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ACCOUNTANCY

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fulfilment of the requirements for the degree of Master of Commerce

**DOES THE HEADQUARTER COMPANY REGIME STILL HAVE A ROLE TO PLAY IN SOUTH
AFRICAN TAX LAW AND IF SO, WHICH ASPECTS OF THE REGIME REQUIRE REVISION?**

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Abstract

The South African Headquarter Company Regime (HQC) was implemented on 1 January 2011, and it was designed to attract multinational companies to establish their headquarters in South Africa for the purpose of investing in other African nations through the country. Since the recommendations of the Katz Commission in 1997, the South African National Treasury (National Treasury) has done substantial work in terms of refining the provisions of the HQC regime to ensure that South Africa becomes an ideal Headquarter Company location.

Since its inception in 2011 the HQC regime has failed to take off, with very few companies adopting the HQC regime. The South African HQC regime has been criticized for not being attractive to potential investors due to issues such as complicated qualifying requirements and the availability of alternative regimes such as Mauritius and Kenya, which are perceived as more appealing and user-friendly. The aim of this research is to assess whether the South African HQC regime remains relevant within South African tax legislation and, if it does, to identify which aspects of the HQC regime necessitate revision. This study will also include recommendations of proposed changes that can be made to address the current criticism of the HQC regime.

The above objective will be achieved through literature review of applicable government publications, journal articles, tax articles from reputable websites, statutes etc.

Key Words: headquarter company, multinational companies, tax incentives, treaty shopping, International Headquarter Company regime, Katz Commission, Davis Tax Committee.

Declaration

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

Thuso Gumula

October 2024

Dedication

Firstly, I would like to thank God for granting me the grace and good health to complete this research report.

Secondly, I would like to thank my husband, Patrick Gumula, whose steadfast love, and support have fueled my academic endeavors.

Lastly, I would like to thank my supervisors, Ms. Hafsa Mansoor and Mr. Reinhard Rudd, for their invaluable time, guidance, and support.

Table of contents

Cover page	i
Abstract	ii
Declaration	iii
Dedication	iv
Table of contents	v-vi
Glossary of terms and abbreviations	vii

Chapter 1: Introduction	1
Background	1-5
Research problem	5-6
Sub-problems	6
Aim of the study	7
Research questions	7
Scope of the research	7-8
Research methodology	8
Significance of the study	8
Chapter 2: Definition and functions of headquarter companies and policy objectives of National Treasury for the creation of the HQC regime	9
General definition of headquarter company and the functions of a headquarter company	9-10
Policy objectives of National Treasury for creating of the HCQ regime	10
Background	10 -11
Primary objective of creating the HQC regime	11
Secondary objective of creating the HQC regime	11-13
Conclusion	13-14
Chapter 3: Tax design elements that underpin the South African HQC regime	14
Background	14-15
Tax legislation that underpins the current HQC regime	15-19
Relief from normal tax and capital gains tax for headquarter companies	20-24
Conclusion	24-26
Chapter 4: Exchange control regulations that impact the South African Headquarter Company regime	26
Background	26-27
Impact of exchange control regulations on HQCs	27-29
Conclusion	29
Chapter 5: Existing criticism against the current South African HQC regime	29
Background	29-30
Existing criticism of the South African HQC regime	30-37
Conclusion	37-39
Chapter 6: Key items that should be considered when designing headquarter company regimes that attracts foreign investment from multinational companies	39
Background	39-40

Fiscal characteristics of an ideal HQC jurisdiction	40-46
Non-fiscal characteristics of an ideal HQC jurisdiction	46-48
Conclusion	48
Chapter 7: Brief comparison between The South African HQC regime and Mauritius's Global Business License	48
Background	48-49
Comparison of South Africa's HQC regime and Mauritius GBL regime	49
High level comparison of the tax characteristics of the South African HQC regime and Mauritius's GBL regime	49-54
Conclusion: Tax characteristics of the South African HQC regime and Mauritius's GBL regime	55-56
High level comparison of the non-fiscal characteristics of the South African HQC regime and Mauritius's GBL regime	56-58
Conclusion: non-tax characteristics comparison	58
Chapter 8: Proposed revision to the current South African HQC regime to ensure it benefits the potential foreign investor	59
Background	59
Proposed revision to the South African HQC regime	59-63
Conclusion	63
Chapter 9: Conclusion	63
Analysis	63-65
Answer to research question	65-67
References	68-73

Glossary of terms and abbreviations

Abbreviation	Detailed Description
CFC	Controlled Foreign Company
DTA	Double Tax Agreement
FSD	Financial Surveillance Department
GBL	Global Business License
HQC	Headquarter Company
IHC	International Headquarter Company
OECD	Organization for Economic Cooperation and Development
POEM	Place of Effective Management
SADC	Southern African Development Community
SARB	South African Reserve Bank
TAA	Tax Administration Act
USA	United States of America

1. Chapter 1: Introduction

1.1. Background of the South African Headquarter Company (HQC) regime

Favourable tax provisions are never the sole reason for selecting a particular jurisdiction for investment purposes, however they remain an important determinant (Holland and Vann, 1998:2). There are other social, political, and economic determinants which are key in selecting a particular jurisdiction for investment purposes, but tax provisions of that particular jurisdiction are also considered (Holland and Vann, 1998:2). In line with tax competition models, governments are likely to decrease their corporate tax rates to attract foreign investment as firms have the flexibility to choose the country with the lowest tax burden for investment (Van Parys, 2012:130). In the international landscape, several regions are well-known for their attractiveness as destinations for multinational group holding and headquarters companies, such as Luxembourg, The Netherlands, Switzerland, and Singapore (Honiball and Killoran, 2011:36). In the African continent, Mauritius has emerged as a top choice for companies looking to establish their headquarters, especially for investments in Africa (Honiball and Killoran, 2011:36) .

The South African Government recognised that the global community was shifting their focus to Africa in terms of investments and a preferential tax regime was one of the factors that can attract foreign multinational companies (Katz Commission, 1997:50). The Katz Commission was a commission of inquiry to investigate the taxation system of South Africa and in the fifth report of the 1997 Katz Commission titled '*Basing the South African Income Tax System on the source or residence principle-options and recommendations*' it was raised that one of the factors that have a bearing on what may be an appropriate system for South Africa is a regional headquarter base (Katz Commission, 1997:50). In 1997 South Africa was still on the source-based system and the Commission determined that by utilizing a source-based tax system, South Africa has positioned itself as an ideal destination for head office, finance, or management companies for investment into Africa (Katz Commission, 1997:51). Source-based tax system is a tax system where income is taxed in the country where that income originates regardless of the residency status of the person that received the income (Katz Commission, 1997:62). Anticipating a significant role for South Africa in the economic revitalization of its region or even the African continent, this was expected to have an impact on South African investment into Africa, and non-African investment into the continent through South Africa, leveraging its relatively advanced financial system and other infrastructure benefits (Katz Commission, 1997:51) .

In 1997 the Katz Commission recommended that the formation of international corporate headquarters and holding companies located in South Africa will be advantageous to the economy as it will motivate domestic investors to increase their international presence without sending valuable human resources offshore and motivate international investors to extend their operations into Africa through South Africa (Katz Commission, 1997:50). Both factors lead to the preservation and transfer of skills, ultimately contributing to the overall economic activity within the country (Katz Commission, 1997:50).

The final recommendation of the Katz Commission regarding the corporate headquarters and holding companies was that the source-based tax system should be further enhanced through appropriate exemptions related to fee income to corporate headquarters and holding companies and through statutory commitment ensuring that headquarter and holding companies established when legislation changes affecting their Favourable status will either receive delayed implementation or be granted a phase-in period to adapt (Katz Commission, 1997:13).

Considering the recommendations made by the Katz Commission in 1997, it was stated in the Revenue Laws Amendment Act 59 of 2000 that section 1 of the Income Tax Act 58 of 1962 (the Act) is hereby amended by the insertion in subsection (1) of the following definition: “*international headquarter company*”, which means a company:

- (i) *The entire equity share capital of which is held by persons who are not residents or trusts;*
- (ii) *Where any indirect interest of residents and of any trust in such equity share capital does not exceed five per cent in aggregate of the total equity share capital of such company; and*
- (iii) *Where 90 per cent of the value of the assets of such company represents interests in the equity share capital and loan capital of subsidiaries (which are not residents) of such company in which such company holds beneficial interest of at least 50 per cent”*
(Revenue Laws Amendment Act 59, 2000:6).

The insertion of the definition of international headquarter company in the Act became the beginning of the International Headquarter Regime (IHC), which became effective from 1 January 2001. The IHC regime was not successful in South Africa, and it was repealed with effect from 1

June 2004. The three reasons for the repeal as mentioned in the Explanatory Memorandum to the Revenue Laws Amendment Bill of 2003 were as follows:”

- (i) *The regime was viewed as a “Harmful Preferential Tax Regime” due to special exemption of IHC’s from worldwide taxation and foreign dividend tax,*
- (ii) *The regime was ineffective owing to exchange control regulations that restricted the currency flow of 90 per cent foreign owned subsidiaries and,*
- (iii) *The inability of the IHC’s to qualify for the benefits of Double Taxation Agreements (DTA’s) as they were non-residents for tax purposes.”* (Explanatory Memorandum to the Revenue Laws Amendment Bill, 2003:38).

After the repeal of the IHC regime in 2004, National Treasury continued to support the idea of enhancing foreign direct investment in Africa by developing South Africa into an ideal Headquarter Company location. In its 2010 National Treasury Budget review, National Treasury announced that it intends to create a business orientated environment that will promote South Africa as a gateway to investment into Africa. With the aim of achieving this objective, National Treasury examined the corporate and business framework in South Africa, along with exchange control and corporate tax laws (National Treasury budget review, 2010:78) . The goal was to assess whether the corporate, business, legal, and tax environment hinders South Africa’s potential to function as a hub for investors seeking access to investment opportunities in Africa (National Treasury budget review, 2010:78) . In the explanatory memorandum of the Taxation Laws Amendment Bill of 2010, it was mentioned that South Africa is the economic powerhouse of Africa and South Africa’s location, sizable economy, political stability, and overall strength in financial services makes it an ideal location for the establishment of regional holding companies by foreign multinationals (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010:77). South Africa’s network of tax treaties provides ready access to other countries in the region, therefore South Africa is a natural holding company gateway into the region (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010:77).

The legislature introduced the concept of “Headquarter Company” into the Act through Taxation Laws Amendment Act 24 of 2011. The introduction of the definition of Headquarter Company was the beginning of the current South African Headquarter Company Regime (HQC) and was deemed to have come into operation on 1 January 2011. In section 7(1)(x) of the Taxation Laws Amendment Act 24 of 2011 the definition of headquarter company was introduced and it read as follows:

'Headquarter Company' in respect of any year of assessment means a company contemplated in section 9I(1) in respect of which an election has been made in terms of that section' (Taxation Laws Amendment Act 24, 2011:22) . Section 9I was a direct result of the headquarter company definition. Section 27(1) of the Taxation Laws Amendment Act 24 of 2011 also included the insertion of section 9I into the Act. In brief, Section 9I stipulates that any resident company meeting the criteria outlined in section 9I(2) may elect to be a headquarter company for a specific assessment year of that company (Taxation Laws Amendment Act 24, 2011:68). Section 9I of the Act was considered to have been enacted and effective as of January 1, 2011 (Taxation Laws Amendment Act 24, 2011:68).

The regulations of the South African HQC regime are designed to entice holding companies to establish South Africa as the primary hub for channeling investments into Africa (Honiball and Killoran, 2011:36). Under the HQC regime, specific domestic tax regulations are eased to treat a HQC as a "flow-through" entity, ensuring that only profits generated within South Africa are subject to taxation, rather than the funds passing through the country.(National Council of Provinces Finance Committee, 2011:1).

The South African HQC regime is in its 13th year of existence since its inception in January 2011, however it is still underutilized with very few companies adopting the HQC regime. The South African HQC regime has often received criticism for *inter alia.*, complicated qualifying requirements, annual election and compliance obligations resulting in temporary and expensive benefits , higher corporate tax rate on remaining taxable income after deductions and exemptions, the potential for South Africa to be utilized for "treaty shopping" purposes, lack of preferential treatment of management fees, and non-alignment with general recommendations put forth by the Organization for Economic Cooperation and Development (the 'OECD') (Mukumba, 2017:39). In addition to the aforementioned criticisms, another factor contributing to the limited adoption of the regime is the presence of alternative regimes in Africa, such as those found in Mauritius and Kenya, which are perceived as more appealing and user-friendly (Davis Tax Committee, 2018:88).

Considering the work that National Treasury has done to refine the provisions of the HQC regime, the existing criticism on the HQC regime and the fact that the HQC regime is still underutilized after 13 years of its existence, this study aims to ascertain the ongoing relevance of the HQC regime within South African tax legislation and, if applicable, identify areas within the regime that necessitate revision to ensure that the regime benefits both the South African economy and the potential investor.

To ascertain whether the South African HQC regime remains relevant within South African tax legislation, it must demonstrate that it embodies the optimal characteristics expected in an ideal jurisdiction for headquarter companies. In addition to possessing the optimal characteristics of an ideal jurisdiction for headquarter companies, the South African HQC regime must also be capable of competing with other appealing headquarter company regimes across the African continent to lure foreign multinational corporations. Therefore, this study will also seek to determine the key items that should be considered when designing an attractive headquarter company regime that embodies characteristics optimal in an ideal headquarter company regime.

In the African continent Mauritius has emerged as a preferred jurisdiction for headquarter companies' jurisdiction, particularly for investments into Africa through its Global Business Licence (GBL) regime (Honiball and Killoran, 2011:36). In addition to the appealing tax benefits of Mauritius's GBL regime, the country possesses other attributes that make it an ideal location for headquarter companies (Gervel, 2023:1). These include political and economic stability, a strong democracy, a skilled workforce, and a Favourable environment for conducting business (Gervel, 2023:1). Hence, the study will also undertake a comparison between the South African HQC regime and Mauritius's GBL regime to evaluate how the South African HQC regime competes with the most Favourable option available in the African continent. This study will also incorporate recommendations on the proposed revisions that can be made to address the current criticism of the South African HQC regime.

1.2. The Research Problem

1.2.1. The statement of the problem

This report will determine if the HQC regime still has a role to play in South African tax law and if so, which aspects of the current HQC regime require revision to enable the regime to achieve its policy objectives as stated by National Treasury. The South African HQC regime is still underutilised and very few companies have taken it up since its introduction in 2011. There is also a lot of existing criticism of the HQC regime.

To determine whether the South African HQC regime remains relevant within South African tax legislation, the study will seek to determine if the HQC regime embodies the optimal characteristics expected in an ideal jurisdiction for headquarter companies and if its competitive when compared to Mauritius's GBL regime which is viewed as the most Favourable in the African

continent. As stated in the background above, to further ascertain if the HQC regime is still relevant in South African tax law the study will seek to determine the key items that should be considered when designing an attractive headquarter company regime and conduct a comparison between South African HQC regime and Mauritius's GBL regime.

1.2.2. Sub-problems

The following sub-problems will be addressed:

The first sub-problem is to determine the policy objectives of National Treasury for the creation of the HQC regime.

The second sub-problem is to determine the tax design elements that underpin the South African HQC regime and the exchange control regulations that impact the provisions of the regime. This will help to comprehend the influence of tax legislation and exchange control regulations on the limited success of the regime.

The third sub-problem is to determine the existing criticism of the South African HQC regime. This will be linked to the second sub-problem and will enable an evaluation of whether the tax design elements and exchange control regulations are among the criticisms of the regime, as outlined in the second sub-problem.

The fourth sub-problem is to determine the key items that should be considered when formulating tax regimes aimed at enticing foreign investment from multinational corporations and to ensure that the country becomes an ideal Headquarter Company location.

The fifth sub-problem involves outlining the existing South African HQC regime and conducting a comparative analysis with Mauritius's GBL regime. This will be linked to the fourth sub-problem to assess how the South African HQC regime and Mauritius's GBL regime compare with the key elements outlined in the fourth sub-problem.

