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A Research report submitted to the Faculty of Commerce, Law, and Management, in partial fulfillment of the requirements for the degree of Master of Commerce (Specialising in Taxation)

The South African Headquarter Company Regime:

A critical examination

Applicant: Boitumelo Agatha Motsatsi

Student Number: 2410060

Supervisor: Professor Maeve Kolitz

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Student Signature:

Supervisor's Signature: M A Kolitz

ABSTRACT

National Treasury, through the 'Explanatory memorandum on the taxation laws amendment bill of 2010' stated that:

> South Africa's location, its sizable economy, political stability, strength in financial services as well as the many treaties the country held with many countries across the globe, made it a natural holding company gateway into Africa (National Treasury, 2010a: p.77), (Lourens, 2019: p.30).

The South African government realised that funds which were received from foreign locations could not be channelled through the country to other foreign locations without explicit exchange control approval. In an effort to enhance its attractiveness as a viable and effective location from which businesses could extend their African operations the government reviewed its tax rules and proposed measures that would provide relief from foreign exchange control and tax. (National Treasury, 2010: p.78). Section 9I of the South African Income Tax Act 58 of 1962 (the Act) was inserted in the Act with effect from years of assessment commencing on or after 1 January 2011 (Taxation Laws Amendment Act, 2010: s 6(1)(o)).

The purpose of this report is to examine how problems with the South African headquarter company regime taxation rules in s 9I (Crowley, 2020) can be resolved in an effort to make South Africa's headquarter company regime more attractive to foreign investors. The report will firstly identify the foreign investors that South Africa wants to target through the headquarter company regime in s 9I. Secondly, the headquarter company regime taxation rules in s 9I will be analysed in detail. Thirdly, weaknesses in the headquarter company taxation rules will be identified and thereafter, the researcher will identify the remedies which can be applied to the aforementioned weaknesses in order to make the headquarter company regime more attractive to foreign investors (Lourens, 2019: p.25).

The critical examination has led the researcher to conclude that redefining the tax policies of South Africa's headquarter company regime in s 9I through the application of the proposed remedies to the weaknesses found in the above-

mentioned regime taxation rules, may boost South Africa's appeal as a preferred location for foreign investors to establish their headquarter companies.

KEY WORDS

South Africa's headquarter company regime

South Africa's headquarter company taxation rules

Foreign investors
Foreign direct investment
Base Erosion and Profit Shifting (BEPS)
The Organisation for Economic Co-operation and Development

DECLARATION

I Boitumelo Agatha Motsatsi declare that this report is my own unaided work and that I have adhered to the ethical standards which have been prescribed by the University of the Witwatersrand, Johannesburg. It is submitted in partial fulfilment for the degree of Master of Commerce (specialising in Taxation) at the University the Witwatersrand, Johannesburg and has not been submitted at any other university.

Boitumelo Agatha Motsatsi

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"Ga ke lebale gore ke ka Mohau wa ga Rara gore kebe ke fitlhile fa! Ka wena Jehovah, Modimo yo o sa palelweng ke sepe, Nna Boitumelo Agatha Motsatsi: THAKADU SEEPA MATSATSA ke kgonne!"

Table of Contents

1. INTRODUCTION

1.1 Background

In 1997 the Katz Commission of Inquiry compiled a report titled ‘Basing the South African income tax system on the source or residence principle – Options and recommendations’. (Lourens, 2019: p.23). The report was compiled after the Katz Commission was appointed to analyse certain aspects of the tax structure of South Africa and the report encouraged the South African government to strategically modify its tax legislation and to create a tax system that would increase the country’s appeal to foreign investors. (Lourens, 2019: p.24). The Katz Commission indicated that making the aforementioned modifications, would enhance South Africa’s position as the gateway into Africa. Accordingly, the Katz Commission indicated that the reforms would eventually lead to a flow of much needed foreign direct investment into the country. (Katz Commission, 1997: par3.14).

The Katz Commission mentioned that the international headquarter company would benefit the country because foreign investors would seize the opportunity to set up their headquarters in South Africa to benefit from the tax incentives they could receive. (Katz Commission, 1997: par3.1.4.2).

1.2 The development of the headquarter company regime

The Revenue Laws Amendment Act 59 of 2000 inserted the definition of an 'International headquarter company' into the Income Tax Act 58 of 1962 (the Act). (Mckinon, 2016: p.103). Accordingly, the effect of the exclusion from the definition of ‘resident’ was that the provisions of s 9D (Controlled Foreign Company rules) and s 9E (Foreign Dividends regulations) would not apply and the income of the subsidiaries of the international headquarter company would not be imputed to such a company. (Arendse, 2014:p.11). The company would not be taxed on the dividends received from its foreign subsidiaries or foreign sourced income. (Revenue Laws Amendment Act, 2000: s(2)(f)). (Lourens, 2019:p.23).

The Explanatory Memorandum on the Revenue Laws Amendment Act Bill of 2003 explained the repeal of the definition of the international headquarter company. (National Treasury, 2003: p.38). National Treasury stated that the reason for the repeal was that under the international best practice, the exemption could be viewed as a ‘Harmful Preferential Tax Regime and as ineffective. (Lourens, 2019: p.25). As a result, the definition was removed from the Act. (SARS, 2003: p.38).

1.3 The new headquarter company regime in s 9I of the Act (Mukumba, 2017).

In 2010, a new headquarter company regime was introduced. According to National Treasury’s Budget Review of 2010, the main goal in creating the new headquarter company was to promote South Africa as a gateway into Africa. The South African government wanted to enhance the country’s position as a viable location from which businesses could expand and the headquarter company was meant to be one of the vehicles that would be used to drive this objective and effectively increase the country’s attractiveness to the foreign investor. The measures which were considered involved granting relief from exchange control and taxation for diverse types of headquarter companies located in South Africa (National Treasury, 2010a: p.78)

In 2010 National Treasury, in the Explanatory Memorandum on the Tax Laws Amendment Bill of 2010 stated that South Africa was the economic powerhouse of Africa, and that the country’s location, sizeable economy, political stability and overall strength in financial services made South Africa an ideal location for the establishment of regional holding companies by foreign multinationals. Furthermore, South Africa’s network of tax treaties provided ready access to other countries in the region. South Africa was as a result viewed as a natural holding company gateway into the region. However, in order to serve as an ideal holding company jurisdiction, the country had to rid itself of tax rules which were identified as significant barriers. These tax rules included Controlled foreign company rules, Dividends withholding taxes, Transfer pricing and Thin capitalisation rules. (National Treasury, 2010b: p.77).

National Treasury proposed that holding companies which qualified to be elected as headquarter companies become eligible for the following tax relief:

- Foreign subsidiaries of a qualifying holding company would not be treated as controlled foreign companies merely because the holding company had significant equity interest in those subsidiaries.

- Dividends declared by a ‘qualifying’ holding company would become exempt from secondary tax on companies (STC).
- The ‘qualifying’ holding company would not be deemed to violate the thin capitalisation rules merely because back-to-back cross-border loans involving the aforementioned company existed. (National Treasury, 2010b: p.78).
- Foreign creditors of the ‘qualifying’ holding company would be exempt from withholding tax on interest in respect of back-to-back loans. (Mckinon, 2016: p.108).

In 2011, more changes were made through the Taxation Laws Amendment Act 24 of 2011. Section 9I of the Act was made to be the main law governing the headquarter company regime. The definition of the headquarter company in s 1(1) of the Act was thus, substituted by the s 9I definition. The definition adopted less restrictive taxation rules than those which had applied to the international headquarter company that was repealed in 2003. The advantage was that prospective headquarter companies could determine their eligibility to qualify as headquarter companies by using s 9I alone. (Arendse, 2014:p.18) Changes made as described in the Explanatory Memorandum on Taxation Laws Amendment Bill of 2011 included:

- The amendment of s 9I(2)(a) of the Act in which the minimum equity shares and voting rights requirement were reduced from 20 per cent to 10 per cent,
- The headquarter company taxation rule in s 9I(2)(b) was relaxed by way of excluding cash holding from total assets,
- Section 9I(3) was inserted in the Act to introduce the headquarter company regime taxation rule that required prospective headquarter companies to elect to become a headquarter company on an annual basis, and
- Section 9I(4) was inserted in the Act to impose the obligation on a headquarter company to report annually to the Minister of Finance at National Treasury. (Lourens, 2019: pp.24-25).

According to the Explanatory Memorandum on Taxation Laws Amendment Act Bill of 2011, the taxation rules in s 9I(3) regarding the election to be a headquarter company and s 9I(4) regarding annual reporting by the headquarter company to the Minister of Finance via National Treasury, were inserted into the Act as a measure to prevent the anomalies and uncertainties which had been observed to give rise to tax base erosion by headquarter companies (National Treasury, 2011b: p.96). Accordingly, National Treasury made a ruling that tax benefits were to be reported on an annual basis to quantify their success and to curb the risks. Reporting was also deemed to be crucial from a financial management perspective as it would assist in measuring the tax expenditure of the concession granted. The entry into the headquarter company regime was thus, made to be voluntary and not automatic. (National Treasury, 2011b: p.93).

According to the Explanatory Memorandum on Taxation Laws Amendment Bill of 2012, the government made the decision to make further refinements to the headquarter company taxation rules as follows:

- The 'always qualification rule' test that was previously applied to the 10 per cent shareholding as well as the 80 per cent assets taxation rules which was required to be adhered to in the year that was being assessed and also in the prior years was relaxed. The relaxation of this taxation rule meant that the test became an annual test, and the tests from the previous years were no longer considered. In addition, relief could be given to a dormant company by virtue of the test being waived to the extent that the company had become dormant. (National Treasury, 2012: p.124)
- Relief was made available to headquarter companies for intellectual property and royalties (National Treasury, 2012: p.125)

The author submits that the introduction of a new headquarter company in 2010 as well as the amendments made from the since 2011 helped the government of South Africa, its legislators, tax experts and academic scholars to develop confidence in the concept of a successful South African headquarter company regime. The government, through the encouragement of the Katz Commission, envisaged the headquarter company regime in s 9I becoming an effective business model which would broaden the tax base of the country and add to the tax revenue collected.

Oguttu (2011: p.63) stated that with the growing international interest in Africa, it was important for South Africa to take advantage of its regional economic and infrastructural superiority, to position itself as a base and improve its chances of becoming the front-runner in Africa's interactions with other countries across the globe. If South Africa became a channel through which foreign investments could expand into Africa, the country would benefit from the inward flow of technology and the income derived from such investment. These investments would also lead to the retention and importation of skills, which would subsequently increase economic development in the country. In that regard, South Africa had to align its international tax legislation to international standards. (Oguttu, 2011: p.64).

