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

by

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ABSTRACT

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

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

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

The South African legal system contains all these taxes and anti-avoidance measures as well as exchange control provisions. However, it also contains tax instruments that alleviate the tax burden on an investor using an IHC such as the participation exemption, advance tax rulings and a network of tax treaties. Against this background this thesis
analyses the South African corporate tax system to determine whether it is suitable for locating an IHC. In the analysis, a comparative study is done of the tax systems of two of the most effective IHC host countries, namely the Netherlands and Mauritius. In addition, a brief discussion of the special features contained in the tax systems of Belgium, Ireland and the United Kingdom outlines why these jurisdictions are not necessarily successful in attracting IHCs.

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

## ABSTRACT  

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>INTRODUCTION</strong></td>
<td></td>
</tr>
<tr>
<td>1.1 BACKGROUND</td>
<td>1</td>
</tr>
<tr>
<td>1.2 PURPOSE</td>
<td>2</td>
</tr>
<tr>
<td>1.2.1 Advantages to the South African Economy of Hosting IHCs</td>
<td>4</td>
</tr>
<tr>
<td>1.2.2 South African Government’s Objectives</td>
<td>5</td>
</tr>
<tr>
<td>1.2.3 Katz Commission Recommendations</td>
<td>8</td>
</tr>
<tr>
<td>1.3 METHODOLOGY</td>
<td>10</td>
</tr>
<tr>
<td>1.4 A COMPARATIVE STUDY OF HOLDING COMPANY REGIMES</td>
<td>11</td>
</tr>
<tr>
<td>1.4.1 The Netherlands</td>
<td>11</td>
</tr>
<tr>
<td>1.4.2 Mauritius</td>
<td>12</td>
</tr>
<tr>
<td>1.4.3 Other Jurisdictions</td>
<td>12</td>
</tr>
<tr>
<td>1.5 THE RELEVANCE OF EXCHANGE CONTROL</td>
<td>12</td>
</tr>
<tr>
<td>1.6 SCOPE OF THE STUDY</td>
<td>13</td>
</tr>
<tr>
<td>1.7 REFERENCE TO THE TAX ACT</td>
<td>15</td>
</tr>
</tbody>
</table>

## CHAPTER 2  

**INTERMEDIARY HOLDING COMPANIES DEFINED AND DISTINGUISHED FROM OTHER SIMILAR ENTITIES**  

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 INTRODUCTION</td>
<td>16</td>
</tr>
<tr>
<td>2.2 AN IHC AS A COMPANY</td>
<td>17</td>
</tr>
<tr>
<td>2.3 TAX RESIDENCE OF AN IHC</td>
<td>17</td>
</tr>
<tr>
<td>2.4 AN IHC AS A HOLDING COMPANY AND A SUBSIDIARY</td>
<td>21</td>
</tr>
</tbody>
</table>
### CHAPTER 2