The sixth sub-problem is to determine the proposed revision to the current South African HQC regime to ensure it benefits both the potential foreign investor and the South African economy. In doing so, the South African HQC regime will fulfill a meaningful role within the framework of South African tax law.

1.3. The aim of the study

Based on the problem statement stated above, the primary focus of this study is to assess whether the South African HQC regime remains relevant within South African tax legislation and, if it does, to identify which aspects of the HQC regime necessitate revision. The study will also provide recommendations of proposed revisions to the current HQC regime to enable the regime to benefit both the potential investor and the South African economy.

1.4. Research questions

Based on the above statement of the problem, this study will seek answers to the following research questions:

- 1.4.1. What are the policy objectives of National Treasury for establishing the HQC regime?
- 1.4.2. What tax design elements underpin the South African HQC regime?
- 1.4.3. What exchange control regulations impact the South African HQC regime?
- 1.4.4. What are the existing criticisms of the South African HQC regime?
- 1.4.5. What are the key items that should be considered when designing headquarter company regimes that attract foreign investment from multinational companies and ensure the country becomes an ideal Headquarter Company location?
- 1.4.6. How does the South African HQC regime compare with Mauritius's GBL regime?
- 1.4.7. What are the proposed revisions to the current South African HQC regime that will benefit the potential foreign investor?
- 1.4.8. What are the proposed revisions to the current South African HQC regime that will benefit the South African economy.

1.5. The scope of the research study

The study will focus on the review of tax design elements and exchange control regulations that underpin the South African HQC regime as well as policy objectives of National Treasury regarding the HQC regime, current criticism of the HQC regime, key considerations when designing a successful HQC regime and proposed revisions to the South African HQC regime. In terms of comparison with similar regimes the study will be limited to comparison with Mauritius's GBL regime.

The analysis of the South African headquarter company regime will look at the following sections of the Act:

- (i) Section 9I, section 31(1), section 31(5), section 31(6), section 10(1)(k)(i), section 9D(1), section 9D(2), section 64E, section 6quat(1), section 6quat(1C), section 64N, section 20C, section 9H, section 10B and paragraph 64B of the Eighth Schedule to the Act.
- (ii) Section 1 (definition of resident and definition of gross income).

The analysis of Mauritius's GBL regime will be limited to the requirements of the GBL regime, the benefits of the GBL regime and how the GBL regime compares to the optimal characteristics expected in an ideal jurisdiction for headquarter companies.

1.6. Research methodology

The study will be conducted through literature review of applicable government publications, journal articles, tax articles from reputable websites, statutes etc. A comparative analysis will be conducted to evaluate the South African HQC regime in relation to Mauritius's GBL regime.

1.7. The significance of the study

Once the aim of this study has been attained, the study will provide detailed understanding of the tax design elements and exchange control regulations that underpin the South African HQC regime and current challenges that are hampering the success of the regime. The study will also provide recommendations of proposed changes that can be made to the HQC regime to ensure it benefits both the potential foreign investor and the South African economy.

There has been published research on the South African Headquarter Company regime previously, therefore this research report aims to contribute to the body of existing academic literature in the field. The findings of this study will offer valuable insights to both lawmakers, academics and prospective investors seeking to gain a deeper understanding of the South African HQC regime and its significance within South African legislation.

2. Chapter 2: Definition and functions of headquarter companies and policy objectives of National Treasury for the creation of the HQC regime

The objective of this chapter is the following:

- Provide a broad explanation of what a headquarter company is, along with a concise summary of its roles and responsibilities and
- Analyse the policy objectives of National Treasury for the creation of the HQC regime

2.1 General definition of headquarter company and the functions of a headquarter company

Headquarter companies are typically established in regions where multinational corporations have substantial economic interests in a region far from its main office, aimed at overseeing and coordinating the corporation's business activities in that specific area (Ogley, 1993:137). Headquarter companies are generally positioned between the ultimate parent company and the operational subsidiaries within a group of companies (Legwaila, 2013:801).

The primary role of headquarter companies typically involves offering a comprehensive array of administrative and managerial functions typically associated with a central office (Ogley, 1993:137). These services may encompass tasks such as treasury and tax administration, internal auditing, public relations, market research, marketing, insurance, and accounting (Ogley, 1993:137). It is common for a group of companies to have several international headquarters, each catering to group companies in neighboring countries within a specific geographic region (Legwaila, 2011:126-142).

Hence, typically, the decision to establish a headquarter company is driven by the economic and structural requirements of the group in which the headquarter company is to be set up (Legwaila, 2011:126-142). However, Legwaila (2011) stated that it is widely understood that the decision to establish a headquarter company is frequently influenced by the desire to leverage available tax incentives in the specific jurisdiction. These are normally tax incentives that investors would not have access to without the utilization of a headquarter company or without establishing the headquarter company in that specific jurisdiction (Legwaila, 2011:126-142). This enables the group to decrease its total tax obligations, thereby enhancing its post-tax profits (Legwaila, 2011:126-142).

Therefore, if the South African HQC regime embodies the optimal characteristics expected in an ideal headquarter company jurisdiction and is competitive compared to other headquarter company regimes in the African continent, it will attract foreign multinational companies to establish their regional headquarters in South Africa. That way the primary objective for creating the HQC regime would be achieved.

2.2 Policy objectives of National Treasury for the creation of the HQC regime

2.2.1 Background

In this section the policy objectives of National Treasury for establishing the HQC regime will be discussed. To conclude on whether the HQC remains relevant within South African tax legislation, the purpose for which the regime was created for must be analysed and understood.

Although tax incentives are never the sole reason investors consider when selecting a particular jurisdiction for investment purposes, they remain an important determinant (Holland and Vann, 1998:2). In its 2010 National Treasury Budget review, National Treasury expressed its intention to position South Africa as a gateway to the African continent (National Treasury budget review, 2010:78).

National Treasury highlighted that South Africa's geographic position, its robust financial services sector, and its banking infrastructure position it as a prospective gateway into Africa (National Treasury budget review, 2010:78). One of the initiatives outlined in the 2010 National Treasury Budget review aimed at promoting South Africa as a gateway into the African continent was the establishment of Headquarter companies' regime. National Treasury indicated its intention to potentially provide exemptions from both exchange control regulations and taxation for headquarter companies situated in South Africa (National Treasury budget review, 2010:78). This consideration stemmed from the fact that in 2010, funds received from foreign sources could not be transferred through South Africa to other foreign destinations without explicit approval from exchange control authorities (National Treasury budget review, 2010:78).

National Treasury additionally indicated its intention in 2010 to assess exchange control barriers and specific tax regulations to improve South Africa's appeal as an ideal location for headquarter companies (National Treasury budget review, 2010:78).

Based on the background provided, the primary objective of National Treasury in establishing the HQC regime was to position South Africa as an attractive destination for headquarter companies, thereby enticing investment from foreign multinational corporations.

Upon achieving the primary objective, National Treasury's secondary objective is to capitalise on the additional benefits associated with the presence of headquarter companies in South Africa (Legwaila, 2011:126-142).

Below is the primary and secondary objectives for establishing a headquarter company regime by National Treasury.

2.2.2 Primary objective: to promote South Africa as a gateway to investment in Africa.

The principal policy objective behind the creation of the HQC regime by National Treasury is to position South Africa as a preferred jurisdiction for investments into Africa by multinational corporations (Davis Tax Committee, 2018:88). This objective entailed mitigating fiscal and regulatory barriers that might otherwise diminish South Africa's appeal as a destination for headquarter companies (Davis Tax Committee, 2018:88). Upon achieving this objective, South Africa is poised to become the foremost destination for foreign direct investment across the African continent, drawing in investors seeking to establish their headquarters for African operations. Amidst the renewed interest in Africa as a promising investment destination, South Africa has the potential to serve as a crucial entry point for foreign investors (Policy Briefing 46, 2012:1).

Therefore, if the South African HQC regime is attractive and competitive enough, foreign multinationals will consider South Africa as a headquarter company location where they can set up their regional headquarters in South Africa. Once multinational corporations have established their regional headquarters in South Africa, the country will reap the rewards of the additional advantages arising from the presence of headquarter companies (Legwaila, 2011:126-142). The spillover benefits from the presence of headquarter companies is the secondary objective of creating the HQC regime and are discussed in detail below.

2.2.3 Secondary objectives of creating the HQC regime.

2.2.3.1 Creation of employment opportunities

The primary role of headquarter companies typically involves offering a comprehensive array of administrative and managerial functions typically associated with a central office (Ogley,

1993:137). Those functions generally include treasury and tax administration, internal auditing, public relations, market research, marketing, insurance, and accounting (Ogley, 1993:137). Hence, to effectively carry out their roles, headquarter companies are inclined to recruit local professionals to occupy certain positions (IBDA, 2023:1). The generation of job opportunities stimulates economic development and growth (IBDA, 2023:1). The local professionals employed will earn income, allowing them to enhance their quality of life, contribute taxes to support the government's revenue, and spend on local businesses, thereby fueling further economic growth.

2.2.3.2 Importation of skills and technology

Most multinational corporations that establish headquarters in various countries are companies from developed countries (Policy Briefing 46, 2012:1). Companies from developed countries such as USA, Japan, Germany, United Kingdom etc. use advanced technologies such as automation and robotics, increase efficiencies and minimize costs (IBDA, 2023:1). Their dedication to innovation and technological advancement will play a significant role in bolstering the economic growth of the country hosting their headquarters (IBDA, 2023:1).

Therefore, the local workforce employed by these headquarter companies stand to gain from both the expertise transferred by foreign employees accompanying the company and the technology systems implemented by these headquarter companies (IBDA, 2023:1). Local companies can also gather insights from these headquarter companies as they become acquainted with the skills and technologies employed by them (IBDA, 2023:1). This knowledge transfer will ultimately enhance the skills pool and capabilities of the South African workforce and companies (Davis Tax Committee, 2018:88).

Therefore, the presence of headquarter companies facilitates the transfer of knowledge and technology, which in turn accelerates progress and fosters innovation across different sectors (IBDA, 2023:1).

2.2.3.3 Economic benefits for local communities

It is expected that international headquarter companies would bring skilled and well-paid professionals to South Africa, who, in turn, would need goods and services from the local communities where they are based. This, in turn, would create indirect economic advantages for these local communities (Bloom and Grant, 2011:211). The foreign employees stationed in South Africa will require various services including real estate, healthcare, and personal care, as well as

goods such as food and clothing (Bloom and Grant, 2011:211). Consequently, local businesses providing these goods and services stand to benefit (Bloom and Grant, 2011:211).

2.2.3.4 Boosts trade relations

The presence of headquarter companies boosts trade relations between the host country and other countries (IBDA, 2023:1). For example, if the multinational corporation that established its headquarter company originates from the USA, fostering strong trade relations is mutually beneficial for South Africa, The USA, and other countries where the company operates (IBDA, 2023:1). Multinational companies wield greater influence than ever in shaping trade policies and international relations (RONESANS, 2023:1). These companies, working alongside governments, have emerged as significant drivers and architects of the global economy (RONESANS, 2023:1).

2.3 Conclusion

One of the initiatives outlined in the 2010 National Treasury budget review aimed at promoting South Africa as a gateway into Africa was the establishment of the HQC regime. Therefore, the primary objective of creating the HQC regime is to position South Africa as a preferred jurisdiction for investments into Africa by multinational corporations (Davis Tax Committee, 2018:88). Although tax considerations are not the only motivation for utilizing headquarter companies, they inevitably and increasingly influence decisions regarding their location (Legwaila, 2011:126-142). The tax implications directly affect the overall profitability of business enterprises (Legwaila, 2011:126-142). The non-tax considerations that prospective investors consider before setting up their headquarter companies in specific jurisdiction will be discussed in detail in chapter 6 of this report.

The secondary objective of creating the HQC regime is the spillover benefits from the presence of headquarter companies in South Africa and those benefits are creation of employment opportunities, importation of skills and technology, economic benefits for local communities and improved trade relations.

In summary, the presence of multinational corporations' headquarters within a country is essential in today's interconnected global economy (IBDA, 2023). It stimulates economic viability, drives technological progress, and creates new avenues for growth and development (IBDA, 2023).

If the South African HQC regime reflects the desired attributes of an optimal headquarter company jurisdiction and effectively attains both the primary and secondary objectives outlined above, it will remain relevant within South African tax legislation.

3. Chapter 3: Tax design elements that underpin the South African HQC regime

3.1 Background

The purpose of this chapter is to examine tax legislation that underpins the South African HQC regime. By examining the tax legislation, we can assess whether the current tax regulations adequately promote the success of the HQC regime or if certain aspects hamper its progress.

In 1997 the Katz Commission recommended that establishing international corporate headquarters and holding companies in South Africa would be beneficial for the economy as it would motivate domestic investors to increase their international presence without sending valuable human resources offshore and motivate international investors to extend their operations into Africa through South Africa (Katz Commission, 1997:50). Considering the recommendations made by the Katz Commission in 1997, the definition of “international headquarter company” was introduced in the Act through Revenue Laws Amendment Act 59 of 2000. In summary, International headquarter company was defined as a company where the entire share capital is held by persons who are not residents or trusts, where any direct interest of residents and trusts does not exceed five percent on aggregate of the total share capital of such company and where 90 percent of the value of the assets of such company represents interests in the equity share capital and loan capital of subsidiaries (which are not residents) of such company in which such company holds beneficial interest of at least 50 per cent (Revenue Laws Amendment Act 59, 2000:6).

The insertion of the definition of international headquarter company in the Act became the beginning of the International Headquarter Regime (IHC) and it was effective from 1 January 2001 (Revenue Laws Amendment Act 59, 2000:6). The Revenue Laws Amendment Act 59 of 2000 also included the insertion of a definition of ‘resident’ in the Act and then South Africa moved from a source-based to a residence-based tax system effective 1 January 2001 (Revenue Laws Amendment Act 59, 2000:6).

The definition of residence with respect to non-natural persons as stated in section 2(h) of the Revenue Laws Amendment Act 59 of 2000 says “*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 excluding any international headquarter company)*” (Revenue Laws Amendment Act 59, 2000:8).

Excluding IHC’s from the definition of resident meant that the Controlled Foreign Company (CFC) provisions and regulations pertaining to the taxation of foreign dividends did not apply to IHC’s (Explanatory Memorandum to the Revenue Laws Amendment Bill, 2000:4). I.e., IHC’s were not taxed on dividends derived from their foreign subsidiaries and their income from sources outside South Africa (Explanatory Memorandum to the Revenue Laws Amendment Bill, 2000:4). The intention of the legislature on granting IHC’s preferential tax treatment was to ensure that the IHC regime attracts foreign investors to South Africa. However, the exclusion of IHC’s from the definition of resident also meant that IHC’s will not benefit from Double Tax Agreements relief (DTA’s) since DTA’s relief only applies to residents of the contracting states (Gutuza, 2013:237). This flaw in the legislation meant that there is potential for double taxation on the IHC’s (Gutuza, 2013:237).

The IHC regime was not successful in South Africa and the regime was repealed with effect from 1 June 2004.

3.2 Tax legislation that underpin the current HQC regime

The current South African HQC regime became effective from 1 January 2011 and is underpinned by the following legislation:

3.2.1 Section 9I

The HQC regime was introduced as section 9I of the Act effective 1 January 2011. Section 9I of the Act outlines the criteria that companies must meet to qualify as HQCs. The summary of qualifying criteria for HQC’s is discussed below:

Resident for tax purposes requirement (section 9I(1)(a)) – To be eligible as an HQC, the company must be considered a resident in South Africa for tax purposes (section 9I(1)(a)). This implies that the company should either be incorporated, established, or formed in South Africa, or have its place of effective management within the country (definition of ‘resident’ in section 1 of the Act). Additionally, it should not be exclusively considered a resident of another country for the

purposes of applying DTAs to which South Africa is a party. (definition of 'resident' in section 1 of the Act).

Being a tax resident implies that the company is liable to pay taxes on its worldwide income in South Africa (Van der Walt, 2020:3). An HQC is taxed similarly to any other resident company in South Africa (Interpretation note 87, 2020:4). However, HQCs enjoy specific tax relief, including certain relief from income tax, capital gains tax (CGT), and dividends tax, which are not accessible to resident companies that do not have headquarter status (Interpretation note 87, 2020:4).

