South African Revenue Service

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ACT : INCOME TAX ACT 58 OF 1962

SECTION : SECTIONS 1(1) – DEFINITION OF "HEADQUARTER COMPANY" AND 9I

SUBJECT : HEADQUARTER COMPANIES

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Preamble

In this Note unless the context indicates otherwise –

- **“CFC”** means “controlled foreign company” as defined in section 9D(1);
- **“CGT”** means the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- “**foreign company**” means “foreign company” as defined in s 1(1), namely any company which is not a resident;
- **“paragraph”** means a paragraph of the Eighth Schedule;
- “**qualifying foreign company**” means a foreign company as described in **3.2.3(b)**;

- **"Schedule"** means a Schedule to the Act;
- **"section"** means a section of the Act;
- **"tax treaty"** means an agreement for the avoidance of double taxation entered into between South Africa and another country;
- **"the Act"** means the Income Tax Act 58 of 1962;
- **"year 1"**, **"year 2"** and **"year 3"** etc. in any of the examples, means the respective calendar years; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issue of these documents should be consulted.

1. Purpose

This Note provides guidance and clarity on the interpretation and application of section 9I which deals with headquarter companies.[1]

The Note also briefly discusses other provisions of the Act that provide special tax relief for headquarter companies, as well as the specific anti-avoidance rules that are designed to prevent misuse or abuse of those provisions.

The Note does not discuss all of the sections which are applicable to headquarter companies. For example, the Note does not discuss "gross income" as defined in section 1(1) or section 11(*a*) which, although these sections do not specifically refer to headquarter companies, are applicable to headquarter companies.

The information in this Note is based on the income tax and tax administration legislation (as amended) as at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 34 of 2019 which was promulgated on 15 January 2020 (as per *Government Gazette* 42951).
- The Tax Administration Laws Amendment Act 33 of 2019 which was promulgated on 15 January 2020 (as per *Government Gazette* 42952).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 32 of 2019 which was promulgated on 15 January 2020 (as per *Government Gazette* 42950).

2. Background

The South African government wished to promote South Africa as a gateway for investments into Africa. The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010* stated the following:[2]

> "South Africa is the economic powerhouse of Africa. South Africa's location, sizable economy, political stability and overall strength in financial services make South Africa an ideal location for the establishment of regional holding companies by foreign multinationals. Furthermore, South Africa's network of tax treaties provides ready

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[1] Section 9I was inserted in the Act with effect from years of assessment commencing on or after 1 January 2011.

[2] In paragraph 5.4.

> access to other countries in the region. South Africa is therefore a natural holding company gateway into the region.
>
> However, in order to serve as an ideal holding company jurisdiction, three sets of South African tax rules were identified as significant barriers: (i) the CFC rules, (ii) the charge on outgoing dividends, and (iii) the thin capitalisation rules."

As part of the initiative to promote South Africa as a location for headquarter companies, the government amended certain provisions of the Act in order to create a more favourable tax dispensation for parties using South Africa as a gateway for investment into Africa.

A headquarter company is subject to tax in the same way as any other resident company, however, it is entitled to certain relief from income tax, CGT and dividends tax which is not available to resident companies that are not headquarter companies. As a consequence of the special relief granted to headquarter companies they are also subject to special anti-avoidance rules.

In addition to the headquarter companies themselves, a foreign person receiving interest or royalties from a headquarter company will, under specified circumstances, be exempt from withholding tax on interest and royalties respectively.

3. Definition of "headquarter company"

3.1 The law

The relevant sections are quoted in the **Annexure.**

3.2 Application of the law

In order to be a headquarter company for any year of assessment, a company must –[3]

- be a resident (see **3.2.2**);
- comply with the requirements of section 9I(2) (see **3.2.3**); and
- make an election (see **3.2.1**) to be a headquarter company.

3.2.1 Annual election [section 9I(1) and (3)]

The election to be a headquarter company must be in the form and manner determined by the Commissioner. The election must be made for a specific year of assessment and is valid for that year of assessment only. The election is currently recorded in the Income Tax Return for Companies (ITR14) which asks the question "Does the company elect to be a headquarter company in terms of s9I for this year of assessment?".

The election to be a headquarter company for a specific year of assessment can be made only at or after the end of that year of assessment if the requirements of section 9I(2) have been met. If any of the requirements in section 9I(2) has not been met for a specific year of assessment, a company cannot elect to be a headquarter company for that year of assessment.

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[3] Section 1(1) – definition of "headquarter company" and section 9I(1).

The election is effective from the commencement of the year of assessment for which it is made.

3.2.2 Resident companies [section 9I(1)(*a*)]

Only a resident company[4] may elect to be a headquarter company. A company is a "resident" if it –

- is incorporated, established or formed in South Africa; or
- has its place of effective management[5] in South Africa; and
- a tax treaty does not deem that company to be exclusively a resident of another country for purposes of the application of any tax treaty.

3.2.3 Requirements of section 9I(2)

A resident company must meet three requirements in order to be eligible to elect to be a headquarter company for any year of assessment, namely, –

- the "10% shareholding and voting rights" requirement [see **3.2.3(a)**];
- the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement [see **3.2.3(b)**]; and
- the "50% or more of gross income" requirement [see **3.2.3(c)**].

(a) The "10% shareholding and voting rights" requirement [section 9I(2)(*a*)]

Section 9I(2)(*a*) provides that each holder of shares in the company, whether alone or together with any other company forming part of the same group of companies as the holder, must hold 10% or more of the equity shares and voting rights in the potential headquarter company. The holder may be a resident or non-resident.

The term "group of companies" is defined in section 1(1) as follows:

> " **'[G]roup of companies'** means two or more companies in which one company (hereinafter referred to as the **'controlling group company'**) directly or indirectly holds shares in at least one other company (hereinafter referred to as the **'controlled group company'**), to the extent that—
>
> (*a*) at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
>
> (*b*) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;"

A holder that is a company may hold 10% of the equity shares and voting rights on its own or together with another company that is part of the same group of companies. The equity shares and voting rights held by a connected person, that is not part of the same group of companies, are not relevant. Similarly, if the holder is a natural person or a trust, connected person holdings are not relevant and the natural person or trust must hold 10% or more of the equity shares and voting rights on its own.

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4 See section 1(1) for the definition of "company".

5 See Interpretation Note 6 "Resident – Place of Effective Management (Companies)" for a discussion of the words "place of effective management". In addition, special considerations apply to determining the place of effective management of a foreign investment entity as defined in the Act.

The term "equity share" is defined in section 1(1) as follows:

> " **'[E]quity share'** means any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution;"

A distribution could take the form of a distribution of profits[6] (dividends) or capital (return of contributed tax capital).[7] The share will be an equity share as long as the right to participate in either of these types of distribution is unrestricted. The share will not be an equity share if both these rights are restricted.

The 10% holding requirement must be satisfied for both the equity shares and the voting rights in the company. Therefore, each holder that is –

- not a company, must hold 10% or more of both the equity shares and the voting rights in the company; and
- a company, must hold 10% or more of the equity shares and voting rights on its own or together with any other company forming part of the same group of companies.

For example, if a trust holds 10% or more of the equity shares but less than 10% of the voting rights in a company, or *vice versa*, the company will not meet the requirements of a headquarter company. However, if the holders of the shares are companies and one company holds 10% or more of the equity shares and another company within the same group of companies holds 10% or more of the voting rights, the requirement will be met.

The "10% shareholding and voting rights" requirement must be met for the entire year of assessment for which a qualifying company wants to make an election to be a headquarter company. That is, the requirement must be met on each and every day of the year of assessment. The shareholding can change within a year of assessment provided that at all times every holder met the "10% shareholding and voting rights" requirement. The only exception to taking each and every day into account, as provided for in the proviso to section 9I(2)(*a*), is for the year of assessment during which the potential headquarter company commences trading. In that year, any period before the company commenced the carrying on of a trade is disregarded.[8] See Interpretation Note 51 "Pre-Trade Expenditure and Losses" for a discussion of the words "carrying on of a trade". Each case must be assessed on its merits in determining when a company commences the carrying on of a trade.

Example 1 – The "10% shareholding and voting rights" requirement

Facts:

ABC Trust and Individual A each hold 40% of the equity shares and voting rights in Company A. Companies B, C, D and E, which are not companies forming part of the same group of companies, each hold 5% of the equity shares and voting rights in Company A.

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6 Depending on the facts profits are not an essential requirement of a dividend.

7 The term "contributed tax capital" is defined in section 1(1).

8 The proviso to section 9I(2)(*a*) applies to years of assessment commencing on or after 1 January 2013.

Result:

Company A cannot elect to be a headquarter company because each of its holders of shares does not hold 10% or more of its equity shares and voting rights. Companies B, C, D and E each hold only 5% of the equity shares and voting rights in Company A. Since Companies B, C, D and E are not part of the same group of companies, their holdings are considered separately.

Company A has not met the "10% shareholding and voting rights" requirement under section 9I(2)(*a*) and is disqualified from being a headquarter company for the relevant year of assessment.

Example 2 – The "10% shareholding and voting rights" requirement

Facts:

ABC Trust and Individual A each hold 40% of the equity shares and voting rights in Company A.

Companies B, C, D and E each hold 5% of the equity shares and voting rights in Company A. Companies B, C, D and E are 100% held by Company F. Companies B, C, D, E and F are therefore part of the same group of companies.

Result:

Company A has met the "10% shareholding and voting rights" requirement under section 9I(2)(*a*) because each of its holders of shares, together with companies forming part of the same group of companies in the case of holders who are companies, hold 10% or more of the equity shares and voting rights in Company A. Companies B, C, D and E together hold 20% of the equity shares and voting rights in Company A.

Company A can elect to be a headquarter company if the other requirements of section 9I(2) are met.

Example 3 – The "10% shareholding and voting rights" requirement

Facts:

Company A's year of assessment ends on 31 December.

ABC Trust and Individual A each held 40% of the equity shares and voting rights in Company A for the duration of Company A's years of assessment ending on 31 December year 1 and year 2. Companies B, C, D and E each held 5% of the equity shares and voting rights in Company A for the duration of these years of assessment. However, Companies B, C, D and E became members of the same group of companies only on 31 January year 2.