#### 2.4.1 Company groups  

#### 2.5 THE INTERMEDIARY NATURE OF AN IHC  

#### 2.6 FUNCTIONS OF AN IHC  

**2.6.1 Acquisitions**  

**2.6.2 Management**  

**2.6.3 Reorganisations**  

**2.6.4 Disposals**  

#### 2.7 DISTINCTION BETWEEN AN IHC AND OTHER SIMILAR ENTITIES  

**2.7.1 International Holding Company**  

**2.7.2 Offshore Holding Company**  

**2.7.3 Foreign Financial Instrument Holding Company**  

**2.7.4 International Headquarter Company**  

**2.7.5 Foreign Base Holding Company**  

**2.7.6 Foreign Group Finance Company**  

**2.7.7 Foreign Financial Services Center Companies**  

**2.7.8 Intellectual Property Holding Company**  

**2.7.9 Personal Holding Company**  

#### 2.8 CONCLUSION  

### CHAPTER 3  

#### 3.1 INTRODUCTION  

#### 3.2 RAISING EXTERNAL FINANCE  

**3.2.1 Country Risk**  

**3.2.2 Currency Risk**  

**3.2.3 Usage of Group Assets**  

#### 3.3 EXCHANGE CONTROLS  

#### 3.4 ASSET PROTECTION  

**3.4.1 What is an “Asset”?**
CHAPTER 4
TAX REASONS FOR FORMING AN IHC

4.1 INTRODUCTION
4.2 DEFERRING TAX ON OPERATING INCOME
4.3 DEFERRING TAX ON CAPITAL GAINS
4.4 MAXIMISING CREDIT FOR FOREIGN TAXES
4.4.1 No Tax on Foreign Income
4.4.2 Foreign Tax as an Allowable Deduction in Determining Taxable Income
4.4.3 Tax Exemption
4.4.4 Tax Credits
4.5 REDUCING WITHHOLDING TAXES
4.6 GROUP TAXATION
4.6.1 Introduction
4.6.2 Fiscal Unity System
4.6.3 Group Contribution System
4.6.4 Group Relief System
4.7 FOREIGN EXCHANGE GAINS AND LOSSES
4.7.1 Introduction
4.7.2 Tax treatment of Foreign Exchange Gains and Losses
4.8 RE-CHARACTERISATION OF INCOME
4.8.1 Income Paid and Received in the Same Jurisdiction
4.8.2 Income Received from a Different Jurisdiction
4.9 UTILISATION OF A LIQUIDATION LOSS
CHAPTER 5
CHARACTERISTICS OF AN IDEAL LOCATION TO
ESTABLISH AN IHC

5.1 INTRODUCTION
5.2 NON-TAX CHARACTERISTICS OF AN IHC JURISDICTION
5.3 TAX CHARACTERISTICS OF AN IHC JURISDICTION
  5.3.1 A Favourable Capital Gains Tax Regime
    5.3.1.1 Determining the Acquisition Price
    5.3.1.2 Timing and Event for Realisation of Gain or Loss
    5.3.1.3 Amount Included in the Calculation of Taxable Capital Gains
    5.3.1.4 Disposals between Related Persons
    5.3.1.5 Roll-Over Provisions
    5.3.1.6 Capital Gains Tax Rate
  5.3.2 Low Income Taxes
  5.3.3 No or Low Tax on Dividends
    5.3.3.1 Numerically Low Amount of Tax on Dividends
    5.3.3.2 Thin Dividend Tax Base
  5.3.4 No or Low Withholding Tax on Dividends
  5.3.5 A Favourable Treaty Network
  5.3.6 Unilateral Avoidance of Double Taxation
  5.3.7 The Absence of Controlled Foreign Company (“CFC”) Legislation
    5.3.7.1 Definition of Controlled Foreign Company
    5.3.7.2 Computation of Attributable Income
      a. The entity approach
      b. The transactional approach
    5.3.7.3 Attributable Amount
    5.3.7.4 Exemptions
a. De minimis exemption 102
b. Genuine business activities exemption 103
c. Distribution exemption 104

5.3.8 Thin Capitalisation and Transfer Pricing Rules 104

5.3.8.1 Transfer Pricing 105
   a. Cross-border transactions 106
   b. Connected persons 106
   c. Arm’s length 106

5.3.8.2 Thin Capitalisation 108

5.4 METHODS OF SETTING UP AN IHC 109

5.4.1 Incorporating a New Legal Entity 110

5.4.2 Changing the Shareholding of an Existing Entity in the Host Country 110

5.4.3 Converting the Functions of an Existing Company in the Host Country 111

5.4.4 Relocating the Tax Residence of a Company 111

5.4.5 Migration 112

5.4.6 Other Variations 113

5.5 CONCLUSIONS 113

CHAPTER 6 115
INTERNATIONAL ATTITUDE TOWARDS SYSTEMS SUITABLE FOR IHCs 115

6.1 INTRODUCTION 115

6.2 HARMFUL TAX COMPETITION 116

6.2.1 Tax Havens 118

6.2.1.1 No or Nominal Taxes on Income from Mobile Activities 122
   a. What is mobile business activity? 122
   b. The tax on mobile income 124

