NovioTax

Kuwait – South African Protocol affects the lower WHT on Dividends between South Africa and the Netherlands

June 2021

The following questions have been raised after the recent signing of the KU – SA Protocol, due to the interplay of the Protocol with the Most Favoured Nation ("MFN") clause in the NL – SA DTAA: What are the effects of the KU – SA Protocol on dividend distributions made between Netherlands subsidiaries and South Africa parent companies? And what does this mean for companies qualifying for a dividend WHT exemption under the NL – SA DTAA? Are South African subsidiaries of Netherlands parent companies (still) entitled to a full elimination of dividend WHT under the NL – SA DTAA? What are the current and future anti-avoidance considerations for claiming 0% WHT on dividends? Can South African or Netherlands companies claim a refund of any dividend WHT paid to Netherlands/South African parent companies and/or what is the statutory time limit? This blog will outline the recent developments surrounding the dividend WHT exemption and address these key questions in relation thereto.

Background – Position before the KU – SA Protocol

MFN clauses

MFN clauses are commonly found in DTAAs between developed and developing countries. These clauses are negotiated into DTAAs to ensure that if one of the treaty partners offers a more beneficial treatment to another country, such treatment will also automatically apply under the DTAA that includes the MFN clause. Although MFN clauses are a popular topic of discussion in the context of treaty law, it is difficult to keep up with the actual application of these clauses because of their inter-dependence and also the complexity of language.

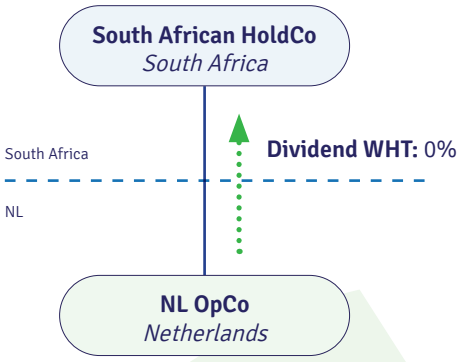
With regard to the effective withholding tax ("WHT") rate on dividends under the Netherlands – South Africa Double Tax Avoidance Agreement ("NL – SA DTAA"), two key court decisions paved the way for a 0% WHT rate (subject to some conditions), by way of applying multiple MFN clauses. These two court decisions are briefly discussed below.

Decision of the Dutch Supreme Cour

On 18 January 2019, the Dutch Supreme Court ruled in favour of a South African company holding more than 10% in a Dutch subsidiary, which claimed a refund of the 5% dividend WHT it had previously paid, based on the MFN clause in the NL – SA DTAA.[1] The court observed that, while Article 10(2)(a) of the NL – SA DTAA provides that the source state may withhold tax on dividends at 5%, Article 10(10) ("the MFN clause") provides that if South Africa agreed on a lower rate of tax on dividends with a third state, the same treatment would have to be afforded to dividends under the NL – SA DTAA.

The MFN clause in the NL – SA DTAA was introduced in 2008 (by way of a Protocol). The MFN clause in the NL – SA DTAA only applies to treaties with third states that have been concluded after the inclusion of the MFN clause in the NL – SA DTAA. At first glance, this eliminates application of the (preferential) Kuwait - South Africa DTAA ("KU – SA DTAA") of 2006. The KU – SA DTAA is however concluded (in 2006) before the inclusion of the MFN clause in the NL – SA DTAA (in 2008) and provides for a 0% dividend WHT rate.

Decision January 18th 2019 – Dutch Supreme Court
and amendments to Dutch domestic dividend WHT provisions



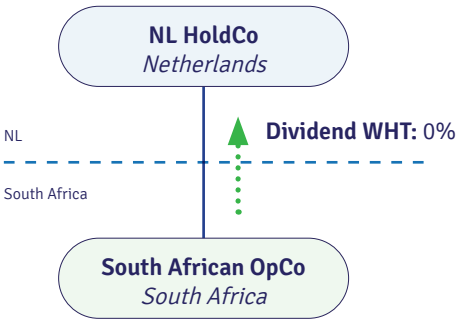
[1] Dutch Supreme Court, 18 January 2019, no. 17/04584. ECLI:NL:HR:2019:57

