

Intermediary holding companies and group taxation

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OPSOMMING

Tussengangerhouermaatskappye en groepbelasting

'n Tussengangerhouermaatskappy (THM) is 'n maatskappy wat tussen 'n uiteindelige houermaatskappy en die bedrywende filiaalmaatskappye in 'n groep van maatskappye geplaas word. Die THM word bedryf op 'n internasionale vlak op so 'n wyse dat óf die houermaatskappy óf filiaalmaatskappye daarvan, óf beide, geleë is in 'n ander land as die land waarvan die THM 'n inwoner is. Die primêre funksies van die THM is om die bates van die groep maatskappye te verkry, te bestuur en te verhandel en om die strukturele buigbaarheid binne die maatskappye groep te vergemaklik. Normaalweg is maatskappye binne die groep onderworpe aan belasting in die lande waarin hulle inwoners is of waarin hulle besigheid bedryf en oor die algemeen word maatskappye in hulle individuele hoedanigheid belas. Groepbelasting is 'n afwyking van hierdie algemene beginsel. Dit omvat spesiale reëls wat van toepassing is op die lede van 'n groep van maatskappye in terme waarvan die groep breedweg geassimileer word vir belastingdoeleindes en belas word asof 'n enkele maatskappy of entiteit. Waar groepbelasting toegepas word, kan dit die gesamentlike belastingaanspreeklikheid van die groep wesenlik verminder in vergelyking met die normale geval waar die maatskappye binne die groep afsonderlik belas word. Hierdie artikel bespreek die aard en funksies van 'n THM, die drie tipes groepbelasting met verwysing na verskeie lande en die voordele wat groepbelasting inhou vir maatskappygroepe wat die THM gebruik.

1 Introduction

Tax liability usually ascribes to persons in their individual capacity. As a separate legal entity, a company's tax liability is separate from the tax liability of its shareholders regardless of whether those shareholders are individuals or other entities.¹ In addition, a company's tax liability is separate from the tax liabilities of other companies that are owned by the same shareholders. A system of group taxation is a deviation from this general principle.² It provides for the tax treatment of a company based on its relationship with its shareholders and other companies.³

This article analyses the tax benefits of group taxation on company groups where an intermediary holding company (an IHC) is incorporated

1 Burns and Krever "Taxation of Income from Business and Investment" 1998 *Tax Law Design and Drafting* Thuronyi (ed) 597.

2 Rohatgi *Basic International Taxation* (2005) 256.

3 *Idem* 597.

to provide the group with structural flexibility of the group's assets. At the outset, this article defines an IHC. This is followed by an outline of the system of group taxation and how group taxation would benefit the IHC group on the IHC's performance of its functions.

At present South Africa (SA) does not have a system of group taxation. The tax provisions applicable to company restructuring do, however, provide limited relief akin to group taxation.⁴ In addition, the idea of group taxation has been considered before in SA. In 1986 the Margo Commission⁵ recommended that group taxation should not be introduced in SA. Subsequently, in 1995 the Katz Commission⁶ recommended the adoption of a system of group taxation on a consolidation basis.⁷ Although the recommendations of the Katz Commission have not been implemented, they are part of authoritative literature that supports the introduction of group taxation for SA.⁸

2 Defining an Intermediary Holding Company

An IHC is a company that is interposed between one company and another, ideally an ultimate holding company and operating subsidiaries. Thus, it is both a subsidiary and a holding company in relation to different companies. Furthermore, it is generally a member of a group of companies and can be a head of a sub-group.⁹

2.1 An IHC as a company

An IHC is a company. It is a legal entity separate and distinct from its members. In most countries' legal systems a company derives its existence from statute.¹⁰ The capital of a company is divided into shares owned by shareholders. However, the company is the owner of its assets and the shareholders do not have proportionate property rights in the assets of the company. The capital of the company is raised by the issue of shares and the liability of the shareholders of a company is limited to the amount which each shareholder has paid for his or her shares.¹¹

4 The Income Tax Act 58 of 1962 ss 42–47 & 64B(5)(f).

5 Margo Commission Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa 1986.

6 Katz Commission Third Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa 1995 par 10.6.

7 A consolidation basis of group taxation is also referred to as fiscal unity. It aggregates the taxable incomes of the members of a group of companies. See the discussion in 3.2 *infra*.

8 See The Political Economy of Taxation www.sars.gov.za/Tools/Documents/Document_Download.asp?FileID; www.sabinet.co.za/abstracts/sabr/sabrv8n3a4.html (accessed 17 Sept 2009).

9 Olivier & Honiball *International Tax, A South African Perspective* (2008) 297

10 See IBFD *International Tax Glossary* (5ed) (2005) definition of "company".

11 As to the nature of a company see further *Salomon v Salomon & Co* 1897 AC 22; *Stellenbosch Farmers' Winery v Distillers Corporation* 1962 (1) SA 458 (A) 471F–473D; *S v De Jager* 1965 (2) SA 616 (A) 624H–625F; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 550–552, 556–557.

2.2 An IHC as a holding company and as a subsidiary

An IHC is a holding company of its underlying operating companies and at the same time a subsidiary of an ultimate holding company of a group of companies.¹² The definitions of “holding company” and “subsidiary” are interdependent and will therefore be discussed together.

A holding is a company which usually does not produce goods or services itself, rather its purpose is to own shares in other companies.¹³ It is a company that owns part, all, or a majority of other companies’ outstanding stock.¹⁴ Thus in essence, for a company to be a holding company it should own enough voting stock in another company to control management and operations by influencing or electing its Board of Directors. Such a company is literally a super corporation which owns or at least controls, such a dominant interest in one or more other corporations that the super corporation is enabled to dictate the policies of those companies through voting power.¹⁵

In the SA context, “holding company” is not directly defined for purposes of the corporate law. The Income Tax Act¹⁶ (the Act) also does not define holding and subsidiary companies. The Companies Act¹⁷ defines a holding company by stating that “a company shall be deemed to be a holding company of another company if that other company is its subsidiary”.¹⁸ In terms of the new Companies Bill¹⁹ a holding company is defined as “in relation to a subsidiary, means a juristic person or undertaking that controls that subsidiary”.²⁰ In terms of both these provisions, it is, therefore, the definition of “subsidiary” that determines what constitutes a holding company.

