Dutch court confirms dividend withholding tax exemption under the treaty between South Africa and the Netherlands

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The Dutch Court of Appeals (s'Hertogenbosch) has decided on the application of the most favored nation (MFN) clause in the tax treaty between the Netherlands and South Africa (the Dutch Treaty). This decision has the effect of reducing the dividend withholding tax rate to 0 percent in both the Netherlands and South Africa.

Background

Dividend distributions by a South Africa resident company to a non-resident are ordinarily subject to dividend withholding tax imposed at a rate of 20 percent. The Dutch Treaty provides that dividends paid by a South African resident entity to a Dutch resident (and vice versa) may be reduced to a rate of 5 percent if the Dutch resident holds 10 percent of the capital of the South African entity.

In itself, the reduction in the dividend withholding tax rate from 20 percent to 5 percent appears to be a positive change.

Application of the MFN Clause

However, the Dutch Treaty contains an MFN clause which essentially provides that if, in any convention for the avoidance of double taxation concluded with a third party after the date of conclusion of the Dutch Treaty, South Africa limits its taxation rights on dividends to a lower rate (including an exemption from taxation), then the more favourable reduced rate/exemption is equally applicable to the Dutch Treaty.

South Africa has concluded a tax treaty with Kuwait (the Kuwait Treaty), as well as with Cyprus and Oman, which prohibits source state taxation rights in relation to dividends (*ie*, no dividends tax is payable on dividend distributions by a South African company to a Kuwait beneficial owner, and vice versa). However, the Kuwait Treaty was concluded ***before*** the Dutch Treaty; the MNF clause in the Dutch Treaty specifically requires that the convention be concluded ***after*** the Dutch Treaty. A taxpayer wishing to rely on the MNF clause in the Dutch Treaty therefore cannot rely on the Kuwait Treaty alone.

The tax treaty between South Africa and Sweden (the Swedish Treaty) was, however, concluded after the Dutch Treaty, which has its own MFN clause that provides that the lower rate of dividends tax applies "if ***any*** agreement or convention between South Africa and a third state" provides that South Africa shall be exempt from tax or limit the tax charged in South Africa, on a more favourable basis. The Swedish Treaty, concluded after the Dutch Treaty, therefore does not contain a similar time limitation as to when the relevant treaty must be concluded.

Taxpayers both in South Africa and the Netherlands have therefore often contended that dividend distributions between South African and Dutch entities (and vice versa) are exempt from dividend tax in the source jurisdiction on the basis that:

- South Africa has concluded a treaty with a third state (Sweden)
- The Swedish Treaty was concluded after the Dutch Treaty and
- Replying on the MNF clause contained in the Swedish Treaty, read together with the Kuwait Treaty, the dividend tax rate must therefore be reduced to 0 percent under the MNF clause in the Dutch Treaty.

Key takeaways

The decision of the Dutch Court of Appeal is not binding on the South African courts, but can certainly be used by South African taxpayers as persuasive authority. South African courts are likely to take cognizance of foreign jurisprudence, particularly in relation to treaty interpretation, given the lack of local binding authority on the issue.

This decision will therefore give persuasive support for those taxpayers that adopted the view that the MFN clause in the Dutch Treaty reduces the dividend tax rate to 0 percent.

Other South African taxpayers adopted a conservative approach (and relied on the 5 percent dividend tax rate) or were not aware of the potential application of the Dutch Treaty to dividend distributions by South African entities to Dutch shareholders. Those taxpayers should consider taking further advice on this issue to determine whether they too can or should rely on the reduced dividend tax rate of 0 percent.

Provided claims are submitted within the prescribed time periods, it is possible that Dutch shareholders who now wish to rely on the MFN clause in the Dutch Treaty can approach the declaring company and/or the South Africa Revenue Service (SARS) for a refund of dividend taxes that should not have been withheld.

However, it is important to appreciate that, prior to the decision of the Dutch Court of Appeal, both revenue authorities did not agree with the court's decision, and the Dutch authorities have appealed the decision. It therefore remains to be seen whether this decision will influence the approach previously adopted by SARS.

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