This indicates that the application of section 9I largely hinges on the prospective HCQs meeting the definition of a resident, a determination that can pose challenges for companies not incorporated, established, or formed in South Africa. Such companies need to resort to the Place of Effective Management test (POEM) to ascertain whether their place of effective management is within South Africa's jurisdiction. A company's POEM is the location where key management and commercial decisions essential for the conduct of its business as a whole are effectively made (commentary on article 4 in the OECD Model convention, 2014:83).

The determination of POEM requires a thorough examination of all relevant facts and circumstances and for prospective HCQs, this process can be daunting due to the complexity involved in assessing and analyzing all the relevant factors and circumstances. Under section 102 of the Tax Administration Act 28 of 2011 (TAA) a company is responsible for demonstrating its place of effective management and is required, as per section 29 of that Act, to maintain the essential evidence to substantiate its position (Interpretation note 6, 2023:4). This means that prospective HCQs that were not incorporated, established, or formed in South Africa have a burden to prove that their place of effective management is in South Africa and retain the records to support this, which can also be a huge administrative burden.

Requirements of section 9I(2)- A resident company is required to meet the three requirements below to be eligible to make the election to be a headquarter company for any year of assessment:

- (a) The 10% shareholding and voting rights requirement (section 9I(2) (a))-** each holder of the shares in the company, either individually or collectively with any other company within the same group, must maintain ownership of 10% or more of the equity shares and voting rights of the potential HQC throughout the assessment year (Section 9I(2)(a)). The holder of the shares and voting rights may be a resident or non-resident and the 10% holding requirement must be satisfied for both equity shares and voting rights

(Interpretation note 87, 2020:5). Therefore, natural persons and trusts need to hold 10% or more of both equity shares and voting rights in the prospective HQC and a company must also hold 10% or more of both equity shares and voting rights alone or together with another company forming part of the same group of companies (Interpretation note 87, 2020:5). The 10% shareholding and voting rights requirement must be met on each day of the year of assessment to avoid losing the benefits of HQC status, which is seen as being very strict and impose a huge compliance burden to potential HQCs (Van der Walt, 2020:3).

(b) The 80-10 asset test (section 9I(2)(b))– section 9I (2) (b) mandates that by the end of the year of assessment and all preceding years of assessment, 80% or more of the cost of the total assets of the potential HQC must be attributed to one of the following assets:

- Any interest in equity shares in one or more qualifying foreign companies.
- Any debt owed by one or more qualifying foreign companies.
- Intellectual property that is licensed by the company to a qualifying foreign company (Section 9I(2)(b)).

A qualifying foreign company refers to a foreign entity in which the prospective HQC holds, either independently or jointly with any other company within the same corporate group, a minimum of 10% of the equity shares and corresponding voting rights by the conclusion of the relevant assessment year (Interpretation note 87, 2020:10). The term foreign company means any company which is not a resident (section 1 of the Act), therefore a qualifying foreign company cannot be a resident. This means that if a potential HQC holds at least 10% of the equity shares and corresponding voting rights in a foreign company that has some operations in South Africa, then a POEM test needs to be applied to prove that the POEM of the foreign company is not in South Africa. Similarly, if a prospective HQC holds a significant or controlling interest in a foreign company it is possible that key management and commercial decisions are taken in South Africa where the parent company is, therefore the prospective HQC will have to prove that the POEM of the foreign company it invests in is not South Africa. As mentioned earlier, establishing a company's POEM can be complex due to the necessity of considering all necessary facts and circumstances. Moreover, this process often entails a significant administrative burden on the prospective HQC.

The 80% or more of the cost of total assets requirement must be fulfilled at the conclusion of the assessment year for which an election is made to become a headquarters company

(Interpretation note 87, 2020:10). Additionally, this requirement must be met at the end of all preceding assessment years of the prospective headquarters company (Interpretation note 87, 2020:10). This implies that failing to meet this requirement in any assessment year renders the company ineligible to meet the requirement and consequently unable to elect to become a headquarters company in that particular year or in any future assessment years (Interpretation note 87, 2020:10).

In determining the total assets of the company, any funds held in cash or as bank deposits payable on demand are not included in the assessment (Section 9I(2)(b) (aa)). Furthermore, when assessing whether a company meets the requirement of having "80% or more of the cost of total assets in, to, or by a qualifying foreign company," as outlined in section 9I(2)(b), for a particular assessment year, that specific year should be disregarded if, at any point during it, the company did not possess assets with a total market value surpassing R50,000 (Section 9I(2)(b) (bb)).

(c) The 50% or more of gross income requirement (section 9I(2)(c)) – the third requirement is called the gross income test and it requires that if the gross income (excluding exchange differences calculated according to section 24I of the Act) for the year of assessment surpasses R5 million, then 50% or more of this gross income should be comprised of amounts in one or both of the following forms:

- Rental, dividends, interest, royalties or service fees paid or payable by a qualifying foreign company (Section 9I(2)(c)(i)).
- Proceeds from the disposal of an interest in equity shares in a qualifying foreign company (Section 9I(2)(c)(ii)).
- Proceeds from the disposal of any intellectual property, as contemplated in section 9I(2)(b)(iii), licensed to a qualifying foreign company (section 9I(2)(c)(ii)).

The proceeds obtained from the sale of equity shares in a foreign company or from the sale of intellectual property will often fall under capital gains and therefore will not be considered as part of the gross income of the potential headquarter company (Interpretation note 87, 2020:20). In such instance, those proceeds would not be factored into the calculation for "50% or more of gross income." Only proceeds categorized as revenue in nature would be accounted for in the gross income calculation and thus be included in this assessment (Interpretation note 87, 2020:20).

There is no tax relief for service fees/service income in the hands of the HQC, which is one of the factors contributing to the reduced attractiveness of the South African HQC regime. It is inherent to the nature of a HQC that some degree of management or coordination of the qualifying foreign companies in which it holds interest in will occur in South Africa, therefore its income will most likely also include management fees, supervisory or coordination fees for services provided by the HQC to the qualified foreign company (Gutuza, 2014:197). Any income derived from services provided, received by, or accruing to a HQC would be liable to taxation at the full South African income tax rate of 27% (Gutuza, 2014:197). Although under Section 6quat(1C) of the Act a resident can claim certain foreign taxes, which are ineligible for the rebate outlined in section 6quat(1), when calculating taxable income (Interpretation note 87, 2020:49). The amount allowed per section 6quat(1C) is the lower of the South African tax and the foreign tax owed, therefore there is most likely going to be a portion remaining which is going to be taxed at the South African tax rate of 27% (Interpretation note 18, 2022:41). The absence of tax relief for HQCs on income earned from these sources does not support South Africa's aspiration to become the 'gateway into Africa'. On a global scale, a crucial fiscal characteristic of a regime Favourable to the establishment of HQCs is the absence of taxation, or the imposition of minimal taxes, on management services provided by a head office to other entities within a multinational group (Katz Commission, 1997:51). Therefore, the South Africa HQC regime lacks this attribute.

Annual election (Section 9I (1) and (3))- a potential headquarter company may elect in the format and procedure specified by the commissioner to be a headquarter company for a particular assessment year of that company provided it meets the requirements of section 9I(2) stated above (section 9I(1)(b)). The election becomes effective starting from the beginning of the assessment year for which it is made (section 9I(3)). The election is only effective for a single year of assessment, therefore prospective HQCs must make the election on an annual basis. A single year of assessment represents a notably brief duration for a company to secure tax relief, highlighting a fundamental flaw within the South African HQC regime (Mukumba, 2017:58). Mukumba (2017) stated that the yearly election and compliance obligations render the benefit of being a HQC too temporary and costly.

Annual report to be submitted to the Minister (section 9I(4))- a headquarter company is required to submit an annual report to the Minister, furnishing the Minister with information as prescribed and within the designated timeframe (Section 9I(4)). This report should contain the details and data specified by the Minister (section 9I(4)).

3.3 Relief from normal tax and capital gains tax for headquarter companies.

If a South African resident company elects to become a headquarter company and meets the aforementioned criteria, it becomes eligible for certain income tax relief with regard to controlled foreign company legislation, dividends tax, and transfer pricing provisions.

3.3.1 Controlled foreign companies (section 9D(2)) – In summary a foreign company is a controlled foreign company (CFC):

- *“when more than 50% of its total participation rights are directly or indirectly held, or more than 50% of its voting rights are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies [paragraph (a) of the definition of “controlled foreign company” in section 9D(1)]; or”*
- *“when its financial results are reflected in the consolidated financial statements of any company that is a resident, other than a headquarter company, as required under IFRS 10 [paragraph (b) of the definition of “controlled foreign company” in section 9D(1)]”.*

Section 9D(2) typically mandates that a portion of a CFC net income must be added to the income of any resident, excluding a resident classified as a headquarters company, who holds any participation rights directly or indirectly in the CFC (Interpretation note 87, 2020:24). This process is commonly known as “attribution” (Interpretation note 87, 2020:24). Section 9D(2) essentially exempts headquarter companies from CFC provisions, which is a positive move towards ensuring that South Africa’s tax framework offers an attractive base for foreign investment into Africa (Oguttu, 2011:76).

3.3.2 Dividends and foreign dividends received by or accrued to a HQC (section 10(1)(k)(i), section 10B and paragraph k of the definition of gross income)

Generally, any local or foreign dividend received or accrued to a resident should be included in gross income (paragraph k of the definition of gross income in section 1(1)). An HQC is a resident and would be required to include dividends and foreign dividends in its gross income. However, with certain exceptions outlined in the Act, dividends received by or accruing to HQCs are typically exempt from normal tax under section 10(1)(k)(i).

Foreign dividend is defined in section 1 of the Act and in simplified terms means a dividend disbursed or due by a foreign company concerning a share in that specific foreign company (Interpretation note 87, 2020:30). Foreign dividends received by or accrued to a HQC may be

eligible for an exemption from regular tax under section 10B of the Act. For the purposes of section 10B of the Act, foreign dividend means any foreign dividend as defined in section 1 of the Act or dividend paid or declared by a HQC (Section 10B(1) (a) and (b)). From an HQC perspective, section 10B foreign dividend is treated as follows:

- where the foreign dividends relate to dividends received or accrued to an HQC, the foreign dividend may be exempt from normal tax in terms of Section 10B, provided the requirements of section 10B(2) are met (Interpretation note 87, 2020:31).
- where the foreign dividends relate to dividends paid or declared by a HQC and received by or accrued to a resident or non-resident, section 10B may apply to the resident and non-resident provided the requirements of section 10B(2) are met (Interpretation note 87, 2020:31).

3.3.3 Transfer pricing (section 31(5) and (6))

Section 31 of the Act includes the provisions of transfer pricing and in summary, section 31 outlines the tax treatment of international transactions between related parties that are not conducted on an arm's length basis, if any party involved in the transaction gains a tax advantage from it (Interpretation note 87, 2020:33).

Section 31 requires the taxpayers to determine the following:

- whether the actual terms of any transaction meeting the definition of “affected transaction” differs from the terms and conditions that would have been agreed upon if the parties were independent parties engaging at arm’s length and
- To compute their taxable income based on arm’s length terms if the difference in arm’s length terms and connected persons terms results in a tax advantage for one of the parties (Section 31(2) of the Act).

In summary, an affected transaction refers to a transaction between related parties where the terms and conditions deviate from what would have been negotiated if the parties were independent and engaged in arm's length dealings (section 31(1)(a) and (b)).

In general section 31 applies to HQCs except where the transaction that has been entered into relates to the provision of financial aid or the granting of intellectual property usage rights (Section 31(5)). In other words, if the HQC is rendering managerial services to connected persons who are not residents, the provisions of section 31 will apply (Interpretation note 87, 2020:33). HQCs are

not subject to the regulations outlined in section 31 only if the affected transaction relates to the provision of financial aid or the granting of intellectual property usage rights (Section 31(5)). As discussed in part 3.2.1 (c) above, there is no tax relief on managerial fees income received or accrued by HQCs from their foreign subsidiaries. The lack of tax relief on these management fees, combined with the fact that section 31(5) isn't applicable to HQCs, adds to the lack of appeal of the South African HQC regime (Oguttu, 2011:85).

Section 31(5) exemption applies when a transaction has been entered into in terms of which the provision of financial aid or the granting of intellectual property usage rights:

- By the HQC to any foreign company in which the HQC holds a direct or indirect ownership stake of at least 10% in both equity shares and voting rights.
- By a non-resident to a HQC (Section 31(5) (a), (b), (c) and (d)).

However, if a HQC provides financial aid or intellectual property usage rights in relation to it or CFC in relation to another company that forms part of the same group of companies as the HQC, the provisions of section 31 will apply (Section 31(6)).

3.3.4 Disposal of equity shares in a foreign company (paragraph 64B(2)) and foreign return of capital received from a foreign company (paragraph 64B(2) and (4)).

An HQC may disregard a capital gain or loss on the sale of equity shares in a foreign company if, either alone or together with a company within the same group, it held 10% or more of the equity shares and voting rights in the foreign company immediately before the disposal (Section 64B(2)). However, if 80% or more of the market value of the equity shares in the foreign company is linked directly or indirectly to immovable property in South Africa held for purposes other than trading stock, and if the headquarter company, either independently or with any affiliated entity, holds at least a 20% stake in those shares, then paragraph 64B(2) does not apply and the HQC will not be allowed to disregard the capital gain or loss on the disposal of those equity shares (paragraph 2(2) of the eighth schedule).

A HQC may disregard a capital gain on a foreign return of capital received or accrued from a foreign company if the HQC, either alone or with a company within the same group, holds 10% or more of the equity shares and voting rights in the foreign company (paragraph 64B(4)). Paragraph 64B(4) also does not apply when 80% or more of the market value of the equity shares in the foreign company relates to immovable property located in South Africa and not used as

trading stock and if the HQC, either alone or with any related person, holds at least a 20% stake in those shares (paragraph 2(2) of the eighth schedule).

3.3.5 Rebate or deduction for foreign taxes on income (Section 6quat(1), section 6quat(1C) and section 64N).

Income earned from foreign sources by a resident, including a headquarter company, may attract taxation from both the source country and South Africa, leading to what is known as juridical double taxation (Interpretation note 87, 2020:49). In this instance the potential double taxation on the resident can be resolved through a tax treaty or through domestic law. The sections in the Act that can be used as a relief from double taxation of a resident (including a headquarter company) are as follows:

Section 6quat(1) - section 6quat (1) allows deduction of rebate by a resident for foreign taxes proved to be payable on income derived from a foreign source that is included in that resident's taxable income. The amount of the rebate that can be deducted is equal to the sum of any taxes on income proved to be owed to any level of government of any country other than South Africa, with no possibility of reimbursement to the individual (Section 6quat(1A)).

Section 64N - section 64N allows for a rebate in respect of foreign taxes on dividends. These are taxes paid on foreign cash dividends (Section 64N(1)). The amount of rebate to be deducted is equal to the amount of any tax paid to any level of government of any country other than South Africa, with no possibility of reimbursement to the individual (Section 64N(2)).

Section 6quat(1C) - according to section 6quat(1C), a resident has the option to deduct specific foreign taxes, which do not meet the requirements for the rebate outlined in section 6quat(1), when calculating taxable income (section 6quat(1C)). In essence, this refers to foreign taxes owed on income sourced from South Africa (Interpretation note 87, 2020:49).

3.3.6 Ring-fencing of royalties incurred by headquarter companies

Section 20C regulates the deductibility of interest accrued by a HQC on financial assistance granted by a non-resident and deductibility on royalties payable by a HQC to a non-resident. The non-resident granting financial assistance to the HQC and who is owed royalties by a HQC should be a company that either alone or with any company within the same group as that non-resident, holds at least 10% of the equity shares and voting rights in the headquarter company (Interpretation note 87, 2020:49). The deduction allowed on interest accrued by the HQC on

financial assistance granted is limited to interest received or accrued to the HQC from a foreign company on the portion of that financial assistance that was directly applied by the HQC as financial assistance to the foreign company (section 20C(2)). The deduction for royalties incurred by a HQC is limited to amounts received by or accrued to the HQC from any foreign company on the use or right of use of any intellectual property or the imparting of scientific or technical knowledge, provided that the HQC holds (alone or together with other companies in the same group) at least 10% of the equity shares and voting rights of the foreign company (Section 20C (2A)).