According to Gutuza (2014: p.203), South Africa could try to attract foreign investors to establish their headquarter companies in the country, but the country's ability to do such was proven to be questionable because South Africa lacked the preferential treatment of management fees and other tax benefits which are provided by other regimes around the world. An amendment was made whereby service fees paid or payable to the headquarter company are now exempt from normal tax as shown in s 9I(2)(c)(i).

Grad-Rusu (2015: p.191) stated that countries needed to implement tools which they would be able to utilise to attract foreign direct investment because foreign companies investing in those countries would result in skills development, a decrease in unemployment, and an increase in the production of goods and services.

Legwaila (2012: p.23) indicated that weaknesses in South Africa's headquarter company regime in s 9I stemmed from the fact that the regime was designed with a specified directive to carry out supervisory and executive roles, but these roles were not automatically conducted by all intermediary holding companies. Legwaila (2012: p.23) argued that the headquarter company regime in s 9I was in itself misleading because the headquarter company definition gave the impression that it applied to all trading companies only for the foreign investors to realise that it only applied to a specific kind of qualifying company. Legwaila (2012: p.23) further indicated that by curbing the weaknesses in the taxation rules of the headquarter company regime, South Africa would increase its potential as the preferred location for multinational companies in Africa.

1.3 Motivation of the research

The majority of existing research on the South African headquarter company regime was performed prior to the finalisation of the 'Base Erosion and Profit Shifting (BEPS) Project in 2017' (Mckinon, 2016:1) and the OECD Progress Report on Preferential Regimes. As explained by Lourens, (2019: p.15) 'it is, therefore, important that more research is conducted on the impact that recent developments in tax both locally and internationally could have on the effectiveness and the continued existence of the South African headquarter company regime'.

The research will be adding significantly to the limited research on the South African headquarter company regime in s 9I, particularly in the identification of weaknesses as well as remedies which could be applied to improve the current headquarter company taxation rules and make the headquarter company regime more appealing to foreign investors.

1.4 The objective of the study

This study aims to examine the issues that plague the South African headquarter company regime taxation rules in s 9I of the Act and suggest ways through which such issues can be resolved to enhance the headquarter company's appeal to foreign investors. The analysis will determine the remedies which can be applied to the weaknesses identified in South Africa's headquarter company regime taxation rules in an effort to make the headquarter company regime more attractive to foreign investors (Mckinon, 2016: p.71).

1.5 Limitations of the study

The analysis will be done on the current headquarter company regime taxation rules in s 9I. All the amendments which were made in prior years will not be analysed in detail. The analysis of the subject matter will be the foundation from which the main research problem will be addressed.

1.6 Research Questions

Main Research Question

How can problems with the South African headquarter company regime taxation rules in s 9I be resolved in order to make the headquarter company regime more attractive to foreign investors?

The main questions will be answered through the research sub questions. The answer will be part of the conclusion at the end of the research report. This answer will be a combination of factual research findings and the researcher's opinion.

Research sub questions

1. **Who are the foreign investors that South Africa wants to target with regards to South Africa's headquarter company regime in s 9I?**

   The focus of this chapter will be to analyse who the foreign investors that South Africa wants to target with regards to the headquarter company regime in s 9I are. To identify the foreign investors that the Katz Commission of Inquiry initially wanted to attract, the explanation in the report of the Katz Commission will be examined. The next step will be an analysis of the kind of foreign investors who South Africa wants to target in regard to the headquarter company regime in s 9I

2. **What are South Africa's headquarter company regime taxation rules in s 9I?**

   This chapter will focus on S 9I. The taxation rules which govern South Africa's headquarter company regime will be discussed in detail. The researcher will start by discussing the definition of a resident, focusing on the place of effective management. The next step will be to identify and discuss the headquarter company regime taxation rules in s 9I. (Mukumba, 2017). Each rule will be explained in detail starting with s 9I(1)(a) regarding resident companies, followed by a detailed analysis of each of the taxation rules which must be adhered to under s 9I(2), s 9I(3) and s 9I(4) of the Act. The researcher will use the Act, SARS Interpretation Note 87 as well as the Explanatory memoranda to taxation laws amendment bills to analyse the headquarter company regime taxation rules, incorporating all the amendments which were made to date.

3. **What are the problems and weaknesses in the South African headquarter company regime taxation rules?**

   The first part of the chapter will be to identify weaknesses in South Africa's headquarter company regime taxation rules in s 9I using the information as well as the analysis performed in chapter 2.

   The identification of the weaknesses will then give an indication of the remedies which can be applied to the weaknesses in the aforementioned headquarter company regime.

4. **What are the remedies which could be applied to South Africa's headquarter company taxation rules to make them more attractive to foreign investors?**

   The researcher will suggest remedies which could be applied to the weaknesses identified in the previous chapter. The researcher will use the findings from Chapter 1 to Chapter 5 of the report to identify remedies that could be applied to the South African headquarter company regime taxation rules in s 9I. The researcher will in this chapter continue to use legislation, journal articles, research reports, and other academic writings to identify the remedies.

1.7 Research Methodology

The research will be qualitative in nature. The researcher will use the following material for the research:

Legislation

- South Africa's Income Tax Act 58 of 1962 and in addition the following amendment act to the Act:

  Revenue Laws Amendment Act 59 of 2000

  Revenue Laws Amendment Act 45 of 2003

  Taxation Laws Amendment Act 7 of 2010

  Taxation Laws Amendment Act 24 of 2011

Taxation Laws Amendment Act 21 of 2012

Taxation Laws Amendment Act 24 of 2015

- The Exchange Control Regulations of 1962
- Constitution of the Republic of South Africa of 1996 (Mckinon, 2016: p.103).

OECD reports:

- Action 5 plan on Base Erosion and profit shifting (BEPS) in 2013 (Mckinon, 2016: p.1).
- Action 15 plan of the BEPS Project in 2017
- Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting in 2018 (Mckinon, 2016: p.1).
- Article 16 of the MLI (Mutual Agreement Procedure) in 2021

Katz Commission of Inquiry reports

- Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa). Fifth interim report of 1997 (Mckinon, 2016: p.103).
- Basing South Africa's Income Tax system on the source of residence principle – Option and recommendations (Mckinon, 2016: p.103).

Davis Tax Committee reports:

- Addressing Base Erosion and Profit Shifting in South Africa (Mckinon, 2016: p.103).
- .
- Interim Report on Base Erosion and Profit Shifting in South Africa (Mckinon, 2016: p.103).
- Second interim (final) report on action 5: counter harmful tax practices more effectively, taking into account transparency and substance.
- Davis Tax Committee: executive summary of second interim report on base erosion and profit shifting (BEPS): OECD BEPS project from a South African perspective: policy perspectives and recommendations for South Africa. (Mckinon, 2016: p.103).

The above-mentioned reports and legislation will be used as the primary sources in the research.

Other sources used as secondary sources in the research include:

- SARS Interpretation Note 6 of 2002: Resident – Place of Effective Management
- SARS Discussion Paper on Interpretation Note 6 of 2011: Place of Effective Management (Lourens, 2019).
- SARS Interpretation Note 87 of 2016: Headquarter Companies
- SARS Interpretation Note 51 of 2012: Pre-Trade Expenditure and Losses
- National Treasury Budget Reviews for 2010 till 2021
- Explanatory Memorandums on Taxation Laws Amendment Act Bills
- South African Reserve Bank (SARB) reports
- Peer reviewed Journal Articles and other Academic Writings

The research will be limited to income tax, focusing on s 9I. All other taxes fall outside the scope of this research and will thus not be examined. (Lourens, 2019).

2. Chapter 2: FOREIGN INVESTORS SOUTH AFRICA WANTS TO ATTRACT

2.1 An overview of foreign direct investment

There is no direct definition of the concept of foreign direct investment in the Act, but the Act provides a definition for a foreign company and a foreign investment entity. The definition of a foreign company was inserted into the Act through s 6(1)(h) of the Taxation Laws Amendment Act 7 of 2010.

The meaning of a foreign company according to s 1(1) of the Act is:

Any company that is not a resident.

According to AngelOne (2023) foreign direct investment in simply refers to an investment made by one company, or an entity based in one country into a company, or an entity based in another country. There have been many studies which show that there is a positive relationship between foreign direct investment and economic growth and these studies also indicate that foreign direct investment is a key source of much needed investment capital. (Kransdorff, 2010: p.70). As a result, countries put in significant effort and try to create favourable conditions to attract foreign direct investments. (Legwaila, 2016: p.159).

Furthermore, Kransdorff (2010: p.70) stated that Foreign direct investment does not only raise the level of investment or capital stock but 'facilitates the dissemination of new technologies and management practices in host countries'. This in retrospect means that there will be a creation of new production capacity and jobs, which would then lead to an increase in employment opportunities and development of skills by the citizens of the host country.

Foreign direct investment continues to be an important aspect of growing the economy in South Africa. This was the main reason that the National Investment Promotions Agency (InvestSA) in conjunction with the Presidency, created the 'High level' Investment Infrastructure Office (IIO) in 2019. The office was created in an effort to continue to enhance investment inflows into South Africa. (InvestSA, 2019).

There are many programmes which were implemented by the Department of Trade and Industry to encourage and promote the inflow of foreign direct investment into South Africa. One of the programmes was the implementation of the Growth, Employment and Redistribution Model (GEAR) in 1996, which accompanied the country's move to democracy and emphasized the importance of foreign direct investment in South Africa. This macroeconomic strategy was explained to be a 'state of the art framework for sustainable economic growth and development with an outward orientation'. The strategy was geared towards the attainment of South Africa's social and economic objectives of improving the quality of life of South Africans and enhancing of economic growth. (Department of Trade and Industry, 2000: pp.267-278).

The typology of foreign direct investment was developed by Jere R. Behrman, Professor of Economics at University of Pennsylvania, to explain the different objectives of foreign direct investments.

The different types were described as follows:

Resource-seeking foreign direct investments, which include investment in minerals or raw material.

Market-seeking foreign direct investments, which are investments made to identify and exploit new markets for a company's finished products.

Efficiency-seeking or global sourcing foreign direct investments which are investments made for the restructuring of existing investments to achieve an efficient allocation of international economic activity. (UNESCAP, 2017: pp.28-31).

