The Ku-waiting is over:
Far-reaching changes to the South Africa-Kuwait Tax Treaty

The recent ratification of the protocol amending the double tax agreement (DTA) between South Africa and Kuwait has far-reaching implications, particularly in relation to the tax treatment of dividends paid from South Africa. The reach of the amendment to the dividend article is not limited to Kuwait, but also extends to the Netherlands and Sweden. This article focuses on the relevant amendment introduced by the protocol, its implications for taxpayers, and the broader context of international tax treaties.

Background and Ratification

Unless a specific exemption or reduction applies, South Africa imposes dividends tax at a statutory rate of 20% on all dividends paid by South African companies. The rate at which dividends tax is levied may, however, be reduced by virtue of the application of a DTA, provided that prescribed administrative requirements are adhered to. For example, the original DTA between South Africa and Kuwait effectively granted an exemption from dividends tax for Kuwaiti shareholders who beneficially owned dividends declared by South African companies. This exemption extended to eligible Dutch and Swedish shareholders through the so-called "most favoured nation" (MFN) clauses in South Africa's DTAs with the Netherlands and Sweden, respectively, as confirmed by the Dutch Hoge Raad and a Cape Town Tax Court in 2019. However, with the ratification of the new South Africa and Kuwait protocol, this position has changed.

The original DTA between South Africa and Kuwait was signed on 17 February 2004 and came into force on 25 April 2006. This agreement provided a framework for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income between the respective countries. However, over the years certain provisions, particularly those related to the taxation of dividends, became points of contention and required renegotiation.

The protocol to amend the DTA was signed by the governments of South Africa and Kuwait on 17 December 2019 and 1 April 2021, respectively. However, despite the signing thereof, the protocol required ratification by both countries to come into effect. Kuwait took its time in this regard and only ratified the protocol on 18 September 2024, which was subsequently published by the South African Revenue Service (SARS) on 22 November 2024 with the date of entry into force being 2 October 2024.

Dividends Taxation

One of the most far-reaching changes introduced by the protocol is the modification of the dividends article. Under the original DTA, Kuwaiti shareholders effectively enjoyed a 0% dividends tax rate, a benefit extended to Dutch and Swedish shareholders through the MFN clauses in South Africa's DTAs with Sweden and the Netherlands. The protocol, however, introduces a new structure for dividends taxation, as follows:

- A 5% tax rate on dividends if the beneficial owner is a company holding at least 10% of the capital of the company paying the dividends.
- A 10% tax rate on all other cases.

This change effectively removes the 0% dividends tax rate previously enjoyed by Kuwaiti, Dutch and Swedish shareholders, aligning the tax treatment more closely with South Africa's broader tax policy of levying a minimum of 5% dividends tax.

Retroactive Application

A particularly contentious aspect of the protocol is its retroactive application. The protocol stipulates that its provisions will have effect from the date that dividends tax came into effect in South Africa, namely 1 April 2012. This retroactive application has understandably raised significant concerns among South African companies that have relied on the previous DTA provisions to not withhold dividends tax from dividends declared to qualifying shareholders since 2012. The retroactive nature of the protocol is likely to lead to legal challenges, as it may well go against the well-established principle of non-retroactivity.

The constitutionality of retrospective legislation was addressed in *Robertson & another v City of Cape Town & another; Truman-Baker v City of Cape Town* 2004 (5) SA 412 (C). The court acknowledged the challenges retroactive legislation poses to the rule of law, especially in criminal law. Although the Constitution does not expressly prohibit retrospective legislation, it can be deemed unconstitutional if it unreasonably or unfairly impairs individuals' ability to regulate their conduct according to the law.

In the recent Constitutional Court case of *Thistle Trust v Commissioner for the South African Revenue Service* (CCT 337/22) [2024] ZACC 19 (2 October 2024), the minority judgment, authored by Bilchitz AJ, emphasised the importance that laws must be rational, capable of being followed, and provide reasonable certainty, even if not perfect lucidity.

Implications for Taxpayers

With the introduction of the new dividends tax rates, Kuwaiti, Dutch and Swedish shareholders will face increased tax liabilities on dividends paid by South African subsidiary companies. This change may therefore necessitate a reassessment of existing investment structures.

