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The South African Headquarter Company Regime: can this be considered an effective intermediary holding company regime?

Porter, Nicole

2014-08-13
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University of the Witwatersrand, Johannesburg

A research report submitted to the Faculty of Commerce,

Law and Management in partial fulfilment of the requirements

for the degree of Master of Commerce (specialising in Taxation)

The South African Headquarter Company Regime: Can this be considered an effective intermediary holding company regime?

Applicant: Nicole Porter
Student number: 0301521m
Supervisor: Roy Blumenthal
Head of School: Prof N Padia
Degree: Master of Commerce (specialising in Taxation)
Date: 31 March 2014

ABSTRACT

Africa is considered to be an emerging market, due to the large number of industries investing into Africa as a result of its low cost of employment and the volume of natural resources. Recently SARS has recognized the benefits of South Africa as an ideal location in which to establish an intermediary holding company through which investments into Africa may be channelled. There are a many factors that contribute to this, such as the wide treaty network established by South Africa, the growing economic sector and the close proximity to other African countries. In order to be considered an effective regime, the newly introduced Headquarter company regime (the new South African HQCR) will have to illustrate that the best practice characteristics required in an intermediary holding company jurisdiction are in fact present in South Africa. Even if these characteristics are present, the there are still a number of other factors that may hinder the effectiveness of such a regime. The most noticeable of which is the attractiveness of other well known and established headquarter company regimes such as Mauritius. Mauritius offers an attractive intermediary holding company regime to offshore investors due to the close proximity to Africa, the lack of exchange control regulations, large treaty networks with well-negotiated rates and the low effective tax rate. Should South Africa be able to compete with these traits, this may pose a risk that South Africa will be considered to participate in harmful tax practices. In these instances, the shifting of profits to a lower tax jurisdiction would likely result in double taxation through the non-applicability of DTAs. This view coincides with the substantial move against abuse of DTAs in what is referred to as the one world tax system. The purpose of this paper is therefore to consider whether or not the new South African HQCR established in South Africa will be considered as an effective regime based on the characteristics provided and whether or not this regime will be able to compete with other more prominent regimes such as Mauritius. Further considerations are also addressed as to whether or not the regime may be viewed as a harmful tax regime. The success of the regime is imperative on this consideration as strong initiatives are being undertaken worldwide to avoid the erosion of a countries tax base. In light of this it has become an increasingly difficult to promote a Headquarter company regime that is in conflict to these initiatives. The purpose of this paper is to establish whether or not SARS has managed to establish an effective headquarter company in light of all of the above.

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other university.

Nicole Porter

31st March 2014

Table of Contents

1. Chapter 1 - Introduction 7

2. Chapter 2 – Characteristics of an ideal Head Quarter Company jurisdiction 13

2.1 A low tax rate on income earned and the absence of tax on dividends earned 14

2.2 The absence of withholding tax on distributions and other payments to non-residents 15

2.2.1 Dividend payments made to a foreign shareholder 15

2.2.2 Interest withholding tax 15

2.2.3 Royalties withholding tax 16

2.2.4 Services withholding tax 16

2.3 A large network of DTA 16

2.4 The absence of capital gains tax on the profit earned from disposals. 17

2.5 The absence of tax on an increase in share capital 18

2.6 The absence of transfer pricing regulations 18

2.7 The absence of a controlled foreign company regime 19

2.8 The optimisation of foreign tax credits 19

2.9 The ability to undertake group reorganisations and asset protection 20

2.10 Reduction of foreign exchange gains or losses 20

2.11 The absence of an exchange control regime 20

2.12 Conclusion 21

3. Chapter 3: The new South African headquarter company regime 22

3.1 Traditional headquarter structure 24

3.1.1 Structure 1: Offshore investment into Africa 24

3.1.2 Structure 2: Offshore investment into Africa and South Africa 25

3.1.3 Structure 3: Foreign Private Equity Structure 27

3.1.4 Structure 4: A South African MNE 28

3.1.5 Structure 5: Intermediary financing company 28

3.2 Section 9I – Headquarter Company definition 29

3.3 Characteristics of the new South Africa HQCR 30

3.3.1 Tax considerations 30

a. Corporate tax rate: Dividend and other income earned under the new HQC Regime 30

b. Exemption from withholding taxes on interest and services 31

c. South African DTAs 32

d. CGT and the new HQCR 48

e. Tax on the increase of share capital 49

f. Transfer pricing legislation in respect of a HQC 49

g. The CFC regime under South African legislation 51

h. The optimisation of foreign tax credits 52

3.3.2 Commercial considerations 52
a. The ability to undertake group reorganisation and asset protection 52
b. Foreign exchange gains or losses 54
c. Exchange Control and the IHC Regime 54
3.4 Conclusions 54

4. Chapter 4: Comparison between South Africa and Mauritius as a headquarter company jurisdiction 58

4.1 Headquarter company regimes in Mauritius 58
4.1.1 Global Business License 1 (GBL1) 58
a. Corporate tax rate: Dividend and other income earned 59
b. Exemption from withholding taxes on interest, royalties and services 60
c. Withholding tax rates under Mauritius DTAs 60
d. CGT Regime in Mauritius 70
e. Tax on the increase in share capital 71
f. Transfer pricing and thin capitalisation 71
g. CFC Regime 71
h. Optimisation of foreign tax credits 71
i. The ability to undertake group reorganisations 72
j. Foreign exchange gains or losses 72
k. Exchange control regulations 72
4.1.2 GBL 2 72
4.2 Transparency of information 73
4.3 Future of Mauritius 73
4.4 Mauritius characteristics versus the characteristics provided for by the new HQCR in South Africa 74
4.5 Conclusion 75

5. Chapter 5: Tax havens versus low tax jurisdictions 78

5.1 Introduction 78
5.2 Definition of a tax haven 79
5.2.1 Tax haven and harmful tax regimes 79
5.2.2 Definition of an Offshore Finance Centre (OFC) 81
5.2.3 Identified tax haven and OFC jurisdictions 83
5.3 Methods of profit shifting used by tax havens. 89
5.3.1 Allocation of Debt and Earnings Stripping 89
5.3.2 Cross crediting and sourcing rules for foreign tax credits 89
5.3.3 Transfer Pricing 89
5.3.4 Contract manufacturing in a low tax jurisdiction 90
5.3.5 Hybrid Instruments and Entities 90
5.4 Does the new South African HQCR participate in the harmful tax practices identified above 90
5.4.1 Allocation of debt and earnings shifting 91
5.4.2 Cross crediting and sourcing rules for foreign tax credits 91
5.4.3 Transfer pricing and thin capitalisation 92
5.4.4 Contract manufacturing in a low tax jurisdiction 92

5.4.5 Hybrid Instruments *92*
5.5 Conclusion 92
6. Chapter 6: OECD and Tax havens **95**
6.1 Issue 1: The spread of digital economy 96
6.2 Issue 2: Establishing coherence of corporate income tax 96
6.2.1 Neutralise the effect of hybrid mismatch arrangements *96*
6.2.2 Strengthen Controlled Foreign Company rules *97*
6.2.3 Limit base erosion via interest deductions and other financial payments *98*
6.2.4 Counter harmful tax practices more effectively, taking into account transparency and substance *98*
6.3 Issue 3: Restoring the benefits of international standards 98
6.3.1 Prevention of DTA abuse *99*
6.3.2 Artificial avoidance of a permanent establishment (PE) *99*
6.3.3 Re-examine Transfer pricing documentation *99*
a. Intangibles *99*
b. Risks and capital *100*
c. Other high-risk transactions *100*
6.4 Issue 4: Ensuring transparency of information while promoting increased certainty and predictability 100
6.4.1 Disclose any aggressive tax planning arrangements *100*
6.4.2 Transparency around Transfer Pricing documentation *101*
6.4.3 Establish a means of data collection *101*
6.4.4 Make dispute resolution procedures more effective *101*
6.5 Issue 5: The need for swift implementation 102
6.6 Comparison to the new South African HQCR 102
6.7 Conclusion 103
7. Chapter 7: Conclusion **105**
Bibliography **112**

1. Chapter 1 - Introduction

The African continent is identified as one of the world's largest emerging markets due to the large volumes of natural resources and the growing population. Consequently, many mining companies and banks have invested into this market in the last few years.

In order to achieve the greatest benefit from investing into emerging markets, many companies consider tax planning to be an integral part of the process. Where detailed tax planning has not been undertaken, a company may be subject to double taxation. (Ogley, 1993, p. 2) has identified this dilemma by stating that:

> fundamental to the problem of double taxation are the questions of overall ceiling on the burden of tax to which an investor is to be exposed, and how the total tax take is to be shared between the revenue authorities of the countries' concerned

The problem of double taxation can be avoided through the careful tax planning of establishing an intermediary company in a jurisdiction that minimises the risk of double tax through the implementation of double tax agreements (DTAs).

This intermediary holding company would also establish a base from which to conduct business and investments into the offshore markets. A large number of tax and business considerations should therefore be taken into account when selecting the regime in which the intermediary holding company will be established. The establishment of a large number of intermediary holding companies would result in an increased flow of economic activities being channelled through the jurisdiction. As a result many countries have attempted to introduce regimes that cater to these characteristics.

South Africa has attempted a similar project through the introduction of the new South African Headquarter Company regime under section 9I of the Income Tax Act (Act). The effectiveness of this regime is dependent on a number of factors, such as whether or not the regime encompasses the characteristics that are identified as best practice characteristics provided by other intermediary holding company regimes, offers unique investment benefits to offshore investors and finally whether or not this regime falls foul of the harmful tax practices that are identified with tax havens.

The first sub-problem identified assesses whether or not the new South African Headquarter Company Regime provides for the best practice characteristics of an intermediary holding company. Chapter 2 enables us to addresses the first sub-problem by highlighting the best practice characteristics.

Chapter 2 identifies these characteristics from both a tax and non-tax perspective. Olivier and Honiball (2011) emphasises that the economic benefits of establishing an intermediary holding company should be non-tax in nature as the tax benefits are at best short to medium term. The economic benefits must therefore be considered to out-weigh the potential tax benefits. A few of the non-tax considerations discussed in Chapter 2 are: exchange control, the raising of external finance, group reorganisation and asset protection. Chapter 2 also considers the tax reason for establishing an intermediary holding company. These reasons include the absence or reduction of withholding taxes, the application of a large DTA network, the deference or elimination of capital gains tax, the deference of tax on operating income, optimisation of foreign tax credits, reduction of the impact of foreign exchange gains or losses and the re-characterisation of the nature of income.

As a result of the fact that the National Department of Treasury in South Africa considered South Africa to meet a large number of the identified tax and non-tax characteristics, they have regarded South Africa as an ideal jurisdiction in which to establish an intermediary holding or headquarter company. These characteristics have been identified as South Africa's close proximity to other African countries, effective communication networks and the growing business sector. In addition to this, South Africa has also managed to establish one of the largest treaty networks into Africa. This would provide a parent company (i.e. the offshore investor) with tax benefits (Example. the reduction of withholding taxes in a certain of the double tax agreements entered into). It was determined in an interview with a representative from the Department of National Treasury (National Treasury), namely Lutando Mvovo (2012), the reasons for identifying South Africa as an ideal holding company jurisdiction is summarised in the statement below:

> We also considered non-tax issues such as our infrastructure in comparison to other African countries, sophistication of our financial sector, our geographical location, our international and political relations (being a member of IBSA, possibility of become a members of BRIC as it was called then, part of the G20 etc.). On the tax side of our tax treaty

network, we had about 68 tax treaties, including 19 tax treaties with African countries.

To make use of these characteristics, the Department of National Treasury has introduced what is known as the Headquarter Company Regime (the new South African HQCR). The implementation of this regime has been built on the previous International Headquarter Company Regime (IHCR) that was introduced in 2002.

Chapter 3 provides a detailed discussion on the history of the IHCR in South Africa. This discussion considers why the previous regime was abolished and how the regime has since evolved. This history is significant in obtaining an understanding of the new South African HQCR, what considerations were accounted for in establishing the new South African HQCR, and whether or not the considerations delivered the required characteristics of an intermediary company. This is achieved through detailed comparison of the best practice characteristics identified in chapter 2 above, and the characteristics implemented in the new HQCR. The comparison addresses the first sub-problem highlighted above in determining whether or not the best practice characteristics are found in the new South African HQCR. If the characteristics provided for in the new South African HQCR are not considered to be unique, the new HQCR may be found to be ineffective in light of already established headquarter company jurisdictions as identified by the second sub-problem.

Chapter 4 addresses the second sub-problem by providing a comparison with another prominent headquarter company regime (namely Mauritius). This comparison assesses the benefits provided under the new South African HQCR and determines if they can be found in other jurisdictions. The discussion also identifies any benefits that are provided for in other jurisdictions, but are considered to be lacking in the new South African HQCR.

As Mauritius is renowned for providing companies with both commercial viability and tax benefits, it will prove difficult to contest with when weighing up the viability of South Africa as a headquarter company regime.

Although Mauritius is generally found to be an effective intermediary holding company jurisdiction, it has regularly received publicity as a tax haven that is used to reduce taxes

paid to African and other jurisdictions. This is a common danger when establishing a headquarter company regime, in that the regime will be considered to illustrate the harmful tax practices similar to those provided for by a tax haven, as identified in the third sub-problem.

The term tax haven triggers many negative connotations that may result in a denial of benefits under double tax agreements (DTAs). The denial of benefits may occur where funds are passed through these jurisdictions via an intermediary holding company, and the beneficial owner of the income or funds is not considered to be the intermediary holding company. Under these circumstances, the benefits normally available under a DTA will be denied as a result of the concept of beneficial ownership. The concept of the beneficial ownership was introduced to a few DTAs to avoid treaty shopping (Olivier & Honiball, 2011).

A deciding factor as to whether or not the benefits under a DTA applies is often considered in terms of whether or not the jurisdiction enters into the harmful tax practices associated with a tax haven or alternatively an offshore finance centre ("OFC"). Tax havens are considered to be involved in harmful tax practices and are the DTAs are therefore subject to increased anti-avoidance initiatives that are aimed at preventing the erosion of tax bases in a jurisdiction. This is achieved by limiting the treaty benefits available to jurisdictions identified as tax havens as the DTAs entered into are subject to anti-avoidance provisions such as the concept of beneficial ownership described above. Although OFCs provide similar characteristics to tax havens, they are largely aimed at providing a financing "hub" and for this reason it may be easier for an OFC to enter into a DTA and benefit from the reduced rates provided in DTAs. If a headquarter company regime is associated with the harmful tax practices often illustrated by a tax havens or OFCs, the jurisdiction in which the regime operates may become subject to similar anti avoidance provisions which prove detrimental to the effectiveness of such a regime. This highlights the third sub-problem as to whether or not the characteristics that are applied by the new South African HQCR may be considered as harmful tax practices that would result in the imposition of anti-avoidance provisions on South Africa.

In chapter 5 this sub-problem is addressed by considering the definition of a tax haven and determining what the similar and the dissimilar harmful tax practices tax haven and an OFC regimes offer. The identified harmful tax practices have been recognised by the OECD (OECD, 1998)as:

> a scheme that is merely a conduit and absent the regime, the investment flow would be unlikely to go through the country providing the regime.

In addressing the third sub-problem a conclusion is drawn as to whether or not the new South African HQCR mimics the harmful tax practices identified in these regimes.

The establishment of both tax haven and OFC regimes are in complete contradiction to the growing trend to establish an international tax system that lends itself to transparency. A strong initiative has been and continues to be implemented against harmful tax practices that erode the tax base of jurisdictions. Various initiatives include limitation of the benefits available under DTAs (as mentioned above), anti-money laundering initiatives, and other proposals directly aimed at minimising tax abuse.

Chapter 6 considers the various initiatives that have taken a stand against tax base erosion and profit shifting transactions. The largest of these initiatives, and the most well known, is the OECD initiative. The impact of this initiative is the most effective as many of the DTAs ratified in South Africa are concluded on the OECD Model Tax Convention on Income and on Capital (OECD Model Convention). The OECD model convention is aimed at minimising tax base erosion; the large number of anti-avoidance articles that are regularly agreed on as part of the DTAs entered into illustrates this.

This growing objective of transparency is making it increasingly difficult for a tax havens and OFC's to function and maintain taxpayer's rights and privacy, while still remaining within the stringent requirements, such as the exchange of information agreements, CFC regime, transfer pricing legislation, that is imposed by the OECD.

Chapter 6 reviews the requirements, the growing initiatives, recent developments and action points that have been determined to prohibit base erosion and profit shifting. The fourth sub-problem is addressed by determining whether or not the provisions under these initiatives were considered and

incorporated in establishing the new HQCR or alternatively what effect these initiatives will have on the new HQCR in the future if they were not considered.

Chapter 7 concludes the report and presents an overview of its findings as to whether or not the new HQCR in South Africa can be considered to be an ideal headquarter company regime under which to incorporate an intermediary holding company.

2. Chapter 2 – Characteristics of an ideal Head Quarter Company jurisdiction

Many multinational enterprises (MNE'S) look to establish what is generally known as an intermediary holding company in a jurisdiction that provides both tax and other commercial benefits. This allows for MNE's to obtain a distinct advantage over companies, which are only operational within one jurisdiction (i.e. the operational jurisdiction in which the MNE is situated), that may be subject to a higher effective tax rate. This advantage has been recognised over the years and has been identified as being able to:

> choose to locate production or some other activity in a country with a lower overall cost structure because the country in question poses a lesser burden of tax on such activity (Ogley, 1993)

In many instances, this idea has been extended, to consider how the intermediary company may in fact benefit from the jurisdiction in which it is situated. The stripping of profits from a company and the distribution thereof to a lower tax jurisdiction, such as a tax haven, will positively benefit the low tax jurisdiction by the increase in economic activities in that jurisdiction. As a result, many jurisdictions have attempted to establish a regime that provides the characteristics associated with a low tax jurisdiction. The purpose of this chapter is to identify what these characteristics are and how they may be beneficial to a MNE.

The effectiveness of a headquarter company can be assessed by determining whether or not the regime provides for the best practice tax characteristics that are considered to be (Olivier & Honiball, 2011):

2.1 A low tax rate on income earned and the absence of tax on dividends earned;
2.2 The absence of withholding tax on distributions and other payments (such as interest, royalties, and management fees) made to non-residents;
2.3 A large network of DTAs;
2.4 The absence of capital gains tax on the profit earned from disposals;
2.5 The absence of tax on an increase in share capital;
2.6 The absence of transfer pricing regulations;
2.7 The absence of a controlled foreign company regime; and
2.8 The optimisation of foreign tax credits.

