Do the South African Headquarters Provisions provide a Competitive Alternative for a Gateway into Africa for International Companies?

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Chapter 1 - Introduction

Special tax regimes (“STR”) and tax havens are topics that feature in global news on an increasingly frequent basis in particular over the last few years. This can be partially attributed to the global financial crisis that has lead many countries being into financial strife coupled with news reporters and critics commenting on the amount of money that companies are avoiding paying in corporate tax due to the use of tax avoidance schemes and tax havens. Therefore Governments are under increasing pressure to curb the amount of revenues that are lost to other jurisdictions. However, whilst that makes the headlines, there is also a necessity for Governments to incentivise companies into their jurisdiction so to provide further revenue to their economy, in particular for the provision of additional jobs and to assist the property market following the crash, this can therefore be seen as very much a double edged sword. So whilst it is clear that a number of countries, governments and non-governmental organisations including the Organisation for Economic Cooperation and Development and groups such as the Tax Justice Network are trying to rid the world of tax havens and countries offering special tax regimes, on the other side many Governments are also trying to lure large corporations into their jurisdictions by offering lucrative tax regimes. South Africa is one such country that has decided to incentivise foreign companies in particular those involved in cross border transactions into its jurisdiction by introducing its Headquarter Company Regime.

The Headquarter Company Regime “HQR” came into force in 2011[1], the central objective for the introduction into legislation is to “make it [South Africa] the location of choice for investment, in particular in Africa[2]”, in turn making South Africa an attractive gateway for foreign and local investment

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[1] Income Tax Act No. 58 of 1962

[2] Anonymous “Increasing Value of the South African International Headquarter Regime” Published on the 1st June 2012 found at http://www.dixcart.com/articles/2012/06/01/in257-increasing-value-of-the-south-african-international-headquarter-regime.htm#.UkVK6hxsIko

into Africa[3]. The HQR in essence is intended to provide tax rules that promote South Africa and make it the regional hub for the rest of Africa. Therefore the central purpose of the HQR would be to ensure that the tax rules are not prohibitive to foreign multinational companies.

In order to entice foreign-based companies, the HQR has a particular focus on the Controlled Foreign Company ("CFC") rules, the withholding of taxes on outgoing dividends and the transfer pricing and thin capitalisation provisions. The normal rate of tax in South Africa is 28 percent[4], this is charged on the company's worldwide income, companies that qualify under the HQR would benefit from an exemption from tax on foreign dividends. A HQR company will be exempt from capital gains tax on the disposal of shareholdings subject to the HQR company having 10 percent of the equity shares and voting shares in the foreign company and it has held them for at least 18 months before the sale and the foreign company does not mostly consist of financial instruments. Furthermore, a HQR company will be exempt from tax on foreign dividends provided that the South African company holds at least 10 percent equity shares and voting rights in the foreign company. As long as the HQR company has more than 50 percent of the share capital is owned by non-South African residents then the CFC rules do not apply[5].

In order to qualify for the relief afforded to a HQR, a company must meet the criteria that are set out in the Act[6];

- For every year of the assessment, each shareholder of the South African resident HQR must hold 10 percent or more of its equity shares and voting rights
- At the end of every tax year, 80 percent or more of the costs of the total assets of the company must be attributable to foreign investments in

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[3] Kruger and Brunton, "South Africa: The South African Headquarter (HQ) Company Regime" http://www.expertguides.com/default.asp?Page=9&GuideID=316&Ed=206
[4] http://www.sars.gov.za/TaxTypes/CIT/Pages/default.aspx last accessed on the 7th February 2014
[5] Honibal. M, Killoran.R, "The New South African Headquarter Regime just does not cut it" Without Prejudice vol 11 issue 1 (2011)
[6] Income Tax Act No. 58 of 1962

the form of equity or equity and debt in, loans to a foreign company, or Intellectual Property licensing rights to, a foreign company in which the HQR company in which the HQR company holds at least 10 percent of the equity and voting rights.

- 50 percent of its gross income must comprise income from foreign subsidiaries, this is however not applicable to companies whose gross income is less than R5 million.

Some economists suggest that this century is one in which Africa will prosper[7]. China is one country in particular that has started to heavily invest in Africa with a specific focus on minerals. Having this in mind, many companies now wish to set up local corporations at least on the continent to help structure their deals. South Africa is an obvious gateway country due to its already established infrastructure, location, sizeable economy, and the perceived political stability[8]. There are a number reasons why prior to the introduction of the HQR provisions why countries would not wish to use South Africa, that would detract investors from taking advantage of the infrastructure in South Africa, and they would look for viable alternatives nearby in particular Mauritius as their gateway as an already established low-tax jurisdiction. With the introduction of the HQR South Africa now becomes a feasible option for setting up such corporations offering a number of other benefits for setting up a holding company within its jurisdiction. One of the prevalent features is that of its Tax treaty network as of 2012 South Africa had over 70 tax treaties, including 19 with African countries, with a further 8 treaties with other African Nations that are under negotiation[9], along with numerous other treaties with countries outside of the continent.

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[7] O'Neill J. Goldman Sachs Economist at African Venture Capitalist Conference 2013 reported at http://www.fin24.com/Economy/Now-could-be-Africas-time-economist-20130409

[8] Honibal.M, Killoran R, "The New South African Headquarter Regime just does not cut it" Without Prejudice vol 11 issue 1 (2011)

[9] "Increasing Value of the South African International Headquarter Regime" Published on the 1st June 2012 found at http://www.dixcart.com/articles/2012/06/01/in257-increasing-value-of-the-south-african-international-headquarter-regime.htm#.UkVK6hxsIko

South Africa’s Gross Domestic Product (“GDP”) is already the largest within the Southern African Development Community (“SADC”) region, “South African’s real GNP is approximately three times larger than the combined GNP of the other thirteen SADC states[10]”, in 2003 South Africa’s Gross National Produce represented 90 percent of that produced in the Southern African countries[11]. Hence, being such a substantial country within the region not only by size but also fiscal dominance makes South Africa an obvious choice to base ones headquarters in this jurisdiction rather than any other country on the continent. Whilst on the face of the Act, there are clear benefits to the companies that choose to base themselves in South Africa, and South Africa will profit from the increased revenue and it is hoped the additional activities that will take place within its jurisdiction. It is however questionable what the benefit will be to the other countries where the operations actually take place, for example if a mining company were to have its base in Angola but its headquarters were in South Africa and to trade through South Africa whilst Angola would be accumulating additional jobs that are created, it would however not obtain the benefit from the tax revenue which clearly would be of profit to the country as a whole. Furthermore what impact will this have on countries within the region who have also set themselves up as to having favourable tax incentives in particular Mauritius. Importantly, it is questionable whether the increased activity within South Africa will also have an impact of the development of the continent as whole, with the increased revenue jobs, and boost to the economy assist the general progression of the people of South Africa and Africans throughout the continent or just the privileged elite?

The G20 have over recent years stated that the use of tax incentives in low taxation destinations can have a negative affect on developing countries as the revenue that is lost by those not paying the tax in their own countries and this also includes the wealthy people on the continent, is money that could be

[10] Gibb. R. “Regional Integration in Post-Apartheid Southern Africa: The case of renegotiating the Southern African Customs Union” (1997) Journal of South African Studies 67.

[11] ibid

used to help Africa to help itself[12]. Consequently by promoting the use of this tax incentive by multinationals it could be suggested that this could be negatively affecting the continent, with some estimates suggesting that the concealment in tax havens of financial assets alone may constitute a loss to developing countries' public revenues of some US$120-160 billion a year[13] South Africa as such a large and dominant country in particular over the Southern African countries if not the whole of Africa could be considered to have a duty to ensure that whilst enticing companies to invest within its jurisdiction that it does not turn into a place that can be described as a "sunny place for shady people[14]" and that the rewards that come to the country filter down to the very people that need it rather than staying among the elite who take advantage of the systems. It can be argued that tax schemes make it possible for large multi-national corporations to shift their money out of the countries in which they are generated into schemes outside of that country and then go on to pay little tax, thereby firstly being able to be more competitive than the local companies in their provision of goods as they do not have to pay the tax rates so often applied to the small companies and secondly they are not benefiting the country that the work is completed in as they then do not pay local taxes and increase the revenues into the developing countries. It can therefore be seen that potentially if such corporations up-root their organisations and place their headquarters in South Africa rather than other developing countries South Africa is in effect taking government revenue away from them.

Mauritius as a comparative jurisdiction to South Africa, it has often been labeled as a tax haven however in recent years it has attempted to shirk the

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[12] "G20 Leaders vow to crack down on tax evasion by multinationals" The Associated Press 6th September 2013 found at http://www.cbc.ca/news/business/g20-leaders-vow-to-crack-down-on-tax-evasion-by-multinationals-1.1699277 last accessed on the 7th February 2013

[13] Tax Justice Network/James Henry, The price of offshore revisited (August 2012),http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf

[14] Syal. R, Vince Cable's crackdown on tax havens may upset some Lib Dem donors, Guardian (UK), 24 September 2012; the quote is generally attributed to novelist William Somerset Maugham.

name tax haven and presents itself as low-tax jurisdiction. Mauritius central bank governor, Rundheersing Bheenick, said in a speech to the Official Monetary and Financial Institutions Forum that Mauritius rejects the tax haven label however “Mauritius aspires to serve as a banking hub for Africa and as a conduit for investment into the continent's economies”[15]. Mauritius and its tax structure is a common feature amongst some of the large international transactions that take place allowing the multi national corporations to avoid paying taxes where the revenue was actually generated. An example of this was in 2007 Vodafone bought a controlling stake in Hutchison Essar Limited a large Indian mobile phone company then owned by the Hong-Kong-based Hutchison Whampoa group, for US$11.2 billion. Hutchison owned the Indian businesses through a maze of holding companies that were based in numerous low tax or tax haven countries including that of Mauritius. Despite protests the transfer of the business was un-taxable by India, India was unable to make any claims to the capital gains tax[16]. This was a significant loss to India and therefore to a country that clearly could benefit from the additional revenue to its Government and to its people.

Notwithstanding the obvious drawbacks for the country that loses the revenue in particular when the country is a developing one, and relies heavily on revenues causing increasing problems and difficulties within the jurisdiction; the benefit to the country providing the tax incentives are vast and far reaching. Mauritius after its independence on the 12th March 1986 is now characterized as an upper-middle income country with a per capita income of $7,500[17]. This is an island that was previously perceived to be a mono-crop economy largely based on sugarcane, has now developed into a diversified economy providing export-orientated manufacturing, tourism, financial services, property development and real estate. Whilst it cannot be proven that the state of the economy is due to the foreign investment and holding of

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[15] Douglas. J, “Mauritius Central Bank Chief: We are not a Tax Haven” The Wall Street Journal, 13th May 2013

[16] Supreme Court of India, Civil appellate jurisdiction, civil appeal No. 733 of 2012 (arising out of S.L.P. (C) No. 26529 of 2010): Vodafone International Holdings B.V. (Appellant) versus Union of India & Anr (Respondents).

[17] http://www.investmauritius.com/Mauritius.aspx

off-shore accounts, however it can be gathered and inferred that it has not held back the economy by having such structure.

Despite the obvious move away from tax havens or special tax regimes following the pledge by the G20 to remove tax havens[18], there are a number of companies that seek and still wish to have the ability to utilise the tax savings incentives that are offered by many countries, therefore one can see that there is a market for the new legislation offered by South Africa. Since 2011 every new entrant to the FTSE100 has tax haven operations[19]. Notably, The FTSE100 brewing firm SABMiller generates annual revenues of just under US$10 billion from successful brewery and beverage operations across Africa[20] yet the company has more than twice as many companies in tax havens as breweries and bottling plants in Africa[21]. That is a clear example where taxable revenues are taken away from the developing countries and placed into tax havens. Whilst those countries would be grateful for the additional business, which usually comes with additional jobs, and money into the economy, the large amounts of revenue that are lost can be seen as detrimental to the developing country, notably when the operations are large conglomerates trading in poorer regions in Africa but not paying the revenue that is so desperately needed. It should not be neglected that by virtue of the large corporations using this technique affects the local competition who are unable to take advantage of such provisions, and therefore such companies are not competing on a level playing field and potentially puts the smaller companies out of business as they are not able to offer such low rates on goods as they are having to factor in the tax that they have to pay.

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[18] BBC News, Tax havens: no place to hide, 2 April 2009, http://www.bbc.co.uk/caribbean/news/story/2009/04/090402_canthide.shtml (last accessed 1st December 2013

[19] Action Aid "How Tax Havens plunder the poor" http://www.actionaid.org/sites/files/actionaid/how_tax_havens_plunder_the_poor.pdf

[20] SABMiller, 2012 annual report, reporting by geographical segment. This includes 'Africa' and 'South Africa' segments.

[21] http://www.sabmiller.com/index.asp?pageid=888 (accessed 24 April 2013) lists 51 breweries and bottling plants in Africa

The underlying objectives in my dissertation is to analyse the HQR in respect of companies and their tax liabilities, identify the positives and negatives for South Africa and whether it will have an impact of the continent as a whole, and compare it to other schemes currently used in other jurisdictions.

The chapter outlines are as follows;

Chapter 2

In order to analyse the effect of the HQR not only on the country but the region it is imperative to look at the history of tax havens and special tax regimes and the basis on which they appeal to corporations. This chapter will focus on the benefits and disadvantages of these regimes to the country that has the low or no tax rules, the company that is intending to base its headquarters there and the country that the operations are based in. This chapter will also look at the potential impact that such schemes have on other jurisdictions.

Chapter 3

This chapter will then focus on the background to the HQR and provide some analysis on the regime, including looking in detail at the Act and similar provisions that are in other jurisdictions. The dissertation will then identify the benefits to the country and to the company and highlight any disadvantages that may be apparent in using this scheme.

Chapter 4

Using specific tax regimes to incentivise companies into basing their companies in a countries jurisdiction is not a new preposition, chapter one sets out the history for this; taking into account that the regime is clearly not meant to make South Africa into a tax haven, it will compare it to Mauritius which also has favourable tax incentives, but also does not see itself as a tax haven despite what the critics may say. I will look at the benefits of each to the company and to the country.

Chapter 5 and 6

These chapters will then look more globally at the different headquarters provisions firstly in Africa and then in Europe. The chapters will discuss the impact of being part of the African Union and the European Union.

Chapter 7

The aim of the conclusion is to draw all of these threads together, to depict the common themes, and analyse the outcomes.

Chapter 2: The Background to Tax Havens and Special Tax Regimes

The use of Tax Havens and Special Tax Regimes is controversial to say the least. Governments whose residents use tax havens and special tax regimes are constantly trying to uncover the regimes and expose the secrecy, they vehemently seek the abolishment of such regimes[22]. Countries that have specific regimes that may be considered tax havens are trying to encourage individuals and companies to use them and their services. However, there is a tendency to fight against being labeled as a tax haven. The benefits to the company or individual are clear; they are able to pay significantly less tax than had they not used such regimes, thereby increasing their take home profits. The detriment to the countries in which the companies operate is also abundantly clear, they do not receive the tax that they would have had the company not used the tax haven and therefore reducing the amount of tax revenue collected that could be used for public services. The difficulty is that although it is easy to describe a tax haven, to define it often causes countries or locations commonly known to be tax havens or special tax regimes to be excluded. In this chapter I intend to explain what a tax haven and a special tax regime is, explore the background of these regimes, describe the common features and examine the benefits and the disadvantages of the use of such regimes.

