Following a sincere effort to establish South Africa as an attractive “Gateway into Africa”, South African tax laws and exchange controls provide significant incentives for private equity investments, not only into Africa, but also in the rest of the world, to be routed through South Africa as holding jurisdiction.

In this publication, the South African headquarter company (HQ) regime, which gives effect to these incentives, is compared to the other popular, and competing, investment holding regime, namely the regime offered by Mauritius for Global Business Companies 1 (generally referred to as the GBC1 regime).

This article is general in nature and is premised on a simple investment structure in terms of which interest and dividend income, as well as gains from the disposal of shares, could be generated.

How easy is it to qualify for the tax benefits offered by the regimes?

The table below briefly summarises and compares the requirements to qualify for the respective regimes.

### South African HQ company regime
- The HQ company must be tax resident in South Africa, which generally would require it to be effectively managed in South Africa, or to be incorporated in South Africa and not be effectively managed in a treaty country.
- Prescribed minimum percentages:
  - All shareholders must at all times hold a minimum of 10% of the equity shares and voting rights in the HQ Company.
  - At the end of each year, 80% or more of the cost of the total assets (excluding cash or bank deposits) of the HQ Company must be attributable to foreign investments in the form of equity or equity and debt in, or IP licensing rights to, a foreign company in which the HQ Company holds at least 10% of the equity and voting rights. This requirement is, in practice, fairly easy to comply with by interposing a foreign wholly-owned subsidiary between the HQ Company and its investments.
  - Fifty percent of its gross income must comprise income from foreign subsidiaries (not applicable if gross income is less than R5 million).
- An annual election to be treated as a HQ Company is required.
- Annual reporting (non-onerous) is required.

### Mauritian GBC1 regime
- The emphasis is on a Mauritius presence:
  - The GBC1 Company must be tax resident in Mauritius, which generally requires central management and control to be in Mauritius.
  - The company must have at least two Mauritian directors.
  - The company is required to have a bank account in Mauritius.
  - Its accounting records must be kept in Mauritius.
  - Its financial statements must be audited in Mauritius.
  - At least two Mauritius directors must attend directors meetings of the company.
- Annual application for tax residence certificate in relation to a specific treaty is required.
It therefore appears that Mauritius weighs heavier on the administrative burden side, whereas South Africa’s substantive requirements to qualify for the regime are more stringent.

How easy is it to qualify for the Excon benefits offered?

Mauritius does not have exchange control rules.

In order to be exempt from the South African exchange control rules, certain requirements (similar, but not exactly the same, as those relevant for the tax benefits) must be met. Having said that, if the requirements to qualify for the exchange control HQ Company status prove problematical, an option would be to incorporate the holding company outside South Africa, yet establishing its place of effective management in South Africa. That way, the company will not be subject to the South African exchange controls, but may still qualify for the South African tax relief.

Comparison of tax benefits offered by the regimes

Below is a short comparison of the tax benefits offered by the regimes.