As previously mentioned the tax benefits are short to medium term at best and commercial characteristics should therefore be considered when selecting an intermediary holding company jurisdiction. The commercial characteristics are identified as (Olivier & Honiball, 2011):

2.9 The ability to undertake group reorganisations and asset protection;

2.10 The reduction of exchange rate fluctuations on the profit of a company by investing in jurisdiction that transacts in a stable currency;

2.11 The absence of exchange control regime to allow for the raising of external finance at a more competitive rate, and the free flow of funds (such as dividends, interest and management fees) to the ultimate parent company.

All of the above characteristics are elaborated on below (Olivier & Honiball, 2011).

2.1 A low tax rate on income earned and the absence of tax on dividends earned

An intermediary holding company is likely to earn dividend income from the subsidiaries in which it invests. In practice, this dividend income is in turn passed on to the ultimate parent company. The ideal intermediary holding company jurisdiction should therefore cater for an exemption in respect of dividend income earned.

Likewise, the intermediary holding company jurisdiction should also cater for the transfer of profits from the subsidiary company via other forms of income earned (i.e. interest income, royalty income or management fee income) to be taxed at a minimal rate or under a special regime. In order to avoid the classification of a tax haven, many jurisdictions do not provide for a minimal corporate tax rate, instead a tax credit is offered either for certain types of income (i.e. foreign income or capital contributions) or as a blanket rule in respect of a specific person (such as a non-resident incorporated under a specific regime).

This allows for the intermediary company to pass on the income earned to the ultimate parent company, without subjecting these amounts to additional tax (over and above the tax already paid by the subsidiary).

A common alternative to remitting the funds back to the parent company (of the intermediary holding company), as described above, is to allow for profits to accumulate in the intermediary holding company and reinvest these profits from the intermediary holding company when required. If this alternative is preferred it would be imperative that the intermediary company jurisdiction applies a low corporate tax rate.

2.2 The absence of withholding tax on distributions and other payments to non-residents

The remission of funds to the parent company results in an erosion of the subsidiary countries' capital base as there will be less funds reinvested into the respective economy. This can be avoided by levying a tax on payments made to non-resident companies. The difficulty of collecting these taxes is mitigated through imposing withholding taxes on foreign residents (Olivier & Honiball, 2011).

Withholding taxes are levied on:

2.2.1 Dividend payments made to a foreign shareholder

Ideally one would look to establish an intermediary holding company in a jurisdiction that would allow for the parent company to extract profits from the low tax jurisdiction without being subject to additional taxes levied thereon. The intermediary company should therefore not have imposed upon it dividends withholding tax on dividend payments made to non-resident shareholders.

2.2.2 Interest withholding tax

In many instances an intermediary holding company, is established through the provision of loan funding by the parent company. An interest charge is usually levied on this loan, thereby allowing the intermediary holding company (i.e. the company paying the interest) to obtain a tax deduction for the amount paid (subject to transfer pricing considerations, if applicable). If the intermediary company is situated in a jurisdiction that levies a withholding tax on these payments, the levying of interest on the loan would result in double tax (i.e. in the hands of the recipient as gross income and the withholding tax levied on the non-

resident payment). It is therefore imperative that the intermediary company be situated in a tax friendly jurisdiction that would allow for the interest payments to be made to the parent company free from withholding taxes.

2.2.3 Royalties withholding tax

Intermediary companies commonly use intellectual property ('IP') relating to group companies to transfer funds to the parent company (i.e. a non-resident company). This also allows for the profit to be retained within the group. If the intermediary company is situated in a jurisdiction that levies a withholding tax on these payments, the royalty payments would result in double tax (i.e. in the hands of the recipient as gross income and the withholding tax levied on the non-resident payment). It is therefore imperative that the intermediary holding company jurisdiction would not levy withholding tax on the royalty payments made.

2.2.4 Services withholding tax

Services withholding tax is becoming more prevalent in certain jurisdictions as a means to identify transactions with non-residents. A common practice in respect of profit extraction is to levy a management fee from the intermediary holding company to the parent company. Where a services withholding tax is levied, this would result in double taxation (i.e. as gross income in the hands of the recipient and withholding tax on the non-resident payment). Ideally, an intermediary holding company must therefore be established in a jurisdiction that does not levy a services withholding tax.

2.3 A large network of DTA

Many jurisdictions enter into DTAs to avoid the same income being subject to tax in two separate jurisdictions. This is normally achieved through agreeing on an overall ceiling (Ogley, 1993) for the total tax take based on a predetermined profit sharing. In many instances full taxing rights are provided to one of the two jurisdictions. In other instances limited taxing rights are provided to the second jurisdiction. The limited taxing rights are agreed at a lower withholding tax rate than the local legislation would have applied had no DTA existed.

As a result of this, DTAs are able to provide potential investors with comfort that double tax will not be levied in respect of the two relevant jurisdictions.

An intermediary holding company should therefore look to be established in a jurisdiction with a large treaty network to ensure that the potential investor is shielded from double tax as well as to enable the potential investor to benefit from reduced withholding tax rates.

2.4 The absence of capital gains tax on the profit earned from disposals.

Capital gains tax ("CGT") is generally levied by jurisdictions in one of two methods (Olivier & Honiball, 2011):

- Deemed disposal (i.e. if tax residency is terminated); and
- On the actual disposal of shares.

Both of these instances would prove to be limiting for an intermediary holding company as:

- the business of a holding company is to purchase and dispose of investments on a regular basis, and it would be ineffective to subject the intermediary holding company to CGT in respect of every sales transaction; and
- Should the intermediary holding company be subject to CGT on a deemed disposal this would prove to be limiting on the commercial rationale of future restructuring or relocation decisions.

A crucial consideration in establishing an intermediary company would therefore be whether or not the potential jurisdiction imposes actual or deemed CGT. Ideally the intermediary company should be situated in a jurisdiction where the sale transaction is disregarded from a CGT perspective. A tax haven or low tax jurisdiction can achieve this through either providing a participation exemption in respect of the sale of shares or the absence of a CGT regime.

Furthermore, this would be even more beneficial in instances where a DTA does exist between the intermediary

holding company jurisdiction and the jurisdiction in which the subsidiaries of the intermediary holding company are situated. In these instances the DTA normally attributes full taxing rights to the holding company jurisdiction (i.e. the alienator), thereby disregarding the capital gain altogether (i.e. full taxing rights are provided to the holding company jurisdiction, which in turn does not impose CGT) in the hands of the subsidiary company.

2.5 The absence of tax on an increase in share capital

Intermediary holding companies are at times established through capital funding. If additional funding is required for business expansion (e.g. the purchase of additional subsidiary companies) the funding can be raised via an increase in capital (Olivier & Honiball, 2011). An ideal intermediary holding company should therefore be situated in a jurisdiction that caters for such expansion. Where tax is levied on an increase in share capital, this would not cater for such transactions.

2.6 The absence of transfer pricing regulations

In a group company context, it may be more beneficial to use the availability of group services as opposed to third party services. This would allow the profit to remain within the group and to simultaneously shift funds to the parent company. The absence of transfer pricing regulations allows for companies to determine the price of the goods or services depending on where the profit is most beneficial. The most beneficial jurisdiction may depend on a number of factors including an analysis of which jurisdiction applies the lowest tax rate etc.

This treatment is only possible where an absence of transfer pricing policies exist.

Thin capitalisation rules are generally applied internationally in instances where the funding is obtained from connected persons. This regime has been developed to ensure that funds are not shifted through the use of excessive interest or obtained at a much lower cost than it would have been obtained at had it been received from a third party.

The absence of thin capitalisation rules would allow for the intermediary company to obtain funding at a much lower

cost than what would have been received from a third party (such as a bank). Alternatively, the interest payments may also be used to shift funds to the parent company in the form of excessive payments.

2.7 The absence of a controlled foreign company regime

Controlled foreign company (CFC) legislation has been introduced in various jurisdictions. This legislation provides that where more than 50% shareholding is held in a foreign company, the taxable income of the foreign company must be calculated as if the company was situated in the shareholders jurisdiction. This regime is normally accompanied by exemptions. These exemptions range from a blanket exemption where the company is situated in a high tax paying jurisdiction to specific exemptions where there is enough substance situated in the country.

A good intermediary holding company regime would either provide enough exemptions to allow for the CFC's to accumulate profit without a risk of double tax on the profits (i.e. in both the CFC jurisdiction and the intermediary holding company jurisdiction), or to not impose a CFC regime.

2.8 The optimisation of foreign tax credits

Foreign tax credits can be optimised through what is referred to as "pooling of funds" (Olivier & Honiball, 2011). Pooling of funds means that income from a high tax jurisdiction (with a large tax credit) and income from a low tax jurisdiction (with a limited tax credit) is earned by the same jurisdiction to allow for the high tax credit to be utilised against the limited tax credit, thereby increasing the average tax credit utilised.

As this treatment is prohibited by many jurisdictions (through various restrictions on how the tax credit may be claimed), the use of an intermediate holding company may facilitate the MNE to achieve this optimisation of the foreign tax credits.

2.9 The ability to undertake group reorganisations and asset protection

Many companies select an intermediary holding company jurisdiction based on commercial rationale. Two significant commercial considerations are (Olivier & Honiball, 2011):

- the ability to undertake future group reorganisations. This would require the intermediary company to be established in a jurisdiction where there is more flexibility around both group tax regulations and company legislation; and
- the establishment of asset protection in a politically safe jurisdiction.

2.10 Reduction of foreign exchange gains or losses

Where an intermediary company is established in a jurisdiction with a different functional currency to the subsidiary company, a foreign exchange gain or loss will be recognised on the difference between the two currency values. This foreign exchange translation may result in a large taxable profit or loss. A few head quarter company regimes offer the alternative of establishing an intermediary holding company in the functional currency used by the subsidiary companies. This would eliminate any foreign exchange fluctuations, as the intermediary holding company will be able to operate in the same currency as the subsidiary.

2.11 The absence of an exchange control regime

Many countries enforce what is known as an exchange control regime. This regime requires that the investor would need to apply for approval in order to invest funds outside of the country. Certain limitations are imposed on the amounts that may be invested outside the country. An intermediary holding company that is established in a jurisdiction situated outside of an exchange control area, would be able to facilitate the re-investment of funds (as either debt or equity) by the MNE, without the risk of forced repatriation or the trapping of funds within a specific exchange control area (Olivier & Honiball, 2011). This would enable to MNE to operate and expand more freely.

2.12 Conclusion

An ideal holding company jurisdiction should be established in a jurisdiction that provides the following characteristics:

- A low corporate tax rate to allow for any income earned from the foreign investments in the form of interest, royalties or management fees to be taxed at a minimal rate;
- A exemptions in respect of certain types of income, such as dividends;
- A wide network of DTAs should also be present to limit the withholding taxes imposed by the investment jurisdictions;
- No or limited withholding taxes to avoid double taxation on the same income streams;
- Lack of a transfer-pricing and thin capitalisation regime to allow for the repatriation of funds without limitation;
- Lack of a CFC regime to avoid the imputation of foreign income earned back to the intermediary company;
- Lack of a CGT regime must exist to allow for future tax free sale of investments and restructurings based on commercial rationale;
- Flexibility around group and company tax and other legislation to allow for the easy reorganisation of assets;
- The ability to transact in a functional currency other than the local currency to minimise foreign exchange gains and losses;
- Lack of an exchange control regime to allow for the reinvestment of funds offshore without restrictions.

National Treasury took these characteristics into consideration in establishing the new HQCR and endeavoured to ensure that these characteristics were met in terms of section 9I.

3. Chapter 3: The new South African headquarter company regime

During the 2010 Budget Speech, the Minister of Finance, Pravin Gordhan, announced the introduction of the new HQCR.

Olivier and Honiball (2011) identified that this was not South Africa's first attempt at introducing this type of incentive for foreign investors. In 2002 to 2004 the first attempt at an IHCR was established, but has subsequently been abolished due to its ineffectiveness. The IHCR was targeted at companies that were defined in section 1 of the Act as an international headquarter or intermediary company. The use of this regime was governed by limiting the application thereof to companies that were defined as such by meeting all of the below requirements:

- 100% of the equity was to be held by a non-resident;
- share capital may not have been directly or indirectly held by a resident or a resident trust;
- 90% of the value of such a company must have been attributed to investments in share capital or loans in subsidiaries; and
- at least 50% of the beneficial interest in the subsidiary companies is to be held.

This regime provided the incentives below to non-resident companies by (Olivier & Honiball, 2011):

- Excluding the International Headquarter Company (IHQC) from the definition of a South African tax resident. Consequently the provisions applying to South African residents were not applicable to the IHQ by virtue of the fact that the IHQC was not a resident. One of the provisions that would not have therefore applied to the IHQC was the CFC regime detailed under section 9D of the Act. This allowed the IHQC to invest through South Africa without any risk of double taxation through the imputation of the foreign income in the South Africa taxable income under section 9D of the Act. Similar, this would also mean that any provisions relating to transfer pricing and thin capitalisation would not apply to the IHQC.
- Exchange Control regulations are only imposed in South Africa on South African residents. As the IHQC was considered to be a non-resident company, these regulations

would therefore not have imposed borrowing restrictions on connected person transactions to and from non-residents.

This regime was abolished due to its lack of sought after characteristics that are normally associated with an IHQC. National Treasury had identified that the principal difficulties with this regime were that (Olivier & Honiball, 2011):

- South African resident companies were excluded from using the IHCR;
- An increased corporate tax rate of 33% applied to South African sourced income earned by an IHQC as opposed to the local tax rate of 29% (at the time).
- The treaty benefits that were available to a South African resident company were not available to the IHQC as DTAs are generally only applicable to residents of a contracting state;
- Although the IHQC was not subject to CGT on conventional disposals (as a result of the non-resident classification), the IHQC would still have been subject to CGT on immovable property held in South Africa. Furthermore, at the time that the IHQC was in existence, the CGT rate applicable to non-residents on the sale of immovable property in South Africa was applied at a higher rate than it would have been, had the company been a South African resident company. Non-resident companies with branches established in South Africa were previously subject to tax a rate of 33%. The IHQC would therefore have been taxed at a rate of 50% * 33% on the sale of immovable property in South Africa. Dependant on the value of the sale, this may be significantly more when compared to the rate that an incorporated resident company would be subject to 50% * 29% (i.e. the corporate rate at the time the IHCR existed);
- The IHCR did not provide any tax incentives other than what a non-resident company was already entitled to by virtue of the fact that non-resident companies are only taxed on locally sourced income.

The Act did however provide for the IHQC to use a few of the benefits applicable to defined non-resident companies:

- Section 10(1)(k) previously provided for an exemption in respect of foreign dividend income received;

- No dividend withholding tax existed during the time of implementation.

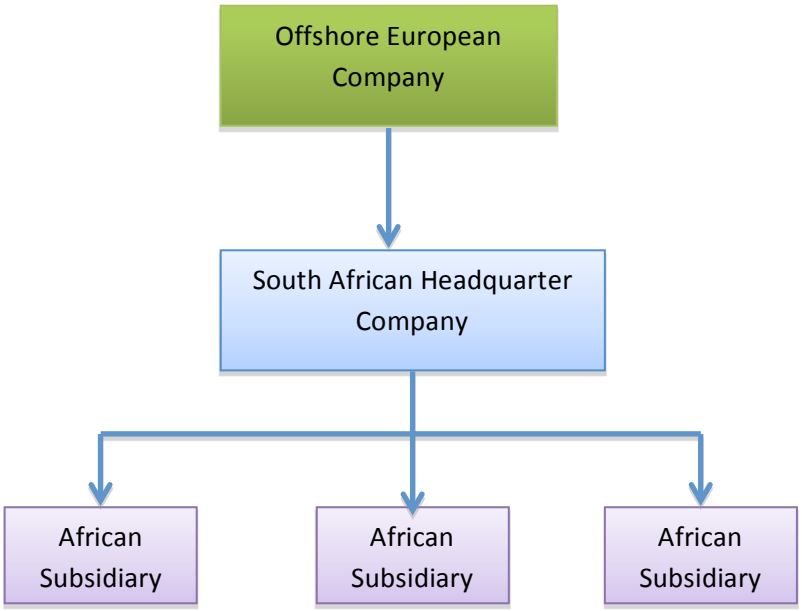
When establishing the new South African HQCR, National Treasury considered all of the concerns previously encountered with the IHCR and attempted to mitigate these problem areas (Mvovo, 2012).

The new South Africa HQCR is detailed under section 9I of the Act and was predominantly introduced to cater for the most commonly used Headquarter structures.

3.1 Traditional headquarter structure

In an interview with a representative from the National Treasury, Lutando Mvovo (2012), it was identified that the new South African HQCR was established with a view to address the following types of structures. Each structure was considered with specific requirements relating to that scenario.

3.1.1 Structure 1: Offshore investment into Africa



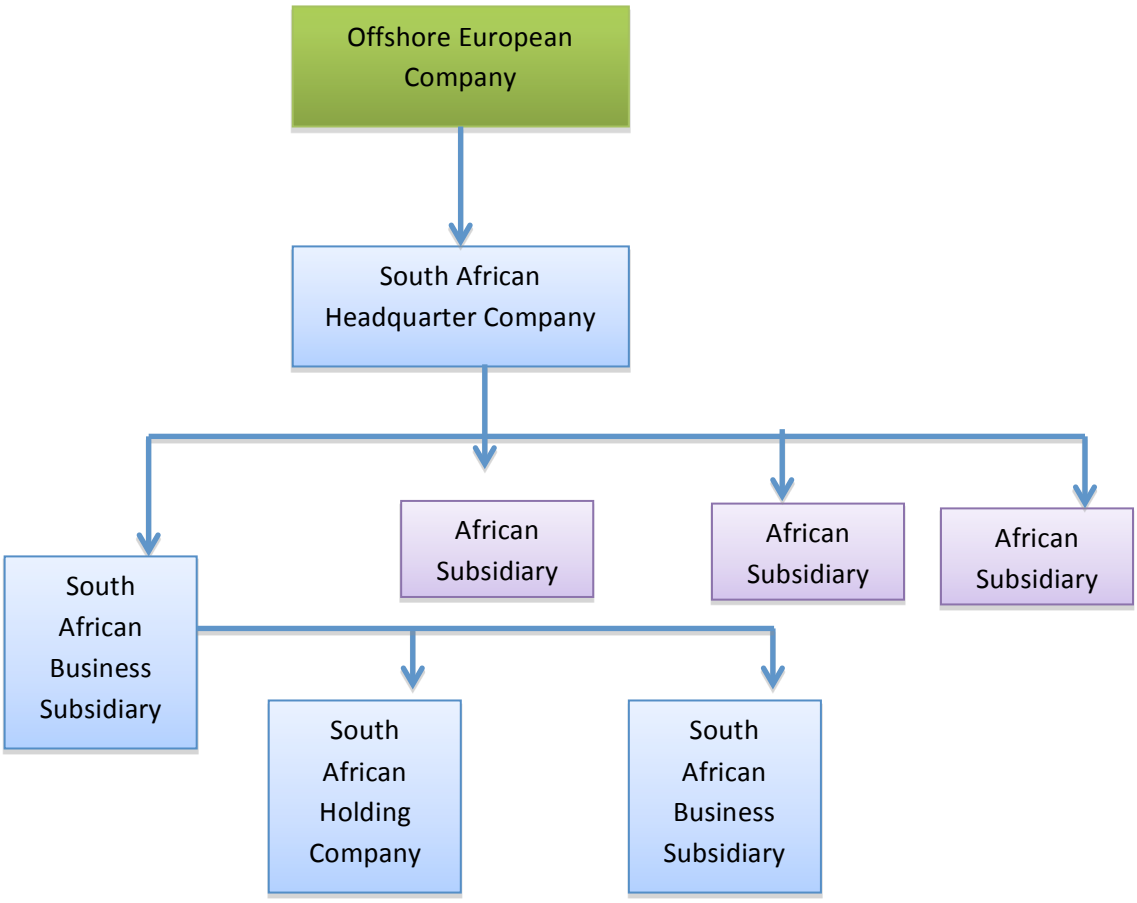
National Treasury (Mvovo, 2012)identified a traditional headquarter company as an offshore company that wishes to invest into various sub-Saharan Africa subsidiaries. This structure is catered for through the establishment of a South African Headquarter Company (HQC). It is envisioned that the South African HQC will own the shares and the substantial holdings in the African subsidiaries.. The South African HQC

is to have managers and financial advisors that are dedicated to managing the regional group. In certain instances, the foreign investor will advance funds to the new South African HQC, to facilitate funding to the subsidiary companies (Mvovo, 2012).