WHAT IS A TAX HAVEN OR SPECIAL TAX REGIME

[22] Found at http://www.actionaid.org.uk/sites/default/files/doc_lib/accounting_for_poverty.pdf

A Tax Haven or more commonly referred to as an International Financial Haven or Financial Haven[23] in essence can be described as those countries or locations offering a wide range of laws and tax incentives that are favourable to off-shore companies and individuals[24]. This can mean that the off-shore company or individual may pay zero or a very low percentage of tax. This tax favourable environment is usually created by the imposition of particular regulations and or legislations that stimulate favourable economic tax provisions[25].

As aforementioned there have been numerous attempts to define a tax haven or a special tax regime, the central issue with trying to be specific is that often when a definition is found it excludes other tax regimes. For example Geoffrey Powell argues that "What ... identifies an area as a tax haven is the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance.[26]". The Organisation for Economic Co-operation and Development ("OECD") OECD defines a tax haven as a jurisdiction that has no or nominal tax, with no transparency, no exchange of information agreements and houses companies that do not have any activity in their jurisdiction[27]. In the Gordon Report it sets out that a "tax haven is any country with tax rates of zero or very low on some categories of income and provides a certain level of banking or commercial secrecy[28]" It should be noted that the Tax Justice Network in 2009 claimed that the US and the UK also were tax havens[29].

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23 Constantin Manea. A "The tax havens between measures of economic stimulation and measures against tax evasion" Bulletin of the Transilvania University of Braşov Vol. 3 (52) - 2010
Series VII: Social Sciences Law

24 Desai. M, C. Foley, J. Hines Jnr, "Do Tax Havens Divert Economic Activity" 2005 found at http://www.bus.umich.edu/otpr/WP2005-2.pdf

25 Dharmapala. D, Hines Jr. J, "Which Countries Become Tax Havens" Journal of Public Economics 93 (2009) 1058–1068

26 Doggart, Caroline. 2002. *Tax Havens and Their Uses* (originally published 1970), Economist Intelligence Unit, ISBN 0-86218-163-1

27 "Tax Havens refuse to take the blame for the Global Financial Crisis" 19 Int'l Tax Rev. 10 2007-2009

28 Gordon. R, "Tax and their use by United Tax Payers: An Overview: A report of the Commission of Internal Revenue, the Assistant Attorney General (Tax

Whilst the companies benefit from using such havens, many countries in particular the USA are fighting against the use of tax havens it is suggested that the companies hide behind a veil, which in the end does not benefit the country in which the company is not truly located[30]. “Ugland House” in the Cayman Islands, is said to house over 12, 748 companies including Coca Cola and Intel Corp, has received significant press attention. On close examination it would be practically impossible for those companies to operate from these locations with such little physical space. President Obama commented that “either this is the largest building in the world or this is a tax scam[31]”. Companies can see the benefit in entering into such arrangements; however it also highlights the lost revenue to countries. A broader definition is “any country which modifies its tax laws to attract foreign capital could be considered a tax haven[32]” If this broad interpretation is used many countries across the world would fall into this category.

How did they come about?

Tax Havens existed prior to the twentieth century[33]. It is suggested that they were established as the Europeans and the Americans were looking for alternative places to put their money as the US and European countries were increasing their tax regimes[34]. There was a significant gap in the market in the way to save money, and tax havens attempted to solve that issue.

The History

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division) and the Assistant Secretary of the Treasury (Tax Policy) (1981), [Washington DC]Department of Treasury, Internal Revenue Service.

29 “Tax Havens refuse to take the blame for the Global Financial Crisis” 19 Int'l Tax Rev. 10 2007-2009

30 Ochieng. A, “Tackling tax havens” July 31 2013 found at http://www.americanprogress.org/issues/security/news/2013/07/31/70955/tackling-tax-havens/

31 US President Barack Obama, Jan. 5, 2008, debate in Manchester, N.H.

33 R. Palan, “History of Tax Havens” October 2009 found at http://www.historyandpolicy.org/papers/policy-paper-92.html

34 ibid

The use of differing tax laws to try to mitigate tax liabilities is not a new phenomenon, however following the Global Financial Crisis “GFC” in 2009 the use of tax havens has attracted much attention in the Global newspapers, with some critics blaming these regimes for the financial crisis itself[35]. In any event the use of tax havens and countries trying to attract business is extremely competitive. Many Tax Havens attempt to assert themselves as the oldest tax havens in the world, for example, the Channel islands stating that their origin dates back to the Norman Conquest in 1066 and the Isle of Man believes that its origin as a tax haven dates back even earlier[36]. Switzerland also purports that it is the oldest tax haven[37]. What can be dated and documented is that Switzerland has long been used by those fleeing social upheaval searching for a capital haven from countries such as Germany, South America and Russia[38]. It has however been stated that the first documented use of tax regulation of incorporation was in the late 19th century was in the United States of Delaware and New Jersey[39]. It is said that in the 1920’s the process was imitated and transported to Europe, where Switzerland and Liechtenstein then set up their operations[40].

Up until about the 1950’s Tax Havens were predominately used by individuals wishing to reduce their tax liability. However, since this time countries have been promoting themselves to be used as tax havens for companies who wish to take advantage of the availability of low or no corporate tax that is imposed. The general trend in the 1980’s changed significantly whereby tax havens used the legislation to create corporate vehicles that were ring-fenced

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35 Kazuyuki Nanto.D, “ The Global Financial Crisis: Analysis and Policy Implications” (2009) DIANE Publishing

36 Palan. R, “History of Tax Havens” October 2009 found at http://www.historyandpolicy.org/papers/policy-paper-92.html

37 Farquet. C, “The Rise of the Swiss Tax Haven in the Interwar Period: An international comparison” October 2012 EHES working Paper in Economic History No. 27 found at http://ehes.org/EHES_No27.pdf

38 ibid

39 Palan, Murphy, and Chavagneux “ Tax Havens: How Globalization Really Works” Cornell University Press (2010)

40 Shafik Hebous “Money at the Docks of Tax Havens: A Guide” CESIFO Working Paper No. 3587 Category 1: Public Finance September 2011

and this entity would be exempt from local taxation[41]. However, this trend has been curbed (however not extinguished) due to the pressure placed on the tax havens by OECD in the 2000's. The OECD is vehemently against the use of tax havens, its position is that such entities are using unfair tax competition and practices[42]. Following reports by the OECD's for example, Promoting transparency and exchange of information for tax purposes[43] and the OECD's Project on Harmful Tax Practices: The 2001 Progress report[44] many tax havens have amended their protocols and legislation and it has been significantly harder for companies to set up off-shore companies to take advantage of the tax regimes.

It was however notable that in the Bank of International Settlements (BIS) Statistics of International Assets and Liabilities ranks the Cayman Islands as the fourth largest international financial centre in the world, while other well-known tax havens/off-shore centres such as Switzerland are 7th, Netherlands 8th, Ireland 9th, Singapore 10th and Luxembourg 11th[45]. It was reported that there was between $USD 5-7 trillion held offshore[46]. The impact of the quantity of money that is passing in these centres, is far reaching as countries do not want to lose the business that is bought into their country despite not receiving their tax revenue, in particular if the company was to move its operations from the host country. It therefore often affects countries not only economically but also socially and politically.

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41 http://www.taxhavenco.com/tax_havens.html
42 http://www.oecd.org
43 19th January 2010 found at http://www.oecd.org/newsroom/44431965.pdf
44 found at http://www.oecd.org/tax/harmful/2664438.pdf
45 R. Palan, "Tax havens, the Crisis of 2007 and Financial Regulations" 15th October 2010 European Financial Review found at http://www.europeanfinancialreview.com/?p=1680
46 J. Owens "TAX HAVENS: The policy response to the changing environment"

THE COMMON CHARACTERISTICS BETWEEN TAX HAVENS

Tax havens often try to distinguish themselves in order to try to obtain new business, however on close examination, they often have a number of similar characteristics[47]. Firstly, they often are relatively small newly formed or recently gained independence countries, examples of which are Andorra, Malta and Liechtenstein. Secondly, they offer what can be described as substantial tax benefits to those persons or companies who are registered outside of their jurisdiction as compared to those who reside in that jurisdiction, this is sometimes referred to as ring-fencing. The reason for this is to attract outside investment from growing companies with the use of tax incentives and tax deductions, with the knowledge that bringing such companies to the jurisdiction will in fact lead to investment in other areas, namely employment of local staff, provision of services such as legal and accounting and property purchases and rental. Thirdly, a common characteristic is detailed and clear protection by law of commercial and financial transactions. There is often the conclusion of numerous bilateral treaties so to ensure that avoidance of double taxation, or the removal of withholding tax, so that at a practical level the taxes that are paid in the production country is low or minimal. Fourthly, as it is apparent that many countries wish to clamp down on the use of tax havens as they would want to receive as much tax as possible from these companies, it becomes important that the tax law that is applied in the tax havens are constantly adapted so to keep up with fiscal trends, this can be seen in Hong Kong. Fifthly, it can be seen that the establishment of banking systems without restrictive rules and constraints, which ensure rapid transactions inside and out for the benefit of corporate trusts, privacy and bank accounts secrecy is important. Examples of such structures are Switzerland, Bahamas, Singapore. Unfortunately this can often lead to companies being set up as fictitious front companies to cover up criminal behavior.

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[47] Dharmapala. D, Hines Jr.J, "Which Countries Become Tax Havens" Journal of Public Economics 93 (2009) 1058–1068

Not all countries want to be classified as a tax haven. There are a number of countries who are advocates for the removal of so called tax havens (dependant on what the definition is) who, at the same time, are also giving privileged treatment to foreign corporations. An example of this is are the territories that fall under the jurisdiction of the United Kingdom, in particular Jersey, Guernsey and Ireland. It seems to be a contradictory in terms for the countries to both advocate and support the use of tax havens[48]. As the definition of tax havens can vary substantially it is therefore difficult to distinguish between the working of a tax haven and that of a special tax regime, it could be argued that a difference is the increased transparency that is so often criticised with tax havens. It is clear however, that countries do not appear to concern themselves with the offering of special tax incentives, but the word tax haven has such negative connotations that countries shy away from this title.

South Africa with the use of its Headquarters provision will be in effect be ring-fencing foreign-corporations who choose to place their companies within the jurisdiction[49]. The significant difference is that they will not be offering zero rated tax, but the scheme will give a certain privilege to foreign owned companies to attract outside investment. So whilst it may not have some of the classic characteristics so often found in tax havens, this could be described as a special tax regime that will encourage foreign investment and could encourage companies to structure their companies in such a way that limited tax is paid in the place where their operations take place and take advantage of the lower scheme offered in South Africa. The benefits of which will be far reaching in South Africa however the effect to the rest of the continent at this stage is unknown; the significant question being will

[48] Gravelle. J, "Tax Havens: International Tax Avoidance and Evasion", Congressional Research Service, Jan 23 2013 found at https://www.fas.org/sgp/crs/misc/R40623.pdf

[49] M. Honnibal and R. Killoran, "The New South African Headquarter Regime doesn't quite cut it" Without Prejudice February 2011 29

companies relocate out of other developing countries, depriving them of the much needed revenue[50].

BENEFITS TO THE COUNTRY OF BEING A TAX HAVEN / SPECIAL TAX REGIME

The obvious benefits of being a tax haven, has been described by Slemrod[51] as the commercialisation of state sovereignty, there is empirical evidence to support the assumption that the use of becoming a tax haven is particularly appealing when there are limited options for attracting other streams of revenue[52]. There will be an increase in revenue that comes into the jurisdiction that will occur not necessarily from the nominal tax that is paid by the foreign companies, but by the ancillary services that are provided within the country, for example, legal, banking and not least travel and tourism. Tax havens sometimes are seen as having a bad reputation, however it would be unfair to suggest that all people and or companies that use tax havens are trying to defraud or hide their assets. Tax havens often attract business; mobile finance and investment capital including reinsurance companies[53], such businesses often require access to international markets and 24 hour support. Often becoming a tax haven is usually a sure way for a small country that is politically and economically stable to attract foreign investment.

ARE THERE ARE NEGATIVES IN BEING A TAX HAVEN / SPECIAL TAX REGIME

Becoming a tax haven is not without its disadvantages. As aforementioned a common characteristic of a tax haven is that they are often small. A successful tax haven has a substantial amount of money flowing through it,

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[50] Gravelle. J, "Tax Havens: International Tax Avoidance and Evasion", Congressional Research Service, Jan 23 2013 found at https://www.fas.org/sgp/crs/misc/R40623.pdf

[51] Slemrod, J. (2008), Why Is Elvis on Burkina Faso Postage Stamps? Cross–Country Evidence on the Commercialization of State Sovereignty, *Journal of Empirical Legal Studies* 5 (4), pp. 683–712.

[53] J. Mclaran and J. Passant, "Tax havens: do they have a future providing banking and financial services" 2010 Canberra L. Rev. 1 2010

the reality is that in such a situation it is incredibly difficult to police, in particular enforcing any regulations, keeping of accounts and doing any spot audits. This inability to regulate the money leaves the country open to exploitation. In certain circumstances it could be argued that such jurisdictions facilitate money laundering of drugs and illegal activities that could include funding terrorism, corruption and economic crime[54].

Tax havens have rapidly come under much scrutiny and criticism in recent years, in particular from the OECD and organizations like the Tax Justice Network. There is considerable pressure for tax havens to enter into Tax Information Exchange Agreements (TIEA's) in order to deter companies from hiding their assets within such jurisdictions. Whilst it may not affect the tax havens directly, the fact that there are many campaigns against their very existence could clearly be detrimental to their place on the world stage. The G20, and the OECD, place some blame on the use of tax havens, they state that "they hid risk and contributed to the spread of financial products across the world blind to the real level of risks involved[55]". The Tax Justice Network develops this argument and states that the tax havens did not cause the global financial crisis but they powerfully contributed to it[56]. Whilst it seems clear that if companies are able to use tax havens and reap the rewards they will continue to do so, the question is whether the countries are willing to maintain this bad reputation in order to gain fiscally.

BENEFITS TO A COMPANY FOR REGISTERING IN A TAX HAVEN / SPECIAL TAX REGIME

It goes without saying that fiscally there are numerous advantages about registering your company in a tax haven or one that has special tax incentives. The most obvious benefit is the no or low tax rates that have to be paid dependant on the country. Other benefits include the lack of

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54 Erikkson, F, "Tax Havens and Development" Report by the Independent Norwegian Commission on Capital Flight from Developing Countries, found at http://www.oecd.org/site/devaeo10/44276169.pdf

55 Mclaran. J and Passant. J, "Tax havens: do they have a future providing banking and financial services" 2010 Canberra L. Rev. 1 2010

56 Tax Justice Network, *Economic Crisis* + *Offshore* <http://www.taxjustice.net/cms/front content.php?idcat=136>.

transparency that is usually associated with being in a tax haven, it could be suggested that if one sets up the company in a particular way the identity of the directors may be unknown to others. Another crucial feature of being in certain tax havens is that they often offer 24-hour support.