The definition of “subsidiary” and “holding company” are premised on the control that the holding company has over the subsidiary. A holding company is basically “a company that holds the controlling shares in one or more companies so that they form part of the same group of companies”.²¹ The definition of “subsidiary” in the Companies Act 2008 is substantially a replica of the definition in the 1973 Companies Act.

A company is a subsidiary of another if that other company is a member of the first-mentioned company and satisfies one of the following requirements:

- holds a majority of the general voting rights in it;

12 Olivier & Honiball 297.

13 IBFD International Tax Glossary.

14 See Connell “Holding companies to account: The expense apportionment conundrum” 2004 *SALJ* 119–127.

15 http://www.trueblueauctions.com/Auction_Terms.html (accessed 17 Sept 2009).

16 Income Tax Act 58 of 1962.

17 The Companies Act 61 of 1973 (The Companies Act 1973).

18 The Companies Act 1973 s 4(1).

19 The new Companies Act 31 of 2008 (The new Companies Bill).

20 Companies Bill s 1. For a further discussion on the nature of a holding and subsidiary relationship in terms of the Companies Act 31 see Delpont *The New Companies Act Manual* (2009) 67–70.

21 Olivier & Honiball 297.

- has the right to appoint or remove directors holding a majority of the voting rights at meetings of the Board; or
- has the sole control of a majority of the voting rights in it, whether pursuant to an agreement with other members or otherwise.²²

Where these rights are held by subsidiaries of another company, or by that other company together with its subsidiaries, such holding makes the company in which these rights or interests are held a subsidiary of that other company.²³ A company is also a subsidiary of another company if it is a subsidiary of that other company's subsidiary.²⁴

A subsidiary is an entity controlled by another entity. "Control" is the power to control the financial and operating policy of an entity in order to benefit from the activities of that entity.²⁵ Control exists when one entity owns, directly or indirectly, more than half of the voting power of another entity unless it can be clearly demonstrated that such ownership does not constitute control.²⁶

The additional characteristics of "the power to control the financial and operating policy of an entity in order to benefit from the activities of that other entity" is central to the essence of a holding and subsidiary relationship.²⁷ In this regard it is noted that benefit is not limited to financial benefit. The holding company may also strategically direct the operations of its subsidiaries or the group.²⁸

Often the holding and subsidiary relationship results in the relevant companies forming a group of companies. Conversely, often companies have to be in a group of companies to have a proper holding and subsidiary relationship.²⁹

2 2 1 Groups of Companies

There is a distinction between companies which belong to a group of companies and which hold significant shareholdings in other companies, and those which hold a diversified portfolio of shares for a group of investors, that is portfolio holding companies.³⁰ The former case is an example of a company group situation. A group of companies consists of at least one subsidiary company and its holding company or, at least two subsidiaries of the same holding company.³¹ The extent of the shareholding

22 The Companies Act 1973 s 1(3)(a)(i); the new Companies Act 2008 s 3(1).

23 Companies Act 1973 s 1(3)(a)(iii).

24 Companies Act 1973 s 1(3)(a)(ii).

25 Kunst, Delpont & Vorster *Henochsberg on the Companies Act* (2008) 14.

26 See Kunst, Delpont & Vorster 14.

27 See Kunst, Delpont & Vorster 14. See also Haydock "The effect of the amendments to the definition of a subsidiary in the Companies Amendment Act 82 of 1992" 1993 *SA Merc LJ* 166–180.

28 Olivier & Honiball 297.

29 Cilliers *et al Corporate Law* (2000) 433–437.

30 IBFD International Tax Glossary.

31 See "Glossary of Terms" <http://www.veoliaenvironmentalservices.co.uk/pages/pack-glossary.asp> (accessed 17 Sept 2009).

to constitute a group is determined by national corporate and tax laws. Typically the required shareholding to constitute a group of companies should be at least fifty percent.³²

In some countries, the definitions of “holding company” require that the holding company together with its subsidiary should form a group of companies.³³ SA law does not have such a requirement. However, where companies form a group of companies in terms of the Act, these companies would have a holding and subsidiary relationship.³⁴

For SA income tax purposes a group of companies is defined in the Act as follows:³⁵

group of companies” means two or more companies in which one company (hereinafter referred to as the “controlling group company”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “controlled group company”), to the extent that—

- (a) at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
- (b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;

A distinction must be made between a holding and subsidiary relationship and a parent and branch relationship. Whereas a subsidiary is a separate legal entity in its own right, a branch is an extension of its parent company.³⁶ It is a part or division of the parent company.³⁷ They are one legal entity.³⁸ When a company does business through a branch, the company is subject to tax on the profits of the branch wheresoever the branch may be located.³⁹ The company may also be taxable in the country where the branch is located based on the source rules.⁴⁰ The IHC takes the form of a subsidiary company and not a branch of another company.

32 Sasfin *Who Owns Whom's Dictionary of Stock Market Terms* (2001) definition of “holding company”.

33 Eg United Kingdom “Holding Company Formation” <http://www.coddan-legal-service.com/holding-companies-formation.html> (accessed 22 September 2010) and Saudi Arabia <http://www.saudisearch.com/dir/saudi-holding-companies> (accessed 22 September 2010); <http://www.araboo.com/dir/uae-holding-companies> (accessed 22 September 2010).

34 The Act s 1.

35 *Ibid.*

36 Olivier & Honiball 571; “Foreign Branch Registration options in Hong Kong” <http://www.guidemehongkong.com/company/c748-hong-kong-branch-options.htm> (accessed 22 September 2010); IBFD International Tax Glossary definition of “Branch”; “Set up a Branch in Romania” <http://www.rolegal.com/company-branch-romania.html> (accessed 22 September 2010).

37 Olivier & Honiball 571; “Foreign Branch Registration options in Hong Kong”.

38 *Ibid.*

39 Olivier & Honiball 571; “Foreign Branch Registration options in Hong Kong” IBFD International Tax Glossary definition of “Branch”; “Set up a Branch in Romania”.