3.3.7 A resident company that becomes a headquarter company (section 9H)

Section 9H(3)(a) stipulates that if a resident company transitions into a headquarter company for a particular assessment year, it must be regarded as having sold off all its assets to a resident on the day just prior to its transformation into a headquarter company (Interpretation note 87, 2020:60). Subsequently, it is to be considered as having repurchased each of those assets on the day it officially becomes a headquarter company, with the value set at the market price of each asset (Interpretation note 87, 2020:60).

Nevertheless, in the event that one of the assets considered disposed of is equity shares, the headquarter company (HQC) will have the option to disregard any capital gains or losses arising from the presumed sale of equity shares in foreign companies as per paragraph 64B(2), provided that the HQC holds a minimum of 10% of both the equity shares and voting rights in those foreign companies (Interpretation note 87, 2020:60). Consequently, for all other assets regarded as disposed of, the presumed capital gain will be subject to taxation.

3.4 Conclusion

The purpose of this chapter was to examine tax legislation that underpins the South African HQC regime and in doing so, also assess whether the current tax regulations adequately promote the success of the HQC regime or if certain aspects of the legislation hamper its progress.

Most tax provisions outlined above, which supports the South African HQC regime, offer Favourable treatment to HQCs when compared to other resident companies. This enhances the appeal of the South African HQC regime. However, certain aspects of the tax legislation do have an adverse impact on the South African HQC regime and those aspects are discussed below:

Residency requirement- A HQC is required to be a resident for tax purposes. This means that prospective HQCs that were not incorporated, established, or formed in South Africa have a burden to prove that their place of effective management is in South Africa and retain the records to support this, which can be a huge administrative burden.

The 10% shareholding and voting rights requirement - The 10% shareholding and voting rights requirement must be met on each day of the year of assessment to avoid losing the benefits of HQC status, which is seen as being very strict and imposes a huge compliance burden to potential HQCs (Van der Walt, 2020:3). This requirement could be relaxed a bit to say the 10% shareholding and voting rights requirements must be met at the end of each month to allow for days in between when shares are being bought and sold. This requirement also mandates each holder in the HQC to hold at least 10% of both equity shares and voting rights, which is another complication as prospective HQCs must consider both when structuring their capital.

The 80-10 asset test- since a qualifying foreign company in which the prospective HQC holds 10% or more of the equity shares and corresponding voting rights is a non-resident, there are instances where it is possible that the POEM of that foreign company is in South Africa. When this happens, work needs to be done to confirm that the POEM of the qualifying foreign company is outside South Africa and sometimes the POEM test may be complex as all the relevant facts need to be considered. This means that prospective HQCs need to ensure that individuals carrying out the effective management function of the companies it invests in are based at locations outside South Africa.

Lack of tax relief for service fees income in the hands of the HQCs- the gross income test mandates that if the gross income of the prospective HQC surpasses R5 million, then 50% or more of this gross income should be comprised of amounts in one or both of the following: rental, dividends, interest, royalties or service fees paid or payable by a qualifying company, proceeds from the disposal of an interest in equity shares in a qualifying foreign company and proceeds from disposal of any intellectual property. However, the tax legislation does not have a provision that exempts the service fees income in the hands of the HQC. Any income derived from services provided by the HQC to the foreign company would be liable to taxation at the full South African income tax rate of 27% (Gutuza, 2014:197). As discussed above, section 6quat(1C) deduction does not fully protect HQCs from tax on management fees. The absence of tax relief for HQCs on service fees income hampers the attractiveness of the South African HQC regime. Lack of relief from transfer pricing rules for rendering of managerial services between a headquarter

company and non-resident connected persons. Section 31(5) of the Act does not apply to management/service fees earned by the HQC through provision of managerial services to its foreign subsidiary (Interpretation note 87, 2020:33). Currently, there is no tax relief for management or service fees earned by HQCs from managerial services rendered to their foreign subsidiaries, except when section 6quat(1C) is applicable which only grants a deduction for foreign taxes payable or paid on income from South African source. Consequently, HQCs are likely to face full taxation on these fees in South Africa and must adhere to section 31 in cases where transactions are not conducted at arm's length since the exemption in section 31(5) does not apply. This adds to the lack of appeal of the South African HQC system (Oguttu, 2011:86).

Annual election - the potential HQCs must make an election to be a HQC annually. This means that even if the prospective HQC meets the requirements of section 9I, they still need to make an election in the format and manner specified by the commissioner to be an HQC. The election is only effective for a single year of assessment, therefore prospective HQCs must make the election yearly. A single year of assessment represents a notably brief duration for a company to secure tax relief, highlighting a fundamental flaw within the South African HQC regime (Mukumba, 2017:58). This yearly election and compliance obligations render the benefit of being a HQC too temporary and too costly (Mukumba, 2017:58).

The proposed amendments to the aspects of the legislation that hampers the attractiveness of the South African HQC regime will be discussed in chapter eight.

4. Chapter 4: Exchange control regulations that impact the South African Headquarter Company regime

4.1 Background

The purpose of this chapter is to give a high-level overview of exchange control regulations that have an impact on the provisions of the South African HQC regime.

Exchange controls seek to limit the trading of a country's currency or safeguard foreign currency reserves (SARB website, 2024). Exchange controls are frequently enforced due to concerns regarding the outflow of currency, but they can also be implemented to limit inflows of currency (SARB website, 2024).

According to the South African Reserve (SARB) website, exchange controls aim to:

- Avoid the loss of foreign currency resources by moving real or financial capital assets away from South Africa;
- Efficiently regulate the transfer of financial and tangible assets both entering and exiting South Africa; and
- Steer clear of hindering the efficient functioning of the commercial, industrial, and financial system (SARB website).

In the absence of any exchange control exemptions, all South African residents (both individuals and companies) must comply with exchange control regulations concerning transactions involving foreign exchange (BakerMckenzie, 2017:10). HQCs are South African tax residents, therefore in the absence of any exchange control exemptions they would need to comply with exchange control regulations relating to transactions involving foreign exchange (BakerMckenzie, 2017:10). Hence, the evaluation of the South African HQC regime would not be complete without evaluating the impact of exchange control regulations on these companies.

Currently South African resident companies (excluding trusts and close corporations) can make genuine new foreign direct investments in companies beyond the Common Monetary Area (which includes eSwatini, Lesotho, Namibia, and South Africa) up to the amount of R1 billion per company per calendar year, facilitated through any Authorized Dealer (SARB website). If the company wants to invest more than R1 billion it must obtain at least 10% of the voting rights of the foreign entity they want to invest in, and their authorized dealer must apply to the Financial Surveillance Department (FSD) of the SARB for approval (SARB website). Authorized dealer is a bank registered in terms of the Banks Act of 1990 and authorized to deal in foreign exchange (SARB website).

4.2 Impact of exchange control regulations on HQCs

According to currency and exchanges guidelines for business entities issued by the FSD of the SARB, HQCs that meet the following criteria may invest outside of South Africa without restrictions:

4.2.1 Registration with the FSD requirement- HQCs must be registered with the FSD through an authorized dealer for reporting purposes. i.e to invest outside of South Africa without restrictions, HQCs must register with the FSD. The registration with the FSD will remain valid as long as the criteria outlined in (4.2.2) to (4.2.4) below are complied with in the current assessment

year and all previous assessment years (currency and exchanges guidelines for business entities, 2024:25).

4.2.2 10% share and voting rights requirement- all shareholders of the HQC, whether individually or collectively with any other company within the same group must possess a minimum of 10% of the equity shares and voting rights of the HQC (currency and exchanges guidelines for business entities, 2024:25). This criterion can be easily satisfied as it corresponds with one of the qualifying criteria for HQCs in section 9I(2)(a) of the Act. Thus, HQCs inherently fulfill this criterion by being classified as HQCs as outlined in section 9I of the Act.

4.2.3 20% South African shareholding restriction- South African residents are prohibited from holding more than 20% of the equity shares of the HQC, whether directly or indirectly (currency and exchanges guidelines for business entities, 2024:25). This requirement limits the ownership of shares in the HQC by South African residents to a maximum of 20%. This restriction is in line with the objective of the South African HQC regime which aims to promote South Africa as a gateway to Africa through attracting foreign multinational corporations to establish their headquarters in South Africa (Katz Commission, 1997:50).

4.2.4 80% of foreign assets requirement- at the conclusion of each financial year, a minimum of 80 percent of the HQC's assets must comprise foreign assets (excluding cash and cash equivalents and short term debt with a duration of less than 12 months). While not identical, this stipulation is more aligned with the requirement in section 9I(2)(b) of the Act which mandates that a minimum of 80% of the value of the total assets held by the HQC must be comprised of equity shares in a foreign company, debt owed by a foreign company or intellectual property licensed to a foreign company (Section 9I(2)(b)). Both requirements mandates that at least 80% of the total assets must be foreign assets. Thus, HQCs inherently fulfill this criterion by being classified as HQCs as outlined in section 9I of the Act.

As stated in the currency and exchanges guidelines for business entities 2024, HQCs that meet the above criteria will be treated as non-residents for exchange control purposes but are still required to report all cross-border transactions. As a result, dealings between South African entities and headquarter companies will be regarded as transactions with non-residents (currency and exchanges guidelines for business entities, 2024:25). HQCs that meet the above criteria have the freedom to borrow from foreign sources, and these funds can be utilized either domestically

or internationally as these transactions are considered as taking place outside South Africa (Currency and exchanges manual for authorized dealers, 2024:25).

Although HQCs are exempt from exchange control regulations as discussed above, they still need to comply to reporting requirements of the extent of foreign investments as stipulated by the SARB (currency and exchanges guidelines for business entities, 2024:25). This is necessary for statistical purposes. Reporting should include inter alia, sources of funds, new or existing funds, destination, and loan funds obtained from local sources (currency and exchanges guidelines for business entities, 2024:25). A detailed organogram together with the latest audited financial statements should also be submitted to the FSD through an authorized dealer annually (currency and exchanges guidelines for business entities, 2024:25).

4.3 Conclusion

As discussed above, HQCs that meet all the criteria stipulated in the currency and exchanges guidelines for business entities are treated as non-residents for exchange control purposes, therefore they can move financial and real assets in and out of South Africa without restrictions (currency and exchanges guidelines for business entities, 2024:25).

The requirements that need to be complied with to qualify for exchange control regulations exemption are also easy for HQCs since they are aligned to the criteria outlined in section 9I of the Act. Thus, HQCs inherently fulfill the criteria of being exempted from foreign control regulations by being classified as HQCs as outlined in section 9I of the Act. The only extra requirement that is not aligned with section 9I of the Act is to register with the FSD through an authorized dealer. The absence of exchange controls is a fundamental characteristic of an optimal location for a headquarter company (Oguttu, 2011:66). Thus, the absence of exchange controls enhances the attractiveness of the South African HQC regime, positioning it competitively against similar regimes in other African nations.

5. Chapter 5: Existing criticism against the current South African HQC regime

5.1 Background

In 1997 the Katz Commission recommended a HQC regime in South Africa stating that South Africa possesses several strengths, including a well-established financial system and infrastructure, which could position it as an appealing destination for investments into other parts

of Africa (Katz Commission, 1997:51). The South African HQC regime became effective on January 1, 2011. The introduction of the regime aimed to enhance South Africa's appeal to multinational corporations, positioning it as a preferred jurisdiction for investments across Africa (Davis Tax Committee, 2018:88). This was achieved by mitigating fiscal and regulatory obstacles that might otherwise diminish South Africa's appeal as a destination for headquarters companies (Davis Tax Committee, 2018:88).

In 2018, the Davis Tax Committee recognised that despite the regulatory and fiscal incentives provided by the South African headquarter company regime, only a limited number of multinational companies have utilized it (Davis Tax Committee, 2018:88). Thus, the HQC regime has not achieved the level of success anticipated by National Treasury. The primary reasons for the low adoption of the regime seem to stem from challenges in meeting its practical and compliance requirements, alongside the presence of alternative regimes offered by other African countries that are more appealing and easier to use (Davis Tax Committee, 2018:88).

Thus, the aim of this chapter is to identify and examine the prevailing criticisms directed towards the provisions of the current South African HQC regime.

5.2 Existing criticism of the South African HQC regime

5.2.1 Lack of tax relief for service fees income in the hands of the HQCs

As discussed in chapter 3 above, it is inherent to the nature of a HQC that some degree of management or coordination of the qualifying foreign companies in which it holds interest in will occur in South Africa, therefore its income will most likely also include management fees, supervisory or coordination fees for services rendered by the HQC to the qualified foreign company (Gutuza, 2014:197). Most of the earnings obtained by HQCs while carrying out these tasks typically consist of management fees, technical fees, service fees and interest payments from its foreign subsidiaries (Mazansky, 2011:3). This clarifies why the Katz Commission report of 1997 highlighted that a crucial fiscal characteristic of a Favourable environment for establishing international headquarters and service companies is the absence of taxes on head office management services provided by the head office to the multinational group (Katz Commission, 1997:51). At present in South Africa, HQCs are subjected to full taxation on the management and service fees received from their foreign subsidiaries (Mazansky, 2011:3).

Although under Section 6quat(1C) of the Act a resident can claim foreign taxes payable on income from a South African source (Interpretation note 87, 2020:49). Thus, if a HQC provides managerial

and technical support services to a qualifying foreign company it invests in, under South Africa's source rules the source of income is in South Africa as that is where the actual work is done (Interpretation note 18, 2022:84). Therefore if the country where the foreign entity is a resident withholds tax on management fees paid to the HQC that is a South African resident and there is no double tax treaty between the two countries, then on calculation of its taxable income the HQC which is resident in South Africa can claim the amount of foreign tax that has been withheld (Interpretation note 18, 2022:84). Section 6quat(1C) is only applicable if there is no right of recovery of the taxes paid or proved to be payable (Interpretation note 18, 2022:82).

5.2.2 Lack of relief from transfer pricing rules for rendering of managerial services between a headquarter company and non-resident connected persons.

Section 31 of the Act includes the provisions of transfer pricing and in general section 31 applies to HQCs except where the transaction that has been entered into relates to the provision of financial aid or the granting of intellectual property usage rights (Section 31(5)). Therefore, the provisions of section 31(5) of the Act do not apply to the rendering of managerial services by the HQC to its foreign subsidiaries (Interpretation note 87, 2020:33). Thus, if a HQC earns income from rendering managerial and technical support services to its foreign subsidiaries and the transaction is not at arm's length, then the HQC must compute its taxable income based on the arm's length terms and conditions of the affected transaction if there exists a discrepancy that leads to a tax advantage for one of the parties (Interpretation note 87, 2020:33). In most cases the parent company will render the services at a discount, resulting in a lower expense for the foreign subsidiary and lower income for the HQC (Oguttu, 2011:86). Lower income for the HQC would mean lower taxable income in South Africa. Thus, arm's length terms will not be favourable to both parties.

In 2011, Deloitte provided feedback to SARS, characterizing the absence of transfer pricing relief on 'non-funding transactions' as a 'deficiency,' hoping that adjustments would be made to the HQC regime to enhance its tax efficiency and broaden its scope of applicability (Deloitte, 2011:7). To date, the provisions of the HQC regime have not undergone any amendments to accommodate transfer pricing relief for management or service fees earned by HQCs on services provided to their foreign subsidiaries. The lack of tax relief in South Africa's transfer pricing regulations for managerial services offered by an HQC to its foreign subsidiary, along with the absence of tax relief on income generated from management and related services by the HQC, might discourage

foreign multinational corporations from establishing their headquarters in South Africa (Deloitte, 2011:7).