Result:

Company A did not meet the “10% shareholding and voting rights” requirement of section 9I(2)(*a*) for the year of assessment ending on 31 December year 1 because each of the holders of its shares did not hold 10% or more of the equity shares and voting rights for the duration of that year of assessment. Companies B, C, D and E were not part of the same group of companies during that year of assessment and their holdings must therefore be considered separately for that year. Company A could therefore not elect to be a headquarter company for the year of assessment ending on 31 December year 1.

Company A could also not elect to be a headquarter company for the year of assessment ending on 31 December year 2, since companies B, C, D and E became members of the same group of companies only on 31 January year 2. Each of the holders of shares in Company A, together with companies forming part of the same group of companies in the case of a company, did not hold 10% or more of Company A’s equity shares and voting rights for the duration of that year of assessment.

Company A may elect to be a headquarter company for future years of assessment, if the other requirements of section 9I(2) have been met and each of the holders of shares in Company A, together with companies forming part of the same group of companies, continue to hold 10% or more of its equity shares and voting rights for the duration of those years of assessment.

Example 4 – The “10% shareholding and voting rights” requirement

Facts:

Company A, Company B and Company C’s years of assessment end on 31 December.

Company A held 100% of the equity shares and voting rights in Company B, a potential headquarter company. On 1 March year 1 Company A disposed of 5% of the equity shares and voting rights held in Company B to Company C. On 1 June year 1 Company A disposed of an additional 5% of the equity shares and voting rights held in Company B to Company C. Company C did not form part of the same group of companies as Company A.

Company C was incorporated on 1 January year 1 and commenced trading on 1 June year 1.

Result:

Company B could not elect to be a headquarter company for the year of assessment ending on 31 December year 1 because each holder of its shares did not hold at least 10% of its equity shares and voting rights for the duration of that year of assessment. The proviso to section 9I(2)(*a*), which permits the period prior to the commencement of trade to be disregarded, refers to the potential headquarter company and is not applicable in relation to a holder of shares in the potential headquarter company. Therefore, the period 1 March to 31 May year 1 in which Company C held only 5% of the equity shares and voting rights in Company B cannot be disregarded under the proviso.

Company B therefore did not meet the "10% shareholding and voting rights" requirement of section 9I(2)(*a*) for the year of assessment ending on 31 December year 1.

Example 5 – The "10% shareholding and voting rights" requirement

Facts:

Company A and Company B each hold 50% of the equity shares in Company C. Company A holds 95% of the voting rights in Company C and Company B holds the remaining 5%.

Result:

Company C cannot elect to be a headquarter company because each holder of its shares does not hold 10% or more of its voting rights. Company B holds only 5% of the voting rights in Company C.

Company C does not meet the "10% shareholding and voting rights" requirement of section 9I(2)(*a*) and is disqualified from being a headquarter company.

Example 6 – The "10% shareholding and voting rights" requirement

Facts:

Company C's year of assessment ends on the last day of February.

Company A and Company B each held 50% of the equity shares and voting rights in Company C. During Company C's year of assessment ending on 28 February year 1, Company B sold 25% of the equity shares and voting rights held in Company C to Company D.

Result:

Notwithstanding the change in shareholding, for the duration of Company C's year of assessment ending on 28 February year 1 each holder of shares held 10% or more of Company C's equity shares and voting rights. Therefore, Company C could elect to be a headquarter company for that year of assessment if the other requirements of section 9I(2) were met.

Example 7 – The "10% shareholding and voting rights" requirement

Facts:

Company B's year of assessment ends on 31 March.

Company B was incorporated on 15 April year 1. All its equity shares and voting rights were initially held by natural persons who each held less than 10% of these equity shares and voting rights. Company B commenced carrying on a trade on 1 July year 1. Company C and Company D each acquired 50% of the equity shares and voting rights in Company B on 1 July year 1.

Result:

Company B has met the "10% shareholding and voting rights" requirement under section 9I(2)(*a*) for the year of assessment ending on 31 March year 2, since each holder of shares held 10% or more of its equity shares and voting rights from the date that it commenced carrying on a trade. Company B can elect to be a headquarter company if the other requirements of section 9I(2) are met.

The fact that each holder of shares did not hold 10% or more of Company B's equity shares and voting rights during the period 15 April to 30 June year 1 did not disqualify Company B from meeting the "10% shareholding and voting rights" requirement under section 9I(2)(*a*) for the year of assessment ending on 31 March year 2 because Company B did not carry on a trade during that period [see the proviso to section 9I(2)(*a*)].

(b) The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement [section 9I(2)(*b*)]

Section 9I(2)(*b*) requires that 80% or more of the cost of the total assets of the potential headquarter company must be attributable to one or more of the following assets at the end of the year of assessment for which that company wishes to make an election *and* at the end of all previous years of assessment:

- Any interest in equity shares in one or more qualifying foreign companies [section 9I(2)(*b*)(i)].
- Any debt owed by one or more qualifying foreign companies [section 9I(2)(*b*)(ii)].
- "Intellectual property" as defined in section 23I(1) that is licensed by the company to a qualifying foreign company. The same intellectual property may potentially be licenced to a qualifying foreign company and another person. The cost of an item of intellectual property which is licenced to both a qualifying foreign company and another person, for example a South African subsidiary, will be taken into account in the "80% or more of the cost of total assets in, to or by a qualifying foreign company" calculation because section 9I(2)(*b*) does not require exclusive licensing to a qualifying foreign company [section 9I(2)(*b*)(iii)].

A qualifying foreign company is a foreign company in which the potential headquarter company holds, whether alone or together with any other company forming part of the same group of companies as the potential headquarter company, at least 10% of the equity shares and voting rights at the end of the year of assessment concerned.

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement must be met at the end of the year of assessment for which an election is made to be a headquarter company and at the end of all previous years of assessment of the potential headquarter company. This means that if the requirement is not met in any year of assessment the company will never be able to meet this requirement and will not be eligible to elect to be a headquarter company in that or a future year of assessment.

The particular assets[9] making up the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement may change from one year to the next provided the requirement is met for each year. For example, a potential headquarter company could meet the requirement because of the cost of its equity shares in qualifying foreign company A in one year and, notwithstanding having sold its equity shares in qualifying foreign company A in the next year, meet the requirement because of the cost of its newly acquired equity shares in qualifying foreign company B.

Meaning of "cost"

In *C v COT* Goldin J stated the following on the meaning of "cost":[10]

> "The word 'cost', when undefined, may be used in various senses. As Jordan CJ said in the case of *Ex parte Brierley, Re Elvidge* (1947) 47 NSWSR 423 at 427; *Words and Phrases Legally Defined* 2 ed –
>
> > 'It may, in the case of manufacture, be used to mean the price paid for the raw material plus the wages paid for turning it into finished articles; and, in the case of trading, the price paid for what is re-sold. Or, in either case, it may include all the other expenses incurred in bringing into existence, or obtaining, and then selling a vendible article – what are generally described as "overheads".' "

Goldin J stated further that –[11]

> "[t]he word 'cost' has to be construed according to its context."

Trollip JA held as follows in *SIR v Eaton Hall (Pty) Ltd:*[12]

> "…[I]n the absence of any definition in the Act of such cost one must look at its ordinary meaning. The *Oxford English Dictionary* defines 'cost' as meaning: 'That which must be given or surrendered in order to acquire, produce, accomplish, or maintain something; the price paid for a thing.' ".

Based on the above, the view is held that "cost incurred" has the same meaning as "expenditure incurred". In *C: SARS v Labat Africa Ltd* Harms AP stated the following on the meaning of "expenditure":[13]

> "The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless the context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent.
>
> The Afrikaans text, in using the term 'onkoste', endorses this reading. In the context of the Act it would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended."

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9 See above for details regarding the assets which are included in the calculation.

10 1973 (4) SA 449 (R), 35 SATC 241 at 246 and 247.

11 At SATC 247.

12 1975 (4) SA 953 (A), 37 SATC 343 at 347.

13 2013 (2) SA 33 (SCA), 74 SATC 1 at 6.

In the above case it was held that the taxpayer, by issuing its own shares, did not expend any money or assets in acquiring a trade mark.[14] Subsequent to the court case section 40CA was introduced into the Act. Section 40CA provides that if a company acquires any asset, as defined in paragraph 1, from any person in exchange for –

- shares issued by that company, that company must be deemed to have actually incurred an amount of expenditure in respect of the acquisition of that asset which is equal to the sum of the market value of the shares immediately after the acquisition and any deemed capital gain determined under section 24BA(3)(*a*)[15] in respect of the acquisition of the asset.[16] This deemed capital gain arises when the market value of the asset immediately before the disposal exceeds the market value of the shares immediately after their issue. The difference between these amounts is deemed to be a capital gain in respect of a disposal by the company of the shares; or
- any amount of debt issued by that company, that company must be deemed to have actually incurred an amount of expenditure in respect of the acquisition of that asset which is equal to that amount of debt.

Once a taxpayer is deemed to have incurred an amount of expenditure that amount is treated as expenditure actually incurred.

In a barter transaction involving assets only, the expenditure incurred is the amount by which each party's assets to the transaction are diminished. For example, if X exchanges asset A, held on capital account, plus an amount of cash for asset B, the expenditure incurred by X in respect of asset B is the market value of asset A plus the cash consideration. Similarly, if X exchanges asset A, held on capital account, plus an amount of cash in return for Y repairing X's fence, the expenditure incurred by X in respect of the repair is the market value of asset A plus the cash consideration. In addition, in both situations, X has disposed of asset A and will have to account for any capital gain or capital loss on disposal and, if applicable, a recoupment or scrapping allowance. The proceeds from disposal of asset A will be equal to its market value, before taking into account any adjustments under paragraph 35, and the base cost will generally be equal to the expenditure actually incurred in acquiring asset A, before taking into account any adjustments under paragraph 20. Y will have gross income equal to the market value of the repair but will be able to deduct, for example, the cost of the materials purchased and used in repairing the fence.