40 See the OECD Model Convention and the commentaries in respect thereof arts 5 & 7.

2.3 The intermediary nature of an IHC

An IHC is a company that is interposed between two companies. It is therefore a subsidiary of one company and a holding company of another company. By its nature, an IHC cannot be an ultimate holding company.⁴¹ At least one of the companies between which it is interposed should be located in a jurisdiction other than that of the IHC itself.⁴²

“Intermediary” holding companies are often interchangeably referred to as “intermediate” holding companies. In this article these companies are systematically referred to as “intermediary holding companies”. The distinction between “intermediary” and “intermediate” might be insignificant in common parlance, however, for the purpose of this article the correct reference is more important than in everyday usage. “Intermediate” used as an adjective is more akin to the interposition of an object between two points or objects. The Collins Concise Dictionary defines “intermediate” as “occurring or situated between two points, extremes, places, etc; in between”. Intransitively, it is to act as an intermediary or mediator.

“Intermediary” is more akin to the person that is positioned between two points and acts as a mediator. The Collins Concise Dictionary defines “intermediary” as “a person who acts as a mediator or agent between the parties”. The Oxford Advanced Learner’s Dictionary⁴³ defines “intermediary” as “a person or organization that helps other people or organizations to make an agreement by being a means of communication between them”. Thus, the term “intermediary” as a noun emphasises both the entity and its functions. Therefore, whilst it might not be fundamentally wrong to refer to such a company as “intermediate”, it is more accurate and precise to use the word “intermediary”.

Olivier and Honiball also use the term “intermediary holding company”, a term they consider to be wider than “offshore holding company” as an offshore holding company is seen as a holding company located in a tax haven.⁴⁴ The IHC would generally be resident outside the country of the ultimate holding company, but in the same country as the operating companies.⁴⁵ This gives the ultimate investor a single management and access point to the investment in the operating subsidiaries.

2.4 General functions of a holding company

The decision to establish a holding company is generally motivated by business acumen.⁴⁶ A holding company can provide a means to own and manage a group of affiliates or subsidiaries in a particular region.⁴⁷ The

41 Olivier & Honiball 297.

42 *Ibid.*

43 *Hornby Oxford Advanced Learner’s Dictionary of Current English* (7ed) (2006).

44 Olivier & Honiball (2008) 297.

45 *Ibid.*

46 “Why do People set up a Holding Company” http://www.linkedin.com/answers/startups-small-businesses/starting-up/STR_STP/427138-32845514 (accessed 16 Sept 2010).

47 Olivier & Honiball 297.

holding company can also result in operational and financial efficiencies, in particular when bundled with other business functions, including broader regional headquarter and management functions, group shared services, financing, cash management, and/or intellectual property ownership and management.⁴⁸ The reasons often cited for the formation of a holding company include:⁴⁹

- the desire to consolidate the company's current (and future) foreign subsidiaries under one foreign holding company structure for management and reporting purposes;
- the creation of a platform for future business acquisitions, joint ventures and other business opportunities;
- to act as a gateway for growth and expanding business operations in new markets and regions; increased financial flexibility and the creation of an efficient vehicle for the redeployment of cash among foreign operations, thereby facilitating the use of internal funding of operations and expansion;
- improved treasury efficiency and financial risk management, by permitting foreign cash, foreign currency receipts and disbursements, and inter-company loans and other transactions to be consolidated, netted and managed within the holding and financing structure;
- facilitation of raising capital offshore thereby enhancing the enterprise's capital structure;
- positioning the company to more effectively reduce foreign income taxes through, for example, internal financing and leveraging;
- to better manage and exploit intellectual property;
- enabling access to the European Community Directives and/or tax treaty networks reducing withholding taxes on dividend, interest and royalty flows; and
- facilitation of the preparation of a sub-consolidation of the combined foreign operations of the company for financial reporting purposes.

2.5 Specific functions of an IHC

The primary functions of an IHC are limited and focused as opposed to those of holding companies in general. The primary functions of an IHC are to acquire, manage and sell investments in group companies, mainly its subsidiaries and, in general, to provide transactional and organisational flexibility in a group of companies.⁵⁰ In the context of a group's business, an IHC in an appropriate jurisdiction enhances the group's transactional flexibility and assists in establishing a robust offshore group structure.⁵¹

48 See Cornell 2004 *SALJ* 119–127. See also "Introduction to Holding Activities" http://online2.ibfd.org/collections/hold/html/hold_introduction.html (accessed on 22 Sept 2009) par 1.1.

49 "Introduction to Holding Activities" par 1.1.

50 The basis of the discussion on the functions of an IHC emanates from a discussion on this topic with Mr Serge de Reus, Partner/Director of Corporate International Tax at PricewaterhouseCoopers Inc. on 19 September 2008 in Sunninghill, Johannesburg.

51 Organisational flexibility provides companies with the ability to restructure their business models when the need arises. As Stuffer & Hiller explain "[d]ecreasing

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These functions are not tax related. The tax is an element that is considered and provided for in order to ensure that it does not make the achievement of the group's economic purpose more expensive than it should be. As a result, in practice, the decision to form an IHC is made by the financial managers as opposed to tax managers.⁵²

Enhanced flexibility within a group caters for acquisitions, re-organisations, disposals, offshore listing, reducing the impact of exchange control rules and free flow of funds. As an addition to these benefits, the IHC can also offer a maximisation of after-tax fund flows. However, it should be noted that the goals of the group may necessitate the interposition of an IHC even if that would result in an increased tax liability for the group. In this case the business and economic benefits of interposing an IHC would be weighed against the additional tax liability. Depending on the specific functions required to be performed by the IHC, it is often beneficial to the group to incorporate the IHC in a jurisdiction where the operations of the group take place.⁵³

Generally, IHCs are not engaged in commercial trade or business.⁵⁴ Where their functions are extended, they would normally be for the purposes of reinvesting excess dividends at the level of the IHC to obviate the need to remit the dividends to the ultimate holding company or shareholders, where such action has tax and exchange control disadvantages.⁵⁵

3 Group Taxation

3 1 Introduction

Perhaps one of the main tax reasons why an investor would form an IHC in a particular country is the fact that the tax systems of certain jurisdictions allow a group of companies to be taxed as one unit, thereby allowing the trade of losses or income. This is premised upon the fact that losses in tax are of great use in reducing tax liability. The investor chooses the location of the IHC by considering this alongside other tax and non-tax motivations for the establishment of an IHC.