In order for this structure to prove beneficial, the regime must provide the following characteristics:

- The lack of exchange control in order
  - to pass the funds from the foreign parent company to the African subsidiaries without the need for exchange control approval; and
  - to enable any growth on the South African investment to be freely invested offshore.
- The lack of CFC regulations to avoid the double taxation of the African subsidiaries under both the South African CFC regime and the CFC regime of the offshore investor (i.e. the ultimate parent company).
- The lack of thin capitalisation rules to enable the offshore investor to provide funding to the structure.

3.1.2 Structure 2: Offshore investment into Africa and South Africa



An offshore company wishes to invest into sub-Saharan African via a new South African HQC. Further to this, a South African Holding Company is established to act as a holding company for South African businesses.

Similar to Structure 1 above, the new South African HQC will have managers and financial advisors that are dedicated to managing the regional group. In certain instances, the foreign investor will advance funds to the new South African HQC, to facilitate funding to the subsidiary companies (Mvovo, 2012).

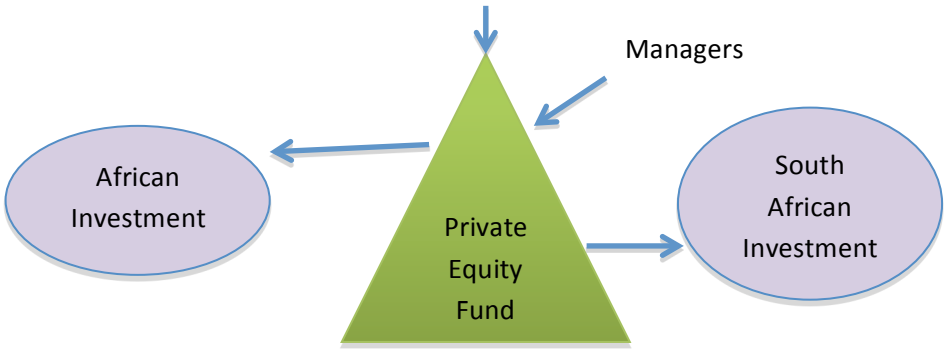
Consideration was given to the fact that the implementation of this structure will result in:

- the South African subsidiary companies being fully taxable under the South African corporate tax regime at a rate of 28%; and
- the South African Holding Company and South African subsidiaries would be subject to the exchange control regime imposed in South Africa.

National Treasury confirmed that the following characteristics will only apply to the new South African HQC, and not to the South African Holding Company:

- the lack of exchange control in order:
    - - to pass the funds from the foreign parent company to the African subsidiaries without the need for exchange control approval; and
    - - reinvest any capital growth earned on the foreign subsidiary companies offshore.
- the lack of CFC regulations to avoid the double taxation of the African subsidiaries under both the South African CFC regime and the CFC regime of the foreign investor (i.e. the parent company).
- the lack of thin capitalisation rules to enable the offshore investor to provide funding to the structure.

3.1.3 Structure 3: Foreign Private Equity Structure

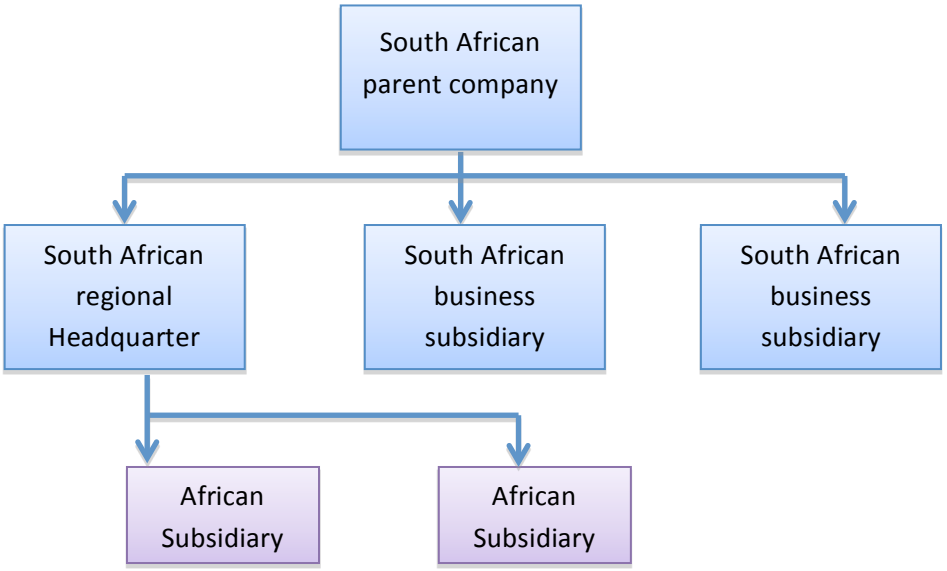


National Treasury identified the typical private equity investments that are established (Mvovo, 2012). This type of private equity fund operates as a limited partnership (*en commandite*). The investors seek to place investments in a South African equity fund, that is dedicated to the African region. The fund managers are general partners and the investors are considered to be the limited partners. The funds are dedicated to a 20%: 80% respective investment into South Africa and sub-Saharan operations (Mvovo, 2012). Presently a dual structure is utilised, whereby the sub-Saharan investments are managed through a tax haven and the South African investments are managed through a private equity fund dedicated to local investments (Mvovo, 2012).

In order for the regime to be considered effective, the private equity fund would have to be free from:

- exchange control regulations to enable the private equity fund to on pass the financing received from the foreign investors through to the African subsidiaries without the need for Exchange Control approval;
- exchange control regulations on any growth in the South African fund to enable further offshore investment without restrictions; and
- being considered a permanent establishment in South Africa only as a result of the South African partners.

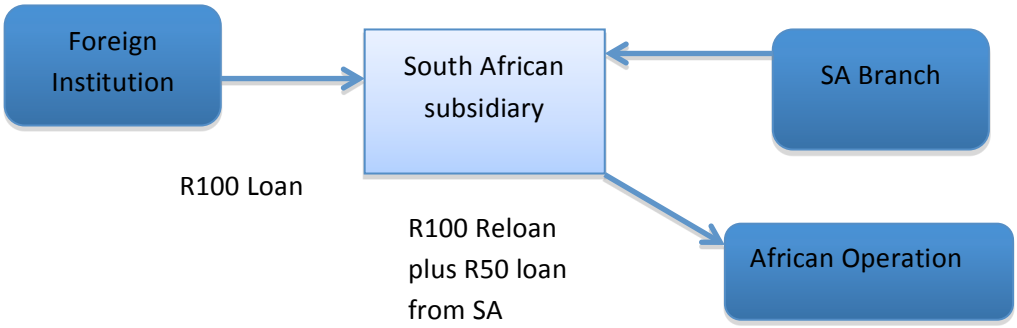
3.1.4 Structure 4: A South African MNE



A South African MNE owns various local and foreign subsidiaries. The MNE's foreign operations are typically held through an intermediary holding company that is situated in a foreign (i.e. a non-South African jurisdiction). This allows for the pooling of offshore funds in a jurisdiction that is free from exchange control.

In order to be considered as an effective regime, the new South African HQC regime must cater for the funds to accumulate in the new South African HQC as if it was an offshore company. This would enable the reinvestment of any future growth on the funds without restrictions (i.e. no exchange control)..

3.1.5 Structure 5: Intermediary financing company



A South African financing company provides financing to independent MNE (i.e. to the South African branch of the MNE). Due to the lack of funds (in the South African financing company) the South African company acts as an

intermediary company (i.e. the South African company borrows funds from international financing companies and on lends these funds).

Section 9I of the Act was introduced in order to provide for these circumstances and allow for the funds to be reinvested offshore without exchange control approval.

3.2 Section 9I – Headquarter Company definition

Section 9I of the Act determines that certain requirements that must be met in order to be classified as an HQC under the new HQCR. These requirements are laid out as follows:

- The company must be a South African resident (this is not the case where a DTA deems the company to be resident of another jurisdiction);
- 80% of the total assets in the current and all previous years (excluding cash or deposits payable on demand) must be attributed to:
    - Debt to a foreign subsidiary company in which the new South African HQC held at least 10% of the equity shares and voting rights; or
    - IP licensed to a foreign subsidiary company in which the new South African HQC holds at least 10% of the equity shares and voting rights; or
    - An investment in equity shares in a foreign company in which the new South African HQC held at least 10% of the equity shares and voting rights; and
- In the year in which the company elects to be treated as a new South African HQC, each shareholder must hold at least 10% of the equity shares and voting rights. If the company is part of a group of companies, the total group holding must be aggregated in determining the total shareholding (Haupt, 2013); and
- If the gross income exceeds R 5 million, at least 50% of the gross income must be attributed to;
    - Dividends, interest, royalties or services fees paid by the foreign companies identified above; or

- Proceeds from the disposal of interest in the companies identified above or IP in the companies identified above.

Should these requirements be met, a company may be classified as a new South African HQC if the company has made such an election in that year of assessment. Should this election be made, the specific legislation applicable to a Headquarter Company would apply and provide the benefits below to that company.

3.3 Characteristics of the new South Africa HQCR

The new HQCR has been established to address both tax and commercial considerations. Below, this report considers both of these areas.

3.3.1 Tax considerations

a. Corporate tax rate: Dividend and other income earned under the new HQC Regime

In terms of Section 9I of the Act a new HQC is regarded as a South African resident company. South African legislation dictates that a South African resident company will be subject to the corporate tax rate of 28%. Any income earned by the new HQC will therefore be subject to tax at this rate unless an exemption applies. Foreign dividend income is considered to be exempt income under section 10B of the Act, which determines that there:

> (2) Must be exempt from normal tax any foreign dividend received by or accrued to a person
> (a) if that person holds at least 10% of the total equity shares and voting rights of the company declaring the foreign dividend.

Section 10B of the Act defines a foreign dividend as:

- Any foreign dividend as defined in Section 1:

  any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to –

(a) tax on income on companies of that country in which that foreign company has a place of effective management; or

(b) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has it place of effective management does not have any applicable laws relating to tax on income,

But does not include any amounts so paid or payable that –

(i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of "company".

- dividend paid or declared by a headquarter company.

If the HQC should receive foreign dividends from a company in which it owns at least 10% of the equity share, the dividend income will be considered to be exempt. Similarly an exemption also exists under Section 10B of the Act in respect of dividend paid by the new HQC to its South African shareholders (provided that the South African shareholders own at least 10% of the total equity shares and voting rights. The Act does not provide for an exemption in terms of interest, management fee or royalty income, and any income of this nature will be considered taxable at a rate of 28%.

b. Exemption from withholding taxes on interest and services

At present, withholding taxes are only levied on royalty and dividend payments made to non-resident companies. This will however be amended with the introduction of withholding tax on interest and management fee payments made to non-residents in sections 50 to 51 of the Act. The withholding tax to be levied on interest is deemed to come into effect in respect of interest payments made on or after the 1st January 2015 and in respect of management fee payments made on or after the 1st January 2016.

A HQC is exempt from the levying of withholding taxes on interest, royalties and service fees paid to a non-resident.

c. *South African DTAs*

An ideal jurisdiction in which to establish a HQC would provide a large treaty network. This characteristic is prevalent in South Africa, as South Africa has established one of the largest available treaty networks. This is can be seen from the large number of DTAs that have been signed between South Africa and other jurisdictions. A review of the below DTA network illustrates that South Africa has entered into many DTAs that are not available under other prominent headquarter company regimes in other jurisdictions, thereby enabling a reduction in some local withholding taxes.

The total number of DTAs signed and under negotiation is 90. These DTAs are identified as (South African Revenue Service, 2014):

#	Source	Rate applied [1]	Dividend Income	Interest Income	Royalty Income	Capital Gains Tax
1	Algeria	Local	15%	10%	24%	20%
		DTA	10% if ≥25% shareholding/15 %	10%	10%	Taxable in hands of alienator (i.e. the seller) unless immovable property or permanent establishment (PE)
2	Australia	Local	30% - unfranked 0% - Franked	10%	30%	30%
		DTA	5% if ≥ 10% shareholding otherwise 15%	0%[2] otherwise 10%	5%	Taxable in hands of alienator unless immovable property or PE
3	Austria	Local	25%	0% on	20%	25%

[1] Local rates agreed to (Ernst and Young, 2014) and (Deloitte, 2014). DTA rates agreed to (South African Revenue Service, 2014)

[2] In specific instances relating to financial institutions and local authorities

				intercompany loans		
		DTA	5% if ≥ 25% shareholding otherwise 15%	0%	0%	Taxable in hands of alienator unless immovable property or PE
4	Bangladesh	Local	20%	10%	10%	15%
		DTA	Under negotiation			
5	Belarus	Local	12%	10%	15%	12%
		DTA	5% if ≥ 25% shareholding otherwise 15%	5% - Bank; 10%	5% transport vehicles; 10%	Taxable in hands of alienator unless immovable property or PE
6	Belgium	Local	25%	25%	25%	33% or 0.412% on shares if the dividend requirement is met or 25.75% on shares if the dividend requirement is not met
		DTA	5% if ≥ 25% shareholding otherwise 15%	10%	0%	Taxable in hands of alienator unless immovable property or PE
7	Botswana	Local	7.5%	15%	15%	22%
		DTA	10% if ≥ 25% shareholding otherwise 15%	10%	10%	Taxable in hands of alienator unless immovable property or PE
8	Brazil	Local	0%	15% or 25% if tax haven	15% or 25% if tax	15%

				(i.e. less than 20% tax rate)	haven (i.e. less than 20% tax rate)	
		DTA	10% if ≥ 25% shareholding otherwise 15%	15%	15% - trademarks ; 10%	Taxable in hands of alienator unless immovable property or PE
9	Bulgaria	Local	5%	5% - EU countries otherwise 10%	5% - EU countries otherwise 10%	10%
		DTA	5%≥ 25% shareholding otherwise 15%	5%	5% - IP otherwise trademarks ; 10%	Taxable in hands of alienator unless immovable property or PE
10	Cameroon	Local	16.5%	16.5%	15%	38.5%
		DTA	Under negotiation			
11	Canada	Local	25%	25%	25%	20% - 31% dependant on state
		DTA	5%≥ 10% shareholding otherwise 15%	10%* specific rules apply in respect of government or retirement interest	6% - IP; 10%	Taxable in hands of alienator unless immovable property or PE
12	Chile	Local	35%	35%	30% - related tax havens or 15%	35%
		DTA	Signed but not ratified			
13	China	Local	10%	10%	10%	25%
		DTA	5%			

14	Croatia	Local	12%	15%	15%	20%
		DTA	5%≥ 25% shareholding otherwise 10%	0% taxable in alienator state	5%	Alienator state unless immovable property or PE
15	Cuba	Local	0% EAC	0% EAC	30% EAC	35%
		DTA	Under Negotiation			
16	Cyprus	Local	0%	0%	0%	20%
		DTA	0% recipient state only	0% recipient state only	0% recipient state only	Alienator state unless immovable property or PE
17	Czech Republic	Local	15%/35% no DTA	15% or 35% if no DTA exists	15% or 35% if no DTA exists	19%
		DTA	5%≥ 25% shareholding otherwise 15%	0% recipient state only	10%	Alienator state unless immovable property or PE or shares in immovable property
18	Democratic Republic of Congo	Local	20%	20%	20%	35%
		DTA	5%≥ 25% shareholding otherwise15%	10%	10%	Taxed where the income is sourced unless immovable property or PE or shares in a property company
19	Denmark	Local	27%	25%	25%	25%
		DTA	5%≥ 25% shareholding otherwise 15%	0% recipient state only	0% recipient state only	Alienator state unless immovable

						property or PE or shares in immovable property
20	Egypt	Local	0%	20%	20%	As corporate profit: 20% <10 million EGP 25%>10million EGP
		DTA	15%	12%	15%	Taxed where the income is sourced unless fixed property or PE
21	Ethiopia	Local	10%	10%	5%-8%	15% or 30% on company shares sale
		DTA	10%	8%	20%	Alienator state unless immovable property or PE or shares in immovable property
22	Finland	Local	0% if paid to a EU company and certain requirements are met or 18.38% if the shares constitute investment assets and < 10% shareholding exists for EU companies otherwise 24.5%	24.5%	24.5%	24.5%
		DTA	5%≥ 10%	0% recipient	0%	Alienator state

			shareholding otherwise 15%	state only	recipient state only	unless immovable property or PE or shares in immovable property
23	France	Local	30% otherwise 50% for un-cooperative states	50% or 0% for EU member	33.3% or 0% for EU member or 50% for uncooperative states	Subject to corporate income tax rate 33.3% subject to reduction under specific legislation
		DTA	5%≥ 10% shareholding otherwise 15%	0% recipient state only	0% recipient state only	Alienator state unless immovable property or PE
24	Gabon	Local	15% reduced to 10% under parent subsidiary regime	10%	10%	35%
		DTA	Signed but not ratified			
25	Germany	Local	25% reduced to 10% under EU regime otherwise 15% under anti-treaty shopping rules	0%	15%	15%
		DTA	7.5%≥ 25% shareholding otherwise15%	10%	0% taxable in recipient hands	Taxable in hands of alienator unless fixed property or PE
26	Ghana	Local	8%	8%	10%	15%
		DTA	5%≥ 10% shareholding otherwise15%	10%	10%	Alienator state unless immovable property or PE or shares in

						immovable property
27	Greece	Local	10%	33%	25%	20%
		DTA	5%≥ 25% shareholding otherwise 15%	8%	5% to 7%	Alienator state unless immovable property or PE
28	Granada	[3]Local	0%	15%	15%	0%
		DTA [4]	0%	15%	15%	0%
29	Hong Kong	Local	0%	0%	4.9% or 16.5% if the IP was previously owned by a Hong Kong resident	0%
		DTA	Under Negotiation			
30	Hungary	Local	0%	0%	0%	19% or 10% if less than HUF 50 million
		DTA	5%≥ 25% shareholding otherwise 15%	0% recipient state only	0% recipient state only	Alienator state unless immovable property or PE
31	India	Local	Dividend distribution tax (DDT) 16.995%	20%	25%	10%
		DTA	10%	10%	10%	Alienator state unless immovable property or PE or shares in immovable