WHAT ARE THE DISADVANTAGES FOR THE HOST COUNTRIES WHO LOSE OUT ON REVENUE

Remarkably in 2004 the amount of money kept or sometimes referred to as hidden money[57], recorded in a report commissioned by the OECD is approximately 11,000 to 12,000 billion US Dollars. Unfortunately, 20% of this money is said to come from developing countries. It is reported by Addison that tax havens have cost the United States in 2008 $100 billion, in the past decade the cost has been $1.027 trillion[58]. It is abundantly clear that should tax have been paid to the developing country from which the money originated this would have indeed assisted developing nations to develop themselves rather than relying on aid. There is a loss of revenue for public expenditure programmes, which in turn in particular for countries in Africa could lead to an increased reliance on international debt[59]. In addition this can lead to a decreased investment in public services.

It can be seen that the use of tax havens can undermine the national tax systems as the way in which the company is structured is to avoid paying tax in the host country. Some startling examples of this are multinationals; Starbucks had sales of £400 million in the UK paid no corporation tax[60];

[57] http://www.oecd.org/site/devaeo10/44276169.pdf
[58] Addison. T, 'Shooting Blanks: The War on Tax Havens' **(2009) 16(2)** *Indiana Journal of Global Legal Studies* **703,** 704
[59] Christenensen. J, "Tax Avoidance and Tax Evasion as an Impediment to Development" 23rd July 2007, United Nations side event to ECOSOC

[60] Found at http://www.huffingtonpost.com/2013/06/23/starbucks-uk-corporate-tax_n_3486612.html

Amazon had sales in the UK of £3.5billion in 2011 however only paid tax expenses at £1.8 million[61].

More than the impact of the loss of the tax revenue is the impact on the loss of sovereignty for the host country. Companies that are registered elsewhere in tax havens also often adopt alternate laws, therefore the countries are unable to impose their own rules and regulations on the way in which companies are run[62].

The views of the citizens who pay all of their taxes to the host country could also be negatively impacted not only against the company but also against the country itself. It could reduce public confidence in the rule of law and the integrity of public institutions. Following on from this, people could look at the fact that the use of tax havens is most predicated by the privileged elites, yet they are forced to pay their taxes in the host country[63].

The use of tax havens is sometimes described as legal tax fraud, on the other-hand it is viewed as a way of minimizing tax obligations and encouraging the development of capital and foreign investments; in any which way it is looked at it is clear that there are many that will continue to fight against the use of havens, and many that will continue to fight to use them. The question that is to be answered is what are the benefits or the disadvantages to the continent as if these regimes are to be continued to be used in South Africa and Mauritius.

The impact on the developing world is significant, it has been argued that there has been too much focus on the use of international aid, that the shift has been away from looking at what the continent can do for itself[64]. There is a substantial amount of tax revenue that is generated in the developing

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[61] Christian Aid "Giving with one hand and taking with the other :Europe's role in tax-related capital flight from developing countries 2013" found at http://www.christianaid.org.uk/images/Campaigns-tax-capital-flight-report-Dec-2013.pdf

[62] OECD Harmful Tax Competition para 75; Spitz & Clarke Offshore Service OECD/3

[63] Oguttu. A "A critique on the OECD campaign against tax havens: has it been successful? A South African Perspective" Stellenbosch Law Review (2010) 172

[64] http://www.taxjustice.net/cms/front_content.php?idcatart=126&lang=1

companies but the taxes are not paid in the relevant country. This was highlighted by Gordon Brown the Former British Prime Minister which stated in 2009 that “we will set out new measures to crack down on the tax havens that siphon off money from developing countries – money that could be otherwise spent on bed-nets, vaccinations, economic development and jobs[65]”. It is questionable firstly that the then Prime Minister of England was claiming that the business of tax havens should be clamped down upon despite within its own jurisdiction, tax havens can be located and secondly whether South Africa with its own preferential treatment with its new provisions will have a negative affect on the continent as a whole, leading to how if at all the developed world can assist the developing world when they do not acknowledge their own failings.

[65] Found at http://www.actionaid.org.uk/sites/default/files/doc_lib/accounting_for_poverty.pdf.

Chapter 3 - An in-depth look at the Act and the advantages of choosing South Africa

Background

The use of Headquarter companies and Regimes is not an innovation created by South Africa nor is this the first time that South Africa has tried to use such provisions in order to attract additional business with the aim of turning South Africa into a gateway into Africa for foreign investment. Australia[66], Netherlands[67] and Mauritius[68] have and currently are using this model to attract large multinational corporations into their own jurisdictions. The Katz Commission in 1997 noted that South Africa was well positioned as a head office, finance, or management company location for investment into the continent[69]. They recommended the need for South Africa to provide statutory commitment to the establishment of holding companies, with a favourable regime for corporate headquarter and holding companies with favourable tax exemptions[70]. Between 2000 and 2004 South Africa utilised the Headquarters provisions. The regime was made possible due to the inclusion of a definition of a Headquarter company in s.1 of the Income Tax Act, this was subsequently abolished in 2004. The failure of this was said to be attributed by in large, as it did not offer a foreign investor any tax privileges as income sourced or deemed to be sourced in South Africa remained taxable in South Africa at the ruling tax rate, and companies were not treated as resident in country they did not obtain the benefit of the numerous tax treaties that have been signed.

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66 https://www.kpmg.com/Global/en/services/Tax/regional-tax-centers/asia-pacific-tax-centre/Documents/CountryProfiles/Australia.pdf
67 http://www.deloitte.com/assets/Dcom-Azerbaijan/Site%20SMF/EN/Events/The%20Netherlands_As%20an%20Intermediary.pdf
68 Low Tax: Global Tax and Business Portal 'Mauritius: Country and Foreign Investment Regime', available at http://www.lowtax.net/lowtax/html/jmucfir.html (accessed on 15 Feb 2011).
69 Katz Commission Report Fifth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa 2.2 found at http://www.polity.org.za/polity/govdocs/commissions/katz-5.html.
70 ibid

South Africa clearly recognises the potential benefit of setting up a HQR this would hopefully attract investors into the country thereby using it as a springboard into the rest of the continent.[71]. This intention was announced not only by the South African Treasury in 2010 Budget Review[72] but also reiterated in 2011[73] Budget review. Since its inception there have been a number of amendments to ensure that its applicability is sufficiently broad enough to attract suitable companies but also rigid enough so that the country still benefit from the investment and not just taken advantage of. In addition the use of the HQR should not erode the South African Tax base which is imperative to the country as a whole. What can be seen is that there has been a thorough investigation into the corporate and business framework as well as exchange-control and corporate-tax laws, to determine if the corporate, business, legal and tax environment will entice companies to base their headquarters in South Africa. What is clear is that companies consider not only the tax position but also other non-tax related factors when deciding where to set up their headquarters. In this chapter I will seek to analyse the HQR provisions and its implications to companies and investors.

The Tax Incentives

A Headquarter company generally will have as its sole business the performance of management functions and services, intra-group shared services, and intellectual property management to affiliate companies. In light of the provision of these services it is likely that a large proportion of the income derived will be in the form of management fees, technical fees, and interest paid by its off-shore subsidiaries[74].In the main the functions of a HQ company are to manage investments and to centralise the income of the subsidiaries before they are to be distributed either back to the ultimate

71 Mbangeleli Goza. K, Dachs. P, "Big changes from headquarter company bill" SA Media The University of the Free State, 8 November 2010
72 National Treasury *Budget Review* (2010) 78–79.
73 National Treasury Budget Review (2011) 73.
74 Honnibal. M and Killoran. R, "The New South African Headquarter Regime doesn't quite cut it" Without Prejudice February 2011 29

holding company or to their investors. The rationale behind setting up a HQ company somewhat varies between companies, but usually one of the reasons would be for tax purposes, therefore it was imperative when South Africa made the decision to make provision for Headquarter companies within its jurisdiction that the legislation paid particular notice of the tax implications for companies and investors[75]. As aforementioned, the legislation has been amended on a few occasions so to widen the applicability and scope. Graatz states "A deal done by very smart people that's absence of tax planning would be stupid[76]". Hence it is more than obvious that in order for the HQR in South Africa to be properly utilised there would have to be certain taxable advantages so that investors choose this jurisdiction over and above others. It should be noted that even when a company is of the view that it falls under the HQR it must notify the commission and also must provide annual reports to the Minister[77] therefore there is a degree of transparency. The tax benefits that have been legislated for are discussed below;

i. Controlled Foreign Company

The Income Tax Act[78] sets out clearly what a Controlled Foreign company ("CFC") is, namely that it is "any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies". When a company qualifies under the HQR the foreign subsidiaries of the HQ company will not be considered to be CFC's of the HQ company. Companies that are resident in South Africa are taxable on their worldwide income. Therefore if said company sets up a subsidiary in another jurisdiction, the subsidiary is a

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[75] Legwaila. T, "Tax reasons for establishing a Headquarter Company" found at http://repository.up.ac.za/bitstream/handle/2263/17178/Legwaila_Tax(2011).pdf?sequence=1

[76] Graetz (Yale Law School) as quoted in Hager, *Treasury Targets Shelters Again, Washington Post* (1999) E3 in relation to tax planning using tax shelters.

[77] Section 9(I)3 Income Tax Act 58 of 1962

[78] 58 of 1962

separate legal entity and its income cannot tax its income until it is distributed to its South African shareholders as dividends. The issue comes that even with the exclusions to the CFC rules, foreign investors often avoid setting up base companies in jurisdictions that have CFC legislation[79] and the fact that they do not apply to South African shareholders may cause further problems should they wish to expand into the rest of Africa, other options could be Mauritius and Botswana neither of which have CFC provisions.

ii. Capital Gains Tax

The distinction between revenue and capital plays an imperative role in the decision where a company sets up its headquarters. In the main most countries treat capital gains more favourably than that of revenue, South Africa in particular has the effective tax rate on capital gains as half of that of the normal income tax rate[80]. A capital gain is usually triggered on the disposal of a capital asset. This area of law in most jurisdictions has a considerable amount of case law, as clearly it is more favourable for assets to be deemed to be capital rather than revenue, therefore the terms ‘capital’ and ‘disposal’ are given very wide definitions. Investors obviously would prefer to invest in countries with no or very low tax levied on capital disposals, however this alone is not the only reason why a company would have its headquarters in a certain jurisdiction, in particular when in most instances capital is not frequently disposed of. That is not to say it is not a relevant consideration, South Africa has made provision for this and under the scheme a HQ company will be exempt from CGT on gains from the sale of a 20% or more equity stake in a foreign company[81]. However, HQ companies will be liable for

[79] Wanyana Oguttu. A, “Developing South Africa as a gateway for foreign investment in Africa: A critique of South Africa’s headquarter company regime” 2011 South African Yearbook of International Law Vol 36 61-93

[80] Legwaila. T, “Tax reasons for establishing a Headquarter Company” found at http://repository.up.ac.za/bitstream/handle/2263/17178/Legwaila_Tax(2011).pdf?sequence=1

[81] http://www.thesait.org.za/news/96607/The-New-Headquarter-Company-Regime.htm

CGT of 18.6%[82] when it disposes of investments or on the termination of tax residence. This rate is still considered rather low and could attract investors from developed countries where the rate is not as competitive for example the US is at a rate of 38.5%[83] and the Uk 28%[84].

Iv. Transfer Pricing Rules

The transfer pricing rules in South Africa since 2001[85] have become increasingly strict. Transfer pricing is dealt with under section 31 of the Income Tax Act. The transfer pricing and thin capitalisation provisions focus on cross-border transactions, operations, schemes, agreements or understandings between connected persons. Generally a HQ company should be subject to the transfer pricing and thin capitalisation rules in the case of excessive financial assistance[86] or if it is granted at a non-arm's length rate. The rules do not apply to a HQ company in circumstances where there is a back-to-back, cross-border loan.

Where a non-resident, which by virtue of the set up of a HQ regime will be a connected person to the HQ company, provides financial assistance to the HQ company, section 31 of the Income Tax Act 1968 will not apply to the extent that the HQ company applies the financial assistance to any foreign company in which the HQ company directly or indirectly holds at least 10% of the equity shares and voting rights. In addition, s.31 will also not apply to the onward financial assistance by the HQ company to the other company[87].

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[82] National Treasury 'Budget review 2012' at 51 available at http://www.treasury.gov.za 165
[83] National Treasury 'Budget review 2012' at 51 available at http://www.treasury.gov.za 165
[84] ibid
[85] Taxation Laws Amendment Act No 24 of 2011
[86] Section 31(1) defines 'financial assistance' to include any loan, advance or debt; or security or guarantee 147
[87]Wellsted. A "Transfer Pricing" June 2012 found at http://www.nortonrosefulbright.com/knowledge/publications/67673/transfer-pricing

As aforementioned most of the income derived by a HQ company will be in the form of management fees, they will be taxed wholly on this income paid by foreign subsidiaries, the HQ company could apply for a rebate under the Taxation laws Amendment Act of 24 of 2011 section 6quin however this does not relieve HQ companies of tax on management fees completely. Interest and royalties incurred by a HQC from non-resident shareholder loans is deductible to the extent of interest and royalties received from loans made to qualifying foreign company investments. Any amounts disallowed may be carried forward for deduction. This is due to the rebate amounts to the lesser of the South African tax and the foreign tax payable.

Further, interest and royalties incurred by a HQ company from a non-resident shareholder are not subject to transfer pricing rules. Interest and royalties earned by a HQC from qualifying foreign investments are not subject to transfer pricing rules.

v. Exchange Control Restrictions

As a further way to develop the HQR, the Minister commented that “"We want to strengthen the usage, and we are getting lots of signals from investors in this regard, as a headquarters from which their operations can extend into Africa as well,[88]" The current exchange control restrictions for a resident of South Africa are particularly stringent. The tax position in respect of HQ companies when originally came into force was quite clear however in terms of the exchange control position, Exchange Control Circular No. 2/2011 issued by the South African Reserve Bank (“SARB”) clarifies the exchange control position. In essence HQ companies can raise and deploy capital offshore without being subject to exchange controls. The company will be treated for exchange control purposes, as a non-resident company save for the reporting obligations. The requirement for reporting, is said will be

[88] Gordhan. P, Finance Minister October 2010 found at http://www.sagoodnews.co.za/economy/exchange_controls_to_be_eased.html

required for statistical purposes, such a report must include but not limited to the source of the funds, new or existing funds, destination of the funds, and loan funds from local sources. Once it has been complied the company can freely borrow from abroad and such funds may be deployed locally or offshore. When local companies transact with HQ companies this will be viewed as transactions with non-residents, and such transactions will be deemed to be occurring outside South Africa[89].

What should however be noted that in order to qualify for the exchange control exemptions do not mirror those qualifications that enable companies to qualify to be a HQ company. Notably the amount of shares that can be held by a South African resident differ, in the HQR no more than 20% can be held directly or indirectly by residents, whereas from a tax perspective a HQ company can be more than 20% held by South African residents. Furthermore, it is not clear whether the asset test relates to the cost or to the market value.