As regards the determination of the market value of the assets or services given in exchange in a barter transaction, Binns-Ward J noted in *South Atlantic Jazz Festival (Pty) Ltd v C: SARS*[17] in relation to sponsorships in kind provided to the Jazz Festival that –

> "…accepting, as one may [in these specific circumstances], that the transactions were at arm's length, the value of the goods and services provided by the appellant [the South Atlantic Jazz Festival] to the sponsors in each case falls to be taken as the same

[14] At SATC 7.

[15] Section 24BA(3) applies to transactions contemplated in section 24BA(2) and not excluded under section 24BA(4). If applicable, section 24BA(3) applies notwithstanding paragraph 11(2)(*b*) which stipulates that there is no disposal of an asset by a company in respect of, amongst other things, the issue, cancellation or extinction of a share in the company.

[16] The deemed capital gain element was inserted in section 40CA(*a*) with effect from 1 January 2020 and applies in respect of acquisitions on or after that date.

[17] 2015 (6) SA 78 (WCC), 77 SATC 254 at 260 and 261.

> as that of the counter performance by the relevant sponsor…In an ordinary arm's length barter transaction the value that the parties to it have attributed to the goods and services that are exchanged seems to me, in the absence of any contrary indication, to be a reliable indicator of their market value."

Therefore, it can be accepted that in a barter transaction, the market value of the assets or services will, "absence any contrary indication", be the market value of the assets or services as agreed between the parties and would be of equal value. In most instances the market value of the assets or services to be exchanged between the parties is reflected in the relevant agreement. The facts and circumstances of the particular transaction, including the contractual terms, must be considered as they could impact on valuation and timing.

The amount of expenditure or cost incurred may be altered by a specific provision of the Act, for example, but not limited to, section 12C(2), 24BA(3)(*a*)(*ii*), 31(2),[18] 80B or paragraph 38(1)(*b*). In these cases if the amount of expenditure or cost is altered it is necessary to consider the wording of the particular section or paragraph in assessing if the alteration applies for purposes of the Act as a whole, and therefore must be taken into account under section 9I(2)(*b*), or if it is limited to a specific section or paragraph. For example, paragraph 38(1)(*b*) applies only for purposes of paragraph 20(1)(*a*) and the Eighth Schedule and therefore will not apply when considering the cost of assets under section 9I(2)(*b*). However, if the cost of any asset was altered under section 31(2) or section 80B then the altered cost must be taken into account when assessing whether the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement has been met.

The word "cost" refers to the original cost of an asset at the date of performing the calculation and is not adjusted by the amount of any provisions, for example, provision for impairments raised for accounting purposes or any capital allowances claimed. The original cost of an asset is reduced by amounts recovered or recouped or returned by the other party to the potential headquarter company.

Meaning of "debt"

The word "debt" is not defined in the Act and should therefore be given its ordinary meaning. In *Joint Liquidators of Glen Anil Development Corporation Ltd (In Liquidation) v Hill Samuel (SA) Ltd* Holmes AJA held that –[19]

> "the ordinary meaning of debt is 'that which is owed or due; anything (as money, goods or services) which one person is under obligation to pay or render to another'. See *Shorter Oxford English Dictionary*".

See Interpretation Note 91 "Reduction of Debt" for a detailed discussion of the ordinary meaning of "debt".[20]

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[18] See **4.2.3**.

[19] 1982 (1) SA 103 (A) at 110.

[20] See also *Makate v Vodacom (Pty) Ltd* 2016 (6) BCLR 709 (CC), 2016 (4) SA 121.

Meaning of "intellectual property"

The term "intellectual property" is defined in section 23I(1) as follows:

> " **'[I]ntellectual property'** means any—
>
> (*a*) patent as defined in the Patents Act including any application for a patent in terms of that Act;
>
> (*b*) design as defined in the Designs Act;
>
> (*c*) trade mark as defined in the Trade Marks Act;
>
> (*d*) copyright as defined in the Copyright Act;
>
> (*e*) patent, design, trade mark or copyright defined or described in any similar law to that in paragraph (*a*), (*b*), (*c*) or (*d*) of a country other than the Republic;
>
> (*f*) property or right of a similar nature to that in paragraph (*a*), (*b*), (*c*), (*d*) or (*e*); and
>
> (*g*) knowledge connected to the use of such patent, design, trade mark, copyright, property or right;"

Exclusion of cash or a bank deposit payable on demand

In determining the cost of the total assets of the potential headquarter company, the amount of any cash or any amount in the form of a bank deposit payable on demand must not be taken into account.[21] A deposit with an entity which is not registered as a bank under the Banks Act 94 of 1990, or the appropriate banking laws of a country other than South Africa, will not qualify for the exclusion from total assets.

The words "payable on demand" mean that the funds deposited with the bank can be obtained upon request. The terms and conditions of the particular bank deposit must be considered when evaluating whether the deposit is payable on demand. For example, a 32-day notice deposit would not qualify as a deposit payable on demand, since the investor must wait the prescribed period and cannot obtain the funds upon request. In contrast, if an investor can immediately withdraw the money or request an electronic funds transfer, the deposit will be considered to be payable on demand notwithstanding that there may be a short standard processing delay. A detailed consideration of all the facts is necessary.

Assets with a market value of at least R50 000

In addition, in determining whether a company complies with the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement of section 9I(2)(*b*) in relation to a year of assessment, that year must be disregarded if the company did not at any time during such year of assessment own assets with a total market value exceeding R50 000.[22]

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[21] Paragraph (*aa*) of the proviso to section 9I(2)(*b*).

[22] Paragraph (*bb*) of the proviso to section 9I(2)(*b*), applicable to years of assessment commencing on or after 1 January 2013.

Example 8 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company A's year of assessment ends on 31 December.

Company A, a resident, is 100% held by Company D. Company A holds 80% of the equity shares and voting rights in a foreign company, Company B, and 10% of the equity shares and voting rights in another foreign company, Company C. The cost of Company A's total assets at the end of its year of assessment ending on 31 December year 3 was as follows:

	R
Equity shares in Company B	80 000
Preference shares (not qualifying as equity shares) in Company B	100 000
Loan advanced to Company B	2 000 000
Equity shares in Company C	20 000
Patent licensed to Company C	500 000
Debt owed by resident companies	1 000 000
Cost of Company A's total assets	3 700 000

Company D advanced R500 000 to Company A. This amount was included in the R2 million advanced by Company A to Company B. Company B was unable to repay the loan and Company A raised a provision for potential non-recovery of R250 000 against the loan of R2 million.

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Companies B and C are both qualifying foreign companies because Company A holds at least 10% of the equity shares and voting rights in each of the companies.

The cost of assets in, to or by a qualifying foreign company as specified in section 9I(2)(*b)* is R2 600 000 [equity shares in Company B (R80 000) and Company C (R20 000), loan to Company B (R2 000 000) and patent licensed to Company C (R500 000)] which represents 70,27% (R2 600 000 / R3 700 000) of the cost of Company A's total assets.

Company A is disqualified from being a headquarter company under section 9I(2)(*b*) for its year of assessment ending on 31 December year 3 *and* future years of assessment, even if the requirement is met in a future year of assessment, since less than 80% of the cost of its total assets was attributable to assets in, to or by qualifying foreign companies as specified in section 9I(2)(*b*) at the end of its year of assessment ending on 31 December year 3.

Note:

The original amount of the loan of R2 million and not the impaired value of R1 750 000 (R2 million – R250 000) is taken into account in determining the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement.

Example 9 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company A's year of assessment ends on 31 March.

Company A, a resident, is 100% held by Company D. Company A holds 80% of the equity shares and voting rights in a foreign company, Company B, and 10% of the equity shares and voting rights in another foreign company, Company C. The cost of Company A's total assets at the end of its year of assessment ending on 31 March year 4 was as follows:

	R
Equity shares in Company B	80 000
Loan advanced to Company B	2 000 000
Equity shares in Company C	20 000
Patent licensed to Company C	500 000
Debt owed by resident companies	100 000
Cost of Company A's total assets	2 700 000

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Company B and Company C are both qualifying foreign companies because Company A holds at least 10% of the equity shares and voting rights in each of the companies.

Company A met the requirement specified under section 9I(2)(*b*) for its year of assessment ending on 31 March year 4 because 96,29% (R2,6 million / R2,7 million) of the cost of Company A's total assets was attributable to assets in, to or by qualifying foreign companies as specified in section 9I(2)(*b*) [equity shares in Company B (R80 000) and Company C (R20 000), loan to Company B (R2 000 000) and patent licensed to Company C (R500 000)].

Company A could elect to be a headquarter company for its year of assessment ending on 31 March year 4 provided the other requirements under section 9I(2) were met.

Example 10 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company A's year of assessment ends on 31 March.

Company A, a resident, is 100% held by Company D. Company A holds 80% of the equity shares and voting rights in a foreign company, Company B, and 5% of the equity shares and voting rights in another foreign company, Company C. The cost of Company A's total assets at the end of its year of assessment ending on 31 March year 4 was as follows:

	R
Equity shares in Company B	80 000
Loan advanced to Company B	2 000 000
Equity shares in Company C	20 000
Patent licensed to Company C	500 000
Debt owed by resident companies	100 000
Cost of Company A's total assets	2 700 000

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Company B is a qualifying foreign company because Company A holds at least 10% of the equity shares and voting rights in Company B.

Company C is not a qualifying foreign company because Company A holds less than 10% of the equity shares and voting rights in Company C. Therefore, the cost of assets attributable to Company C of R520 000 (equity shares of R20 000 + patent licensed of R500 000) is ignored in calculating the cost of total assets held by Company A in qualifying foreign companies. The cost of R520 000 is, however, included in calculating the cost of Company A's total assets.

The cost of assets in, to or by a qualifying foreign company as specified in section 9I(2)(*b)* is R2 080 000 (equity shares of R80 000 + loan of R2 million) which represents 77,03% (R2 080 000 / R2 700 000) of the cost of Company A's total assets.

Company A is disqualified from being a headquarter company under section 9I(2)(*b*) for its year of assessment ending on 31 March year 4 *and* future years of assessment, even if the requirement is met in a future year of assessment, since less than 80% of the cost of its total assets was attributable to assets in, by or to qualifying foreign companies as specified in section 9I(2)(*b*) in its year of assessment ending on 31 March year 4.

