The headquarter tax regime

Introduction

The definition of headquarter company ("**HQC**") was introduced as section 9I of the Income Tax Act No. 58 of 1962 ("**the Act**") with effect from the commencement of years of assessment commencing on or after 1 January 2011. The purpose of the HQC regime was to make South Africa an attractive location for multinationals wishing to invest in Africa.

South Africa's large economy, sophisticated financial services, relative political stability, sophisticated legal, banking and accounting sectors, sound regulatory practices, extensive double tax treaty network and BRICS membership makes South Africa an ideal location for the establishment of regional holding companies by foreign multinationals.

Prior to the HQC regime, there were four major barriers to South Africa becoming a regional HQC jurisdiction. These included the Controlled Foreign Company ("**CFC**") rules, the charge on outgoing dividends i.e. dividends tax; withholding taxes on royalties; and transfer pricing rules.

The premise of the HQC regime is that investments originated and redeployed offshore should not attract South African tax because the investments are routed through South Africa. With the introduction of the HQC regime, the CFC rules, the charge on outgoing dividends i.e. dividends tax; withholding taxes on royalties; and transfer pricing rules are not applied to the HQC.

An election made by a company to be a HQC is effective from the commencement of the year of assessment in respect of which that election is made. A HQC must submit an annual report providing information that the Minister may prescribe within such time and containing such information as the Minister may prescribe.

A company, on becoming a headquarter company, is treated as having disposed of its assets on the date immediately before the day on which it became a headquarter company for an amount equal to the market value of that asset and reacquired the assets on the day that it became a headquarter company equal to the market value. This does not apply in respect of an asset comprising immovable property or interest therein situated in South Africa.

The rules to qualify as a HQC

The company must be a South African company.

In the year that the company elects to be a HQC, each shareholder must hold 10% or more of the equity shares and voting rights of the company. If a shareholder is part of a group of companies, all the holdings of the companies in the group must be aggregated to determine whether the 10% requirement is satisfied.

For the current and all the previous years of assessment, at least 80% of the cost of the total assets must be attributable to one or more of the following:

1. an interest in equity shares in, or
2. a debt (loan, advance or debt) to, or
3. intellectual property ("IP") licenced to

any foreign company in which HQC held at least 10% of the equity shares and voting rights.

Any amount in cash or in the form of a bank deposit payable on demand is excluded from the calculation of the cost of the total assets. No regard must be had to any year of assessment in which the company does not have assets with a total market value exceeding R50 000.

- where the HQC's gross income exceeds R5 million for the year of assessment, 50% or more of the gross income must

consist of one or both of the following amounts:any rental, dividend, interest, royalty, or service fee paid or payable by a foreign company in which the HQC holds at least 10% of the equity shares and voting rights; or
- proceeds from the disposal of equity shares in a foreign company in which the HQC holds at least 10% of the equity shares and voting rights, or IP licensed to a foreign company in which the HQC holds at least 10% of the equity shares and voting rights.

What does the HQC regime offer?

- Dividends paid by a HQC are exempt from dividends withholding tax.
- Dividends received by HQC are exempt from South African income tax.
- No capital gains tax payable on the sale of shares in a foreign company if the HQC immediately before that disposal held at least 10% of the equity shares and voting rights in that foreign company.
- Foreign exchange control rules and regulations are not applied to the HQC.
  The CFC rules (in terms of which the income of a foreign company in which South African shareholders hold more than 50% is attributed to the South African shareholders) in section 9D of the Act are not applicable to HQC. Thus, section 9D does not attribute the net income of the foreign company to HQC. If a HQC holds shares in a foreign company, its shareholding does not count towards the 50% participation rights of South African residents in that foreign company.

Transfer pricing of interest and royalties incurred and earned by HQCs:

- Interest and royalties incurred by a HQC from 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.

Ring-fencing of interest and royalties incurred by HQCs:

- 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.

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