Group taxation is classifiable into three forms: Fiscal unity, group contribution or group relief. These general references can lead to an inaccurate classification as the terms are often used to refer to group

transportation costs and briefer innovation cycles, changing customer demands as well as an increasingly competitive environment in hand with the encroachment of competitors located in low-cost countries are only some examples of factors that give rise to the decision to undertake business restructuring" (Stuffer & Hiller "Introduction – Drivers of Business Restructuring" in Bakker (ed) 2009 *Transfer Pricing and Business Restructurings* 3).

52 Discussion with Mr Serge de Reus.

53 *Ibid.*

54 Olivier & Honiball 297.

55 *Ibid.*

taxation in general as opposed to being used as descriptive of the nature of the particular group taxation system.⁵⁶

Group taxation comprises special rules that are applicable to members of a group of companies which is broadly assimilated for tax purposes to a single company or entity.⁵⁷ This assimilation is expounded by an adoption of special rules used to offset the losses and profits of companies within a group. These provisions avoid the need to operate as a single legal entity with divisions or branches for tax purposes. In order to further neutralise the taxation within the group of companies, the gain on transfer of capital assets is ignored and only accounted for in the tax system when the assets are transferred to persons who do not form part of that group.⁵⁸

Most countries that apply group taxation provisions allow tax consolidation for resident companies. For example,

Finland,⁵⁹ the Netherlands⁶⁰ and the UK.⁶¹ However, some countries offer world-wide tax consolidation, for example Austria,⁶² Denmark,⁶³ Italy⁶⁴ and France.⁶⁵ Non-resident companies could be taken into account when determining whether companies form a group of companies without providing such non resident companies with any tax benefits arising from the group taxation system.⁶⁶ In this regard, subsidiaries of an IHC located in a single country that provides for group taxation would benefit from the applicable group taxation treatment.⁶⁷

Where the group of companies consists of companies that are not resident in the country which grants group taxation, the non residence of such companies may result in three different group tax outcomes for

56 Eg Finland, Norway and Sweden refer to it as "group consolidation". The UK and Ireland refer to it as "group relief" and Denmark as "joint taxation".

57 IBFD International Tax Glossary definition of "group treatment".

58 Rohatgi *Basic International Taxation* (2005) 256.

59 See 3.5.2.a *infra*. See also Snellman (2009) An Overview of Corporate Tax in Finland http://www.linexlegal.com/content.php?content_id=83182 (accessed 18 Sept 2009).

60 See 3.5.2.a *infra*. See also Kavelaars & Willeme (2008) Netherlands Tax Alert – Fiscal Unity Rules on Cross-border Group Taxation referred to ECJ http://www.deloitte.com/view/en_GX/global/services/tax/internationaltax/article/bf91ebf4c52fb110VgnVCM100000ba42f00aRCRD.htm (accessed 18 Sept 2009).

61 See 3.5.3.a *infra*.

62 See 3.5.1.b *infra*. See also Austrian Holding Companies <http://www.lowtax.net/lowtax/html/offon/austria/austriahold.html> (accessed 18 Sept 2009).

63 See Smith (2008) Group Taxation in Denmark http://www.equinox.eu/pdfs/GROUP_Taxation_in_Denmark.pdf (accessed 18 Sept 2009).

64 Gianni, Origoni, Grippo & Partners (2003) Italy: How company groups are taxed in Italy <http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=12608&SID=469849&TYPE=20> (accessed 18 Sept 2009).

65 Wiman "Equalising the income tax burden in group of companies" (2000) *Intertax* 352–359; Jasmon & Shaikh "Developments and new ideas in the group relief framework" (2002) *Asia-Pacific Tax Bulletin* 334–339.

66 Rohatgi 256.

67 *Ibid.*

resident companies in the group.⁶⁸ Firstly, non resident companies can be considered in order to determine whether companies form a group. For example, if a non-resident company owns numerous subsidiaries that are resident in the group taxation jurisdiction, such subsidiaries could be seen to be a group regardless of the fact that their common holding company is not resident.⁶⁹ In this case group taxation would apply to subsidiaries and not to the holding company. The holding company's purpose would be to make the subsidiaries a group.⁷⁰

Secondly, a non resident holding company could be ignored when determining whether a group exists, resulting in subsidiaries failing to pass the group tax primarily due to the fact that the holding company is not resident. Thirdly, a non-resident holding company could be considered to both enable subsidiaries to constitute a group and in order for the holding company to benefit from group taxation on its income that is sourced in the group taxation jurisdiction.

3.2 Fiscal unity system

Under this system the company group is treated as a single business entity for tax purposes. This system recognises the companies as a single business undertaking of a single or group of shareholders divided into separate business units for corporate law and governance purposes. The group pools the profits and losses of the group members and files a joint and consolidated tax return.⁷¹

According to Rohatgi “[g]enerally the losses incurred before the consolidation period by a company are not applied to offset joint profits within the tax group. However, such losses may be carried over by the particular company for offset against its own future profits”.⁷²

There are variations as to the treatment of gains and losses. For example, the fiscal unity option in Luxembourg does not lead to taxation of the group on its consolidated profits:

Rather, the tax base of each of the members of the fiscal group is calculated separately and includes transactions between members of the fiscal unity, which should be carried on under commercial conditions. Subsequently, the individually computed tax base of each member is added up and taxed at the level of the parent company.⁷³

68 See section 1 of the 1973 Companies Act definition of “subsidiary” read with section 1 of the 1973 Companies Act definition of “holding company”; section 1 of the 1973 Act definition of “group of companies”; section 41 of the 1973 Act definition of “holding company” and section 10 of the Foreign Acquisitions and Takeovers Act of 1975.

69 *Ibid.*

70 *Ibid.*

71 *Ibid.*

72 *Idem* 256–257.

73 “Inconsistency of Luxembourg Fiscal Unity Rules with Tax Treaties and EU Law” http://www.ey.com/GLOBAL/content.nsf/Luxembourg_E/Inconsistency_of_Luxembourg_fiscal_unity_rules_with_tax_treaties_and_EUaw (accessed 8 September 2009).