In reference to the GEAR macroeconomic strategy, it is noticeably clear that South Africa needs to open doors to foreign investors who are active business traders and are willing to participate in the sustainable development of the country. Such investors, together with the government of the Republic would then work towards growing the economy by bringing their resources (foreign direct investment), their skills and expertise into the country while trading profitably. Nonetheless, the headquarter company regime in s 9I, was not intended to be the kind of vehicle that drives those objectives. In that regard, the author submits that the headquarter company regime in s 9I cannot be criticised for not living up to those ideologies. As a result, the concepts are beyond the scope of this research and will not be discussed any further.

2.2 The link between foreign direct investment and tax incentives

According to Legwaila (2021:p.126) in the development of their tax systems, countries show great interest in attracting investors to set up headquarter companies within their jurisdictions to benefit from the benefits that attach to the presence of headquarter companies and South Africa added itself to the list of those countries by its announcement in the 2010 Budget Review that it planned to market itself as a gateway to investment into Africa.

When considering investment destinations, the investing entity's consideration is an infrastructure that is conducive to the performance of its operations and the achievement of its goals. The social, economic, and political stability of a country could be the primary determining factors considered, but in addition to these factors, the potential investors and decision-makers would also look at the legal system of a country and the functioning of its legal systems. (Legwaila, 2012: p.24). Although tax may not be the primary consideration when it comes to investment decisions, it remains to be an important determinant (Honibal and Killoran, 2011: p.36). Legwaila (2021: p.128) reasoned that investors often set up headquarter companies in specific jurisdictions to access tax benefits offered by those jurisdictions. The aforementioned benefits would be in the form of tax benefits and incentives which the investor would otherwise not have been able to access without the use of the headquarter company regime for that particular jurisdiction (Legwaila, 2012: p.24). According to Tuomi (2011: p.136) the range of tax benefits which may be offered to the investor through a headquarter company regime's tax legislation would include tax holidays, low or preferential tax rates, grants, preferential loans, monopoly rights, preferential infrastructure access, relief on taxation of dividends, capital gains, interest, and royalties.

Kranskorff (2010: p.71) stated that historically fiscal considerations where found to have an insignificatn impact on foreign direct investment, but more recent research proved that taxation can be influencial in the investment decision under certain circumstances.

Consequently, it is the author's view that South Africa's headquarter company regime in s 9I of the Act, may be used as a tool that would attract foreign investments into the country. When the value of the tax benefits are made known to the foreign investor, and the tax benefits are packaged in a manner that guarantees that such tax benefits and incentives will be made available to the foreign investor after they elect to be headquarter companies under the South African headquarter company regime in s 9I, foreign investors will find the headquarter company to be more appealing and give more consideration to bringing their resources in the form of foreign direct investments into the country.

2.3 Tax characteristics of an ideal headquarter company regime

According to Legwaila (2012: p.26), the critical characteristics that must be met by a potential jurisdiction for it to be classified as an ideal headquarter company location are the following:

- A low or no effective tax rate,
- There are exemptions in the withholding taxes imposed on dividends, interest, royalties, and management fees, (Lourens, 2019)
- The jurisdiction has a large Double Taxation Agreement network,
- There are no Capital Gains Tax rules,
- There are no transfer pricing and thin capitalisation rules,
- There are no Controlled Foreign Company rules,
- There are rebates in the form of deductions and tax credits which allow the headquarter company to maximise foreign tax credits.
- The regime has the ability to undertake group restructurings without triggering adverse tax effects,
- The regime has specific provisions which address foreign exchange gains or losses in order to avoid taxation on such gains or losses on foreign transactions,
- The are no exchange control rules and a result the regime allows reinvestments of capital growth and the free flow of funds. (Legwaila, 2012: 24-38).

In order for South Africa's headquarter company regime in s 9I to be appealing to the foreign investor, it must meet the above-mentioned requirements. Foreign investors and multinational entities use these characteristics to measure the effectiveness of the tax systems, the tax policies and the legislation that governs a potential holding company location. Subsequently, when a country's headquarter company regime has the following characteristics, foreign investors may deem the jurisdiction to be ideal to conduct business activities of a holding company and that would in effect lead to the country attracting increased investment. (Davis Tax Committee, 2015). Examples of such jurisdictions are Mauritius, The Netherlands and Luxemburg. Because they have been dubbed ideal holding company destinations, these countries continue to attract various forms of investments. And they also possess the ability to manipulate and redirect the investment strategies of many investors from across the globe (Arendse, 2014). Whether those countries intended and designed their tax systems to attract foreign direct investors or not, their success in doing so has proven to pose serious threats to the tax bases of other countries which are not offering the same preferred tax and administrative treatment to investors. It is, therefore, vital for South Africa to ensure that they measure up to those characteristics if the headquarter company regime in s 9I is going to achieve its objective of becoming the gateway into Africa. (Legwaila, 2012: p.45).

2.4 South Africa promoting itself as an investment destination under the headquarter company regime in s 9I of the Act

In the 2020 Budget Review, National Treasury reflected that South Africa had not managed to become the 'gateway into Africa' that it was expected to become even though the country had initially met most of the required factors for an ideal headquarter company location (National Treasury, 2020: p.36). Nevertheless, South Africa still desires to be the gateway into Africa, and this is the reason the South African government continues to make amendments to the headquarter company regime in s 9I of the Act. Accordingly, refining and redesigning it in a quest to make it less complex and more attractive to foreign investors (National Treasury, 2020: p.37).

An article in the Charleston Daily Mail in 1999, titled 'South Africa wants to put itself on the investor's maps' stated the fact that South Africa had struggled to gather the kind of momentum it had expected to acquire in order for it to gain much needed foreign direct investment into the country. The Article indicated that in 1986 when South Africa had been sanctioned by the USA because of its apartheid system, the country had about 360 US multinational entities doing business in the country. In 1999 the country having 386 US companies doing business in the country, had acquired a mere 26 more companies even though South

Africa was viewed differently having become a democracy (Charleston News, 1999: p.1).
In 2022 the US Department of State in its Bilateral relations fact sheet, stated that South Africa was the largest U.S. trade partner in Africa, with a total two-way goods trade of $17.8 billion in 2019. Furthermore, an approximation of 600 American businesses were recorded to be operating in South Africa, and that many of those use South Africa as regional headquarters. (US Department of State, 2022).
Based on the findings above, the author submits that it is imperative for the South African government to work towards attracting more foreign investors because despite all the non-tax related ills which swamp the country, there are a lot of countries like the United States, which have continued business relations with South Africa. For example, China is South Africa’s largest trading partner both overall and within the BRICS grouping. (Arendse, 2014). SARS stated that in 2022, South Africa’s exports to China were valued at R188,4 billion, while imports from China to South Africa amounted to R367,4 billion. (SARS, 2023).

The tax benefits which a jurisdiction offers to foreign investors can enhance the appeal of the country as a preferred location to establish their holding companies. It is thus the view of the author that when South Africa starts offering the kind of tax benefits and incentives which are valuable in the eyes of the foreign investors through s 9I, many foreign investors may become more attracted to the South African headquarter company regime and see potential in having their headquarter companies established in the country. (Arendse, 2014:p.5). South Africa must continue to market itself as an economy that can offer foreign investors desirable tax incentives so that investors become more attracted to the country. In that regard, a more desirable headquarter company regime may attract more foreign direct investment into the country. (Mukumba, 2017:p.37).

2.5 The foreign investor targeted under the headquarter company regime in s 9I of the Act

To determine the of the kind of investors South Africa wants to target with regards to the headquarter company regime in s 9I, it is important to look at what the government, through tax legislation was aiming to achieve when the headquarter company regime in s 9I was enacted.

The Budget Review for 2010 indicated that in an effort to enhance its attractiveness as a viable and effective location from which businesses could extend their African operations, the government reviewed its tax rules and proposed measures that would provide relief from foreign exchange control and tax to promote South Africa as a gateway into Africa. (National Treasury, 2010a: p 78).

Considering the statement above, the concept presented by National Treasury was that South Africa would open its doors to all kinds of foreign investors and multinationals which sought to penetrate the African continent. In that regard, South Africa's headquarter company in s 9I would become the designated connection between Africa and foreign investors from other countries across the globe.

According to Olivier & Honiball (2011: p.690), a s 9I company may in effect be viewed as an intermediary holding company whose main function includes the administration of investments in group companies.

Gutuza (2014: p.201) reasoned that the benefits available under the headquarter company regime were designed for use by an intermediary holding company acting as a conduit.

For example: a headquarter company under s 9I can access an exemption from the arm's length principle for financial assistance received from a non-resident and transferred to a qualifying foreign company in accordance with s 31(5)(a) of the Act. The above example is a typical scenario of conduit loan financing. (Gutuza, 2014: p.201)

Mukumba (2017: p.5) stated that National Treasury appeared to lean towards attracting more holding companies conducting specialised activities into the country through the South African headquarter company regime in s 9I as they continue to make more amendments to the Act.

According to Mukumba (2017: p.39) the grounds for the enactment of the headquarter company regime in s 9I gave the impression that all prospective headquarter companies would be eligible to elect to be headquarter companies, but the provisions in s 9I, proved themselves to be an interference to the qualification of most companies. (Lourens, 2019).
Mukumba further stated that the problem was that a company could at the initial stages seem to qualify to be a headquarter company under the headquarter company regime in s 9I but end up becoming disqualified as a result of a technicality or restrictive provision.
Therefore, whilst it is not a specified requirement of s 9I, it can be argued that a company seeking to benefit from the headquarter company regime in s 9I would be best suited for the regime if it is intermediary in nature and held significant investments in qualifying foreign companies (Mukumba, 2017: p.7).

The author submits that the statements which were made by National Treasury in the 2010 Budget review whereby the headquarter company regime in s 9I was introduced as a canal that would promote South Africa as a gateway into Africa was an open-ended statement. None the less the headquarter company taxation rules in s 9I of the Act set specific boundaries which show the kind of foreign investors that the Act meant to target. An example of such companies includes foreign investors who establish headquarter companies in South Africa with their main activities being to render debt financing services to their subsidiaries and in return, earning interest for these services which they render to their subsidiaries. Another example is of a foreign investor who owns intellectual property, and as a result sets up a headquarter company under s 9I to lease the aforementioned intellectual property licence to subsidiaries in which the same headquarter company invests and in return, earn royalties for those services rendered. According to s

50D(1) ss(i) of the Act, interest flowing through the s 9I company will be excluded from withholding taxes. Similarly, under s 49D of the Act, royalties flowing through a s 9I company are excluded from withholding taxes. (SARS, 2016: pp.55-58).