<table>
<thead>
<tr>
<th>Sources of income/transactions</th>
<th>South African HQ Company</th>
<th>Mauritius GBC1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains generated in the underlying structure</td>
<td>The company is exempt from the Controlled Foreign Company (CFC) rules, and as such the profits and gains in the underlying structure will not be attributable to, or taxable in, the company. (The CFC rules could, however, be applicable to shareholders of the HQ Company if they are residents in South Africa and none of the CFC exemptions apply.)</td>
<td>There are no CFC rules in Mauritius, so that the profits and gains in the underlying structure will not be taxed in the GBC1.</td>
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<tr>
<td>Interest received</td>
<td>The South African transfer pricing rules do not apply to loans to subsidiaries, so that it is possible to avoid interest receipts in the HQ Company by making interest-free loans to subsidiaries. Interest paid on money borrowed to on-lend to foreign subsidiaries is tax deductible against interest received from the foreign subsidiaries. If the loan is from a connected person, the thin capitalisation and transfer pricing rules do not apply to this liability. Other interest receipts are subject to the normal tax rules and can, in principle, attract tax at 28%. Any such taxable interest could be avoided by interposing a wholly-owned subsidiary of the HQ Company in a tax-free jurisdiction. The subsidiary can charge the interest and the HQ Company can receive the “interest” in the form of tax-free dividends from the subsidiary (but this might have adverse withholding tax results in the country of the borrower in the absence of a treaty with the country in which the interposed company is a resident).</td>
<td>Interest received is taxable at a maximum rate of 3% (but the amount is eligible for reduction by foreign withholding taxes). No transfer pricing rules exist.</td>
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<tr>
<td>Dividends received</td>
<td>The dividends received by the HQ Company from its foreign subsidiaries will be exempt from South African tax in terms of the participation exemption.</td>
<td>Dividends received from the underlying investments are taxable at a maximum rate of 3%, but reduced by foreign withholding taxes, which often means that the effective tax rate on dividends received would be nil.</td>
</tr>
<tr>
<td>Capital gains on the disposal of shares in foreign subsidiaries</td>
<td>The HQ Company would likely qualify for the capital gains tax (CGT) participation exemption if it held the shares for 18 months or longer and the foreign subsidiaries are not foreign financial instrument holdings companies (FFIHCs). In terms of draft legislation the 18 months and FFIHC requirements are to be removed. Consequently, it is unlikely that CGT would arise on a disposal of shares in underlying investments.</td>
<td>Mauritius does not levy CGT on foreign capital gains.</td>
</tr>
<tr>
<td>Dividends declared to shareholders</td>
<td>South Africa does not levy dividends tax on dividends declared by companies with HQ status.</td>
<td>Mauritius does not have a dividend withholding tax.</td>
</tr>
<tr>
<td>Interest paid on borrowings</td>
<td>South Africa will not levy an interest withholding tax on interest payments by HQ Companies. Interest paid by HQ Companies on money borrowed to on-lend to foreign subsidiaries is tax deductible against interest received from the subsidiaries. Interest received by non-South African lenders from a HQ Company will not be subject to South African tax, unless the lenders have a permanent establishment in South Africa.</td>
<td>Mauritius does not levy an interest withholding tax. Interest received by foreign shareholders from a GBC1 is not subject to Mauritius tax, provided the shareholders do not carry on business in Mauritius.</td>
</tr>
</tbody>
</table>
Tax treaty networks

South Africa has almost twice as many double tax treaties as Mauritius, with 70 treaties currently in force, compared to Mauritius’ 36 treaties currently in force. South Africa’s extensive treaty network allows for treaty relief in almost every continent of the world, including Australia, North and South America, Africa and Europe. The Mauritius treaty network is, on the other hand, more focused on specific jurisdictions such as India and China and notably does not have treaties with Australia, Brazil, Canada, Ireland, Japan, Malta, Netherlands, New Zealand, Russia, Switzerland and the United States. Some of its treaties with African countries, however, are more favourable than South Africa’s.

What are the consequences of disinvestment?

Non-residents are generally not subject to CGT in South Africa unless the asset disposed of is or relates to fixed property located in SA, or to a permanent establishment of the non-resident in South Africa.

As the shares in the HQ Company would most likely not fall into any of the exclusions (the whole point being that the bulk of the HQ Company’s investments must be outside of South Africa), the general principle would apply so that the disposal of the shares by non-resident shareholders would not give rise to any South African CGT implications for them. They may, however, be subject to tax in their jurisdiction of residence.

Assuming the shares in the HQ Company are held on capital account (as it would generally be in a private equity scenario), South African resident shareholders who dispose of their shares in the HQ Company to another resident would be subject to CGT at the effective rate of 18.64% (for companies), 13.32% (for individuals) and 26.64% (for trusts). If, however, the shares are disposed of to a non-resident, the CGT participation exemption (discussed above) would apply.

In appropriate circumstances, a disinvestment could also take the form of a share buy-back out of profits, in which case the exit could be free of South African tax.

As no CGT is levied in Mauritius, the disposal by Mauritian residents of shares in a GBC1 would not give rise to any income tax implications in Mauritius. The disposal by non-residents in relation to Mauritius of shares in a GBC1 may, however, be subject to tax in the country where the shareholder is a resident.

What are the consequences of cessation of HQ or GBC1 status?

Cessation of HQ status has no tax consequences, save that the benefits described above going forward might be lost. If, having given up HQ status, the company elects back into that status, the election triggers a deemed disposal at market value of the company’s world-wide assets, thereby potentially triggering CGT.

The cessation of GBC1 status would not give rise to tax implications in Mauritius.

Expected future developments in South Africa

Pursuant to the effort to establish South Africa as a “Gateway into Africa”, it was proposed in the 2012 Budget that an investment manager exemption be introduced in the domestic legislation in order to prevent foreign funds from being tax resident in SA by virtue of the activities of the fund manager.

Specific provisions relating to the investment manager exemption, such as the scope of its application as well the conditions that must be satisfied in order for it to apply, are yet to be finalised.

However, on the face of it, it appears as if the investment manager exemption, coupled with the HQ Company regime could very well score South Africa another point against Mauritius in the race for an appropriate holding company jurisdiction.
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