

Corporate Tax - South Africa

Introduction of regional holding company regime

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Introduction

New qualifying company rule

New private equity incentives

Introduction

Generally, South Africa taxes its residents on a global basis. In addition, it taxes South African residents in respect of the notional income derived by interests which they may have in so-called controlled foreign companies, to the extent that a South African resident has acquired more than 50% of the participation rights in the foreign company concerned.

South Africa is ideally suited to serve as a base for investment into Africa. As South Africa has concluded more than 60 double taxation treaties with foreign countries, it is thus perceived as a natural holding company gateway into Africa.

New qualifying holding company rule

Pursuant to the requirement to entice foreign multinationals to use South Africa as an entry point into investment into Africa, a number of more relaxed tax rules have recently been introduced. In particular, it is proposed that the following exemptions will apply to a so-called qualifying holding company:

- Foreign subsidiaries of the holding company will not be treated as a controlled foreign company merely because the South African holding company holds a significant equity interest in a foreign subsidiary.
- The dividends declared by the holding company will generally be exempt from secondary tax on companies or the new dividend tax once it has been introduced.
- The so-called thin capitalization rules will not apply to the holding company and it can thus be funded on a back-to-back basis with loans as opposed to the normal 3:1 (debt: equity) rules.

In order to qualify for the relevant exemptions, the following requirements must be met:

- Each shareholder of the holding company must hold at least 20% of the equity shares in the holding company.
- Eighty percent of the tax value of the holding company must represent investments in foreign subsidiaries (whether through means of equity or debt), on the basis that the holding company must hold at least 20% of the equity shares in the foreign subsidiary concerned.
- Eighty percent of the income of the holding company must be derived from the foreign subsidiaries in which the holding company holds at least the mentioned 20% of the equity shareholding. Such income will include management fees, royalties, interest, dividends and sole proceeds derived from the sale of the interest in the foreign subsidiaries.

New private equity incentives

In addition, it was recently announced that specific incentives will be provided towards so-called private equity funds that use South Africa as their base to invest in companies. This is particularly the case to the extent that the vehicle used for the private equity fund is a partnership or a vesting trust. Generally, the existence of the partnership or the trust would have resulted in a permanent establishment in South Africa, resulting in a tax liability. It is now proposed that the limited partners or beneficiaries be placed in the same position as if they held the underlying assets of the partnership or trust directly. Thus, investors will not be exposed to South African tax because the activities are carried on through means of the partnership or the trust. However, management

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fees of the general partner or trustee will remain taxable in South Africa. The general partner is effectively treated as an independent agent and its existence in South Africa will not create a permanent establishment resulting in a tax liability in South Africa.

The relevant amendments will come into effect on January 1 2011.

For further information on this topic please contact [Emil Brincker](#) at *Cliffe Dekker Hofmeyr Inc* by telephone (+27 11 290 7000), fax (+27 11 290 7300) or email (emil.brincker@dlacdh.com).

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