According to Silke (2022: p.896) the headquarter company regime is an elective regime that relaxes the requirements of the tax laws for certain South African Companies that are used by foreign investors as investment vehicles into other countries. The prior statement corroborates the author's view that the headquarter company regime in s 9I was not necessarily formed to be an active trading business, but to be 'used' as a type of company that generates passive income in the form of rental income, interest received, royalties and dividends.

3. Chapter 3: SOUTH AFRICA'S HEADQUARTER COMPANY REGIME TAXATION RULES

The author will concentrate on the headquarter company regime taxation rules in s 9I of the act for the purpose of this research.

3.1 Taxation Rule 1: The Resident requirement in s 9I (1) of the Act

Section 9I of the Act states the following:

(1) Any company that

(a) is a resident; and

(b) complies with the requirements prescribed by subsection (2), may elect in the form and manner determined by the Commissioner to be a headquarter company for a year of assessment of that company.

Analysis of Taxation Rule 1: The Resident requirement in s 9I (1) of the Act

A test must be performed in order to check the resident status of a company. This test is referred to as the residency test, and it is performed by applying the definition of a resident in s (1)(1). (For the purpose of s 9I, subsection 1 (a) which describes a natural person is excluded)

The definition of a resident as per s 1(1) of the Act:

Resident means any –

(b) person (other than a natural person) which is incorporated, established, or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation. (SARS, 2016: p.5).

If residency cannot be determined, the Act then requires the company to do a residence test to determine whether the company has its place of effective management in the Republic. (SARS, 2020:p.5)

In view of the above statements, the interpretation of the place of effective management in the context of South African tax law has proven to be difficult. The amendments to the Act, interpretations through interpretation note 87 and explanatory memoranda of the taxation laws amendment act bills have given rise to more than one explanation of the place of effective management. Currently, there are 3 different interpretations of the place of effective management. There is a SARS interpretation, a Case Law interpretation, and an OECD interpretation.

According to Interpretation Note 6, there are multiple facts that need to be considered, often involving multiple locations and it is necessary to determine a single dominant place where effective management is located within those multiple locations. The determination looks at where the key management and commercial decisions are regularly and predominantly made. Therefore, all the relevant facts and circumstances must be examined on a case-by-case analysis (SARS, 2016: p.4).

Based on the views above, determining the place of effective management involves tests and investigations, which may be unique to every headquarter company and as a result, there is no standard approach that can be applied in these tests. The major concern, in relation to those views, is that South Africa may stand to lose revenue if the mutual agreement procedure and tie-breaker rules, favour the other country instead of South Africa when the interpretations for the place of effective management are conducted.

3.2 Taxation rule two: The 10 per cent or more shareholding and voting rights requirement in s 9I (2)(a) of the Act

Section 9I(2(a) of the Act states the following:

> A company complies with the requirements contemplated in subsection (1)(b) for a year of assessment of that company if,
>
> (a) for the duration of that year of assessment, each holder of shares in the company (whether alone or together with any other company forming part of same group of companies as that holder) held 10 per cent or more of the equity shares and voting rights in that company (Mukumba, 2017).
>
> Provided that in determining whether a company complies with the requirements prescribed by this paragraph in relation to any year of assessment of that company during which the company commenced the carrying on of trade, no regard must be had to any period during that year before which the company so commenced the carrying on of trade. (SARS, 2016: p.6).

Analysis of Taxation rule two: The 10 per cent or more shareholding and voting rights requirement in s 9I (2)(a) of the Act

The analysis will be broken down into 3 steps.

Firstly: '**for the duration of the year of assessment**' requirement. The 10 per cent shareholding test was changed to become an annual test so as not to consider ownership of prior years. This meant that to determine whether or not a prospective headquarter company complies, all periods before the prospective headquarter company started carrying on a trade must be disregarded. (National Treasury,2012: p.123).

Throughout the year of assessment, the shareholders alone or together with other companies should hold 10 per cent in the headquarter company. Therefore, if at any point in the year, if the shareholding as well as the voting rights drops below the 10 per cent criteria, the company would then fall outside the 10 per cent shareholding rule and the company would be non-compliant to the headquarter company taxation rule in s 9I(2)(a). (SARS, 2016: p.5)

The second step, we look at the '**10 per cent or more of the equity shares and voting rights'** requirement

As was stated in the headquarter company regime taxation rule in s 9I(2)(a) provides that each holder of shares in the company, whether alone or together with any other company forming part of the same group of companies as the holder, must hold 10 per cent or more of the equity shares and voting rights in the potential headquarter company. The holder may be a resident. A holder that is a company may hold 10 per cent of the equity shares and voting rights on its own or together with another company that is part of the same group of companies. The equity shares and voting rights held by a connected person, which is not part of the same group of companies, are not relevant. Similarly, if the holder is a natural person or a trust, connected person holdings are not relevant and the natural person or trust must hold 10 per cent or more of the equity shares and voting rights on its own. (SARS, 2016: p.5).

Interpretation Note 87 indicated that the 10 per cent shareholding and voting rights requirement must be met for the entire year of assessment for which a qualifying company wants to make an election to be a headquarter company. That is, the requirement must be met on each and every day of the year of assessment. The shareholding can change within a year of assessment provided that at all times every holder met the 10 per cent shareholding and voting rights requirement. The only exception is for the year of assessment during which the potential headquarter company commences trading. In that year, the company does not need to comply with this requirement for any period before the company commenced the carrying on of a trade. Furthermore, a distribution could take the form of a distribution of profits (dividends), or capital (return of contributed tax capital). The important fact is that a share will be an equity share as long as the right to participate in either of these types of distribution is unrestricted. The share will not be an equity share if either of these rights are restricted. (SARS, 2016: p.6).

3.3 Taxation rule three: The asset qualification requirement in s 9I (2)(b)

As stated in s 9I (2)(b) of the act:

> A company complies with the requirements contemplated in subsection (1)(b) for a year of assessment of that company if,
>
> (b) at the end of that year of assessment and of all previous years of assessment of that company, 80 per cent or more of the cost of the total assets of the company was attributable to one or more of the following:
>
> (i) any interest in equity shares in,
>
> (ii) any debt owed by,
>
> (iii) any intellectual property as defined in section 23I(1) that is licensed by that company to,
>
> any foreign company in which that company (whether alone or together with any other company forming part of the same group of companies as that company) held at least 10 per cent of the equity shares and voting rights: Provided that in determining
>
> (aa) the total assets of the company, there must not be taken into account any amount in cash or in the form of a bank deposit payable on demand,
>
> (bb) whether a company complies with the requirements prescribed by this paragraph in relation to any year of assessment of that company, no regard must be had to any such year of assessment if the company did not at any time during such year of assessment own assets with a total market value exceeding R50 000. (the Act, s 9I (2)(b)).

Analysis of Taxation rule three: The assets requirement in s 9I (2)(b) of the Act

The 80 per cent or more of the cost of total assets in, to or by a qualifying foreign company requirement must be met at the end of the year of assessment for which an election is made to be a headquarter company. However, an exception is made whereby, a company has not yet commenced the carrying on of a trade, or whereby the company is dormant. (SARS, 2016: p.10).

The proviso in s 9I (2)(b)(bb) of the act requires the market value of the total assets held by the headquarter company to exceed R50 000 during the year of assessment.

It should be noted that the value of the total cost of assets held by the headquarter company in the qualifying companies in which it invests, may change from time to time. The main reason for such a change is that over time the value of assets may change due to appreciation or depreciation. Depreciation occurs when an asset decreases in value from its original price over time as a result of wear and tear. Appreciation refers to an asset's value increasing over time. An example of both scenarios is that: The headquarter company may invest in a qualifying real estate company and earn rental income from its' investment. If the property is situated in an affluent area which is well kept, safe and has all the amenities which make it a great district, it is highly likely that the value of the property will appreciate, meaning that it will increase over time. However, if the property is situated in an area where the area is not well maintained, is unsafe and lacks the amenities which would qualify it as a good district, the value of the property would depreciate or decrease over time. In an instance whereby the value of the total cost of assets held in by the headquarter company decreases and the value is less than the R50 000 that is required in the proviso as is required in s 9I(2)(b)(bb), the headquarter company will lose its status and will no longer qualify to be a headquarter company under the South African headquarter company regime.

When determining the total cost of asset, all cash, and cash equivalents (bank deposits payable on demand) must not be included in the calculation. (SARS, 2016: p.14). It may happen that the value of the total assets held by the headquarter company could change if the real estate company that the headquarter company has invested in continuously buys and sells property. If the company sells its property and receives cash for the sale, the amount of cash will have to be excluded in determining the value of the total cost of assets held by the headquarter company. And if because of the sale, the value of the assets held in the qualifying real estate company decreases to an amount below R50 000, the company will no longer qualify to be a headquarter company and that will mean that the company no longer qualifies for the tax incentives and concessions under the headquarter company regime in s 9I of the act.

An Example from Interpretation Note 87 of 2016:

An example of the '10% shareholding and voting rights' and the '80% or more of the cost of total assets in, to or by a qualifying foreign company' requirements as demonstrated in the Interpretation Note 87 of 2016:

Facts: Company B, a resident, is 100% held by Company A. Company B holds 5% of the equity shares and voting rights in a foreign company, Company C. Company D, which is a company forming part of the same group of companies as Company B, holds 10% of the equity shares and voting rights in Company C.

The cost of Company B's total assets was as follows at the end of its year of assessment ending on 31 December year 4:

- Equity shares in Company C R 100 000
- Loan advanced to Company C R 5 000 000
- Current account R 2 000 000

The total Cost of Company B's total assets R 7 100 000

The '80% or more of the cost of total assets in, to or by a qualifying foreign company' requirement was met in all previous years of assessment.

Result: Company C is a qualifying foreign company because Company B, together with Company D, holds at least 10% of the equity shares and voting rights in Company C. Company B has met the requirement specified under section 9I(2)(b) for the year of assessment ending on 31 December year 4 because 100% (R5,1 million (loan of R5 million + equity shares of R100 000) / R5,1 million) of the cost of Company B's total assets was attributable to assets in, to or by qualifying foreign companies as specified in section 9I(2)(b). The current account of R2 million is excluded from the calculation of the cost of Company B's total assets under paragraph (aa) of the proviso to section 9I(2)(b). (SARS, 2016: p.18)

3.4 Taxation Rule four: The gross income in s 9I (2)(c) of the Act

S 9I(2)(c) of the Act states the following:

(2) A company complies with the requirements contemplated in subsection (1)(b) for a year of assessment of that company if,

(c) where the gross income of that company for that year of assessment exceeds R5 million, 50 per cent or more of that gross income consisted of amounts in the form of one or both of the following:

(i) any rental, dividend, interest, royalty, or service fee paid or payable by any foreign company contemplated in paragraph (b), or

(ii) any proceeds from the disposal of any interest contemplated in paragraph (b)(i) or of any intellectual property contemplated in paragraph (b)

(iii): Provided that in determining the gross income of the company, there must not be taken into account any exchange difference determined in terms of section 24I in respect of any exchange item as defined in that section to which that company is a party. (SARS, 2016:p.19).

