of G will be to advance the loan to the South African resident.

### **Location of Central Management and Control**

D Ltd forms part of the M Group which operates in the Financial Services Industry. Another division of the group, namely the group's banking arm has existing operations in Mauritius and D Ltd intends to utilize the existing presence in Mauritius by appointing, inter alia, one or two directors from this part of the group, which directors are located in Mauritius to the Board of G. In addition, it is intended that additional Mauritius resident directors be appointed to the Board of G. No South African resident directors will be appointed to G's Board. Furthermore all Board meetings will be held in Mauritius, strategic decisions will be taken in Mauritius, an auditor and company secretary will be appointed in Mauritius and the implementation of the decisions will take place in Mauritius. As such, G will have all its world activities managed and controlled in Mauritius.

As a result of the above, G will be registered as a foreign company as set out under Section 276 of the Companies Act 2001. G does not intend to apply for a Global Business Licence.

### **Point of Issue**

- 1) Whether -
  - a. G would be considered as a tax resident in Mauritius and benefit from the double taxation avoidance agreement between Mauritius and S. Africa; and
  - b. G will be issued a tax residency certificate by the Mauritius Revenue Authority?
- 2) Whether preference share dividends that would be paid on A, B and C Pref. Shares will be treated as interest / finance cost in Mauritius and be deductible for Mauritius tax purposes?
- 3) Confirmation that there will not be any withholding tax implications in Mauritius on payment of the Preference share dividends or the ordinary share dividends by G.

## **Ruling**

- 1) (i) On the basis of facts submitted, since G will have its central management and control in Mauritius, it will qualify as a company resident in Mauritius in accordance with our domestic legislation, viz. the provisions of Section 73 (1) (b) of the Income Tax Act. It will also be resident in South Africa by reason of being incorporated in South Africa. Therefore as it will be a resident of both Mauritius and South Africa, its residence status for the purposes of the Mauritius-South Africa DTA will have to be determined in accordance with the tie-breaker clause of Article 4(3) of the above treaty.  
  
(ii) In the light of the ruling given above, a tax residence certificate may be issued to G certifying that it is resident in Mauritius, subject to the condition that G shall at all times be able to demonstrate that its central management and control is in Mauritius.
- 2) On the basis of facts given, the A,B and C Pref Shares would be classified as long-term liability in the balance sheet of G, and since the distribution that would be made on these shares does not satisfy the definition of "dividends" in Section 2 of the Income Tax Act, it will be treated as interest, and therefore deductible for income tax purposes.
- 3)
- 4) It is confirmed that there will be no withholding tax implications in Mauritius on payment by G of dividends on the ordinary shares. As regards the distribution on the Pref Shares, it will be treated as interest, and it will not be subject to tax deduction at source in accordance with the provisions of Sub-Part BA of the Act, given that the recipients of such interest are non-residents. However, in accordance with Section 111K (2) of the Act, G will have to submit to the Director-General a statement in respect of each payee, where such aggregate interest payable exceeds Rs 50,000.