5.2.3 The definition of resident in the Act and its relationship with qualifying criteria of the HQC regime

The HQC qualifying criteria per section 9I are significantly shaped by the definition of 'resident' in the Act. As previously discussed above, to qualify as a resident for tax purposes a company must either be registered, established, or formed in South Africa, or have its POEM in South Africa. Additionally, it must not be exclusively classified as a resident of another country solely for the application of DTA in which South Africa is involved (definition of 'resident' in section 1 of the Act). If a company is deemed tax resident in both South Africa and another country (with which South Africa has a DTA), according to the domestic tax laws of both nations, the determination of the tax residency of that company must ultimately rely on the application of what is commonly known as the 'tie-breaker' rule outlined in the relevant DTA (Olivier and Honiball, 2011:25). SARS states that the POEM test serves as the tie-breaker rule in numerous DTAs involving South Africa (interpretation note 6, 2023:16).

The definition of 'resident' influences the qualifying criteria for HQCs as it mandates that the prospective HQC must be a resident in South Africa and Section 9I(2) (b) of the Act mandates that by the end of the year of assessment and all preceding years of assessment, 80% or more of the cost of the total assets of the potential HQC must be attributed to one of the following assets:

- Any interest in equity shares in one or more qualifying foreign companies.
- Any debt owed by one or more qualifying foreign companies.
- Intellectual property that is licensed by the company to a qualifying foreign company (Section 9I(2)(b)).

A qualifying foreign company refers to a foreign entity in which the prospective HQC holds, either independently or jointly with any other company within the same corporate group, a minimum of 10% of the equity shares and corresponding voting rights by the conclusion of the relevant assessment year (Interpretation note 87, 2020:10). The term foreign company means any company which is not a resident (section 1 of the Act), meaning that the companies in which the potential HQC invests in must not be registered, established or formed in South Africa and their POEM must not be in South Africa. If such companies are registered, established, or formed in

South Africa, they must be regarded solely as tax residents in another country under a DTA involving South Africa, e.g. based on the premise that their POEM is located outside South Africa (interpretation note 6, 2023:3).

Zwarts (2013) stated that the interaction between the definition of 'resident' and the provisions of section 91 of the Act governing the HQC regime, alongside the conditions prevalent in Africa, negatively impact a company's eligibility to be classified as an HQC. Consequently, this diminishes the appeal of South Africa as a desirable HQC destination. Zwarts's argument is that it is possible that a company will fail to be classified as an HQC if it possesses a solitary, centralized management team located in South Africa, responsible for delivering 'effective management services' to its invested subsidiaries across Africa. Considering the scarcity of skills in Africa, offering those 'effective management services' might be a necessity (Zwarts, 2013:98). To fulfill the criteria for HQC qualification, the POEM of the HQC's African subsidiaries must be outside of South Africa, so that they constitute foreign companies. This means that foreign investors would still need to ensure that the individuals carrying out the effective management function are situated at the subsidiaries located outside of South Africa, which in the African context can be challenging and could discourage foreign investors from establishing headquarters in South Africa (Zwarts, 2013:98).

Zwarts's assertion holds merit; nevertheless, the mentioned risk can be mitigated through proper planning of corporate procedures and therefore should not be regarded as a significant flaw inherent in the structure of the HQC regime itself.

5.2.4 The 10% shareholding and voting rights requirement

HQCs must comply with the provisions of section 91(2)(a) which mandates that every shareholder of the company, whether individually or in conjunction with any other company within the same group, must possess 10% or more of the equity shares and voting rights of the potential HQC throughout the assessment year (Section 91(2)(a)). The requirement of holding 10% shareholding and voting rights must be satisfied on every day of the assessment year to avoid losing the benefits of HQC status, which is seen as being very strict and impose a huge compliance burden to potential HQCs (Van der Walt, 2020:3).

Requiring continuous adherence opens the door to the potential for a prospective HQC to inadvertently fail to comply, even without its awareness or fault (Mukumba, 2017:42). Instances

that could disrupt adherence in such a manner include: the liquidation of assets belonging to an insolvent shareholder, the transfer of shares as collateral for debt, and the dilution of ownership when an individual distributes ownership among multiple beneficiaries (Mukumba, 2017:42). Given the global scope of HQCs, it is possible that the company may lack comprehensive information regarding its foreign shareholdings throughout the entire Year of Assessment. The prospect of an HQC making investments, expecting to reap the advantages of section 9I, only to have those efforts thwarted by unforeseen events beyond its awareness or control, serves as a significant deterrent to pursuing access to the South African HQC regime (Mukumba, 2017:42).

Section 9I(2)(a) mandates each holder of the shares in the HQC to hold at least 10% of both equity shares and voting rights. The term equity share is defined as *“any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution”* (section 1 of the Act). Ordinary shares will be classified as equity shares since they grant the entitlement to partake in dividends and assets upon winding up without any limitations (Mukumba, 2017:42). Voting rights are not defined in the Act but are defined in the Companies Act 71 of 2008. Voting rights signify the entitlement of a holder of a company's securities to participate in voting on matters to be decided by the company (section 1 of the Companies Act 71 of 2008).

Mandating a combination of both equity shares and voting rights places a constraint on the inherent flexibility within the bundle of rights that constitute a share or security (Farouk, 2012:214). Prospective HQCs should exercise caution when employing financing structures involving preference shares or hybrid instruments that incorporate voting rights. This is because the separation of voting rights from equity shares might result in a breach of the minimum 10 percent requirement (Farouk, 2012:214). This rigidity is another aspect that diminishes the commercial appeal of the South African HQC regime, as it hampers the company's ability to organize its capital in a manner that strategically benefits the business (Mukumba, 2017:43).

5.2.5 Annual election

A potential headquarter company must make an election in the format and procedure specified by the commissioner to be a headquarter company for a specific assessment year provided it meets the requirements of section 9I(2) as stated above (section 9I(1)(b)). The election becomes effective starting from the beginning of the assessment year for which it is made (section 9I(3)).

The election is only effective for a single year of assessment, therefore prospective HQCs must make the election annually. A sole Year of Assessment represents a notably brief duration for a company to secure tax relief, highlighting a fundamental flaw within the South African HQC regime (Mukumba, 2017:58). Mukumba (2017) further stated that the yearly election and compliance obligations make the benefit of being a HQC too temporary and costly. At first glance, the annual election mandated by section 9I appears to be merely an administrative procedure. However, the underlying concern persists that a HQC would never be guaranteed access to the relief throughout the duration of its investment, or even for a substantial portion of it (Mukumba, 2017:58). Therefore, the absence of any reasonable assurances diminishes the commercial appeal of the South African HQC regime and reduces the competitiveness of the regime compared to regional competition (Mukumba, 2017:58).

5.2.6 Private equity funds cannot utilize an HQC as an investment vehicle

As the appetite for investing in African regions grows, it is imperative for the private equity environment in South Africa to evolve. This evolution is essential for attracting foreign investment directly and ensuring smooth processes for investing in and exiting from these areas (Webber Wentzel, 2017:1). The selection of the private equity fund's structure primarily hinges on two key factors: providing investors with limited liability and optimizing tax efficiency (Webber Wentzel, 2017). Although the legal standing of companies is firmly established and the limited liability of shareholders is evident, companies prove to be tax-inefficient due to their status as separate taxpayers (Webber Wentzel, 2017:1). Therefore, South African private equity funds typically adopt the structure of Partnerships and in terms of South African tax law, partnerships are not categorized as 'persons' under the Act, and they are not recognised as independent taxpayers (as seen in the ruling of the case *Sacks v CIR 1946 AD 31, 13 SATC 343*). Thus, any income passing through the partnership maintains its original nature and is taxed in the hands of the partner (Webber Wentzel, 2017:1).

Because a Partnership isn't a separate entity and not a separate taxpayer, the DTAs between the partner's home country and the jurisdiction of the investments might offer lower withholding taxes (Webber Wentzel, 2017:1). However, if there's no DTA (common in certain African and European jurisdictions), withholding taxes will be imposed at their standard rates on the partner, diminishing the attractiveness of the investment and potentially dissuading investors (Webber Wentzel, 2017:1). This is why to address this inefficiency, Partnerships employ a dual fund structure, creating a mirrored partnership outside of South Africa, known as the "Foreign Partnership," which

shares the same purpose, investment strategy, and framework as its South African counterpart (Webber Wentzel, 2017:1). These foreign partnerships are usually registered in Mauritius, Gernesey or Jersey and they are normally the only shareholder in an investment holding company, enabling access to DTA networks to address the inefficiencies mentioned earlier (Webber Wentzel, 2017:1).

Nonetheless, the dual fund structure mentioned earlier is costly and involves a significant amount of administrative work. To be classified as a HQC and reap the benefits such as exemption from withholding tax on dividends, interest and royalties, capital gains resulting from the sale of equity shares in foreign companies, South African transfer pricing rules on funding from the HQC to its foreign subsidiaries and exchange control regulations, the private equity fund must meet requirements of section 9I of the Act and SARB requirements on HQCs. However, one of the requirements of section 9I is that each shareholder in the prospective HQC should hold at least 10% of both the equity shares and voting rights. 10% is a significant shareholding and its difficult for a general partner to hold at least 10% of the shares and voting rights in a Partnership (Newham and Beilings, 2017:11).

Conversely, the 10% equity ownership and voting rights threshold were specifically crafted to correspond with the threshold set for the 'foreign participation exemption' (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011:29). This exemption applies to foreign dividends under section 10B of the Act and to capital gains arising from the disposal of equity shares in foreign companies under paragraph 64B of the Eighth Schedule to the Act (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011:29). Reducing the equity ownership and voting rights threshold for general partners of private equity funds could provide these partners with an advantage over other investors, a scenario seemingly not foreseen by National Treasury (Lourens, 2019:73). In essence, if an investor wouldn't have qualified for the 'foreign participation exemption' by directly investing in the foreign company, they shouldn't be able to do so when investing in a HQC (Lourens, 2019:73). Thus, this criticism is debatable and would need to be looked at in comparison with the provisions of a comparative HQC regime in Africa such as Mauritius GBL regime, which will be done in chapter 7 of this research.

5.2.7 Higher corporate tax rate compared to other African HQC regimes

South Africa's corporate tax rate is currently 27%, therefore the remaining taxable income for a HQC after all the exemptions granted will be taxed at 27% corporate tax rate. As outlined in the

introduction, for South Africa to be the preferred HQC location in Africa it also needs to be competitive against attractive regimes from other African countries such as Mauritius's GBL regime. Mauritius's corporate tax rate is generally 15%, therefore the remaining taxable income for a GBL company after all the exemptions granted will be taxed at only 15% corporate tax rate compared to South Africa's 27%, which is a huge difference. However, lowering the tax rate for HQCs requires careful consideration to prevent harmful tax competition and erosion of the tax base (OECD, 1998:3).

5.3 Conclusion

The aim of this chapter was to identify and examine the prevailing criticisms directed towards the provisions of the current South African HQC regime.

The Davis Tax Committee 2018 stated that the primary reasons for the low adoption of the regime seem to stem from challenges in meeting its practical and compliance requirements, alongside the presence of alternative regimes offered by other African countries that are more appealing and easier to use (Davis Tax Committee, 2018:88). The statement made by the Davis Tax Committee above has merit as some of the criticism considered above related to compliance requirements and competitiveness towards alternative regimes offered by Other African countries.

Criticism against compliance requirements relating to the 10% shareholding and voting rights requirement and the annual election were deemed valid. Regarding meeting the 10% shareholding and voting rights requirement each day of the year of assessment this chapter concluded that it is challenging to achieve, especially in instances where there has been liquidation of assets belonging to an insolvent shareholder, the transfer of shares as collateral for debt, and the dilution of ownership when an individual distributes ownership among multiple beneficiaries (Mukumba, 2017:42). Thus, it is recommended that national treasury look at amending this requirement to at least be applicable for each month in the year of assessment to allow for days where there is a movement of shares.

Another issue found is that Section 9(2) (a) mandates each holder of the shares in the HQC to hold at least 10% of both equity shares and voting rights. This chapter concluded that requiring a combination of both equity shares and voting rights also poses its own challenges as it requires prospective HQCs to exercise caution when employing financing structures involving preference shares or hybrid instruments that incorporate voting rights (Farouk, 2012:214). Hence, it is recommended for National Treasury to reconsider this requirement.

Another criticism against compliance requirements relates to the annual election where prospective HQC's are required to elect to become a HQC annually. This chapter concluded that the fact that the election is only effective for that one year of assessment represents a very short period for a company to secure tax relief, highlighting a fundamental flaw in the design of the regime (Mukumba, 2017:58). It is recommended that National Treasury provide guaranteed access to the HQC regime for a certain period, such as five years, even if compliance remains a prerequisite for ongoing benefits. Prospective HQCs would appreciate this certainty.

The last criticism relating to compliance requirements is the 'resident requirement'. As discussed above, the definition of 'resident' impacts HQC qualifying criteria. The prospective HQCs must ensure that the companies they invest in are not registered, established or formed in South Africa and their POEM is also outside South Africa. Thus, prospective HQCs will need to ensure that individuals carrying out effective management function for their foreign subsidiaries are based in the subsidiaries outside South Africa (Zwarts, 2013:98). The chapter concluded that although there is merit in Zwarts argument, this risk can be mitigated through careful corporate procedure planning.

There were other criticisms that did not relate to compliance requirements but relate to aspects that are lacking in the South African HQC regime. The first aspect is the lack of tax relief on managerial and service fee income in the hands of the HQCs as they are currently subject to taxation. The chapter concluded that lack of tax relief on management and service fees hampers the attractiveness of the South African HQC regime, therefore it is recommended that National Treasury re-visits this, considering the OECD recommendations on harmful tax practices and base erosion.

The other criticism is on the absence of relief from transfer pricing regulations on management and service fees. Prospective HQCs also have the burden to ensure that the managerial services they render to their foreign subsidiaries are at arm's length prices as the transfer pricing exemption in section 31(5) does not apply to management and service fees (Interpretation note 87, 2020:33). Therefore, it is recommended that National Treasury re-visits this, considering the OECD recommendations on harmful tax practices and base erosion.

The final critique regarding the deficiencies in the headquarter company (HQC) regime concerns the inability of private equity funds to utilize HQCs as an investment avenue. This is attributed to the challenge faced by a general partner in holding a minimum of 10% of the equity shares and

voting rights in a partnership. This chapter concluded that this criticism is debatable and would need to be looked at in comparison with the provisions of a comparative HQC regime in Africa such as Mauritius GBL regime, which will be done in chapter 7 of this research.

Lastly, there is criticism on the higher corporate tax rate of 27% compared to other appealing African HQC regimes such as Mauritius's GBL regime (15%). As a result, multinational corporations may prefer Mauritius as a headquarters location. This chapter concluded that it is not an easy process for National Treasury to lower the corporate tax rate for HQCs as there are a lot of considerations such as harmful tax competition amongst countries and erosion of the tax base (OECD, 1998:3).

The proposed amendments to the aspects of the legislation that hampers the attractiveness of the South African HQC regime will be discussed in chapter eight with a heading "Proposed revision to the current South African HQC regime to ensure it benefits the potential foreign investor".

6. Chapter 6: Key items that should be considered when designing headquarter company regimes that attracts foreign investment from multinational companies

6.1 Background

Headquarter companies are normally international headquarter companies where multinational corporations possess or aim to possess substantial economic interests in a region distant from their main office and these international headquarters are then responsible for overseeing and coordinating the group's business activities within that specific region (Legwaila, 2012:23). Once an investor has recognised the necessity for establishing a headquarter company within their investment structure, they embark on identifying a jurisdiction with the infrastructure best suited to achieve their objectives optimally (Legwaila, 2012:23). Infrastructure manifests through the characteristics, encompassing both fiscal and non-fiscal aspects, of the specific jurisdiction (Legwaila, 2012:23). The taxation system in a particular area typically significantly influences the effectiveness of a headquarter company and often influences the choice of jurisdiction for establishing the holding company (Legwaila, 2012:23). However non-fiscal aspects also play a role as they are crucial to the success of the investment being pursued (Legwaila, 2012:23). Therefore, an HQC regime should embody both fiscal and non-fiscal characteristics expected in an ideal HQC jurisdiction.