Example 11 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company B, a resident, is 100% held by Company A. Company B holds 5% of the equity shares and voting rights in a foreign company, Company C. Company D, which is a company forming part of the same group of companies as Company B, holds 10% of the equity shares and voting rights in Company C. The cost of Company B's total assets was as follows at the end of its year of assessment ending on 31 December year 4:

	R
Equity shares in Company C	100 000
Loan advanced to Company C	5 000 000
Current account	2 000 000
Cost of Company B's total assets	7 100 000

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Company C is a qualifying foreign company because Company B, together with Company D, holds at least 10% of the equity shares and voting rights in Company C. Company B has met the requirement specified under section 9I(2)(*b*) for the year of assessment ending on 31 December year 4 because 100% [R5,1 million (loan of R5 million + equity shares of R100 000) / R5,1 million] of the cost of Company B's total assets was attributable to assets in, to or by qualifying foreign companies as specified in section 9I(2)(*b*).

The current account of R2 million is excluded from the calculation of the cost of Company B's total assets under paragraph (*aa*) of the proviso to section 9I(2)(*b*).

Example 12 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company A's year of assessment ends on 31 March.

Company A, a resident, is 100% held by Company C. Company A holds 80% of the equity shares and voting rights in a foreign company, Company B. The cost of Company A's total assets at the end of its year of assessment ending on 31 March year 4 was as follows:

	R
Equity shares in Company B	10 000
Debt owed by resident companies	30 000
Cost of Company A's total assets	40 000

The market value of Company A's assets did not exceed R50 000 at any stage during the year of assessment.

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Company B is a qualifying foreign company because Company A holds at least 10% of the equity shares and voting rights in Company B.

Although only 25% (equity shares of R10 000 / total assets of R40 000) of the cost of Company A's total assets is attributable to assets in, to or by qualifying foreign companies as specified in section 9I(2)(*b*) (equity shares in Company B) at the end of the year of assessment, Company A can still potentially qualify as a headquarter company for the year of assessment ending on 31 March year 4 provided the other requirements under section 9I(2) are met. This is possible because paragraph (*bb*) of the proviso to section 9I(2)(*b*) provides that the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement must be disregarded, since the market value of Company A's total assets did not at any time during the year of assessment exceed R50 000.

Example 13 – The "10% shareholding and voting rights" and the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirements

Facts:

Company X's year of assessment ends on 31 March.

Company X, a potential headquarter company, held 100% of the equity shares and voting rights in Company Y, a foreign company, for the duration of Company X's year of assessment ending on 31 March year 3. On 30 June year 3 Company X disposed of its shares in Company Y to an unconnected person. Company X acquired 5% of the equity shares and voting rights in Company Z, a foreign company, on 1 July year 3 and a further 25% on 1 March year 4. At the end of both years of assessment, 80% of the cost of the total assets of Company X was attributable to assets held in Company Y and Company Z.

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement was met in all previous years of assessment.

Result:

Company Y is a qualifying foreign company for Company X's year of assessment ending on 31 March year 3 because Company X held at least 10% of Company Y's equity shares and voting rights as at the end of that year of assessment.

Company Z is a qualifying foreign company for Company X's year of assessment ending on 31 March year 4 because Company X held at least 10% of Company Z's equity shares and voting rights as at the end of that year of assessment. It is of no relevance that Company X obtained the required shareholding and voting rights of at least 10% only on 1 March year 4.

Company X has met the requirement under section 9I(2)(*b*) for both years of assessment. Even though 80% of the cost of its total assets at the end of these years of assessment was attributable to equity shares in different qualifying foreign companies, the requirement that 80% or more of its cost of total assets be attributable to assets in, to or by qualifying foreign companies at the end of the current and all previous years of assessment was met.

Company X could elect to be a headquarter company for the years of assessment ending on 31 March year 3 and year 4 if the other requirements under section 9I(2) were met.

(c) The "50% or more of gross income" requirement [section 9I(2)(*c*)]

When the gross income[23] of a potential headquarter company exceeds R5 million in a year of assessment for which the company wishes to make an election to be a headquarter company, 50% or more of that gross income must consist of amounts in the form of one or more of the following:

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

Proceeds from the disposal of equity shares in a foreign company or proceeds from the disposal of intellectual property will often be of a capital nature and will not be included in the gross income of the potential headquarter company. In these circumstances those proceeds would not form part of the "50% or more of gross income" calculation. Only proceeds of a revenue nature will be included in gross income and therefore form part of this calculation.

In determining the gross income of the company any exchange difference determined under section 24I on any exchange item as defined in section 24I(1) to which that company is a party must be disregarded[24] [see **4.2.4(b)** for a discussion of section 24I].

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23 The term "gross income" is defined in section 1(1).

24 The proviso to section 9I(2)(*c*).

Example 14 – The "50% or more of gross income" requirement

Facts:

Company X, a resident, holds 40% of the equity shares and voting rights in a foreign company, Company Y. Company X also holds 5% of the equity shares and voting rights in another foreign company, Company Z. Company X received the following income during its year of assessment ending on 31 March year 2:

	R
Dividends – Company Y	2 000 000
Interest – Company Z	3 000 000
Management fees – Company Y	900 000
Gross income of Company X	5 900 000

Result:

Company Y is a qualifying foreign company because Company X holds at least 10% of the equity shares and voting rights in Company Y.

Company Z is not a qualifying foreign company because Company X holds less than 10% of the equity shares and voting rights in Company Z. Therefore, the interest of R3 million received from Company Z is excluded from the calculation of gross income received by or accrued to Company X from qualifying foreign companies. The interest of R3 million is, however, included in the calculation of total gross income.

The gross income received by or accrued to Company X from a qualifying foreign company (Company Y) amounts to R2,9 million (R2 million + R900 000) which represents 49,15% (R2,9 million / R5,9 million) of the gross income of Company X.

Company X cannot elect to be a headquarter company for the year of assessment ending on 31 March year 2 because its gross income from a qualifying foreign company is less than 50% of its total gross income. Company X does not comply with the requirement under section 9I(2)(*c*).

Example 15 – The "50% or more of gross income" requirement

Facts:

Company X, a resident, holds 40% of the equity shares and voting rights in a foreign company, Company Y. Company X also holds 5% of the equity shares and voting rights in another foreign company, Company Z. Company X received the following income during its year of assessment ending on 31 March year 2:

	R
Dividends – Company Y	2 000 000
Interest – Company Z	3 000 000
Gross income of Company X	5 000 000

Result:

Company X's gross income does not exceed R5 million therefore the "50% or more of gross income" requirement under section 9I(2)(*c*) need not be met. Company X can elect to be a headquarter company for the year of assessment ending on 31 March year 2 if the other requirements of section 9I(2) are met.

Example 16 – Election to be a headquarter company

Facts:

Company A's year of assessment ends on the last day of February.

Company A was incorporated in South Africa and commenced carrying on a trade in South Africa on 10 March year 1.

Since incorporation, the equity shares and voting rights in Company A have been equally held by Company B, a resident, and Company C, a foreign company.

Company A holds 50% of the equity shares and voting rights in two foreign companies, namely, Company M and Company N. The cost of Company A's total assets at the end of its year of assessment ending on 28 February year 2 consisted of the following:

	R
Equity shares in Company M	100 000
Equity shares in Company N	200 000
Loan advanced to Company M	4 000 000
Patent licensed to Company N	1 000 000
Investments in other companies	300 000
Cost of Company A's total assets	5 600 000

The gross income received by or accrued to Company A during its year of assessment ending on 28 February year 2 is as follows:

	R
Dividends – Company M	6 000 000
Dividends – Company N	1 200 000
Interest – Company M	240 000
Royalties – Company N	100 000
Interest – Other companies	18 000
Gross income received by or accrued to Company A	7 558 000

Result:

The "10% shareholding and voting rights" requirement

Company B and Company C each held 50% of the equity shares and voting rights in Company A for the duration of Company A's year of assessment ending on 28 February year 2. Each holder of shares therefore held at least 10% of Company A's equity shares and voting rights. Therefore, the requirements of section 9I(2)(*a*) have been met.

The "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement

Company A was incorporated in March year 1, therefore the year of assessment ending on 28 February year 2 is its first year of assessment.

Company A held 50% of the equity shares and voting rights in both foreign companies, Company M and Company N, at the end of the year of assessment. Companies M and N are therefore qualifying foreign companies.

The cost of total assets in, to or by qualifying foreign companies as specified in section 9I(2)(*b)* equals R5,3 million (R5,6 million – R300 000) which represents 94,64% (R5,3 million / R5,6 million) of the cost of Company A's total assets at the end of its year of assessment. Therefore, the "80% or more of the cost of total assets in, to or by a qualifying foreign company" requirement in section 9I(2)(*b*) has been met.

The "50% or more of gross income" requirement

Gross income received by or accrued to Company A from Company M and Company N in the form of dividends, interest and royalties equals R7 540 000 (R7 558 000 – R18 000) which represents 99,76% (R7 540 000 / R7 558 000) of Company A's gross income for the year of assessment. Therefore, the "50% or more of gross income" requirement under section 9I(2)(*c*) has been met.

Company A can elect to be a headquarter company for its year of assessment ending on 28 February year 2 because all the requirements of section 9I(2) have been met.

3.2.4 Other

(a) Years of assessment

The term "year of assessment" is used extensively in section 9I. It is defined in section 1(1) as follows:

> " **'[Y]ear of assessment'** means any year or other period in respect of which any tax or duty leviable under this Act is chargeable, and any reference in this Act to any year of assessment ending the last or the twenty-eighth or the twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company or a portfolio of a collective investment scheme in securities be construed as a reference to any financial year of that company or portfolio ending during the calendar year in question."

The term "financial year" is defined in section 1(1) as follows:

> " **'[F]inancial year'**, in relation to any company, means—
>
> (*a*) the period, whether of 12 months or not, commencing upon the date of incorporation or creation of such company and ending upon the last day of February immediately succeeding such date or upon such other date as the Commissioner having regard to the circumstances of the case may approve; or
>
> (*b*) any period subsequent to the period referred to in paragraph (*a*), whether of 12 months or not, commencing immediately after the last day of the immediately preceding financial year of such company and ending upon the first anniversary of such last day or upon such other date as the Commissioner having regard to the circumstances of the case may approve;"

Section 27(2) of the Companies Act 71 of 2008 provides that the first financial year of a company begins on the date that the incorporation of the company is registered, as stated in its registration certificate, and ends on the date set out in the Notice of Incorporation, which may not be more than 15 months after the date of its incorporation. Section 27(4)(*c*) of the Companies Act provides that when the board of a company changes its financial year the date as changed may not result in a financial year ending more than 15 months after the end of the preceding financial year.