The benefits of a fiscal unity system include:⁷⁴

- A determination of consolidated tax statements on the basis of current rules. In this regard, an application of homogeneous calculation rules favoured by application to all subsidiaries in a group makes group taxation procedures easier and more accurate;
- Creation of a system of audits protecting the parent company or organisation in relation to joint liability for the fiscal data of the entities included in the consolidation area; and
- A reliable assessment of the tax benefits of including an entity or a number of entities in the consolidation area.

3.3 Group contribution system

Also referred to as the intra-group contribution system, this system involves the contribution by profit-making companies in the group to one or more loss-making companies within the same group.⁷⁵ Contributions so transferred are tax-deductible for the paying company and taxable for the receiving companies.⁷⁶ Each company files its own tax return and pays its own taxes.⁷⁷

To the extent that the group contribution system is used to eliminate losses, it has the same economic effect as a group relief system described below.⁷⁸ The benefit of this system is generally that the profit-making companies reduce their taxable income by transferring some or all of it to loss-making companies.⁷⁹ The loss-making companies off-set the income against the losses made. Consequently, the tax on the group of companies is reduced.⁸⁰

3.4 Group relief system

This system is a reverse of the group contribution system. In the group relief system a loss-making company surrenders its current losses to the profitable companies in the group.⁸¹ The transferee company will then be

74 http://www.finconsgroup.com/Offers/ProprietarySolutions/Fiscal_Accounting.kl (accessed 22 Sept 2009).

75 Commission of the European Communities, Communication from the Commission to the Council, The European Parliament and the European Economic and Social Committee, Tax Treatment of Losses in Cross-Border Situations SEC (2006) 7.

76 *Ibid.*

77 *Ibid.*

78 See Commission for European Communities 7. See also Äimä & Kiikeri "Direct Tax Rules and the EU Fundamental Freedoms: Origin and Scope of the Problem; National and Community Responses and Solutions, Finland" (2006) 5 http://www.Fide2006.org/TOPC1/Tax_%20Kiikeri%20Finland.pdf (accessed 21 Sept 2009).

79 *Ibid.*

80 *Ibid.*

81 See Rohatgi 257. See also Payments for Loss Transfers under the Group Relief System — the GST Angle <http://www.lawgazette.com.sg/2003-8/Aug03-col.htm> (accessed 21 Sept 2009).

able to utilise the transferred losses to offset against its taxable profits.⁸² Each company files its own tax return and pays its own taxes.⁸³ The surrender of current losses can be done with a subvention payment or without such a payment.⁸⁴ A subvention payment is an inter-company payment specifically made for the transfer of company losses for trading or other reasons.⁸⁵

3 5 Country examples

In the discussion that follows different jurisdictions that apply the above systems are discussed. In each instance, two jurisdictions are briefly discussed. Firstly the basic form is discussed and then this discussion is followed by a discussion of one other jurisdiction whose system is similar but with variations in order to highlight the adjustments there are on the systems.

3 5 1 Fiscal Unity Systems

(a) The Netherlands

In the Netherlands, a holding company is allowed to file a consolidated tax return with its resident domestic subsidiaries under the fiscal unity (*fiscale eenheid*) rules.⁸⁶ Prior to 1 January 2003, it was required that for a holding company to submit a consolidated tax return it had to own at least ninety nine percent of the issued share capital of its subsidiaries throughout the accounting period.⁸⁷ This has since been reduced to ninety five percent with effect from 1 January 2003.⁸⁸ Fiscal unity treatment is optional.⁸⁹ The Ministry of Finance should approve the fiscal unity.⁹⁰ However, once it is granted it can be terminated at any time at the request of any of the group members.⁹¹

82 Rohatgi 257.

83 *Ibid.*

84 *Ibid.*

85 IBFD International Tax Glossary.

86 Rohatgi *Basic International Taxation* (2002) 191. Note: references to the First Edition (2002) of this book are made due to the fact that the Second Edition (2005) does not provide country examples for different forms of group taxation.

87 *Ibid.*

88 The 95% holding requirement is similar to the Luxembourg requirement. Further, the holding requirement "has to be fulfilled without interruption from the beginning of the first accounting year for which the fiscal unity is requested. An indirect participation of 95% will qualify if the shares of the subsidiary are held through entities that are treated as partnerships for Luxembourg corporate income tax purposes or through companies that are subject to a tax which corresponds to Luxembourg corporate income tax". "Inconsistency of Luxembourg Fiscal Unity Rules with Tax Treaties and EU Law" *supra* (accessed 23 Sept 2009).

89 "Doing Business in the Netherlands - Dutch Corporate Tax Regime" http://www.tax-consultants-international.com/read/Dutch_corporate_tax_regime (accessed 17 Sept 2009).

90 *Ibid.*

91 Rohatgi (2002) 191.

Fiscal unity is allowed for companies that are tax resident in the Netherlands, that is, companies that are effectively managed in the Netherlands.⁹² Fiscal unity would, therefore, include foreign incorporated subsidiaries which are tax resident in the Netherlands due to the place of effective management being located in the Netherlands. A permanent establishment (branch) in the Netherlands of a company with its effective management outside the Netherlands may also be included in a fiscal unity.⁹³ The Luxembourg fiscal unity system is similar to the Dutch system but contains a requirement as to a permanent establishment of a foreign company that the permanent establishment should be subject to taxation comparable to the Luxembourg corporate income tax.⁹⁴

The Dutch fiscal unity regime allows the group companies to pool their profits and losses and to transfer the assets within the group without a capital gains tax liability.⁹⁵ Thus, losses of one subsidiary may be offset against profits of other members of the group. Furthermore, reorganisations have no direct tax consequences.⁹⁶ There is no requirement that all qualifying subsidiaries should be included in the fiscal unity or that there should be full economic integration within the group companies.⁹⁷

(b) *Austria*

Effective from 2005, a group taxation regime that allows parent and subsidiary companies to consolidate their taxable income was introduced in Austria.⁹⁸ The head of the corporate group must be an Austrian corporate entity and should hold more than fifty percent of the capital and voting rights in the subsidiary for the duration of the subsidiary's fiscal year.⁹⁹

92 *Ibid.*

93 Muller *The Netherlands in International Tax Planning* (2005) 251–252. IBFD, “Taxation of Holding Companies par 3.4.2.3 <http://online2.ibfd.org/hold/> (accessed 18 Sept 2009).

