CHALLENGES REGARDING THE ESTABLISHMENT OF HEADQUARTER COMPANIES IN AFRICAN COUNTRIES

by

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DECLARATION

I, Tamatha-Mari Arendse, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other university.

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Thanks to Mum and Dad who always encouraged me to study further.

ABSTRACT

This dissertation evaluates the South African headquarter company provisions and their suitability as a gateway for investment into Africa, when compared with the UK, Netherlands and Botswana. When considering how the South African headquarter company provisions have developed since their re-introduction in 2011, it is evident that the regime is beneficial; specifically through the absence of the controlled foreign company ('**CFC**') rules, transfer pricing concessions, and the conclusion of double tax agreements ('**DTAs**').

When compared with a similar taxing jurisdiction such as the UK, South Africa appears equally competitive. The UK has also identified its tax regime as an ideal holding or headquarter location for business activities into the rest of the world (including Africa). The UK has affirmed its commitment as a holding company jurisdiction through the reduction of its corporate income tax rate, the overhaul of its CFC provisions, and the absence of exchange control and dividends withholding tax.

As a result of the UK's historical presence in Africa, it too has an extensive DTA network in Africa. Upon closer inspection, it appears that concessions available to a UK resident company are similar to a South African headquarter company.

When compared with other African jurisdictions, the Botswana IFSC regime appears less competitive than the South African regime. Similarly, the 'traditional' use of a Netherlands holding company appears to be better suited as a holding company regime for business activity in Europe.

Accordingly, the South African headquarter company provisions provide efficient, practical and commercial concessions for multinationals as a gateway into Africa.

LIST OF ACRONYMS AND ABBREVIATIONS

Botswana Revenue Service	BRS
Capital Gains Tax	CGT
Controlled Foreign Company	CFC
Common Monetary Area	CMA
Double Tax Agreement	DTA
European Union	EU
Her Majesty's Revenue and Customs	HMRC
International Financial Service Centre	IFSC
South African Reserve Bank	SARB
Secondary Tax on Companies	STC
South African Revenue Service	SARS
Taxation Laws Amendment Act	TLAA
Taxation Laws Amendment Bill	TLAB
United Kingdom	UK
Value-Added Tax	VAT

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CHAPTER 1. INTRODUCTION

With the increase in business activity in Africa and its emergence in global markets, establishing efficient structures for entry into African markets are critical. With its location, South Africa appears to be perfectly situated as a gateway for multinationals to enter into the African economy.

Recognising this opportunity, National Treasury re-introduced the headquarter company provisions in the 2010 TLAA.[1] Notwithstanding, South Africa's location with the increase in political instability which has negatively impacted on the economy,[2] multinationals will need to carefully evaluate their options when entering into Africa. This dissertation will focus on whether South Africa is in fact an ideal location to do so. I will be considering whether the South African headquarter company provisions provide sufficient incentives for offshore companies to utilise, the potential advantages, anomalies, and practical difficulties arising out of establishing a headquarter company in South Africa.

In evaluating the South African headquarter company provisions, the main focal point of this dissertation will be its comparison with the provisions in the UK tax legislation. However, the Botswana and Netherlands tax regimes will also be considered as suitable holding company jurisdictions as a gateway into Africa. In this regard the Explanatory Memorandum to the 2010 TLAA, which re-introduced the headquarter company provisions in the Income Tax Act,[3] identified three tax areas which acted as obstacles to an ideal headquarter company location; these were 'the CFC rules, the charge on outgoing dividends and the thin capitalisation rules'.[4]

1 7 of 2010.

2 Given the strikes at the Marikana, Lonmin and Goldfields mines. The Rand has also significantly weakened in relation to other currencies. As a further result of the unrest at the mines, Moody's and Standard and Poor's have downgraded South Africa's ratings in their ability to service debt.

3 58 of 1962, as amended.

4 SARS. (2010). *Explanatory Memorandum to the Taxation Laws Amendment Bill 2010*, p77. Available at http://www.sars.co.za/home.asp?pid=2631.

The South African headquarter company regime will be evaluated from the re-inception of the regime until its current provisions in order to determine whether it indeed meets its stated objectives. It will also be considered whether the South African headquarter company regime is in fact an ideal location for headquarters, or whether it should be rather utilised as a pure holding company regime.

The UK, which although does not provide specific headquarter company provisions, has several provisions which would be beneficial for companies wishing to establish headquarters. In addition, the UK tax rates and treaty networks appear to be most suitable for a comparison with the South African headquarter company provisions. The UK has historically had a presence in most of Africa, and as a result has concluded approximately 19 DTAs with various African jurisdictions.

A comparison of the UK jurisdiction thus appears to be more appropriate, as opposed to Mauritius, which has clearly been identified as a 'tax haven' and whose tax rates are significantly lower than South Africa, in that comparing the two jurisdictions appears to be inequitable. When considering the UK tax regime, its effective tax rate is lower than South Africa (20%), there are no dividends withholding taxes, and non-resident shareholders of the headquarter company are able to dispose of their shares in a tax neutral manner, with no minimum shareholding requirements.[5] Furthermore, the UK does not have any exchange control regulations,[6] thus enabling UK companies to freely remit and receive funds offshore.

However, it has been acknowledged that the main obstacle to the UK system is its onerous CFC provisions.[7] As a result new CFC provisions were introduced. These provisions will be considered and evaluated in order to determine whether they in fact remain an obstacle to the UK as a holding company location of choice. Accordingly,

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[5] Deloitte. (2012). *Comparison of European holding company regimes*. Available at http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/DITS/dttl_tax_holdcomatrix_europe%202012_2.pdf, p12-13.

[6] Legwaila, T. (2011) Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa *South African Law Journal,* vol. 128 issue 3, p552.

[7] *Ibid*, p550.

given the UK's location (that it is not too remote from Africa), it may be that incorporating headquarters in this jurisdiction becomes increasingly more popular than South Africa.

Botswana, similar to South Africa, has recognised its position in Africa and created a platform for multinationals to set up headquarters through its IFSC regime. As a result of its limitations, and reliance on mineral resources as the driver in its economy, this regime was introduced as an alternative to the South African headquarter company regime in order to stimulate investment in Botswana.

Although Botswana has not concluded as many DTAs compared with South Africa, its tax rate is almost equivalent to that of South Africa (27.85%). Through the use of an IFSC company, withholding taxes are eliminated and transactions are exempt from VAT. Although an IFSC company is limited as to the type of business it can operate, it will be considered whether this regime, and the Botswana tax system in general, is a beneficial holding or headquarter company location for entering into Africa.

In addition, it is well known that the Netherlands is a beneficial jurisdiction in which to set up holding company operations. It has a low effective tax rate (25%), and provides relief in the form of the ‘participation exemption’. The absence of withholding taxes on royalties and interest is also beneficial. Given these concessions it will be considered whether the Netherlands would be an ideal location as holding or headquarter company jurisdiction for entering into Africa.

It is submitted that in order to provide an ‘ideal’ comprehensive comparison with the South African headquarter company regime, several jurisdictions should be studied; for example Mauritius, Luxembourg or Malta. Nevertheless, this research objective will demonstrate that South Africa has in fact put in place a competitive regime for multinationals to utilise when engaging in business in Africa.

CHAPTER 2. SALIENT CHARACTERISTICS OF A BENEFICIAL HOLDING REGIME IN COMPARISON TO A HEADQUARTER REGIME

2.1. Introduction

This chapter will explore the characteristics of a beneficial holding regime in comparison with a headquarter regime. A holding company is one that that holds and manages investments, but it does not engage in ordinary trading activities; whereas a headquarter company 'services its affiliates through managing or administering activities, and it does not involve itself in financial activities.'[8]

2.2. Establishing a beneficial holding regime

A holding regime allows an entity to hold and 'manage its investments in foreign subsidiaries.'[9] It is generally interposed between the 'ultimate holding company and the operating subsidiaries of a multinational group of companies'.[10] A holding company would generally sell, manage, or hold investments and would not engage in trade. The ideal holding company jurisdiction will depend on the type of business the multinational is engaged in. However, whatever form the business takes, it is essential that the ideal holding company jurisdiction has the following so called 'non-tax' characteristics:[11]

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8 *Offshore Incorporation Introduction to Offshore Incorporation.* Available at http://www.offshioreincorporation.net/Glossary.A.J/H.Headquarters.Company/.

9 Roghati, R, (2001). *Basic International Taxation Volume 2: Practice.* 2nd Ed. London: BNA International Inc., p316.

10 Olivier, L. & Honiball, M. (2011) *International Tax, A South African Perspective* 5th ed. Cape Town: CiberInk, p689.

11 Discussed in Roghati, R. (2001) *Basic International Taxation Volume 2: Practice.* 2nd Ed. London: BNA International Inc., p316.

- Financial and economic infrastructure.
- Political and legal stability.
- Company and employment law.
- Accounting requirements.
- 'Stable tax laws and treaties (countries which have frequent changes to their tax laws are less favourable).'[12]
- Human resources, language and culture: most jurisdictions require financial reporting and legal documents to be done in English.
- Ability to migrate the corporate seat of the company to another jurisdiction if later necessary.
- Flexibility in group reorganisation to 'enable the group to list on a stock exchange'[13] since all its investments will be held by one common holding company.
- Lack of exchange control: jurisdictions with exchange control regulations may 'force or trap the repatriation of profits within the exchange control jurisdiction'.[14]
- The ability to raise group finance abroad: this will assist the holding company to raise funding for the multinational group on the strength of the group as a whole, instead of the individual subsidiaries raising funds independently. This may lead to a more favourable interest rate, since the credit rating of the group as a whole in comparison with a specific subsidiary will rank higher. In addition, this is less risky for the borrower who can rely on the strength of the group's balance sheet instead of an individual subsidiary.

The ideal holding regime should have the following tax qualities:[15]

- Wide treaty network to minimise withholding taxes.
- Ability to use foreign tax credits.

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12 Udal, N. & Cinnamon, A. (2004). How to select a jurisdiction for your holding company. *International Tax Review,* November 2004.

13 Olivier, L. & Honiball, M. (2011). *International Tax, A South African Perspective* 5th ed. Cape Town: CiberInk, p692.

14 *Ibid*, at p691.

15 Discussed in Roghati, R. (2001). *Basic International Taxation Volume 2: Practice.* 2nd Ed. London: BNA International Inc. p316; Udal, N. & Cinnamon, A. (2004). How to select a jurisdiction for your holding company. *International Tax Review,* November 2004.

- Low effective corporate tax rate.
- No tax on disposal of investments.
- Deductibility of interest payments on funds borrowed to finance the subsidiaries against the income, and the deductibility of these losses.
- No tax on dividends or other income received.
- No dividends withholding taxes.
- Favourable foreign exchange gains and loss treatment.
- Participation exemption for dividends and gains received from foreign subsidiaries.
- Ability to obtain a ruling from revenue authorities in advance of setting up a group structure.
- No CFC legislation, or if CFC rules exist, exclusions to be provided to holding regimes.
- Specific thin capitalisation rules for holding companies permitting them to borrow outside the thin capitalisation parameters.
- The absence of a minimum subsidiary/holding company, holding period.

Generally, the tax benefits of establishing a holding regime in the correct jurisdiction is that it assists in reducing pre-tax profits of operating subsidiaries offshore through deductible expenses; minimises the withholding taxes payable; and defers the payment of dividends to the main operating company; thus allowing the profits to be accumulated in a strong currency free from exchange control which are then available to be reinvested.

2.3. Headquarter regime

Headquarter companies 'do not make investments or carry on the main business activities of the group.'[16] Instead, they can fulfil several roles; namely, 'to hold the group's interests in the region, to act as treasury centre, or to provide central management or technical support services.'[17] Multinationals may thus have several headquarter

16 Olivier, L. & Honiball, M. (2011). *International Tax, A South African Perspective* 5th ed. Cape Town: CiberInk, p 692.

17 Roghati, R. (2001). *Basic International Taxation Volume 2: Practice.* 2nd Ed. London: BNA International Inc., p322.

companies fulfilling different roles.

A headquarter company 'may not lead to tax savings, but the decision to form a headquarter company in a specific jurisdiction will be influenced by tax consequences'.[18] An ideal headquarter regime should have the following characteristics:[19]

- Allows you to remit only exempt income back to the investor country.
- Can defer tax on the headquarter company's (in its capacity as a CFC) operating income.
- Low or no capital gains tax (or fewer deemed disposal events).
- No tax on cessation of place of effective management or residence.
- The ability to use foreign tax credits.
- Reduced withholding taxes.
- A group taxation system.
- Favourable treatment of foreign exchange gains and losses.
- Wide network of investment protection agreements.
- Political stability.
- Strength in financial services.

Accordingly, the role of a holding regime is different to that of a headquarter regime; thus necessitating the need for both types of regimes to exist within a multinational organisation. With the holding regimes function closely linked to investments, the protection of the multinationals' investments is crucial. Thus, opting for a jurisdiction with political and economic stability is essential.

Second to this should be the tax benefits relating to the kind of income the holding regime is likely to accrue. Concessions from interest, dividends and withholding taxes are essential in creating a favourable holding regime.

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18 Legwaila, T. (2011). Tax reasons for establishing a headquarter company. *Obiter,* p126.

19 Discussed *supra;* Olivier, L. & Honiball, M. (2011). The new South African headquarter regime doesn't quite cut it. *Without Prejudice,* February 2011, p29.

Headquarter regimes, however, require a different focus. Depending on the type of activity the headquarter company is engaged in, a multinational will have to determine which jurisdiction would best suit the activity. For example, a headquarter company that provides management and technical support services would be best placed in a jurisdiction which offers low to no withholding taxes on this type of income.

However, it is evident that different considerations will apply to the different regimes, and accordingly, the tax considerations should match.

CHAPTER 3. ISSUES WITH THE INITIAL HEADQUARTER COMPANY PROVISIONS

3.1. Introduction

The headquarter company provisions were re-introduced in the 2010 TLAB with effect from 1 January 2011. As stated previously, the Explanatory Memorandum to the 2010 TLAB identified three tax areas which acted as obstacles to an ideal headquarter company location; these were 'the CFC rules, the charge on outgoing dividends, and the thin capitalisation rules'.[20] However, the initial headquarter company provisions, although a positive step, did not fully overcome the above obstacles.

3.2. Headquarter company definition

In order for a company to qualify as a headquarter company, several requirements had to be met. Each shareholder (whether alone or together with any other company forming part of the same group of companies as the shareholder) of the headquarter company had to at least have held 20% of the equity shares and voting rights in that holding company, for that year of assessment and all previous years of assessment.[21]

In addition, 80% of the cost of the total assets of the company had to represent equity, debt, or intellectual property investments in foreign subsidiaries in which the holding company (whether alone or together with any other company forming part of the same group of companies as the shareholder) held at least 20% of the equity shares. Similarly, this requirement had to have been met in all previous years of assessment and at the end of that year of assessment.

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20 SARS. (2010). *Explanatory Memorandum to the Taxation Laws Amendment Bill 2010,* p77. Available at http://www.sars.co.za/home.asp?pid=2631.