(b) Annual report to be submitted to the Minister [section 9I(4)]

A headquarter company must submit an annual report to the Minister of Finance within such time and containing such information as the Minister may prescribe.[25]

4. Normal tax and capital gains tax

A headquarter company is subject to normal tax (including normal tax on capital gains) in the same way as any other resident company but it is also subject to some additional provisions (see **4.3**) and entitled to certain relief (see **4.2**) that are not applicable to resident companies that are not headquarter companies.

4.1 The law

The relevant sections and paragraphs are quoted in the **Annexure**.

4.2 Relief from normal tax and capital gains tax

4.2.1 Controlled foreign companies [section 9D(2)]

This Note does not discuss section 9D in detail. The discussion which follows is limited to the aspects which are affected by a headquarter company.

The term "controlled foreign company" is defined for the purposes of section 9D in section 9D(1). The definition is quoted in the **Annexure**.

In summary, a foreign company[26] is a CFC –

- when more than 50% of its total participation rights[27] are directly or indirectly held, or more than 50% of its voting rights are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies [paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1)]; or
- when its financial results are reflected in the consolidated financial statements of any company that is a resident, other than a headquarter company,[28] as required under IFRS 10 [paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1)].

When determining if the "more than 50% of participation rights or voting rights" requirement has been met under paragraph (*a*) of the definition of "controlled foreign company", the participation rights or voting rights that are directly or indirectly held or exercisable by a headquarter company itself are not taken into account. However, the participation rights and voting rights which are indirectly held or exercisable by another person through a headquarter company are taken into account.

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[25] In the interim, National Treasury have requested that headquarter companies submit their annual financial statements and group structure to National Treasury on an annual basis. The information must be submitted to **2020AnnexCProp@treasury.gov.za**.

[26] The term "foreign company" is defined in section 9D(1) for purposes of that section and includes in paragraph (*c*) of that definition a foreign company as defined in section 1(1) other than a protected cell company.

[27] The term "participation rights" is defined in section 9D(1). See the Annexure.

[28] A headquarter company is excluded from paragraph (*b*) of the definition of "controlled foreign company" with effect from date of promulgation of the Taxation Laws Amendment Act 34 of 2019, namely 15 January 2020.

Example 17 – Participation rights or voting rights in a CFC

Facts:

Company A, a resident, holds 90% of the participation rights and voting rights in Company B, a headquarter company. The other 10% are held by non-residents. Company B holds 100% of the equity shares and voting rights in a foreign company, Company C.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Result:

Company B's 100% holding of participation rights and voting rights in Company C is not taken into account under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1).

However, Company A indirectly holds 90% (90% × 100%) of the participation rights and voting rights in Company C. Company C is therefore a CFC because residents (in this case one resident) indirectly hold more than 50% of its participation rights or voting rights.

Example 18 – Participation rights or voting rights in a CFC

Facts:

Company A, a foreign company, holds 100% of the participation rights and voting rights in Company B, a headquarter company. Company B holds 100% of the participation rights and voting rights in a foreign company, Company C.

Result:

Company B's 100% holding of participation rights and voting rights in Company C is not taken into account under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1). In addition, none of the participation rights or voting rights in Company C is indirectly held or exercisable by residents. Therefore, Company C is not a CFC under paragraph (*a*) of the definition of "controlled foreign company" because residents (other than a headquarter company) do not directly or indirectly hold or exercise more than 50% of its participation rights or voting rights.

Company C can also not be a CFC under paragraph (*b*) of the definition, because of the exclusion of a headquarter company, in this example Company B, from its provisions.

Section 9D(2) generally requires that a portion of a CFC's net income[29] must be included in the income of any resident, other than a resident that is a headquarter company, who directly or indirectly holds any participation rights in a CFC. This is commonly referred to as "attribution". The amount which must be attributed to a particular resident is a proportional amount determined by applying the percentage of the resident's participation rights over the total participation rights in the company on the last day of the year of assessment to the CFC's net income as determined under

[29] As determined under section 9D(2A).

section 9D.[30] If only paragraph (*b*) of the definition of "controlled foreign company" is met, the percentage of a resident holding company's[31] participation rights in relation to that CFC is equal to the net percentage of that CFC's financial results that is included in the resident holding company's consolidated financial statements under IFRS 10.

Attribution of a CFC's net income is not required for a particular resident if that resident, together with a connected person in relation to the resident, in aggregate holds less than 10% of the participation rights and voting rights in that CFC.[32]

Attribution of a CFC's net income to a resident is also not required to the extent the participation rights are indirectly held by that resident through a resident company other than a headquarter company.[33] Therefore, to the extent the participation rights in the foreign company are indirectly held by a resident through a direct or indirect holding of another resident company, excluding a headquarter company, attribution of the CFC's net income to that resident is not required. A CFC's net income is therefore attributed to the first level of residents (other than headquarter companies), meeting the 10% participation rights and shareholding requirement.

Example 19 – Participation rights or voting rights in a CFC and attribution

Facts:

Company A and Company B, both residents, each hold 30% of the participation rights and voting rights in Company C, a headquarter company. Company C holds 100% of the participation rights and voting rights in a foreign company, Company D.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Result:

Company C's 100% holding of participation rights and voting rights in Company D is not taken into account in the calculation of the percentage of participation rights and voting rights held by residents in Company D under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1). The reason for this exclusion is that Company C is a headquarter company.

However, any participation rights and voting rights that are indirectly held by residents through a headquarter company must be taken into account. Therefore, because Company A and Company B, which are residents, indirectly hold 60% [(30% + 30%) × 100%] of the participation rights and voting rights in Company D, Company D is a CFC under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1).

Under section 9D(2), 60% of Company D's net income must be included in the income of residents, namely 30% in Company A's income and 30% in Company B's income, if all the other requirements of section 9D are met.

[30] Section 9D(2)(*a*).
[31] Holding company as defined as defined in the Companies Act 71 of 2008.
[32] Paragraph (A) of the proviso to section 9D(2).
[33] Paragraph (B) of the proviso to section 9D(2).

Example 20 – Participation rights or voting rights in a CFC

Facts:

Company A and Company B, which are residents, each hold 30% of the participation rights and voting rights in Company C, a headquarter company. Company C holds 80% of the participation rights and voting rights in a foreign company, Company D.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Result:

Company C's 80% holding of participation rights and voting rights in Company D is not taken into account in the calculation of the percentage of participation rights and voting rights held by residents in Company D under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1). The reason for this exclusion is that Company C is a headquarter company.

In addition, Company A and Company B indirectly hold only 48% [(30% + 30%) × 80%] of the participation rights and voting rights in Company D. Therefore, Company D is not a CFC under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1), since residents do not directly or indirectly hold more than 50% of the participation rights or voting rights in Company D.

Example 21 – Participation rights or voting rights in a CFC and attribution

Facts:

Company A and Company B, which are residents, each hold 30% of the participation rights and voting rights in Company C, a resident. Company C holds 100% of the participation rights and voting rights Company D, a headquarter company. Company D holds 80% of the participation rights and voting rights in a foreign company, Company E.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Result:

In determining if Company E is a CFC, Company D's direct 80% holding of participation rights and voting rights in Company E are not taken into account under paragraph (*a*) of the definition of "controlled foreign company" in section 9D(1). However, Company C's indirectly held participation rights and voting rights in Company E must be taken into account. Company C indirectly holds 80% (100% × 80%) of the participation rights and voting rights in Company E which means Company E is a CFC, since more than 50% of its participation rights and voting rights are held by residents. It is not necessary to consider Companies A and B's indirect holding for purposes of paragraph (*a*) of the definition of "controlled foreign company", since the "more than 50% participation rights and voting rights" requirement has already been met.

None of Company E's net income must be attributed to Company D, since headquarter companies are excluded from section 9D(2).

Company C will be required to include 80% of Company E's net income in its income. The exclusion from attribution under proviso B to section 9D(2) does not apply because Company C's participation rights are indirectly held through Company D which is a headquarter company.

None of Company E's net income must be attributed to Company A and Company B because their participation rights are indirectly held through Company C, a resident, which is not a headquarter company. Double attribution would arise if a percentage of Foreign Company E's income were also to be included in Company A and Company B's income. Proviso B to section 9D(2) therefore applies.

Example 22 – Participation rights or voting rights in a CFC and attribution

Facts:

Company A, a resident, holds 100% of the participation rights and voting rights in Company B, a resident. Company B holds 100% of the participation rights and voting rights in Company C, a headquarter company. Company C holds 100% of the participation rights and voting rights in Company D, a resident, and 100% of the participation rights and voting rights in a foreign company, Company F. Company D holds 80% of the participation rights and voting rights in a foreign company, Company E.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Result:

Company E and Company F are CFC's, since more than 50% of the participation rights and voting rights in these companies are directly and indirectly held by residents (Company D and Company B respectively) that are not headquarter companies.

Company D must include 80% of Company E's net income in its income under section 9D(2).

Company C must not include any of Company E or Company F's net income in its income, since headquarter companies are excluded from section 9D(2).

Company B must not include any of Company E's net income in its income because its participation rights are indirectly held through Company D, which is a resident and not a headquarter company. Proviso B to section 9D(2) therefore applies. However, Company B is required to include 100% of Company F's net income in its income under section 9D(2). The exclusion from attribution under proviso B to section 9D(2) does not apply because Company B's participation rights are indirectly held through Company C which is a headquarter company.

Company A must not include any of Companies E or F's net income in its income because its participation rights and voting rights are indirectly held through Company B, which is a resident and not a headquarter company. Proviso B to section 9D(2) therefore applies.

Example 23 – Participation rights or voting rights in a CFC and attribution

Facts:

Company A and Company B, which are residents, each hold 50% of the participation rights and voting rights in Company C, a headquarter company. Company C holds 40% of the participation rights and 60% of the voting rights in a foreign company, Company D.