Commercial Law reasons other than Tax to choose South Africa for setting up HQ

Looking at the global market, with numerous countries trying to provide attractive legislation to entice companies to hold their headquarters in a particular jurisdiction, it can be seen that tax advantages alone do not necessarily make any particular jurisdiction ideal. In a recent survey conducted by Grant Thornton in April 2013 found that 67% of companies would not relocate their headquarters just to reduce their corporate tax[90]. It is not unusual for large multi-national corporations to have numerous headquarters, "Such centres will usually provide the full range of administrative and management functions associated with a head office; for example, treasury and tax management, internal audit, public relations,

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[89] Ensight "International Headquarter companies – exchange control position clarified" http://www.ens.co.za/news/news_article.aspx?iID=183&iType=4

[90] http://www.gt.co.za/news/ibr/2013/04/80-of-sa-businesses-would-not-locate-to-another-country-for-any-level-of-reduction-in-the-corporate-tax-rate/ (last accessed 24th November 2013).

market research and marketing, insurance and accounting.[91]" Having this in mind, the location is also an important factor when choosing a jurisdiction as they often oversee and co-ordinate a groups activities within a particular region. Alongside the location are specific factors that are often considered when choosing a jurisdiction for a HQ company outside of tax considerations which include, political and investment climate including country risk, company and corporate law, rule of law, availability of reputable law and accounting firms, treasury considerations, including monetary control and currency exposure and risk, administrative ease and availability of reliable service, existing operational substance and infrastructure and cost factors[92]. It has been asserted that when certain features are not present in a jurisdiction, companies and their investors will not to set up their HQ companies there; such was the case in Denmark where the HQR was said to fail in the 1990's and the main consideration was that there were insufficient suitable accountants, lawyers or bankers[93].

i. Political and Investment Climate

The stability of a country is clearly an important factor when choosing to invest sums of money into that jurisdiction. "South Africa's post-democracy investment climate has been known to be one of the most attractive in Africa[94]" The country operates in a free-market economy and is viewed as one of the leading countries of such on the continent. There is however some controversy levied at the use of the Black Economic Empowerment Policies

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91 Ogley *Principles of International Tax: A Multinational Perspective* (1993) 137.
92 Finnerty *Introduction – Holding Companies* http://online2.ibfd.org/collections/hold/html/hold_ introduction.html
93 Shelton "Denmark Squares up for Holding Battle" December 1998 / January 1999 *International Tax Review* http://www.internationaltax review.com/?Page=10&PUBID=35&ISS=12655&SID=468670&SM=&SearchStr=%22interm ediary%20holding%20company%22
94 Otto. L, "Talks of Nationalisation: A bane for the South African Investment Climate" 16th August 2011 found at http://www.consultancyafrica.com/index.php?option=com_content&view=article&id=827:talks-of-nationalisation-a-bane-for-the-south-african-investment-climate&catid=82:african-industry-a-business&Itemid=266 last accessed 25th November 2013

("BEE") as some comment that this had led to an elite few becoming very affluent but has left the masses without education and empowerment. In 2010 the World Bank in its assessment of investment climates worldwide commented that South Africa "good relative to its peer group of upper-middle income economies[95]" having made significant strides forward since the turn of the last century, however it did note that it had considerable difficulties when it came to attracting direct foreign investment; this preposition was concurred with by the United States Department of States 2011 Investment Climate on South Africa. It found that whilst being open and encouraging to foreign investment there were an increasing amount of obstacles preventing companies from investing in South Africa, namely criminal violence, energy security, reintroduction to parliament a controversial expropriations bill and the talk of Nationalisation of Mines[96].

Political instability is regarded as one of the biggest stumbling blocks when it comes to investing in Africa, with companies reluctant to invest in Angola, Nigeria and the Democratic Republic of the Congo[97]. However, recently in South Africa issues have been raised in relation to the labour strikes most notably the Marikana strikes would cause concern in relation to investment. However when looking across the continent in comparison to other countries that have the same or similar infrastructure South Africa's stability would make it an attractive place to invest.

ii. The Legal System

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95 The World Bank Group, 2010. South Africa: Second Investment Climate Assessment.

96 US Department of State, "2011 Investment Climate Statement – South Africa", http://www.state.gov.

97 A Visser, "Political stability, Africa's biggest stumbling block says PWC" Business Day Live 1st October 2013, http://www.bdlive.co.za/africa/africanbusiness/2013/10/01/political-stability-africas-biggest-stumbling-block-says-pwc accessed 23rd November 2013

The South African system is said to provide for "robust legal enforcement through the use of various legal instruments of enforcement[98]" In addition the Constitution can be seen to have a clear entrenchment of rights in relation to proprietary deprivation[99], it states "[n]o one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property". The constitution also sets out the right to have your case heard in a court or independent forum, the right for access to documents held by the government, and a wide range of constitutional rights which will assist when it comes to enforcing rights within a company. This therefore acts a source of security when it comes to investing in South Africa.

iii Availability of Reputable and Competent Accounting and Law firms

As aforementioned in Denmark it has been remarked that the failure of the HQR in the 1990's was due to the lack of available firms. South Africa has the benefit that many of the top international firms have decided either to partner with or have set up offices within this jurisdiction. It would therefore seem that South Africa is well placed in respect of this element that is sought after when choosing a jurisdiction for a HQ company.

iv. Treasury considerations including currency risk

Companies have to consider when placing their HQ often consider the possibilities of financing within said jurisdiction. It has been reported that financiers are often reluctant to provide foreign borrowings or foreign currency borrowings due to the risk of repayment[100]. Despite the recent slump in the value of the South African Rand, it is still ranked amongst the least currency

[98] Thabo Legwaila "Commercial-law reasons (other than tax) for setting up a Headquarter company: A South African Observation" found at
[99] S 25(1) of the Constitution of the Republic of South Africa, 1996 (hereinafter "the Constitution");
[100] International Monetary Fund *Foreign Currency Borrowing More Risky for Eastern Europe* http://www.imf.org/external/pubs/ft/survey/so/2008/car102808a.htm

risk, it frequently ranked alongside Thailand or Mexico and on occasion is ranked above Euro and the Pound, Russia, Brazil, Indonesia and Turkey[101].

v. Raising external finance

Companies have various options available to them to assist them in raising funds, for example debentures, bonds, initial public offerings, preference shares, and loans. A holding company can be used to obtain preferential rates in the country in which it is resident. Moody's credit rating system for South Africa in 2013 for foreign currency rating was Baa1 stable compared to that of Mauritius which is BAA2 stable, this could be a deciding factor should the company know and wish to utilise the preferential rates.

Is the scheme a HQR?

Within the Income Tax Act and throughout much of the commentary the scheme that is being promoted is referred to as a Headquarters company that is a regime that allows companies to set up the Headquarters for their International companies. However it is suggested that this term maybe somewhat misleading, it is said that there is a difference between a Headquarter Regime and intermediary holding company regimes ("IHC"). The essential difference between a HQR and an IHC regime when one looks at it from this perspective is that an IHC is normally incorporated to facilitate the holding of other controlling interests within a group of companies to facilitate and manage the interests within a multinational group. A HQR would normally perform management functions, intra-group services and intellectual property services to affiliate companies. The difficulty with this is such actions most notably management fees, technical fees and interest paid by off shore subsidiaries are fully taxable under the current South African HQR[102].

101 Sovereign Risk and Currency Risk Ratings by Country http://seekingalpha.com/article/248600-sovereign-risk-and-currency-risk-ratings-by-country

102 http://www.thesait.org.za/news/96607/The-New-Headquarter-Company-Regime.htm

It is asserted that an IHC is "generally interposed between the holding company and the operating subsidiaries of a multinational group", with its primary purpose of an IHC is to hold shares. When choosing a location for an IHC the most common characteristics found within such jurisdictions are an absence of tax on dividend income and preferably also on other income received; little or no holding tax on dividends that are to be declared to the shareholders; no capital gains tax on profits from the disposal of investments; no tax on capital introduced; inapplicability of any control foreign currency on any money flowing into or out of the company; and the absence of exchange controls. South Africa with its current legislation exhibits most of the aforementioned features, save for It does apply a securities transfer tax on the transfer of any security at a rate of 0.25% of the taxable amount[103].

Will it Attract Investment?

Despite these clear advantages for companies to gain from the use of the HQR in South Africa, it can be seen that there are certain areas that have not been legislated for that the Act in its current form may still act as a barrier to companies basing such companies in South Africa. These factors include the HQ company will remain fully taxable on all other income, including donations tax and some forms of Capital Gains Tax, further it will not be a resident for corporate structuring purposes. In addition the restrictions mean that if South African residents hold more than 50% of the HQ company then its subsidiaries will be deemed to be CFC's. It is hoped by many critics of the scheme that there will be further amendments so to allow and encourage companies to choose South Africa for their HQC as opposed to the well established Mauritius which is also well placed for investment purposes and links into the Africa. Whilst it can be seen that South Africa has opened the doors for such investment, having such legislation is not fail-safe, some countries have utilised such legislation with little or no success, notably

[103] http://www.thesait.org.za/news/96607/The-New-Headquarter-Company-Regime.htm

Belgium, Ireland and the United Kingdom, so South Africa if to be utilised should ensure that it frequently considers what the investors are looking for in a HQR and endeavour to illustrate that South Africa can offer such.

Regardless of the relaxation of some of the exchange control rules, restrictions still apply in South Africa. In particular a South African incorporated company will be treated as if it is a ‘resident company’ therefore the exchange control restrictions will apply; therefore the ‘loop rule’ still applies, prohibiting South African residents from exporting capital by investing in non-CMA based jurisdictions that reinvest back into the CMA in whatever form possible[104]. Albeit, this issue can be averted if the company is not resident in South Africa, there is no rule that states that the company needs to be resident, it can be registered anywhere. A foreign incorporated company can be a tax resident in South Africa if it so elects, therefore avoiding the onerous exchange control restrictions.

An additional issue is the VAT regulations imposed in South Africa, which relates to the zero-rating of services to non-residents. This is deemed as very restrictive, as there is no provision for VAT relief provided for[105] .

Furthermore, South Africa may have to do some work on the immigration law, as it is seen as very difficult for even highly skilled migrants to obtain work permits in South Africa. Therefore it would be difficult for companies to set up headquarters within this jurisdiction if they wish to hire some staff from outside of the country[106] .

Conclusions

South Africa has taken considerable strides forward in opening itself up to be a place where investors will feel able and confident to invest in. Legislators

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104 Honnibal. M, and Killoran. R, “The New South African Headquarter Regime doesn’t quite cut it” Without Prejudice February 2011 29
105 ibid
106 ibid

have taken care in order to try to eliminate the previous tax disadvantages that were may have prevented investors from choosing South Africa before. There are however some issues that cannot be legislated against in particular the criminal problems and the somewhat turbulent political environment. That being said within the African continent there are very few alternatives that have the infrastructure that South Africa has. It appears that the strongest competitor on the continent would be Mauritius; Mauritius has been operating as a favourable tax jurisdiction for a significant amount of time it clearly will not be easy to compete for business against Mauritius, however it cannot be said to be an impossible task.

Chapter 4 - An in-depth look at Mauritius and its tax incentive scheme in comparison to South Africa

Mauritius is similar to South Africa in a number of ways, therefore makes an ideal comparator country, in that it is an African country, it is developing, and a member of SADC[107]. Mauritius is seen as one of the success stories of Africa, remarkably it was left relatively unscathed by the 2008 economic crisis that hit the rest of the world. It is therefore a likely template that other countries in and around the world not just the continent would try to mirror when trying to attract foreign investment. Despite the different historical backgrounds and vast population disparity it is apt to try to elicit similarities and differences in principle to the South African Headquarters regime and the Mauritian tax model. In this chapter I will discuss the background to Mauritius and its model, then go on to compare the South African Model with the Mauritius model.

Background

The island of Mauritius is renowned for not only its beauty but also for its place on the financial stage. In the 1970's Mauritius became one of the worlds first export processing zones. This was then developed further in the 1990's where it set up an International Financial Centre. Following this introduction Mauritius has been one of the top choices for businesses that choose to invest across the world[108]. There are a range of schemes that are permitted and often utilised, including investment holdings and collective schemes.

Mauritius has a resident based tax system governed by the Income Tax Act 1995, it is substantially based on that of the English system. A company is treated as a resident company if it is incorporated in Mauritius or if it is managed and controlled within Mauritius. Joory states that "The fact that the

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[107] T. Legwaila, "The tax treatment of holding companies in Mauritius : lessons for South Africa" (2011) SA Mercantile Law Journal Vol 23 Issue 1

[108] A. Zafar, "Mauritius: An Economic Success Story" January 2011 found at http://siteresources.worldbank.org/AFRICAEXT/Resources/Mauritius_success.pdf

board of directors of a company normally meet in Mauritius is prima facie evidence that the company's central management and control is in Mauritius.[109] " It is noted by Joory that "Foreign enterprises carrying on business in Mauritius are subject to tax only on their Mauritian-sourced income. When business is carried on through a registered branch, income is reasonable head office expenses incurred in relation to the branch operations. A branch is liable to tax at the same rate and in the same manner as a local corporation. There is no additional tax on the transfer of branch profits. Further capital gains are generally not subject to tax in Mauritius, although in certain instances capital gains that arise from the disposal of land can be taxed" [110].

The Financial Services Act which was adopted in July 2007 provides for a new more simplified regulatory regime, it differentiates between local Mauritian companies carrying out their business in Mauritius and those that conduct business outside Mauritius. The companies who are ultimately focussed on providing services or investment outside of Mauritius may choose to apply for the global business licence. The requirements for the Category 1 Global Business Companies are managed and controlled in Mauritius, such companies are required to have a form of "substance" in the country, they are also encouraged to make use or have their own research and other support services in Mauritius.

<u>What makes Mauritius a good place to do business</u>

Mauritius is a small island found in the Indian Ocean off the coast of the continent of Africa, measuring just over 2040 km2, with a population of 1.2 million, it is reported to have an economy one-hundredth the size of India yet it is the biggest exporter of capital to India. It has the single biggest source of

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[109] D Joory International Taxation of Low-Tax Transactions (2008) at II/63, available at http://books.google.co.za/books?id=prLYMAwtTcC&pg=PT52&lpg=PT52&dq=Mauritius

[110] Low Tax: Global Tax and Business Portal 'Mauritius: Country and Foreign Investment Regime', available at http://www.lowtax.net/lowtax/html/jmucfir.html (accessed on 15 Feb 2011).

foreign direct investment reported in 2002-2003 totalling $523 million[111]. Mauritius gained its independence from Britain in 1968, post colonisation it has managed to put itself on the forefront offering various range of services in particular services focussed on the financial sector. It is reported to be one of the most open and financially sound countries in sub-Saharan Africa[112].

Since independence Mauritius has enjoyed political stability, neutrality and democracy. It has designed its legislation so that it is business friendly based on best international industry practice with laws. The corporate taxes have been structured so that they range from between zero and 3 %. The Financial Services Commission, acts as an integrated regulator for non-banking financial services and global business has opted to take a business-friendly approach to regulation, this therefore encourages investment. The functions of the Commission include promoting the development of the financial services sector, it enforces norms that are prescribed international standard setters, for example the use of OECD compliant double tax treaties. With all of these issues in mind Mauritius is considered to be as reported by HSBC and Deloitte a jurisdiction of sound repute with a business friendly regulatory framework which acts an ideal platform for doing business with the rest of the world and encouraging outside investment[113].