6.2.1.2 Availability to Non-Residents 125

6.2.1.3 Ability to Fund National Expenditure without Income Taxes 125

6.2.1.4 Characterisation of Tax Havens 126
a. Production Havens
b. Base Havens
c. Treaty Havens
d. Concession Havens

6.2.1.5 Taxation in Tax Havens

6.2.2 Harmful Preferential Tax Jurisdictions

6.2.2.1 Low or No Tax on Income

6.2.2.2 Ring-fencing of Foreign Income from the Domestic Economy

6.2.2.3 Lack of Transparency

6.2.2.4 No Exchange of Information

6.2.2.5 Other Features

6.2.2.6 Assessing the Economic Effects of a Preferential Regime in terms of its Potential Harmfulness

6.2.3 A Summary of the Differences between Tax Havens and Harmful Preferential Tax Regime Countries

6.2.4 Offshore Financial Centres

6.2.4.1 Introduction

6.2.4.2 Nature and Functions of Offshore Financial Centres

6.3 INITIATIVES AGAINST TAX HAVENS

6.3.1 Unilateral Initiatives

6.3.1.1 Controlled Foreign Companies Legislation

6.3.1.2 Transfer Pricing Rules

6.3.1.3 Restriction of the Exemption Method on Certain Income

6.3.1.4 Addition of Anti-Avoidance Measures

   a. Focus on the countries from which the foreign income originates
   b. The type of income
   c. The effective rate of tax to which the income has been subjected
   d. Foreign investment funds
   e. Transparency of rulings
f. Foreign information reporting 151

g. Taxation of foreign dividends 151

h. Access to banking information 152

6.3.2 Treaty Measures 153

6.3.2.1 Greater and More Efficient Use of Exchanges of Information 153

6.3.2.2 Restriction on Entitlement to Treaty Benefits 153

6.3.2.3 Status of Domestic Anti-Avoidance Rules and Doctrines in Tax Treaties 154

6.3.2.4 Synchronising Exclusions from Treaty Benefits 154

6.3.2.5 Terminating Treaties with Tax Havens 154

6.3.2.6 Other Recommendations of the OECD Report 156

6.3.3 OECD Developments since the 1998 Report 157

6.3.3.1 Access to bank information 157

6.3.3.2 Effective Exchange of Information 158

6.3.3.3 Countering Harmful Tax Practices 159

6.4 CONCLUSION 159

CHAPTER 7 161

THE NETHERLANDS 161

7.1 INTRODUCTION 161

7.2 BACKGROUND 162

7.3 THE DUTCH CORPORATE TAX SYSTEM 164

7.3.1 General 164

7.3.2 Corporate Income Tax 164

7.3.3 Capital Gains Tax 165

7.3.4 Dividend Tax 165

7.3.5 Controlled Foreign Company Provisions 166

7.3.6 Transfer Pricing 166

7.3.7 Thin Capitalisation 168

7.3.8 Foreign Tax Credit 168

7.3.9 Exchange Control 169
7.4 THE DUTCH HOLDING COMPANY
7.4.1 Defining a Holding Company
7.4.2 Various Uses of the Dutch Holding Company
7.5 TAX ASPECTS THAT MAKE THE NETHERLANDS POPULAR
7.5.1 The Participation Exemption
  7.5.1.1 The Nature of the Participation Exemption
  7.5.1.2 Application of the Dutch Participation Exemption
    a. Qualifying participations
    (i) Ownership of at least 5%
    (ii) Subsidiary’s capital divided into shares
    (iii) Shares not held as trading stock
    (iv) Additional requirements for foreign subsidiaries
7.5.2 Advance Tax Rulings
7.5.3 Treaty Network
7.5.4 Parent-Subsidiary Directive
7.5.5 Comparison between the Directive and the Participation Exemption
7.6 PROPOSALS FOR THE DUTCH CORPORATE TAX REFORM
7.6 CONCLUSION

