

The Suitability of the South African Corporate Tax Regime for the Use of South African Resident Intermediary Holding Companies

by

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ABSTRACT

An Intermediary Holding Company (“IHC”) is a company that is interposed between an ultimate holding company and the operating subsidiaries of a group of companies. The IHC operates at an international level such that either its holding company or its subsidiaries or both are located in a country foreign to the IHC. Its main functions are to acquire, manage and dispose of the assets of the group of companies and to facilitate structural flexibility of a group of companies. Investors have tax and non-tax reasons for conducting business using an IHC, and, depending on the reasons, they determine the location of the IHC based on the characteristics of potential host countries.

This thesis analyses the suitability of the South African corporate tax regime for the use of South African-resident Intermediary Holding Companies. The South African government has the objective of promoting South Africa as a gateway for investment in Africa and for this reason the present research is important. Such an objective could be adversely affected by a corporate tax regime that is not suitable for the operations of an IHC. Furthermore, the Katz Commission recommended in 1997 that South Africa should consider introducing a regime that is suitable for the location of holding companies.

In discharging its functions the IHC attracts liability for corporate income tax, capital gains tax, controlled foreign company tax and dividends tax. It also exposes itself to anti-avoidance measures such as thin capitalisation and transfer pricing provisions. The existence of such taxes and anti-avoidance measures in the tax system of a country may deter investors from locating an IHC in such country. Exchange control regulations could also adversely affect the ability of the IHC to perform its functions effectively, as their purpose is to restrict the movement of capital out of the country.

The South African legal system contains all these taxes and anti-avoidance measures as well as exchange control provisions. However, it also contains tax instruments that alleviate the tax burden on an investor using an IHC such as the participation exemption, advance tax rulings and a network of tax treaties. Against this background this thesis

analyses the South African corporate tax system to determine whether it is suitable for locating an IHC. In the analysis, a comparative study is done of the tax systems of two of the most effective IHC host countries, namely the Netherlands and Mauritius. In addition, a brief discussion of the special features contained in the tax systems of Belgium, Ireland and the United Kingdom outlines why these jurisdictions are not necessarily successful in attracting IHCs.

The thesis also discusses harmful tax practices and the attitude of the international community towards countries that engage in harmful tax competition in order to determine the limits to which a country should use the tax system to attract investment. Finally, the thesis makes recommendations as to what adjustments could be made in order to enhance the suitability of South Africa to host an IHC. The thesis recommends a special dispensation as regards corporate income tax and exchange control that would apply to wholly-owned South African companies that own foreign subsidiary shares and loans that consist of 80% of the gross asset total of these companies.

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