Mauritius' reputation globally is quite outstanding for a country of its size and its relatively new independent status. It was ranked 1st in the 2010 Ibrahim Index of African Governance, it was also ranked 1st in the Small Island Developing state on the ease of doing business 2010 by the World Bank (whereon it was 1st in Sub-Saharan Africa and 17th globally); it is considered to be a white-listed jurisdiction recognised by the OECD, and it is ranked 12th in the 2010 index of economic freedom tracked by the Wall Street Journal and

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111 VShridhar.V, "Mauritius as a tax haven" Frontline, November 2003 found at http://www.frontline.in/static/html/fl2023/stories/20031121002108900.html last viewed on the 3rd December 2013

112 HSBC and Deloitte "Mauritius: A guide to local business" 2nd edition November 2010 found at https://www.hsbc.co.mu/1/PA_ES_Content_Mgmt/content/website/documents/guide_to_global_business.pdf last accessed on 7th December 2013.

113 ibid

the Heritage Foundation[114]. Mauritius' growth as a financial centre has been exponential; in 2010 it was reported to have 28,000 global business vehicles which includes 600 funds[115].

The Tax Structure

So whilst it is accepted that there are many other reasons why companies choose to set up their off-shore companies in Mauritius, a large proportion of companies will choose Mauritius for its possible tax incentives. There are two types of Global Business Companies (GBC) available to investors which are efficient for tax structuring, these types are based on the category of licence GBC1 and GBC2. A GBC1 is structured as a collective investment scheme, global fund, protected cell company or an investment holding company, trusts are also eligible to qualify for this scheme. A GBC1 has the benefits of the following;

- expanding double tax arrangements,
- low tax rate, tax rebates/credits,
- no withholding tax on dividends, interest and royalties paid
- No capital gains tax
- Free repatriation of profits, capital and interest
- No estate duty, inheritance, wealth or gift tax
- Protection of assets
- Income generated from Global Business activities is taxable at a maximum effective rate of 3%.
- A GBC1 is generally used when overseas income is predominantly in the form of dividends.

A GBC2 is eligible to carry out most business activities however with the caveat that it can only do so with non-residents and not using the Mauritian rupee. As a GBC2 it is not a tax resident and therefore cannot benefit from the

[114] http://www.hsbc.co.mu
[115] ibid

numerous double tax agreements. It is however completely exempt from paying taxes in Mauritius. It can take advantage of the flexible legal regime. This structure is suited to companies that are engaged in invoicing, marketing and international trading activities, it should however be noted that a GBC2 cannot conduct the following business activities, banking and financial services, carrying out the business of holding or managing or otherwise dealing with a collective investment, fund or scheme as a professional functionary, providing of registered office facilities, nominee services, directorship services, secretarial services or other services for corporations, providing trusteeship services by way of business. The normal tax rate is at 15% on taxable income. However in terms of Global Business Licence 2 companies, HQ companies, companies that are licenced to carry out activities in a Freeport Zone, and offshore trusts electing non-residence status there is nil income tax rate on total net income before distributions[116].

The use of tax credits in Mauritius has been provided for in the Mauritian Income Tax Regulations 1996. There are three forms of credit provided for, two of which apply to the tax paid, and the other is a notional presumed tax credit. Firstly, underlying tax credit is a mechanism that is used to reduce substantially or eliminate double taxation so that the same income is not taxed in more than one country. Foreign taxes that are paid by a resident taxpayer on foreign-source income generally is utilised to reduce the domestic taxes that are payable by the amount of the foreign tax. The foreign tax credit is granted on the amount taxable in Mauritius to extent that such amount that has been taxed in a foreign jurisdiction. This will also apply in relation to dividend income and where the shareholding is not less than 5 %. Secondly, presumed tax credit, this is based on presumed tax paid. It is an alternative to the underlying tax credit, whereby a certain amount of tax is presumed to have been paid, however there is no need for the taxpayer to produce no records of such payments or liability [117]. The legislation provides for 80% of

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[116] Legwaila. T, "The tax treatment of holding companies in Mauritius : lessons for South Africa" (2011) SA Mercantile Law Journal Vol 23 Issue 1
[117] Campbell. D, International Taxation of Low-Tax Transactions (2007) at II/61

the Mauritian tax chargeable in the case where no documentary evidence is produced in support of the payment of foreign tax at the same rate as Mauritius. Finally the tax sparing credit, which is a tax-treaty provision where the country of residence of the taxpayer for foreign taxes that for some reason were not actually paid to the source country, although would have been paid under the source country's normal tax rules. Such credit is normally provided for in respect of notional source country taxes of a certain kind, usually dividends, interest and royalties[118] .

Along with the tax exemptions aforementioned a company would also benefit from low operational costs, the use of well established and renowned financial and banking institutions, Mauritius also has a high number of qualified professionals who speak both English and French, which makes them even more appealing worldwide. Mauritius has also despite the label often being attached as a "tax haven" it is not referred to as such by the OECD and it is FATF complaint and has never been blacklisted. In addition, the country also benefits from relatively low crime rates and is seen as relatively safe[119].

Mauritius has also ensured that it provides adequate protection for the investors, namely, it has entered into a number of Investment and Protection Agreements (IPPA's) 18 of which are in force, including India and China, a further 16 are awaiting ratification. In addition Mauritius is also a member of the Multilateral Investment Guarantee Agency (MIGA), which is part of the World Bank Group. MIGA offers political risk insurance for projects and help investors manage risks relating to currency transfer restrictions and expropriation[120].

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118 Olivier. L & Honiball.M, International Tax – A South African Perspective (2008) at 333
119 Imra investing in Africa "Taxation and International Tax in Mauritius" http://www.imara.mu/files/Imara-Taxation%20&%20International%20Tax%20Sructuring%20in%20Mauritius.pdf last accessed 3rd December 2013
120 HSBC and Deloitte "Mauritius: A guide to local business" 2nd edition November 2010 found at https://www.hsbc.co.mu/1/PA_ES_Content_Mgmt/content/website/documents/guide_to_global_business.pdf last accessed on 7th December 2013.

A further incentive to utilise Mauritius is the tax system allows a taxpayer to obtain a tax ruling from the Director-General of the Mauritian Revenue Authority in respect of the application of the tax law to income that the taxpayer derives or may derive in the future. The ruling however does not apply to in respect of the transaction, as is the case with the rulings in South Africa, the ruling is in relation to the income[121] .

South Africa's system has been examined in detail in the previous chapter, the obvious differences in the tax exemptions that are;

- Whilst HQ companies are exempt from the CFC rules, however they could become applicable to shareholders of the HQ company if they are residents in South Africa and none of the CFC exemptions apply.
- South African transfer pricing rules do not apply to loans to subsidiaries so it is possible to avoid interest receipts in the HQ company by making interest free loans to subsidiaries. Money borrowed to on-lend to foreign subsidiaries is tax deductible against interest received from the foreign subsidiaries. In addition if the loan is from a connected person the thin capitalisation and transfer pricing rules do not apply. However other interest receipts are subject to the normal tax rules and can in principle attract 28%.
- Dividends received from its foreign subsidiaries are not liable to South African tax.

<u>Eligibility for HQR</u>

When considering where to place a HQ company the ease in which one is able to set up that business is imperative. For a GBC1 it must be a tax resident in Mauritius, the company must have at least two Mauritian directors, hold a Mauritian bank account, its accounting records must be kept in Mauritius, financial statements must be audited in Mauritius, at least two

[121] s 159(1) of the Income Tax Act of 1995, read with the definitions in s 1 of 'Director-General' and 'Authority'

Mauritius directors must attend directors meetings of the company and the company must apply for annual tax certificate[122].

In the previous chapter the requirements in order to qualify under the HQR in South Africa have been outlined, what can be seen that the requirements for local directors is not a pre-requisite, the focus is somewhat different from Mauritius it is based more on minimum percentages of what the company can own including that of its shareholders. Comparatively, one could say that Mauritius is more burdensome in terms of administration wise, however South Africa is more stringent in terms of the substantive ways in which to qualify under the scheme.

<u>The use of double tax treaties</u>

Mauritius has entered into a relatively high number of double tax agreements, it has entered into 39 agreements[123]. In general the benefits of the tax agreements are available to all Mauritian companies other than international companies. All of the Mauritian treaties are based on the OECD model treaties, and in the main have exchange of information clauses, however it should be noted that the exchange is limited to that of the working of the treaties themselves[124]. In comparison however South Africa has a greater number of double tax treaties with 70 in force. Having such an extensive number of treaties the network allows for tax relief in various corners of the world, including Australia, North and South America, Europe and Africa[125], whereas the Mauritian network is more target orientated and focuses on China and India and the surrounding countries.

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122 http:www.werksmens.co.za

123 Mauritius double tax treaties http://www.lowtax.net/lowtax/html/jmu2tax.html last accessed 7th December 2013

124 ibid

125 Lessing D, Malan D, “Private equity investments: SA headquarter company vs Mauritius GBC1 regime” found at http://www.werksmans.com/legal-briefs-view/private-equity-investments-sa-headquarter-company-vs-mauritius-gbc1-regime/ last accessed on 7th December 2013

The signing of the treaty with India found in the Income Tax Act 1961, marked a significant turning point with Mauritius in terms of the investment growth. The agreement specifies that capital gains tax will only be paid in Mauritius, and with the current effective tax rate of 3%, quality of service, long standing relationship with India, it is no doubt as to why the Indian connection is so strong[126].

China has become of huge importance to the region, notably in 2009 South Africa imported goods and services to the value of Rs70.8 Billion and exported goods and services to China for Rs48.7 Billion. Despite this, the tax agreement between South Africa and China signed on the 7th January 2001 is denoted as not a comprehensive agreement, in that it only applies to South African normal tax and secondary tax on companies, and Chinese individual income tax and income tax for enterprises with foreign investment and foreign enterprises. Juxtaposing this agreement with that of the one between Mauritius and China entered into on the 1st August 1994 highlights the inadequacies of the agreement, as it also applies to Chinese local income and capital gains tax as well as those mentioned in the agreement between South Africa and China[127]. It is concerning to note that as China is such an influential country in terms of its input into the South African economy that the agreement was not wider in scope.

Despite the obvious vast number of agreements that have been signed, the use of double tax treaties is however not without criticism, in 2002 the agreement between India and Mauritius came under scrutiny and attack from the Indian tax authorities, as a result of alleged abuses by Indian resident investors. After a number of high profile cases the issue for now has been resolved however there remain many critics of the agreement, there is now much talk of a new agreement being signed to quieten its critics.

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[126] Found at http://www.lowtax.net/lowtax/html/jmu2tax.html

[127] Van de Berg. A, "A comparative study of the double tax agreements between South Africa, Mauritius and China" found at http://upetd.up.ac.za/thesis/submitted/etd-03222012-172313/unrestricted/dissertation.pdf last accessed on the 6th December 2013

Disinvestment

When companies choose to enter into a new jurisdiction they should also consider what happens should they choose to disinvest, having certain requirements could be prohibitive. As aforementioned there is no capital gains tax levied in Mauritius, the disposal of shares in a GBC1 would therefore not give rise to any income tax implications; however dependant on the residence of shareholder they may be liable in that jurisdiction. In South Africa a HQ company applies the general principle in that non-residents are not subject to capital gains tax unless the asset disposed of is or relates to a fixed property situated in South Africa or to a permanent establishment of the non-resident in South Africa. Similarly with the disposal of shares by non-resident shareholders would not give rise to any South African capital gains tax implications. South African resident shareholders who dispose of their shares in the HQ company to another resident would however be subject to capital gains tax, although should it be disposed of to a non-resident then it will be exempt.

Termination of the schemes

A common question for investors is once they are in the scheme what are the consequences should they want to leave. The cessation of GBC1 status in Mauritius would not give rise to any tax implications. Similarly in South Africa cessation of the HQ status will not give rise to any tax consequences, aside from the issue should the company elect back into the status, doing so would be deemed to be a disposal at market value of the company's world-wide assets, and therefore potentially triggering the right f[128]or South Africa to levy capital gains tax on the disposal.

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[128] Lessing D, Malan D, "Private equity investments: SA headquarter company vs Mauritius GBC1 regime" found at http://www.werksmans.com/legal-briefs-view/private-equity-investments-sa-headquarter-company-vs-mauritius-gbc1-regime/ last accessed on 7th December 2013

Criticisms of the use of a HQ Regime in Mauritius

Earlier this year, Kofi Annan, the former UN secretary general, said it was "unconscionable" for companies to use unethical tax avoidance to maximise their profits "while millions of Africans go without adequate nutrition, health and education"[129]. As aforementioned the fight for the business of the multi-nationals takes place all over the world not just in Africa, countries are constantly offering preferential schemes in order to entice big business into their countries. The question that follows is what are the consequences to the countries that are being used to trade in but are not reaping the rewards by the tax being paid at a low or zero rate in other countries. Whilst Mauritius is OECD compliant and is not considered to be a tax haven by such institutions there are obvious knock on affects of companies not paying such tax. Actionaid[130] has levied such accusations on Deloitte who advise their clients legitimately to structure their investments through Mauritius so that they take advantage of the tax structure, an example that is highlighted is that a foreign company investing in Mozambique, such company would expect to may a withholding tax on the dividends flowing back to it from Mozambique to be that of 20%, a sale of the Mozambique investment could potentially leave the company liable for a tax bill of up to 32%. However, if the investment is channelled through a holding company in Mauritius it could limit the withholding tax to 8% and capital gains tax would be reduced to zero. This loss to a country of revenue is harmful, especially when we talk about developing countries in Africa, where countries are so reliant on foreign aid, if companies were paying the tax in the designated country such aid may be reduced significantly. Tax campaigners and activists are becoming increasingly concerned about the way in which Mauritius is being utilised by large corporations, in particular as it has taken steps to advertise itself as the gateway to Africa for companies embarking on investment on the continent. Mauritius has a large amount of double tax treaties within the continent, and it

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[129] http://www.africaprogresspanel.org/african-resource-revenue-widens-income-gap-says-africa-progress-report/ last accessed 12th January 2014

[130] Goodhall. A, "Charities dismiss Deloitte tax boss's broadside" Tax Journal 15th February 2013 found at http://www.taxjournal.com/tj/articles/charities-dismiss-deloitte-tax-boss%E2%80%99s-attack-15022013

is suggested by the critics that the terms of the treaties can be and have been abused so to avoid tax bills[131].

"The tax strategy advised by Deloitte could potentially be used to deprive some of the poorest countries in the world of desperately needed tax revenues," said Toby Quantrill, ActionAid Tax Justice Policy Adviser. "In using the example of Mozambique to illustrate their strategy Deloitte chose a country where the average income is less than two dollars per day and one third of the population is chronically food insecure. Developing countries need to grow their tax revenues, which are vital to help lift people out of poverty. But that can only properly happen if large companies stop avoiding their taxes."

Whilst the benefits can be seen for South Africa it is questionable whether the country has thought about the disadvantages that will be imposed upon the countries that are stripped of the tax revenue. There are however a number of counter arguments to this, namely it is questionable whether it is South Africa's responsibility to look after other countries on the continent and if they do not do it such business will be channelled elsewhere. Although one could argue that South Africa is seen as the 'big brother' of the Southern African states and by them encouraging such behaviour is not necessarily setting the right tone and atmosphere for investment in Africa. It could therefore be suggested whilst attracting investment into the continent is important, it is of a greater importance that the other states are not disadvantaged because of the structure.