21 S6(1)(o) of Act 7 of 2010.

Furthermore, 80% of the total receipts and accruals of the company for that year of assessment had to consist of amounts in for the form of one or both of:

- Any dividend, interest royalty or fee paid or payable by any foreign company (as discussed above).
- Any proceeds from the disposal of any interest in equity shares or intellectual property (as discussed above).

This meant that existing companies wishing to make use of the headquarter company provisions may or may not have been eligible since they would have to have met the requirements for *all previous years of assessment*. This created a significant barrier, since now, new companies would need to be incorporated in order to comply with the provisions. Furthermore, there was no indication as to whether companies who unintentionally met the definition of headquarter company would automatically be treated as such by SARS.

In addition, the new provisions require companies to undertake an annual test, at the end of every year of assessment, as to whether they qualify as a headquarter company.

3.3. Initial proposals to overcome the obstacles

3.3.1 *CFC rules*

Where a resident company held, directly or indirectly, more than 50% of the total participation or voting rights in a foreign company, and that resident company was a headquarter company, the foreign company was exempt from the CFC rules. This meant that the foreign company’s income would not be attributed to the headquarter company.[22] However, if the headquarter company's shareholders hold, directly or indirectly, more than 50% of the total participation or voting rights in the foreign company, the net income of the foreign company would be attributed to the headquarter company's shareholders.

[22] S16(1)(a) of Act 7 of 2010.

3.3.2 *Dividends*

Dividends declared by the headquarter company will be exempt from income tax in the hands of its shareholders.[23] The headquarter company will also not be subject to any STC (at the time) on dividends declared.[24]

3.3.3 *Transfer pricing and interest rules*

In terms of the transfer pricing rules, certain financial assistance granted to the headquarter company will not be subject to transfer pricing. This is subject to the proviso that the person providing the financial assistance is not a resident. Should the headquarter company provide financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as the shareholder) holds at least 20% of the equity shares and voting rights, the transfer pricing rules will not apply.[25] However, for all other transactions, the transfer pricing rules will still apply.

Special ring-fencing of interest provisions were introduced.[26] Where a headquarter company incurred interest in respect of financial assistance granted to it by a non-resident person, the interest deduction will be limited to the amount of interest received by or accrued to the headquarter company as relates to any portion of that financial assistance that is directly applied as financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 20% of the equity shares and voting rights.

Any amount of interest that is disallowed may then be carried forward to the next year of

23 S18(1)(n) of Act 7 of 2010.

24 S68(1)(b)of Act 7 of 2010.

25 S56(1) of Act 7 of 2010.

26 S38(1) of Act 7 of 2010.

assessment and will be deemed to be actually incurred in that next year of assessment.

3.3.4 *Foreign exchange gains*

In addition, any amount received or expenditure incurred by that headquarter company in a currency other than the currency of South Africa, and the functional currency of the headquarter company is not in the currency of South Africa, the amount must be determined in the functional currency of the headquarter company and has to be translated into the currency of South Africa, applying the average exchange rate for that year of assessment.[27]

3.3.5 *Capital gains*

Foreign companies will be exempt from CGT on the sale of their shares in a headquarter company, provided that the foreign company holds 20% of the equity shares and voting rights in the headquarter company.[28] However, the sale of other assets will still be subject to the normal CGT rules.

3.4. Income received by the headquarter company

Any amounts received in respect of management fees, normal revenue income, and royalties will be fully taxable at the corporate tax rate of 28%. The headquarter company will also be subject to donations tax.

Headquarter companies are also excluded from the definition of ‘company’ in section 41 of the Income Tax Act,[29] as a result are precluded from utilising the corporate rollover relief provisions in section 42 to 47 of the Income Tax Act.[30] The sale of shares in the

27 S50(1) of Act 7 of 2010.
28 S108 of Act 7 of 2010.
29 58 of 1962, as amended.
30 *Ibid*.

headquarter company will further be subject to securities transfer tax at the rate of 0.25%.[31]

3.5. Exchange control

The exchange control regulations were also amended to provide for headquarter companies to freely raise and export capital offshore.[32] However, the headquarter company (if South African incorporated) will continue to be an exchange control resident company and thus still be subject to the remaining exchange control regulations, such as the 'loop rule' 'which prohibits South African residents from exporting capital by investing in non-CMA based jurisdictions which reinvest back into the CMA[33] in whatever form possible'.[34]

3.6. Tax credits

Section 6 *quat* (1)[35] provides a rebate in respect of foreign taxes on income. This rebate is deducted from the normal tax payable of a resident in whose taxable income any income received by or accrued to such resident from a source outside South Africa which is not deemed to be from a source within Africa.

In the context of withholding taxes paid on management fees, interest, and royalties, the tax paid on these amounts may not qualify for the section 6 *quat* (1) rebate. This is because the source rules, as discussed in SARS interpretation note 18,[36] and deemed source rules in the context of this section, bear the ordinary meaning which they have for the purposes of the gross income definition and will deem the source of the income

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31 S2(1) of the Securities Transfer Tax Act, 25 of 2007.

32 Circular 37/2010.

33 Lesotho, Namibia, South Africa and Swaziland.

34 Olivier, L. & Honiball, M. (2011). The new South African headquarter regime doesn't quite cut it. *Without Prejudice,* February 2011, p30.

35 Income Tax Act, 58 of 1962, as amended.

36 31 March 2009.

to be from South Africa if the originating cause of the income is derived here.[37]

Although the withholding taxes may be subject to a deduction from the taxable income of the headquarter company in terms of section 6 *quat* (1C), this section contains more restrictions in that the headquarter company must have been in receipt of foreign income and is restricted from claiming the deduction in respect of passive income. It is also evident that this section provides a less beneficial result than the section 6 *quat* (1) rebate. For example: A headquarter company derives foreign income of 100 of which 25% tax is payable:

	Deduction Method (section 6 *quat*(1C))	Credit Method (Section 6 *quat*(1))
Taxable income from foreign source	100	100
less foreign taxes qualifying for a deduction	(25)	
Taxable income after deduction of foreign taxes	75	100
Domestic taxes	21	28
less foreign tax credit	NIL	(25)
Final domestic tax	21	3
Total Tax	46	28

However, because the headquarter company is a 'resident', it will qualify for treaty relief if available.

37 See cases such as *Overseas Trust Corporation v CIR 1926 AD 444, 2 SATC 71, CIR v Lever Brothers & Unilever Ltd* (1946) 14 SATC 1.

3.7. VAT

Since the headquarter company will presumably be carrying on an enterprise in South Africa it will be a registered VAT vendor.[38] However, the services it supplies to non-residents will only be subject to VAT at the rate of 0% in certain circumstances. For example, section 11(2)(l) of the VAT Act[39] restricts the zero rating where the services are services being supplied in connection with land or any improvement situated in South Africa; or in connection with movable property (excluding debt securities, equity securities or participatory securities) situated inside South Africa at the time the services are rendered, except movable property which -

i. is exported to the said person subsequent to the supply of such services; or
ii. forms part of a supply by the said person to a registered vendor and such services are supplied to the said person for purposes of such supply to the registered vendor; or,

to the said person or any other person, other than in circumstances contemplated in ii above, if the said person is in South Africa at the time the services are rendered.

Accordingly, only in these limited circumstances may the services be zero rated. No specific VAT concessions apply to headquarter companies.

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38 Provided the requirements in s23 of the VAT Act 89 of 1991 are met.

39 89 of 1991.

CHAPTER 4. SUBSEQUENT AMENDMENTS AIMED AT RESOLVING THE HEADQUARTER COMPANY PROVISIONS

4.1. Introduction

National Treasury acknowledged that certain of the headquarter company provisions introduced 'anomalous requirements which rendered the regime impractical.'[40] Accordingly, new provisions were introduced to increase the likelihood of the headquarter company provisions being utilised.

4.2. Headquarter company provision, new section 9I

With the introduction of section 9I in the TLAA 2011, certain of the threshold requirements to qualify as a headquarter company were amended. The new section 9I provides that each shareholder of the headquarter company (whether alone or together with any other company forming part of the same group of companies as the shareholder) of the headquarter company had to at least have held 10% of the equity shares and voting rights in that holding company.

The 80% asset test requirement remains. However, when calculating the total assets in the company, no cash in the form of a bank deposit payable on demand will be included in the calculation. The shareholding requirement similarly has been reduced to 10%.

In addition, where the gross income of the company for that year of assessment exceeds R5 million, 50% or more of the gross income has to consist of amounts in the form of one or both of -

40 SARS. (2011). *Draft Explanatory Memorandum to the Taxation Laws Amendment Bill 2011*, p109. Available at http://www.sars.co.za/home.asp?pid=2631.

- Any dividend, interest royalty or service fee paid or payable by any foreign company (as discussed above).
- Any proceeds from the disposal of any interest in equity shares or intellectual property (as discussed above).

For the purpose of this section, foreign exchange differences would be excluded from the calculation. In order to qualify as a headquarter company, it has to make an election to qualify as such and would be subject to annual reporting requirements as determined by the Minister of Finance.

4.3. Proposed pre-approval process

The Draft Explanatory Memorandum on the TLAB 2011 provides that 'in order to promote better control and monitor the incentive (and to limit concerns about undesirable inadvertent entries), the new regime will require pre-approval.'[41] It sets out the pre-approval process as follows;[42] in the case of companies formed or established on or after 1 January 2011, this pre-approval may come from either the SARB or from the National Treasury.

Companies formed or established (and effectively managed) within South Africa are deemed to receive approval in respect of the Income Tax Act[43] when approval is received from Exchange Control to treat the company as a foreign company for Exchange Control purposes (pursuant to the headquarter company notice). Companies formed or established within foreign jurisdictions (but effectively managed within South Africa) must obtain approval from National Treasury (after consultation with SARS). In order to obtain this approval, National Treasury must be satisfied that the formation or establishment of the company within a foreign jurisdiction will not lead to the erosion of the tax base. National Treasury has the power to set the date from when approval takes effect.

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41 *Ibid*.

42 *Ibid*.

43 58 of 1962, as amended.

Pre-existing companies (i.e. companies formed or established before 1 January 2011) seeking to enter the regime may do so only upon approval from National Treasury (after consultation with SARS). National Treasury will provide this approval if satisfied that headquarter company treatment will:

- Enhance South Africa as a regional headquarter destination.
- Lead to the creation of additional skills or related intellectual infrastructure.
- Not lead to the erosion of the South African tax base.

National Treasury will again have the power to set the date of approval.

These requirements, specifically for existing companies wishing to become headquarter companies, would seek to deter investors; specifically since the approval requirements to be considered by National Treasury are subjective. As a result, investors may be further deterred, since applying for pre-approval may not guarantee them headquarter company status even if the requirements in section 9I are met. However, these requirements seem to have been disregarded, and are not present in the TLAA 2011.

4.4. Deemed disposal

In terms of the proposed amendments, the change to headquarter company status will trigger a deemed sale of the headquarter company's shares on the date of approval in terms of the new section 9H of the Income Tax Act.[44] The headquarter company will be deemed to have disposed of its assets at market value, and then re-acquire the assets at the same value which will constitute the base cost of the assets going forward. The reason for the change is seemingly to 'reduce the opportunity for taxpayers to utilise the headquarter company regime solely to undermine the pre-existing tax base (i.e. pre-existing taxable gain).'[45] This is a further deterrent for existing companies to utilise the

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44 *Ibid*.

45 *Ibid*.

headquarter company provisions.

The legislation has been amended to ensure that the participation exemption contained in paragraph 64B[46] does not apply when making a transfer to a headquarter company; in other words, the sale will be subject to CGT.

However, the same consequences will apply when the headquarter company disposes of its offshore subsidiaries to connected persons. In terms of section 64B(3) and section 64B(4),[47] if the distribution from the proceeds of the sale would be subject to STC, the sale would be exempt from CGT. Since a headquarter company is exempt from STC, it can never meet this requirement, which results in the inequitable result of the proceeds being subject to CGT.

4.5. Tax credits

Section 6 *quin* was introduced with effect from 1 January 2012 and provides welcome relief for headquarter companies in receipt of service fees. Where the headquarter company provides services in South Africa, and receives income from a source within South Africa, and that amount is subject to withholding tax, the headquarter company will be subject to a rebate which must be deducted from the normal tax payable by that headquarter company. However, one drawback is that foreign withholding taxes in excess of the South African tax cannot be carried forward.

4.6. Exchange control

The exchange control regulations were also further amended.[48] Headquarter companies which meet certain criteria will now be able to invest offshore without restriction. The

[46] Of the Eighth Schedule to the Income Tax Act, 58 of 1962, as amended.

[47] Income Tax Act, 58 of 1962, as amended.

[48] Exchange Control Circular 2/2011 dated 25 January 2011.

criteria as set out in the exchange control circular are as follows:

- No shareholder in the headquarter company, whether alone or together with any company forming part of the same group of companies as that shareholder, may hold less than 20% of the shares and voting rights.
- The shares and/or debt of the headquarter company may not be listed on the JSE Limited, nor may the shares in the headquarter company be directly or indirectly held by a shareholder with shares or debt listed on the JSE Limited.
- No more than 20% of the headquarter company shares may be directly or indirectly held by residents.
- At the end of each financial year, at least 80% of the assets of the holding company must consist of foreign assets.

The headquarter company that meets the above requirements will be treated as a non-resident for exchange control purposes other than for their reporting requirements. Thus headquarter companies can freely borrow from abroad and such funds may be deployed locally or offshore. Transactions by South African entities with headquarter companies will be treated as transactions will non-residents.

However, there is an obvious misalignment with the Income Tax requirements to qualify as a headquarter company and the exchange control regulations. In terms of section 9I there is a minimum 10% shareholder requirement, whereas for exchange control they may not hold less than 20%. In addition, there is a restriction for exchange control on the percentage shareholding held by residents (20%). There is also no requirement for tax purposes that the shares may not be listed on the JSE Limited.

Further, it is not clear how the value of the assets will be determined. Whereas for tax purposes the tax cost is usually calculated to determine the value, other methods such as the market value or book value may be considered appropriate from an exchange control perspective.

CHAPTER 5. CURRENT HEADQUARTER COMPANY PROVISIONS

5.1. Introduction

Further refinements to the headquarter company regime have been introduced. The Explanatory Memorandum to the TLAB 2012[49] acknowledged it as a successful holding company regime. However, Treasury accepts that there is still a barrier to its use because of the additional tax charges in South Africa.[50]

5.2. Headquarter company provisions now cater for dormant companies

A welcome change to section 9I is the provisions surrounding the use of shelf or dormant companies. Since the use of an existing company results in CGT, it is often more beneficial to use a shelf company. However, in terms of the previous provisions in section 9I, this was often impossible since the various shareholding and asset requirements could not be met.

The requirement that the shareholders of the headquarter company must at least hold 10% is still present. However, in the case of companies who start trading in the year of assessment, the shareholding requirement will only be tested in that year of assessment.[51] In addition, relief from the 80% asset test is also provided. In terms of the amendment, if the headquarter company did not at any time own assets exceeding R50 000, it is exempt from complying with the 80% asset test.