Assume that paragraph (*b*) of the definition of "controlled foreign company" in section 9D(1) does not apply.

Company D's net income was as follows for the foreign tax year ending on 28 February:

	R
Rental income	10 000 000
Interest	4 000 000
Total net income	14 000 000

Result:

Company A and Company B indirectly hold 40% [(50% + 50%) × 40%] of the participation rights and 60% [(50% + 50%) × 60%] of the voting rights in Company D. Company D is a CFC because more than 50% of its voting rights are held by residents.

The portion of Company D's net income that must be included in Company A and Company B's income is based on the percentage participation rights held in Company D. The following amounts of net income must be included in *both* Company A and Company B's income:

	R
Net income (R14 million × 50% × 40% participation rights)	2 800 000

4.2.2 Dividends, foreign dividends and related exemptions from normal tax (paragraph (*k*) of the definition of "gross income" in section 1(1) and sections 10(1)(*k*)(i) and 10B)

This Note does not discuss the various definitions and sections applicable to dividends and foreign dividends in detail. The discussion which follows is high level and highlights certain aspects which apply to dividends and foreign dividends received by or accrued to a headquarter company and to dividends declared or paid by a headquarter company.

See Interpretation Note 93 "The Taxation of Foreign Dividends" for a detailed interpretation of the meaning of "foreign dividend" and the exemption from normal tax under section 10B and the *Comprehensive Guide to Dividends Tax* for a detailed interpretation of the normal tax and dividends tax implications of dividends paid by a company and received or accrued by beneficial owners.

(a) Dividends and foreign dividends received by or accrued to a headquarter company and related exemptions from normal tax

Any amount received by or accrued to a resident by way of a dividend or a foreign dividend must be included in gross income.[34] A headquarter company is a resident (see **3.2.2**) and must include dividends and foreign dividends received by or accrued to it in gross income.

The term "dividend" is defined in section 1(1) and means, in simplified terms, an amount, other than a dividend *in specie* declared and paid as contemplated in section 31(3),[35] transferred or applied by a resident company for the benefit or on behalf of any person in respect of any share in that company.

The term "foreign dividend" is defined in section 1(1) and means, in simplified terms, an amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company under the specified laws of that country.

Subject to certain exceptions,[36] dividends that are received by or accrue to a headquarter company are exempt from normal tax under section 10(1)(*k*)(i). Foreign dividends received by or accrued to a headquarter company may be exempt from normal tax under section 10B [see **4.2.2(c)**].

(b) Dividends paid or declared by a headquarter company and related exemptions from normal tax

A dividend received or accrued from a headquarter company is from a source within South Africa and must be included in both a resident and non-resident's gross income.[37] A dividend received or accrued from a headquarter company does not qualify for exemption from normal tax under section 10(1)(*k*)(i) but may qualify for exemption under section 10B [see **4.2.2(c)**].

(c) "Section 10B foreign dividend" exemption from normal tax

Foreign dividends received by or accrued to a person, or dividends paid or declared by a headquarter company, may qualify for an exemption from normal tax under section 10B.

For the purposes of section 10B a "foreign dividend" means a "foreign dividend" as defined in section 1 or a dividend paid or declared by a headquarter company. This Note refers to a foreign dividend under section 10B as a "section 10B foreign dividend".

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[34] Paragraph (*k*) of the definition of "gross income" in section 1(1).

[35] The deemed dividend contemplated in section 31(3) is excluded from the definition of "dividend" in section 1(1), with effect from years of assessment commencing on or after 1 January 2019.

[36] Paragraphs (*aa*) to (*kk*) of the proviso to section 10(1)(*k*)(i).

[37] Paragraph (*k*) of the definition of "gross income" in section 1(1).

From a headquarter company perspective a section 10B foreign dividend can be –

- received by or accrued to a headquarter company in which case the possible exemption under section 10B may be applied to the headquarter company; or
- paid or declared by a headquarter company and received by or accrued to a resident or non-resident, in which case the possible exemption under section 10B may be applied to the resident or non-resident.

A section 10B foreign dividend received by or accrued to a person (including a headquarter company) will be exempt under section 10B(2) –[38]

- if that person, whether alone or together with any other company forming part of the same group of companies as that person, holds at least 10% of the equity shares and voting rights in the company declaring the section 10B foreign dividend [section 10B(2)(*a*)];
- if that person is a foreign company and the foreign dividend is paid or declared by another foreign company that is a resident in the same country as that person [section 10B(2)(*b*)];
- if that person is a resident then, under certain circumstances, to the extent that the foreign dividend does not exceed the aggregate of all amounts previously attributed under section 9D which relate to the net income of the company declaring the foreign dividend or from any other company by virtue of that resident's participation rights in that company held indirectly through the company declaring the foreign dividend [section 10B(2)(*c*)];
- to the extent that the foreign dividend is received by or accrues to that person on a listed share and does not consist of the distribution of an asset *in specie* [section 10B(2)(*d*)]; or
- to the extent that the foreign dividend is received by or accrues to a resident company in respect of a listed share and consists of the distribution of an asset *in specie* [section 10B(2)(*e*)].

To the extent a section 10B foreign dividend is not exempt under section 10B(2) it may qualify for a partial exemption under section 10B(3).[39] The exempt portion under section 10B(3) is determined by multiplying the section 10B foreign dividend that is not otherwise exempt under section 10B(2) by a factor. The factor, if the person is –

- a natural person, deceased estate, insolvent estate or trust, is 25/45;[40]
- a company or an insurer in respect of its company policyholder fund, corporate fund or risk policy fund, is 8/28;[41] or
- an insurer in respect of its individual policyholder fund, is 10/30.[42]

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38 See, however, the provisos to section 10B(2), and section 10B(4), (5) and (6).

39 See, however, section 10B(5) and (6).

40 With effect from years of assessment commencing on or after 1 March 2017, namely the 2018 year of assessment. The ratio was 26 to 41 for years of assessment commencing on or after 1 March 2015 and 25 to 40 for previous years.

41 With effect from years of assessment commencing on or after 1 March 2017. The ratio was 13 to 28 for previous years.

42 With effect from years of assessment commencing on or after 1 March 2017. The ratio was 15 to 30 for previous years.

The effect of the exemption under section 10B(3) is that section 10B foreign dividends received by or accrued to a person, which are not exempt under section 10B(2), will generally be subject to a maximum rate of tax of 20%[43] thus giving a result similar to that produced by dividends tax.

Example 24 – Dividends received by or accrued to and declared and paid by a headquarter company

Facts:

Company A, a foreign company, and Company B, a resident, each hold 50% of the equity shares and voting rights in Company C, a headquarter company. Company C holds 100% of the unlisted shares in a foreign company, Company D. Company D declared a dividend of R500 000 to Company C on 31 October 2017. Company C declared a dividend of R400 000 to its shareholders on 30 November 2017.

Result:

Normal tax implications

Dividend of R500 000 received by a headquarter company (Company C)

The foreign dividend of R500 000 received by Company C is included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). However, the foreign dividend is exempt from normal tax under section 10B(2)(*a*), since Company C held at least 10% of Company D's equity shares and voting rights.

Dividend received by Company A and Company B

The dividend declared by Company C is from a source within South Africa and must be included in Company A and Company B's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

The dividend constitutes a section 10B foreign dividend, since it is declared by a headquarter company, and must therefore be considered for exemption from normal tax under section 10B and not section 10(1)(*k*)(i). The section 10B foreign dividend is exempt from normal tax under section 10B(2)(*a*), since Company A and Company B both held at least 10% of the equity shares and voting rights in Company C.

Dividends tax implications[44]

Dividend paid by Company D

Dividends tax is not levied on the foreign dividend paid by Company D, since the dividend is not a "dividend" as defined in section 64D.

Dividend paid by a headquarter company (Company C)

Dividends tax is not levied on the dividend paid by Company C, since dividends paid or declared by headquarter companies are specifically excluded from section 64E(1).

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43 15% for years of assessment commencing before 1 March 2017.

44 Dividends tax is discussed in **5.2.3.**

4.2.3 Transfer pricing [section 31(5) and (6)]

Very broadly, section 31 determines the taxation of international transactions between connected persons not dealing at arm's length if any person that is a party to that transaction, operation, scheme, agreement or understanding derives a tax benefit from it. Section 31 requires taxpayers to –

- determine whether the actual terms and conditions of any transaction, operation, scheme, agreement or understanding meeting paragraph (*a*) of the definition of "affected transaction"[45] differ from the terms and conditions that would have existed if the parties had been independent persons dealing at arm's length; and
- to calculate their taxable income based on the arm's length terms and conditions of the affected transaction if there is a difference which results or will result in a tax benefit for one of the parties to the affected transaction.

A headquarter company must comply with section 31 except in the circumstances provided for in section 31(5) as discussed below. For example, section 31 will apply to the rendering of managerial services between a headquarter company and connected persons who are not residents.

Section 31(5)

Section 31(5) provides that when any transaction, operation, scheme, agreement or understanding has been entered into and in terms of which –

- the granting of financial assistance,[46] or
- the granting of the use, right of use or permission to use any intellectual property as defined in section 23I(1),[47]

is provided –

- by a non-resident to a headquarter company, section 31 will not apply to so much of that financial assistance as is directly applied or to so much of the use, right of use or permission to use intellectual property as is granted to any foreign company in which the headquarter company directly or indirectly holds at least 10% of the equity shares and voting rights[48] and, in the case of intellectual property, the headquarter company does not use it otherwise [section 31(5)(*a*) and (*c*)]; or
- by a headquarter company to a foreign company in which the headquarter company directly or indirectly holds at least 10% of the equity shares and voting rights,[49] section 31 will not apply to that financial assistance or granting of the use, right of use or permission to use that intellectual property [section 31(5)(*b*) and (*d*)].

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45 See the definition of "affected transaction" in section 31(1).

46 The term "financial assistance" is defined in section 31(1) and includes any debt, security or guarantee.

47 See **3.2.3(b)** for the definition of "intellectual property" in section 23I(1).

48 The headquarter company may hold that interest alone or together with any other company forming part of the same group of companies.