[3] (PKF, 2013)

[4] A proclamation was signed between Grenada and the UK in 1960. All provisions still refer to the United Kingdom. Therefore local rates have been quoted.

						property
32	Indonesia	Local	20%	20%	20%	20%
		DTA	10% ≥ 10% shareholding otherwise 15%	10%	10%	Taxable in hands of alienator unless immovable property or PE
33	Iran[5]	Local	3%	3%	3%	25%
		DTA	10%	5%	10%	Taxable in hands of alienator unless immovable property or PE
34	Ireland	Local	20%	20%	20%	33%
		DTA	5%≥ 10% shareholding otherwise 10%	0% recipient state only	0% recipient state only	Alienator state unless immovable property or PE
35	Isle of Man	Local	0%	0%	0%	0%
		DTA	Under Negotiation			
36	Israel	Local	25% if < 10% shareholding exists otherwise 30%	15% to 25% depending on the type of loan	25%	At local rate of 26.5%
		DTA	25%	25%	0% recipient state only	Alienator state unless immovable property or PE
37	Italy	Local	20%	20%	30%	13.67%
		DTA	5%≥25% shareholding otherwise15%	10%	6%	Taxable in hands of alienator unless immovable

[5] (Iranian Ministry of Economic Affairs and Finance, 2014)

						property or PE
38	Japan	Local	20%	0%	20%	25.5%
		DTA	5%≥ 25% shareholding/15 %	10%	10%	Taxable in hands of alienator unless immovable property or PE
39	Kenya	Local	10%	15%	20%	0%
		DTA	Signed not ratified			
40	Korea	Local	0%	14%	0%	22%
		DTA	5%≥ 25% shareholding/15 %	10%	10%	Taxable in hands of alienator unless immovable property or PE
41	Kuwait	Local	15%	0%	0%	15%
		DTA	0% taxable in recipient state	0% taxable in recipient state	10%	Taxable in hands of alienator unless immovable property or PE
42	Lesotho	Local	25%	25%	25%	25%
		DTA	15%	10%	10%	
43	Luxembourg	Local	15%	15%	0%	21%
		DTA	5%≥ 25% shareholding otherwise15%	0% taxable only in recipient state	0% taxable only in recipient state	Taxable in hands of alienator unless immovable property or PE
44	Malawi	Local	10%	20%	20%	30% to 35%
		DTA	No provision in DTA. Domestic rate will apply.	No provision in DTA. Domestic	Exempt if subject to tax in	No provision in DTA. Domestic rate will apply.

				rate will apply.	other state	
45	Malaysia	Local	0%	15%	10%	15%
		DTA	5% ≥ 25% shareholding otherwise10%	10%	5%	Taxable in hands of alienator unless immovable property or PE
46	Malta	Local	0%	0%	0%	35%
		DTA	5% if ≥ 10% shareholding otherwise 10%	10%	10%	Taxable in hands of alienator unless immovable property or PE
47	Mauritius	Local	0%	15%	15%	NA
		DTA	5%≥ 10% shareholding otherwise 15%	0%	0%	0%
48	Mexico	Local	0%	30%	30%	30%
		DTA	5%> 10% shareholding /10%	10%	10%	Taxable in hands of alienator unless immovable property or PE
49	Morocco	Local	10%	10%	10%	30%
		DTA	Under Negotiation			
50	Mozambique	Local	10% - listed otherwise 20%	20%	20%	32%
		DTA	8% if ≥ 25% shareholding otherwise15%	8%	5%	Taxable in hands of alienator unless immovable property or PE
51	Namibia	Local	10%≥ 25%	10%	10.2%	0%

			shareholding otherwise 20%			
		DTA	5%≥ 10% shareholding otherwise 15%	10%	10%	0%
52	Netherlands	Local	15%	0%	0%	25%
		DTA	5% ≥10% shareholding otherwise 10%	0% (taxable in recipient state)	0% (taxable in recipient state)	Taxable in hands of alienator unless immovable property or PE
53	New Zealand	Local	30%	15%	15%	0%
		DTA	New Zealand: 15% SA: 5%≥25% shareholding otherwise 15%	10%	10%	Taxable in both states
54	Nigeria	Local	10%	10%	10%	10%
		DTA	7.5%≥ 10% shareholding otherwise 10%	7.5%	7.5%	Taxable in hands of alienator unless immovable property or PE
55	Norway	Local	25%	0%	0%	28%
		DTA	5% ≥25% shareholding otherwise 15%	0% taxable in recipient state	0% taxable in recipient state	Taxable in hands of alienator unless immovable property or PE
56	Oman	Local	10%	10%	10%	12%
		DTA	5%≥10% shareholding exists otherwise 10%	0% (Taxable in recipient state)	0% (Taxable in recipient state)	Taxable in hands of alienator unless immovable property or PE

57	Pakistan	Local	10%	10%	15%	35%
		DTA	10% ≥ 10% shareholding otherwise 15%	10%	10%	Taxable in hands of alienator unless immovable property or PE
58	Poland	Local	19%	20%	20%	19%
		DTA	5%> 15% shareholding otherwise 15%	10%	10%	Taxable in hands of alienator unless immovable property or PE
59	Portugal	Local	25%	25%	25%	25%
		DTA	10%≥25% shareholding otherwise 10%	10%	10%	Taxable in hands of alienator unless immovable property or PE
60	Qatar	Local	5% to 7%	5% to 7%	5% to 7%	10%
		DTA	Under negotiation			
61	Romania	DTA	15%	15%	15%	Taxable in hands of alienator unless immovable property or PE
		Local	16%	16%	16%	16%
62	Russian Federation	Local	15%	20%	20%	Taxable as corporate
		DTA	10% if ≥30% shareholding and ≥$100 000 investment otherwise 15%	10%	0% (Taxed in recipient state only)	NA

63	Rwanda	Local	15%	15%	15%	30%
		DTA	10%≥ 25% shareholding otherwise20%	10%	10%	Alienator state unless PE or immovable property
64	Saudi Arabia	Local	5%	5%	15%	20%
		DTA	5%≥10% Shareholding; debt claims income:5% otherwise 10%	10%	10%	Alienator state unless PE or immovable property
65	Senegal	Local	10%	16%	20%	25%
		DTA	Under Negotiation			
66	Serbia	Local	20%	20%	20%	15%
		DTA	Under negotiation			
67	Seychelles	Local	15%	15%	15%	0%
		DTA	5%≥ 10%% shareholding exists otherwise 10%	7.5%	10%	
68	Sierra Leone	Local	15%	15%	15%	0%
		DTA	Dividend paid by SA to Sierra Leone is exempt from withholding tax. This provision may not apply as the proclamation was between the British government and Sierra Leone before South African became	NA – local rates apply	NA – local rates apply	NA – local rates apply

			a republic.			
69	Singapore	Local	0%	15%	10%	0%
		DTA	5%≥ 10% shareholding otherwise 15%	0% (only in recipient state)	5%	NA
70	Slovak Republic	Local	0%	19%	19%	23%
		DTA	5%≥25% shareholding otherwise 15%	0% (recipient state only)	10%	NA
71	Spain	Local	21%	21%	24.75%	30% corporate tax rate with a 12% credit
		DTA	5% ≥25% shareholding otherwise 15%	5%	5%	Alienator state unless PE or immovable property
72	Sri Lanka	Local	10%	10%	10%	0%
		DTA	Under negotiation			
73	Sudan	Local	0%	7%	15%	2% to 5%
		DTA	Signed not ratified			
74	Swaziland	Local	15%	10%	15%	0%
		DTA	10% ≥ 25% shareholdings otherwise 15%	10%	10%	0%
75	Sweden	Local	30%	0%	0%	22%
		DTA	5% ≥ 10% shareholding; otherwise 15%	0% (recipient state only)	0% (recipient state only)	Alienator state unless PE or immovable property
76	Switzerland	Local	35%	0%	0%	0%
		DTA	5% ≥20% shareholding	5%	0% (recipient	Alienator state unless PE or

			otherwise 15%		state only)	immovable property
77	Syria	Local	0%		7%	7.5%
		DTA	Under Negotiation			
78	Taiwan	Local	20%	20%	20%	17%
		DTA	5%≥ 10% shareholding; 15%	10%	10%	Alienator state unless PE or immovable property
79	Tanzania	Local	5%: listed 10%: unlisted	10%	15%	30%
			10% if > 15% ownership exists otherwise 20%	10%	10%	Alienator state unless PE or immovable property
80	Thailand	Local	10%	15%	15%	20%
		DTA	10%≥ 25% shareholding otherwise 15%	15%	15%	Alienator state unless PE or immovable property. Shares are taxable in both states.
81	Tunisia	Local	0%	20%	15%	30%
		DTA	10%	5% Banks 12%	10%	Alienator state unless PE or immovable property
82	Turkey	Local	15%	15%	20%	20%
		DTA	10% ≥25% shareholding otherwise 15%	10%	10%	Alienator state unless PE or immovable property. Unless property been held <1 year.

						Then taxable in other state.
83	Uganda	Local	15%	15%	15%	30%
		DTA	10%≥ 10% shareholding exists otherwise 15%	10%	10%	
84	Ukraine	Local	15%	15%	15%	19%
		DTA	5% ≥20% shareholding; 15%	10%	10%	Alienator state unless PE or immovable property
85	United Arab Emirates	Local	0%	0%	0%	0%
		DTA	Under negotiation			
86	United Kingdom	Local	0%	20%	20%	24%
		DTA	5% if ≥ 10% shareholding; 15% in respect of investment property companies; otherwise 10%;	0% (taxable in recipient state)	0% (taxable in recipient state)	Alienator state unless PE or immovable property
87	United States of America	Local	30%	30%	30%	35%
		DTA	5% if ≥ 10% shareholding; otherwise 15%;	0% (taxable in recipient state)	0% (taxable in recipient state)	Alienator state unless PE or immovable property
88	Vietnam	Local	0%	5%	10%	25%
		DTA	Under negotiation			
89	Zambia	Local	15%	15%	20%	0%
		DTA	15%	15%	20%	0%
90	Zimbabwe	Local	10% if listed	15%	15%	1% listed shares;

			company otherwise 15%			5% unlisted shares or 15% for immovable property
		DTA	15%	15%	20%	N/A

The application of the DTAs in respect of foreign transactions is not however only limited to the new South African HQC. South African resident companies are also entitled to apply these DTAs to transactions with other jurisdictions.

d. CGT and the new HQCR

An intermediary or head quarter company frequently purchases new investments in subsidiary companies and sells off non-profitable investments. Should the company be situated in a jurisdiction that imposes a tax on capital gains, this would give rise to CGT. One of the reasons that the Department of National Treasury considers South Africa to be an ideal holding company regime is attributed to the disregarding of capital gains on a disposal under paragraph 64B of the Eighth Schedule to the Act. This exclusion is further extended to specifically disregard any capital gains made by the new South African HQC in paragraph 64B(2) of the Eighth Schedule to the Act which states that:

> Subject to subparagraph (4), a headquarter company must disregard any capital gain or capital loss determined in respect of the disposal of any equity share in any foreign company (other than an interest contemplated in paragraph 2(2)) if that headquarter company (whether alone or together with any other person forming part of the same group of companies as that headquarter company) immediately before that disposal held at least 10 per cent of the equity shares and voting rights in that foreign company.

Should a non-resident shareholder choose to sell off certain of the investments held by the new HQC, the sale would be free from CGT if at least 10% of the equity shares was held in that investment.

It is noted however, that in instances where a South African company enters into the new HQCR, a deemed disposal will occur and give rise to CGT as determined in section 9H of the Act through the provision of the following wording in the Act:

> Where, during any year of assessment or foreign tax year of a company, the company ceases to be a resident, becomes a headquarter company or ceases to be a controlled foreign company as contemplated in paragraph (a), that company must be treated as having-
>
> i)disposed of each of that company's assets on the date immediately before the day on which that company so ceased to be a resident, became a headquarter company or ceased to be a controlled foreign company for an amount received or accrued equal to the market value of that asset on that date; and
>
> ii)reacquired each of those assets on the day on which that company so ceased to be a resident, became a headquarter company or ceased to be a controlled foreign company at an expenditure equal to the market value contemplated in sub paragraph (i).

Certain assets, such as assets relating to a permanent establishment or immoveable property are excluded from this deemed disposal due to the fact that it will remain taxable in South Africa as a result of source rules. The levying of this deemed CGT would make it difficult for an already established South African company to enter into the new South African HQCR.

e. Tax on the increase of share capital

Capital duty is not imposed in South Africa on the increase of share capital. Where funding is raised by means of additional share capital, this increased funding will not be subject to tax. South Africa therefore appears to be suitably equipped to promote additional investment in the form of share capital.

f. Transfer pricing legislation in respect of a HQC

In order to avoid non-market related prices from being imposed between connected persons, the Act imposes a transfer pricing and thin capitalisation regime under section 31 of the Act. Section 31(5) provides that the transfer pricing legislation does not apply if:

- Financial assistance has been received by the new South African HQC from a non-resident company and is applied to a foreign subsidiary company in which the new South African HQC owns at least 10% of the equity shares or voting rights; or
- Where financial assistance has been granted by the new South African HQC to a foreign company in which it owns at least 10% of the equity shares or voting rights; or
- A transaction that has been entered into between the new South African HQC and another foreign company in respect of which the foreign company has provided the use, right of use or permission to use IP (as defined in section 23I of the Act) to the new South African HQC, and the new South African HQC in turn grants the use, right of use or permission to use the IP to a foreign company in which it holds at least 10% of the equity shares and voting rights (provided that the new South African HQC does not make use of the IP otherwise); or
- A transaction has been entered into between the new South African HQC and a foreign company in which at least 10% of the equity shares or voting rights is held, and the transaction provides that the foreign company may have right of use, permission to use, or may have been granted use of any IP (as defined in section 23I of the Act).

The new South African HQCR is therefore ideally suited to facilitate funding by an offshore investor that is on-passed to the foreign subsidiaries. Similarly, funding provided by a new South African HQC to foreign subsidiaries (that was not received from an offshore investor) will also not be subject to the thin capitalisation and transfer pricing legislation.

In contradiction to the above relaxation of transfer pricing and thin capitalisation rules, legislation has also introduced a limitation under section 20C of the Act (South African Revenue Service, 1962) on the deduction relating to royalty and IP payments.

Section 20C determines that the interest and royalty payments made in respect of IP services and financial assistance to a shareholder is only deductible to the extent of the income earned from on passing these services to the subsidiary companies, in which at least a 10% of the equity shares and voting rights is held.

The relaxation of transfer pricing and thin capitalisation regime does not provide relief in practice as the Act continues to impose a limitation on the deductibility of interest and royalty payments. In addition to this, the relaxation, if the regime does not extend to transactions such as the sale of goods and services, and any such transactions would still be subject to the transfer pricing regime on the difference in price between the market value and the transaction price. Should a price difference exist on these transactions, this would be considered to be a loan on which the South African Revenue Service ('SARS') may levy a market related interest rate (Haupt, 2013).

g. The CFC regime under South African legislation

The CFC regime under section 9D of the Act determines that the net income of a CFC must be imputed into the taxable income of the South African parent company as if the CFC is considered to be a resident company of South Africa. This inclusion is subject to certain exclusions. The net income is calculated under the provisions detailed in section 9D(2) of the Act. Section 9D(2) determines the imputed income in the hands of a new South African HQC from CFC, to be nil by virtue of the wording:

> There shall be included in the net income for the year of assessment of any resident (other than a resident that is a headquarter company) who directly or indirectly holds any participation rights in a controlled foreign company-
> On the last day of the foreign tax year of that controlled foreign company which ends during the year of assessment an amount equal to
> Where that foreign company was a controlled foreign company for the entire foreign tax year, the proportional amount of net income of that controlled foreign company determined for that foreign tax year, which bears to the total net income of that company during that foreign tax year, the

> same ratio as the percentage of the participation rights of that resident in relation to that company bears to the total participation rights in relation to that company on the last day.

Therefore a new South African HQC is not required to impute the income earned by the subsidiary companies in its calculation of taxable income.

h. The optimisation of foreign tax credits

Sections 6quat and 6quin of the Act (South African Revenue Service, 1962) allows for a taxpayer to claim a foreign tax credit relating to an amount included in the taxable income. The Act determines that specific provisions must be applied in calculating the allowable credit that is limited to,

- the lower of the South African tax payable; and
- the actual foreign tax paid on amounts included in the South African taxable income of the recipient.

Tax credits relating to income earned from different jurisdictions may be claimed in the same entity, however the restrictions imposed on the calculation of the claimable credit may make it difficult to "pool" funds in South Africa.

3.3.2 Commercial considerations

In consideration of the regular amendments to the legislation, Olivier and Honiball (2011) determined that:

> the tax considerations are short-term considerations at best, and one should therefore consider the tax considerations in addition to the commercial considerations.

National Treasury considered exactly this, when establishing the provisions relating to the new HQC.

As a consequence the new HQCR was established with the commercial considerations in mind, namely the ability to undertake both group reorganisations and asset protection, and the relaxation of the exchange control regime.

a. *The ability to undertake group reorganisation and asset protection*

The Act provides for what is known as corporate restructurings within a group context to be completed free of tax implications. These sections of the Act are

known as the corporate rules. These provisions determine the specific requirements that must be met in order for the corporate rules to apply. It is noted that these provisions are rather onerous and will only apply in apply in very specific circumstances, which may make it difficult to effect such transactions.

Example. If a section 45 restructuring is completed in respect of an offshore group, the restructuring must be completed on loan account. This loan account is deemed to have a base cost of nil and cannot be distributed without triggering adverse tax effects (i.e. the loan account would have to be repaid in cash).