Conclusions

[131] Doward. J, "Deloitte promotes Mauritius as tax haven to avoid big payouts to poor African nations" 3rd November 2013 found at http://www.theguardian.com/business/2013/nov/03/deloittes-tax-savings-investments-in-poor-countries last accessed on 12th December 2013

On close analysis of the two regimes there are a great deal of similarities. What is highlighted is that within the South African model there are a number of exemptions that one must be careful not to fall foul of whereas the Mauritian structure seems to be straight forward in its application. The difficulties come in the application and the question as to whether the HQR in whether South Africa is able to be fully utilised by the companies that may want to take advantage of the scheme. It could be suggested that South Africa could have used greater use of the knowledge and practice that Mauritius has acquired, a country who has a track record in the financial sector and they could have copied the Mauritian template, it would therefore be on a level playing field when competing against Mauritius, but as it stands there are still a number of cogent reasons why companies would choose Mauritius over South Africa regardless of the political and economic stability along with its track record may make Mauritius a more feasible option. Some critics suggest that in some ways the South African scheme is not at tax efficient when used as an international headquarter company regime, aside from the difficulties already mentioned there are exchange control issues which will continue to cause companies difficulties should they choose to set up their headquarters in the jurisdiction[132].

There is clearly a need to channel investment onto the continent, however it is dubious by offering such tax incentives whether this will benefit the continent or rather it will be another way of the large corporations taking advantage of the developing countries, leaving such countries without their natural resources and not providing tax revenues in return.

[132] Olivier. L, Honibbal. M, "International Tax – A South African perspective" Siber 2011

Chapter 5 - Other incentives that are used across the continent and the impact of the African Union

Whilst the focus of the dissertation has been on the South African use of the Headquarter Regime, it is interesting to note that some of the other African states have opted to introduce specialised regimes, that would attract companies who are in search of preferential rates. The benefits of being used as a haven or scheme has been discussed in detail in previous chapters, in essence the countries utilise the policy of imposing little or no tax with the hope of attracting high net-worth individuals and corporations to transfer much needed skills into their jurisdictions; what the countries lose out of in the form of direct taxes are often made up from indirect taxes, tourism, property purchases, and the increased amount of professionals employed in ancillary services[133]. This chapter will examine some of the alternative schemes that are available on the continent, initially looking at the SADC region and countries within this, briefly looking at other countries on the continent and look at how they could look and compare with the African Union intentions juxtaposed with the sovereignty arguments.

An overview of regional communities and countries and their tax incentives

South Africa forms an integral part of the Southern African Development Community ("SADC"). SADC was established in 1992, the goals of the SADC treaty in essence were to facilitate economic cooperation and integration between the signatory countries on the basis of equality and mutual benefit through cross-border investment and trade as well as freer movement of factors of production among members states[134]. At present the current

133 Mazansky 'The new South African headquarter regime' (2011) 65/3 Bulletin for International 26
134 Yinusa, Olalekan "Fiscal incentives for FDI and infrastructure development : economic diversification options for SADC countries" African Finance Journal, Issue 1 Volume 15 2013

members of SADC are Angola, Botswana, Democratic Republic of Congo ("DRC"), Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe[135]. Since its inception, the SADC countries have introduced individually and collectively an array of tax incentives in order to promote economic diversification and regional development. Such incentives have included reduced rate of taxes, remissions from customs duty for specified goods in particular manufacturing, corporate taxes that range in the region between 15-40%, with most of the SADC countries have withholding taxes for dividends, interest and royalty payments and sector-specific incentives are entered into and offered in order to attract foreign investment[136].

Angola

The Angolan economy is remarked upon as one of the fastest-growing economies in the world[137], between 2001 and 2010, Angola's Annual average GDP growth was 11.1 percent[138]. However like many developing countries it is recovering from the past unrest, in particular the Angolan Civil war that took place from its independence in 1975 to 2002[139]. The country has extensive oil and gas resources, diamonds, hydroelectric potential and rich agricultural land, infrastructure seems to be the main stumbling block however this situation is constantly improving, along with its political and social institutions[140]. It has made substantial strides forward in the last few years and is now in a position to promote itself as a stable country to attract foreign investment. In light of the political and economic stability the Government has

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135 http://www.sadc.int/about-sadc/overview/

136 Yinusa, Olalekan "Fiscal incentives for FDI and infrastructure development : economic diversification options for SADC countries" African Finance Journal, Issue 1 Volume 15 2013

137 Birgitte Refslund Sørensen and Marc Vincent. *Caught Between Borders: Response Strategies of the Internally Displaced*, 2001. Page 17 Pluto Press (October 20, 2001)

138 http://www.economist.com/blogs/dailychart/2011/01/daily_chart

139 Birgitte Refslund Sørensen and Marc Vincent. Caught Between Borders: Response Strategies of the Internally Displaced, 2001. Page 17 Pluto Press (October 20, 2001

140 http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Angola%20-%20African%20Economic%20Outlook.pdf

put forward various schemes to entice investment. These are set out as follows;

15 YEARS EXEMPTION - Investors will be free from paying tax in Angola on the capital invested, for a period of 15 years, when they invest in the provinces of Huambo, Bié, Moxico, Kuando Kubango, Cunene, Namibe, Malanje and Zaire[141].

12 YEARS EXEMPTION - Investors will be free from paying tax in Angola on the capital invested, for a period of 12 years, when they invest in the provinces of Kwanza Norte, Kwanza Sul, Bengo, Uíge, Lundas and inland municipalities of Benguela, Cabinda and Huíla[142].

8 YEARS EXEMPTION - Investors will be free from paying tax in Angola on the capital invested, for a period of eight years, when they invest in the provinces of Benguela, Cabinda and Huíla, and in the municipality of Lobito.[143]

Much of these incentives are targeted at projects that are located in the rural areas, and would hopefully aid the development of such regions. The Angolan regulations stipulate that exemptions or reductions are allowed for industries producing goods that the local industries do not produce, or they are introducing new technologies that are deemed to be important to the national economy. Such incentives are also available to new industries and to commercial activities that are set up within the region that can be considered to be of interest to the Angolan national economy. There are also special tax exemptions that are provided for when acquiring land and buildings for the use of new industries or the improvement of existing ones[144].

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[141] http://www.angolaconsulate-tx.org/index.php/us/angola-o-pais/investments-investimentos.html last accessed 13th January 2014
[142] ibid
[143] ibid
[144] Angola Tax Guide 2012 found at https://www.pkf.com/media/386978/angola_2012.pdf

Botswana

Botswana, has a population of less than 2 million, regardless of its size is entering the market and offering a sustainable low tax environment[145]. The Botswana International Financial Services Centre("IFSC") states that it is an attractive location as is a stable country, with "economic liberalisation, privatisation, infrastructure development, and the growth of consumer services and financial services group positions Botswana as a strong and economically sound investment destination of choice[146]". SADC has an estimated market of 200 million people, therefore despite the small population in Botswana its positioning lends itself to access a greater market. With all this in mind Botswana is considered to be one of the most successful of all small developing countries in attracting and managing FDI to achieve economic growth and transformation.

Aside from the position of Botswana and its political stability, Botswana has put in place a relatively low tax environment to entice investors and corporations. Companies that fall under the IFSC qualify for a discounted corporate tax rate of 15% of profits, they are also exempted from withholding tax on interest, dividends, management fees, royalties paid to a non-resident, value added tax, capital gains tax and the disposal of shares. Such companies are also eligible and have access to Botswana's 200% tax training rebate. Much like South Africa it has access to many double tax treaties, however Botswana has significantly less with only 13 actually in force, albeit 12 are under negotiation and ratification. Botswana has made provision for the reasonably small amount of double tax treaties and the legislative framework as set out in the Income Tax Act, this allows accredited companies access to a unilateral credit of up to 15% for withholding taxes which are incurred in jurisdictions with which Botswana does not currently have a double tax treaty[147].

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[145] http://www.botswanaifsc.com/about_botswana.php last accessed 20th December 2013.
[146] ibid.
[147] KPMG "2013 – Thinking beyond borders Botswana" found at https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/thinking-beyond-borders/Documents/botswana-2013.pdf

Malawi

The economy of Malawi is predominantly reliant on agriculture. The current economy relies on substantial inflows of economic assistance from International Organisations. In 2011 Malawi was ranked the 118th safest investment destination in the world[148]. In order to improve the economy Malawi has begun to start to target foreign investment. New corporate investors investing in excess of US$10 million are offered two options, either they can pay their corporate tax at the rate of 15% or alternatively they can take a 10-year tax holiday. In addition for those that invest between US$5-10million, they are given the option to pay 15% corporate tax or they can take a 5 year tax holiday. Furthermore, manufacturing companies are able to deduct operating expenses that are incurred up to 24 months before the start of their operations[149]. There is however no holding company regime[150].

Namibia

Namibia gained its independence relatively recently in 1990 from South Africa. It has a similar size population to that of Botswana with a population of 2.1 million. It has a stable multi-party parliamentary democracy. Its main sources of income are agriculture, herding, tourism and mining industry. It is however considered to be a higher middle income country with an estimated annual GDP per capita of US$5,828 albeit there are extreme disparities and inequalities in the population[151].

Since its independence, Namibia has pursued free-market economic principles with its aim to promote commercial development and job creation.

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148 Euromoney Country Risk. Euromoney Country Risk: Euromoney Instiutional Investor PLC, last accessed 23rd August 2013

149 Yinusa, Olalekan "Fiscal incentives for FDI and infrastructure development : economic diversification options for SADC countries" African Finance Journal, Issue 1 Volume 15 2013

150 http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-highlight-2013-Malawi.pdf

151 "Independent Evaluation of the UNDP Country Programme Document" (doc). UNDP.

In 1990 the Government passed the Foreign Investment Act of 1990 this sets out guarantees against nationalisation, freedom to remit capital and profits, currency convertibility and a process of settling disputes equitably.

Investment incentives in Namibia due to the nature of the industries already established are targeted at manufacturing and export promotion. The incentives that are provided for are to registered manufactures these include a deduction, limited to taxable income from manufacturing of 50% of manufacturing gross income, for a period of 5 years, spread over 9 years, there is an accelerated allowance in relation to buildings for the purpose of manufacturing, and further there is an additional allowance of 25% for employment and approved training costs for employees that are directly engaged in manufacturing operations. Companies can also claim for an additional tax allowance in respect of particular export marketing expenditures[152].

South Africa

Aside from the central focus of this dissertation being the headquarters regime, South Africa also provides for certain tax exemptions to encourage foreign investment. There are provisions for a tax holiday scheme for newly formed companies that commence new manufacturing activities; such companies have to make an investment exceeding 3 million South African rands in plant, machinery, land and buildings. This exemption can apply to companies that take over assets from a connected party, provided that the company makes an equal investment into new and unused assets.

Zambia

Zambia has a population of about 13 million, it is considered to be one of the sub-Saharan Africa most highly urbanized countries, with half of the

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[152] Yinusa, Olalekan "Fiscal incentives for FDI and infrastructure development : economic diversification options for SADC countries" African Finance Journal, Issue 1 Volume 15 2013

population concentrated in a few urban zones along the major corridors[153]. The National GDP has actually doubled since independence, however the annual incomes have not increased in line with this, this is reported to be due to high birth rates and AIDS, it is therefore considered to be among the world's poorest nations. Zambia was ranked the 127th safest investment destination in the world[154]. Like the other SADC countries is trying to incentivise investment, although they have taken a different approach and are focussing on the development of small enterprises and specific sectors which include firms producing for the external market that are deemed vital to the growth process of the economy. Significant discounts are given for instance to rural enterprises, they are taxed at a reduced rate of one seventh of the normal tax rate. There are numerous incentives offered under the Small Enterprises Development Act of 1996, they are entitled to exemption from income tax for the first three years should they operate in an urban area and they get the exemption for five years should they operate in a rural area. They are also entitled to operate as a manufacturing enterprise without a license and are exempt for paying taxes for the first five years[155]. This approach seems to be promoting growth from within rather than foreign investment, however there does not appear to be any restriction on a foreign company setting up their operations and conducting business and therefore taking advantage of the incentives that are targeted at small businesses.

Countries Outside of the SADC Region

Nigeria

Nigeria's economy has been growing exceptionally quickly especially when compared to that of South Africa, accordingly it is said that it is the second largest economy after South Africa[156]. The International Monetary Fund puts

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153 World Bank "Upgrading of low income settlements, country assessment report" 2002
154 Euromoney Country Risk". *Euromoney Country Risk*. Euromoney Institutional Investor PLC
155 Yinusa, Olalekan "Fiscal incentives for FDI and infrastructure development : economic diversification options for SADC countries" African Finance Journal, Issue 1 Volume 15 2013
156 http://www.oecd.org/swac/publications/Nigeria_e-version_en_light.pdf last accessed 16th January 2014.

Nigeria's GDP this year at $292 billion (R2.8 trillion) and South Africa's at $354bn[157]. It is also asserted that should this trend continue it will become the largest economy in South Africa in just a few years. Naturally with a bigger economy, increased foreign investment is likely to follow, therefore it stands as a good comparison to South Africa as to what the country is doing to entice such investment.

Like many of the other African countries aforementioned, Nigeria has entered into a number of double taxation agreements. Such agreements have the purpose of affording relief from double taxation in relation to taxes imposed on profit taxable in Nigeria and any taxes of a similar character that are imposed by the opposing country. Nigeria has signed double taxation agreements with the following countries;

- UK;
- France;
- Netherlands;
- Belgium;
- Pakistan;
- Canada;
- Czech Republic;
- Philippines; and
- Romania.

There are ongoing discussions with various other countries, including Turkey, Russia, India and Korea. In addition, as a concession the Government of Nigeria has approved a lower treaty rate of 7.5 on dividends, interest, rent and royalties.[158]

In order to gain more traction and to promote confidence in the Nigerian economy, the Nigerian Government has also entered into bilateral investment promotion and protection agreements ("IPPAs") with countries that do

[157] E. Hazelhurst, "Nigeria to overtake SA as top economy" Business Report October 21 2013, found at http://www.iol.co.za/business/opinion/columnists/nigeria-to-overtake-sa-as-top-economy-1.1594704#.UtU3ObuXRjQ last accessed on the 14th January 2014
[158] http://www.nipc.gov.ng/investment.html last accessed on the 14th January 2013

considerable businesses with Nigeria. This serves to guarantee the safety of the investment of the contracting parties in the event of a war, revolution, expropriation or nationalisation. This agreement also guarantees the investors the transfer of interests, dividends, profits and other incomes including compensation for dispossession or loss. These agreements have been signed with numerous countries including France, UK and South Africa[159].

There have also been a number of changes to legislation in order to assist with the perception and the reality of doing business in Nigeria, for example the repeal of the Nigerian Enterprises Promotion Act 1972 coupled with the promulgation of the Nigerian Investment Promotion Act of 1995 liberalised the ownership structure of business, that removed the early restriction for foreigners could only own 40% of businesses to them now being able to own 100% shares in any company. Furthermore, under the Monitoring and Miscellaneous Provision Act No. 17 of 1995 foreign investors that states that foreign investors are able to freely repatriate their profits and dividends net of taxes through an authorised dealer[160].

Ghana

Ghana has a population of just over 25 million[161], its economy is diverse, from primary manufacturing and exportation of digital technology goods, automotive and ship construction, to industrial minerals and hydrocarbons[162]. Ghana is said to have one of the highest GDP per capita in Africa, it is also regarded as being one of the top-ten fastest growing economies in the world, and the fastest growing economy in Africa[163]. The top income tax and corporate tax rates are 25%[164]

[159] http://www.nipc.gov.ng/investment.html last accessed 12th November 2013
[160] ibid
[161] http://www.ghanaembassy.org/index.php?page=population
[162] "New fuel for faster development". *worldfolio.co.uk*
[163] "The Top 5 Countries for ICT4D in Africa". *ictworks.org*.
[164] Ghana Economy". *heritage.org*.