94 The requirement that the permanent establishment should be subject to taxation comparable to the domestic corporate income tax is necessitated by differing tax systems for different permanent establishments in the same jurisdiction. See “Inconsistency of Luxembourg Fiscal Unity Rules with Tax Treaties and EU Law”.

95 Rohatgi (2002) 191. “The advantages of a fiscal unity are that profits and losses of group companies can be offset against each other. This means that transactions between group companies can be eliminated for tax purposes and hence assets can under certain conditions be transferred within the group without triggering taxable capital gains.” http://www.tax-consultantsinternational.com/read/Dutch_corporate_tax_regime_#18 (accessed 10 Jun 2008).

96 *Ibid.*

97 *Ibid.*

98 Prior to 2005, a group of resident companies could elect to file a joint tax return where they are financially, economically and legally integrated. In addition at least 75% of the shares in each company must be owned by an Austrian holding company for the entire duration of its tax year. The election to file a joint return applied for a minimum period of five years. See Rohatgi (2002) 187.

99 In Germany, a “non-resident company may become the head of a German consolidated group if the following requirements are satisfied: (a) the company has registered a branch in the German Commercial Register; (b) the profit-and-loss absorption agreement with the German group companies is entered into under the firm name of the branch; and (c) the investments in the German subsidiaries are assets of the German branch.” Ernst & Young *Worldwide Corporate Tax Guide* (2006) 312.

The shareholding in the subsidiary can be direct or indirect through a partnership, corporation or a joint venture.¹⁰⁰

Only corporations, not partnerships, qualify as group members.¹⁰¹ If the more than fifty percent requirement is satisfied, one hundred percent of the taxable income, profit or loss, of domestic group members is allocated to the taxable income of the ultimate holding company, regardless of the percentage of the shareholding in the subsidiary. No actual profit or loss transfer takes place.¹⁰² An application that is binding for three years must be filed with the tax authorities.¹⁰³

Group taxation also allows a cross-border tax consolidation if the foreign subsidiary is directly held by an Austrian holding company, tier one, and if the type of entity is comparable to an Austrian corporation from a legal perspective.¹⁰⁴ Losses from a foreign group member can be deducted from the Austrian tax base in proportion to the shareholding only.¹⁰⁵ Profits of a foreign group member are generally not included in the Austrian holding company's income.¹⁰⁶ Companies in a group can earn either active or passive income.¹⁰⁷ Thus, a pure holding company is not precluded from participating in a group of companies.¹⁰⁸

100 Ernst & Young 52. In the US, a consolidated return may be filed only if all corporations that were members of the affiliated group at any time during the tax year consent to all the consolidated return regulations prior to the last day for filing the return. See Rohatgi (2002) 194.

101 Schmidt "Austria: Significant Changes Regarding Corporate Income Tax" (2004) par 3 <http://www.mondaq.com/article.asp?articleid=27677> (accessed 14 Aug 2009).

102 See Schmidt par 3.

103 *Ibid.*

104 The German group rules are similar to the Austrian rules in this regard. However, in addition, the following apply in the German system: (a) the pooling arrangement requires the approval of 75% of the shareholders of the companies pooling their finances; (b) the controlling parent entity may be a corporation, a sole trader, a partnership or a company subject to unlimited taxation, or a registered branch of a non-resident company; and (c) the losses of a subsidiary company before pooling of profits are not deductible.

105 See Fruehmann "Austria, extensive tax reform" 2005 *European Legal Developments Bulletin* 11.

106 *Ibid.*

107 *Ibid.*

108 Schmidt par 3. See also Ernst & Young 52 where it is stated that "[t]o avoid double utilization of losses of a foreign group member, foreign losses that have been deducted from income of the Austrian group shareholder are added in Austria, if the losses can be offset in the foreign jurisdiction at a subsequent time. Consequently, if the foreign country takes into account the losses in subsequent years (as part of a loss carry forward), the tax base in Austria is increased by that amount in order to avoid a double dip. Foreign losses must also be added to the Austrian income tax base if the foreign subsidiary leaves the group. Relief is provided only in the event of a liquidation or insolvency".

3 5 2 Group Contribution Systems

(a) Finland

In the Finnish system the group contribution can be made between a holding company and its subsidiary.¹⁰⁹ To qualify, both the paying company and the receiving companies must be resident and carrying on business in Finland.¹¹⁰ Furthermore, the companies must be at least ninety percent owned by the holding company from the beginning of the holding company's tax year to the end of that year.¹¹¹ The paying company and the receiving companies must have the same accounting year.¹¹² The taxpayer cannot create a loss by crediting group contributions.¹¹³

Profits and losses may be balanced between Finnish corporations belonging to the same group of companies through an open group contribution. A group contribution may be deducted from the taxable profits of the contributing company and added to the taxable income of the recipient company.¹¹⁴ This balancing of profits and losses is not available for non-resident companies.¹¹⁵

(b) Norway

Under the Norwegian system, there is no requirement as to the period of ownership provided the ninety percent holding requirement is met at the end of the accounting period and the concerned companies all have common year-ends.¹¹⁶ It is not required that all subsidiaries or qualifying subsidiaries are included and the holding company does not have to be Norwegian.¹¹⁷ Assets in the group may be transferred tax-free provided the transfers are at market value.¹¹⁸ "Contributions are deductible for the contributing company and taxable in the hands of the recipient. The contribution may be set off against any losses of the recipient".¹¹⁹

3 5 3 Group Relief Systems

(a) United Kingdom ("UK")

The aim of the UK group relief system is to ensure fiscal neutrality of the effects of the creation of a group of companies.¹²⁰ A group of companies

109 See Rohatgi (2002) 188.

110 *Ibid.*

111 Juusela "Finnish investment now less taxing" (2007) *International Financial Law Review*, Supplement – The 2007 Guide to Private Equity and Venture Capital <http://www.iflr.com/includes/supplements> (accessed 10 July 2009).