Generally, tax havens also allow for the use of such rules to "step up the base cost" of the investment to reflect a market value. A "step up of the base cost" is possible in a tax free environment as the sale transaction is entered into on market related terms, with no corresponding tax effect (i.e. the new acquisition cost will be recorded at market value) This feature is not provided for in the new HQCR, as a step up of the base cost is not allowed as can be seen above.

Another significant consideration is to ensure that the equity investments are held in a politically safe environment in which to conclude business. In an interview with a representative from National Treasury (Mvovo, 2012) it was identified that a few of the potential problems that South Africa may encounter with this this regime was:

- Immigration issues and the related administrative issues: Attracting foreign skilled people and the time it takes to obtain a work permit or visa, and
- Labour issues: Inflexibility of the labour laws is often cited as problematic for doing business in SA by imposing a high burden on business management and increasing the cost.

These issues may create a lack of confidence in the political security of the equity investments held in South Africa. This problem is further compounded by the fact that South Africa is viewed as a politically unstable environment due to the volume of labour and other protests.

b. Foreign exchange gains or losses

Section 25D of the Act (South African Revenue Service, 1962)dictates the treatment of foreign exchange gains and losses relating to the new HQC. This section determines how the income and expenditure incurred by a new HQC in a different function currency must be translated back into Rands using the average exchange rate for the year. This would result in a taxable foreign exchange gain or loss incurred in the new HQC, and does not cater to the characteristics required by an intermediary or head quarter company.

c. Exchange Control and the IHC Regime

The new HQCR has been established to promote the use of South Africa as an intermediary jurisdiction in which to hold equity investments. One of the key considerations identified in assessing the potential structures that this regime may potentially be applied to, is the freedom to invest without exchange control limitation. The following amendment to the Exchange Control Act provides that exchange control regulations do not apply in respect of a new South African HQC (Mvovo, 2012):

> Subject to registration with the Financial Surveillance Department for reporting purposes, newly established headquarter companies who meet the following shareholding and asset criteria may invest offshore without restriction.

3.4 Conclusions

In conclusion to the first sub-problem identified, it is determined that the new HQCR illustrates a few of the characteristics (identified in chapter 2 above) required by an ideal intermediary holding company jurisdiction, such as a disregard of the withholding taxes levied on non-residents, a large network of DTAs and a relaxation of the exchange control regime. Although the remaining best practice characteristics normally illustrated by a headquarter company are partially present, restrictions have been imposed thereon, which may prove difficult for potential investors. At a high level, the HQCR can be summarised as follows:

- A corporate tax rate of 28% will apply to income earned by the HQC. If an offshore investor aims to only use the HQC as an intermediary company through which foreign dividend income is repatriated back to the ultimate offshore parent company, this would not be a potential problem as dividend income is considered to be exempt income in South Africa. This exemption will however apply to both South African resident companies and to offshore investors that have established a new HQC in South Africa. As no exemption is available to in respect of income not of a dividend nature, this may prove to be problematic where interest and royalty income is repatriated back from the foreign subsidiary companies to the new HQC. Income of this nature will be taxed at the comparatively high corporate tax rate of 28% in South Africa.
- Dividend and royalty payments made to non-resident shareholders will be exempt from withholding tax under the new HQCR;
- The Act proposes to provide for an exemption from withholding tax on interest and management fee payments to non-resident (under the new HQC) on implementation thereof in the future;
- South Africa has entered into a large number of DTAs with other jurisdictions. These DTAs include jurisdictions that have not signed DTAs with more prominent head quarter company jurisdictions. Where these DTAs are found to be comparable to other holding company jurisdictions, this will prove to be an advantage for an offshore investor looking to invest into Africa. These DTAs are however also available to a South African resident company transacting with other jurisdictions. The DTA will not provide any additional benefits to a South African MNE;
- Paragraph 64B(2) of the Eighth schedule to the Act provides for disregarding of capital gains on the sale of the investments by a new South African HQC. A similar provision is determined under paragraph 64B(1) of the Eighth Schedule to the Act in respect of to resident companies, although this provision does impose certain requirements (example. the purchaser of the equity shares must be a non-resident). This

limitation illustrates that there are fewer restrictions imposed on a new South African HQC than on a South African resident company. The benefits that are only provided to the new South African HQC, illustrate that the new South African HQCR caters for the best practice characteristics that are required in an intermediary holding company.

- Upon entering the new HQCR, section 9H provides that a South African company will be subject to a deemed sale of assets. This may prove to limit the South African companies that would utilise the regime and may be seen to mimic the previous IHQ that was not aimed as South African companies.
- Capital duty is not imposed on the increase of share capital in South Africa, this would allow for the shareholder of the new HQC to invest further capital into the new HQC where additional funding is required.
- The new HQC provides for an exemption from the transfer pricing and thin capitalisation regime on financial assistance and royalty payments to and from foreign shareholders or foreign subsidiaries. The Act has however provided a limitation on the relaxation of these rules by introducing section 20C to the Act. Section 20C provides that the deduction relating to such expenses is limited to the income earned from the supply of these services to foreign company in which at least 10% of the equity shares and voting rights are held. Although the provisions relating to transfer pricing and thin capitalisation legislation appear to have been relaxed, in essence they have just been transferred to an alternative section of the Act. In addition to this, the relaxation of the transfer pricing regime has not been extended to cover sales and services transactions due to the fact that the intermediary company is not envisioned to received this type of income;
- A new HQC will not be required to impute the income earned in the hands of its respective CFC's back into South Africa;
- South Africa does allow for a deduction or rebate in respect of foreign taxes paid. This is however limited to the South African tax on the foreign income earned.

This limitation on the calculation of the credit will prove to be a adversity in the maximisation of foreign tax credits, as no credit is available if the income is exempt;

- Reorganisation transactions are possible under the corporate rules in South Africa. These rules are very specific and will only apply in limited circumstances, making the application thereof onerous. In a normal intermediary or head quarter company jurisdiction one is able to utilise these rules to step up the base cost of an investment. Under South African legislation this would not be possible as the assets are transferred at the original cost. This will prove to be a limitation on the effectiveness of the new HQCR as;
  - no certainty exists that the corporate rules will apply;
  - should the corporate rules apply, there would be no additional tax benefit in a group reorganisation.
- The new HQCR does not provide for any relief from exchange gains or losses incurred. If the foreign subsidiary companies where to transact in a functional currency other than Rands, the fluctuating value of the Rand on translation would result in a both an additional tax and accounting gain or loss.
- Many investors wish to invest in a jurisdiction that provides for freedom to reinvest any growth offshore as is best required from a commercial perspective. The new HQCR does provide for this by the relaxation of the exchange control regulations relating to the new HQC.

4. Chapter 4: Comparison between South Africa and Mauritius as a headquarter company jurisdiction

Internationally a few foreign jurisdictions have managed to successfully establish effective intermediary holding company regimes. This chapter considers a well-known jurisdiction (i.e. Mauritius) and reviews whether or not the characteristics previously identified in Chapter 2 are present in this jurisdiction and comparable to the characteristics provided for by the HQCR in South Africa as identified in Chapter 3.

Interest is often expressed in Mauritius as an intermediary holding company jurisdiction. This is attributed to the good infrastructure, and close proximity to Africa, which contributes to ease of business. As a result of these and other characteristics Mauritius has been able to provide a good holding company jurisdiction for many different types of businesses such as offshore banking and business services, insurance services and investment fund management. More specifically however, Mauritius also affects two different types of offshore holding company regimes, namely the Global Business Licence 1 (GBC 1) and the Global Business License 2 (GBL 2).

4.1 Headquarter company regimes in Mauritius

Mauritius has established a number of regimes that provide good opportunities for companies to invest through Mauritius into other jurisdictions. These regimes include:

4.1.1 Global Business License 1 (GBL1)

The GBL 1 regime caters for foreign investors who wish to invest into other jurisdictions through a Mauritian intermediary company. In order to establish a GBL1, the following requirements must be met:

- A minimum of two Mauritius directors;
- The principal bank account must be situated in Mauritius;
- The accounting records must be kept within a registered office in Mauritius;
- The annual financial statements must be prepared and audited in Mauritius; and
- Board meetings with at least two Mauritian directors present must be held in Mauritius.

Under the GBL 1 regime a company is classified as a tax resident company and may enter into trading transactions in Mauritius. As a Mauritius tax resident, the Mauritian tax legislation would apply to the GBC1.

a. Corporate tax rate: Dividend and other income earned

A corporate tax rate of 15% is levied on the worldwide income of a Mauritius tax resident company. Conversely to taxing residents on worldwide income, Mauritius only taxes non-resident companies (such as a GBC2 see below) on Mauritius sourced income (Deloitte, 2014a) .The taxable income is calculated on the profit earned from trading activities less any allowable expenses.

The Mauritian headquarter company may claim a foreign tax credit (FTC) If the underlying shareholding in the foreign subsidiary company is 5% or more (Ernst and Young, 2014). In addition to this, a deemed FTC can also be claimed in respect of a GBC1, this FTC is presumed to be 80% of the Mauritius taxes paid. The deemed FTC will therefore reduce the corporate income tax rate to an effective rate of 3%.

As mentioned previously, an ideal headquarter company regime would allow for the repatriation of funds, (such as dividend distributions or payments in the form of management fees, interest or royalties) to the shareholder without any tax effects. One of the methods in which Mauritius allows for this is in the form of dividends (Mauritius Revenue Authority, 1995). Dividend income received from a Mauritian company will be tax exempt in the hands of the GBC 1. Dividend income received by the GBC 1 from a foreign subsidiary company will be taxed as normal income at the corporate rate of 15%, but as discussed above, the legislation affords the recipient a tax credit of 80%.

Another effective manner of repatriating funds is in the form of interest. Interest income received by a company is exempt (Mauritius Revenue Authority, 1995) in certain instances where the amount has been

received from a non-resident company that is not carrying on business in Mauritius by:

- a corporation in possession of GBL1 and the interest income is paid out of foreign sourced income; or
- by a bank if the interest arises from transactions with non-resident and corporations holding GBL1.

If none of the above exemptions apply, then the income will be subject to tax at the corporate rate of 15%. As mentioned previously, this rate will be reduced via a deemed foreign tax credit of 80%, and an effective tax rate of 3% will apply.

The same principle would apply in respect of any royalty or management fee income earned (i.e. the income will be taxable at the effective corporate rate of 3%).

b. Exemption from withholding taxes on interest, royalties and services

The Mauritius Revenue Authority 'MRA' does not impose a dividend withholding tax on payments made to non-resident shareholders (Mauritius Revenue Authority, 1995).

On the other hand, should the funds be repatriated to non-resident shareholders in the form of interest, royalties or management fees, then the MRA will impose a withholding tax on these payments at the respective rates of 15% on interest and royalty payments and 10% on service fee payments made to the non-residents respectively.

c. Withholding tax rates under Mauritius DTAs

These withholding tax rates can be reduced through the application of the DTAs that have been entered into between Mauritius and other jurisdictions. Mauritius has ratified a total of 39 agreements that are currently in force (Mauritius Revenue Authority, 2014a). The table below highlights the reduction in the local withholding tax rates, but does not address any exemptions provided for by the local legislation (Deloitte, 2014b).

#	Jurisdiction	Type	Dividends	Interest	Royalties	CGT
1	Australia	Local	0% - Franked 30%- Unfranked	10%	10%	30%
		DTA[6]	-	-	-	
2	Barbados	Local	25% (if paid out of tax exempt profits), otherwise 15%	15%	15%	No specific rules.
		DTA	5%	5%	5%	Taxed in the alienator state unless it is a PE or immovable property
3	Belgium	Local	25%	25%	25%	33% or 0.412% - equity shares
		DTA	5% ≥ 10% shareholding exists otherwise 10%	10%	Exempt	Taxed in the alienator state unless it is a PE
4	Botswana	Local	7.5%	15%	15%	22%
		DTA	5%≥ 25% shareholding or 10% (limited to the local rate of 7.5%)	12%	12.5%	Taxed in the alienator state unless it is a PE or immovable property
5	China	Local	10%	10%	10%	25%

[6] The Australia DTA is a limited DTA in that it is only a mutual agreement procedure document in respect of transfer pricing.

		DTA	5%	10%	10%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
6	Croatia	Local	12%	15%	15%	20%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
7	Cyprus	Local	0%	0%	0%	20%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
8	France	Local	30% or 50% if low tax jurisdiction	50% if low tax jurisdiction	50% if low tax jurisdictio n 0% or 33.3%	33.3%
		DTA	5% ≥ 10% shareholding exists otherwise 15%	domestic rate applies	15%	Taxed in the alienator state unless it is a PE or immovable property
9	Germany (new)	Local	25% reduced to 10% under EU regime or 15%	0%	15%	15%

			under anti-treaty shopping rules			
		DTA	5% ≥ 10% shareholding otherwise 15%	Exempt	10%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
10	India	Local	DDT 16.995%	20%	25%	10%
		DTA	5% ≥ 10% shareholding otherwise 15%	Domestic rate applies	15%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
11	Italy	Local	20%	20%	30%	13.67%
		DTA	5% ≥ 25% shareholding otherwise 15%	Domestic rate applies	15%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
12	Kuwait	Local	15%	0%	0%	15%
		DTA	Exempt	Exempt	10%	Taxed in the alienator state unless it is a PE

						or immovable property or shares in a property company
13	Lesotho	Local	25%	25%	25%	25%
		DTA	10%	10%	10%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
14	Luxembourg	Local	15%	15%	0%	21%
		DTA	5% ≥ 10% shareholding otherwise 10%	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
15	Madagascar	Local	0%	20%	10%	20%
		DTA	0%	10%	5%	Taxed in the alienator state unless it is a PE or immovable property
16	Malaysia	Local	Local	0%	15%	10%
		DTA	5% ≥ 10% shareholding	15%	15%	Taxed in the alienator state

			otherwise 15%			unless it is a PE or immovable property
17	Monaco[7]	Local	0%	0%	0%	0%
		DTA	Exempt	Exempt	Exempt	N/A
18	Mozambique	Local	10% - listed or 20%	20%	20%	32%
		DTA	8% ≥ 25% shareholding (i.e. a company), 10% < 25% shareholding by a company otherwise 15%	8%	5%	Taxed in the alienator state unless it is a PE or immovable property
19	Namibia	Local	10%≥ 25% shareholding or 20%	10%	10.2%	0%
		DTA	5%≥ 25% shareholding, otherwise 10%	10%	5%	Taxed in the alienator state unless it is a PE or immovable property
20	Nepal[8]	Local	5%	15%	15%	25%[9]
		DTA	5% ≥ 15% shareholding or 10% ≥ 10% shareholding	10% financial institutions	15%	Taxed in the alienator state unless it is a PE or immovable

[7] (Consulat General de Monaco)
[8] (Inland Revenue Authority Nepal: Income Tax Act 2058, 2004)
[9] (Inland Revenue Authority Nepal, 2000)

			otherwise 15%	or 15%		property
21	Oman	Local	10%	10%	10%	12%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
22	Pakistan	Local	10%	10%	15%	35%
		DTA	10%	10%	12.5%	Taxed in the alienator state unless it is a PE or immovable property
23	People's Republic of Bangladesh	Local	20%	10%	10%	15%
		DTA	10%	Normal rate -10%	Normal rate- 10%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
24	Rwanda	Local	15%	15%	15%	30%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
25	Senegal	Local	10%	16%	20%	25%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state

						unless it is a PE or immovable property
26	Seychelles	Local	15%	15%	15%	0%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
27	Singapore	Local	0%	15%	10%	0%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
28	South Africa	Local	15%	N/A	15%	18.6% (for companies)
		DTA	5% ≥ 10% shareholding otherwise 15%	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
29	Sri Lanka	Local	10%	10%	10%	0%
		DTA	10% ≥ 10% shareholding or 15%	10%	10%	Taxed in the alienator state unless it is a PE or immovable property
30	State of Qatar	Local	5%-7%	5%-7%	5%-7%	10%
		DTA	Exempt	Exempt	5%	Taxed in the alienator state

						unless it is a PE or immovable property
31	Swaziland	Local	15%	10%	15%	N/A
		DTA	7.5%	5%	7.5%	Taxed in the alienator state unless it is a PE or immovable property
32	Sweden (New)	Local	30%	0%	0%	22%
		DTA	0% ≥ 10% shareholding if a company, otherwise 15%	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
33	Thailand	Local	10%	15%	15%	20%
		DTA	10%	10% & 15%	5% & 15%	Taxed in the alienator state unless it is a PE or immovable property
34	Tunisia	Local	0%	20%	15%	30%
		DTA	Exempt	2.5%	2.5%	Taxed in the alienator state unless it is a PE or immovable property
35	Uganda	Local	15%	15%	15%	30%
		DTA	10%	10%	10%	Taxed in the alienator state unless it is a PE

						or immovable property
36	United Arab Emirates	Local	0%	0%	0%	0%
		DTA	Exempt	Exempt	Exempt	Taxed in the alienator state unless it is a PE or immovable property
37	United Kingdom	Local	0%	20%	20%	24%
		DTA	10% > 10% shareholding otherwise 15%	Domestic rate	15%	Taxed in the alienator state unless it is a PE or immovable property
38	Zimbabwe	Local	10% if listed company otherwise 15%	15%	15%	1% listed shares; 5% unlisted shares or 15% for immovable property
		DTA	10% > 25% shareholding otherwise 20%	10%	15%	Taxed in the alienator state unless it is a PE or immovable property or shares in a property company
39	Zambia	Local	15%	15%	20%	0%
		DTA	5% ≥ 25% shareholding exists or 15%	10%	5%	0%

This treaty network is expected to increase as Mauritius has signed, but not yet ratified an additional 9 DTAs with Congo, Egypt, Gabon, Kenya, Nigeria, Guernsey, Russia, Rwanda (renegotiated) and South Africa (renegotiated). Mauritius has also negotiated but has not yet signed a DTA with Ghana (Mauritius Revenue Authority, 2014a).

In the past the DTAs entered into by Mauritius predominantly provided for full taxing rights to be granted to Mauritius in respect of capital gains made on the sale of Mauritius property. As Mauritius does not impose tax on capital gains, this allowed for many instances where profits may have remained untaxed. As a result of this, together with the fact that some of the treaties in force may be out-dated, Mauritius has started to renegotiate a few of the DTAs (e.g. the DTAs with South Africa and Rwanda) (Mauritius Revenue Authority, 2014a).

There are an additional 17 treaties that are under negotiation, these DTAs include jurisdictions such as, Algeria, Burkina Faso, Canada, Czech Republic, Greece, Hong Kong, Lesotho (renegotiated), Portugal, Republic of Iran, Malawi, Saudi Arabia, St. Kitts & Nevis, Vietnam, Yemen, Tanzania, Morocco and Montenegro.

d. CGT Regime in Mauritius

As an intermediary company transacts in the sale and purchase of investments, it is imperative that the sale transaction be free from CGT to avoid tax leakage on these transactions. This can be achieved in one of two manners, firstly through disregarding of the capital gain as a result of the provisions or secondly, through lack of a capital gains tax regime.