The objective of this chapter is to determine and examine the key factors that should be considered when formulating headquarter company regimes aimed at attracting investments from foreign multinational corporations. In other words, these key factors are the optimal characteristics expected in an ideal HQC jurisdiction. Therefore, when designing a HQC regime, countries should ensure that the optimal characteristics expected in an ideal HQC jurisdiction are present.

In this chapter both fiscal and non-fiscal characteristics of an ideal HQC jurisdiction will be discussed as both need to be considered when designing a HQC regime that will attract foreign investment from multinational corporations. The characteristics discussed below are from Legwaila (2012:24-41) and Katz Commission (1997:51). Below are the characteristics to be discussed:

Fiscal characteristics of an ideal HQC jurisdiction

- No tax on rendering of managerial services by the HQC to its foreign subsidiaries (Katz Commission, 1997:51)
- Low corporate income tax rate (Legwaila, 2012:29)
- A Favourable capital gains tax regime (Legwaila, 2012:26)
- No or low tax on dividends (Legwaila, 2012:30)
- A Favourable tax treaty network (Legwaila, 2012:32)
- Unilateral avoidance of double taxation (Legwaila, 2012:34)
- The absence of controlled foreign company (CFC) legislation (Legwaila, 2012:35)
- Transfer pricing rules (Legwaila, 2012:40)

Non- fiscal characteristics of an ideal HQC jurisdiction

- Economic and political stability (Legwaila, 2012:24)
- Ease of doing business (Legwaila, 2012:24)
- Adequately developed infrastructure (physical, business, accounting and legal) (Legwaila, 2012:24)
- Commercial language (legwaila, 2012:25)

6.2 Fiscal characteristics of an ideal HQC jurisdiction

6.2.1 No tax on rendering of managerial services by the HQC to its foreign subsidiaries

According to the Katz Commission (1997), a critical fiscal characteristic of an ideal regime for establishing international headquarters and service companies is the lack of taxation on services

provided by the head office to the multinational group. As discussed in chapter 3 and chapter 5 above, it is inherent to the nature of a HQC that some degree of management or coordination of the qualifying foreign companies in which it holds interest in will occur in South Africa, therefore its income will most likely also include management fees, supervisory or coordination fees for services rendered by the HQC to the qualified foreign company (Gutuza, 2014:197). However, currently HQCs are subjected to full taxation on the management and service fees received from their foreign subsidiaries (Mazansky, 2011:3). Although there is some relief in terms of section 6quat (1C) of the Act where a resident can claim foreign taxes paid or payable on income from South Africa source, the amount allowed is the lesser of the South African tax and foreign tax payable (Interpretation note 18, 2022:41). Therefore, the South African HQC regime lacks this characteristic.

6.2.2 Low corporate income tax rate

Income tax serves as the primary source of direct taxation for nearly every nation (Legwaila, 2012:29). Income tax is a standard levy that covers all sources of income except those that are explicitly earmarked, such as donations tax, estate duty, and capital gains tax (Legwaila, 2012:29). Reducing the tax burden on companies is frequently viewed as necessary to enhance a country's competitiveness, particularly because companies have the option to relocate their multinational operations to more Favourable jurisdictions (Clausing, 2018:42). Simultaneously, governments strive to deter the depletion of the tax revenue base (Clausing, 2018:42). Hence, governments must strike a balance between the necessity of lowering corporate tax rates to attract foreign multinational corporations and their responsibility to safeguard against the decrease in tax revenue.

However, there is also no assurance that reducing the corporate tax rate would necessarily entice foreign multinational corporations to establish their headquarters in a particular country (OECD, 1998:3). This is because the corporate tax rate and associated tax expenses are factors to be weighed when evaluating investment in a country, but they are not the sole determinants in the decision-making process (OECD, 1998:3).

Exemptions, deductions, and allowances can lower the effective income tax rate, as can tax incentives employed by a country to attract foreign investors (Legwaila, 2012:30). As outlined in Chapter 3 of this study, the South African HQC regime provides numerous tax exemptions to HQCs. These exemptions include but are not limited to dividends received from foreign

companies, capital gains on the sale of shares in foreign companies, Controlled Foreign Company (CFC) rules, specific transfer pricing provisions, and South African withholding taxes on dividends, interest, and royalties paid.

The South African corporate tax rate is currently 27%. This corporate tax rate is higher compared Mauritius's 15% and Botswana's 22%. Mauritius and Botswana have been chosen because they both provide comparable regimes to the South African HQC regime within the SADC region. Therefore, the competitiveness of the South African HQC regime is closely linked to the competitiveness of other regimes in the region.

However as discussed above, corporate tax rate is not the only factor considered by multinational corporations when considering an ideal headquarter location and reducing the corporate tax rate does not guarantee increase in foreign investment from multinational corporations. Thus, the South African HQC regime must compete with its regional counterparts by leveraging tax advantages provided by the regime, as well as non-fiscal factors that multinational corporations consider when selecting an ideal Headquarter company location.

6.2.3 A Favourable Capital Gains Tax regime

Companies that serve as headquarters often hold shares in various investments. Hence, it is crucial for a company's tax system not to impose severe tax treatment on the sale of these shares, as this could discourage investment by headquarters companies (Legwaila, 2012:26). The OECD has also explained that prospective investors assess whether they will face capital gains tax upon asset disposal and whether any capital losses will be permitted to offset capital gains (OECD, 1998:35).

In South Africa, a HQC may disregard a capital gain or capital loss from selling equity shares in a foreign company if the HQC, either independently or with a company within the same group, owned 10% or more of the equity shares and voting rights in the foreign company just before the disposal. (Section 64B (2)). However, if 80% or more of the market value of the equity shares in the foreign company is derived directly or indirectly from immovable property in South Africa held for purposes other than trading stock, and if the headquarter company, either independently or with any related person, holds at least a 20% stake in those shares, then paragraph 64B (2) does not apply and the HQC will not be allowed to disregard the capital gain or loss on the disposal of those equity shares (paragraph 2(2) of the eighth schedule). A HQC is also allowed to disregard a capital gain on a foreign return of capital received or accrued from a foreign company if the

HQC independently or in conjunction with a company within the same group, holds 10% or more of the equity shares and voting rights in the foreign company (paragraph 64B (4)).

Therefore, the South African HQC regime has this crucial characteristic. Thus, the capital gains tax provisions in South Africa do not negatively impact South Africa's suitability as a location for hosting headquarter companies.

6.2.4 No or low tax on dividends

Investors regard a company as successful if it can distribute dividends to shareholders while also increasing the company's overall value (Legwaila, 2012:30). Therefore, it is anticipated that a headquarters company would distribute dividends to shareholders from its operating companies. Ideally, the company aims for the value of its retained earnings to be reflected in the dividends received by its shareholders without, or with minimal, tax liability (Legwaila, 2012:30). When dividends tax is imposed upon distribution of profits to the shareholders of the headquarters company, it introduces an extra expense when profits are distributed to the shareholders (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010:77).

In South Africa, dividends declared and paid by a headquarter company are exempt from dividends tax per section 10B of the Act. Likewise, dividends acquired by the HQC from its foreign subsidiaries (referred to as foreign dividends) are tax-exempt in the hands of the HQC according to section 10B(2) of the Act, provided specific conditions outlined in section 10B(2) are met. Therefore, the South African HQC regime has this crucial characteristic of an ideal HQC regime.

6.2.5 A Favourable tax treaty network

A broad treaty network is a beneficial feature for a country to possess when drawing foreign as well as domestic investment (OECD, 1998:33). A concern for companies operating across different jurisdictions is the potential for double taxation. As a result, DTAs alleviate the expense of investment by mitigating or eliminating this double taxation (OECD, 1998:33). Double tax treaties also possess the capacity to establish mechanisms for resolving tax disputes between jurisdictions (OECD, 1998:33). However, the importance doesn't just stem from the number of treaties but also, more crucially, from the content or substance of the treaty (Legwaila, 2012:33).

While the primary aim of double tax agreements is to prevent double taxation, it is also important to note that they are not intended to enable tax avoidance or evasion (Weeghel, 1998:1). Double tax agreements prevent double taxation through mechanisms such as the exemption or credits

methods, as well as by assigning exclusive taxing rights to one country in certain cases (Legwaila, 2012:33). The specific methods employed vary depending on the negotiations between the countries involved (Legwaila, 2012:33).

As of March 15, 2024, South Africa has approximately 102 tax treaties in force, 26 of which are with other African countries (SARS, 2024). Therefore, South Africa possesses an extensive tax treaty network that encompasses several developing African countries, presenting opportunities for investment by foreign multinational corporations.

6.2.6 Unilateral avoidance of double taxation

Unilateral avoidance of double taxation is when countries autonomously offer tax relief for income that has been taxed in a source country or provide credit for taxes paid in those countries on the same income (Legwaila, 2012:34). This system is attractive to investors considering the suitability of a HQC jurisdiction (Legwaila, 2012:34). A tax credit that wholly or partially offsets the foreign taxes paid becomes significant when a country, aiming to attract foreign investment, operates under a residence-based tax system (OECD, 1998:32). South Africa is on the residence-based tax system. When a country possesses sufficient unilateral double tax avoidance measures, the objective of a double tax agreement would be to complement and enhance these existing provisions (Legwaila, 2012:34). One drawback of unilateral avoidance of double taxation measures is that countries can change or cancel them unilaterally, thus they lack certain assurance to prospective investors (Legwaila, 2012:34). DTAs offer assurance as they can only be altered through negotiations between the treaty partners, ensuring stability and predictability (Legwaila, 2012:34).

South Africa offers unilateral double tax avoidance through mechanisms such as rebate or deduction for foreign taxes on income (Section 6quat(1), section 64N and section 6quat(1C)). Section 6quat(1) rebate is utilised to grant relief for foreign taxes that have been demonstrated to be payable on income earned from a foreign source that is included in the resident's taxable income (Interpretation note 87, 2020:49). Section 64N rebate offers provisions for relief from foreign taxes paid on foreign cash dividends distributed by a foreign company on its publicly listed shares (Interpretation note 87, 2020:49). According to section 6quat(1C), a resident has the option to claim a deduction for foreign taxes that have been demonstrated to be payable on income earned from a South African source (Interpretation note 87, 2020:49). HQC's are considered tax

residents of South Africa, therefore they are eligible for the rebate under Section 6quat(1) and the deduction under section 6quat(1C).

These provisions represent a Favourable aspect of the South African HQC regime.

6.2.7 The absence of controlled foreign company (CFC) legislation

South Africa operates under a residence-based tax system, where residents are generally taxed on their worldwide income, with some exemptions, regardless of the source of income earned (Section 1 of the Act). Conversely, non-residents are taxed solely on income sourced from South Africa (Section 1 of the Act). Countries employing a residence-based taxation system supplement their tax revenue collection by imposing taxes on residents for income generated by foreign corporations in which residents possess significant ownership stakes (i.e foreign corporations that meet the requirements of CFC) (Legwaila, 2012:35). Under CFC legislation the income of a CFC is taxed in the hands of the resident shareholder (Legwaila, 2012:35). Implementation of the CFC rules entails that foreign shareholders of a South African HQC may face double administrative tax obligations if their home country also applies CFC rules (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010:77). Therefore, the absence of CFC legislation in a country can be appealing when deciding on the optimal location for an HQC.

South Africa has CFC anti-avoidance legislation which is regulated by section 9D of the Act. Put simply, section 9D mandates that a proportionate share of the 'net income' of a CFC must be incorporated into the taxable income of the resident. As described in chapter 3 above, a CFC is described as a foreign company in which over 50% of the participation rights or voting rights are owned by a South African tax resident, excluding entities classified as headquarter companies (Section 9D of the Act). Thus, HQCs are exempt from CFC rules in South Africa, which enhances the appeal of the South African HQC regime.

6.2.8 Transfer pricing rules

Transfer pricing is a field within economics and tax law focused on ensuring that the prices exchanged between related parties or affiliated enterprises for the transfer of assets, goods, and services is at arm's length (Legwaila, 2012:41). The intent behind a multinational group setting the price at a transfer rate rather than a market rate typically involves shifting tax losses to a high-tax jurisdiction and directing profits to a low-tax jurisdiction or a jurisdiction offering specific tax advantages (Legwaila, 2012:41). Transfer pricing regulations typically stipulate that in cases where goods or services are traded internationally between connected persons at a price not

reflecting an arm's length transaction, adjustments are made to ensure the pricing aligns with arm's length (OECD, 2014:181).

In South Africa transfer pricing regulations are governed by section 31 of the Act. Section 31 applies to HQCs except where the transaction that has been entered into relates to the provision of financial aid or the granting of intellectual property usage rights (Section 31 (5)). Therefore, not all transactions involving HQCs are exempt from transfer pricing regulations outlined in section 31, particularly noteworthy is the fact that managerial services rendered between a headquarter company and non-resident connected persons are not exempt per section 31(5). Thus, if a HQC earns income from rendering managerial and technical support services to its foreign subsidiaries and the transaction is not at arm's length, then the HQC must compute its taxable income according to the arm's length terms and conditions of the affected transaction if there exists a disparity resulting in a tax advantage for either party (Interpretation note 87, 2020:33).

This partial exemption from transfer pricing regulations adds to the diminished appeal of the South African HQC regime.

6.3 Non-fiscal characteristics of an ideal HQC jurisdiction

6.3.1 Economic and political stability

In evaluating the investment cost in a country, companies must also factor in the potential risks associated with investing in that country. These risks encompass the stability of the political system, the accessibility to a fair legal system, anticipated inflation rates, exchange rate fluctuations, and prevailing interest rates (OECD, 1998:35).

Currently South Africa's political environment is somewhat unsettled, as elections are scheduled for 2024, introducing uncertainty regarding which political party will govern the country for the next five years. In terms of economic growth, the economy only grew by 0.4 percent from January to March 2023 (International Monetary Fund, 2023:1). Factors such as frequent power outages, volatile commodity prices, and a challenging global environment have all played a role in the country's sluggish growth performance (International Monetary Fund, 2023:1). Nevertheless, South Africa continues to maintain its position as the most advanced and developed economy in Africa, boasting top-tier companies in finance, real estate, business services, manufacturing, and wholesale and retail trade sectors (Overseas business risk: South Africa, 2021:3). South Africa was ranked number 61 out of 64 countries in the Global Competitiveness Report 2023 (world competitiveness ranking, 2023:1). Botswana was the only other African country on the list and

was ranked number 59. The Global Competitive Report ranks the countries according to economic performance, government efficiency, business efficiency and infrastructure (world competitiveness ranking, 2023:1).

6.3.2 Ease of doing business

The ease of conducting business in a country is a key factor that multinational corporations take into account when evaluating an ideal location for their headquarters (Legwaila, 2012:24). Ease of doing business in a country simply means the regulatory environment is Favourable for business operations (world competitiveness ranking, 2023:1). The world Bank published a “Doing Business Report” in 2020 comparing business regulations of 190 economies in the world. South Africa was ranked number 84 in this report with a score of 67 points. The report considers factors such as starting a business, registering property, getting credit, trading across borders, resolving insolvency, enforcing contracts etc. Mauritius was ranked number 13 in the same report with a score of 81.5 points. Comparing the gap in rankings between South Africa and Mauritius, it is evident that Mauritius boasts a significantly more Favourable regulatory environment for business operations compared to South Africa.

6.3.3 Adequately developed infrastructure (Physical, business, accounting and legal)

A country that has developed physical infrastructure essential for operations such as telecommunications, energy, water, and transportation alongside well-developed soft infrastructure such as education system, government efficiency, effective legal and financial systems, and healthcare, is appealing to foreign investors (Clausing, 2018:40).

As stated in the Katz Commission (1997) South Africa could be an attractive location for HQCs due to its geographic proximity and its regional superiority as regards infrastructure (Katz Commission,1997:51). However, currently there is an electricity and water crisis and high levels of crime in South Africa, which negatively impacts business operations. Thus, the government must address these issues to regain investor confidence.