Analysis of Taxation rule four: The gross income requirement in s 9I (2)(c) of the Act

The gross income requirement in s 9I(2)(c) suggests that all income earned by a South African headquarter company besides proceeds from rentals, dividends, interest, royalties, or service fees paid or payable will be taxable at the normal corporate income tax rate (Arendse, 2014: p.12). According to the SARS website, corporate tax rate in South Africa was reduced from 28 per cent to 27 per cent following the announcement by the Minister of Finance on the 23 of February 2021. The change came into effect from the year ending on or after 31 March 2023.

Section 9I of the Act qualifies a prospective headquarter company who invests in the purchase of shares offshore to be able to repatriate the profits without any withholding of taxes. The headquarter company will also benefit if it is in the debt-finance space where it plays the role of an intermediary holding company to its subsidiaries and earns interest for such services. Where the headquarter company is a business enterprise that manufactures, produces, buys, and sells tangible goods to make a profit, there will be no benefits as the company will be subject to normal tax just like the residents of the country. Furthermore, the headquarter company's taxation rule in s 9I(2)(c) requires for 50 per cent of the gross income to be passive income as soon as the income derived from its business activities exceeds R5 million. Income derived in the form of service fees has been exempted from normal income tax as indicated in s 9I(2)(c)(i). (SARS, 2016: p.20).

Interpretation Note 87 of 2016 indicates that proceeds from the disposal of equity shares in a foreign company or proceeds from the disposal of intellectual property will often be of a capital nature and will not be included in the gross income of the potential headquarter company. In these circumstances those proceeds would not form part of the '50 per cent or more of gross income' calculation. Only proceeds of a revenue nature will be included in gross income and therefore form part of this calculation. (SARS, 2016: p.20)

The author submits that the headquarter company regime taxation rule gives preferential treatment to specific types of businesses. Especially those businesses which intend to invest in passive income.

3.5 Taxation Rule five: The requirement to make an election in s 9I (3) of the Act

S 9I(3) of the Act states the following:

> (3) An election made by a company in terms of subsection (1) is effective from the commencement of the year of assessment in respect of which that election is made

Analysis of taxation rule five: requirement to elect to be a headquarter company in s 9I(3) of the Act

In accordance with s 9I(3) of the Act, when a company meets all of the requirements of s 9I, the company must make an election in order to become a headquarter company under the South African headquarter company regime in s 9I of the Act. The company will thus become a headquarter company under the South African headquarter regime effective from the first day of the year of assessment in which it chose to make the election. (Lourens, 2019: p.26).

According to SARS' External Guide: How to complete the company income tax return, a company that elects to be a headquarter company must initiate the election through the Income Tax Return for Companies (ITR 14). (SARS, 2023a: pp.1-3) In addition to the ITR14, a company that elects to be a Headquarter Company must complete the RCH01 Schedule for companies electing to be a Headquarter Company. (SARS, 2023: p.19)

Interpretation Note 87 of 2020 indicates that choosing the correct company, and using the correct schedule is a vital part of the election process as this determines whether the company will be eligible to receive the tax benefits for a headquarter company, or whether the company will enjoy other tax benefits for normal corporate companies.

It is therefore possible that an election to be a headquarter company will mean that a person will not be entitled to tax relief under the corporate rules (such as those on change of ownership and reorganisation) on a transaction conducted during the year for which an election under the corporate rules is made, but before the election to be a headquarter company was made, and on which that person had anticipated being entitled to relief. On a case-by-case basis it is also important to consider the impact that an election to be a headquarter company will have on previous transactions, if any, which were subject to the corporate rules. (SARS, 2016: p.64)

There are currently no provisions in the Act dealing specifically with a company ceasing to be a headquarter company. The election to be a headquarter company for a specific year of assessment can be made only at or after the end of that year of assessment if the requirements of section 9I(2) have been met. If any of the requirements in section 9I(2) has not been met for a specific year of assessment, a company cannot elect to be a headquarter company for that year of assessment. In addition, a company may meet the requirements and decide not to elect to be a headquarter company. If a company, for example, qualified as a headquarter company and elected to be one for a year of assessment, but does not meet the requirements of section 9I(2) for the next year of assessment, it cannot elect to be a headquarter company for that next year of assessment. (SARS,2016: p.64). The company would then be taxed as a normal company for the next year of assessment. This means that the company would no longer qualify for the tax benefits and relief it may have enjoyed as a headquarter company and it would also not be subject to the special anti-avoidance rules such as the provisions on the tax consequences of a company becoming a headquarter company in s 9H(3) of the Act as well as corporate tax rules which apply in regards to tax consequences of changes in ownership and reorganisation including exclusions from the scope of s 45(6) in the Act (SARS, 2016: p.65). The Explanatory Memorandum on Tax Laws Amendment Bill of 2011 indicated that there will be a deemed disposal of all the company's assets before a company can qualify to become a headquarter company. This amendment was introduced in order to prevent the use of the headquarter company regime to avoid capital gains tax. (National Treasury, 2012, p. 95).

3.6 Taxation Rule six: The annual reporting requirement in s 9I (4) of the Act

S 9I(4) of the Act states the following:

> (4) A headquarter company must submit to the Minister an annual report providing the Minister with the information that the Minister may prescribe within such time and containing such information as the Minister may prescribe

Analysis of taxation rule six: The annual reporting requirement in s 9I(4) of the Act

S 9I(4) of the act requires a headquarter company to submit an annual report to the minister of finance within such time, containing such info as the minister may prescribe.

According to the Interpretation Note 87 issue 3 of 2020, National Treasury requested that headquarter companies submit their annual financial statements and group structure to National Treasury on an annual basis. The Minister can request any additional information and supporting documentation as they see fit. (SARS, 2020: p.23)

3.7 Tax concessions for headquarter companies under s 9I of the Act

There are several tax concessions, which have been made for headquarter companies which meet all the headquarter company regime taxation rules in s 9I of the Act.

These include the following:

3.7.1 The foreign company is not classified as a Controlled Foreign Company, based on voting or participation rights held by headquarter companies or because its results are included in the consolidated financial statements of a headquarter company. Furthermore, a headquarter company is not required to impute any amount if it holds participation rights in Controlled Foreign Companies as is stated in s 9D(2). (SARS, 2016: p.24)

3.7.2 There are concessions which exist for interest and royalties in respect of financial assistance and licensing of intellectual property to the headquarter company if it applies the financial assistance or grants the right of use to foreign companies in which it held at least 10 per cent of the equity shares and voting rights (back-to-back transactions). There are no withholding taxes on royalties as per ss 49D(c) of the Act. (SARS, 2016: p.58). There are also no withholding taxes on interest paid to a foreign person by a headquarter company as per ss 50D(1)(a)(i)(cc)) of the act (SARS,2016: p.55). These back-to-back transactions are also not subject to transfer pricing in South Africa under s 31(5) of the Act (Mckinon, 2016: p.63). The deduction of interest and royalties incurred by the headquarter company towards foreign shareholders is, however, limited to the amounts that the headquarter company receives in terms of the pass-through transactions as contemplated in s 20C of the Act. (SARS, 2016: p.24).

3.7.3 Dividends paid by headquarter companies are not subject to dividends tax in s 64E(1) of the Act. Such dividends are taxed in the same way as foreign dividends in the hands of a resident who received it as per s 10B(1) of the Act. The requirements for the participation exemption are however, relaxed in respect of capital gains tax on the disposal of the shares of foreign companies in which a headquarter company held at least 10 per cent of the equity shares and voting rights as per paragraph 64B(2) of the Eighth Schedule. Returns of capital received from these companies must similarly be disregarded for purposes of capital gains tax as per paragraph 64B(4) of the Eighth Schedule. (SARS, 2016: p.29)

3.7.4 The headquarter company is afforded some flexibility when it comes to the translation of foreign currency amounts to rand in ss 24I(3), 25D(4) and 25D(7) of the Act, as well as paragraph 43(7) of the Eighth Schedule. (Stiglingh, et al, 2022: p.897)

4. Chapter 4: WEAKNESSES IN HEADQUARTER COMPANY TAXATION RULES

The South African headquarter company regime taxation rules in s 9I of the Act, continue to seek transformation and improvements as the headquarter company regime has not yet been successful as a gateway into Africa (Arendse, 2014: p.iv). Proposals on the improvement of the headquarter company regime taxation rules in s 9I are at times not implemented by the South African government, and as a result, amendments often take longer to be effected. The weaknesses in the taxation rules because of inaction by the legislators have resulted in the headquarter company becoming less and less attractive to the foreign investor. The aim of this chapter is to ensure that the weaknesses in the headquarter company regime taxation rules in s 9I of the Act are identified, so that the correct remedies can also be identified and recommended.

The following are weaknesses that have been identified in the headquarter company regime taxation rules in s 9I:

4.1 Weaknesses in the resident requirement in s 9I(1)

The definition of a resident in s 1(1) of the Act may have a negative impact on the appeal of the headquarter company regime to foreign investors. (Lourens, 2019: p.48). The first taxation rule of the headquarter company regime in s 9I(1) of the Act requires a company to qualify as a tax resident in South Africa (Mckinon, 2016:30). As stated by Lourens (2019: p37) in a situation whereby a company is considered to be a tax resident in South Africa as well as in another country that has a Double Taxation Agreement with South Africa, the tax residence of that company will be determined through the tie-breaker rule (SARS, 2011: p.2). (Lourens, 2019: p.49).

Nonetheless, the following is required of the foreign companies the headquarter company invests in:

- The companies in which the prospective headquarter company invests must be incorporated, established, or formed outside of South Africa and their place of effective management must not be in South Africa, or,
- The companies in which the prospective headquarter company chooses to invest are incorporated, established, or formed in South Africa, they must be deemed exclusively to be tax resident in another country in terms of a double taxation agreement to which South Africa is a party. (Lourens, 2019: p.49)

In view of the aforementioned taxation rule, if the place of effective management of the companies in which a headquarter company invests changes to South Africa, the company will no longer qualify to be a headquarter company under s 9 I as it will now be non-compliant to the headquarter company regime taxation rule in s 9I(1) of the Act. According to Zwarts (2013: p.19) the World Bank in 2013 indicated that there was a limited access to sufficiently skilled human capital in most Sub-Saharan Africa countries. Accordingly, setting up management structures in those African countries would be a challenge (Zwarts, 2013: p.20).