Mauritius provides for this characteristic in that it does not impose a CGT Regime (Mauritius Revenue Authority, 1995). Any future sales of the investments would therefore be free from CGT. Furthermore, the lack of a CGT regime will allow a MNE to undertake group reorganisations based on commercial rationale.

e. *Tax on the increase in share capital*

Mauritius does not impose either capital duty or stamp duty on an increase of share capital. An injection of additional share capital in respect of additional funding will therefore not give rise to an additional tax (Deloitte, 2014a).

f. Transfer pricing and thin capitalisation

Other aspects in which the Mauritius legislation is favourable to foreign investors is the lack of a thin capitalisation regime (Mauritius Revenue Authority, 1995). This allows for foreign investors to repatriate funds back to the shareholder's jurisdiction without a limitation in regard to the value of debt introduced versus the value of equity introduced. Debt is a preferred method of financing offshore investments as it results in a tax deduction for the company paying the interest and a before tax return of profits. This is converse to the employment of equity that facilitates the receipt of dividend income as a return on after tax profits.

Although no specific transfer pricing rules exist, the MRA provides for anti-avoidance legislation that determines that transactions must be completed at a market related value. This provision would apply where goods or services are sold between group companies, effectively providing for a limitation on the pricing of inter-group transactions (Mauritius Revenue Authority, 1995).

g. CFC Regime

Any income earned by foreign subsidiary companies owned by the GBC 1 would not need to be imputed back to Mauritius, as Mauritius does not impose a CFC regime (Mauritius Revenue Authority, 1995).

h. Optimisation of foreign tax credits

Mauritius provides for an 80% deemed foreign tax credit against any income earned (Mauritius Revenue Authority, 1995). This allows for a reduction in the effective corporate tax rate from 15% to 3%.

i. The ability to undertake group reorganisations

As mentioned above the absence of a CGT regime in Mauritius allows for a MNE to undertake group reorganisations free of any CGT consequences.

j. Foreign exchange gains or losses

The Mauritius Revenue Authority (1995) does not provide for specific legislation in respect of foreign exchange gains or losses, and as a result of this, any attributed fluctuations will be taxable at the effective corporate rate of 3%.

k. Exchange control regulations

Mauritius does not impose exchange control regulations.

4.1.2 GBL 2

The Companies Act, 2001 and the Financial Services Act, 2007, regulate GBL2 companies (GBC2). In order to qualify as a GBC2, the company must be beneficially owned by non-residents and operate exclusively outside Mauritius. GBC2 companies are considered to be non-resident and are therefore not subject to corporate income tax. Likewise any payments made to a non-resident shareholder will not be subject to any withholding taxes.

A large degree of privacy is applied around GBC2, as there is no requirement imposed to reveal the names of the beneficial owners (Anderson Ross Legal). Should additional privacy be required, a nominee company can be incorporated with nominee shareholders and directors. Mauritius does not apply a limitation on the number of shareholders and directors of a GBC2, and consequently the director and shareholder may be one and the same.

Up until recently no requirement of presenting annual financial statement to the MRA was imposed, allowing for the annual financial statements of GBC2 to be kept private, and accounting records to be maintained only for the purposes of keeping track of the financial status of the company (Anderson Ross Legal). This requirement was amended and a GBC2 is now required by the Financial Services Act to submit their annual financial summary and

all information on the beneficial ownership to the Financial Services Commission (FSC).

The GBC2 is subject to a more flexible regime than GBC1, but they do not benefit from double tax treaties. This is in contradiction to the fact that the exchange of information agreement may be applied to GBC2 companies (Mauritius Revenue Authority, 2014b).

Another limitation that applies to a GBC2, in that in order to maintain its non-resident status, it may not carry on trade within Mauritius.

4.2 Transparency of information

Mauritius allows for privacy of information surrounding the shareholders of companies and beneficiaries of trusts. This has drawn attention and has resulted in Mauritius being placed on the OECD black list of tax havens along with many other similar jurisdictions. In order to avoid this categorisation, many jurisdictions have agreed to enter into exchange of information (EOI) agreements. To date Mauritius has entered into 5 EOI agreements that are presently in force. These agreements are with the following countries (Mauritius Revenue Authority, 2014a):

- Australia
- Denmark
- Finland
- Norway
- States of Guernsey.

An additional 2 EOI agreements have been signed, but are not yet ratified, with Faroe Island Greenland and Iceland. This list is soon to increase, as there are 3 more EOI agreements with the Isle of Man, Greece and India that are awaiting signature (Mauritius Revenue Authority, 2014a).

4.3 Future of Mauritius

The number of EOI agreements entered into and negotiated by Mauritius illustrates that Mauritius is under pressure by the OECD to amend its current regime as a tax haven. This is emphasized by the fact that Mauritius is renegotiating a few of the DTAs previously entered into, due to

unfavourable and out-dated provisions. This is evident from the South African / Mauritius DTA).

Mauritius may therefore not be able to maintain its favourable regime indefinitely into the future.

4.4 Mauritius characteristics versus the characteristics provided for by the new HQCR in South Africa

The GBL 1 regime provides for most of the best practice characteristics required by an intermediary holding company. It can however be seen from the above discussion in Chapter 2, that some of the provisions that the new HQCR in South Africa also caters to these characteristics (subject to certain requirements being met). For the new South African HQCR, specific requirements must be met in order to obtain the exemptions relating to transfer pricing and thin capitalisation, furthermore, where these requirements have been met, the related deduction is still limited under section 20C of the South African Income Tax Act. The limitations imposed on the new South African HQCR contrasts the fact that Mauritius does not impose legislative requirements at all, such as:

- No CGT regime is imposed in Mauritius;
- No exchange control regulations are imposed in Mauritius;
- No thin capitalisation regime is imposed in Mauritius;
- No CFC regime exists in Mauritius.

The above differences are further emphasised by the fact that:

- Mauritius imposes an effective tax rate at 3% as opposed to the corporate tax rate of 28% in South Africa, and
- An offshore investor can transact in a more stable currency, the Mauritian Rupee, rather than the South African Rand.

It is therefore determined that if South Africa and Mauritius have both entered into a DTA with the respective jurisdiction required by a potential investor, it is likely that Mauritius will continue to be used as a headquarter company jurisdiction. This may not hold true in instances

where only South Africa has entered into a DTA with the respective jurisdiction as the potential investors may then consider entering into the new South African HQCR due to the lack of alternatives.

4.5 Conclusion

The GBL 1 regime in Mauritius is a long established regime that is used by offshore investors to invest into Africa. The Mauritius regime provides for many of the characteristics that are required to establish an effective headquarter company regime:

- Although companies are considered to be Mauritian tax residents under this regime, the Mauritian corporate tax rate of 15% is reduced by an 80% tax credit. As a result of this, an effective tax rate of 3% will apply to all companies registered as a GBC 1.
- Dividend income received by the GBC1 from a Mauritius tax resident company is exempt. Interest income received by a GBC1 company is also exempt if paid out of foreign sourced income. All other income will be taxed at the effective corporate tax rate of 3%.
- Mauritius currently has a total of 39 treaties with other jurisdictions. In addition to these DTAs Mauritius will also be entering into new DTAs with an additional 7 jurisdictions, of which 6 have been signed but are not yet ratified and one is awaiting signature.
- Dividend payments made to non-resident shareholders of Mauritius will not be subject to a withholding tax in Mauritius if the intermediary company is in possession of a GBL1.
- Mauritius does however levy a withholding tax on interest, royalties and management fees paid to non-resident. The withholding tax is levied at the respective rates of 15%, 15% and 10%. These rates may be reduced through application of any one of the 39 DTAs entered into and shortly the other seven DTAs to be entered into.
- Mauritius does not impose a CGT regime and consequently any sale of equity shares in

investments held will therefore not be subject to CGT.

- Mauritius does not impose a thin capitalisation regime on transactions with non-resident companies, thereby allowing for the repatriation of funds to a non-resident shareholder in the form of interest. Although no specific transfer pricing regime exists, transactions are required to be completed at an arm's length price.
- Mauritius does not impose CFC legislation in respect of subsidiaries where more than a 50% shareholding is held. Any income earned by the subsidiary companies will therefore not be imputed back to the Mauritius company.
- The lack of CGT would allow for a company to undertake group reorganisations free from any CGT implications, based only on commercial rationale.
- No specific foreign exchange regulations are provided for in the Mauritian tax act, resulting in a taxable gain or loss on any foreign exchange movement. This gain or loss will only be subject to tax at the maximum effective tax rate of 3%.
- Mauritius does not impose an exchange control regime, thereby allowing the intermediary company to freely invest offshore.

In addition to the GBL 1 regime, Mauritius also offers non-residents, who wish to retain their non-resident status and not undertake any business in Mauritius an opportunity to register for a GBL 1I. These companies will not be subject to the benefits provided under the DTAs.

The second sub-problem assesses whether or not the new South African HQCR is able to compete with other well established headquarter company regimes. In order to assess this it must be determined if there are any characteristics that are offered by the new South African HQCR that is not offered by other headquarter company jurisdictions (i.e. such as Mauritius). The above discussion highlights that there is only one characteristic that is offered by the new South African HQCR which is not offered by Mauritius. This characteristic is identified as the blanket exemption in respect of withholding taxes on payments made to non-residents.

Mauritius does however provide for many characteristics that are not provided for in the new South African HQCR such as the much lower corporate tax rate (i.e. at 3%) versus the corporate tax rate of 28% imposed by South Africa. It can therefore be seen that the new South African HQCR does not offer potential investors with any unique benefits, instead there are jurisdictions that offer more beneficial characteristics (such as Mauritius).

The only instance that a potential investor may consider the alternative option of entering into the new South African HQCR is where a DTA is available between South Africa and a respective jurisdiction that has not been entered into between Mauritius and that jurisdiction. This will only hold true if the negotiated rates in the DTA are more beneficial than the local rates applied in that jurisdiction.

It is also noted that the generous tax system is giving rise to Mauritius being regularly viewed as a tax haven. This is initiating a large amount of pressure on Mauritius to amend the beneficial tax characteristics that identify it as a tax haven. This can be seen from both the increasing number of Exchange of Information agreements entered into by Mauritius and the renegotiated DTAs. As a result it has become questionable as to whether or not Mauritius will be able to indefinitely provide the beneficial characteristics that it currently offers to potential investors under the GBL1.

5. Chapter 5: Tax havens versus low tax jurisdictions

5.1 Introduction

The term tax haven does not have a precise meaning, but has been identified by the OECD as a country that is able to finance its public services with no or nominal income taxes and which actively makes itself available to non-residents for the avoidance of tax which would otherwise be paid at a relatively high rate (Ogley, 1993).

Due to the implementation of harmful tax practices, tax havens have acquired a negative image. Jurisdictions can establish a tax haven in one of three ways as a (Olivier & Honiball, 2011):

- a jurisdiction that does not impose any taxes;
- low tax jurisdictions; or
- a jurisdiction that grants tax concessions or privileges.

As a result of the limitation of corporate taxes imposed, tax havens are considered to hamper the development of other countries by what is identified as the 7 tax haven sins (Eriksson, 2009):

- Tax havens encroach heavily on the on the sovereignty of other countries;
- Tax havens harm the efficiency of financial markets;
- Tax havens undermining the national tax systems and thereby increase the costs of taxation;
- Tax havens reducing the efficiency of resource allocation;
- Tax havens make it more profitable and less risky to engage in economic and other crimes;
- Tax havens hurt private income;
- Tax havens hurt institutional quality (bureaucracy at large) and thereby economic growth (and democratic development in the long run).

This chapter considers the most prominent characteristics that are identified with a tax haven as (Tax Justice Network, 2007) (Gravelle, 2013):

- No or nominal income taxes that result in a place for non-residents to escape their taxes.
- A lack of exchange of information through the application of laws that promote secrecy and lack of

transparency. This is normally in the form of banking secrecy, and secrecy of legal entities.

- A lack of application in respect of legislative, legal or administrative provisions.
- The absence of qualifying activity. This would suggest that the jurisdiction has established tax laws with the purpose of attracting investments.
- A ring fenced tax system. (i.e. a regime that provides preferential treatment and that is isolated from the domestic economy); and
- Legislation that favours foreign investors.

5.2 Definition of a tax haven

MNE's require an ideal base from which to expand into different parts of the world, and they therefore look to establish an offshore holding company in a jurisdiction that is an OFC jurisdiction or a tax haven.

Although, an OFC and a tax haven are closely linked and share many of the same features, a distinction does exist between what is referred to as a tax haven jurisdiction, and what is referred to as an OFC jurisdiction (Tax Justice Network, 2007).

5.2.1 Tax haven and harmful tax regimes

The dominant features of a tax haven, is that no tax or tax at a low rate is imposed, and that the country is generally able to meet its fiscal needs through the levying of indirect taxes (Ogley, 1993). As a result of the nominal taxes imposed, a large volume of activity flows through these jurisdictions. Minimisation of taxes is an important feature in a tax haven, and this minimisation is effected through the implementation of tax laws. Other characteristics that identify tax havens are elaborated on below.

These jurisdictions often struggle to enter into DTAs, as they have no taxes to reduce and are not able to offer a compromise with another jurisdiction. As a result, they are not generally recognised as ideal holding company jurisdictions.

Various lists have been released over time identifying the countries' that are regarded as tax havens. The most well-known report that was released in 1998 by the OCED, not

only identified these jurisdictions but also the characteristics that can be found in these jurisdictions (Tax Justice Network, 2007).

According to the Tax Justice Network (2007), the OECD initially identified 47 tax haven jurisdictions in this report, which were 'blacklisted'. Amongst the jurisdictions identified as tax havens, the list also mentioned a number of significant OFCs such as Luxembourg, Switzerland, UK, Ireland, Singapore and Dubai, which illustrates that OFCs at large share many of the same characteristics as tax havens.

Subsequently the 47 tax haven jurisdictions were reduced to 41, when 6 of the jurisdictions agreed to co-operate.

As a result of being blacklisted, many of the identified countries committed to improving transparency and establishing effective exchange of information, which resulted in a decrease of the blacklist from 41 to 5 countries. In addition to this, three of the jurisdictions that were previously identified, were no longer considered to be tax havens. The remaining 5 countries that were identified, as non-committed countries, were Andorra, Lichtenstein, Monaco, Liberia and the Marshall islands.

The OECD also completed work in identifying preferential tax regimes in jurisdictions that are not considered to be tax havens. The regimes were identified based on the same characteristics provided by a tax haven (Tax Justice Network, 2007):

- Low or nominal tax rates;
- Ring fencing of the regime;
- Lack of transparency;
- Lack of effective exchange of information.

In general these regimes were found to encourage tax driven operations or arrangements and in this sense correspond to tax havens.

A list of 47 potential harmful tax regimes was identified in 20 OECD countries. A subsequent list was published in 2006 (Tax Justice Network, 2007) that confirmed that most of the regimes had either been abolished or were not found to be harmful (after a detailed investigation into the

regimes). The Luxembourg holding company regime was found to be an exception and remained identified as a harmful tax regime.

Simultaneously, the European Union (EU) performed an investigation into tax havens, and identified a number of harmful tax regimes based on the EU Code of Conduct on Business Taxation This list that was released in the Primarolo Report, identified many of the same states as the OECD report. Included in this Report, that has subsequently been cleared after its holding company regime was amended, was Austria.

The EU still continues its work in identifying tax havens, but no amendments have been released since the Primarolo Report (Tax Justice Network, 2007).

The list of identified EU tax havens below is compared to the list of identified OFC's (Tax Justice Network, 2007).

5.2.2 Definition of an Offshore Finance Centre (OFC)

The Financial Stability Forum (FSF) is another recognised body that has also made an effort to identify what is referred to as an OFC. The criteria used to identify these jurisdiction was similar to the criteria used by the OECD, and was based on the regulatory environment. These criteria included characteristics such as (Tax Justice Network, 2007);

- limited or no taxes imposed on investment income;
- lack of withholding taxes;
- no or limited regulation around incorporation;
- limited regulation around supervisory regimes;
- flexible use of trusts or other special corporate vehicles;
- no physical presence required;
- high level of client confidentiality;
- incentives only apply to non-residents.

The International Monetary Fund (IMF) has made use of this list identifying OFC's in order to monitor financial institutions compliance. In determining this list, the IMF has performed a detailed study into what basis should be used in identifying an OFC (Tax Justice Network, 2007).

Tax Justice Network (2007) detailed the definition of an OFC provided by Ahmed Zerome (2007) to the IMF as:

> An OFC is a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy.

This definition was concluded on the following three characteristics:

- the primary orientation of business towards non-residents;
- the favourable regulatory environment (low supervisory requirements and minimum disclosure);
- low or zero tax schemes.

The report released by the Tax Justice Network (2007), noted that there was a discrepancy between the FSF's view that the regulatory requirements are significant in determining whether or not a jurisdiction qualifies as an OFC, and the work performed by the IMF. Instead Ahmed Zerome (2007) considered that the economic environment of the respective jurisdiction is a significant factor.

Defining an OFC based on the economic environment gives rise to two potential problems:

The first problem being identified as the lack of available data on the net financial services exports to a non-resident company or individual.

The second problem is determining what ratio of financial services to non-residents would be considered as incommensurate to the domestic economy. The Tax Justice Network (2007) resolved that the domestic GDP should be calculated in proportion to the net financial services exports to determine what is considered as incommensurate. This potential solution poses an additional potential problem as it does not address instances where financial services are limited in comparison to corporate and trust formation services.

A large number of similar characteristics between OFC's and tax havens do exist, even though many OFC's are not considered to be tax havens and vice versa (Tax Justice Network, 2007). The dominant distinction is that the primary focus of an OFC is to provide a base from which

financial services can be performed. This base may generally be situated in normal to high tax jurisdiction (Olivier & Honiball, 2011), with specific incentives offered. This distinction allows OFC's to enter into DTAs (an opportunity that is generally not afforded to tax havens as there cannot be a compromise of taxes by both parties), thereby allowing the foreign shareholder to benefit from the reduced treaty rates.

Olivier and Honiball (2011) defined a OFC as a low or no tax haven jurisdiction sometimes situated within a high tax country. In instances where the OFC is situated within a high tax country, it may be easier for the OFC's jurisdiction to enter into DTAs as a compromise relating to taxes, between the two jurisdictions can occur. The tax beneficial characteristics (that are similar to tax havens) are provided by OFC's in the form of special regimes. This affords a financial services company with an ideal environment in which to establish an intermediary company, as the MNE will benefit from a reduced tax rate through the application of the incentives provided for in the DTAs, as well as the large network of DTAs.