In 2010, the DTAA between South Africa and Sweden was amended to include a similar MFN clause (to that in the NL – SA DTAA). This MFN clause in the Sweden - South Africa DTAA ("SW – SA DTAA") was introduced in the existing SW – SA DTAA via a Protocol, which entered into force in 2012. Interestingly, the MFN clause in the SW – SA DTAA applied irrespective of the conclusion date of treaties with third states. This is contrary to the restricted application of the MFN clause in the NL – SA DTAA. Hence, the South African parent of the Dutch subsidiary reasoned that it could apply the 0% dividend WHT rate of the KU – SA DTAA via the application of the SW – SA DTAA MFN clause. The court agreed with the arguments of the taxpayer and applied the 0% WHT rate on dividends between the Netherlands and South Africa, entitling the taxpayer to a refund of the withholding tax paid.

Decision of the Tax Court of South Africa

On 12 June 2019, the Tax Court of South Africa decided in favour of the taxpayer, a South African subsidiary of a Dutch parent company (holding more than 10% in its subsidiary).[2] The Court applied, in general, the same reasoning (interposing the aforementioned MFN clauses). It ruled that the effective rate of WHT on dividends paid by the South African subsidiary to the Dutch parent company was 0% in accordance with the MFN clause in the SW – SA DTAA and the exemption from WHT on dividends provided for in the KU – SA DTAA.

Decision June 12th 2019 – Tax Court South Africa



Precedent - 0% WHT on Dividends between South Africa and the Netherlands

In light of the two cases described above, both the courts in the Netherlands and in South Africa confirmed that the effective WHT rate on dividends under the NL – SA DTAA is 0%, should a company hold at least 10% of the shares in the company paying the dividend. This rate was conditional upon three factors, namely:

(i) the MFN clause in the NL – SA DTAA remaining unchanged;
(ii) the MFN clause in the SW – SA DTAA remaining unchanged; and
(iii) the exemption from dividend WHT in the KU – SA DTAA remaining in force.

Accordingly, the aforementioned court decisions set a precedent for an exemption from dividend WHT on dividends flowing between South Africa and the Netherlands for qualifying companies (subject to, for instance, beneficiary ownership provisions, the MPT test in the NL – SA DTAA and the impact of the MLI). At the same time, the South African Revenue Authorities ("SARS") have tried to end the application of the exemption via directly amending the preferential dividend provision in the KU – SA DTAA (instead of amending the MFN clauses in the SW – SA DTAA and the NL – SA DTAA).

Position after the KU – SA Protocol

On 1 April 2021, the KU – SA Protocol was signed, which will amend the KU – SA DTAA. The KU – SA Protocol will, among other amendments[3], replace the dividends article (Article 10). The new Article 10 introduces a right for the source state to impose a WHT on dividends at a rate of 5%, where the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends (and 10% in all other cases), effectively bringing an end to the 0% dividend WHT rate. The most critical question for qualifying companies is whether they will be able to claim the exemption of dividend WHT when the KU – SA Protocol becomes enforceable. This question is answered below.

Effective date of the KU – SA Protocol

According to Article 7(1) of the KU – SA Protocol, each of the Contracting States (Kuwait and South Africa) shall notify the other, in writing, of the completion of procedures required by their respective laws for the bringing into force of the Protocol. The Protocol shall enter into force on the date of the later of these notifications. Article 7(2) states that the Protocol shall have effect from the date on which a system of taxation at shareholder level of dividends declared enters into force in South Africa.