49 The headquarter company may hold that interest alone or together with any other company forming part of the same group of companies.

Example 25 – Transfer pricing

Facts:

Company A is a headquarter company which holds 50% of the equity shares and voting rights in a foreign company, Company B. Company A and Company B are connected persons in relation to each other.[50] Company A advanced a loan of R10 million to Company B.

Result:

Under section 31(5)(*b*), the transfer pricing provisions of section 31 do not apply to the loan of R10 million advanced by Company A to Company B, since Company A granted the financial assistance to a foreign company in which it held at least 10% of the equity shares and voting rights.

Example 26 – Transfer pricing

Facts:

Company A, a foreign company, holds 50% of the equity shares in Company B, a headquarter company. Company B holds 20% of the equity shares and voting rights in Company C and in Company D. Company C and Company D are foreign companies. Company B is a connected person in relation to Company A, Company C and Company D.[51]

Company A advanced R50 million to Company B on 25 March year 1. Company B advanced R20 million of this loan to Company C and R10 million to Company D on 31 March year 1.

Result:

R50 million loan granted by Company A to a headquarter company (Company B)

Under section 31(5)(*a*), section 31 does not apply to R30 million (R20 million + R10 million) of the loan advanced by Company A to Company B because R30 million was advanced to foreign companies (Company C and Company D) in which Company B held at least 10% of the equity shares and voting rights.

Section 31 must be applied to the remaining portion of R20 million (R50 million – R20 million – R10 million) which was not advanced by Company B to a foreign company in which Company B held at least 10% of the equity shares and voting rights.

Note:

Section 20C may apply if Company B incurred interest on the loan advanced by Company A (see **4.3.1**).

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50 Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

51 Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

R20 million loan granted by a headquarter company (Company B) to Company C and R10 million granted by Company B to Company D

Under section 31(5)(*b*), section 31 does not apply to the loans advanced by Company B to Company C and Company D because Company B held at least 10% of the equity shares and voting rights in Company C and Company D.

Example 27 – Transfer pricing

Facts:

Company A, a foreign company, holds 20% of the equity shares in Company B, a headquarter company. Company B holds 40% of the equity shares and voting rights in Company C, a foreign company. Company B is a connected person in relation to Company A and Company C.[52]

Company A granted the right of use of a patent to Company B on 30 June year 1. On 15 July year 1 Company B granted this right of use of the patent to Company C. This was the only use of the patent.

Company B paid royalties of R2 million to Company A and received royalties of R1 million from Company C.

Result:

Under section 31(5)(*c*), section 31 does not apply to the granting of the right of use of the patent by Company A to Company B, since Company B granted the right of use of the patent only to a foreign company (Company C) in which it held at least 10% of the equity shares and voting rights.

Under section 31(5)(*d*), section 31 does not apply to the granting of the right of use of the patent by Company B to Company C, since Company B held at least 10% of the equity shares and voting rights in Company C.

Note:

Section 20C(2A) may apply to limit the deduction for royalties paid by Company B to Company A to the amount of royalties received from Company C (see **4.3.2**).

Section 31(6)

Section 31(6) provides that if a resident, other than a headquarter company, grants –

- financial assistance, or
- the use, right of use or permission to use any intellectual property

to a CFC in relation to that resident or to a CFC in relation to a company that forms part of the same group of companies as the resident, section 31 does not apply to that granting provided certain requirements are met.[53] The exclusion in section 31(6) does not apply to headquarter companies.

[52] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

[53] See section 31(6)(i) and (ii).

4.2.4 Foreign currency provisions [sections 24I(3), 25D(4) and (7), and paragraph 43(1A) and (6A)]

(a) Determination of taxable income of a headquarter company in foreign currency [section 25D(4) and (7)]

Section 25D specifies when and at what rate an amount or value denominated in a foreign currency must be translated to an amount in rand.[54] Section 25D contains the core rules for the translation of amounts expressed in foreign currency to rand, however, there are other sections which contain rules for specific circumstances that often override the core rules in section 25D, for example section 6*quat*(4).[55]

The translation of an amount in foreign currency to rand is essential because any liability of a person for normal tax must be expressed in rand.

A headquarter company's functional currency (see definition and discussion below) could be a foreign currency or the rand.

Section 25D(4) applies to a headquarter company which has a functional currency other than the rand. In circumstances when a headquarter company's functional currency is the rand the other provisions of section 25D must be considered.[56]

Under section 25D(4) a headquarter company that has a functional currency other than the rand must determine taxable income in its functional currency and translate that figure to rand using the applicable average exchange rate for that year of assessment. In determining taxable income a headquarter company's receipts, accruals and expenditure which are denominated in a currency other than the functional currency of the headquarter company, including amounts in rand, must be translated to the headquarter company's functional currency.

The term "functional currency" is defined in section 1(1) as follows:

> " **'[F]unctional currency'**, in relation to—
>
> (*a*) a person, means the currency of the primary economic environment in which the business operations of that person are conducted; and
>
> (*b*) a permanent establishment of any person, means the currency of the primary economic environment in which the business operations of that permanent establishment are conducted;"

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[54] See Interpretation Note 63 "Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule" for a detailed interpretation of section 25D.

[55] Section 6*quat*(4) provides that foreign tax must for the purposes of section 6*quat* be translated to rand on the last day of a year of assessment by applying the average exchange rate for that year of assessment.

[56] The other provisions of section 25D are not discussed in this Note. See Interpretation Note 63 "Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule" for a detailed interpretation of section 25D.

The accounting treatment of foreign currency transactions is addressed in IAS 21.[57] The term “functional currency”, as defined in section 1(1), corresponds closely with the definition of that term in IAS 21. As a result IAS 21 can provide useful guidance in interpreting and applying the definition of “functional currency” for income tax purposes.

The accounting definition of “functional currency” is as follows:[58]

> “Functional currency is the currency of the primary economic environment in which the entity operates.”

IAS 21 describes the primary economic environment in which an entity operates as normally the one in which it primarily generates and expends cash. The functional currency will usually be the currency in which, amongst other things, –

- sales prices of goods and services are denominated and settled; or
- costs of providing goods or services are denominated or settled.[59]

Additional factors which may be considered include –

- the currency of financing activities (debt and equity instruments); and
- the currency in which receipts from operating activities are retained.[60]

SARS will generally accept the functional currency used by a person for financial accounting purposes as its functional currency provided that the determination of that functional currency is made in accordance with IAS 21. For example, if a headquarter company has a United Kingdom parent company and the headquarter company primarily transacts in British pounds, its functional currency may be the British pound.

Section 25D(4) does not state how amounts not expressed in the functional currency of the headquarter company must be translated to its functional currency. It will be acceptable to SARS if –

- the spot rate is used to translate other currencies (including rand) to the headquarter company’s functional currency and, if applicable, to the headquarter company’s permanent establishment’s functional currency; and
- the average exchange rate is used to translate taxable income of a headquarter company’s permanent establishment to the headquarter company’s functional currency if the headquarter company’s permanent establishment has a different functional currency to that of the headquarter company.

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[57] IAS 21 is the International Accounting Standard 21 “The Effects of Changes in Foreign Exchange Rates”. IAS 21 prescribes that when a reporting entity prepares financial statements, each individual entity included in the reporting entity – whether it is a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch) – must determine its functional currency and measure its results and financial position in that currency.

[58] IAS 21 in paragraph 8 under the heading: Definitions.

[59] IAS 21 in paragraph 9 under the heading: Elaboration on the Definitions / Functional Currency.

[60] IAS 21 in paragraph 10 under the heading: Elaboration on the Definitions / Functional Currency.

Once the income and expenses of a headquarter company are determined in the functional currency of the headquarter company, these amounts, together with amounts denominated in the headquarter company's functional currency, must be translated from the functional currency to rand at the average exchange rate for the year of assessment.[61]

The term "spot rate" is defined in section 1(1) as follows:

> " **'[S]pot rate'** means the appropriate quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency;"

The term "average exchange rate" is defined in section 1(1) as follows:

> " **'[A]verage exchange rate'** in relation to a year of assessment means the average determined by using the closing spot rates at the end of daily or monthly intervals during that year of assessment which must be consistently applied within that year of assessment;"

Example 28 – Determination of taxable income of a headquarter company in foreign currency

Facts:

The functional currency of Company A, a headquarter company, is the US $. Company A's taxable income for a year of assessment, ending on 31 March, is $330 000. Assume for purposes of this example that the average exchange rate for the year of assessment, is $1,0000 = R13,5000.

Result:

Taxable income must be calculated in US $ and then translated to rand using the average exchange rate for the year of assessment, since Company A's functional currency is the US $. Company A's taxable income for the year of assessment is R4 455 000 ($330 000 × R13,5000).

(b) Gains or losses on foreign exchange transactions [section 24I(3) and (4)]

Under section 24I(3)[62] in determining taxable income a specified person[63] must, subject to section 24I(7) and (10A) as appropriate, include in or deduct from that person's income –

- any exchange difference in respect of an "exchange item" of or in relation to such person [section 24I(3)(*a*)];
- any premium or like consideration received by or paid by such person under a foreign currency option contract entered into by such person [section 24I(3)(*b*)(i)]; or
- any consideration paid by such person under a foreign currency option contract acquired by such person [section 24I(3)(*b*)(ii)].

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[61] Under section 25D(4) and (7).

[62] See Interpretation Note 101 "Section 24I – Gains or Losses on Foreign Exchange Transactions" for a detailed interpretation of section 24I.

[63] The persons subject to section 24I are specified in section 24I(2) and include a company and therefore a headquarter company.

An exchange difference, referred to in section 24I(3)(*a*), is determined on each exchange item for the year of assessment in which such exchange item arose, as well as every subsequent year of assessment until and including the year of assessment in which it is realised. To calculate an exchange difference for a specific year of assessment, a commencement date and a final date must be established in that year of assessment. The following combinations of commencement dates and final dates are possible:

- Transaction date and realisation date.
- Transaction date and translation date (last day of the year of assessment).[64]
- The previous translation date (last day of the previous year of assessment) and realisation date.
- The previous translation date (last day of the previous year of assessment) and the current translation date (last day of the current year of assessment).