The IMF published a working paper identifying three of the characteristics found in an OFC as (Tax Justice Network, 2007):

- the primary orientation of business is aimed towards non-residents;
- a favourable regulatory environment (i.e. low supervisory requirements and minimal information disclosure); and
- the application of low or zero taxation schemes.

5.2.3 Identified tax haven and OFC jurisdictions

The Tax Justice Network (TJN) released a comprehensive list in 2007 that identified both tax havens and OFC's. This list included all the jurisdictions identified by the OECD as pure tax havens, some of which are identified as *the standard offshore island states which facilitate tax avoidance through low tax rates and secrecy* (Tax Justice Network, 2007).

This list was further extended to cover jurisdictions that facilitate harmful tax regimes but are not considered to be

pure tax havens, as well as countries that have a reputation of being a tax haven.

We compare the lists below (Tax Justice Network, 2007; Gravelle, 2013):

Country	OECD	FSF- IMF	TJN
Andorra	Tax Haven	OFC	Tax Haven
Anguilla	Tax Haven	OFC	Tax Haven
Antigua and Barbuda	Tax Haven	OFC	Tax Haven
Aruba	Tax Haven	OFC	Tax Haven
Australia	Harmful Regime		
Austria	Harmful Regime		
Bahamas	Tax Haven	OFC	Tax Haven
Bahrain	Tax Haven	OFC	Tax Haven
Barbados	Removed from OECD 2006 List	OFC	Tax Haven
Belgium	Harmful Regime		
Belize	Tax Haven	OFC	Tax Haven
Bermuda	Tax Haven	OFC	Tax Haven
British Virgin Isles	Tax Haven	OFC	Tax Haven
Canada	Harmful Regime		
Cayman Islands	Tax Haven	OFC	Tax Haven
Cook Islands	Tax Haven	OFC	Tax Haven
Costa Rica	Removed from OECD 2006	OFC	Tax Haven

	List		
Cyprus	Tax Haven	OFC	Tax Haven
Dominica	Tax Haven	OFC	Tax Haven
Dubai	Removed from OECD 2006 List		Tax Haven
Finland	Harmful Regime		
France	Harmful Regime		
Germany	Harmful Regime		Tax Haven
Gibraltar	Tax Haven	OFC	Tax Haven
Greece	Harmful Regime		
Grenada	Tax Haven	OFC	Tax Haven
Guernsey, Sark and Alderly	Tax Haven	OFC	Tax Haven
Hong Kong	Removed from OECD 2006 List	OFC	Tax Haven
Hungry	Harmful Regime		Tax Haven
Iceland	Harmful Regime		Tax Haven
Ireland	Harmful Regime	OFC	Tax Haven
Isle of Man	Tax Haven	OFC	Tax Haven
Israel	Removed from OECD 2006 List		Tax Haven

Italy	Harmful Regime		Tax Haven
Jersey	Tax Haven	OFC	Tax Haven
Korea	Harmful Regime		
Lativia	Removed from OECD 2006 List		
Lebanon	Removed from OECD 2006 List	OFC	Tax Haven
Liberia	Tax Haven		Tax Haven
Lichtenstein	Tax Haven	OFC	Tax Haven
Luxembourg	Harmful Regime	OFC	Tax Haven
Macao	Removed from OECD 2006 List	OFC	Tax Haven
Malaysia	Removed from OECD 2006 List	OFC	Tax Haven
Maldives	Removed from OECD 2006 List		Tax Haven
Malta	Tax Haven	OFC	Tax Haven
Marshall Islands	Tax Haven	OFC	Tax Haven
Mauritius	Tax Haven	OFC	Tax Haven
Monaco	Tax Haven	OFC	Tax Haven
Montserrat	Tax Haven	OFC	Tax Haven
Nauru	Tax Haven	OFC	Tax Haven
Netherlands	Harmful		

	Regime		
Netherlands (Antilles)	Tax Haven	OFC	Tax Haven
Niue	Tax Haven	OFC	Tax Haven
Northern Mariana Islands	Removed from OECD 2006 List		Tax Haven
Palau	Removed from OECD 2006 List	OFC	
Panama	Tax Haven	OFC	Tax Haven
Portugal	Harmful Regime		Tax Haven
Russia	Removed from OECD 2006 List		Tax Haven
Saint Kitts and Naves	Tax Haven	OFC	Tax Haven
Saint Lucia	Tax Haven	OFC	Tax Haven
Saint Vincent and Grenadines	Tax Haven	OFC	Tax Haven
Samoa	Tax Haven	OFC	Tax Haven
San Marino	Tax Haven		
Sao Tome e Principe	Removed from OECD 2006 List		Tax Haven
Seychelles	Tax Haven	OFC	Tax Haven
Singapore	Removed from OECD 2006 List	OFC	Tax Haven
Somalia	Removed from OECD 2006		Tax Haven

	List		
South Africa	Removed from OECD 2006 List		Tax Haven
Spain	Harmful Regime		Tax Haven
Sweden	Harmful Regime		
Switzerland	Harmful Regime	OFC	Tax Haven
Taiwan	Removed from OECD 2006 List		Tax Haven
Tonga	Removed from OECD 2006 List		Tax Haven
Turkey	Harmful Regime		
Turkish Republic North of Cyprus	Removed from OECD 2006 List		Tax Haven
Turks and Caicos Isles	Tax Haven	OFC	Tax Haven
United Kingdom	Removed from OECD 2006 List		Tax Haven
Uruguay	Removed from OECD 2006 List		
US Virgin Isles	Tax Haven		Tax Haven
USA	Harmful Regime		Tax Haven
Vanuatu	Removed from OECD 2006		Tax Haven

	List		

The above lists have been identified through the common characteristics found in tax havens and OFC's. The similarities identified between these two types of jurisdictions is determined as the method of profit stripping applied in order to repatriate funds to the parent company (namely the foreign investor). The most prominent methods of profit shifting are identified below (Gravelle, 2013).

5.3 Methods of profit shifting used by tax havens.

5.3.1 Allocation of Debt and Earnings Stripping

One method identified of profit shifting (Gravelle, 2013) is to shift the borrowing exposure from a low tax jurisdiction to a high tax jurisdiction. This would result in the overall group debt remaining the same but a lower group tax exposure. This is known as debt stripping.

Alternatively, earning stripping (Gravelle, 2013) can also occur where financing is obtained from a unrelated foreign borrower that lends the required financing to the group company, as opposed to a related borrower that would have been subject to tax on the interest income earned.

5.3.2 Cross crediting and sourcing rules for foreign tax credits

Taxation may also be limited by the use of foreign tax credits to offset local taxes payable. The timing of cross crediting can be used in such a way to maximise the benefits of a foreign high tax jurisdiction, where income is simultaneously repatriated from a low tax jurisdiction.

5.3.3 Transfer Pricing

MNEs utilise the sale of goods and services between affiliates to shift profits. Profit shifting in this manner is usually achieved by an increase in the cost of goods sold to a parent company (where profits are repatriated out of a jurisdiction) and decreasing the pricing of goods where profits want to be retained in a jurisdiction (Gravelle, 2013). Where transfer-pricing legislation is applied, the price of the goods would be dictated by the actual market value that could be obtained. The absence of this regime,

would allow for a company to determine the most beneficial price of the goods sold, where the mark up would prove to be the most effective (i.e. in a low tax jurisdiction).

5.3.4 Contract manufacturing in a low tax jurisdiction

A subsidiary is established in a low tax jurisdiction to manufacture products (Gravelle, 2013). These products are then sold from this jurisdiction to the customers situated in a high tax jurisdiction, thereby avoiding the effect of the increased tax rate.

5.3.5 Hybrid Instruments and Entities

Hybrid entities that are recognised by one jurisdiction and not by another may result in different tax treatment between two jurisdictions and give rise to tax benefits (example: Excessive interest payments from a hybrid entity may not be taxable as the hybrid entity is not considered to be a separate entity).
Similarly hybrid instruments may be viewed as debt instruments in one jurisdiction and as an equity instruments in another, giving rise to a tax deduction but no corresponding inclusion in taxable income.

5.4 Does the new South African HQCR participate in the harmful tax practices identified above

In view of the fact that Mauritius and the new South African HQCR share many of the same characteristics, consideration must be given as to whether or not the new South African HQCR will be recognised as partaking in potentially harmful tax regime.

In establishing the regime, the Department of National Treasury identified one of the key intentions of the new SA HQCR to not be considered as partaking in harmful tax practices.

A tax haven is identified as a jurisdiction that provides certain characteristics that are aimed at foreign investors. The new South African HQCR provides beneficial characteristics that are aimed at foreign investors in a similar manner, in some respects to Mauritius, such as the:

- limitation of withholding tax applied to payments made to non-residents

- exemption from corporate tax on dividend income earned;
- exemption from CGT on the sale of investments and subsidiaries to foreign residents;
- exemption from exchange control regulations.

As beneficial as these characteristics may be, one would need to consider whether or not the harmful tax practices associated with a tax haven are apparent in the new SA HQCR.

The harmful tax practices, as identified above are:

5.4.1 Allocation of debt and earnings shifting

Where a foreign investor lends money to a new SA HQCR, the transaction would be free from thin capitalisation legislation, due to the headquarter company exemption provided for under section 31. This would allow for the offshore investor to interject a foreign company (situated in a low tax jurisdiction) in between the new South African HQC and the foreign parent company and use debt funding via this entity.

The lack of thin capitalisation rules would allow for the new South African HQC to transfer interest income to the low tax jurisdiction from South Africa without a limitation. This will however not be beneficial to the new SA HQC as a limited tax deduction will apply to the interest paid, in terms of section 20C of the Act.

5.4.2 Cross crediting and sourcing rules for foreign tax credits

Section 6*quat* and 6*quin* of the Act allows for foreign tax credits to be claimed in respect of foreign income earned. The calculation of the allowable foreign tax credit is limited to the South African tax paid on the foreign income included in taxable income. This limitation will make it difficult to offset excessive foreign tax credits against local taxes or other high tax jurisdictions. The new South African HQCR will not fall foul of this profit shifting mechanism.

5.4.3 Transfer pricing and thin capitalisation

Although the new South African HQCR does not impose a transfer pricing or thin capitalisation regime, this is only in respect of foreign financing and IP. Should the new HQC wish to purchase goods or services from a parent company at a value that does not reflect the fair market value, this regime would still be applicable.

In order to provide shareholders with the option of repatriating funds to the jurisdiction that the shareholders consider most effective, tax havens do not generally impose a transfer pricing or thin capitalisation regime in any measure.

The relaxation of this regime still imposes certain limitations and will not likely be considered as a harmful tax practice.

5.4.4 Contract manufacturing in a low tax jurisdiction

The new HQCR imposes a normal corporate tax rate of 28% on income earned. When comparing this tax rate to other low tax jurisdictions, (such as the effective corporate tax rate of 3% imposed by Mauritius) it can be seen that South Africa will not be considered to be a low tax jurisdiction and will therefore not fall foul of this mechanism of profit shifting.

5.4.5 Hybrid Instruments

Section 8E and section 8F of the Act provides for specific anti-avoidance provisions that relates to instruments identified as hybrid debt instruments. These provisions apply to equity instruments that are considered to reflect the nature of debt instruments. Any income received in respect of such instruments is consequently deemed to be taxable income in the hands of the recipient. This anti-avoidance provision will therefore prohibit the avoidance of tax using hybrid debt instruments.

5.5 Conclusion

The OECD is not concerned about low or no tax jurisdictions in itself. Instead it is the practices that these jurisdictions often become associated with that result in the unjust non-taxation of MNE's that the OECD is concerned about. These practices are normally achieved through the

application of the bilateral agreements and gaps in the interaction of relevant tax jurisdictions, and result in what is commonly referred to as Base Erosion and Profit Shifting (BEPS).

Tax havens achieve BEPS through reducing the effective tax rate applicable in a jurisdiction to nil or a minimal rate. In addition to this, they offer an environment where no transfer pricing legislation is effective and a specific regime that is aimed at foreign investors is applied.

A large number of lists identifying tax havens have been published by various bodies such as the OECD, EU and Tax Justice Network in order to assist with the identification of tax haven jurisdictions. These lists consider all the jurisdictions that have implemented a regime displaying profit-shifting characteristics. It became apparent that these characteristics are also found in an OFC even though it may not be formally classified as a tax haven. This is due to the fact that the OFC is predominantly aimed at providing financial services to a non-resident, and not at promoting foreign investment through tax incentives.

In reviewing the prominent methods of profit shifting undertaken by a tax haven or an OFC, it is found that the new HQC regime does not participate in harmful tax practice as there are a large number of anti-avoidance provisions that would still apply in respect of the new HQCR:

- The limitation on the interest deductibility in respect of section 20C;
- The requirements as determined by section 6quat and section 6quin before a foreign tax credit can be utilised;
- The high tax rate of 28%;
- The anti-avoidance provisions relating to hybrid debt instruments under Section 8E and section 8F address the third sub-problem as to whether or not the profit shifting mechanisms frequented by harmful tax regimes are implemented in the new HQCR.

As determined above, the new HQCR is subject to a vast range of anti-avoidance provisions that are intended to

prohibit profit shifting through the abuse of a headquarter company. The initiative applied in this regard may prove to be beneficial to the new HQC as an increasing number of headquarter companies may fall foul of these initiatives.

6. Chapter 6: OECD and Tax havens

According to the OECD (2013), *the increased sophistication of tax planners in identifying and exploiting the legal arbitrage and boundaries of acceptable tax planning* causes a large loss to the fiscus. This is a common problem for many different jurisdictions that results in the receipt of fewer resources to allocate to infrastructure and services and has become known as Base Erosion and Profit Shifting (BEPS). BEPS is the reason that the OECD and many other countries have taken to combating the use of tax haven jurisdictions. The OECD has identified the cause of BEPS as (OECD, 2013):

> In an increasingly interconnected world, national tax laws have not kept pace with global corporations, fluid capital, and the digital economy, leaving gaps that can be exploited by companies who avoid taxation in their home countries by pushing activities abroad to low or no tax jurisdictions.

Where MNEs have decided to minimise their tax burden through a tax haven jurisdiction, this has resulted in three dominant problems, namely (OECD, 2013):

- **Governments are being harmed**. Governments incur a higher cost of compliance and a smaller revenue stream. This results in an under funding in public investments that could otherwise have promoted growth in developing countries.
- **Individual taxpayers are harmed**. If MNEs pay less tax, the individual taxpayer is required to carry a larger share of the tax burden.
- **Businesses are harmed**. Smaller businesses that do not have the ability to shift profits to low tax jurisdictions would have a competitive disadvantage. Fair competition is harmed by the misrepresentation of the MNE's tax rate.

The recent G20 summit held in July 2013 in Moscow launched an action plan of 15 points to combat BEPS (OECD, 2013). The G20 Head of States at the meeting in Saint Petersburg further endorsed this plan. The points identified in the action plan addressed the three dominant causes of BEPS that were identified by the OECD as:

6.1 Issue 1: The spread of digital economy

The digital economy is largely based on the intangible assets of data usage. As a result of this, it has become difficult to determine in which jurisdiction the source and value creation of the asset occurs in (OECD, 2013). The OECD has determined that these risks should be addressed and options should be established to ensure that both direct and indirect tax collection occurs with respect to digital economies.

The OECD (2013), identified the risks that to be addressed as:

- the company's ability to have a digital presence in a jurisdiction without the liability of tax due to the lack of a nexus;
- the characterisation of income derived from new business models;
- the application of source rules;
- attribution of the value created from the generation of marketable location relevant data through the use of digital products and services.

6.2 Issue 2: Establishing coherence of corporate income tax

Each country enforces sovereignty over the tax legislation implemented at the country level. As a result, consideration as to how the legislation would interact between countries is often disregarded. Where the domestic tax legislation of the two countries do not correspond, this may result in a loophole that gives rise to double non-taxation (OECD, 2013). The OECD international standards have not yet resolved this issue, and consequently a need exists to align the current international standard (i.e. the DTA addressing the issue of double tax) with standards addressing the issue of non-taxation. The OECD have identified four action points to address the risk of non-coherence:

6.2.1 Neutralise the effect of hybrid mismatch arrangements

Hybrid mismatch arrangements and arbitrage are common BEPS instruments used to achieve a double deduction with no corresponding tax inclusion (OECD, 2013). This is achieved through the misuse of tax credits or participation exemption regimes and commonly occurs in countries that allow a taxpayer to choose the tax treatment of domestic and foreign entities. Although no taxes have been lost in the actual countries (as the legislation has been complied with),

the total taxes paid have been reduced overall. This results in a competitive disadvantage to other companies, as well as economic inefficiencies.

The OECD proposes that model treaty provisions and recommendations regarding the domestic legislation be amended in order to avoid the unjust benefits provided by hybrid instruments and entities. These provisions should be directed at reducing double non-taxation, double deduction or long-term deferral and can be achieved through changes to the OECD Model Tax Convention and /or domestic law provisions. The OECD has suggested that provisions be introduced that:

- prevents an deduction in one jurisdiction where the corresponding income in a different jurisdiction is exempt; and
- denies a deduction for exempt income earned by the recipient; and
- prohibits a double deduction; and
- provides guidance on the application of the tiebreaker rules in the DTA if more than one country attempts to simultaneously apply the provisions to a structure.

Upon determining these provisions, it is imperative that the domestic legislation is aligned to the amendments made to the OECD Model Tax Convention.

6.2.2 Strengthen Controlled Foreign Company rules

It has become increasingly common to achieve profit shifting by creating a non-resident subsidiary in another low tax jurisdiction (OECD, 2013). This would allow for the routing of income through this non-resident group company.

In order to oppose this, many jurisdictions impose CFC legislation. These rules are however country specific and may not be targeted at addressing the risk of BEPS.

CFC regimes in principle lead to the proportional inclusions of taxable income in the resident country of the ultimate parent. As a result of this incentive, profit shifting to a low tax jurisdiction is minimised. The design of CFC legislation must be considered internationally.

6.2.3 Limit base erosion via interest deductions and other financial payments

It has become a common practice for MNEs to shift profits by means of an interest payment made to the parent company on hybrid debt (OECD, 2013). This would allow for a tax deduction in the high tax state and a favourable or non-taxed interest in the recipient state. Transfer pricing legislation should be implemented to avoid an excessive interest deduction.

6.2.4 Counter harmful tax practices more effectively, taking into account transparency and substance

The competitive reduction of taxes may result in what is known as a "race to the bottom" (OECD, 2013). A common set of transparency rules should be introduced to avoid this from occurring. These rules should improve transparency around harmful tax practices by improving exchange of information on preferential regimes. Preferential regimes are to be evaluated in light of BEPS and the existing framework revised to restore the benefits of international standards.