In addition, the absurd retroactive application of the amendments, if left unchallenged and as is, may lead to potential historical financial exposure in terms of the underpayment of dividends tax and resultant penalties and interest.

Test Court Case and Findings

A notable test court case that sheds light on the interpretation of the MFN clauses in DTAs is the Cape Town Tax Court judgment of ITC1925 82 SATC 144 delivered on 12 June 2019 and previously discussed in our Tax Flash published in July 2019. The case involved ABC Pty Ltd (Taxpayer) and SARS, where the Taxpayer sought a refund of dividends tax overpaid based on the interpretation of the MFN clause in the SA/Netherlands DTA, read with the MFN clause in the SA/Sweden DTA and the SA/Kuwait DTA.

The original SA/Kuwait DTA provided for a 0% dividends tax rate and even though the protocol with Kuwait was not yet in force, the SA government nevertheless proceeded to implement the 5% dividends tax regime with effect from 1 April 2012.

A few months earlier on 18 January 2019, the Dutch Supreme Court passed down the much-anticipated Hoge Raad Judgment (17/04584) in favour of the taxpayer. The judgment considered the interpretation of the MFN clause in the double taxation agreement between South Africa and the Netherlands, dated 10 October 2005, as amended by the protocol dated 8 July 2008 (Dutch DTA). In finding in favour of the taxpayer, the judgment concluded that to the extent that any other DTA entered into by South Africa with any other country provided a more favourable dividends withholding tax rate than the Dutch DTA, that more favourable rate must automatically apply.

The MFN clause contained in the Dutch DTA contemplated that the automatic application of a more favourable rate should apply in respect of DTAs concluded after the Dutch DTA came into effect. However, the DTA concluded with Sweden on 25 December 1995 (as amended by the protocol on 18 March 2012) (Sweden DTA) contained wording which extended its own MFN clause to retrospectively concluded DTAs. The result was that if either the Dutch DTA or the Sweden DTA were utilised, the most favourable dividends withholding tax rate contained in the Kuwait DTA could be applied, thereby resulting in a dividend withholding tax rate of 0%.

The Tax Court found in favour of the Taxpayer, ordering SARS to refund the overpaid dividends tax with interest and to pay the Taxpayer's costs, including the costs of two counsel. The court's decision was based on the clear provisions of the DTAs, which stipulated that if another state received preferential treatment, the same treatment must be extended to the Netherlands and Sweden. This judgment provided significant relief to many taxpayers engaged in similar disputes with SARS and highlighted the importance of adhering to the clear terms of DTAs.

Interestingly, SARS never appealed the Tax Court judgment. In retrospect, it appears that SARS and National Treasury rather focused their efforts on getting the Kuwait protocol ratified with the aim of closing this 'loophole' and to prevent taxpayers from 'exploiting' the MFN clause.

Relevance of the Judgment for Future Cases

The Tax Court judgment on this topic underscores the importance of clear and unambiguous language in DTAs and the interpretive principle that the written terms of an agreement should prevail over the intentions of the parties or extrinsic evidence. This principle will continue to guide the interpretation of DTAs in South Africa, even in light of the new protocol. However, this should be understood in the context of the widely accepted purposive approach to interpretation as developed in *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] ZASCA 13; [2012] 2 All SA 262 (SCA), where Wallis JA wrote the following: "*Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or* *contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors."*

Furthermore, the tax court judgment gives an indication on how South African courts may handle disputes related to the retroactive application of tax treaties. Given the contentious nature of the retroactive application of the South Africa-Kuwait protocol, it is likely that similar legal challenges will arise.

Conclusion

The ratification of the South Africa-Kuwait protocol represents a pivotal development in the tax relationship between the two countries. The changes introduced by the protocol, particularly those related to dividends, have far-reaching implications for Kuwaiti, Dutch and Swedish investors in South African companies. It would be prudent for businesses and investors to reassess their tax positions, ensure compliance with the new provisions, and seek professional advice to navigate the evolving tax landscape. By staying informed and proactive, taxpayers can effectively manage the impact of these changes and continue to thrive in the dynamic international tax environment.

Disclaimer

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