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49 Published on 10 December 2012.

50 SARS. (2012). *Explanatory Memorandum to the Taxation Laws Amendment Bill, 2012* p123.

51 S18(1) of the Taxation Laws Amendment Act, 2012.

Although the provisions are a positive step, it is uncertain if a shelf company starts trading half way through the year whether the 10% shareholding requirement will be met (since the test is for the whole year of assessment). On a literal interpretation of the section it can be concluded that the relevant shelf company will not meet the headquarter company provisions. However, it is clear that the purpose of the section is to provide relief for shelf companies, and thus they should qualify. It is uncertain which approach the courts or SARS would take on this matter.

5.3. Transfer pricing

Currently, the transfer pricing rules do not apply in the case of loans provided to a headquarter company, which is then on lent to its foreign subsidiary, or in the case of loans directly provided to the foreign subsidiary of that headquarter company (subject to the 10% shareholding requirement) (a 'qualifying subsidiary'). In terms of the new amendments, the provision of intellectual property to the headquarter company, which is then on supplied to its foreign subsidiary or in the case of intellectual property directly supplied to its foreign subsidiary by the headquarter company, will not be subject to transfer pricing.[52]

Like in the case of interest, the deduction claimed by the headquarter company in providing the intellectual property to its qualifying subsidiary will be ring-fenced. Any excess will be carried forward to the next year of assessment.[53] Previously royalties withholding tax would have been payable in this instance, unless the relevant DTA reduces the rate.[54] However, with effect from 1 July 2013, headquarter companies are exempt from withholding tax on royalties.[55]

52 S64 of the Taxation Laws Amendment Act, 2012.

53 S39(1) of the Taxation Laws Amendment Act, 2012.

54 S35 Income Tax Act, 58 of 1962, as amended.

55 S49D(b) Income Tax Act, 58 of 1962, as amended.

The 2013 amendments to the TLAA[56] further introduced transfer pricing relief for so called 'equity loans'. In this instance, where a qualifying subsidiary of a resident company (including headquarter company) owes a debt to the resident company, and that foreign company is not obliged to redeem the debt in full within 30 years from the date the debt is incurred and the redemption of the debt is conditional upon the market value of the assets of the qualifying foreign company exceeding its liabilities, with effect from 1 April 2014 the transfer pricing rules will not apply.[57]

This is a positive change, specifically in the context of struggling African qualifying subsidiaries, where long-term investment is essential for the growth and operational requirements of the subsidiary, although the headquarter company would in any event have been subject to relief by virtue of section 31(5)(b),[58] since the provision of financial assistance provided by a headquarter company to its qualifying subsidiary will not be subject to transfer pricing. This new provision will assist headquarter companies should the other relevant revenue authority seek to classify the provision of long-term debt as equity, thus falling out of the definition of 'financial assistance' as contemplated in section 31.[59]

While this proposal is attractive for foreign investors, it is submitted that this relief should be extended even further. Namely, that the transfer pricing rules should be relaxed in the event that the headquarter company receives an interest-free loan from its shareholder in order to fund the acquisition of shares in its 'qualifying' subsidiary. In terms of the current provisions, because the loan is not back-to-back or provided to its qualifying subsidiary, the transfer pricing rules will still apply.

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56 2013.

57 S82 of the Taxation Laws Amendment Act, 2013.

58 Income Tax Act, 58 of 1962, as amended.

59 Income Tax Act, 58 of 1962, as amended.

5.4. Withholding taxes

From 1 April 2012, headquarter companies are exempt from dividends tax.[60] Headquarter companies will also be exempt from interest withholding taxes (which is to come into effect from 1 January 2015). However, the exemption is limited to the granting of financial assistance as contemplated in section 31(5)(a);[61] in other words, the exemption will only apply in the case of back-to-back loans. As per the example above, should the headquarter company receive financial assistance to purchase shares in its qualifying subsidiary, withholding tax on interest will be payable at the rate of 15% (subject to DTA relief).

With effect from 1 January 2016, withholding tax on service fees will be introduced at the rate of 15% (subject to DTA relief).[62] These provisions do not contemplate that headquarter companies will be exempt. However, in this instance it appears that this exemption is less appropriate since headquarter companies in most instances will be in receipt of service fees (rather than paying for service fees). If withholding tax on service fees are applied on the amounts, section 6 *quin*[63] provides relief and grants the headquarter company with a tax credit.

5.5. CGT

The CGT implications for headquarter companies disposing of its qualifying subsidiaries have also been simplified. Headquarter companies will not be subject to CGT should they dispose of shares in a non-resident qualifying subsidiary.[64] Resident shareholders of the headquarter company will still be subject to CGT or income tax (as the case may be) on the disposal of their shares in the headquarter company.

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60 S64E(1) of the Income Tax Act, 58 of 1962, as amended.

61 S50D(1)(a)(cc) of the Income Tax Act, 58 of 1962, as amended.

62 S51B of the Income Tax Act, 58 of 1962, as amended.

63 Income Tax Act, 58 of 1962, as amended.

64 Para 64B(1) of the Eighth Schedule to the Income Tax Act, 58 of 1962, as amended.

However, since non-resident shareholders are only subject to CGT in limited circumstances,[65] it is unlikely that they will be subject to CGT on the disposal of their shares in the headquarter company. In alignment with this relief, shareholders will also be exempt from STT on the disposal/transfer of their shares in the headquarter company.[66]

5.6. Exchange control

In addition to the abovementioned amendments, the exchange control regulations were further amended.[67] The prohibition against the headquarter company listing on the JSE Limited or the shares in the headquarter company be directly or indirectly held by a shareholder with shares or debt listed on the JSE Limited have been removed. The shareholding requirement has further been reduced to 10%, in line with the provisions of section 9I.[68]

For reporting purposes, the headquarter company must set up a ring-fenced foreign currency account in its name. Authorised dealers will also be obliged to annually submit to SARB a detailed organogram and latest available audited financial statements of the headquarter company.

5.7. Investment protection agreements

As mentioned in Chapter 2, a beneficial headquarter company regime will have an extensive range of investment protection agreements. South Africa has approximately 47 investment protection agreements in place, which include countries such as the UK,

65 Refer to Para 2(1)(b) of the Eighth Schedule to the Income Tax Act, 58 of 1962, as amended.

66 S8(1)(s) of the Securities Transfer Tax Act, 25 of 2007.

67 Circular 17/2012 dated 1 November 2012.

68 Income Tax Act, 58 of 1962, as amended.

Switzerland, Netherlands, Luxembourg, Mauritius and Germany.[69]

However, on 1 November 2013 the Protection of Investment Bill[70] was introduced. The Bill is intended to replace the need for treaty investment protection, and introduces investor protection in the domestic legislation. In terms of the Bill, the South African domestic legislation will override it, if applicable. It is anticipated that South Africa will unilaterally withdraw from its investment treaties, and instead rely on the domestic legislation, once enacted.[71] It is uncertain whether this will receive positive feedback from respective foreign investors, since now, the South African legislators will be able to amend the regulations as they see fit, without the respective foreign countries acceptance, knowledge or input.

5.8. How does the South African headquarter company regime compare with the 'ideal' headquarter and holding company regime?

As discussed in Chapter 2, a headquarter company generally provides treasury or central management and support services for the group. Holding companies, on the other hand, assist multinationals in managing its foreign investments; not really engaging in trade. The key characteristics of a holding company and headquarter company, compared with the South African headquarter company regime, can be tabulated as follows:

Ideal Headquarter Company	**South African Headquarter Company**	
Defer tax on operating income	No, fully taxed at 28%	X
Possibility to remit only exempt income	Yes, this is possible but not limited to only exempt income	√

69 Refer to Hattingh, J. (2014). *South Africa - Business and Investment* sec. 6. Country Surveys. Available at IBFD online database.

70 2013, Notice 1083 No. 36995.

71 Refer to Hattingh, J. (2014). *South Africa - Business and Investment sec. 6. Country Surveys*. Available at IBFD online database.

Ideal Headquarter Company	**South African Headquarter Company**	
No CGT	No, only exempt in certain circumstances	X
No tax on cessation of residence	No, deemed tax on ceasing to become a resident	X
Foreign Tax Credits	Yes available in domestic law and treaty	√
No withholding tax	Yes	√
Group tax system	No, South Africa does not have a group tax system	X
Favourable foreign exchange gains and loss treatment	Yes, this is available	√
Investment protection agreements	Yes	√
Wide treaty network	Yes	√
Foreign Tax Credits	Yes available in domestic law and treaty	√
Low effective corporate tax rate	No, fully taxed at 28%	X
No CGT on disposal of investments	Yes, subject to a 10 % shareholding requirement	√
Interest deductions	Yes, but the excess is ring-fenced	√
No dividends withholding tax	Yes	√
No tax on income received	No, fully taxed at 28 %	X
Favourable foreign exchange gains and loss treatment	Yes, this is available	√
No CFC rules	Yes, exemptions apply	√
Tax rulings can be obtained	Yes, if this is done in advance of the transaction	√
Specific thin capitalisation rules	Yes, exemptions are available	√
Lack of exchange control	Yes, subject to certain requirements	√

Ideal Headquarter Company	South African Headquarter Company	
Defer tax on operating income	No, fully taxed at 28%	X
Possibility to remit only exempt income	Yes, this is possible but not limited to only exempt income	√
No CGT	No, only exempt in certain circumstances	X
No tax on cessation of residence	No, deemed tax on ceasing to become a resident	X
Foreign Tax Credits	Yes available in domestic law and treaty	√
No withholding tax	Yes	√
Group tax system	No, South Africa does not have a group tax system	X
Favourable foreign exchange gains and loss treatment	Yes, this is available	√
Investment protection agreements	Yes	√

Ideal Holding Company	South African Headquarter Company	
Wide treaty network	Yes	√
Foreign Tax Credits	Yes available in domestic law and treaty	√
Low effective corporate tax rate	No, fully taxed at 28%	X

No CGT on disposal of investments	Yes, subject to a 10 per cent shareholding requirement	√
Interest deductions	Yes, but the excess is ring-fenced	√
No dividends withholding tax	Yes	√
No tax on income received	No, fully taxed at 28 per cent	X
Favourable foreign exchange gains and loss treatment	Yes, this is available	√
No CFC rules	Yes, exemptions apply	√
Tax rulings can be obtained	Yes, if this is done in advance of the transaction	√
Specific thin capitalisation rules	Yes, exemptions are available	√
Lack of exchange control	Yes, subject to certain requirements	√

It is evident from the table above that the South African headquarter company regime is better suited to that of a holding company regime, rather than a headquarter company regime. Providing management and technical services to the group from South Africa will lead to the income being fully taxable at the rate of 28%. However, notwithstanding its label, it is submitted that the regime successfully provides a platform for foreign investors to channel their African investments via South Africa in a pure holding capacity. However, the provision of services to the rest of the multinational group is less ideal.

In addition, in order for foreign investors to take the South African regime more seriously, it is suggested that there should be some sort of guarantee that the legislation will not be repealed in due course, as was the case with the previous headquarter company regime. Ultimately, in order for the South African regime to be successful, it would need to be more attractive than its counterparts. When compared with Mauritius, the headquarter company provisions in South Africa seem less desirable. In comparison, Mauritius appears to be the jurisdiction of choice for the entry into the African economy.

However, it is submitted that the South African headquarter company provisions cannot be compared with Mauritius since South Africa has not identified itself as a ‘tax haven’ nor does it have any intention to do so. Further, Mauritius has encountered push back from a number of so-called ‘high tax countries’ that are threatening to unilaterally cancel their DTAs with Mauritius, which could have dire consequences for Mauritius as a financial centre.

It is submitted that, in order to best evaluate the South African headquarter company provisions, other similar taxing jurisdictions should be compared, such as the UK and other non-tax haven jurisdictions such as Botswana and the Netherlands.

CHAPTER 6. THE UK SYSTEM AND TREATY NETWORK

6.1. Introduction

This chapter will consider and evaluate the UK tax system and its suitability as a headquarter or holding company location as a gateway into Africa. 'The UK has a long history as a trading nation and is the sixth largest in the world.'[72] The UK has also 'consistently attracted more headquarter operations than any other location in Europe'.[73]

The UK, similar to South Africa has commercial upsides, such as 'the relative ease of set-up, language factors and communication links'.[74] Companies can 'register a company, set up banking facilities and start trading'[75] quite quickly. In addition, as a member of the EU, the benefits of such membership are available to UK corporations. The UK legal system is also widely tried and tested throughout. The UK government has also recognised the need to make it more attractive for multinational companies. 'Underlining this is a commitment to the modern international principles of fair and open trade.'[76]

'There are new flexible and competitive rules for taxing the profits of multinationals, including a modernised CFC regime, as well as an extensive treaty network, making the UK an attractive location for headquarters, regional holding companies and global or regional business hubs.'[77] The UK has further affirmed its commitment to create a

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72 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p5.

73 *Ibid*, p6.

74 Grant Thornton. (n.d.). *A guide to business relocation in Europe*. Available at http://www.grant-thornton.ch/files/gti%20business%20relocation%20a5%20f.pdf, p3.

75 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p5.

76 *Ibid*.

77 *Ibid*, p3.

competitive tax regime through the reduction of its corporate tax rate. Currently,[78] the tax rate of 23% was dropped to '21 % in April 2014 and will drop to 20% in April 2015. The UK's main corporation tax rate is the lowest in the G7'.[79]

In determining whether the UK is in fact a more attractive jurisdiction than South Africa, the UK tax system, its CFC rules and its treaty network will be evaluated.

6.2. The UK tax system

The UK has a worldwide system of taxation on residents of the UK. However, the trend is that 'the UK is moving from a system of worldwide taxation for UK companies to a broadly 'territorial tax system'.[80] Companies incorporated in terms of the UK Companies Act are subject to tax and are resident in the UK. 'Non-resident companies are subject to tax on the taxable profits attributable to its UK permanent establishments.'[81] Other companies will also be resident in the UK if its central management of control takes place there. The treatment of non-resident companies generally follows the same rules for resident companies.

In order to make the tax regime more attractive, the UK introduced an elective branch exemption and reformed its CFC regime. In other words, a new elective tax exemption for offshore trading branches of UK companies is created, it 'allows a choice between potential loss relief (and taxation of profits, with double tax relief) and exemption for both profits and losses.'[82] 'A UK resident company may also elect that its profits (and losses)

78 1 April 2013 to 31 March 2013.

79 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p8.

80 *Ibid*, p9.

81 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation* sec. 1, Country Surveys. Available at IBFD online database, p7.

82 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p10.

from its foreign permanent establishment are excluded from UK corporation tax.'[83] However, once this election is made the UK company cannot alter this status.

6.2.1 *Deductions*

Similar to South Africa, expenses incurred in the production of income and for the purposes of trade may be deducted.