6.3.4 Commercial language

The commercial language of the host country is also crucial as it enables effective communication (Legwaila, 2012:25). Countries with a commercial language that aligns with the language of the investor are generally perceived as more appealing for investment (Bellofatto, 2017:1). It is crucial

that the language used is either the same as that of the investor or at least a common language such as English or French (Legwaila, 2012:25).

South Africa's primary business language is English, which is widely spoken globally. Hence, this aspect enhances the appeal of the South African HQC regime.

6.4 Conclusion

This chapter dealt with the fiscal and non-fiscal characteristics of an ideal HQC jurisdiction, linking each of them to the current situation in South Africa. For the South African HQC regime to be appealing it must embody the characteristics of an ideal HQC jurisdiction. Eight fiscal characteristics were identified, and the chapter concluded that South Africa possess most of the characteristics except the lack of tax on rendering of managerial services and the partial exemption from transfer pricing regulations. Therefore, it is recommended that National Treasury reevaluates these two aspects.

Four non-fiscal characteristics of an ideal HQC jurisdiction were identified, and the chapter concluded that while South Africa possesses all of them, substantial enhancements in economic and political stability, ease of doing business, and infrastructure for water and electricity are necessary for South Africa to effectively compete against another African country such as Mauritius.

Chapter seven will examine the comparison between South Africa's HQC regime and Mauritius' GBL regime, illustrating how Mauritius measures up against the fiscal and non-fiscal attributes of an ideal HQC jurisdiction discussed in this chapter.

7. Chapter 7- Brief comparison between The South African HQC regime and Mauritius's Global Business License

7.1 Background

In Mauritius, a Global Business Corporation (GBC) is a specialized business structure tailored for facilitating international trade and investment (BBCIncorp, 2024:1). GBC's benefit from a range of tax advantages, rendering them appealing to businesses aiming to invest across Africa, Asia, and numerous other regions (BBCIncorp, 2024:1). GBCs are permitted to engage in a wide range of operations, encompassing activities such as trading, investment holding, intellectual property

holding, fund management, and similar activities (BBCIncorp, 2024:2). Foreign investors commonly establish such entities for financial services and investment holding purposes, particularly when their foreign earnings stem from dividends, interest, and capital gains (BBCIncorp, 2024:2). GBC's are incorporated, established or formed in Mauritius and are tax residents in Mauritius (BBCIncorp, 2024:2). The primary revenue-generating operations of a GBC should occur outside of Mauritius (BBCIncorp, 2024:4). GBC's are obliged to obtain a Global Business License (GBL) from Mauritius's Financial Services Commission to be regarded as a GBC (BBCIncorp, 2024:9). Therefore, for the rest of this chapter we will refer to GBC entities as GBL entities.

In the African continent Mauritius has established itself as a Favourable headquarter company jurisdiction, especially for investments into Africa through its GBL regime (Honiball and Killoran:36). Therefore, the objective of this chapter is to make a brief comparison between the South African HQC regime and Mauritius's GBL regime to determine how the South African HQC regime compares with Mauritius's regime.

7.2 Comparison of South Africa's HQC regime and Mauritius GBL regime

7.2.1 High level comparison of the tax characteristics of the South African HQC regime and Mauritius's GBL regime

Item	South Africa's HQC regime	Mauritius GBL regime
<ul style="list-style-type: none"> ➤ Tax residency 	<p>The HQ company must be tax resident in South Africa by either being incorporated, established or formed in South Africa or has its POEM in South Africa. The HQC should not be deemed to be exclusively resident in another country in terms of a DTA (Section 1 of the Act)</p>	<p>The GBL entity must be tax resident in Mauritius incorporated under companies Act 2001 of Mauritius (BBCIncorp, 2024:2). The emphasis is on having a substance in Mauritius. A GBL entity must:</p> <ul style="list-style-type: none"> ➤ have a registered office in Mauritius, which is the entity's official address.

		<ul style="list-style-type: none"> ➤ be managed and controlled from Mauritius. ➤ Conduct its primary income-generating operations within Mauritius or from Mauritius. ➤ Have two resident (local) directors in its board. ➤ Maintain all its records and conduct all board meetings in Mauritius and ➤ Ensure that minimum level of annual expenditure is proportionate to its level of activities (BBCIncorp, 2024:7).
<ul style="list-style-type: none"> ➤ Corporate income tax rate 	<p>Corporate tax rate of 27%.</p>	<p>Corporate tax rate of 15%. GBL entities receive a partial exemption of 80% to certain categories of income. This entails that the standard tax rate of 15% is decreased by 80%, resulting in the GBL entity being subject to an effective tax rate of only 3%.</p> <p>Categories of income qualifying for 80% partial exemption are as follows:</p>

		<ul style="list-style-type: none"> ➤ Foreign source dividends. ➤ Foreign source interest. ➤ Profit derived from a permanent establishment of a resident company in a foreign country. ➤ Income from foreign sources derived by a Collective Investment Scheme (CIS), Closed End Funds, CIS manager, CIS administrator, investment adviser, or asset manager licensed or sanctioned by the Financial Services Commission (FSC). ➤ Revenue generated from the leasing and provision of global fibre capacity. ➤ Earnings derived by companies involved in the leasing of ships and aircraft. ➤ Revenue generated from activities related to reinsurance and reinsurance brokerage (HLB Mauritius, 2024:2)
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<ul style="list-style-type: none"> ➤ Capital gains tax 	<p>Effective capital gains tax rate is 21.6%. HQCs are granted relief on capital gain or capital loss on the disposal of equity shares in a foreign company per paragraph 64B (2) of the Eighth schedule to the Act, subject to certain requirements.</p>	<p>There is no tax on capital gains in Mauritius (BBCIncorp, 2024:4).</p>
<ul style="list-style-type: none"> ➤ Dividends tax 	<p>HQCs are exempt from dividends tax per section 64E (1) of the Act.</p>	<p>There is no withholding tax on dividends in Mauritius (BBCIncorp, 2024:4).</p>
<ul style="list-style-type: none"> ➤ Tax treaty network 	<p>Approximately 102 tax treaties in force as of March 15, 2024 (SARS website, 2024).</p>	<p>Mauritius has 46 tax treaties concluded as at March 2024 (Mauritius Revenue Authority website, 2024:1)</p>
<ul style="list-style-type: none"> ➤ CFC legislation 	<p>HQCs are exempt from CFC regulations per section 9D (2) of the Act.</p>	<p>A CFC in Mauritius means:</p> <ul style="list-style-type: none"> ➤ A non-resident company in which 50% of its total participation rights are held directly or indirectly by a resident company and ➤ includes a permanent establishment of the resident company (Section 90A of Mauritius Income tax Act 1995). <p>GBL entities are eligible for 80% partial exemption on Profit derived from a permanent establishment of a resident</p>

		company in a foreign country. Therefore, GBL entities are subject to effective tax of 3% on profits from CFC since a permanent establishment of a resident company is a CFC.
➤ Transfer pricing legislation	HQCs are exempt from transfer pricing rules only when the transaction that has been entered into relates to the granting of financial assistance or the granting of the use, right of use or permission to use any intellectual property (Section 31 (5)). All other transactions will be subject to transfer pricing rules per section 31 of the Act.	At present, Mauritius does not have established transfer pricing legislation. Nevertheless, the Mauritius Income Tax Act mandates that companies generating income in or from Mauritius conduct their transactions at arm's length (Section 75 of Mauritius income tax act 1995). The tax authorities reserve the right to modify a company's assessable income if they find that the transaction does not meet the arm's length standard (Section 75 of Mauritius income tax act 1995).
➤ Unilateral avoidance of double taxation	South Africa provides unilateral double tax avoidance in the form of rebate or deduction for foreign taxes on income (Section 6quat (1) and section 6quat (1C)). HQC's are eligible for the rebate under Section	GBL entities are eligible for a credit on any double taxation suffered per section 77 of Mauritius income tax act 1995.

	6quat (1) and the deduction under section 6quat (1C).	
➤ Tax on rendering of managerial services	HQCs are subjected to full taxation on the management and service fees received from their foreign subsidiaries (Mazansky, 2011:3). HQCs are eligible to claim a deduction for foreign taxes paid on income from South African source per section 6quat(1C) of the Act.	The Mauritius Income Tax act is silent on this and management and service fees income is not stated as a category that qualifies for the 80% partial exemption per BBCIncorp document, 2024. Therefore, GBL entities are subject to the full 15% taxation on management and service fees. GBL entities can claim credit on foreign taxes paid per section 77 of Mauritius income tax act 1995.
➤ Private equity funds	Private equity funds not able to use HQCs as an investment vehicle (Webber Wentzel, 2017:1).	Mauritius has positioned itself as a center for investment funds, and GBL's can serve as vehicles for the holding and management of investments on behalf of investors (BBCIncorp, 2024:10).
➤ Annual election	A prospective HQC must make an annual election to be recognized as a HQC for a specific assessment year (section 91(1) of the Act). The election is only effective for a single year of assessment.	No annual election, however, entities holding a Global Business License (GBL) must pay an annual license fee (Section 74(1) of the Mauritius Financial Services Act of 2007).

7.2.2 Conclusion: Tax characteristics of the South African HQC regime and Mauritius's GBL regime

In terms of tax residency, the requirements for both South Africa and Mauritius are similar as they both have to be registered in the host country. The requirements by Mauritius on GBL entities 'having substance in Mauritius' also address the POEM of those entities in Mauritius as it requires GBL entities to have a certain number of directors and board meetings in Mauritius, managed and controlled from Mauritius, having a registered office in Mauritius etc. Thus, the 'substance' requirements in Mauritius should not be viewed as an additional administrative burden, as many of these requirements can also be utilized to ascertain the POEM of an entity.

Regarding the corporate income tax rate, Mauritius has a more Favourable rate of 15% compared to South Africa's 27%. Over and above the Favourable tax rate GBL entities are entitled to 80% partial exemption on certain categories of income, making the effective tax payable on those income streams only 3%. Therefore, it is advisable for South Africa to consider reducing the tax rate for HQCs. However, lowering the tax rate for HQCs requires careful consideration to prevent harmful tax competition and erosion of the tax base (OECD, 1998:3). As discussed in previous chapters, reducing the corporate tax rate does not guarantee influx of foreign investment from multinational corporations.

Regarding capital gains tax, Mauritius is the most Favourable jurisdiction as there is no tax on capital gains. In South Africa, HQCs may still be subject to capital gains tax when disposing of specific assets. Therefore, it is recommended that National Treasury considers scrapping capital gains tax for HQCs.

In terms of Dividends tax both Mauritius and South Africa do not have dividends tax on GBL and HCCs.

In terms of tax treaty networks, South Africa is more advantageous as it possesses a significantly broader tax treaty network compared to Mauritius. Therefore, South African HQCs will benefit from a broader tax treaty network.

Regarding CFC legislation, South Africa is a more Favourable jurisdiction as HQCs are exempt from CFC regulations. In Mauritius GBL entities are still liable for effective tax rate of 3% on profits from CFC.

Regarding transfer pricing legislation HQCs need to comply with transfer pricing regulations on certain transactions that are not exempt per section 31(5) of the Act. Similarly, although Mauritius does not have formal transfer pricing regulations, the tax authorities have the right to adjust the company's income if they find that the transaction does not meet the arm's length standard (Section 75 of Mauritius's income tax act 1995).

In terms of Unilateral avoidance of double taxation, HQCs and GBL entities can claim deduction for foreign taxes paid or payable.

In terms of tax on rendering of managerial services both Mauritius and South Africa do not grant a tax exemption on management and service fees received from their foreign subsidiaries. Nevertheless, Mauritius is deemed more Favourable due to its lower tax rate of only 15%, in contrast to South Africa's rate of 27%.

Regarding private equity funds, Mauritius is more Favourable as GBL entities can serve as vehicles for the holding and management of investments on behalf of investors (BBCIncorp, 2024:10). Hence, it is advisable for the National Treasury to contemplate amending the HQC legislation to accommodate private equity funds. However as stated in chapter five, reducing the equity ownership and voting rights threshold for general partners of private equity funds could provide those partners with an advantage over other investors (Lourens, 2019:73).

When it comes to the annual election, Mauritius presents a more advantageous situation since the license is perpetual; the sole obligation for GBL holders is to annually settle licensing fees to prevent the loss of GBL status. In South Africa, the requirement for an annual election to attain HQC status diminishes the attractiveness of the South African HQC regime. This is because HQCs are assured tax relief solely for the duration of one assessment year, given that the election remains effective for only a single assessment year. Consequently, HQCs cannot guarantee continuous access to the relief for the entirety of their investment period (Mukumba, 2017).

7.2.3 High level comparison of the non-fiscal characteristics of the South African HQC regime and Mauritius's GBL regime

Item	South Africa's HQC regime	Mauritius GBL regime
➤ Economic and political stability	➤ Political stability- South Africa is a democracy that	➤ Apart from possessing a multi-party system and a history of

	<p>follows the multi-party system. Currently the political landscape is unsettled due to elections scheduled for 2024 (investors uncertain which party is going to lead for the next five years)</p> <ul style="list-style-type: none"> ➤ Economic stability-grew by 0.4 percent only from January to March 2023 but remains the most advanced and developed economy in Africa. South Africa ranked number 61 out of 64 countries in the Global Competitiveness report. 	<p>political stability, the nation maintains steady economic policies and upholds human rights (BBCIncorp, 2024:5).</p> <ul style="list-style-type: none"> ➤ Economic stability-economic growth of 4.6% in 2023 (Coface for trade, 2023:1). Mauritius did not make the cut of the 64 countries ranked in the Global competitive report.
<ul style="list-style-type: none"> ➤ Ease of doing business 	<p>South Africa ranked number 84 in the world Bank 'Doing Business Report' in 2020. The report was comparing business regulations of 190 economies in the world.</p>	<p>Mauritius ranked number 13 in the world Bank 'Doing Business Report' in 2020. The report was comparing business regulations of 190 economies in the world.</p>
<ul style="list-style-type: none"> ➤ Adequately developed infrastructure (physical, business, accounting and legal) 	<p>South Africa has well developed financial and legal infrastructure (SARB website, 2024). The physical infrastructure for water and</p>	<p>Mauritius has concentrated on the ongoing enhancement of the country as a regional and global financial hub, providing investors with a</p>

	electricity has deteriorated in recent years and the government is currently addressing these issues.	business-friendly atmosphere, exceptional infrastructure, and advanced connectivity (BBCIncorp, 2024:5).
➤ Commercial language	In South Africa English is the commercial language (South African Embassy, 2024:1)	In Mauritius English is the official language (ENS Africa: Doing business in Mauritius, 2023:1)

7.2.4 Conclusion: non-tax characteristics comparison

Regarding political and economic stability, South Africa and Mauritius both adopt the multi-party system. However, Mauritius has experienced significant economic growth in recent decades compared to South Africa, largely attributable to its business-friendly policies and stable political climate (BusinessTech,2023:2). Hence, it is recommended that the South African government address the prevailing electricity and water crisis which is hampering economic growth and undermining investor confidence.

In terms of the ease of doing business Mauritius is significantly ahead of South Africa as evidenced by the rankings received from the “Doing Business Report” published by the world Bank in 2020 where Mauritius was ranked 13th and South Africa ranked 67th out of 190 economies in the world. Ease of doing business in a country simply means the regulatory environment is Favourable for business operations (world competitiveness ranking, 2023:1). Mauritius simply has business friendly policies. Therefore, it is recommended that South Africa reassess its regulatory environment to ensure its friendliness toward business.

Regarding physical and business infrastructure, both Mauritius and South Africa have well developed infrastructure. South Africa simply needs to address the current deterioration of electricity and water physical infrastructure.

Both South Africa and Mauritius utilize English as their commercial language, which is widely spoken worldwide.

8. Chapter 8- Proposed revision to the current South African HQC regime to ensure it benefits the potential foreign investor

8.1 Background

In 2018, the Davis Tax Committee recognized that despite the regulatory and fiscal incentives provided by the South African headquarter company regime, only a limited number of multinational companies have utilized it (Davis Tax Committee, 2018:88). Thus, the HQC regime has not achieved the level of success anticipated by the National Treasury.