Furthermore, taking the lack or shortage of the aforementioned skills into account the benefits which foreign investors may have benefited from if they established their headquarter companies in South Africa, could be drastically reduced. The investors would be required to ensure that the 'persons performing the effective management functions' are based at the subsidiaries in locations outside of South Africa and it could be costly to move people with the required skills to the subsidiaries outside the country. The headquarter company would not be beneficial to foreign investors and this would further discourage such investors from establishing headquarter companies under the South African headquarter company regime in s 9I. (Zwarts, 2013: p.110). It must be noted that there is a significant skills deficit for industry specialists as well as a local skills shortage in Sub-Saharan Africa (Onu,et al, 2023: p.853). In 2019, Sub-Saharan Africa's population was about 14,3 per cent of the world total. But the region's cellular 'Internet of Things' connections as a proportion of the global total, was less than one per cent. Furthermore, Sub-Saharan Africa's 'Internet of Things' industry and market are disproportionately concentrated in South Africa. For instance, South Africa with only 5,3 per cent of the Sub-Saharan Africa population in 2019, accounted for about 50 per cent or half of all cellular 'Internet of Things' connections of the region. (Kshetri, 2022: p.81). It is apparent that gaps and a shortage of skills remain an issue in Sub–Saharan Africa, and South Africa is the country in the region in which the required management, entrepreneurial and digital skills are concentrated. In view of the abovementioned facts, the South African headquarter company regime taxation rule in s 9I(1) of the Act, has not created incentives which would allow foreign investors to be able to use the human capital that is located in South Africa without the fear of attaining more costs for such resources.

4.2 Weaknesses in the 10 per cent or more shareholding and voting rights in s 9I(2)(a)

The requirement for 10 per cent or more shareholding and voting rights in s 9I(2)(a) of the Act excludes private equity funders from using the South African headquarter company as an investment vehicle.

South African private equity funds usually take the form of *en commandite* partnerships (Partnerships). Partnerships for South African tax purposes are fiscally transparent, which means that any income flowing through the Partnership retains its character and is taxed in the partner's hands (Manton, 2015, p.39). As was stated in the judgement in the case of Sacks v CIR 1946 AD 31,13 SATC 343, a partnership is not included in the definition of 'person' in the Act, and partnerships are not considered to be taxpayers in their own right. A partnership is as a result not considered to be a resident of South Africa for tax purposes. Consequently, this means that the partnership is barred from enjoying the benefits of double taxation agreements and thus adds to the disadvantage of the Partnership structure, being more costly and administratively burdensome. (Olivier & Honiball, 2011: p.172).

South African legislation currently lacks a suitable investment holding vehicle regime for a Partnership's foreign Investors to invest through. Without even looking to the limited partners, a Partnership's general partner will never hold at least a 10 per cent of the interests in the partnership and therefore the underlying headquarter company. Under the current regime, fund managers are therefore limited to using the "dual fund" model in order to attract offshore capital. At face value the South African headquarter company regime in s 9I, seems to be an attractive proposition. However, it does not serve its purpose in the context of private equity and the benefits which the South African headquarter company regime is positioned to attract such as increasing foreign direct investment, improving the 'Balance of Payments', job creation, and creating a wealth of technical expertise within South Africa are therefore frustrated. (Webber Wentzel, 2017).

4.3 Weaknesses in the 80 per cent or more total asset requirement in s 9I(2)(b)

The requirement of 80 per cent or more of the total assets to be owned by the headquarter company in s 9I(2)(b) could hinder the headquarter company's objective of becoming the 'gateway into Africa'.

The limitation of the investment into South African assets to 20 per cent of the cost of the total assets of the headquarter company indicates that the headquarter company was intended to act as a flow-through for foreign investment, in that incoming foreign investments were not intended to remain in South Africa and were instead intended to pass through the headquarter company to its underlying investments. As a result of the aforementioned limitation, the headquarter company will not be able to make proportionately large investments into local, South African operations. (Lourens, 2019: p.44). Lourens (2019: p.45) further states that the ultimate size and cost of the South African investments will be determined by the cost of the headquarter company's total assets and that whilst the South African government intended for the headquarter company's foreign investments to be four times the cost of its South African investments, it hoped that the sheer size of the foreign investments being made would lead to more valuable investments being made in South Africa.

The author submits that South Africa's headquarter company is limiting foreign investors from investing fixed asset infrastructure in South Africa, creating an effortless way for the foreign investors to want to only come and make profits in the country and to repatriate the incomes earned back to their own countries as soon as these profits are earned. This would be detrimental to the country as there will be no need to make long-term investments in the country's economy and its citizens and thus deter the objectives of the headquarter company to attract investors who want to make the country a long-term investment jurisdiction.

4.4 Weaknesses in the gross income requirement in s 9I(2)(c) of the Act

The headquarter company regime taxation rule in s 9I(2)(c) of the Act is 'biased' against companies which carry on an active trade.

Limitations have been placed on companies carrying on an active trade as follows:

> Where the gross income of a prospective headquarter company for the year of assessment in question exceeds R5 million, 50 per cent or more of that gross income must consist of amounts in the form of (either or both of the following)

(i) Rental, dividend, interest, royalty, or service fee paid or payable by any foreign company in which the prospective headquarter company held at least 10 per cent of the equity shares and voting rights, or

(ii) Any proceeds from the disposal of any interest in equity shares in a Foreign Company or of any intellectual property licensed to a Foreign Company. (SARS, 2016: p.20).

Notwithstanding that there have been ground-breaking changes with regards to the exemption of service fees paid or payable to the headquarter company in s 9I(2)(c)(i). The fact remains that all other income earned by the headquarter company is subject to normal tax on companies at a rate of 2j7 per cent. has been changed to include service fee paid or payable to the headquarter company by its subsidiaries under s 9I(2)(c)(i).

The Katz Commission (1997: par.7.15) indicated the fact that internationally, one of the key fiscal attributes of a regime conducive to the establishment of headquarter companies is the lack of taxation, or the imposition of minimal taxes. As a result, South Africa’s headquarter company regime in s 9I lacks such a key fiscal attribute. This makes it less appealing to foreign investors.

Legwaila (2013: p.5) stated that ‘South Africa’s headquarter companies were not created to be active trading companies and their activities consist largely of holding capital assets rather than embarking on schemes of profit making'. Furthermore, headquarter companies were often formed by multinational groups to oversee and co-ordinate their commercial interests in a particular region (Legwaila, 2013:5).

A headquarter company is subject to normal tax in South Africa on any taxable income that it may have left after the concessions shown in chapter 3, under note 3,7 have been applied. The taxation of headquarter companies is similar to any other resident company. However, a number of anti-avoidance rules specifically apply in respect of headquarter companies. These include specific provisions that govern the tax consequences when a company becomes a headquarter company in s 9H(3) of the Act. (Silke, 2022: p.897)

The author submits that the South African headquarter company regime in s 9I, only makes preferential treatment available to a headquarter company that deals within a particular type of market. Those companies which trade mostly with passive income as well as the management of such passive income benefit greatly from the exemption but for any other income earned the headquarter company remains tax neutral. Subsequently, income received by or accrued to the headquarter company from the manufacture, purchase and sale of goods and services would thus be subject to normal tax in its hands at the South African income tax rate of 27 per cent. This defeats the purpose of the headquarter company attracting the foreign investors into the country as no investor would want to bring foreign direct investment into a jurisdiction in which they bear little to no tax benefits. The fact that there are other jurisdictions within the African continent which offer lower tax rates may also hamper the appeal of the headquarter company regime to foreign investors.

4.5 Weaknesses resulting from the repeal of s 6quin and implementation of s 6quat and s 6quat 1C

The repeal of s 6quin has created a lack of credit mechanism for foreign taxes suffered in respect of income derived from services rendered by a headquarter company from South Africa.

SARS refers to the 'credit method' as the 'rebate method'. In addition to the credit or rebate method, the deduction method and the exemption method are also used in a domestic context to provide relief from double taxation (Olivier & Honiball, 2011: p.6). In terms of the deduction method, a resident is allowed to claim a deduction for taxes paid to a foreign state, whereas the exemption method exempts certain foreign-sourced income from tax in the country of residence. South Africa uses a mix of the rebate and deduction methods and supplements these methods with exemptions for foreign-sourced amounts received by or accrued to residents (SARS, 2020:p.5). According to issue 4 of SARS' Interpretation Note 18 on Rebate and Deduction for foreign taxes on Income (2020: p.5), s 6quat(1) of the Act ‘is the principal mechanism used to provide relief for foreign taxes proved to be payable on income derived from a foreign source that is included in a resident’s taxable income' and foreign taxes that fall in this category do not qualify for a deduction in terms of s 6quat(1C) of the Act. Being a credit or rebate method s 6quat(1) provides for the deduction of foreign taxes against normal tax payable. Mckinon (2016: p.56) stated that s 6quat(1C) is the embodiment of the deduction method in the Act. He further stated that s 6quat(1C) allows a South African tax resident to claim foreign taxes that do not qualify for the rebate under s 6quat(1). These aforementioned taxes were foreign taxes payable on amounts from a source within South Africa. and they could thus be deducted in the determination of the resident's taxable income (Mckinon, 2016: p.63).

The Davis Tax Committee (2017b: p12) pointed out that if the words 'paid or proved to be payable' as used in deduction provision in s 6quat(1C) were interpreted as requiring an unconditional legal liability to pay the tax. The deduction would (similar to the s 6quat(1) credit) also not be available in cases where another country withholds tax contrary to the provisions of a Double Tax Agreements. The Davis Tax Committee therefore proposed that South African resident service providers should be able to enjoy a deduction under the section where tax is 'levied' or 'imposed' by a foreign government in the circumstances in question. This proposed change to s 6quat(1C) has, to date, yet to be effected. (Davis Tax Committee, 2017: p.12).

4.6 Weaknesses as a result of misalignment between s 9I taxation rules and exchange control rules

In addition to the weaknesses in the headquarter company taxation rules in s 9I, there are exchange control rules which a headquarter company must adhere to, which are significantly affected and negatively impacted by their interaction with the headquarter company regime taxation rules in s 9I. Although there may be arguments that they are not tax issues, they can have a negative effect on the appeal of the headquarter company regime to foreign investors and should thus be addressed.