Dividends: There is no deduction for dividends. However, there is no dividends withholding tax in the UK. Dividends received by UK resident companies are also generally exempt from corporation tax. 'The Corporation Tax Act 2009 contains a list of exempt dividends, which include, *inter alia,* distributions –

- From controlled companies.
- In respect of non-redeemable ordinary shares.
- Of certain shares accounted for as liabilities.

However, the dividend must not be paid in relation to a transaction falling within a list of excluded schemes.'[84] Dividends received by 'small companies'[85] are also exempt from corporation tax if the paying company is resident in the UK or in a territory in which the UK has a DTA containing a non-discrimination clause, and is not an 'excluded company'.[86] 'The distribution to a small company must also not be part of an arrangement to avoid tax.'[87]

83 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p22.

84 *Ibid*, p17.

85 'Defined in the Annex to Commission Recommendation 2003/361, however, excluded from this definition are open ended investment companies, authorised unit trusts, insurance companies and friendly societies.' Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database.

86 An excluded company is one that is excluded from the benefits of any tax treaty for the time being in force in relation to that territory. Obuoforibo, B, (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys*. Available at IBFD online database.

87 *Ibid*, p18.

Interest: Where interest is incurred in the production of income, it may be deducted for tax purposes. There is no restriction on interest deductions for the funding of offshore investments. This is subject to certain limitations, and the rate must be at an arms-length rate. With effect from 1 January 2010, 'UK companies which qualify as large worldwide groups, with net finance expenses are limited to a deduction for interest up to an amount which is equal to the gross finance expense of the group.'[88]

Intellectual property: 'The cost of the assets is treated as deductible expenditure in accordance with accounting principles and is amortised accordingly.'[89] Stamp duties are applied at the rate of 0.5% on the transfer of stock or marketable securities. There is also a stamp duties reserve tax at the rate of 0.5% on the 'transfer of UK shares and related securities including options, interests and unit trusts'.[90]

Capital gains: The capital gains of a UK resident company are taxed at the normal rate of corporation tax applicable to that company. Similar to South Africa, special rules apply for the calculation of the base cost of the asset. There is also an exemption from capital gains, where a trading company disposes of its shares in other trading companies or groups where it holds at least 10% of the shares for at least 12 months.[91]

Similar to South Africa, capital losses are set off against capital gains, and any available losses are carried forward to the next year of assessment. Capital gains incurred by a non-resident company on the disposal of an asset situated in the UK are 'generally not taxable unless they are attributable to a trade being carried out in the UK through a

88 *Ibid*, p9. A large worldwide group is one in which no member falls within the categories of micro, small and medium sized enterprises for the purposes of Commission Recommendation 2003/361.

89 *Ibid*, p9.

90 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p19.

91 Legwaila, T. (2011) .Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p549.

branch or agency'.[92]

6.2.2 *Special dispensation for UK groups*

The UK tax system allows for the consolidation of taxes within a group context provided that this takes place in the same accounting period. Depending on the shareholding percentage, different tax incentives apply. For 51% groups, a special arrangement for the payment of tax exists. Consortiums[93] may only transfer their losses within the consortium.

Companies in a group may offset taxable income in one company against losses in another group company. 'This relief similarly can be applied to members of the group resident outside of the UK, and to UK permanent establishments of non-resident companies and to overseas permanent establishments of UK companies.'[94] 'A group of companies comprises the UK parent company and all UK resident subsidiaries that are owned directly or indirectly by a percentage of 75% or more by a holding company.'[95]

'A UK resident parent company may also claim group relief for losses of a non-resident subsidiary resident in European Economic Area (EEA) countries (EU member states and Iceland, Liechtenstein and Norway) or the relevant losses of a permanent establishment in the EEA where all scope for claiming non-UK relief for the losses has been exhausted.'[96]

Within a 75% group structure and consortium, losses may be surrendered upwards,

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92 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p23.

93 'A consortium consists of 20 or fewer UK resident companies that each own 5% or more, and together 75% of a company.' Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p16.

94 *Ibid*.

95 Legwaila, T. (2011). Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p552.

96 *Ibid*.

downwards, or sideways in a corresponding accounting period. In addition, in relation to a consortium company held indirectly, being a 90% subsidiary of an intermediary company, it may also surrender its losses. Similar to the South African rollover relief regime, companies in a 75% group context are able to transfer assets free of any negative tax implications. This relief applies to companies which are subject to UK corporation tax (thus certain non-resident companies will qualify). The transferor company will then step into the shoes of the transferee company as regards the base cost of the asset. A taxable gain will only arise when the asset or transferee company ceases to be part of the group.

6.2.3 *Transfer pricing*

All transactions (including loan transactions) between 'related'[97] companies (whether resident in the UK or not) must be at an arm's length rate. 'Like South Africa, companies are obliged to apply any necessary transfer pricing adjustments, in terms of a 'self-assessment' regime.'[98]

6.2.4 *Advance tax rulings*

'There is no general statutory system of advanced rulings.'[99] However, the HMRC provides rulings where the position relating the interpretation and application of tax law (including in relation to proposed transactions) is uncertain. The query must related to '(i) legislation passed in the last four Finance Acts; (ii) older legislation where the uncertainty is of commercial significance to the business; (iii) the application of tax treaties; or (iv) areas of major public interest.'[100] 'It recognises that responding to the

97 Two companies are related if one controls the other, or if they are both under common control. This is where the company has the power to ensure that the affairs of the company are conducted in accordance with its wishes and this power is exercised either by means of holding the shares or the possession of voting power, directly or indirectly.

98 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p26.

99 *Ibid*, p15.

100 Deloitte. (2012) *Comparison of European holding company regimes.* Available at http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/DITS/dttl

requests as soon as possible is important, and 'responds within 28 days.'[101] In addition, 'there are also provisions in place for advance pricing agreement and thin capitalisation agreements.'[102]

6.2.5 *Assessed losses*

Assessed losses 'incurred may be carried back for one year, and carried forward indefinitely, provided that the company continues to trade.'[103]

6.2.6 *Withholding taxes and double tax relief*

'There are no withholding taxes on any payments to resident companies.'[104] As mentioned above, there is no withholding tax on dividends. Interest and royalties are subject to a withholding tax of 20%. However, DTA relief may apply in certain circumstances. In terms of the 'Interest and Royalties Directive, outbound interest and royalty payments are allowed to be paid free from withholding tax, provided the UK holding company has at least 25% shareholding in the EU company paying the interest'.[105]

In addition, in terms of the EU Parent/Subsidiary Directive, 'dividends are paid to the holding company from all EU member states free of withholding tax on any shareholding in excess of 10%'.[106]

_tax_holdcomatrix_europe%202012_2.pdf, p35.

101 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p23.

102 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p15.

103 *Ibid*, p12.

104 *Ibid*, p13.

105 KPMG. (May 2013). *The UK as a holding company location*. Available at http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Tax/investing-in-the-uk-2013.PDF, p7.

106 *Ibid*.

The UK also provides a tax credit for corporate taxes paid by foreign countries against UK corporation tax; this claim may be made under a DTA or domestic legislation. The credit is limited to the UK corporation tax.[107] 'Unused credits may be carried back for one year and carried forward indefinitely to be set off against corporation tax on income or gains from the same source.'[108]

6.2.7 *Indirect taxes*

VAT is applied at the rate of 20% on the supply of goods and services. Non-residents, irrespective of their level of turnover, are obliged to register for VAT in the UK. Stamp duty (applies to paper transactions) or stamp duty reserve tax (applies to electronic transactions) is payable on the purchase of shares. The standard rate is 0.5%.

6.2.8 *Exchange control*

The UK foes not have any exchange control regulations.[109]

6.3. The new CFC regime

6.3.1 *Overview*

According to the HMRC, the purpose of the UK CFC rules is to 'protect the country from the artificial diversion of UK profits to overseas companies that are controlled from the

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107 Legwaila, T. (2011). Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p549.

107 *Ibid*.

108 Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation* sec. 1, Country Surveys. Available at IBFD online database, p22.

109 Legwaila, T. (2011). Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p552.

UK and located in low tax jurisdictions'.[110] It is common understanding that the UK CFC's rules were quite complicated and unpopular with investors. As a result of the stringent UK CFC rules, 'a number of companies made public declarations about moving out of the UK ... some have gone to the Netherlands'.[111] The UK tax authorities recognised this hurdle and thus reformed the CFC rules with effect from 1 January 2013.

A CFC will be created where a UK company holds 25% of the interest in a non-resident company. Generally, the new UK CFC rules exempt profits earned in controlled overseas companies from UK tax unless they have been artificially diverted from the UK. Special rules apply to offshore finance profits earned by a CFC from loans to non-resident companies. Generally, the rules allocate 25% of the net profit to the UK, giving an effective tax rate of 5% from 2015 (where the corporation tax rate will be reduced to 20%). Depending on the percentage interest held by the UK resident company in the CFC, an apportionment of the CFC's profits will be attributable to the UK resident company.

6.3.2 *Steps for determining the CFC charge*

Once it has been established that a foreign company is a CFC of a UK company, a CFC charge will only arise if:[112]

- There is a UK interest holding that is not exempt and that holds an interest of at least 25%.
- None of the CFC exemptions apply.
- The CFC has chargeable profits.

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110 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p9.

111 Legwaila, T. (2011). Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p551.

112 S371BA(2) to Schedule 20 Part 1 of the UK Finance Act 2012.

The above conditions may be applied in any order; so for example, if one of the CFC exemptions applies it is not necessary to consider whether or not it has any chargeable profits.[113] The new provisions allow for multinationals to more easily establish whether its foreign subsidiary would be exempt or subject to the new CFC rules.

The above steps will be considered in more detail below.

6.3.3 *Does the UK company hold at least a 25% interest?*

The general rule is that a UK company that holds at least 25% in a foreign company is a chargeable company.[114] However, there are certain exemptions for managers and participants of offshore funds and companies holding shares as trading assets.[115]

6.3.4 *CFC exemptions*

There are certain exemptions which result in the UK resident company excluding the profits of a CFC from its income; these are:

- The temporary exempt period exemption.[116]
- The excluded territories exemption.[117]
- The low profits exemption.[118]
- The low profit margin exemption.[119]

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113 HMRC Draft Guidance. (16 May 2012) *Overview of CFC rules.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p1.

114 S371BD to Schedule 20 Part 1 of the UK Finance Act 2012.

115 S371 BE, BF, BG, BH to Schedule 20 Part 1 of the UK Finance Act 2012; HMRC Draft Guidance. (16 May 2012). *Overview of CFC rules*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p6.

116 Chapter 10 to Schedule 20 Part 1 of the UK Finance Act 2012.

117 See Obuoforibo, B. (2014). *United Kingdom - Corporate Taxation sec. 1, Country Surveys.* Available at IBFD online database, p26.

118 S371LA to Schedule 20 Part 1 of the UK Finance Act 2012.

119 S 371MA to Schedule 20 Part 1 of the UK Finance Act 2012.

- The tax exemption.[120]

The temporary exempt period exemption: This provides for a temporary period of exemption for a non-resident company coming under the control of a UK resident company. The CFC will be exempt from the imputation of its profits for 12 months.[121] This period may be extended by the HMRC.[122] However, this exemption will not apply if it is part of a scheme to avoid tax or to purely obtain the temporary exempt period exemption.[123]

The excluded territories exemption: This provides for the exclusion for companies that are resident and carry on business in specific territories. 'Its purpose is to exempt those CFC's that pose a low risk to the UK corporate tax base of artificial diversion of UK profits due to their territory and type of income the CFC can receive.'[124]

For this exemption to apply, the CFC must[125] be resident in Australia, Canada, France, Germany, Japan or the United States of America;[126] the total of the amounts (if any) of the CFC's income which falls within Categories A, B, C and D (as set out in sections 371KE to 371KI[127]) is no more than the 'threshold' amount for the accounting period (as described in section 371KD[128]) (the income condition); the IP condition (provided by section 371KJ[129]) is met; and the CFC is not at any time during the accounting period

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120 S371NA to Schedule 20 Part 1 of the UK Finance Act 2012.

121 S371JD to Schedule 20 Part 1 of the UK Finance Act 2012.

122 S371JD to Schedule 20 Part 1 of the UK Finance Act 2012.

123 S371JF to Schedule 20 Part 1 of the UK Finance Act 2012.

124 HMRC Guidance. (May 2013) *Chapter 11 – The excluded territories exemption*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p1.

125 S371KB(1) to Schedule 20 Part 1 of the UK Finance Act 2012.

126 HMRC Guidance. (May 2013). *Chapter 11 – The excluded territories exemption.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p9.

127 To Schedule 20 Part 1 of the UK Finance Act 2012.

128 To Schedule 20 Part 1 of the UK Finance Act 2012; generally, 10% of the CFC's accounting profits for the accounting period, or if more, £50,000.

129 To Schedule 20 Part 1 of the *UK Finance Act* 2012. This condition is met unless the CFC's assumed total profits for the accounting period include amounts arising from IP held by the CFC (the 'exploited IP'); all or parts of the exploited IP were transferred (directly or indirectly) to the CFC by a related person at any time during the 'relevant

involved in an arrangement, the main purpose or one of the main purposes of which is to obtain a tax advantage (the anti-avoidance condition).

The low profits exemption: There is no CFC charge where a CFC's accounting profits or assumed taxable profits do not exceed GBP 50,000. However, this is subject to anti-avoidance conditions; namely, if the sole purpose was to secure the low profit exemption;[130]or if the CFC's business is wholly or mainly the provision of UK intermediary services;[131] or where 'in determining the CFC's assumed taxable total profit, group mismatch schemes would have effect so as to exclude an amount from being brought into account as a debit or credit for the purposes of loan relationships or derivative contracts.'[132] If these scenarios are present the exemption will not apply.

The low profit margin exemption: The low profit margin exemption applies for a CFC's accounting period if the CFC's accounting profits (before the deduction for interest) for the period are no more than 10% of the CFC's relevant operating expenditure.[133] However, this is subject to anti-avoidance condition that if the sole purpose was to secure the low profit exemption this exemption will not apply.[134]

The tax exemption: These provisions are similar to the South Africa high tax exemption

period' (defined in subsection (5) as the accounting period in question and the preceding six years), or it was otherwise derived, (directly or indirectly), out of or from IP held by a related person at any time during that period; as a result of the transfer or other derivation there has been a significant reduction in the value of the IP held by the related person or persons taken together; and if only parts of the exploited IP were transferred or derived, the significance condition is met. See HMRC Guidance. (May 2013). *Chapter 11 – The excluded territories exemption.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p7.

130 S371LC(2) to Schedule 20 Part 1 of the UK Finance Act 2012.

131 S371LC(3) to Schedule 20 Part 1 of the UK Finance Act 2012. The CFC provides 'UK intermediary services' if (a) a UK resident individual ('the service provider') personally performs, or is under an obligation personally to perform, services in the United Kingdom for a person ('the client'), and (b) the services are provided not under a contract directly between the service provider and the client but under an arrangement involving the CFC.

132 HMRC Guidance. (May 2013). *Chapter 12 – The low profits exemption*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p3.