According to the South African domestic laws, the Protocol requires ratification before it can come into force. Currently, it is unclear which domestic steps have been taken to ratify the KU – SA Protocol, as there are no government statements/notices available in this regard. According to SARS (update of 4 June 2021), ratification has not taken place in South Africa or in Kuwait, and therefore, it seems that no public notification has been made. In general, we note that upon tabling of the KU – SA Protocol

[2] *ABC Proprietary Limited v Commissioner for the South African Revenue Services* (14287) [2019] ZATC 9 (12 June 2019)
[3] The Protocol also deals with the replacement of the interest (Article 11), capital gains (Article 13) and exchange of information (Article 26) articles.

before the South African Parliament, the Parliament typically requires at least 8 weeks to process such agreements. Accordingly, the Protocol may already enter into force in the second part of this year (assuming that the Kuwait government takes similar steps). We are currently monitoring the South African ratification process, however, the 0% dividend WHT rate may still apply for some months.

Interplay with the Netherlands dividend WHT Act (and the domestic dividend WHT exemption)

From the Netherlands point of view, the impact of the Protocol may be limited. As of 1 January 2018, a full exemption of dividend WHT may be applied on dividends distributed to entities resident in the EU/EEA or in a state with which the Netherlands has concluded a DTAA that includes a dividend article (i.e. the NL – SA DTAA). As an additional requirement, the recipient entity must be able to apply the Dutch participation exemption if it would have been a resident of the Netherlands. Reference is made to the blog of November 2017.[4] The rationale behind this requirement is to ensure that the dividend WHT exemption will only be available for "active" businesses/holding companies. Typically, in cases involving active companies, which are subject to ordinary taxation in the South Africa, an exemption of Netherlands dividend WHT should apply. Accordingly, relief may still be available under the Dutch Dividend WHT Act for dividends flowing from the Netherlands to South Africa. This, however, would need to be checked/validated based on the facts of the case.

Application of case law as support for the exemption of dividend WHT

Both the aforementioned cases are reliant on the fact that (i) the exemption from dividend WHT in the KU – SA DTAA would remain in force; and (ii) that the MFN clause in the SW – SA DTAA and the NL – SA DTAA remains unchanged. Accordingly, the replacement of Article 10 by the KU – SA Protocol will result in the fact that the first requirement will no longer be satisfied. Therefore, it is expected that these decisions will not support claims for 0% dividend once the KU – SA Protocol comes into force.

Main purpose test in relation to Netherlands – South Africa DTAA

We note that Article 10(8) of the NL – SA DTAA provides for a main purpose test as an anti-abuse measure in respect of the application of the DTAA to dividend distributions. This also includes the MFN clause as stipulated in Article 10(10) of the NL – SA DTAA. Therefore, the 0% WHT benefits under the NL – SA DTAA shall not apply if the main purpose (or one of the main purposes) of the particular entity/taxpayer is to take advantage of the MFN-clause, and accordingly, the preferential dividend provision in the KU-SA DTAA. The main purpose test should be considered when setting-up cross-border investments and/or to maintain/monitor treaty entitlement. Once the KU – SA Protocol becomes effective and is in force, a beneficial owner company would, at minimum, pay dividend WHT at a rate of 5% (subject to the fact that it is not the main purpose of the company to take advantage of the dividend WHT provision). The additional relief, of 5%, is only available under the Dutch WHT Act (which provides for separate/additional anti-avoidance measures – see discussion above).

Applying MFN clauses

In day-to-day advisory, caution is required when relying on MFN clauses due to their inter-dependence and complexity of language. Furthermore, countries tend to re-negotiate DTAAs to reflect their current and future economic policies (for instance, via protocols like the KU – SA Protocol). Until a few years ago, a number of South African DTAAs (Cyprus, Oman and Kuwait) granted full taxation rights, with regard to dividends, to the respective resident states. The Cyprus and Oman treaties have since been renegotiated/amended to grant/increase WHT rights to the source state at 5%. Since the KU – SA DTAA will be amended in a similar manner, these treaties can now be said to broadly align with the economic policies of South Africa.