CHAPTER 8
MAURITIUS

8.1 BACKGROUND
8.2 MAURITIAN CORPORATE INCOME TAX
  8.2.1 Rates of Tax
  8.2.2 Alternative Minimum Tax
  8.2.3 Other Tax Instruments
8.3 TAX ASPECTS THAT MAKE MAURITIUS POPULAR
  8.3.1 Companies Holding Global Business Licences
    a. Tax residence of a GBL1 company

viii
b. Tax treatment of a GBL1 company
   (i) Underlying Tax Credit
   (ii) Presumed Tax Credit
   (iii) Tax Sparing Credit
   (iv) Application of the Credits
   (v) The Benefits of a GBL1 Licence for an IHC

8.3.1.2 GBL2 Companies
   a. Taxation of GBL2 companies

8.3.2 Advance Tax Rulings

8.4 CONCLUSION

CHAPTER 9
SPECIAL FEATURES IN OTHER TAX REGIMES

9.1 INTRODUCTION AND BACKGROUND
9.2 BELGIUM
   9.2.1 Introduction
   9.2.2 Corporate Income Tax
      9.2.2.1 CFC Legislation
      9.2.2.2 Transfer Pricing
      9.2.2.3 Notional Interest Deduction
      9.2.2.4 Dividend Withholding Tax
   9.2.3 Special Features in the Belgian Tax System
      9.2.3.1 Dividends Received Deduction
      9.2.3.2 Tax Exemption for Capital Gains Realised on Shares
      9.2.3.3 Thin Capitalisation
   9.2.4 Conclusion
9.3 IRELAND
   9.3.1 Introduction
   9.3.2 Corporate Income Tax
   9.3.3 Special Features in the Irish Tax System
10.3.2.1 Participation Rights 251
10.3.2.2 Controlled Foreign Company 252
10.3.2.3 Attributable Amount 253
10.3.2.4 Net Income 255
10.3.2.5 Exclusions / exemptions 256
   a. Income that has already been taxed 257
   b. Dividend income from a related CFC 258
   c. The foreign business establishment (“FBE”) exemption 259
      (i) Definition of an FBE 260
      (ii) Locational permanence 261
      (iii) Economic substance 261
      (iv) Business purpose 261
      (v) Application of the FBE 262
   (aa) Amounts arising from non-arm’s-length transactions with residents 263
   (bb) Sale of goods by a CFC to a resident connected person 264
   (cc) Sales to unconnected South African residents 265
   (dd) Services performed for connected residents 265
   (ee) Mobile passive income 267
   d. CFC interest, rents and royalties 268
10.3.2.6 Special Rulings Provisions 268
10.4 TAXATION OF DIVIDENDS 268
10.4.1 General 272
10.4.2 Definition of Dividend under the STC Regime 273
   10.4.2.1 Liquidation Dividends 274
   10.4.2.2 Going-Concern Dividends 275
   10.4.2.3 Partial Reduction or Redemption of Capital or Share Buy-Backs 276
   10.4.2.4 Company Reconstructions 276
10.4.3 New Definition of Dividend 277
10.4.4 Tax Treatment of Foreign Dividends 277
   10.4.4.1 Exemptions 279
a. Dividends from taxable amounts 279
b. Amounts arising from resident company dividends 280
c. Dividends declared by listed companies 280
d. CFC dividends 281
e. Participation exemption 282

10.4.4.2 Deductibility of Expenditure Incurred in Producing Foreign Dividends 284

10.5 REBATE IN RESPECT OF FOREIGN TAXES ON INCOME 285
10.5.1 General 285
10.5.2 Foreign-Source Income 287
10.5.2.1 CFC Income Attributable to the Resident 288
10.5.2.2 Foreign Dividends 289
10.5.2.3 Capital Gains 289

10.6 EXCHANGE CONTROL 290
10.6.1 Introduction 290
10.6.2 Purpose of Exchange Control 290
10.6.3 Application of Exchange Controls in South Africa 291
10.6.4 Restriction on Export of Currency and Import of South African Rand 292
10.6.5 Rules Applicable to Subsidiaries of South African Companies 293
10.6.6 Local Borrowing Restrictions 297
10.6.7 Dividends 299
10.6.8 Interest on Foreign Loans 300
10.6.9 Management and Administrative Fees 300
10.6.10 2009 Developments 300