133 S371MB to Schedule 20 Part 1 of the UK Finance Act 2012.

134 S371MC to Schedule 20 Part 1 of the UK Finance Act 2012.

in section 9D.[135] No CFC charge will result if the CFC pays domestic tax which equates to 75% of the corresponding UK tax.[136]

6.3.5 *Does the CFC have chargeable profits?*

The CFC charge applies to the profits that pass through the CFC charge gateway. Depending on certain tests, only certain profits will pass through the actual charge gateway and be subject to UK corporation tax. The tests are contained in chapter three,[137] and only if this chapter directs will the more detailed rules in chapters four to eight need be considered. 'If none of chapters four to eight are engaged by chapter three, then there are no chargeable profits.'[138] Not more than one chapter may be applied to profits, thus income is only brought into charge once.[139]

These tests are set out in chapter three,[140] as follows:

- Where the CFC has profits attributable to UK activities, chapter four[141] will apply.
- Where the CFC's profits include non-trading finance profits, chapter five[142] will apply.
- Where the CFC's profits include trading finance profits, chapter six[143] will apply.
- Where the CFC's profits include profits from captive insurance business, chapter seven[144] will apply.
- Where the CFC's profits include any amounts falling within the rules on solo

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135 Income Tax Act, 58 of 1962, as amended.

136 S371NB to Schedule 20 Part 1 of the UK Finance Act 2012.

137 To Schedule 20 Part 1 of the UK Finance Act 2012.

138 HMRC Draft Guidance. (16 May 2012). *Overview of CFC rules*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p6.

139 *Ibid*.

140 To Schedule 20 Part 1 of the UK Finance Act 2012.

141 To Schedule 20 Part 1 of the UK Finance Act 2012.

142 *Ibid*.

143 *Ibid*.

144 *Ibid*.

consolidation, chapter eight[145] will apply.

The above tests will be considered at a high level. It is submitted that the tests are relatively detailed, and where a specific chapter is applicable, it is preferable that the specific provisions are studied as set out in the legislation.

Chapter four (where the CFC has profits attributable to UK activities) will need to be considered and a CFC charge included if profits are earned where the majority of the key management functions are undertaken by UK-connected persons and where the profits would not occur had the functions been undertaken by independent thirdparties.[146] However, certain exemptions exist if the CFC meets the local business premises condition. If the CFC's profits will include 'non- trading' finance profits[147] as a result of lending to members of the multinational group and third parties where a link to the loan funding takes place in the UK, chapter five will apply.

However, in most cases the profits will be apportioned or excluded.[148] Profits that are incidental to the exempt business activity of the CFC or fall within chapter eight (the solo consolidation rule for banks) are similarly excluded from chapter five. Further, a 'CFC that has 'non-trading finance profits' derived from a 'qualifying loan relationship' may claim that the profits arising should be dealt with under chapter nine (exemptions for profits from qualifying loan relationships) instead of chapter five'.[149]

If the CFC earns 'trading finance profits'[150] that are derived from excess capital held by

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145 *Ibid*.

146 See HMRC Draft Guidance. (16 May 2012). *Overview of CFC rules.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p5.

147 These include: exchange gains and losses arising on loan relationships, repos and stock lending, disguised interest, derivative contracts and related transactions. See HMRC Draft Guidance. (1 May 2013). *The CFC Gateway – Chapter 3.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p15.

148 See B.T.R. 2012, 4 454-462 p456.

149 See HMRC Draft Guidance. (1 May 2013). *The CFC Gateway – Chapter 3.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p15.

150 These are profits arising from loan relationships, derivative contracts or company distributions. See HMRC Draft Guidance. (1 May 2013). *The CFC Gateway – Chapter 3.*

a CFC, chapter six will apply. If the CFC is a group treasury company, it may give notice to the HMRC that this chapter will not apply and instead the profits are treated as non-trading finance profits.[151] 'In this instance the CFC will qualify for relief under chapter five (and chapter nine) on the basis of a finance company partial exception.'[152]

Chapter eight will result in a CFC charge where its business is that of a captive insurer written with UK members of the multinational group.[153] If profits of a CFC pass through the CFC charge they are the subject of a solo consolidation waiver[154] or they are subject to arrangements that have broadly equivalent regulatory effects.

6.3.6 *CFC rulings*

As discussed in 6.2.4 above, the HMRC does have a system of advance tax rulings. It specifically provides rulings (advice or clearances) on various aspects of the CFC legislation and whether they would apply to a UK company's subsidiary. The ruling will normally apply indefinitely and the HMRC will be bound by the ruling (provided all the facts are given). The clearance will be annually reviewed by the HMRC representative who will assist corporations in obtaining certainty in relation to its treatment of CFCs.[155]

Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p22.

151 See HMRC Draft Guidance. (1 May 2013). *The CFC Gateway – Chapter 3*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p23.

152 B.T.R. 2012, 4 454-462 p457.

153 See HMRC Draft Guidance. (16 May 2012). *Overview of CFC rules.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p5.

154 Solo consolidation is an arrangement whereby the UK Financial Services Authority allows a regulated financial company to treat an unregulated subsidiary for regulatory purposes as if it were a division of the regulated company. A company that wishes to solo consolidate must apply to the UK Financial Services Authority for a waiver. See HMRC Draft Guidance. (1 May 2013). *The CFC Gateway – Chapter 3.* Available at http://www.hmrc.gov.uk/drafts/cfc.htm, p25.

155 See HMRCDraft Guidance. (1 May 2013). *CFC Clearance – General*. Available at http://www.hmrc.gov.uk/drafts/cfc.htm.

6.3.7 *Conclusion*

The overhaul of the CFC legislation indicates the HMRC's willingness to make the UK a more attractive jurisdiction of choice for multinationals. As is apparent from the provisions, it is easily determinable whether a company will be exempt from the CFC charge by virtue of the CFC exemptions and control provisions. Only if a company falls within the specific CFC charge rules do the provisions become more complicated. However, in these instances, UK companies are encouraged to obtain rulings or clearances from the HMRC on the treatment of its CFCs.

6.4. The UK's treaty network

The UK has a treaty network with approximately 100 countries. According to the HMRC, 'the UK treaty policy has been to reduce withholding taxes on interest and royalties to zero wherever possible'.[156] The UK, with its commonwealth position, has a number of treaties with African jurisdictions. These include, Botswana, Egypt, Ghana, Gambia, Kenya, Lesotho, Libya, Malawi, Morocco, Namibia, Sierra Leone, South Africa, Sudan, Swaziland, Tunisia, Uganda, Zambia and Zimbabwe.[157]

Most notably, South Africa and Libya have a zero withholding tax rate in respect of interest and royalties. A reduced withholding tax rate of 10% also applies in Botswana, Lesotho, Morocco, Zambia and Zimbabwe in respect of interest and royalties. As mentioned above, the UK does not have any withholding tax on dividends.

The UK has also concluded approximately 104 bilateral investment treaties, of which 22 agreements have been concluded with African countries (including South Africa).[158] The

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156 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p11.

157 See IBFD. (2014). *United Kingdom - Treaty Withholding Rates Table, Quick Reference Tables.* Available from IBFD online database.

158 A full list of the Bilateral Investment Treaties concluded with the UK can be found on the website of the United Nations, available at http://unctad.org/Sections/dite_pcbb/docs/bits_uk.pdf.

UK, as a member of the European Community, is also a member to the EC Treaty.[159] 'The UK Bilateral Investment Treaties provide for non-discrimination standards and minimum standards of treatment for investments already in the UK. It further also provides for substantive and procedural relief.'[160]

6.5. The UK as a holding or headquarter company

The UK does not have a specific regime for holding or headquarter companies. However, the UK tax system contains several concessions which are beneficial for holding and headquarter companies.

As mentioned above, the HMRC's efforts have been towards making the UK more attractive for foreign investment, and as part of this effort are the new CFC rules which were once a deterrent for foreign investors.[161] Multinationals who intend setting up in the UK will also have the support of the 'HMRC's dedicated inward investment support team. The team will assist in addressing areas of uncertainty prior to establishing a UK presence.'[162]

As mentioned in Chapter 2, a pure holding company's function would be to hold and dispose of investments on behalf of the multinational group, whereas a headquarter company can have several roles. The key characteristics of a holding company and

159 Dr. James Harrison International Academy of Comparative Law. (2010) *XVIII International Congress of Comparative Law Washington 2010 Section IV. A: The Protection of Foreign Investment United Kingdom National Report*. Available at http://www.law.ed.ac.uk/includes/remote_people_profile/remote_staff_profile?sq_content_src=%2BdXJsPWh0dHAlM0ElMkYlMkZ3d3cyLmxhdy5lZC5hYy51ayUyRmZpbGVfZG93bmxvYWQlMkZwdWJsaWNhdGlvbnMlMkYxXzYyOF91bml0ZWRraW5nZG9tcmVwb3J0b250aGVwcm90ZWN0aW9ub2Zmb3JlLnBkZiZhbGw9MQ%3D%3D.

160 *Ibid*, p6-7.

161 See Legwaila, T. (2011). Tax impediments to holding company structures in Belgium Ireland and the United Kingdom: Caution for South Africa. *South African Law Journal,* vol. 128 issue 3, p553.

162 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p23.

headquarter company, compared with the UK tax regime, are tabulated below:

Ideal Headquarter Company	**UK Regime**	
Defer tax on operating income	Yes	√
Possibility to remit only exempt income	It may be possible for the UK holding company to remit interest and royalties free of withholding tax if the respective DTA provides. There is no withholding tax on dividends	X/√
No CGT	No, only exempt in certain circumstances	X
Foreign Tax Credits	Yes available in domestic law and treaty	√
No withholding tax	No, withholding tax on interest and royalties subject to DTA relief	√
Group tax system	Yes	X
Investment protection agreements	Yes	√

Ideal Holding Company	UK Regime	
Wide treaty network	Yes, 'multinationals moving to the UK are able to make use of a one-year exemption to allow any restructuring necessary for them to be able to take advantage of the other exemptions available to them.'[163]	√
Foreign Tax Credits	Yes available in domestic law and treaty	√
Low effective corporate tax rate	Yes, 20 %	√
No CGT on disposal of investments	Yes, subject to a 10 % shareholding requirement and 12 month holding period	√

163 *Ibid*.

Interest deductions	Yes, but the excess is ring-fenced	√
No dividends withholding tax	Yes	√
No tax on income received	No, fully taxed at 20 % (1 April 2015)	X
No CFC rules	Yes, exemptions apply and CFC rules amended	√
Tax rulings can be obtained	Yes, favourable ruling system. The HMRC will assist in agreeing on advanced pricing agreements with other tax authorities or agree unilaterally on advanced pricing. 'The HMRC is also available to offer a view on the risks associated with transfer pricing issues without a formal advanced pricing agreement.'[164]	√
Specific thin capitalisation rules	No, part of normal transfer pricing, must be at arm's length	X
Lack of exchange control	Yes	√

It is evident that the UK tax system would cater favourably to both headquarter and holding companies. With the introduction of the new CFC rules it is also unlikely that they will be applied to the headquarter or holding company. As stated above, the aim of the CFC rules is to protect against the artificial diversion of UK profits to overseas companies that are controlled from the UK and located in low tax jurisdictions. Since the holding/headquarter company will not perform a 'controlling' function and will most likely be in high tax jurisdictions, it is unlikely that these provisions will apply.

Specifically, in African jurisdictions where the corporate tax rate is generally between 30 and 35%, it is likely that the CFC high tax exemption will apply (since 75% of the corporate tax rate from 1 April 2015 will be 15%),[165] thus excluding the application of the

164 *Ibid*.

165 See Deloitte. (2014). *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm.

UK CFC rules.

In addition, where the group structure consists of an EU trading company wholly owning a UK holding/headquarter company that in turn owns the shares in an African resident company, beneficial tax treatment will result. The UK company will benefit from the EU parent/subsidiary directive resulting in no withholding taxes on payments of dividends to the UK company. The UK company, if a 'small company' and in a jurisdiction in a territory with a DTA containing a non-discrimination article, will be exempt from tax on dividends. In addition, no withholding taxes will be applied on dividends distributed to the African resident company. As mentioned above, it is unlikely that the African resident company will be a CFC of the UK holding company.

If the UK holding company disposed of its shares in the African resident company, no CGT will result by the UK company provided that the UK holding company is a trading company or member of a trading group, held at least 10% of the shares for at least 12 months in the African resident company, and the holding company is still a trading company or member of a trading group after the disposal of the shares.[166]

As a result, a favourable regime does exist in the UK. However, the next chapter will consider how the UK's regime compares with that of South Africa, and which jurisdiction, if any, should be preferred.

166 Dixcart. (November 2011). *The use of a UK Holding Company for entry into the EU, Information note 245.* Available at http://dixcart.com/articles/2011/11/24/in245-the-use-of-a-uk-holding-company-for-entry-into-the-eu.htm, p6.

CHAPTER 7. THE UK TAX SYSTEM COMPARED WITH THE SOUTH AFRICAN HEADQUARTER COMPANY PROVISIONS - WHICH IS BETTER AS A PLATFORM FOR INVESTMENT INTO AFRICA?

7.1. Introduction

This chapter will consider and evaluate whether the UK, as opposed to South Africa, would be better placed as a gateway for multinationals into Africa. As discussed in the previous chapters, South Africa with its ideal location re-introduced its headquarter company regime in order to make it an attractive headquarter company location into Africa. The UK in turn, has taken a broader view; focusing on making its overall tax regime more attractive, not just as a gateway into Africa, but also into the EU, for multinational headquarter and holding companies.

This chapter will compare the two regimes and conclude which is most efficient, through the use of practical scenarios. Firstly, by comparing the most efficient regime where an EU parent company wishes to set up headquarter facilities as a gateway into Africa; and secondly, where a non EU parent company (i.e. tax resident in another country) company wishes to set up headquarter facilities as a gateway into Africa.

7.2. EU parent company sets up headquarter operations as a gateway into Africa

7.2.1 *Start-up phase*

When the holding company is set up, from a language perspective, South Africa is no different to the UK, with the majority of business language being English. In addition, both have suitably efficient company registration procedures, thus the actual company registration process in both jurisdictions can be set up with ease.

However, South Africa would serve as a better geographical location. Although the UK is a short flight away from most countries in Africa, and the time zone does not differ substantially, in my view, South Africa with its inherent understanding of African culture and its people, would form the ideal geographical location for a holding company into Africa.

South Africa, unlike the UK, has a specific headquarter regime providing tax incentives to these types of companies. In order to qualify as a headquarter company in South Africa, a special election needs to be made[167] and certain criteria met (as discussed in Chapters 1-4), whereas the UK does not prescribe the kind of activities the headquarter companies may engage in.

In order to qualify for the South African headquarter regime, certain requirements have to be met. Namely, if the gross income of the company for that year of assessment exceeds R5 million, 50% or more of the gross income of the headquarter company to consist of amounts in the form of one or both of -

- Any rental, dividend, interest, royalty or service fee paid or payable by any qualifying foreign company[168], or
- Any proceeds from the disposal of any interest in the equity shares of the qualifying foreign subsidiary[169] or intellectual property licensed to the qualifying foreign subsidiary.[170]

This indirectly prescribes the kind of activities the South African headquarter company may engage in. However, it is submitted that if the headquarter company is in fact

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167 See S9I(1) of the Income Tax Act, 58 of 1962, as amended.