The goal of this chapter is to detail the proposed modifications to the current HQC regime, aiming to maximize its advantages for potential foreign multinational corporations interested in selecting South Africa as their headquarters location. As mentioned in the introduction, in order for the South African HQC regime to appeal to foreign multinational groups, it must possess the characteristics of an ideal HQC jurisdiction. The characteristics of an ideal HQC jurisdiction were discussed in chapter six. The proposed revisions in this chapter will focus on those characteristics that were identified as lacking or requiring improvement within the South African HQC regime. Some of the proposed revisions will also be influenced by the existing criticism of the South African HQC regime as discussed in chapter five.

8.2 Proposed revision to the South African HQC regime

8.2.1 Proposed revision 1: No tax on rendering of managerial services

Lack of tax on services provided by the head office to the multinational group was one of the characteristics of an ideal HQC regime stated in the Katz commission (1997) report. However, currently in South Africa HQCs are fully taxed on the management and service fees derived from rendering managerial services to their foreign subsidiaries. As discussed in chapter 3 and chapter 5 above, it is inherent to the nature of a HQC that some degree of management or coordination of the qualifying foreign companies in which it holds interest in will occur in South Africa, therefore its income will most likely also include management fees, supervisory or coordination fees for services rendered by the HQC to the qualified foreign company (Gutuza, 2014:197).

Therefore, it is recommended that the National Treasury considers amending the current HQC provisions to cater for a full exemption of management and service fees received by HQCs for services rendered to their foreign subsidiaries. As outlined in Chapter Seven, Mauritius's GBL

regime also lacks an exemption on management and service fees received by GBL entities from their foreign subsidiaries. Therefore, if the South African HQC regime includes this exemption, it will help enhance its competitiveness against the Mauritius GBL regime. However, the National Treasury should contemplate this amendment while also taking measures to prevent harmful tax competition and the erosion of the tax base as per OECD recommendations.

8.2.2 Proposed revision 2: Favourable Capital gains tax regime

As discussed in chapter seven above, the OECD (1998) stated that prospective investors assess whether they will face capital gains tax upon asset disposal and whether any capital losses will be permitted to offset capital gains. It was concluded in chapter seven that the South African HQC regime has a Favourable Capital gains tax regime as paragraph 64B (2) of the eighth schedule allows HQCs to disregard a capital gain or loss on the disposal of equity shares and paragraph 64B (4) of the eighth schedule allows HQCs to disregard a capital gain on a foreign return capital received from a foreign company. Any other capital gain or loss except the one's mentioned above will be taxable in the hands of the HQC.

However, Chapter Seven pointed out that Mauritius does not impose any tax on capital gains at all. Therefore, for the South African HQC regime to remain competitive against other regimes on the continent, such as Mauritius's GBL regime, the National Treasury must contemplate eliminating capital gains tax on disposals made by HQCs.

8.2.3 Proposed revision 3: Lack of exemption from transfer pricing rules for rendering of managerial services between a HQC and its foreign subsidiaries.

It was concluded in chapter six that the partial exemption from transfer pricing regulations adds to the diminished appeal of the South African HQC regime. As discussed in item 8.1.1 above, it is inherent to the nature of a HQC that some degree of management or coordination of the qualifying foreign companies in which it holds interest in will occur in South Africa. In 2011, Deloitte provided feedback to SARS, characterizing the absence of transfer pricing relief on 'non-funding transactions' as a 'deficiency,' hoping that adjustments would be made to the HQC regime to enhance its tax efficiency and broaden its scope of applicability (Deloitte, 2011:7). Therefore, it is recommended that National Treasury considers amending section 31(5) to include an exemption for management and service fees derived by a HQC from rendering managerial services to its foreign subsidiary. This will enhance the appeal of the South African HQC regime.

8.2.4 Proposed revision 4: Annual election

A prospective headquarter company must make a formal election, as specified by the commissioner, to be recognized as a headquarter company for a specific assessment year, contingent upon meeting the criteria outlined in section 9I(2). The election is only effective for a single year of assessment, therefore prospective HQCs must make the election annually. Mukumba (2017) stated that one year of assessment is a short duration for a company to secure tax relief, therefore the annual election makes the benefit too temporary and costly. Mukumba (2017) further stated that the concern is that HQCs would never be guaranteed access to the relief throughout the duration of its investment, or even for a substantial portion of it.

Therefore, It is recommended that National Treasury considers providing guaranteed access to the prospective HQCs for a certain period, such as five years, even if compliance remains a prerequisite for ongoing benefits. Prospective HQCs would appreciate this certainty. In Mauritius there is no annual election, however a corporation holding a Global Business License (GBL) must pay an annual license fee (Section 74(1) of the Mauritius Financial Services Act of 2007). Failure to pay the annual license fee will result in the lapse of the GBL, leading to the corporation forfeiting the tax benefits associated with GBL status (Section 74(2) of the Mauritius Financial Services Act of 2007). Hence, in Mauritius the responsibility to avail the advantages of the GBL regime lies with the entity itself, contingent upon its adherence to licensing regulations.

8.2.5 Proposed revision 5: The 10% shareholding and voting rights requirement

The criticism on the 10% shareholding and voting rights requirement is due to the following:

- **The 10% shareholding and voting rights requirement must be met on each day of the year of assessment to avoid losing the benefits of HQC status-** this requirement is viewed as being extremely strict and impose a huge compliance burden to potential HQCs. The concern is that there are instances that could disrupt adherence such as the liquidation of assets belonging to an insolvent shareholder, the transfer of shares as collateral for debt, and the dilution of ownership when an individual distributes ownership among multiple beneficiaries (Mukumba, 2017:42). Thus, it is recommended that national treasury consider amending this requirement to at least be applicable for each month in the year of assessment to allow for days where there is a movement of shares.

- **Each holder of the shares in the HQC must hold at least 10% of both equity shares and voting rights-** the concern with this is prospective HQCs should exercise caution when employing financing structures involving preference shares or hybrid instruments that incorporate voting rights. This is because the separation of voting rights from equity shares might result in a breach of the minimum 10 percent requirement (Farouk, 2012:214). This rigidity hampers the company's ability to organize its capital in a manner that strategically benefits the business (Mukumba, 2017:43). Therefore, it is recommended that the National Treasury consider making the requirement just 10% of the equity shares.

8.2.6 Proposed revision 6: Economic and political stability

As discussed in chapter 6 above, in evaluating the investment cost in a country, companies must also factor in the potential risks associated with investing in that country. These risks encompass the stability of the political system, the accessibility to a fair legal system, anticipated inflation rates, exchange rate fluctuations, and prevailing interest rates (OECD,1998:35).

Politically South Africa is a young democracy that has adopted a multi-party system. The political landscape has experienced turmoil in recent times, marked by protests from opposition parties urging action against ANC members implicated in corruption, increasing incidents of political violence in KZN, and unrest following the arrest of former president Jacob Zuma in 2021 (SAHRC, 2024:1). The upcoming elections in 2024 could potentially unsettle foreign investors due to uncertainty regarding which party will govern the country for the next five years. Hence, it is advisable for the South African government to take responsibility for ensuring a smooth electoral process, reassuring prospective investors of the stability of the political environment.

8.2.7 Ease of doing business

As discussed in chapter six, South Africa was ranked number 84 in the 'Doing Business Report' published by the world bank and Mauritius was ranked number 13 in the same report. It is evident by the gap in rankings that Mauritius has a more Favourable regulatory environment for business operations than South Africa. Mauritius' business-friendly policies, political stability, and low tax rates make it an appealing destination for businesses to establish their operations (BusinessTech,2023:2). In contrast, South Africa has fostered a hostile business environment characterized by high taxes, stringent requirements such as BEE and affirmative action, and deteriorating infrastructure (BusinessTech,2023:2). Numerous prominent South African

companies choose to establish their headquarters in Mauritius due to its more conducive business environment (BusinessTech, 2023:2). Therefore, it is recommended that the National Treasury and the government undertakes measures to assess and enhance the regulatory environment, ensuring its suitability for conducting business operations.

8.2.8 Adequate developed infrastructure

As discussed in chapter six, South Africa has well developed financial and legal infrastructure (SARB website, 2024). However, physical infrastructure for roads, water and electricity has deteriorated in recent years. The ongoing risk of power outages and infrastructure breakdowns presents notable hurdles for businesses, causing disruptions to supply chains and affecting the broader economy (engineering news, 2024:3). Therefore, it is recommended that the South African government undertake measures to address the issue of deteriorating infrastructure in order to regain investor confidence.

8.3 Conclusion

The Davis Tax Committee (2018) recommended that National Treasury re-evaluates the HQC regime considering its lack of attractiveness. Thus, the proposed revisions outlined in this chapter will contribute to the knowledge base that the National Treasury can leverage during its reassessment of the South African HQC regime.

9. Chapter 9: Conclusion

9.1 Analysis

The primary focus of this study is to determine if the South African HQC regime still has a role to play in South African tax law and if so, which aspects of the HQC regime require revision. In 2018, the Davis Tax Committee recognized that despite the regulatory and fiscal incentives provided by the South African headquarter company regime, only a limited number of multinational companies have utilized it (Davis Tax Committee, 2018:88). Thus, the HQC regime has not achieved the level of success anticipated by the National Treasury. The Davis Tax Committee (2018) further stated that the primary reasons for the low adoption of the regime seem to stem from challenges in meeting its practical and compliance requirements, alongside the presence of alternative regimes

offered by other African countries that are more appealing and easier to use (Davis Tax Committee, 2018).

The reasons for the low adoption of the South African HQC regime outlined in the Davis Tax Committee report (2018) were validated in this research. Chapter five, which addressed the existing critiques of the South African HQC regime highlighted that compliance requirements relating to the annual election and the 10% shareholding and voting rights are adversely affecting the appeal of the regime. As discussed in chapter 5, the election is only effective for a single year of assessment, which is a noticeably short period for a company to secure tax relief. Prospective HQCs must make the election annually. Mukumba (2017) stated that the concern is that HQCs would never be guaranteed access to the relief throughout the duration of its investment, or even for a substantial portion of it. In chapter eight of this study, the concern regarding the annual election requirement was highlighted as an element of the HQC regime that the National Treasury should reassess. It was suggested that prospective HQCs be granted guaranteed access for a defined period, such as five years, rather than just one.

With regards to the 10% shareholding and voting rights requirements, there were two issues raised with this requirement in chapter five, namely:

- The fact that the 10% shareholding and voting requirement has to be met on each day of the year of assessment to avoid losing the benefits of HQC status. The concern is that the continuous adherence could be disrupted in instances such as when there is liquidation of assets belonging to an insolvent shareholder, the transfer of shares as collateral for debt, and the dilution of ownership when an individual distributes ownership among multiple beneficiaries (Mukumba, 2017:42). Daily adherence is too rigid. In Chapter eight of this study this requirement was highlighted as an element of the HQC regime that the National Treasury should reassess. It was proposed that the National Treasury contemplate modifying this requirement to apply at least on a monthly basis during the year of assessment, allowing for flexibility on days when there are changes in shares.
- The fact that each holder of the shares in the HQC must hold at least 10% of both equity shares and voting rights to avoid losing the benefits of HQC status. The concern with this requirement is that prospective HQCs should exercise caution when employing financing structures involving preference shares or hybrid instruments that incorporate voting rights. This is because the separation of voting rights from equity

shares might result in a breach of the minimum 10 percent requirement (Farouk, 2012:214). This rigidity hampers the company's ability to organize its capital in a manner that strategically benefits the business (Mukumba, 2017:43). In Chapter eight of this study this requirement was highlighted as an element of the HQC regime that the National Treasury should reassess. It was proposed that the National Treasury consider making the requirement just 10% of the equity shares.

The Davis Tax Committee (2018) also highlighted that the reason for the low adoption of the regime is the availability of alternative regimes offered by other African countries that are more appealing and easier to use. This was also validated in this research. In Africa, Mauritius has established itself as an ideal Headquarter Company jurisdiction mostly due to its business-friendly policies, low taxes and political stability (BusinessTech,2023:2). Chapter seven of this study compared the fiscal and non-fiscal characteristics of the South African HQC regime and Mauritius's GBL regime. In terms of tax characteristics Mauritius was more attractive due to its low tax rates, lack of capital gains tax, no annual election, and the fact that GBL entities can serve as private equity funds. Nevertheless, the South African HQC regime also presents certain aspects that are more appealing compared to Mauritius's GBL regime, notably, a broader tax treaty network than Mauritius and the exemption of HQCs from CFC legislation. Regarding non-fiscal attributes, Mauritius stands out as significantly more appealing due to its economic and political stability, as well as the ease of conducting business within the country. Hence, Mauritius holds greater appeal, and most foreign multinational corporations would prefer to utilize it as a 'gateway' to Africa rather than South Africa.

Chapter eight of this research outlined the proposed amendments to the South African HQC regime that the National Treasury and the South African government should consider, aiming to ensure that the regime benefits the prospective foreign investor, which in turn will benefit the South African economy. The recommendations were based on the findings of chapter three to chapter seven.

9.2 Answer to research question

The research aimed to assess whether the South African HQC regime remains relevant within the context of South African tax legislation, and if it does, to identify which aspects of the HQC regime necessitate revision. As stated in the introduction, to ascertain whether the South African HQC regime remains relevant within South African tax legislation, it must demonstrate that it

embodies the optimal characteristics expected in an ideal jurisdiction for headquarter companies. In addition to possessing the optimal characteristics of an ideal jurisdiction for headquarter companies, the South African HQC regime must also be capable of competing with other appealing headquarter company regimes across the African continent to lure foreign multinational corporations.

The fiscal and non-fiscal characteristics expected in an ideal HQC jurisdiction are outlined in chapter six. Among the eight fiscal characteristics outlined in chapter six, the South African HQC regime encompasses six of them, falling short in only two aspects: tax on rendering of managerial services and partial exemption from transfer pricing rules. In South Africa HQCs are subjected to full taxation on the management and service fees received from their foreign subsidiaries (Mazansky, 2011:3). In South Africa HQCs are exempt from transfer pricing rules only when the transaction that has been entered into relates to the granting of financial assistance or the granting of the use, right of use or permission to use any intellectual property (Section 31 (5)). In Chapter eight of this study these two characteristics were highlighted as elements of the HQC regime that the National Treasury should reassess. Hence, the South African HQC regime encompasses the majority of the characteristics of an ideal HQC jurisdiction. However, there is a need to consider amending the transfer pricing rules and potentially introducing a tax exemption on management and service fees received by HQCs from their foreign subsidiaries.

In addition to possessing the optimal characteristics of an ideal jurisdiction for headquarter companies, the South African HQC regime must also be capable of competing with other appealing headquarter company regimes across the African continent to lure foreign multinational corporations. Chapter seven of this study compared the fiscal and non-fiscal characteristics of the South African HQC regime and Mauritius's GBL regime. As discussed above, in terms of tax characteristics Mauritius was more attractive due to its low tax rates, lack of capital gains tax, no annual election and the fact that GBL entities can serve as private equity funds. However, the South African HQC regime also presents certain aspects that are more appealing compared to Mauritius's GBL regime, notably, a broader tax treaty network than Mauritius and the exemption of HQCs from CFC legislation. The only areas where South Africa is significantly behind Mauritius are on economic and political stability and ease of doing business. As stated in chapter eight of this report, it is recommended that the South African Government and the National Treasury undertake measures to assess and enhance the regulatory environment, ensuring its suitability for conducting business operations. Chapter eight of this report also proposed that the South

African government take responsibility for ensuring a smooth electoral process, reassuring prospective investors of the stability of the political environment.

Thus, if the South African HQC regime considers all the suggested revisions outlined in Chapter eight, it will become a valuable and competitive framework that will yield benefits for both foreign investors and the South African economy.

The significance and value of a headquarter company regime should not be underestimated (Davis tax Committee, 2018:88). A well-designed regime can serve as a highly valuable mechanism for drawing investment and expertise into South Africa, thus fostering economic expansion (Davis tax Committee, 2018:88).

Therefore, this study concludes that the South African HQC regime still has a role to play in South African tax law. However, it acknowledges the need for revisions to certain aspects of the HQC regime, as outlined in chapter eight of this study.

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