10.7 CAPITAL GAINS TAX IN SOUTH AFRICA 301
10.7.1 Introduction 301
10.7.2 Key Terms, Taxpayer and Exclusions 303
10.7.2.1 Capital Gain and Asset 303
10.7.2.2 Base Cost 304
10.7.2.3 Disposal 306
10.7.2.4 Persons Liable to Capital Gains Tax 307
10.7.2.5  Exclusions

   a. Disposals by creditor of a debt owed by a connected person
   b. Disposal of interest in equity share capital of a foreign company

10.7.2.6  Capital Distributions

10.8   TAX RULINGS

10.8.1  Binding General Rulings
10.8.2  Binding Private Rulings
10.8.3  Binding Class Rulings
10.8.4  Non-Binding Private Opinions

10.9   GROUP TAXATION IN SOUTH AFRICA

10.9.1  Margo Commission
10.9.2  The Katz Commission Recommendations
10.9.3  Current Law

10.9.3.1  Company Formations
10.9.3.2  Intra-Group Transactions
10.9.3.3  Liquidation, Winding-up and Deregistration

10.10  TRANSFER PRICING PROVISIONS

10.11  THIN CAPITALISATION PROVISIONS

10.12  INTERNATIONAL HEADQUARTER COMPANY REGIME

10.13  CONCLUSION

CHAPTER 11

CONCLUSIONS AND RECOMMENDATIONS

11.1  INTRODUCTION
11.2  BACKGROUND
11.3  ASSESSING THE SUITABILITY OF SOUTH AFRICA TO HOST
      IHCs
11.3.1  Corporate Tax Rate
11.3.2  Taxation of Dividends
11.3.3  The Participation Exemption
| 11.3.4 Controlled Foreign Company Legislation | 344 |
| 11.3.5 Thin Capitalisation | 345 |
| 11.3.6 Advance Tax Rulings | 347 |
| 11.3.7 Exchange Control | 348 |
| 11.4 RECOMMENDATIONS | 349 |
| 11.4.1 Exchange Controls Recommendations | 349 |
| 11.4.1.1 Recommendation regarding the Residence of an IHC | 350 |
| 11.4.1.2 Recommendation regarding Loop Structures | 350 |
| 11.4.2 Recommendation on the Special Income Tax Dispensation for IHCs | 351 |
| 11.4.2.1 Recommendation regarding the Participation Exemption | 351 |
| 11.4.2.2 Recommendation regarding CFC Ownership Rules | 352 |
| 11.4.2.3 Recommendation regarding Thin Capitalisation Rules | 353 |
| 11.4.3 Recommendation on the Introduction of Group Taxation | 354 |
| 11.5 ADDRESSING RECOMMENDATIONS OF THE KATZ COMMISSION | 355 |
| 11.5.1 A Reasonable Double Tax Agreement Network | 356 |
| 11.5.2 The Exemption of Offshore Corporate Dividend Income from Local Income Tax | 356 |
| 11.5.3 The Exemption of Defined Offshore Corporate Income from Local Income Tax | 356 |
| 11.5.4 The Absence of Local Corporate Capital Gains Tax | 356 |
| 11.5.5 Low or No Local Withholding Tax on Dividends Paid to Shareholders | 357 |
| 11.5.6 An Efficient Local Tax Rulings System | 357 |
| 10.6 COMPLIANCE WITH THE NON-DISCRIMINATION CLAUSE IN SOUTH AFRICAN TAX TREATIES | 358 |
| 11.7 CONCLUSION | 359 |

**BIBLIOGRAPHY**

**BOOKS**

**JOURNAL ARTICLES**

**ELECTRONIC SOURCES**
LEGISLATION 397
South African Legislation and Regulations 397
Explanatory Memoranda 397
Gazettes and Regulations 398
Foreign Legislation 398

    Australia 398
    Belgium 398
    Canada 398
    Ireland 398
    Luxembourg 398
    Mauritius 399
    Netherlands 399
    New Zealand 399
    United Kingdom 399
    United States of America 399

CASES 400
South African Cases 400
Foreign Cases 401

OFFICIAL PUBLICATIONS, PRESENTATIONS AND DISCUSSIONS 402

INDEX 406