112 *Ibid.*

113 See Juusela. See also Rohatgi (2002) 188.

114 Juusela.

115 Juusela. See also Rohatgi (2002) 188. The Swedish system is similar to the Finnish system. See also Ståhl Direct tax rules and the EU fundamental freedoms – Swedish report <http://www.fide2006.org/TOPC1/Tax%20Sweden%20Stahl.pdf> (accessed 12 July 2009).

116 Rohatgi (2002) 192.

117 *Ibid.*

118 *Ibid.*

119 Gruner "EFTA Court rules on Norwegian tax credit" 2008 *Norway Tax Alert*. <http://www.deloitte.com/dtt/alert.html> (accessed 01 Sept 2009).

120 Walton and Stone Marks & Spencer: UK group relief rules at risk, <http://tax.practicallaw.com/1-200-6684>, accessed on 10 July 2008.

comprises the UK parent company and all UK resident subsidiaries that are owned directly or indirectly by a percentage of seventy five percent or more by a holding company, unless the shares are held as inventory. In this regard Collinson and Tiley¹²¹ state the following:

Group relief enables current trading losses, capital allowances, a non-trading deficit on loan relationships, excess management expenses of investment companies and excess charges on income to be surrendered by one company (the surrendering company) to another (the claimant company) enabling the latter to put the other company's loss against its total profits. Both companies must satisfy the group or consortium tests throughout their respective accounting period but need not be members of the same group or consortium when the claim is made.¹²²

Foreign incorporated subsidiaries may be included, provided they are tax resident.¹²³ Thus, non-resident companies do not benefit from the group relief.¹²⁴ Where the loss arises in a group member that is not resident in the UK, group relief is only available if the surrendering company is resident in another member state of the European Economic Area, or has a permanent establishment in another European Economic Community, and the loss is not relievable in that other member state.¹²⁵

(b) *Barbados*

In Barbados companies have the opportunity to offset wholly or partially, losses sustained against taxable profits of companies in the same group.¹²⁶ Resident companies may elect to surrender only the current, not past, eligible trading losses within a group.¹²⁷ Eligible trading losses exclude depreciation allowances, and any inter-group expenses that are claimed as expenses but not included in the taxable income for the receiving company in the same fiscal year.¹²⁸

121 Collinson & Tiley *Tiley and Collinson UK Tax Guide 2006–07* (2006) par 28:05 and references contained therein.

122 In Barbados, resident companies may elect to surrender only the current, not past, eligible trading losses within a group. Eligible trading losses exclude depreciation allowances, and any inter-group expenses that are claimed as expenses but not included in the taxable income for the receiving company in the same fiscal year. See Rohatgi (2002) 194. In Trinidad and Tobago the taxpayer cannot reduce its tax liability by more than 25% through the tax losses of the surrendering company. See Rohatgi (2002) 194.

123 See Foster "Losses for Companies Mean Losses for Governments" <http://www.dlapiper.com/hu/global/publications/detail.aspx?pub=1412> (accessed on 28 September 2009). The group relief system applicable in Ireland is analogous to the UK provisions in that it restricts loss relief to Irish companies and branches.

124 *Ibid.*

125 Tiley and Collinson par 28:05.

126 Wehby Modernising the Tax System: The Need for "Group Relief" http://icaj.org/docs/pdf/modernising_tax_system.pdf accessed on 28 September 2009.

127 *Ibid.*

128 Ernst & Young 74.

The group companies must be at least seventy five percent directly or indirectly beneficially owned by a resident holding company other than as portfolio investments, and must be a member of the group throughout the tax year.¹²⁹ The group relief is not available for offshore companies and entities that are granted special tax incentives.¹³⁰ A claim for group relief is only valid if it is made within two years from the end of the surrendering company's tax year.¹³¹

4 Benefits of Group Taxation on Discharge by the IHC of its Functions

As stated above, the primary functions of an IHC are to acquire, manage and sell investments in group companies, mainly its subsidiaries. By doing this, the IHC provides the group of companies with transactional and organisational flexibility that is required in large multinational groups of companies. Group taxation neutralises the tax implications of transactions entered into by the IHC and its operating subsidiaries that form a group of companies. Group taxation is most beneficial where the IHC and the subsidiaries are tax resident in the same country. This is because, as was stated above,¹³² generally group tax treatment is afforded to companies that are tax resident in the country providing group taxation.

4 1 Acquisitions

The credibility of a group depends, to a very large extent on the balance sheet of the group.¹³³ An IHC's balance sheet consists of its own assets and those of its subsidiaries.¹³⁴ By consolidating all these assets, the group is able to present a larger and credible financial statement to guarantee liquidity to both creditors and persons with whom the group conducts business.¹³⁵ Raising finance through the use of the aggregate group assets as collateral is made easier by using the sum of all investments.¹³⁶ This results in the IHC acquiring assets for the group and passing them on to the group members that need the assets.¹³⁷

On acquisition of assets by the IHC, the IHC records a base cost of such asset and on transfer of the asset to the group members, capital gains tax is not triggered.¹³⁸ Such assets could be transferred from one group

129 Foster "Losses for Companies Mean Losses for Governments" <http://www.dlapiper.com/hu/global/publications/detail.aspx?pub=1412> (accessed on 17 September 2010).

130 *Ibid.*

131 *Ibid.*

132 See par 3.1.

133 Olivier & Honiball 298–299.

134 *Ibid.*

135 *Ibid.* See also Vanistendael "Taxation of Corporate Reorganizations" in (Thuronyi ed) *Tax Law Design and Drafting* (1998) 896.