168 Qualifying foreign subsidiary means a foreign company in which the headquarter company holds (whether alone or together with any other company forming part of the same group of companies as that company) at least 10 % of the voting rights and equity shares.

169 Qualifying foreign subsidiary means a foreign company in which the headquarter company holds (whether alone or together with any other company forming part of the same group of companies as that company) at least 10 % of the voting rights and equity shares.

170 S9I(2)(c) of the Income Tax Act, 58 of 1962, as amended.

operating true to its form; it will nevertheless earn income from the abovementioned sources. It is further submitted that only large income earning headquarter companies are subject to this restriction. Accordingly, it appears that this in itself would not result in a deterring effect for investors.

South Africa and the UK both have a system of advanced rulings. From a South African perspective it is likely that the potential headquarter company is able to receive a ruling from the SARS that it would qualify as same. However, the UK has a more sophisticated ruling system catering for advanced pricing agreements and transfer pricing views. What is really beneficial is the HMRC's dedicated inward investment support team aimed at assisting multinationals in setting up its presence in the UK.[171] Comparatively, the UK's corporate tax rate of 20% is lower than South Africa's 28%, offering a further incentive for multinationals to set up their holding or headquarter operations in the UK.

7.2.2 *Operational phase*

Both South African and the UK have historically had complex CFC rules. By virtue of the South African headquarter regime, a headquarter company is exempt from the CFC rules,[172] and in Chapter 3[173] it was mentioned that this would not exclude the headquarter companies parent company from falling outside the CFC net (in other words, that the qualifying subsidiary's income be imputed). However, in most instances (and in the present instance) the parent company is a non-resident company which does not fall into the South African tax net.

On the other hand, the UK CFC rules will still need to be applied. As discussed in Chapter 6,[174] the UK holding company is able to obtain a ruling from the HMRC as to whether the provisions will apply. In addition, because it is likely that the corporate tax

171 UK Government (n.d.). A guide to UK taxation. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/183408/A_guide_to_UK_taxation.pdf, p23.

172 S9D(1) of the Income Tax Act, as amended.

173 At para 3.1.

174 At para 3.

rate of the respective African resident company will be between 30 and 35%, the CFC high tax exemption will apply. Since the incorporation of the UK holding company will be set up for a legitimate purpose (to facilitate the multinationals African business) and not to avoid UK tax, it unlikely that the CFC rules will be applied on this basis.

The South African headquarter company will be exempt from tax on any dividends received[175] from its EU parent company. However, depending on the specific EU jurisdiction, it may be subject to withholding taxes. In countries such as Spain, France, Italy and Malta, provided the minimum shareholding requirement is met (usually 10%) the withholding tax rate is reduced to 5% in terms of the relevant DTA.[176]

In the UK, the receipt of dividends may be exempt provided certain requirements are met (as discussed in Chapter 6). In addition, as part of the EU, the UK will benefit from the EU Parent/Subsidiary Directive, resulting in no withholding taxes when the EU parent company declares a dividend. The South African headquarter company will further be subject to income tax at the rate of 28% on all royalties and interest received. The UK company will similarly be subject to corporation tax at the rate of 20%.

As more fully discussed in Chapters 3 and 4, the South African headquarter company is able to deduct interest and royalties expenditure, subject to ring-fencing provisions. The UK holding company is similarly able to deduct its interest expenses (without limitation if not classified as a large worldwide group). Intellectual property may similarly be deducted.

The disposal of a qualifying subsidiary[177] by the South African headquarter company will not be subject to CGT.[178] However, should the anomaly arise where a subsidiary of a

175 S10(1)(k)(i) of the Income Tax Act, 58 of 1962, as amended.

176 IBFD. (2014). *South Africa -Treaty Withholding Rates Table, Quick Reference Tables*. Available at IBFD online database.

177 Qualifying foreign subsidiary means a foreign company in which the headquarter company holds (whether alone or together with any other company forming part of the same group of companies as that company) at least 10 % of the voting rights and equity shares.

178 Para 64B(2) of the Eighth Schedule to the Income Tax Act, 58 of 1962, as amended.

headquarter company is not 'qualified', it appears that CGT implications will result since the 10% shareholding requirement is absolute. Similarly, if the UK holding company disposes of its African resident company subsidiary, relief from CGT is available provided the minimum shareholding percentage and holding period is met.

The UK, unlike South Africa, provides for group relief which may be utilised to the EU parent company's advantage. In addition, no VAT relief is available in either jurisdiction. However, the VAT rate of 14 % in South Africa is lower than the UK's 20%.

7.2.3 *International aspects*

If the EU parent disposes of its shares in the holding company, it is unlikely that CGT will result if the company is a South African headquarter company.[179] Similarly, no CGT will result in the UK.

South African headquarter companies are further exempt from transfer pricing to the extent that they provide loans or intellectual property to its qualifying subsidiaries.[180] The UK, however, applies an arm's length rate between these transactions. As mentioned previously, the ability to provide low interest or interest-free loans to African subsidiaries is of critical importance in order to secure the success of the subsidiary. This is clear evidence that South Africa understands the commercial realities of doing business in Africa.

The UK does not have any exchange control restrictions. Notwithstanding South Africa's exchange control restrictions, a special dispensation applies to headquarter companies, treating them as non-residents for exchange control purposes.[181]

The South African headquarter regime also provides for an exemption from interest,

179 Refer to para 2(1)(b) of the Eighth Schedule to the Income Tax Act, 58 of 1962, as amended which limits the application of CGT to non-residents.

180 S31 of the Income Tax Act, 58 of 1962, as amended.

181 Circular 17/2012 dated 1 November 2012.

dividends, and royalties withholding tax.[182] The UK applies withholding tax on interest and royalties, but does not have a withholding tax on dividends. In addition, no withholding tax will be withheld on payments made to the EU subsidiary provided it holds 25% of the shares in the UK holding company.[183]

Accordingly, the UK holding company will have to rely on the reduction of withholding taxes by means of the respective DTAs. The UK has concluded over 100 DTAs; it has 19 treaties with African jurisdictions, namely, Botswana, Egypt, Ghana, Gambia, Kenya, Lesotho, Libya, Malawi, Morocco, Namibia, Sierra Leone, South Africa, Sudan, Swaziland, Tunisia, Uganda, Zambia and Zimbabwe. Accordingly, it has reduced withholding tax rates in most of Southern, Northern and West Africa. South Africa has concluded 73 DTAs; it has 18 treaties with other African jurisdictions, and is in the process of concluding further DTAs with Cameroon, Lesotho, Morocco and Senegal.[184] As a result, it is evident that the UK's DTA regime is a fierce competitor to that of South Africa's within the African context.

South Africa, similar to the UK, has bilateral investment agreements in place. However, the UK with 22 agreements in place in Africa, coupled with its stable economic and political environment, would seem more ideal from the perspective of investor protection. Until the Protection of Investment Bill[185] is assented to, the South African bilateral investment agreements are still in place and continue to apply.

7.3. Non-EU parent company sets up headquarter operations as a gateway into Africa

In the event that a non-EU parent company intends investing into Africa, the same considerations discussed above would apply. However, in the event that the parent

182 S49D(b), 50D(1)(a)(cc) and 64E(1) of the Income Tax Act, 58 of 1962, as amended.

183 In terms of the Interest and Royalties Directive.

184 Refer to SARS. (n.d.) *Summary of all Treaties for the Avoidance of Double Taxation*. Available at http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx.

185 2013, Notice 1083 No. 36995.

company makes payments to the respective holding company, it may now be subject to withholding tax. In addition, payments made by the UK holding company to the parent company will attract withholding taxes (excluding dividends and subject to DTA relief).

7.4. Comparable table between the two regimes

Set out below is a comparable table considering the tax implications discussed above, the items highlighted indicate a more favourable position in the respective jurisdiction.

	Parent Company South African Headquarter Company (Holdco) African subsidiary Company	Parent Company UK Company (Holdco) African subsidiary Company
Language	English	English
Company registration	Relatively simple	Relatively simple
Geographical location	More beneficial	Less beneficial
Special regime	Yes	No
No prescription on activities	To a certain extent	No
Advanced tax rulings	Yes	Yes, and more sophisticated
Low effective tax rate	28 %	20 %
Will the CFC rules apply	No	Unlikely, but will need to be considered
No tax on dividends received by Holdco	Yes	Depends
Parent company not subject to withholding tax on payments made to Holdco	Depends on parent	If EU parent, then no withholding tax
Holdco not subject to tax on interest, royalties and management fees	No, fully taxed at 28 %	No, fully taxed at 20 %
Holdco can deduct interest, royalties, intellectual property	Yes, but subject to ring fencing provisions	Yes

	Parent Company South African Headquarter Company (Holdco) African subsidiary Company	Parent Company UK Company (Holdco) African subsidiary Company
No CGT on the disposal of African subsidiary company	Yes	Yes, but must meet certain requirements
Group relief	No	Yes
VAT relief	No, but rate 14 %	No, rate 20 %
No CGT on the sale of Holdco's shares	Yes	Yes
Transfer pricing / thin cap restrictions on Holdco	No	Yes
Exchange control restrictions	Exempt, provided requirements are met	No
Holdco exempt from withholding tax on interest, royalties, dividends	Yes	No, but exempt if declared to EU parent which holds 25 % of Holdco
Holdco's DTAs in Africa	18, with more to be concluded	19
Holdco's bilateral investment agreements in Africa	Yes , but soon to be replaced with new domestic legislation	22

7.5. Conclusion

Upon review of the table above it is evident that there are minor differences between the South African headquarter company regime and the UK tax regime. The South African regime appears to be better placed as a gateway into Africa and is strongly competitive with the UK regime. The differing factor in my view would thus be commercial factors, as it should be, and (less likely) political factors; namely, whether that specific multinational has a historical presence in Europe and would prefer it to remain so, or whether it has a presence elsewhere which would result in the South African headquarter company being more beneficial.

In addition, the number and different African jurisdictions the multinational intends on doing business in could also be a determining factor, since the use of DTAs may be beneficial. For example, the UK has a DTA with Morocco, whereas South Africa does not. South Africa has a DTA with Nigeria and the UK does not. Accordingly, a multinational intending to enter into Nigeria would be best suited to set up headquarter operations in South Africa in order to benefit from the respective DTA (assuming the consideration is taken in a vacuum).

Ultimately, if South Africa's political economy remains strong and stable, it will prove a guiding force for investment into Africa.

CHAPTER 8. SUITABILITY OF OTHER JURISDICTIONS SUCH AS BOTSWANA AND THE NETHERLANDS

8.1. Introduction

As discussed in the previous chapters, South Africa is an ideal location for multinationals to enter into Africa. The new headquarter company regime, despite its initial teething problems, has proven optimal when compared with the UK tax system. However, perhaps another African jurisdiction would be equally or better suited as a gateway for multinationals into Africa. The tax regime in Botswana will be evaluated in order to consider whether Botswana, with its ideal location in Africa, would be equally or better suited than South Africa. In addition, the Netherlands is also characterised as being an ideal location for multinationals to set up headquarters.

Notwithstanding the various other jurisdictions such as Mauritius, Malta, Luxembourg etc., which have traditionally identified itself as ideal holding company locations, the Netherlands and Botswana regimes will be considered for the purpose of this chapter. In comparison with the latter jurisdictions, multinationals may make use of the Netherlands or Botswana, without being tainted through the use of 'tax havens'.

8.2. Botswana as a gateway into Africa

8.2.1 *Non-tax considerations*

Botswana, similar to South Africa, has a relatively stable political environment. According to the Botswana IFSC website, a combination of the spread of democracy, economic liberalisation, privatisation, infrastructure development, and the growth of consumer services and financial services groups positions Botswana as a strong and economically sound investment destination of choice.[186] Botswana also is recognised as being creditworthy; 'Moody's Investor Services changed its outlook rating from negative to stable'.[187] In additional, according to Amnesty International and the World Bank's report on doing business in Africa, Botswana is recognised as the least corrupt country in sub-Saharan Africa.[188] Further, with its ideal location in Africa, it has recognised its position and created a platform for multinationals to set up headquarters or holding operations in Botswana through its IFSC regime.

Established in 2003, the IFSC regime aims to establish Botswana as 'a world class hub for cross border financial and business services into the rest Africa'.[189] Since Botswana's economy has been predominately reliant on its mineral resources and is a land-locked country,[190] through the IFSC regime, it is able to stimulate investment into Botswana through other means. 'To date the Botswana IFSC has attracted world reputable companies regionally and internationally.'[191]

As a result, from a socio-economic perspective, Botswana appears an ideal location for multinationals to set up headquarters as a gateway into Africa.

8.2.2 *Tax system*

Botswana has a source based taxation system. Its tax system appears similar to that of

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186 Refer to the Botswana International Financial Service Centre website. Available at http://www.ifsc.co.bw/about_botswana.php.

187 Deloitte. (2014). *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm, p41.

188 *Ibid*, p42-43. According to the International Fiscal Service Centre Website, in terms of the 2008 corruption perceptions index, Botswana ranks first in Africa, and 38th in the world in terms of transparency. Available at http://www.botswanaifsc.com/other_benefits.php.

189 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/why_botswanaIFSC.php.

190 Refer to Oguttu, A. (2011). Developing South Africa as a gateway for foreign investment in Africa: A critique of South Africa's headquarter company regime. *South African Yearbook of International Law,* vol. 36 p70.

191 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/why_botswanaIFSC.php.

South Africa. Generally, multinationals are not restricted on the type of activities they are permitted to engage in Botswana. However, only certain businesses may be undertaken by Botswana nationals, for example -

- Supermarkets (excluding chain stores and franchise operations).
- Certain tourist operations (i.e. camping sites, including caravan sites, guest houses, and mobile and motorboat safaris).
- Certain government building projects (e.g. those involving an amount of up to BWP 150,000).[192]

Resident companies are subject to income tax at the rate of 22%, with a further 7.5% domestic withholding tax applied on dividends, resulting in an effective tax rate of 27.85%,[193] almost equivalent to South Africa's corporate income tax rate. In addition, unlike South Africa, Botswana does not have any CFC rules or exchange control.[194] It also does not have a formalised system of tax rulings. However, the BRS is able to provide non-binding opinions.[195]

Botswana applies a domestic withholding tax system. As stated above, dividends declared by Botswana resident companies to other companies (resident and non-resident) are subject to a 7.5% final withholding tax.[196] Interest paid to Botswana resident companies is subject to a withholding tax rate of 10%. A 3% withholding tax applies to payments made for construction services. Rental payments are also subject to a withholding tax rate of 5%. Other than the withholding tax on dividends, this is not a final

192 Refer to Amos, J. (2013). *Botswana - Business and Investment, Country Surveys.* Available at IBFD online database, p11.