In recent years Ghana has set up a number of investment incentives that promote new enterprises and support the business that are already ongoing; this includes tax holidays, tax rebates and exemptions and capital allowances. The tax holidays that are given vary dependant on the business type ranging from 5 to 10years. In terms of capital allowances, these are granted to investors who own depreciable assets and use these assets in the production of income. Again the assets are grouped and the rates vary from 10% to 80%. There are a number of general incentives that are offered to foreign investors to assist the economy, one such way is that whilst foreign investors are permitted to own a company 100% in Ghana, partnerships and joint-ventures with locals are encouraged. This is done by lowering the equity requirement for a joint venture to USD$10,000 as opposed to USD$50,000 for wholly foreign enterprises. Furthermore, foreign businesses operating in country are eligible for a set number of work permits for foreign expatriates, the amount of such is dependant on the amount of the investment[165]. What can be seen is by offering this, would increase the exposure of the potential workforce, and add value to the economy including real estate, and general living expenses of the foreign expatriates.

In addition to the above there are also tax rebates given for certain industries dependant on where they are located. For example manufacturing industries that are located in Kumasi are entitled to a 25% tax rebate, and manufacturing industries located outside Kumasi but within the Ashanti region are entitled to a 50% tax rebate.

Furthermore, there are incentives under the Ghana Free Zones Program, when an enterprise operates under the Ghana Free Zones Act, 1995 it is eligible to the following[166];

1. 100% exemption from payment of direct and indirect duties and levies on all imports for production and exports from free zones.
2. 100% exemption from payment of income tax on profits for 10 years and shall not exceed 8% thereafter.

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[165] *The GIPC Act, 1994 (478),*
[166] http://investinkumasi.com/investment-incentives last accessed 15th January 2014

3. 100% exemption from payment of withholding taxes from dividends arising out of free zone investments.
4. Relief from double taxation for foreign investors and employees.
5. No import licensing requirements.
6. Minimal customs formalities.
7. 100% ownership of shares by any investor, foreign or national.
8. No conditions or restrictions on: repatriation of dividends or net profit; payments for foreign loan servicing; payments of fees and charges for technology transfer agreements; and remittance of proceeds from sale of any interest in a free zone investment.
9. Permission to operate foreign currency accounts with banks in Ghana.
10. Authorization to sell 30% of annual production of goods and services in the local market (at least 70% of goods and services of free zone enterprises must be exported).
11. Guarantee against nationalization and expropriation.

How does this fit with the Goals of the African Union

The main objectives of the AU were, 'inter alia, to rid the continent of the remaining vestiges of colonization and apartheid; to promote unity and solidarity among African States; to coordinate and intensify cooperation for development; to safeguard the sovereignty and territorial integrity of Member States and to promote international cooperation within the framework of the United Nations'[167].

Each of the countries that have been detailed above are signatories to the African Union Charter, that is that they agree to be part of the overall objectives. Each country is also a signatory to one if not more than one regional organisation which have similar objectives, including free trade. As illustrated each of the countries have differing tax incentives and benefits that are offered with little or no harmony, which then leads to foreign corporations shopping around for the system that best suits their needs. The difficulty that

[167] http://www.au.int/en/about/vision

arises is that by virtue of the headquarters scheme in South Africa, it could in effect be taking money that should have been paid into Botswana, or Nigeria for example or the reverse, this clearly would not promote unity and may of course hinder development.

A further issue when considering the impact of the African Union is that of fiscal sovereignty which can be described as the legal right of a country to maintain control over its fiscal policy without any supervisory control from another country[168].The general principle that is applied worldwide is that a country need not take heed of the tax rules that are applicable outside of its jurisdiction, this can be traced back as early as 1735. Notably in the Government of India v Taylor[169], the House of Lords rejected the claim for the recovery of capital gains tax levied by the Indian Government by a company that was trading in India, however the company had transferred its assets to England prior to it being wound up. The difficulty arises when the property is moveable, so the country must devise means of collecting the taxes from a taxpayer while the taxpayer or his property are still within its jurisdiction or alternatively embark upon the use of the double taxation agreements with its trading partners. The African Union objectives therefore somewhat conflict with these principles, and therefore make it increasingly difficult for countries to pursue their own interests economically whilst trying to stay in line with the economic policies of the African Union, however similarly in the European Union each country is sovereign and has the right to pass its own legislation in relation this is not found to go against the protocol utilised in the EU.

Conclusion

With a brief overview of the tax incentives and other incentives that offered to facilitate further investment in each of the countries aforementioned on the continent, it is clear that there are multiple strategies employed in order to attract said business and investment. Botswana is a country that has

[168] Sanni. A, "Sovereign rights of tax havens and the charge of harmful tax competition" Taxtalk issue 31 14-18 Nov/Dec 2011

[169] 1955] AC 491

employed a similar concept to that of South Africa in terms of setting up a regime to facilitate headquarters. Nigeria has offered a comprehensive system to also try to attract foreign investment. It appears that most of the countries that have been mentioned went through considerable hardship and struggle, the infrastructure is something that most countries need to be able to improve upon in order to compete with the likes of South Africa, or indeed worldwide alternatively they are utilised to remove natural resources and these are then sold to the rest of the world. It does beg the question as to whether there could be some way in which to harmonise these policies so that he investment that comes in benefits the continent as a whole rather than competing with each other?

The question that follows is whether these incentives to encourage foreign investment are they actually worthwhile. From much of the commentators it is clear that the relative costs and benefits of the incentives the debate is inconclusive. Commentators like Sherif and organisations such as the World Bank[170] have argued that fiscal incentives in the form of tax holidays may indeed have a positive effect on the location of foreign direct investment under certain conditions, and therefore stimulate industrial development. There are many sceptics including Morrisset and Pirnia[171], Edmiston, Mudd and Valev[172] who question the relevance of fiscal incentives in achieving the objective of industrial development. They argue that the use of fiscal incentives is an unproductive diversion of hard to generate revenues to attractive foreign investment when compared with the significant revenue losses that are made to the continent of Africa where such funds are desperately needed.

Something that cannot be denied is the need for the economies in Africa to diversify and to grow in order to compete with other countries worldwide. There is the need for substantial investment in each of the countries

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[170] Sherif. K, "Globalization of investment and its impact on the developing world" found at www.k**sherif**.com/.../30-**Global**ization_of_investment_and_its_impact_o... last accessed on the 15th January 2014.

[171] Morisset, J. and Pirnia, N, 'How tax policy incentives affect foreign direct investment: A Review', World Bank Policy Research WP. 1999

[172] Edmiston, K, S. Mudd and N. Valev, "Tax Structures and FDI: The deterred Effects of Complexity and Uncertainty", William Davidson Working Paper 558. 2008

aforementioned, it is therefore hoped that by using foreign investment does not lead to the demise of such economies by in effect taking money from one developing country to give to another developing country. In light of this it may be necessary that when countries are facilitating the use of tax schemes that the countries that are being denied the use of such revenues that are paid elsewhere are somehow compensated for that along with the use of the OECD's concept of harmful tax practices should be borne in mind.

Chapter 6 Brief analysis on some countries in Europe and the affect of the European Union

Introduction

The African Union and Regional communities in Africa often try to mirror or utilise best practices that can be garnered from the European Union structure so to fulfil the goals and ambitions of the members of the organisations. It is evident that the countries within Europe are at significantly different development stages to that of the countries in Africa. In this chapter I will look briefly at the some of the countries in Europe that have favourable tax incentive schemes to entice foreign investment, look at the regulations by other institutions including identifying if there are any lessons that can be learned by South Africa in order to have a successful tax scheme without impinging on the aims and objectives of the African Union.

European Union ("EU")

The EU currently comprises of 28 countries that are located within Europe[173], it is considered to be a "unique economic and political partnership[174]" that was set up in the aftermath of the Second World War. Initially, its mandate was to create a state of economic cooperation and to encourage trade between themselves, however this organisation has significantly grown from what started as an agreement between 6 countries, its focus has also rapidly expanded to include political, legal, development aid and environment. It is argued that through the work of the EU, it has created an environment of peace, stability, prosperity, helped raise living standards and has launched a single European currency.

Despite the obvious progress and development that has been made within the EU, there is still an appetite for countries to encourage businesses to set up within specific jurisdictions and for foreign investment; this has significantly

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173 http://europa.eu/about-eu/facts-figures/economy/index_en.htm
174 http://europa.eu/about-eu/index_en.htm

heightened after the economic crisis of 2008. In order to attract investors many countries are offering lower than average corporate tax rates and special incentives.

Ireland and the Luxembourg are both members of the EU. The EU's Parent-Subsidiary Directive applies directly to dividends that are declared by companies that are resident within the EU to companies that are resident in these countries[175] . This in effect means that when the holding company receives a distribution of profits from the subsidiary, the country of the holding company should not tax these profits, or should only tax such profits while authorising the holding company to deduct from the amount due the portion of the corporation tax paid by the subsidiary that relates to those particular profits. In relation to the profits that a subsidiary distributes to its holding company should also be exempt from withholding tax It is said that the Parent-Subsidiary Directive only benefits investors on dividend payments within the EU[176] .

Republic of Ireland

Ireland joined the European Economic Community, the predecessor to the EU in 1973, since that time it has had the benefit of €67 billion in funding from the EU[177]. In recent years Ireland entered into a financial depression, this occurred after the property crash in 2007/8 which had a lingering affect on the Irish economy. Subsequently the Government has instituted a number of incentives that have been formulated and implemented into the economy, importantly Ireland was able to diversify its economy by using structures such as the Shannon Free Zone and the International Financial Centres in Dublin Notably, the Republic of Ireland has one of the lowest corporate tax rates in the EU, which currently stands at 12.5%, this is less than half the level offered

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175 Council Directive of 23 July 1990, Parent-Subsidiary Directive 90/435/EEC

176 Legwaila. T, "Tax impediments to holding company structures in Belgium, Ireland and the United Kingdom: caution for South Africa" South African Law Journal 2011 Vol 128 Issue 3 533-559

177 "How the EU is financed" found at http://www.eu2013.ie/ireland-and-the-presidency/abouttheeu/theeuexplained/howtheeuisfinanced/

by the UK[178]. Ireland has a global system of corporate income tax, in that it has a residence-based tax system, the provisions for this are contained in the Tax Consolidation Act of 1997.

In terms of foreign investment, Ireland has made itself attractive in a number of ways, a number of which can be seen in the South African system[179].

- There is no foreign exchange control restrictions that are imposed on the import or the export of capital.
- Any repatriation payments can be made in any currency.
- There is no restriction on the holding of bank accounts by either residents or non-residents and such accounts can hold money in any currency.
- A corporation is deemed to be a resident if it managed and controlled in Ireland, non residents are taxed only on Irish source income.
- Corporate tax is imposed on a company's profits, this includes business/trading income, passive income and capital gains.
- Dividends that are received by an Irish-resident company from another Irish company are exempt from corporation tax, dividends that are received from a foreign company are subject to corporation tax in the period the dividends are payable but a credit for underlying corporate and withholding tax is usually available for any foreign tax that has been paid.
- Capital gains are taxed at 33 and 40%, where there are gains on the sale of substantial shareholdings in companies resident in EU member states or alternatively a tax treaty country (where a tax treaty has been signed) are exempt when certain conditions are satisfied, however certain dividends from the EU and tax treaty territories are taxed at the 12.5% rate. It should also be noted that foreign tax paid generally may be credited against Irish tax on the same profit, however the credit is limited to the amount of Irish tax payable on the foreign income[180].

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[178] http://www.detini.gov.uk/attracting_fdi_corporation_tax.pdf

[179] See 'Irish holding companies' available at http://www.byrnemccall.ie/byrnemccall/ Main/HoldingCompanies2006–5.htm, accessed on 17 December 2013.

[180] http://www.omahonydonnelly.ie/taxation-ireland/ last accessed 20th January 2014

Notably and similarly to South Africa, Ireland has a holding company regime. There are generous reliefs given if one can qualify, in order to do this a company an Irish parent company must own at least 5% of the subsidiaries ordinary share capital for a period of 12 months over the proceeding 24 months, the investee company must be in the EU or a tax treaty country, and at the time of the disposal the investee must exist wholly or mainly for the purposes of carrying on a trade. Should this be the case, broadly speaking disposals of shareholdings in EU or double tax treaty resident countries would not pay Irish tax[181].

The benefits of falling under this scheme are numerous, they entail;

- Share disposals which are generally tax free
- Benefit of the tax credit scheme means that receipt of dividends are tax free
- Access to the tax treaty network which is rapidly expanding, currently standing at 55 of which 46 are in effect[182]
- Generally the interest on withholding tax is nil along with dividend withholding tax
- No thin capitalisation rules
- Limited transfer pricing rules[183].

The comprehensive package of tax incentives has been proven to entice a number of multinational corporations to set up their headquarters in its jurisdiction. It has been reported that the "top ten born on the internet companies have chosen Ireland for their FDI, together with 8 of top 10 the US

181 Vale. P, "Ireland: Further positive changes to the Holding Company Regime" 30th July 2012 found at http://www.internationaltaxreview.com/Article/3068216/Ireland-Further-positive-changes-to-holding-company-regime.html last accessed 21st January 2014

182 Callan, T., Savage, M. "Tax and Taxable Capacity: Ireland in Comparative Perspective", ESRI Research Note 2012/4/1

183 Phelan. M 'Holding companies: The new regime' (2005) 37 Accountancy Ireland 44–5; A Connell & C O'Meara 'Ireland: Ireland's new rules on the taxation of dividend income — Some practical considerations' (2008) 19 International Tax Review available at http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=24924&SID=710730&TYPE=20, accessed on 14 November 2009

ICT companies and 9 of the top 10 global pharmaceutical companies.[184]" It is however debateable whether it is purely for tax purposes that the countries have chosen to locate themselves in this jurisdiction, or as discussed in earlier chapters was the decision more than just for tax reasons.

It can be seen that the main tax attractions in Ireland are somewhat restricted to companies that are resident in the EU and countries which Ireland has a DTA. The corporate tax rate of 12.5% is not applicable to dividends not received from non-EU member states and countries that Ireland does not have a DTA with. However the pooling of foreign tax credits could be used to offset the adverse implication on dividends that are forthcoming from non-EU member states and that do not have DTA with Ireland[185].

Luxembourg

Luxembourg is regarded as the richest member state of the EU, second highest by gross domestic product per capita in the world and perhaps the world-leading hub for global fund distribution[186]. As a country its economy mostly relies upon the banking, steel and industrial sectors. It has a longstanding tradition as a financial hub and business centre. Its location is helpful to its working relationship within Europe, it is in the centre of Europe, it is regarded as politically stable, and has a highly qualified workforce. In 1957, Luxembourg became one of the six founding countries of the EEC and in 1999 it joined the euro currency, as a member it has to comply with all EU directives and regulations including the single external tariff and a single market within its external borders.