136 Vanistendael 908–916.

137 *Ibid.*

138 *Ibid.*

member to another over a period of time without any tax attaching to such transfers.¹³⁹ Capital gains tax would only be triggered when the asset is disposed of to a person who is not part of the group, or to whom benefits of group taxation do not apply.¹⁴⁰

Group taxation could limit the application and impact of thin capitalisation provisions where the assets of the IHC and those of its operating subsidiaries are considered as capital of the IHC for thin capitalisation purposes.¹⁴¹ For example, in the Netherlands a company may elect to apply the group ratio. If the company makes this election, the company will look at the commercial consolidated debt-to-equity-ratio of the group (including international members of the group) of which it is a member. If the company's commercial debt-to-equity ratio does not exceed the debt-to-equity ratio of the group, the tax deduction for interest on connected person loans is allowed.¹⁴²

4.2 Management

Each company in a group consists of its own management personnel. The management personnel's responsibility is to manage the investments of that company.¹⁴³ In order to synchronise the group objectives and ensure that each company works towards the achievement of such goals, a single senior management is placed in an IHC.¹⁴⁴ This also assists where sub-groups are tasked with achieving certain goals, including management and reporting.¹⁴⁵ Furthermore, this ensures that the ultimate investors have control of the management of the group and can push the overall policy positions of the group down to all subsidiaries.¹⁴⁶

On discharging these management duties, management fees should be levied by the IHC to all companies to which it provides the management services.¹⁴⁷ Where these services are provided for no consideration, or the consideration paid for such services does not represent the market value of the services rendered, the local transfer pricing rules of the country in which the IHC is located, where applicable, would apply to adjust the price to represent the market value consideration.¹⁴⁸ Once the

139 *Ibid.*

140 *Ibid.*

141 Müller *The Netherlands in International Tax Planning* (2005) 109

142 *Ibid.*

143 "Introduction to Holding Activities" par 1.1.

144 *Ibid.*

145 "Introduction to Holding Activities" par 1.1.

146 *Ibid.*

147 Atkinson, Chip and Blackwood "Transfer Pricing" <http://webcache.googleusercontent.com/search?q=cache:5zDgjbRMy6AJ:www.internationaltaxview.com/%3FPage%3D17%26ISS%3D13191%26SID%3D487784+management+fees+transfer+pricing&cd=6&hl=en&ct=clnk&gl=za> (accessed on 17 September 2010).

148 Mehta "India: Formulating an Intragroup Management Fee Policy: An Analysis from a Transfer Pricing and International Tax Perspective" http://www.transferpricing.com/worldtransferpricing_files/world_files/india/Article%20on%20Mgt%20Fees.pdf (accessed on 17 September 2010).

adjustment is made, the IHC would be taxed on the basis of such adjusted price.¹⁴⁹

The application of group taxation in this regard would result in the transfer pricing adjustment being neutralised when the group is considered to be a single unit for tax purposes.¹⁵⁰ The income resulting from the adjustment of the price attributed to the IHC would be added to the aggregate taxable income of the group.¹⁵¹ However, a disproportionately higher amount of losses may be required to set-off such income as the company to which the services were rendered might not be allowed to deduct the corresponding adjustment amount.¹⁵² In this regard group taxation may not achieve the best possible tax result.¹⁵³

4.3 Reorganisations

Reorganisations are a part of the life of the group of companies.¹⁵⁴ Most often these are done to enable company groups to access some convenience, economy or business activities, for example moving a licensing company to the same subgroup as the operating companies that use the licence.¹⁵⁵ Such reorganisations could require stringent regulatory requirements from the home country of the ultimate investors. Furthermore, an IHC is ideal where the subgroup is to be reorganised.¹⁵⁶

Under the general tax principles reorganisations result in income or a capital gain.¹⁵⁷ Where one company's assets are moved from it to another company, depending on whether the asset was held as a revenue asset or capital asset, such company would realise revenue income or capital gain respectively.¹⁵⁸ The acquiring company would also hold the asset in the capacity in which it acquired it and also realise revenue income or capital gain on disposal.¹⁵⁹

As stated above group taxation neutralises the tax effect of transfers of assets within the group.¹⁶⁰ On transfer of assets within the group of companies, the gains on transfer of capital assets are ignored and only accounted for in the tax system when the assets are transferred to persons who do not form part of that group.¹⁶¹

149 See further on transfer pricing: Vann "International aspects of income tax" in *Tax Law Design and Drafting* Thuronyi (ed) (1998) 781–784; Arnold & McIntyre *International Tax Primer* (2002) 55–80.

150 See par 3 *supra*.

151 *Ibid*.

152 *Ibid*.

153 *Ibid*.

154 Vanistendael 896.

155 *Ibid*.

156 Olivier & Honiball 299.

157 Vanistendael 901–903.

158 *Idem* 901.

159 *Idem* 902.

160 See par 3.1.

161 Rohatgi 256.

4 4 Disposals

Third party investment becomes easier with the IHC being a single entry point for the group or subgroup.¹⁶² Flexible third party investment is a key consideration when an investor plans to acquire part of the group, where separate aspects of the business are conducted in separate subsidiaries. In this case, acquiring stock in a subsidiary or some of the subsidiaries could result in an inchoate investment that depends on interaction with other entities.¹⁶³ Thus, an IHC enables the sale of a conglomerate where separate businesses are run in different subsidiaries.¹⁶⁴ This would entail the sale of shares in the IHC rather than in the subsidiaries.

This method of disposal of interests in the IHC group to persons that are not members of the group results in capital gains tax as the transaction occurs between the members of the group and persons that are not members.¹⁶⁵ The IHC group would realise a gain or a loss on the disposal of such assets.¹⁶⁶ However, the group can use the losses or gains of other companies in the group to offset against the gain or losses, respectively.¹⁶⁷ In this way the overall tax of the group on the disposal of the assets would be reduced.¹⁶⁸

5 Conclusion

As has been seen, the system of group taxation could be of great tax benefit for IHC groups operating in more than one country. This benefit is realised where the group taxation system recognises the non-resident companies as members of the group even where the group tax system does not offer any tax relief to non-resident companies. In this way, the operating subsidiaries of the IHC benefit from the fact that they form a group for tax purposes in the country in which they operate.

Generally, the ultimate holding company would not derive any direct tax benefits from group taxation in a country where it is not resident. The benefit to the ultimate holding company would be in the form of after-tax distributions that are impacted minimally due to group taxation application to its subsidiaries.

162 Mergers and Acquisitions: Definition” <http://www.investopedia.com/university/mergers/mergers1.asp> (accessed on 22 September 2010) “What is Acquisition or Takeover of a Company?” <http://lastbull.com/what-is-acquisition-or-takeover-of-a-company/> (accessed on 22 September 2010); <http://www.highbeam.com/doc/1O19-acquisitioncompany.html> accessed on 22 September 2010.

163 *Ibid.*

164 *Ibid.*

165 See par 3 *supra*.

166 *Ibid.*

167 *Ibid.*

168 *Ibid.*

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