6.3 Issue 3: Restoring the benefits of international standards

Although specific country legislation and DTAs may be effective in the respective if individually considered, interaction with another jurisdiction may result in a double non-taxation (OECD, 2013).
A realignment of taxation and relevant substance is needed to restore the intended effects and benefits of OECD international standards, which may not have been amended according to recent changes.

As an example, DTAs do not always address profit shifting where a third party shell company has been used to facilitate the transfer of funds. These third party shell companies often have no or little substance.

The OECD identified 5 methods of addressing the above problems:

6.3.1 Prevention of DTA abuse

The introduction of DTAs may result in the unintended consequences of treaty shopping and double non-taxation practices, which can be avoided through anti-avoidance provisions in DTA clauses (OECD, 2013).
Further to this, the original intention of a DTA should be emphasised which is the avoidance of double taxation as opposed to non-taxation.

6.3.2 Artificial avoidance of a permanent establishment (PE)

Fragmentation of income streams and specific PE planning allows for a significantly different tax effect than that that may have occurred if a PE had existed (OECD, 2013), as a result a clearer definition of a PE must be introduced.

6.3.3 Re-examine Transfer pricing documentation

The BEPS report (OECD, 2013) identified disconnect between the location where value creating activities and investment occur and the location where profits are taxed.

Transfer pricing rules should be imposed to ensure that the activities and taxation occurs in the same jurisdiction to minimise profit shifting through the use of intangibles and capital. This cannot be achieved through applying a general profit apportionment formula to all transactions as MNE's may undertake investment decisions that are not commercially viable in order to achieve a more tax neutral approach (OECD, 2013).

The OECD proposes to develop and enforce regulations that require all MNE's to provide relevant governments with an allocation of income, economic activities and taxes paid to all countries.

The principle of transfer pricing is dependent on transparency of information. Where this does not exist the arms-length principle is undermined and BEPS can occur (OECD, 2013).

Furthermore, emphasis on transfer pricing provisions must be addressed in three areas, namely (OECD, 2013):

a. Intangibles

Rules should be developed to prohibit the shifting of intangibles between group companies. In order to do this, a clear definition of intangibles must be established, the profits earned from intangibles must

be appropriately allocated based on the value creation, transfer pricing rules must be established for the transfer of intangibles and finally guidance must be developed on cost contribution arrangements between MNE companies.

b. Risks and capital

Rules should be developed to prohibit allocation of excessive capital to group members. Transfer pricing rules will need to be developed to ensure that inappropriate returns for excessive capital and risk assumption are not assumed. This will require the realignment of value creation and returns.

c. Other high-risk transactions

Legislation should be introduced that would prevent high-risk transactions that do not normally occur between third parties, from occurring between group companies. This can be achieved by:

- clarify the situation in which transfer pricing rules would apply; and
- providing protection against base erosion in the form of head office expenses and management fees.

6.4 Issue 4: Ensuring transparency of information while promoting increased certainty and predictability

It is difficult to impose transparency of a taxpayer's information, as the right balance between privacy and the need for a jurisdiction to enforce their laws must be obtained. The OECD has determined that transparency can be obtained by implementing the following procedures (OECD, 2013):

6.4.1 Disclose any aggressive tax planning arrangements

Mandatory disclosure must be made in respect of tax planning arrangements that may be regarded as aggressive arrangements, with significant focus on international tax schemes.

6.4.2 Transparency around Transfer Pricing documentation

The OECD has recognised the need to develop transfer-pricing legislation that promotes transparency. A general design of transfer pricing legislation will be used to allow for identified country specific risks.
Implementation of this general design may prove onerous and consideration should therefore be given to the administrative burden and costs involved for companies in doing so.
The general design would require MNEs to provide information on income, economic activity and taxes paid to the respective governments. This would enable a more targeted approach to tax planning strategies and transfer pricing.

6.4.3 Establish a means of data collection

In promoting the transparency of information, a means of collecting data must be established. This tool should enable the monitoring of the specific points identified in the action plan at the G20 conference and provide for:

- improved data collection;
- identifying new types of data; and
- creating new methodologies.

6.4.4 Make dispute resolution procedures more effective

The OECD has identified that where greater transparency is required from taxpayers, a need will arise for an increased certainty around dispute resolution procedures.
Solutions must therefore be developed to address instances where dispute resolution cannot be achieved due to the lack of arbitration provisions in the treaties. Work must be performed to streamline the dispute resolution process and enforce arbitration provisions in the DTAs.
This may require amendments to domestic legislation and the Commentary to the OECD Model Tax Convention and the Transfer Pricing Guidelines, and OECD Model Tax Convention. In addition to this, it would also require amendments to the DTAs; which would be a lengthy process if it were to be undertaken on a treaty-by-treaty basis. Introducing a multilateral instrument used to amend bilateral treaties going forward can solve this problem.

6.5 Issue 5: The need for swift implementation

The delivery of these points identified in the action plan will require a number of outputs and amendments to domestic legislation. Should the jurisdiction be willing to comply with these points identified in the action plan, a bilateral or multilateral agreement can be implemented in order to facilitate the adoptions (OECD, 2013).

6.6 Comparison to the new South African HQCR

A new South African HQC incorporated under the new South African HQCR is subject to the South African tax legislation. As previously mentioned in Chapter 5, the Income Tax Act imposes the anti-avoidance provisions identified above in the form of:

- Transfer pricing legislation imposed under Section 31;
- CFC legislation under Section 9D;
- Provisions to Hybrid Debt instruments under Section 8E and Section 8F; and
- Exchange of information agreements in the DTAs.

Although certain of these provisions have been relaxed in relation to a new South African HQC, there are still limitations imposed thereon (such as the limit on deductibility of debt in respect of transfer pricing). The application of these provisions would create difficulty to enter into base erosion and profit shifting transactions, as the restrictions would limit the resulting benefit. This can be seen from the examples below:

Example 1. Although there are no restrictions imposed on thin capitalisation rules under a new South African HQC in terms of Section 31, BEPS would not be possible as there is a limit imposed on the deductibility of the interest expenses. Similarly should excessive interest income be earned by the new South African HQC, the income would be taxable at the corporate rate of 28%, resulting in a tax leakage.

Example 2. Section 8E and 8F determine that where a hybrid debt instrument is entered into, the resulting income is taxable (i.e. the preference share income is taxable),

however, no corresponding deduction will occur in respect of preference dividends paid.

Example 3. South Africa imposes a CFC regime under Section 9D of the Act. This has been relaxed in respect of the new South African HQCR. However as CFC legislation is aimed at avoiding instances where the income earned from a CFC is shifted to a low tax jurisdiction, as South Africa is not considered to be a low tax jurisdiction (i.e. at 28% corporate tax rate), any income earned from a CFC will likely not be viewed as shifting of profits to a low tax jurisdiction.

Example 4. South Africa has entered into exchange of information agreements in all the recent DTAs.
As illustrated, South Africa already imposes most of the points identified in the action plan as identified at the G20 conference. It is therefore determined that the initiative introduced will not impact the effectiveness of the new South African HQCR. Conversely, it may prove beneficial to the regime, as South Africa offers a headquarter company alternative that is in compliance with the G20 initiative.

6.7 Conclusion

The G20 conference has identified the four risk areas that must be addressed, these areas are identified as follows:

- the spread of the digital economy;
- restoring the benefits of OECD international standards;
- transparency of information; and
- the swift implementation of this plan.

These four risk areas are to be addresses through a number of the points identified in the action plan (action points) that must be implemented. These action points are intended to ensure that the BEPS does not occur through the commonly used profit shifting mechanisms.

Specifically action points such as the prevention of DTA abuse, emphasis on transfer pricing and the transparency thereof, dispute resolution procedures are all designed to

avoid BEPS. It can be seen from this, that there is a direct attack on the establishment of tax havens worldwide.
As the new South African HQCR does not fall foul of the profit shifting mechanisms associated with a harmful tax practices, it may prove to be an effective alternative to current tax havens as the world environment becomes increasingly difficult for tax havens to function in.

7. Chapter 7: Conclusion

National Treasury has introduced the new South African HQCR in an attempt to create an ideal intermediary holding company jurisdiction. This conclusion is attributed to the fact that South Africa provides a central location and good infrastructure, from which to invest into Africa.

An ideal intermediary holding company jurisdiction requires more than good location and infrastructure of the country, and should illustrate the best practice characteristics of an ideal headquarter company regime. The characteristics identified above are:

- minimal or no effective tax rate;
- lack of withholding taxes imposed on dividends, interest, royalties and management fees;
- a large DTA network;
- the absence of a CGT regime;
- the absence of transfer pricing and thin capitalisation regimes;
- the absence of a CFC regime;
- the ability to maximise foreign tax credits;
- the ability to undertake group restructurings without triggering adverse tax effects;
- specific provisions addressing foreign exchange gains or losses to avoid taxation thereof on foreign transactions;
- the absence of an exchange control regime to allow for reinvestments of capital growth and the free flow of funds.

The new South African HQCR provides a few, but not all of these characteristics in that:

- The Act provides for an exemption from withholding taxes in respect of dividend, interest, royalty and management fee payments made to non-resident shareholders;
- South Africa has entered into a large number of DTAs that, in many instances, allow for reduced withholding tax rates to apply to transactions with foreign jurisdictions;
- The exchange control regulations have been relaxed in respect of foreign investments made by the new South African HQC. This allows for the new South African HQC to retain any foreign capital growth outside of the South

African exchange control arena and to re-invest the funds as required; and

- South Africa does not impose a tax on the increase in share capital, thereby allowing for an investor to provide additional funding in the form of equity shares without being subject to any additional tax thereon.

Although National Treasury has provided for the above characteristics to manifest in the new South African HQC, other characteristics have only been relaxed in the legislation. These partially relaxed characteristics that still impose onerous restrictions are identified as:

- Relaxation of the transfer pricing and thin capitalisation regime. The relaxation of this regime only applies in respect of foreign financing and royalty payments where the new South African HQC passes on the respective services to the foreign subsidiary companies. A limitation is imposed on the relaxation of the regime in terms of section 20C. Section 20 provides for a limit on the deductibility of the interest paid, (i.e. the interest expense is limited to the income earned from the subsidiary companies).
- The Act allows for group reorganisations under the corporate rules in South Africa. The corporate rules require a transaction to meet onerous requirements. Should these requirements be met, the Act does not provide for any additional tax benefits (over and above the disregarding of the capital gain realised on the sale of the equity shares) such as a step up in the base cost.
- Paragraph 64B of the Eighth schedule allows for the disregarding of a capital gain where equity shares have been sold by a new South African HQC (subject to certain requirements). This treatment is not available for an already established South Africa resident company that wishes to enter the new South African HQCR, as this will give rise to a deemed disposal of the assets held by the South African company.
- Sections 6*quat* and 6*quin* of the Act allows for a company to claim credit in respect of the foreign tax paid. The calculation of this credit is limited to the South African tax on the amount included in the taxable income of the company, deeming it impossible to achieve an optimisation of tax credit.

The remaining characteristics required by an intermediary company are not displayed at all by the new South African HQCR in that:

- South Africa imposes a high corporate tax rate of 28% when compared to other intermediary company jurisdictions;
- All transactions entered into by the new South African HQC must be translated to Rands, thereby incurring an additional taxable gain or loss in relation to the foreign exchange gain or loss.

As illustrated above, many of the provisions offered by the new South African HQCR can be utilised outside of the regime. The remaining provisions are subject to requirements that impose a limiting effect on the possible benefits. In conclusion to the first sub-problem identified, it can be seen that the new South African HQCR does not display all of the best practice characteristics required by a headquarter company regime.

When comparing to the new South African HQCR to Mauritius, which is regarded by Malan and Lessing (2012) as a popular and competing investment holding company regime, it will prove difficult for the new South African HQCR to compete as:

- Mauritius imposes a minimal effective corporate tax rate of 3%;
- Even though Mauritius does not impose withholding tax at on dividends tax, there is a withholding tax imposed on interest, royalty and management fees of 15%, 15% and 10% respectively. This is more stringent than the new South African HQCR which provides a blanket exemption in respect of all withholding taxes;
- A diverse DTA network is a significant consideration as to whether or not a jurisdiction qualifies as an ideal intermediary holding company. This is imperative, to limit the withholding tax rates applied by certain countries (especially the African jurisdictions). Mauritius provides a total of 39 DTAs that have been entered into with other jurisdictions. In this respect South Africa proves to be a comparable jurisdiction as it has entered into and is currently negotiating a total of 90 DTAs with other

jurisdictions. These DTAs include jurisdictions that have not signed DTAs with more prominent intermediary holding company jurisdictions. Where these DTAs are found to be comparable to other holding company jurisdictions, this will prove to be an advantage for an offshore investor looking to invest into Africa. It is however noted that DTAs are also available to a South African resident company transacting with other jurisdictions and does not provide any benefits specifically aimed at a new South African HQC;

- The repatriation of funds is easy to achieve in the absence of a thin capitalisation regime, as no limitation will exist on either the level of debt or equity invested into the company. This is possible under the legislation imposed by Mauritius as a thin capitalisation regime does not exist. This proves more difficult if the transaction is entered into as a sale agreement, as Mauritius transactions are required to be completed on an arm's length basis. The new South African HQCR is not competitive in this area as the specific exemption from the transfer pricing and thin capitalisation provisions (relating to foreign financing and IP charges), under section 31 is still subject to a limit imposed on the corresponding deduction.
- Another important characteristic of an ideal holding company jurisdiction is the absence of a CFC regime. This ensures that foreign subsidiary income is not repatriated back to the holding company jurisdiction.
  Neither Mauritius nor South Africa impose a CFC regime in respect of the headquarter company regimes, thereby allowing for all foreign subsidiary income to remain offshore.
- Mauritius does not impose a CGT regime. This enables a foreign shareholder to sell non-profitable investments and undertake reorganisations based on commercial rationale.
- Mauritius does not enforce an exchange control regime, thereby allowing for companies to freely transfer funds offshore without any restrictions. This also proves true in South Africa, as exchange control regulations are relaxed in respect of the new South African HQCR.
- The Mauritius Income Tax Act does not provide for specific foreign exchange provisions. Any foreign exchange gain or loss is therefore considered to be taxable or deductible under the normal corporate tax rate. This is

similar to the tax treatment in South Africa. These gains or losses will however be taxed at the corporate tax rate in both instances, the foreign exchange gain or loss will be susceptible to tax at a significantly lower rate in Mauritius (i.e. 3%) as opposed to the South African tax rate of 28%.

Due to the generous tax system, Mauritius has been viewed in many instances as a tax haven. This is cemented by the fact that Mauritius illustrates the dominant methods used by a tax haven to shift funds. These methods have been identified as:

- Debt or credit stripping, as Mauritius does not impose a thin capitalisation regime, thereby allowing the foreign investor to obtain a tax deduction in Mauritius for the interest paid to the non-resident shareholder. Should this interest be excessive, this would allow for a large tax deduction in Mauritius, and a reduction in the already low effective tax rate.
- Cross crediting and foreign tax credits, as Mauritius provides for a deemed foreign tax credit of 80%, thereby reducing the effective tax rate to 3%;
- Although Mauritius does not impose a thin capitalisation regime, the MRA does require that a transaction be completed on an arm's length basis, therefore a type of transfer pricing regime does apply in Mauritius;
- Contract Manufacturing in a low tax jurisdiction, as the effective tax rate of 3% imposed by the MRA, creates a tax friendly environment in which to enter into the manufacture and sale of items, even when the product would be best suited to manufacture in a different jurisdiction.

Conversely, these methods of profit shifting cannot be illustrated through the new South African HQCR as:

- even though the thin capitalisation rules have been relaxed in terms of new South African HQCR, the benefits of the relaxation is limited due to the imposed ceiling on the deduction of the interest. This ceiling will prohibit the new HQC to transfer funds to obtain a tax deduction while simultaneously transferring funds to a low tax jurisdiction (i.e. debt or credit stripping); and
- the sections 6*quat* and 6*quin* deductions allowed in respect of foreign tax credits are only claimable up to the lower of

the South African tax imposed on the foreign income included in taxable income and the actual foreign taxes paid. This limit would prohibit the new South African HQC to claim a foreign tax credit or deduction (from a high tax jurisdiction) against income earned from low tax jurisdiction (in respect of which a limited foreign taxes have been paid); and

- Even though the transfer pricing rules have been relaxed for a new South African HQC in specific instances (such as financial assistance and royalty payments), a limit on the deductibility of these expenses is still imposed. This limit provides the same effect as if transfer pricing and thin capitalisation rules had applied; and
- South Africa applies a corporate tax rate of 28% to the new South African HQCR; thereby it would not prove economically efficient to establish a manufacturing establishment in South Africa unless the items manufactured were directly sold in South Africa.

When comparing the new South African HQCR to existing intermediary company regimes (such as Mauritius), the above considerations illustrate that the characteristics provided by the new South African HQCR are not considered unique, as it can be found in Mauritius. This problem is further aggravated by the fact that South Africa imposes the normal tax rate of 28% on new South African HQCs as opposed to the 3% offered by Mauritius. In instances where a DTA exist between both Mauritius and South Africa in a specific jurisdiction, it is likely that the potential investor will continue to use Mauritius as an intermediary holding company jurisdiction. South Africa does however offer a much wider DTA network, and in instances where a DTA only exists between a specific jurisdiction and South Africa, the new South African HQCR may prove to be a viable alternative.

It is apparent that there is presently a large move against tax havens and countries that enter into harmful tax practices, which is illustrated by the increased number of jurisdictions that have been identified by the OECD and the EU. Changing tax legislation makes it difficult to determine what meets the definition of a tax haven, and it is therefore more effective to identify a tax haven or a harmful tax regime based on its methods of profit shifting. As determined above, the new South African HQCR does not illustrate the either harmful tax practices or profit shifting mechanisms that are normally displayed by tax havens and other similar regimes. The third sub-problem is therefore addressed in that the new South

African HQCR is not considered to fall foul of profit shifting mechanisms identified as harmful tax practices.

This was again illustrated in regard to the action points identified at the G20 conference. The G20 conference endorsed the fight against tax havens by identifying 15 specific action points to limit BEPS. These action points are already incorporated into the South African tax legislation through the anti-avoidance provisions imposed by the Act(i.e. Section 31 - transfer pricing legislation, Section 9D - CFC legislation, Section 8E and Section 8F legislation). This changing landscape against harmful tax practices and base erosion and profit shifting may prove to be an advocate for the new South African HQCR in the future as an increasing number of current tax havens are amending their legislation to comply with the action points as determined by the OECD.

Even though the new South African HQCR is unable to currently compete with alternative intermediary holding company regimes, this may not prove true in the future due to the increasing initiatives against current tax havens.

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