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[184] Vale. P, "Ireland: Further positive changes to the Holding Company Regime" 30th July 2012 found at http://www.internationaltaxreview.com/Article/3068216/Ireland-Further-positive-changes-to-holding-company-regime.html last accessed on the 21st January 2014

[185] Legwaila. T, "Tax impediments to holding company structures in Belgium, Ireland and the United Kingdom: caution for South Africa" South African Law Journal 2011 Vol 128 Issue 3 533-559

[186] World Bank http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries/1W?display=default last accessed 22nd January 2014

The Luxembourg government like many other European countries actively seek foreign investment, there are however no special procedures for the approval of foreign direct investment. The two most commonly used corporate entities are sociètè à responsabilitè limitèe (“SARL”) and sociètè anonyme (“SA”). A SARL is a private limited company and a SA is a public limited company. However there are special structure, a significant one is the Societas Eurpaea (“SE”) that are designed specifically to enable companies to operate across the EU with a single legal structure, this would facilitate mergers and provide flexibility should a company wish to move its head office from one EU state to another with minimal formalities. Notably in terms of SA or SARL there are no residence or nationality requirements[187].

In relation to tax, Luxembourg offers tax credits for qualifying investments in enterprises located within its borders, as well as eligible assets physically used in another European Economic Area (“EEA”) country. Such assets in the main consists of depreciable tangible goods other than buildings, livestock and mineral or fossil deposits. There is a global investment tax credit of 7% of the acquisition price of investments made during the year is available, subject to a ceiling of €150,000 and 2% on investments made over €150,000. Any credit that is not used can be carried forward for a period of 10 years[188].

Luxembourg offers an attractive regime for locating the headquarters of a multinational enterprise. However it should be noted that the activities must be limited to intra-group transactions in order to benefit from the tax advantages that are offered. Qualifying headquarters are exempt from withholding tax paid on dividends or liquidation proceeds, royalties and interest payments, the tax administration in relation to thin capitalization is fairly flexible, and tax losses can be carried forward indefinitely. In terms of corporate income tax this applies only to the remuneration of activities effectively carried out by the headquarters, in the case of an intra-group back to back financing, the tax base consists of a small interest spread which can range from ¼ to 1/32%

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[187] http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-luxembourgguide-2013.pdf
[188] ibid

depending on the amount involved, the profit share generated by the Luxembourg offices of up to 5% on activities carried out by the foreign branch. In addition, similar to Ireland and South Africa, Luxembourg has a broad tax treaty network, with 64 countries, companies that are located within its jurisdiction can benefit from the treaty networks and benefit from the tax exemptions notably income tax, and withholding tax on outgoing distributions. The company Skype notably has its global headquarters and data centre facilities in Luxembourg[189].

Luxembourg is often a country utilised when using cross-border distribution of investment products, in particular due to the exemptions that are offered, no taxation on income and capital gains, no withholding tax (subject to any EU directives) and no wealth tax. The only cost is on the subscription tax and the minimum income tax could apply to the fund. Further to this Luxembourg also offers an attractive environment for Islamic finance investments, with regulations that are imposed within the jurisdiction are particularly flexible and allow for the possibility to structure regulated vehicles so that they can efficiently accommodate Sharia'a-compliant investments[190]. Notably, South Africa has also made provision for this within its rules.

The View of Europe and the Impact

It will be rare to find a country that is content to be regarded as a tax haven under the definition of the OECD, most countries do not wish to be blacklisted and indeed change their regulations to become more transparent and compliant so that they are not deemed to be a tax haven; a label that has activists, campaigners and the public at large are easily alarmed at. Ireland and Luxembourg are two examples of countries that have fought hard to rid themselves of such labels. However, as one can see when their tax structure is analysed is that they have certain incentives that are meant to entice

[189] www.luxembourg.public.lu/catalogue/ecomie/lfb-conquer-world-lux-headquarter/lfb-conquer-world-2011-EN.pdf
[190] http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-luxembourgguide-2013.pdf

foreign investment and fit particular criteria that could lead critics to suggest that they have tax haven tendencies. Being part of the EU somewhat tames any suggestion that either country could be labelled as a tax haven, as the EU, OECD and other bodies are against tax havens, and force countries to comply and to adopt what some could say are international practices.

There are a number of proposals that are currently being adopted so to discourage companies from ‘dodging’ tax to the detriment of the country where the operational or works are being physically carried out. Within the EU, the European Commission has designed the Commission Consolidated Corporate Tax Base (“CCCTB”) initiative, which is an optional additional new tax code that would be adopted across the EU. The concept in essence will be for a set of common rules to be agreed for determining the tax base of companies with operations in several EU Member States. It will concentrate on the company’s real activities in particular the share of a company’s total property, payroll and sales, instead of prioritising the legal form of the company. It is envisaged that participating member state corporations could opt for the application of the common European tax base to be used regarding all their activities within the EU. It is also suggested that the International Financial Reporting Standards should be used as a framework for defining the tax base.

In addition, in 2010, numerous EU foreign affairs ministers committed themselves and their countries to providing for a more development-friendly international framework in order to assess the harmful tax practices and to increase cooperation and transparency. Further that year there was a reforming directive 77/799/EEC “on which administrative cooperation in the field of taxation has been based since 1977”. This working paper is an attempt to take heed of the previous commitments made by the G20 and EU in relation to effectively addressing cross-border tax evasion and illicit financial flows.

The OECD have also championed a peer review system, this followed the transformation of the transparency and exchange of information for tax purposes. The aim of this is to safeguard the commitments made and respond to the G20 call for rapid and effective implementation of the standards of transparency and exchange information. All parties to this will undergo reviews of the implementation of their systems, the process is overseen by the 30 members of the Peer Review Group[191].

Conclusion

Whilst each country wishes to actively pursue direct foreign investment there is a consequence that can be shown from the countries that are losing out on the revenues. With the likes of Apple and Skype that have chosen to locate within Europe in particular within jurisdictions that offer low tax rates there is increasingly more safeguards and protocols put in place so to curb the abuses that can take place in these jurisdictions. The EU has a considerable role to play, it has the ability to implement directives that ensure that countries are complying with international standards, however note has to be had to sovereign rights of countries to implement their own tax regimes. The aforementioned strategies and procedures that have been put in place, are likely over time to provide an adequate platform for ensuring transparency and fairness within Europe.

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[191] http://www.oecd.org/tax/transparency/

Chapter 7 Conclusions and Recommendations

South Africa has adopted the Headquarters regime with the view for enticing foreign investment and business into its jurisdiction, the benefits of doing this are abundantly clear, to increase revenue and exposure of South Africa amongst other benefits that have been highlighted earlier in this paper. Like so many other strategies that are applied in the developing world, the ideas for the use of a headquarter system or special tax regimes is not new, it has been used and some may say abused across the world for years, Ronen Palan, Christian Chavagneux and Richard Murphy assert that “Cayman Islands, British Virgins Islands, Bermudas and Bahamas receive 52% of the worlds’ speculative funds[192]”. The question in which this paper seeks to address is that by looking at the different systems that are in place, in particular the use of low tax countries, is South Africa well placed to offer these services, and whether there will be any lingering effect on the other countries in Africa. I will then look at recommendations that South Africa can learn from the other jurisdictions that are more mature.

South Africa is clearly an opportune place for investment when looking at infrastructure, stability and location. It is remarked as having an exchange rate that makes it one of the least expensive countries for foreigners to live and do business in. Despite the labour unrest in 2011 which bought with it demands for higher wages, there are industries in which the costs are reducing in particular telecommunication costs, it also has favourable petroleum prices[193]. South Africa is ranked 39th out of 185 countries in the World Bank and International Finance corporation’s Doing Business 2013 report, which is an annual survey that measures the time, cost and incidents or delays for businesses to comply with legal and administrative requirements. South Africa was in company of France, Spain and ranked above the likes of Mexico, China, Russia, Brazil and India. It was also remarked as the best of all African

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[192] Palan. R, Murphy. R and Chavagneux. C,,”Tax Havens: How Globalization Really Works” , Cornell University Press (2010)

[193] http://www.southafrica.info/business/investing/open.htm#.UuJPKrv8Jok#ixzz2rJazgFIR

countries for its protection for investors as well as making significant improvements in relation to trading across borders and enforcing contracts[194].

The tax regime itself appears to fall short of those that are offered in more long-standing and established tax-centres or jurisdictions. In particular, when compared to the likes of Mauritius, which are in effect the closest competitors with both countries seeking to put themselves forward as the gateway to Africa. If corporations are deciding between the different jurisdictions, not only is Mauritius more well established, in that it is well known for conducting such business, but also the rates that are offered are significantly lower than those offered by South Africa. Mauritius in relation to the structure of its system can be argued that it is more burdensome in terms of administration when setting up the company, whereas South Africa's substantive requirements are more stringent. However, South Africa has a greater network of double tax havens, albeit Mauritius appears to have targeted certain areas, South Africa has treaties in most continents. Notably, South Africa was also admitted into BRICS (Brazil, Russia, India, China and South Africa) in 2011 extending its network and strategic alliances. It should be noted that originally Mauritius was referred to by most critics as a Tax Haven, it has however fought against this title and is no longer regarded as a Tax Haven by the OECD. South Africa should also take heed of this, and ensure that whilst it is important to attract foreign investment, many corporations especially after the 2008 economic crash, do not want to be associated with the negative press that follows being located in a country that is deemed to be a Tax Haven. Whilst on the face of it, looking at the tax structures that are offered it is unlikely that South Africa will face that problem.

South Africa with its positioning amongst SADC, and Africa as a whole, maybe somewhat figuratively, as within SADC it has the highest GDP and within Africa it is seen as one of the most developed countries. Offering such

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194 "Doing Business 2013 Smarter Regulations for Small and Medium-Size Enterprises" Co-publication between the World Bank and the International Finance Corporation 2013 found at http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf last accessed 24th January 2014.

discounts to entice foreign investment, in particular when it could be taking the much needed revenues from other developing countries within the region, may not sit right. When one looks at the goals of SADC and the AU, it is a coming together, not necessarily in all ways, but it can be questioned is good faith for one of the wealthiest nations to be taking from some of the poorest. However, there is no restriction within the constitution of either SADC or the AU for South Africa for setting up such regimes, furthermore other countries within Africa are setting up similar regimes, in particular Botswana which has almost the same scheme in operation. It cannot be denied that each country has a sovereign right to choose its own tax rules, and legalities, so it would be wrong for this paper to suggest otherwise, but without careful attention being paid to the detrimental affect that could occur to the other countries South Africa could be doing more harm than good on the continent.

It can also be seen that there are a number of countries within Africa, that have chosen to be specific about the kind of foreign investment that they are attracting, notably Nigeria and Namibia. Whilst South Africa has a broad base in many different sectors, it could be advantageous for the incentives that are offered to be targeted at specific industries that could do with the assistance, rather than potentially bringing in competition for the companies that are already struggling, as these companies may not qualify for the tax incentives, which may lead to them not being competitive.

The use of tax havens and incentive schemes is clearly not limited to developing nations, there are numerous countries within Europe and the rest of the developed world that offer such services. The ones within Europe also have to comply with any directives that are applied by the EU, this therefore provides an extra regulatory body and framework. Ireland in particular was very concerned about its international reputation, and has put in place significant structures to ensure that it will not be labelled as a tax haven, so that the companies that are there do not move their businesses away. The EU and the OECD has put in a number of structures so that the way in which these incentives are offered are monitored, one model that has been discussed in the previous chapter is that of the Peer Review System. When countries are assessing each other, it could often foster better compliance with rules and regulations in their own jurisdictions.

As discussed, critics of tax schemes and havens argue that such economies harm other countries, this is particularly relevant in the developing world, as it is suggested that their finances depend to a larger degree on corporate taxes than wealthier countries do[195]; the low tax schemes attract foreign income from these economies and therefore remove the tax revenues that would have gone to the developing countries directly this cannot be replaced by external sources of finance; capital flight may also exacerbate the indebtedness situation of many countries, due to the drain on the national foreign exchange resources forces governments to borrow abroad, this loss of capital has undeniable repercussions on the ability of states to deliver essential services to the poorest people; the use of these schemes intensify tax competition behaviour; introduce the maintenance of low quality institutions in developing countries by for example increasing the profitability of illegal and wasteful activities; there is also an increase in the disparity in the developing countries of the high net wealth individuals by enabling them to increase their wealth and the average person; and furthermore they undermine the tax morale of and the culture of tax compliance[196].

However, as also highlighted there are advantages of having such systems, namely the potential reduced effective tax rates to drive increased investment in developing countries; is argued by Johannesen that the presence of low tax systems may make it less attractive for countries without these systems to compete for profits, and thus induce low-tax countries to become high-tax countries, which then may increase tax revenues and welfare[197]. It therefore

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[195] José Luis Escario Díaz-Berrio "The fight against tax havens and tax evasion Progress since the London G20 summit and the challenges ahead "Coordination and Supervision: Manuel de la Rocha Vázquez Documento de Trabajo 59/2011

[196] Torvik. R, "Why do some resource-abundant countries succeed while others do not" Oxf Rev Econ Policy (2009) 25(2): 241-256.

[197] Johannesen, N. (2010), Imperfect Tax Competition for Profits, Asymmetric Equilibria and Beneficial Tax Havens, Journal of International Economics 81 (2010) 253–264 - See more at: http://www.ictd.ac/en/knowledge/socio-econ#Johannesen

can be argued to be a careful balance of obtaining the correct investment to benefit the economy but a country should be careful that by doing so it is not damaging the economy of the continent as a whole.

Best Practice and Recommendations

Whilst there are benefits and disadvantages in the use of tax havens and special tax scheme, in order for South Africa and the rest of Africa to benefit from the use of such schemes it would be in their best interests to align themselves with particular organisations specifically the OECD so that the conduct does not fall foul of the rules. The OECD plays a key role it has in recent years adopted the following;

- it has defines transparency standards for tax information exchange that are adopted when countries sign bilateral agreements, these standards have also been adopted in the UN Model Tax Convention of 2008.
- The Global Forum of Transparency and Exchange of Information for Tax purposes which was created in 2009 monitors the implementation of tax information exchange agreements. In addition to this there is the peer review system
- The Financial Stability Board (FSB), combats illicit financial flows and asks states for information on the functioning of their financial systems and regulation and supervision mechanisms. It promotes transparency and integrity in the financial markets and the need for protection against illicit financial risk arising in non-cooperative

Therefore, it would also be advantageous as aforementioned for South Africa to take heed of the need to work together within Africa, so that appropriate information is shared with other countries in the continent so that the right amount of taxes are paid globally.

Furthermore, South Africa would be sensible to not copying carte blanche other ideas, but more to look at the sectors that need assistance, then seeing whether any specialised schemes would assist similar to that of Namibia.

South Africa should look at working with other countries on the continent to entice specialised investment into particular sectors, by negotiating together, may yield better results, than negotiating alone. In addition, it would assist if South Africa along with other countries in Africa utilised a system similar to that in Luxembourg similar to that of Societas Eurpaea that are designed specifically to enable companies to operate across the EU with a single legal structure, this would help international businesses to do business across the continent with ease, and facilitate mergers and acquisitions.

South Africa has the opportunity to develop significantly with the use of foreign investment, however care needs to be taken to ensure that such investment is in the right industries by the right industry players. Whilst having investment is imperative to development, South Africa should not lose sight of the bigger picture, it does not want to be taken advantage of, there is much that can be learnt from other countries systems such information should be used to strengthen South Africa's attractiveness to foreign investment.

"Alone we can do so little, together we can do a lot[198]*"*

[198] Helen Keller

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