193 Deloitte. (2014). *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm, p35.

194 Refer to Amos, J. (2013). *Botswana - Business and Investment, Country Surveys.* Available at IBFD online database, p14.

195 *Ibid*, p19.

196 S58(1)(a), para 2(1)(a) of the Seventh Schedule to the Botswana Income Tax Act CAP 52.01.

tax and can be used as a credit against the company's taxable income.[197]

Generally, 'the gross income of every person for each tax year shall be the total amount, whether in cash or otherwise, accrued or deemed to have accrued from every source situated or deemed to be situated in Botswana but shall not include any amount of a capital nature.'[198] This would include income received in the form of management fees, royalties, interest and dividends. Similar to South Africa, Botswana resident companies are able to deduct expenditure incurred for the purposes of trade.[199] Productive interest qualifies for deduction.[200] Payments made to non-residents in the form of royalties, management fees, or interest will also only qualify for deduction if a further requirement is met; namely, that proof of the withholding tax has been deducted and paid is provided to the BRS.[201]

Capital gains are included and taxed at the corporate tax rate of 22%. Capital gains or losses incurred as a result of the disposal of shares or debentures by Botswana resident companies are subject to tax.[202] In addition, any liquidation distributions made by the Botswana resident company will be subject to tax (other than amounts representing a return of capital).[203] 'Capital gains arising as a result of the disposal of shares will only be subject to tax on 75% of the amount. In addition, capital gains from shares which are listed on the Botswana Stock Exchange will be tax exempt if the seller holds at least 49% of the shares.'[204]

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197 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p12.

198 S9 to the Botswana Income Tax Act CAP 52.01.

199 S39(2) to the Botswana Income Tax Act CAP 52.01.

200 S41(1)(k) to the Botswana Income Tax Act CAP 52.01.

201 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p9; Deloitte. (2014). *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm, p38.

202 S35(1)(b) of the Botswana Income Tax Act CAP 52.01.

203 S35(2) of the Botswana Income Tax Act CAP 52.01.

204 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p12.

Similar to South Africa, capital losses may be offset against capital gains. Non-resident companies disposing of its shares in a Botswana resident company will similarly be subject to capital gains at the same rate as domestic companies (75% inclusive). Non-resident companies are subject to tax at the rate of 30% on Botswana source income.[205] Botswana also applies a VAT rate of 12% on taxable supplies made.[206] It does not have a group system of taxation.[207]

8.2.3 *International aspects*

Botswana does not have any specific transfer pricing or thin capitalisation rules. However, Botswana does have general anti-avoidance rules. In this regard, it provides that where a transaction,

> '… *is fictitious or artificial, or is entered into or carried out otherwise than as a transaction between independent persons dealing at arm's length and that such transaction has the effect of avoiding, reducing or postponing the liability to tax of any person for any tax year, the Commissioner may disregard such transaction for the purposes of th[is]e Act and determine the liability for the tax chargeable under th[is]e Act as if the transaction had not been entered into or carried out, or in such manner as in the circumstances he or the Commissioner deems appropriate to counteract such avoidance, reduction or postponement*.'[208]

There are also certain transactions which are deemed not to be concluded at arm's length; these include payments for management fees, royalties and contracts for the sale of goods if there is a relationship between the parties as contemplated in Section

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205 Refer to Deloitte. (2014.) *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm, p35 and also refer to s11 of the Botswana Income Tax Act CAP 52.01 for detailed source rules.

206 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p30.

207 Refer to Deloitte. (2014). *Guide to fiscal information, key economies in Africa 2013/2014.* Available at http://www.deloitte.com/view/en_ZA/za/services/taxservices/tax-publications/index.htm, p37.

208 S36(1) of the Botswana Income Tax Act CAP 52.01.

36(2).[209] Accordingly, these provisions indirectly create transfer pricing requirements for Botswana resident companies engaging in transactions with other companies (resident or non-resident).

In addition, transactions between so called 'close companies' are also regulated. A 'close company' is a private company resident in Botswana in which another company (together or with a group of companies) holds at least, or is the beneficiary of, 5% of the equity shares of the company, and either has the voting power or indirectly controls the company; or is a loan creditor.[210] Banks are excluded from the definition of loan creditor.[211]

Loans made by the 'close company' to a participator, not at arm's length, will be deemed to be a dividend, less any repayments of the loan if it is repaid in the same year of assessment.[212] In addition, if the rate of interest is not at arm's length, the BRS will deem the rate of interest and deem that amount to be received by the participating company. In addition, no deduction for the interest will be allowed.[213]

These provisions effectively similarly result in transfer pricing rules as regards interest on loans. Since the percentage shareholding is relatively low, it will apply to most transactions. In addition, these provisions appear more restrictive in that they include domestic transfer pricing rules between transactions with resident companies.

As discussed above, Botswana applies a domestic and 'international' rate of withholding tax. Other than dividends tax (discussed above), withholding tax on interest, royalties and management fees is applied at the rate of 15% (subject to DTA relief).[214] However, Botswana has only concluded 13 DTAs. It has concluded DTAs with six African

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209 Botswana Income Tax Act CAP 52.01.

210 Refer to S132 of the Botswana Income Tax Act CAP 52.01.

211 Refer to S132(3) of the Botswana Income Tax Act CAP 52.01.

212 S133(1) and s33(2) of the Botswana Income Tax Act CAP 52.01.

213 S134 of the Botswana Income Tax Act CAP 52.01.

214 Seventh Schedule to the Botswana Income Tax Act CAP 52.01.

jurisdictions; namely, Lesotho, Namibia, Mauritius, South Africa, Swaziland and Zimbabwe, in comparison with South Africa's 18, and 73 total concluded DTAs. However, the Botswana government is putting measures in place to increase its treaty network. Treaties with Malawi, Tanzania, and Zambia are awaiting ratification, and treaties with Angola, Nigeria, Kenya and Uganda are in the process of negotiation.[215] It has also concluded protection of investment treaties with 'Belgium and Luxembourg, China, Egypt, Germany, Ghana, Malaysia, Mauritius, Switzerland, the United States, and Zimbabwe.'[216]

In general, the Botswana tax system appears less optimal as a gateway into Africa. However, as stated above, with the introduction of the IFSC regime, Botswana appears competitive with South Africa.

8.2.4 *IFSC regime*

An IFSC company is one that is specifically granted a licence to operate as such in Botswana. An IFSC company is only permitted to engage in activities with non-resident companies, other IFSC companies, or specified collective investment undertakings. They are also restricted to the following activities:

- Banking and financing operations transacted in foreign currency.
- The broking and trading of securities denominated in foreign currency.
- Investment advice.
- Management and custodial functions in relation to collective investment schemes.
- Insurance and related activities.
- Registrars and transfer agency services.
- Exploitation of intellectual property.
- Development and supply of computer software for specific use.

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215 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/double_taxation_avoidance_treatnetwork.php.

216 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p13.

- Accounting and financial administration.
- Other operations that the Minister may declare by order from time to time to be approved financial operations.[217]

However, provisions must also be made for the inclusion of job creation for Botswana citizens.[218] According to the IFSC, its main objective is to target companies that operate across various sectors of the economy and have projects in several sub-Saharan countries, investment funds, insurance funds, and outsourcing functions such as call centre operations.[219]

IFSC companies will be subject to tax on their gross income, similar to normal resident companies.[220] IFSC companies are allowed to transact in any internationally recognised currency,[221] thus limiting foreign exchange fluctuations. However, foreign exchange gains and losses are included or deducted from the IFSC company's gross income.[222] IFSC companies are exempt from tax on dividends received from 'qualifying foreign participation.'[223] This phrase is defined in Section 2[224] where the IFSC company holds at least, whether directly or indirectly, 25% of the share capital or voting rights of a non-resident company. Disposals of property by an IFSC company are exempt from CGT.[225] In addition, the disposal of IFSC company shares is also exempt from CGT.[226]

IFSC companies are also entitled to deduct interest arising out of 'foreign debt' in terms

217 S138(7) of the of the Botswana Income Tax Act CAP 52.01.

218 S138(8) of the of the Botswana Income Tax Act CAP 52.01.

219 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/focus_sectors.php.

220 S139 of the of the Botswana Income Tax Act CAP 52.01.

221 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/other_benefits.php.

222 S140 of the of the Botswana Income Tax Act CAP 52.01.

223 Part II, xxxvii of the Second Schedule to Botswana Income Tax Act CAP 52.01.

224 Botswana Income Tax Act CAP 52.01.

225 S35(1)(d) of the Botswana Income Tax Act CAP 52.01.

226 Para 1(h) of the Tenth Schedule to the Botswana Income Tax Act CAP 52.01.

of an approved formula as set out in Section 141(1).[227] IFSC companies (other than banks) are required to maintain a debt to equity ratio of 3:1; any interest in excess of this ratio will be disallowed.[228] 'Foreign debt' is specifically defined in Section 141(3)[229] as debt owed to a non-resident company which has control,[230] whether directly or indirectly, over the IFSC company. IFSC companies are taxed at the rate of 15%,[231] and are also exempt from VAT.[232] Dividend, interest, royalties and management fees paid by an IFSC company to a non-resident are also exempt from withholding tax.[233]

IFSC companies are further able to utilise Botswana's DTA network, and in the absence of a DTA, 'where withholding tax is applied on the IFSC company, it is entitled to a tax credit of up to 15 %.'[234]

8.2.5 *Conclusion*

In relation to its location and socio economic criteria, Botswana is an ideal location for multinationals to set up headquarters. When compared with South Africa's headquarter company regime, the Botswana general tax regime does not prove as efficient. Although

227 Botswana Income Tax Act CAP 52.01.

228 S141(3) of the of the Botswana Income Tax Act CAP 52.01.

229 Botswana Income Tax Act CAP 52.01.

230 'Control' is defined in section 1 of the Botswana *Income Tax Act CAP 52.01*, as meaning where a person exercises, is able to exercise or is entitled to acquire control whether directly or indirectly, over the company's affairs and in particular if the person possesses or is entitled to acquire- (i) the greater part of the share capital of or voting rights in the company; (ii) such part of the share capital that would entitle them to the greater part of the distribution of all the income of the company; or (iii) such rights as would entitle the person to the greater part of the assets of the company upon winding up, or in any circumstances.

231 Eighth Schedule to the Botswana Income Tax Act CAP 52.01.

232 Refer to the Botswana International Financial Service Centre website. Available at http://www.botswanaifsc.com/sustainable_low_tax_environment.php.

233 Refer to Amos, J. (2013). *Botswana - Corporate Taxation, Country Surveys.* Available at IBFD online database, p18.

234 Oguttu, A. (2011). Developing South Africa as a gateway for foreign investment in Africa: A critique of South Africa's headquarter company regime. *South African Yearbook of International Law,* vol. 36 p71.

the rate of income tax is almost identical, and the absence of exchange control and CFC regulations is beneficial, Botswana's withholding tax system and CGT legislation is less competitive than South Africa's regime; specifically when considering that there is little opportunity to reduce the withholding tax rates by means of DTAs.

On the other hand, the IFSC regime provides a competitive alternative to the South African headquarter company regime. With an effective tax rate of 15%, the only drawback of this regime is that it is limited to certain kinds of activities, whereas the South African headquarter company regime is less restrictive. Notwithstanding this, should a company already engage in the prescribed IFSC activities, it would be well placed to make use of the IFSC regime and thus utilise Botswana as its holding company location.

The concessions applied to IFSC companies are similar to that of the South African headquarter companies; namely that interest deductions are available, and no CGT will result on the disposal of its shares or on the disposal of its subsidiaries. Dividends received are generally exempt from tax and there is no withholding tax on the payment of dividends, royalties and management fees to non-residents. In addition, IFSC companies have the added advantage of being exempt from VAT, which potentially creates a significant tax and cash flow benefit.

On the other hand, it appears that IFSC companies are still subject to the overall anti-avoidance provisions in Section 36;[235] thus they are subject to restrictions on the provision of debt (in addition to the 3:1 debt to equity ratio) and intellectual property to its subsidiaries (resident and non-resident). Companies thus wishing to make use of the IFSC provisions would have to be cognisant of the advantages and disadvantages of utilising this regime. However, it has clearly proven to be a competitive alternative to the South African headquarter company regime.

235 Botswana Income Tax Act CAP 52.01.

8.3. The Netherlands as a gateway into Africa

8.3.1 *Non-tax considerations*

The Netherlands is commonly used as a holding company location, specifically because of its location in Europe. It also has a stable political environment; 'the Netherlands is ranked 26 out of 181 economies in terms of ease of doing business'.[236] Similar to Botswana, it has a small domestic market, and as a result the 'government is pro-business and seeks to grow its financial service sector.'[237]

The Netherlands has identified its tax regime to be beneficial as a holding company location for business activities in Europe and it is committed to remaining as such. 'Last year the Ministry of Economic Affairs, Agriculture and Innovation appointed a specific headquarters team',[238] thus strengthening its commitment as an ideal holding company location. It will be considered whether the Netherlands will be advantageous as a gateway for holding or headquarter operations into Africa.

8.3.2 *Tax system*

The Netherlands does not have a specific regime for holding or headquarter companies. It applies a source-based system of taxation and has a 'corporate income tax rate of 20% on the profits up to EUR 200,000 and 25% the amount above'.[239] The Netherlands also does not have any CFC rules, nor does it have any restrictions on activities. Generally dividends received by a Netherlands' resident company are subject to tax. However,

236 Legwaila, T. (2012). Taxation of Holding Companies in the Netherlands: A South African Observation. *Obiter,* vol. 33 p2.

237 Grant Thornton. (n.d.). A guide to business relocation in Europe available at http://www.grant-thornton.ch/files/gti%20business%20relocation%20a5%20f.pdf, p41.

238 Gerritsen, R. & Kuipers, I. (2012). *Netherlands: The advantages of a Dutch holding company.* Available at http://www.internationaltaxreview.com/Article/3068219/Netherlands-The-advantages-of-a-Dutch-holding-company.html.

239 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p10.

dividends are exempt if the 'participation exemption' applies.

The 'participation exemption' will apply if the Netherlands resident company owns at least 5% of the nominal paid up capital of the subsidiary or its voting rights, if the subsidiary is a member of the EU, and the DTA with that state provides for a reduction of the dividend withholding tax on the basis of voting rights. The shares must also not be held as trading stock.[240] If the subsidiary is a Netherlands non-resident, additional requirements must be met in order for the 'participation exemption' to apply; namely, it must be subject to tax in its jurisdiction.[241] The 'participation exemption' also applies to deemed dividends and distributions received as a result of so called 'hybrid-equity instruments.'[242] However, interest, royalties and management fees received by the Netherlands resident company will be fully taxable.

Interest expenditure is generally fully deductible. As from 1 January 2013 thin capitalisation rules were abolished in the Netherlands.[243] With effect from 1 January 2013 transactions are subject to the general anti-avoidance provisions. Capital gains are included and taxed as part of normal income.