South Africa's headquarter company taxation rules in s 9I, are not aligned to the exchange control rules and provisions which are imposed by the Currency and Exchanges Manual for Authorised Dealers (Arendse, 2014: p.20). When the South African headquarter company regime in s 9I was enacted the intention was for the exchange control regulations to work closely and be aligned to the tax requirements of the headquarter company in s 9I. However, the exchange control regulations are yet to be aligned to s 9I requirements. (Mukumba, 2017: p.66).

In terms of section 9I there is a minimum of 10 per cent shareholder requirement whereas for exchange control purposes, the shareholders may not hold less than 20 per cent of equity shares in a qualifying company. In addition, there is a restriction for exchange control on the percentage shareholding held by residents (20 per cent). (SARB, 2023: p.60). Furthermore, it is not clear how the value of the assets will be determined. Whereas for tax purposes the tax cost is usually calculated to determine the value other methods such as the market value or book value may be considered appropriate from an exchange control perspective. (Arendse, 2014: p.20).

Although the Act does not impose a restriction on the number of South African tax residents that may hold shares in a South African headquarter company, the

Currency and Exchanges Manual for Authorised Dealers requires that for exchange control purposes, no more than 20 per cent of the shares in a headquarter company may be held by persons who are South African exchange control residents (Lourens, 2019: p.65).

In addition, the determination of South African assets versus foreign assets are through s 9I of the Act are not aligned to those of the Currency and Exchanges Manual for Authorised dealers. For tax purposes, the s 9I(2)(b) requires that at least 80 per cent of the cost of the total assets of the prospective HQC must be attributable to foreign assets. (SARS,2016:p.10). For exchange control purposes, the Currency, and Exchanges Manual for Authorised Dealers merely states that 'at the end of each financial year, at least 80 per cent of the assets of the holding company must consist of foreign assets'. (SARB, 2023: p.60). Therefore, whilst the Act specifically requires the composition of the assets to be split on the basis of the cost of the headquarter company's total assets, the Authorised Dealer Manual's requirements are less clear and could be interpreted as 80 per cent of the cost, value, or number of the total assets of the headquarter company.

Notwithstanding National Treasury and SARS' response to a comment received on the Taxation Laws Amendment Bill of 2010 that the 'goal is to simplify compliance and enforcement as much as possible in order to enhance the success of the proposed headquarter company regime', the South African headquarter company taxation rules (s 9I) imposed by the Act and by the Currency and Exchanges Manual for Authorised Dealers have not been aligned.

4.7 Weaknesses from the requirements to comply to s 9I(3) and s 9I(4) of the Act

According to Mukumba (2017: p.66) a heavy compliance burden lies on the shoulders of a prospective headquarter company under s 9I, to ensure eligibility for tax and exchange control relief.

Whilst National Treasury may argue that compliance with the requirements is within the headquarter company’s control aspects that are not fully within the control of the headquarter company can cause the headquarter company not to meet all of the criteria required to retain its status as a headquarter company for tax purposes. It is possible that a company may overlook or forget that an election must be made for it to continue operating as a headquarter company under s 9I. Failure to elect by the prospective headquarter company will have a negative impact as the company may lose all the tax benefits they might have enjoyed as a headquarter company under the headquarter company regime in s 9I. (Mukumba, 2017: p.61).

As stated in the Act in s 9I(4) The headquarter company must report to the Minister of finance on a yearly basis. This is a submission of statements which are requested by National Treasury. The biggest disadvantage is that it may not be information that is readily available as the Act mentions that the Minister may ask for whatever documents he wants. This means that the information required may be different from what is presented to SARS in the form of financial statements. (SARS,2016: p.24)

The requirements are that SARS makes a requirement for RCH01 schedules, and for supporting documents to the income tax return, National Treasury makes a requirement for documentation in the form and the manner that is determined by the Minister. Thirdly, albeit not a tax requirement, there is also an annual obligation for the headquarter company to submit to SARB a detailed organogram of the headquarter company and its most recent audited financial statements to the Financial Surveillance Department (SARB, 2023: p.60). The author is of the view that all the reporting adds to the headquarter company's compliance burden, as the responsibility for the preparation of the aforementioned organograms is likely to fall on the headquarter company itself (whilst the directors of the headquarter company will naturally have the responsibility to ensure that financial statements are prepared).

5. Chapter 5: REMEDIES TO BE APPLIED TO THE WEAKNESSESS IN THE HEADQUARTER COMPANY REGIME TAXATION RULES

The author submits that the headquarter company regime in s 9I possesses most of the characteristics which are required for an ideal headquarter company regime (Lourens, 2019: p.131).

However, it is obvious that the many restrictions which have been imposed by the headquarter company taxation rules in s 9I are a hindrance to the headquarter company regime becoming more attractive to foreign investors.

It is thus vital, to recommend remedies which may assist to combat the weaknesses which currently impact the regime's appeal to the foreign investor.

The remedies below, are based on the weaknesses which the author identified in chapter 4.

5.1 Remedy for the weaknesses resulting from the resident requirement in s 9I(1) of the Act

The author submits that the tax residence requirement in s 9I(1) of the act could be tightened and not be based on the definition of a resident in s 1 of the Act. This would involve the insertion of a more explicit and clear definition that solely refers to a tax resident under s 9I(1) and leaves less room for interpretation or ambiguity. The government could also implement more robust tie-breaker rules which provide clear guidelines on determining the tax residency of a company in cases where it is considered to be a resident in multiple countries. As the global economic landscape evolves, South Africa must do regular reviews of the laws governing the headquarter company regime in s 9I with the aim of adapting to new challenges and opportunities. Furthermore, the South African government, law makers and tax experts could collaborate with international organisations such as the OECD as well as countries with successful headquarter company regimes in order to gain more knowledge and expertise on improving the headquarter company regime taxation rules in s 9I.

5.2 Remedy for the weaknesses resulting from the 10 per cent or more shareholding and voting rights requirement in s 9I(2)(a)

The South African government should consider inserting concessions or allowances with regards to the 10per cent or more shareholding and voting rights requirement as follows:

5.2.1 The government must consider making exceptions to the requirements for a prospective headquarter company to hold a similar percentage (10 per cent) for the equity shareholding as well as the voting rights to meet the qualifying criteria of a headquarter company regime in s 9I. (Lourens, 2019: p.60).

There are instances where a foreign investor who may be a prospective headquarter company may hold a large number of shares in an organisation but have fewer voting rights, but their affluence, in terms of the equity shares held could give them enough ground to be able to be the decision makers. Likewise, there may be instances where a foreign investor who has prospects of becoming a headquarter company may have a significant percentage of voting right, and thus have influence in the company's management decisions. Therefore, it may be important to give allowances/exceptions to the rule in situations similar to the 2 mentioned as examples.

5.2.2 The government should consider inserting an exception to the equity shareholding and voting requirement to cater for private equity investors and partnerships. (The following has been addressed in detail under note 5.4 below).

5.3 Remedy for the weaknesses resulting from the 80 per total asset requirement in s 9I(2)(b)

5.3.1 Similar to the taxation rule in s 9I 2(a), the government should consider allowing exceptions to the rules and eliminate the limitations on percentages of assets to be held in foreign companies versus percentages held in in local companies. (Lourens, 2019: p.65).

5.3.2 To increase its chances of attracting foreign investors into the South Africa the government should consider making allowances for those companies who do not have fixed asset and deal with copious amounts of cash flow. It is obvious that in the new digital age there is no limit to how successful companies are managed. Most companies in this era are digital and are not even in ownership of immovable property. An example of such companies is Uber. The South African government must consider relaxing the requirements of the taxation rule in s 9I (2)(b) for those kinds of foreign investors to be attracted to the South African headquarter company regime in s 9I of the Act.

5.4 Remedy for the weaknesses resulting from the gross income requirement in s 9I(2)(c)

5.4.1 The government should consider making more concessions to allow the tax rate on other active income besides management and service fees to be lowered in order to attract more foreign investors to set up their headquarter companies in South Africa. (Lourens, 2019: 65).

5.4.2 There are multinational entities which are more active and trade in goods and services, but they may at the same time possess the ability to play the role of financier or lender to their subsidiaries. The government will be opening up more doors to the investors whose core business is trading in the purchase and sale of goods and services but who also are in the space where they can perform treasury or management and finance services.

5.5 Remedy for the weaknesses the compliance and reporting requirement in s 9I(3) and s 9I(4)

5.5.1 Where a headquarter company is expected to elect to be a headquarter company regime annually the government should consider scrapping or getting rid of the requirement to elect to be a headquarter company every year. This would eliminate time consuming administration and the yearly anxiety that a prospective headquarter company may develop knowing that it is possible for the company not to qualify or be allowed to elect to become a headquarter company in the next year.

5.5.2 In regard to the reporting requirement in s 9I (4) The government should consider a standardised method of reporting, so that reporting to different bodies within the same jurisdiction does not prove to be a costly administrative exercise. Foreign investors may feel more at ease and be more eager to set up their headquarter companies in South Africa under the headquarter company regime especially when the administrative aspects such as reporting to different bodies within government does not require more work to be performed on different documents. A viable option would be for the required documents to be standard for all of the bodies that the headquarter company is expected to report to eliminate submissions which carry irreconcilable differences. (Lourens, 2019: p.66).

5.6 Section 9I taxation rules must be aligned to exchange control rules as per SARB's Currency and Exchanges Manual for Authorised Dealers (SARB, 2023)

South Africa's headquarter company taxation rules in s 9I must be aligned to the requirements of the South African Reserve Bank's Currency and Exchanges Manual for Authorised Dealers (Lourens, 2019: 9.67).

The alignment of the taxation rules governing the headquarter company regime in s 9I to the exchange control provisions stated in the Currency and Exchanges Manual for Authorised Dealers is of vital importance to the country's objective of attracting foreign direct investment into the country. (SARB, 2023). As indicated by the Davis Committee, National Treasury and the SARB should consider relaxing the exchange control criteria for qualification as a headquarter company to allow at least 50 per cent of the shares of a headquarter company to be held by South African exchange control residents (no limitation is currently imposed on shareholding by South African tax residents) so as to allow the prospective headquarter companies to meet the 'qualified person' threshold in the simplified Line of Business rule. In addition, it is suggested that further research consider if, and to what extent, the recommended relaxation will facilitate the achievement of the policy objectives for the headquarter company regime or clash with National Treasury and the SARB's tax and exchange control policy in general. (Lourens, 2019: p.67).

