NovioTax

Interrelating treaties lower the WHT on Dividends between South Africa and the Netherlands

December 2019

Tax courts in the Netherlands and South Africa have confirmed that the effective withholding tax ("WHT") rate on dividends under the Netherlands – South Africa Double Tax Avoidance Agreement ("NL – SA DTAA") is 0%, should a company hold at least 10% of the shares in the company paying the dividend. This rate remains conditional upon two factors: the exemption from dividend WHT in the South Africa – Kuwait DTAA ("KU – SA DTAA") remaining in force and the most favoured nation clause in the South Africa – Sweden DTAA ("SW – SA DTAA") remaining unchanged. The decisions of the Tax Courts, which apply to dividends flowing between South Africa and the Netherlands, has interesting implications for multinational companies looking to invest in the Netherlands or in South Africa.

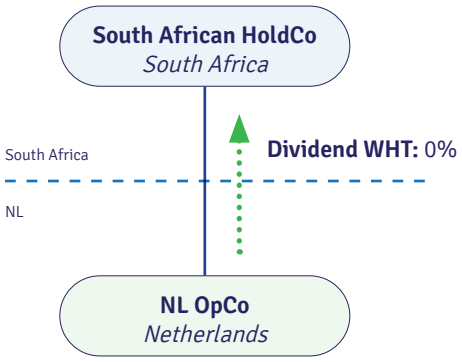
"Most Favoured Nation" (MFN) clauses

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 as well as EU 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.

Decision of the Dutch Supreme Court

On 18 January 2019, the Dutch Supreme Court ruled in favour of a South-African company holding more than 10% in a Dutch subsidiary, that claimed a refund of the 5% dividend WHT it had previously paid, based on the MFN clause in the NL – SA DTAA. 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.

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

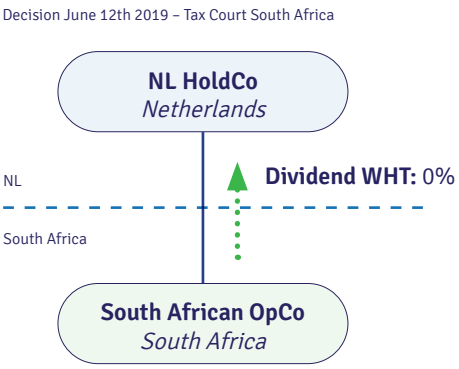


The MFN clause in the NL – SA DTAA was introduced in 2008 (by way of a Protocol). The MFN clause in the NL – SA DTAA only applies to treaties with third States that have been concluded after the conclusion of the MFN clause in the NL – SA DTAA. At first glance this eliminates application of the (preferential) KU – SA DTAA of 2006. This treaty provides in Article 10(1) for a zero dividend WHT rate. The KU – SA DTAA is however concluded before (2006) the conclusion of the MFN clause in the NL – SA DTAA (2008).

In 2010 the DTAA between South Africa and Sweden was amended to include a similar (to that in the NL – SA DTAA) MFN clause. This (i.e. SW – SA DTAA) MFN clause 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 Netherlands taxpayer reasoned that it could apply the zero dividend WHT rate of the Kuwait – South Africa DTAA via the application of the Sweden – South Africa MFN clause. The court agreed with the arguments of the taxpayer and applied the zero rate of WHT on dividends, 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). The Court 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.



Precedent - 0% WHT on Dividends between SA and the Netherlands

The decisions of the Dutch and South African Court set a precedent for the WHT rate on dividends flowing between South Africa and the Netherlands. It also does away with the possibility that either of the tax authorities could argue that they should not be obliged to exempt the WHT on dividends paid to a holding company, where the other country did not exempt the WHT on dividends.

In day-to-day advisory caution is however required while relying on these MFN clauses due to their inter-dependence and complexity of language. Further, countries tend to re-negotiate DTAAs to reflect their current and future economic policies (via for instance protocols; the alterations not included in the main text of the original DTAAs). Until a few years ago, a number of South African DTAAs (Cyprus, Oman, Kuwait) granted full taxation rights with regard to dividends to the respective resident states. Some of these treaties have since been renegotiated to grant WHT rights to the source state at 5% and some of these treaties are no longer in force. The DTAA with Kuwait has also been renegotiated to grant WHT rights on dividends to the source state at 5% but the DTAA has not been ratified by Kuwait and is hence, not yet in force.

If and when the new provisions of the KU – SA DTAA come into force, the application of the MFN clauses in the SW – SA DTAA and the NL – SA DTAA would be altered. Until then, the Netherlands (and Sweden) may serve as a beneficial location within Europe to have a holding company with respect to operations in South Africa enabling an elimination of South African dividend WHT.

Main purpose test 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 rule in respect of the application of the treaty to dividend distributions. In our opinion this includes also the MFN clause as stipulated in Article 10(10) of the NL – SA DTAA. Therefore, the 0% WHT benefits of the NL – SA DTAA shall not apply if the main purpose (or one of the main purposes) of any person is to take advantage of the dividend provision. The main purpose test should be considered when setting-up cross-border investments.

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

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) NL – SA DTAA (read with the SW – SA DTAA and the KU – SA DTAA) has to be lodged with the Netherlands Tax Authorities and (vice versa the South African Revenue Service) 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).

Key-takeaways

- Under South African domestic law, the WHT on dividends paid to foreign companies is 20%. Hence, treaties and especially, MFN clauses play a significant role in the decision-making process of companies looking to invest in South Africa.
- The operation of the MFN clauses in the DTAAs discussed in this blog potentially provides a favourable route for multinationals looking to invest in South Africa (in principle 0% dividend WHT).
- Caution is however required. If and when the new provisions of the KU – SA DTAA come into force, the application of the MFN clauses in the SW – SA DTAA and the NL – SA DTAA would (in principle) be altered.

- Until then, the Netherlands may serve as a beneficial location within Europe to have a holding company with respect to operations in South Africa enabling an elimination of South African dividend WHT.

- It is important to note that in both cases the recipients of the dividends had at least 10% shareholding in the company paying the dividend.

- In addition the main purpose test of Article 10(8) of the NL – SA DTAA should be considered when setting-up cross-border investments.

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.

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 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.

Neha Mohan
+31(0) 6 44 96 10 86
neha.mohan@noviotax.com

Dewald Claassen
+31(0) 6 44 96 10 86
dewald.claassen@noviotax.com