If the 'participation exemption' applies, capital gains are exempt from tax.[244] If a non-resident shareholder disposes of its shares in the Netherland resident company, CGT is payable at the normal corporate income tax rate if the shareholder holds the shares as trading stock.[245] It will also be subject to CGT if the main objective of the shareholding

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240 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p15.

241 Legwaila, T. (2012). Taxation of Holding Companies in the Netherlands: A South African Observation. *Obiter,* vol. 33 p17.

242 *Ibid*, p13.

243 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p24.

244 Legwaila, T. (2012). Taxation of Holding Companies in the Netherlands: A South African Observation. *Obiter,* vol. 33 p13.

245 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p21.

is to avoid paying tax.[246]

The Netherlands also has transfer pricing. If transactions between connected parties are not at arm's length, the revenue authorities will deem the amount to be a non-deductible distribution, which may also be subject to dividends withholding tax.[247] However, the Netherlands Revenue Authorities are able to provide rulings on applicable transfer prices. Rulings are also provided in respect of holding companies and future transactions. Thus a potential multinational is able to receive a ruling on the application of the 'participation exemption'.[248] Similar to South Africa, the rulings are only binding between the revenue authorities and a specific taxpayer, based on specific factors.

Generally dividends distributed to non-residents are subject to withholding tax at the rate of 15% (and may be reduced by a DTA). However, as a member of the EU, Netherlands' resident companies are able to benefit from the Parent/Subsidiary Directive[249] and dividends can be declared free of withholding tax provided the shareholder is subject to tax in its jurisdiction and holds at least 5% of the voting rights or shares in the Netherlands subsidiary.[250] However, even in the absence of the Parent/Subsidiary Directive, many of the Netherland DTAs provide for a reduced withholding tax on dividends of zero.[251] Unfortunately, in relation to DTAs concluded with various African jurisdictions, only Egypt and Uganda have zero withholding tax rates for dividends.[252]

The Netherlands also does not apply any withholding tax on royalties and generally on

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246 *Ibid*.

247 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p24.

248 Legwaila, T. (2012). Taxation of Holding Companies in the Netherlands: A South African Observation. *Obiter,* vol. 33 p20.

249 (2011/96/EU).

250 Schellekens, M. (2013). *Netherlands - Corporate Taxation*, Country Surveys. Available at IBFD online database, p22.

251 IBFD. (2013). *Netherlands - Treaty Withholding Rates Table, Quick Reference Tables*. Available at IBFD online database.

252 For the reduced rate to apply to Egypt a 25% shareholding requirement must be met, for Uganda the percentage is 50. IBFD. (2013). *Netherlands - Treaty Withholding Rates Table, Quick Reference Tables*. Available at IBFD online database.

interest.[253]

Similar to the UK, the Netherlands have an extensive treaty network with approximately 96 treaties concluded. However, the Netherlands has only nine treaties concluded with African jurisdictions; namely, Egypt, Ghana, Malawi, Morocco, Nigeria, South Africa, Uganda, Zambia and Zimbabwe; less than the UK and South Africa.[254] In addition, it also has concluded approximately 100 bilateral investment treaties.[255] Unlike, Botswana, the Netherlands does not have any concessions in relation to VAT and transactions are subject to VAT at the rate of 21%. The Netherlands also does not have any exchange control regulations, thus capital is permitted to be freely remitted offshore.[256]

8.3.3 *Co-operatives*

A co-operative is another vehicle used in the Netherlands as a tax structuring mechanism. A co-operative allows for an exemption from dividends withholding tax and corporate income tax. However, since these structures were subject to abuse, anti-avoidance provisions exist prohibiting same. In a scenario involving an artificial transaction, dividends withholding tax will be applied.[257]

8.3.4 *Conclusion*

As a whole, the Netherlands tax regime is attractive as a holding company location. It

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253 IBFD. (2013). *Netherlands - Treaty Withholding Rates Table, Quick Reference Tables*. Available at IBFD online database.

254 Refer to IBFD. (2013). *Netherlands - Treaty Withholding Rates Table, Quick Reference Tables*. Available at IBFD online database.

255 Gerritsen, R. & Kuipers, I. (2012). *Netherlands: The advantages of a Dutch holding company*. Available at http://www.internationaltaxreview.com/Article/3068219/Netherlands-The-advantages-of-a-Dutch-holding-company.html.

256 Legwaila, T. (2012). Taxation of Holding Companies in the Netherlands: A South African Observation. *Obiter,* vol. 33 p10.

257 Gerritsen, R. & Kuipers, I. (2012). *Netherlands: The advantages of a Dutch holding company*. Available at http://www.internationaltaxreview.com/Article/3068219/Netherlands-The-advantages-of-a-Dutch-holding-company.html.

has a competitive corporate tax rate and provides for a low threshold in order for companies to benefit from the participation exemption, making the concessions easier to obtain. Specifically when coupled with the advantages of the EU Parent/Subsidiary Directive, the Netherlands is particularly attractive as a holding company within Europe (with the effect resulting in no CGT and dividends withholding taxes). Multinationals are also able to gain certainty on the applicability of the tax provisions through advance tax rulings.

However, with its limited DTAs concluded in Africa, it appears that the Netherlands is less appropriate as a holding company location as a gateway into Africa. Unlike South Africa and the UK, dividends withholding taxes will be applied, with limited opportunity to have the rates reduced in terms of a DTA. In addition, because of the application of transfer pricing, it is unlikely that any concessions will be able to be made to the African subsidiary, such as low interest loans or support services.

CHAPTER 9. PRACTICAL ANOMALIES WHEN DOING BUSINESS IN AFRICAN JURISDICTIONS

9.1. Introduction

With the increase of business activity into Africa, multinationals should be aware that entering into Africa equates to entering into undeveloped economies, legal and tax systems. There are often limited country tax and legal specialists available in the specific jurisdiction, which leads to a heavy reliance on external advisors (specifically South Africa) advising on a number of factors, including the optimisation of tax structuring.

When providing advice based on the applicable tax laws, the multinational should be aware that its practical application may not always coincide with the respective legal interpretation. This chapter will briefly consider some of these practical anomalies and commercial factors to consider when doing business in Africa.

9.2. Treaty application and deemed source

As mentioned above, often the respective legislation may prescribe the requirements in terms of a tax or company law. These provisions are interpreted by so called 'out of country' specialists. However, in many instances the provisions are not followed to the 'letter of the law'. This can have catastrophic results for the multinational that would have optimised its tax structuring based on the respective legal provisions. As a result, it is always advisable to obtain 'in country' specialist advice when engaging in business activity in a specific African jurisdiction.

A limiting factor to many multinationals entering into Africa, are that there are certain 'practical' rules applicable to non-resident companies prescribing that, in order to engage in activity in that specific jurisdiction, it incorporate/register a company there. This may create logistical and potentially adverse tax consequences, specifically if the multinationals' presence in that country is short-term, or it does not immediately have the resources to set up permanent operations there. From a tax planning perspective, the multinational may have taken into consideration permanent establishment exclusions which may have been applied. However, as a result of the prescribed practice, it no longer is able to utilise the various permanent establishment exclusions provided for by the respective DTA.

In addition, although several African jurisdictions have concluded DTAs, in many cases they interpret the source rules in contradiction to the DTA, resulting in the application of withholding tax on the amounts paid to the non-resident multinational. This is specifically relevant in the context of South Africa. For example, the African jurisdiction will deem income to be from a source within its Republic, whereas the respective DTA with South Africa will deem it to be from a source in South Africa. As a result, the South African non-resident company will be subject to withholding tax on the amount.

The South African company will also be denied a tax credit on the amount. In terms of Section 6 *quat,*[258] a rebate or deduction from foreign taxes on income will only be permitted in the case of income received from a source outside the Republic. Consequently, in terms of South African tax laws, if the DTA prescribes that the specific amount is of a South African source, notwithstanding the DTA, the African jurisdiction will deem it to be otherwise.

National Treasury attempted to remedy this anomaly through the introduction of Section 6 *quin.*[259] It acknowledged that this is a reality within African jurisdictions and realised the need to correct it in order to increase the attractiveness of the headquarter company regime. In this regard the Explanatory Memorandum states –

> '*A number of African jurisdictions impose withholding taxes in respect of services (especially management services) rendered abroad if funded by payments from their home jurisdictions. These withholding taxes are sometimes even imposed when tax treaties suggest that the practice should be otherwise. African imposition of these withholding taxes in respect of South African sourced services*

258 Income Tax Act, 58 of 1962, as amended.

259 Income Tax Act, 58 of 1962, as amended.

is no exception. The net result of these African withholding taxes is double taxation with little relief. While the South African position is theoretically correct, the practical implication of this position is adverse to South Africa's objective of becoming a regional financial centre. As long as this theoretically correct position is maintained, the only viable solution for regional operations is to shift their management location to a low-taxed or no-taxed location so as to avoid double taxation.'[260](emphasis added)

In this regard Section 6 *quin* provides that where services are rendered in South Africa to a non-resident and the amount is subject to withholding tax, irrespective of its source, the South African resident company will be entitled to rebate of the taxes paid. Although this is a welcome change, it only applies in limited circumstances of services rendered. It is submitted that in respect of other income received, this anomaly may nevertheless still result.

9.3. The concept of 'equity loans'

As discussed in Chapter 4, as a result of the commercial realities of doing business in Africa, often multinationals provide so called 'equity-loans' to their African subsidiaries. The characteristics of these loans are that they attract a low or no rate of interest, and the terms of the loan are quite long, thus making them akin to equity.

Often revenue authorities seek to tax these loans on the basis that an arm's length rate of interest is not applied, without actually considering the commercial reality that the respective African subsidiary would be unable to afford debt in an arm's length scenario and thus a comparable rate for transfer pricing cannot be applied. In addition, this form of funding is often crucial to the ability of the African subsidiary to remain operational. This is something that the South African National Treasury is aware of, thus the amendments to section 31[261] were introduced. In terms of this section, the transfer

260 SARS. (2011). *Draft Explanatory Memorandum to the Taxation Laws Amendment Bill 2011*. Available at http://www.sars.co.za/home.asp?pid=2631, p99.

261 Income Tax Act, 58 of 1962, as amended.

pricing provisions will not apply to so-called ‘equity loans’ provided certain characteristics are present.

This is an element which speaks to our revenue authorities’ understanding of the commercial realities of doing business in Africa, and can provide comfort to multinationals when using the South African headquarter regime as a platform to engage in business in Africa. This is an element that positively distinguishes South Africa from the UK tax regime.

9.4. Conclusion

As discussed above, there are additional considerations that need to be taken into account when doing business in African jurisdictions. Multinationals entering into Africa are thus advised to take proper advice when considering the various tax implications. It is evident that when considering which jurisdiction has their ‘finger on the pulse’ as regards the commercial realities in Africa, South Africa by far has the advantage.

CHAPTER 10. CONCLUSION

With the introduction of the South African headquarter company regime, it is evident that the South African government is committed to ensuring that South Africa is the jurisdiction of choice for multinationals to invest as a gateway into Africa. Although the initial headquarter company provisions were less efficient, it appears that through various amendments, the current provisions are competitive with other so called ‘holding company’ jurisdictions, such as the Netherlands, specifically when applied in the African context.

When considering the South African headquarter company provisions, it is evident that it should perhaps be better labelled as ‘holding’ company provisions. Notwithstanding, its label, the South African regime provides various tax concessions, most notably the absence of the CFC rules and transfer pricing provisions which are extremely beneficial. The relief from CGT on the disposal of the headquarter companies shares and for headquarter companies disposing of its ‘qualifying subsidiaries’ are also benefits. In addition, the absence of withholding taxes (dividends, interest and royalties) serves as the ideal element of a beneficial regime.

South Africa has also proven competitive in relation to the conclusion of DTAs. It has concluded approximately 73 DTAs, 18 of which are concluded with African jurisdictions, making its treaty network the most competitive in Africa and extremely competitive in the rest of the world.

When compared with a similar taxing jurisdiction similar to the UK, South Africa appears equally competitive. The UK has also identified its tax regime as an ideal holding or headquarter location for business activities into the rest of the world (and not only Africa). The UK has affirmed its commitment through the reduction of its corporate income tax rate, which will be reduced to 20% by April 2015. The overhaul of its CFC provisions have also proven to be advantageous since now it is unlikely that holding or headquarter companies would be subject to the CFC rules; specifically, when applied to Africa where the corporate income tax rate is high and it is most likely that the UK company will be exempt on the basis of the ‘high tax exemption’.

Further benefits to the UK's tax regime are the absence of exchange control and dividend withholding tax. In addition, as a result of the UK's historical presence in Africa, it too has an extensive DTA network in Africa. Upon closer inspection, it appears that concessions available to a UK resident company are similar to the South African headquarter company. Thus when multinationals are considering which jurisdiction to utilise, the non-tax consideration is essential. Elements such as commercial factors, industry experience, and understanding of the respective African market are essential.

When considering the non-tax considerations, it appears that the South African authorities have their 'finger on the pulse' as regards the practical realities in the respective African jurisdictions. Through the provision of concessions for 'equity loans' and tax rebates for services fees (through the instruction of section 6 *quin*), the South African authorities have demonstrated their commitment to make South Africa an attractive location for headquarter (or 'holding') companies. In addition, depending on the number and different African jurisdictions a multinational intends doing business in, a treaty network may also be a determining factor, since the use of DTAs may be beneficial. Thus, considering the combination of tax and non-tax considerations is essential.

When compared with other African jurisdictions, the Botswana IFSC regime appears competitive with the South African regime. Although several concessions apply, such as the absence of withholding tax and CGT, what makes this regime attractive and stands out from South Africa is its exemption from VAT. It is submitted that in order for the South African headquarter company regime to 'stay ahead of the curve', specific VAT concessions should be introduced for headquarter companies in order to exempt certain activities from VAT. This will prove extremely attractive for multinationals, since VAT often results in adverse cash flow implications.

However, compared with South Africa, the Botswana regime appears less attractive because of the few DTAs it has concluded. The IFSC regime is also only available to certain activities, thus restricting the multinationals' activities and use of the headquarter (or holding) company.

The 'traditional' use of a Netherlands holding company may also prove to be attractive when entering into African for business. However, although the Netherlands tax regime provides many positive concessions, specifically if making use of the 'participation exemption', this regime has traditionally been used as a successful holding company regime for business activities in the EU.

In considering the Netherlands as an ideal headquarter (or holding) company regime as a gateway into Africa, its DTA network is not substantial, and when compared with the UK (which does not apply any dividends withholding taxes) it appears to be better to utilise a UK holding company (if an EU company is required).

As a result, despite its initial teething problems, the South African headquarter company provisions have come a long way in providing useful, practical and commercial concessions for multinationals. When considering doing business in Africa, multinationals should consider whether the South African headquarter company provisions should be utilised, as opposed to other jurisdictions such as the Netherlands or the UK. Through the comparison of these jurisdictions, it is evident that South Africa may prove more efficient as a gateway into Africa. South Africa is committed to making itself attractive for this purpose, therefore multinationals can be assured that should the practicalities or commerciality in any African jurisdiction create a tax anomaly, the South African authorities will seek to remedy it within its own domestic legislation.

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