Based on the above, the foreign investors may not become attracted to the current headquarter company regime until its taxation rules are made to look more realistic and coordinated with other legislation which govern the headquarter company regime. This would include aligning the qualifying criteria of the different Authorities that the headquarter company is expected to adhere to.

In addition to s 9I, the South African Reserve Bank made the following exchange control provisions for South African headquarter companies:

i. Subject to registration with the Financial Surveillance Department for reporting purposes, newly established international headquarter companies (headquarter company) that meet the following shareholding and asset criteria may invest offshore without restriction: (SARB, 2023)

   a. no shareholder in the headquarter company, whether alone or together with any other company forming part of the same group of companies as a shareholder, may hold less than 10 per cent of the shares and voting rights,

   b. no more than 20 per cent of the headquarter company shares may be directly or indirectly held by residents,

ii. at the end of each financial year, at least 80 per cent of the assets of the holding company must consist of foreign assets, and (SARB, 2023: pp.60-61).

   c. for the purposes of the requirement in (c) above, cash, cash equivalents and debt with a term of less than one year should not be taken into account. (SARB, 2023: pp.60).

iii. Registration with the Financial Surveillance Department will remain valid for as long as the criteria in (i) above is adhered to for the duration of that year of assessment as well as all previous years of assessment. (SARB, 2023)

iv. Reporting of the extent of the foreign investments will be required for statistical purposes which must, inter alia, include the source of funds, new or existing funds, destination of funds, loan funds from local sources. (SARB, 2023)

v. Authorised Dealers must submit annually to the Financial Surveillance Department a detailed organogram of the headquarter company as well as their latest available audited financial statements.

vi. In order to report all transactions on behalf of the headquarter company via the Reporting System, a ring-fenced resident foreign currency account in the name of the company must be opened.

vii. Certain reporting requirements as outlined in section B.4 of the Operations Manual as mentioned in section J.(C) of the Currency and Exchanges Manual for Authorised Dealers will have to be adhered to as a result of the nature of these transactions over this account.

viii. Headquarter companies will be treated by the Financial Surveillance Department as non-resident companies but are still required to report all cross-border transactions. Transactions by South African entities with headquarter companies will therefore be viewed as transactions with non-residents.

ix. Headquarter companies can freely borrow from abroad and such funds may be deployed locally or offshore. These transactions are regarded as occurring outside South Africa.

x. Any lending by local banks to headquarter companies will form part of the banks' macro-prudential limits. (SARB, 2023: pp.60-61).

5.4 The headquarter company taxation rules in s 9I must be amended to accommodate private equity funders

The government must consider relaxing the 10 per cent shareholding and voting rights requirement to give access to private equity owners to and who want to use the headquarter company regime in s 9I as a vehicle to bring their business into South Africa (Lourens, 2019: p.70). In that regard the taxation rules in s 9I (2)(a) must be amended to include private equity funders (Partnerships). This will open doors for foreign investors who do not hold the required participation and voting rights but are leaders and front runners in their fields with qualifications, skill and influence required to bring even more funding into the country.

With the increasing appetite for investments into African jurisdictions, the South African private equity landscape needs to adapt in order to attract direct foreign investment and to facilitate the seamless investment and divestment in and from these jurisdictions. (Webber Wentzel, 2017)

The author submits that it is in the interest of South Africa to make the headquarter company taxation rules more accommodating to private equity funders and partnerships for a new type of investor to be established and attracted to the headquarter company regime in s 9I.

6. Chapter 6: CONCLUSION

Section 9I taxation rules must be amended to fit the objective of South Africa becoming a gateway into Africa by aligning it with OECD requirements for a headquarter company regime.

As stated in the National Treasury (2021: p19) Budget Review the country still wishes to become the gateway into Africa and this objective can only be accomplished as soon as investors are more aware of what they will be gaining for coming into South Africa and establishing headquarters in the country. Furthermore, The Davis Tax Committee's Introductory Report on Base Erosion and Profit Shifting (BEPS) in South Africa stated that the country's government and legislators must acknowledge the fact that South Africa is the only African country that is a member of the G20 (Mckinon, 2016: p.93). Although it is not a member of the OECD but only has OECD observer status, it is a member of the OECD BEPS Committee (Mckinon, 2016: p.93). This does not necessarily mean that South Africa's presence on this committee is representative of the interests of all African countries. The economic development of African countries varies immensely and so is the level of development of their tax laws. (Davis Tax Committee, 2015a: p.17)

There are also varying levels of administrative capacity to deal with the challenges associated with implementing international tax reforms. Nevertheless, South Africa has made major investments on the African continent and holds many tax treaties with other African countries. It is thus important that South African is seen as a leader in the OECD's Multilateral Conventions. It is within South Africa's interest as a country aspiring to be the 'Gateway for investment into Africa' to use its membership of the G20 and OECD BEPS subcommittee to set the 'tone' in Africa around key OECD recommendations on BEPS and to also play a key role to ensure a consistent African view on BEPS issues. South Africa should also take note of the fact that it plays a leading role as a net exporter of investment capital to the rest of Africa. Other African countries view South Africa as a threat, and they have taken a long-term protectionist view of their tax systems since South Africa's investments into the rest of Africa often make local African activities non-viable. (Davis Tax Committee, 2015a: p.17)

South Africa must take the necessary measures to ensure that the South African headquarter company regime taxation rules in s 9I, are not only aligned to the requirements of the OECD Multilateral Conventions, but that they are fair and not contributing to the impediment or unjust treatment of other African countries within the region so that those countries are also more supportive and open to the idea of South Africa becoming the gateway into Africa.

The headquarter company regime taxation rules in s 9I of the Act appear to create more barriers to the objective of the headquarter company regime resulting in the headquarter company 'failing to get much uptake to date' despite all the relief and tax concessions which are available to the foreign investor. (Stiglingh, et al, 2022: p.897). It is imperative to redesign and transform the headquarter company taxation rules in s 9I if South Africa wishes to attract all investors, especially the foreign investors who can invest substantial amounts of funds and contribute massively to the country's economic and social transformation. The taxation rules must be transformed in such a way that the benefits are visible to the foreign investor and are at the same time not harmful nor superficial in their presentation to the foreign investor. As stated by Mukumba (2017: p.39), the fact that the decision to elect to be a headquarter company is a 'choice undertaken by the investor' is a flawed ideology because the headquarter company regime taxation rules seem to be a 'barrier from within'. To do away with these barriers, South Africa could increase the tax benefits and expand on the incentivisation, and relief offered to foreign investors to attract the much-needed foreign direct investment into the country.

As per the Explanatory Memorandum to the Tax Law Amendment Bill of 2010 South Africa already had a network of treaties with a lot of countries around the world. Currently, South Africa has the largest treaty network than other African countries. In total, the country has 73 treaties with countries across the globe. (SARS & National Treasury, 2023: p.18),

Mukumba (2017: p.69) mentioned that 'it was important for any investor who wished to establish a company within any jurisdiction to have certainty and reliable evidence that the tax relief and tax benefits being offered, would be guaranteed and accessible as this would allow the investor to plan effectively over the medium term'.

Governments choose tax incentives as tools to help them achieve their economic and social objectives other than any other government actions. The tax incentives could play a significant role in attractring foreign investments in to a country. This would contribute to substantial growth and development of the country in which these tax incentives are being offered. Furthermore, tax incentives are a manifestation of tax competition and becoming a host country for businesses which supply markets in different countries from one location could boost a country's economy substantially. (Zolt, 2015: p.7).

Mukumba (2017: p.iii) stated that it is possible for South Africa's headquarter company regime to improve its 'commercial attractiveness' by amending its taxation rules to accommodate investors who through active trade would bring sizeable foreign direct investment into the country and create opportunities for citizens to get employment and learn skills.

The author submits that the examination conducted demonstrates that despite the weaknesses which have been identified in South Africa's headquarter company regime taxation rules in s 9I it is practicable to remedy the aforementioned weaknesses. South Africa is without a doubt, capable of positioning itself as the jurisdiction of choice and the gateway that it wants to become in Africa. This may open doors to foreign direct investment and lead to sustainable growth and development of all the different sectors of business in South Africa, more employment opportunities for the people of South Africa, the elimination of poverty, better education opportunities and better financial and economic standing of the country and the entire African continent.

As mentioned in the introduction, a number of studies have examined the determinants of foreign direct investment for different countries. The determinants are many and diverse. The foreign investor will firstly consider none-tax related factors such as the host country's market size, labour costs, political stability, the effectiveness of its banking sector as well as its government policies. But added to that, tax planning is one of the most important determinants of foreign investment location in the world.

As indicated by Ogley (1993: p.137) international tax planning and international headquarter company regimes play a key role in the management of the foreign investments. This is because, headquarter companies are often formed where multinational groups of companies have significant economic interests in a region which is distant from the head offices so that they can oversee and coordinate the group's business interests in that particular region.

National Treasury's Budget Review for 2020 indicated that South Africa aimed to strengthen its progressive tax system, by taking measures that will broaden the tax base and improve its administration through its tax policy (National Treasury, 2020: p.37). In line with this approach government reviewed tax incentives over the medium term and made the decision that incentives that were deemed to be inefficient or inequitable would be repealed or redesigned (National Treasury, 2020: p.33). Such measures should be undertaken annually and the proposals by tax experts, scholars and organisations which specialise in professional tax planning. Analysis of legislation must be considered, and laws must be duly implemented by the government for the benefit of the country and its people. South Africa needs foreign direct investment to flow into the country. Furthermore, the country cannot take a backseat and continue to watch other countries without the required human capital and natural resources occupying spaces as the gateway into Africa. The weaknesses in the headquarter company taxation rules, are not fixed nor permanent deterrents.

It is important for South Africa to speed up its process to redesign and transform South Africa's headquarter company regime taxation rules in s 9I in order to attract foreign investors to choose South Africa as their preferred location to establish their headquarter companies. The author submits that this can only happen when the South African headquarter company regime taxation rules in s 9I, are simplified and made to be more realistic and less intimidating to the foreign investor.

In conclusion, South Africa needs to intensify its strategies on international tax planning and the refinement of its headquarter company regime in s 9I. The author is of the mind that South Africa's headquarter company regime in s 9I, may become more desirable to the foreign investor when the South African government consideres applying the remedies proposed to counter the weaknesses which were identified. In that regard, the regime may bring more foreign direct investment into the country and this will in effect assist the country's economic and social development and growth.

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