Application for restitution of tax levied contrary to the Netherlands – South Africa DTAA

If companies have withheld dividend WHT in excess of 0% (or 5% following the entry into force of the KU-SA Protocol), they may request a refund of the excess amount. Based on Protocol no. II *ad* Articles 10, 11 and 12 of the NL – SA DTAA, an application for the restitution of tax levied contrary to the application of the MFN clause as mentioned in Article 10(10) of the NL – SA DTAA (read with the SW – SA DTAA and the KU – SA DTAA) has to be lodged with the Netherlands Tax Authorities (or with SARS) within a period of three years after the expiration of the calendar year in which the tax has been levied. Conceptually, the arguments discussed in this note could have been applied as from 2012 (from that time that the MFN clause was introduced in the existing SW – SA DTAA). Looking forward, 0% WHT claims on dividends, based on the NL – SA DTAA, will only be possible until such time that the KU – SA Protocol enters into force.

[4] See our earlier blog on the Dutch legislative amendments per 1 January 2018 aim to strengthen tax climate whilst tackling tax avoidance (November 2019) for an example on the application of the Dutch participation exemption.

Key-takeaways

- Under South African domestic law, the WHT on dividends paid to foreign companies is 20%. Hence, DTAAs and especially, MFN clauses play a significant role in the decision-making process of companies looking to invest in South Africa. In this respect, both court decisions, of South Africa (of 12 June 2019) and the Netherlands (of 18 January 2019), were welcomed because they offered a possibility for an elimination of dividend WHT between South Africa and the Netherlands.

- Due to the KU – SA Protocol, more specifically Article 10(1) coming into force, the exemption of dividend WHT based on the interplay with the MFN clauses in the SW – SA DTAA and the NL – SA DTAA comes to an end.

- According to the South African domestic laws, the Protocol requires ratification before it comes into force. Currently, it is unclear which domestic steps have been taken to ratify the KU – SA Protocol, as there are no government statements/notices available in this regard. According to SARS (update of 4 June 2021), ratification has not taken place in South Africa or in Kuwait, and therefore, it seems that no public notification has been made.

- In general, we note that upon tabling of the KU – SA Protocol before the South African Parliament, the Parliament typically requires at least 8 weeks to process these types of agreements. Accordingly, the Protocol may already enter into force in the second part of this year (assuming that the Kuwait government takes similar steps). We are currently monitoring the South African ratification process, but companies may consider applying the exemption from dividend WHT and/or liaise with South African counsel for a sign-off.

- In relation to the Netherlands, Dutch domestic law may still provide for a 0% WHT on dividends, where a company is able to satisfy the Dutch participation exemption criteria/requirements and the additional anti-avoidance measures (incl. the main purpose test of Article 10(8) of the NL – SA DTAA).

- Observing the fact that the MFN clause of the SW – SA DTAA has been concluded in 2012, and that both court cases confirm that the requirements of the MFN clause of the NL – SA DTAA has been satisfied, companies may lodge a request for restitution of dividend WHT within a period of three years after the expiration of the calendar year in which the tax has been levied. Entities wishing to distribute dividends at 0% would only be able to do so until the KU – SA Protocol enters into force.

DISCLAIMER

In this blog we have commented on the legal interpretation of tax treaties. It should be noted that in the context of base erosion and profit shifting it is recommend to embed legal ownership with economic rationale. In addition, and observing internal developments in view of the Danish cases of the European Court of Justice (C-115/16, 116/16, C-117/16, C-118/16, C-119/16 & C-299/16) as well as the ratification of the Multilateral Instrument, concepts such as “beneficial ownership” and “abuse of law” should also be considered. Reference is made to the specific indications presented by the ECJ in the Danish cases that could lead to the conclusion that there is an abuse of law. It is recommend to discuss, in advance, with a local (South African) and Dutch counsel.

The information contained in this blog is of a general nature and does not address the specific circumstances of any particular individual or entity. Hence, the information in this blog is intended for general informational purposes and cannot be regarded as advice. Although we endeavour to provide accurate and timely information and great care has been taken when compiling this blog, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. We do not accept any responsibility whatsoever for any consequences arising from the information in this publication being used without our consent.

Dewald Claassen
+31 (0) 6 45 04 31 83
dewald.claassen@noviotax.com

Patrick Schrievers
+31 (0) 6 10 24 61 40
patrick.schrievers@noviotax.com