The exchange difference on a particular exchange item for a specific year of assessment is determined by multiplying the foreign currency amount of the exchange item by the difference between the ruling exchange rate[65] on the commencement date in that year of assessment and the ruling exchange rate on the final date in that year of assessment. An exchange difference calculated in this manner represents the effect of the weakening or strengthening of the relevant exchange rate between the two dates and will be reflected as a foreign exchange loss or gain respectively. Exchange differences on exchange items, in the form of foreign exchange gains and losses, are included in or deducted from income under section 24I(3)(*a*).

The term "exchange item" is defined in section 24I(1) as follows:

> " **'[E]xchange item'** of or in relation to a person means an amount in a foreign currency—
>
> (*a*) which constitutes any unit of currency acquired and not disposed of by that person;
>
> (*b*) owing by or to that person in respect of a debt incurred by or payable to such person;
>
> (*c*) owed by or to that person in respect of a forward exchange contract;[66] or
>
> (*d*) where that person has the right or contingent obligation to buy or sell that amount in terms of a foreign currency option contract;"[67]

Exchange differences are determined only on exchange items, namely, specified amounts in foreign currency (see the definition of "exchange item" above).

The term "foreign currency" as defined in section 24I(1) means, in relation to an exchange item of any person, any currency which is not local currency.

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[64] See **4.4.6** in Interpretation Note 101 "Section 24I – Gains or Losses on Foreign Exchange Transactions" for the impact of the approval of different accounting periods under section 66(13A) and (13C).

[65] The term "ruling exchange rate" is defined in section 24I(1).

[66] The term "forward exchange contract" is defined in section 24I(1).

[67] The term "foreign currency option contract" is defined in section 24I(1).

The term “local currency” is defined in section 24I(1). The following paragraphs of the definition apply to a headquarter company:

> “ **‘[L]ocal currency’** means in relation to—
>
> (*a*) any person in respect of an exchange item which is attributable to any permanent establishment outside the Republic, the functional currency of that permanent establishment: Provided that for purposes of this paragraph any exchange item shall be deemed not to be attributable to any such permanent establishment if the functional currency of that permanent establishment is the currency of a country which has an official rate of inflation of 100 per cent or more throughout the relevant year of assessment;
>
> …
>
> (*d*) any headquarter company in respect of an exchange item which is not attributable to a permanent establishment outside the Republic, the functional currency of that headquarter company;”

In the case of a headquarter company, if a unit of currency, a debt, a forward exchange contract or a foreign currency option contract is not attributable to the headquarter company’s permanent establishment outside South Africa and is denominated in the headquarter company’s functional currency, it will not constitute an exchange item as defined. The reason being that it is dominated in the headquarter company’s local currency. In the absence of an exchange item[68] as defined, section 24I does not apply.

A headquarter company will, however, be subject to section 24I on gains and losses on foreign exchange transactions, if a unit of currency, a debt, a forward exchange contract or a foreign currency option contract is not attributable to a permanent establishment outside South Africa and it is denominated in a foreign currency (that is a currency other than its functional currency).

In the case of a unit of currency, a debt, a forward exchange contract or a foreign currency option contract that is attributable to a headquarter company’s permanent establishment outside South Africa the same principle applies. However, the functional currency of the permanent establishment, which could be different to the headquarter company’s functional currency, is considered to be local currency. In this situation it would be necessary to calculate the headquarter company and its permanent establishment’s foreign exchange gains and losses separately before including them in income.

Example 29 – Gains on foreign exchange transactions

Facts:

Company X’s year of assessment ends on 31 December.

The functional currency of Company X, a headquarter company, is the US $. Company X advanced $100 000 to Company Y, a foreign company on 1 January year 3 when $1,0000 = R10,0000. This debt was still outstanding on 31 December year 4. Assume $1,0000 = R11,0000 on 31 December year 3 and $1,0000 = R15,0000 on 31 December year 4.

68 Assuming one is not dealing with a premium or like consideration on a foreign currency option contract.

Result:

Company X is not subject to section 24I(3). The debt does not constitute an "exchange item" as defined in section 24(1), since it is denominated in Company X's local currency (that is, its functional currency).

Section 24I(4) was inserted in the Act with effect from years of assessment commencing on or after 1 January 2019. It provides that ,subject to section 11, in determining the taxable income of any person contemplated in section 24I(2) in respect of a debt owing to that person as referred to in paragraph (*b*) of the definition of "exchange item", to the extent that on realisation the debt was irrecoverable by reason of becoming bad or the realisation of the debt resulted in a loss determined in the foreign currency due to a decline in the market value of that debt, the amount of –

- any foreign exchange gain, relating to that debt, that is or was included in the income of that person in the current or any previous year of assessment must be deducted from the income of that person; and
- the amount of any foreign exchange loss, relating to that debt, that is or was deducted from the income of that person in the current or any previous year of assessment must be included in the income of that person.

See Examples 31 and 32 in **4.2.4 (c)** below.

(c) Assets disposed of or acquired in foreign currency [paragraph 43(1A)]

Paragraph 43 is discussed in detail in the *Comprehensive Guide to Capital Gains Tax*. Only certain aspects of paragraph 43 are discussed below.

The capital gain or capital loss arising from the acquisition or disposal of assets in foreign currency must be determined in rand. Paragraph 43 provides the rules for converting the various components making up the capital gain or capital loss (proceeds, expenditure and when applicable, market value) to rand. It specifies when the conversion must take place and the appropriate exchange rate to be used. Paragraph 43 takes precedence over section 25D.

The term "foreign currency" as defined in paragraph 43(7) means currency other than local currency. The term "local currency" is defined in paragraph 43(7) and means, in relation to a headquarter company, in respect of amounts not attributable to a permanent establishment outside South Africa, the functional currency of that headquarter company. Local currency in relation to a headquarter company's permanent establishment outside South Africa means that permanent establishment's functional currency (other than the currency of any country in the common monetary area).

Paragraph 43(1A) applies to companies and provides that if a person disposes of an asset for proceeds in a foreign currency, or after having incurred expenditure on the asset in a foreign currency, the person must, for purposes of determining the capital gain or capital loss on the disposal of the asset, translate the proceeds and expenditure as follows:

- The proceeds must be translated to the local currency at the average exchange rate for the year of assessment in which the asset was disposed of, or at the spot rate on the date of disposal of the asset.

- The expenditure must be translated to local currency at the average exchange rate for the year of assessment during which the expenditure was incurred, or at the spot rate on the date on which the expenditure was incurred.

The capital gain or capital loss determined in local currency must then be translated by the headquarter company to rand using the average exchange rate for the year of assessment.[69]

Example 30 – Assets disposed of in foreign currency

Facts:

Company C's year of assessment ends on the last day of February.

The functional currency of Company C, a headquarter company, is the Botswana Pula (BWP).

Company C purchased 5% of the equity shares in Company D, a foreign company, on 1 March year 1 for BWP100 000 as a capital investment. On 15 December year 4, Company C disposed of the equity shares in Company D for $20 000. Company C elected to apply the average exchange rate to convert proceeds to its functional currency. Assume that the average exchange rates for the year of assessment ending on 29 February year 5 was $1,0000 = BWP7,9800 and BWP1,0000 = R1,1200.

Result:

Paragraph 43(1A) provides that the proceeds on disposal of the equity shares must be translated to the local currency of the headquarter company, which is the headquarter company's functional currency, at the average exchange rate for the year of assessment or at the spot rate on date of disposal. Company C elected to apply the average exchange rate. The proceeds on disposal of the equity shares in Botswana Pula is BWP159 600 ($20 000 × BWP7,9800).

The capital gain on disposal of the equity shares is calculated as follows:

	BWP
Proceeds	159 600
Less: Base cost	(100 000)
Capital gain	59 600

The capital gain must be translated to rand at the average exchange rate for the year of assessment as follows:

	R
Capital gain (BWP59 600 × R1,1200)	66 752

[69] Section 25D(2), (4) and (7).

Before 15 January 2020

Before the deletion of paragraph 43(6A) on 15 January 2020,[70] the paragraph provided that paragraph 43(1A) did not apply to the disposal of –

- any amount of a debt owed to a person denominated in a foreign currency [paragraph 43(6A)(*b*)]; or
- any right of that person arising from any contractual agreement or arrangement to which that person and another party are parties when –
  - that contractual agreement or arrangement gives rise to that right and to a corresponding obligation of the other party; and
  - the value of that right and the amount of that obligation are determined directly or indirectly with reference to a debt owed to a person that is denominated in a foreign currency [paragraph 43(6A)(*c*)].

The exclusion under paragraph 43(6A)(*b*) avoided the duplication of foreign currency gains and losses arising under section 24I. It follows that a person falling outside paragraph 43(1A) because of the exclusion in paragraph 43(6A)(*b*) before 15 January 2020 had to determine a capital gain or capital loss under the core rules of the Eighth Schedule taking into account section 24I and section 25D.

In terms of these rules section 24I(6) and paragraph 35(3)(*a*) prevent any double taxation or double deduction arising when there is an overlap between section 25D and section 24I, or for that matter section 25D and paragraph 43. Section 24I(6) provides that any inclusion in or deduction from income under that section shall be in lieu of any deduction or inclusion which may otherwise be allowed or included under any other provision of the Act.

Under paragraph 35(3)(*a*) the proceeds from the disposal of an asset by a person must be reduced by any amount of the proceeds that must be or was included in the gross income of that person or that must be or was taken into account when determining the taxable income of that person before the inclusion of any taxable capital gain.

See Examples 31 and 32 in Issue 2 of this Note, which has been archived, for the application of paragraph 43(6A).

On or after 15 January 2020

The deletion of paragraph 43(6A), with effect from 15 January 2020, has the effect that paragraph 43(1A) applies to, amongst other things, any amount of a debt owed to a person that is denominated in a foreign currency. The proviso to paragraph 43(1A)[71] stipulates that the amount of any capital gain or capital loss determined under paragraph 43(1A) in respect of an exchange item contemplated in section 24I must be taken into account under paragraph 43(1A) only to the extent to which it exceeds the amounts determined in respect of that exchange item under section 24I. The proviso therefore avoids the duplication of foreign exchange gains and losses arising under section 24I.

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70 Paragraph 43(6A) was deleted by section 61(*c*) of the Taxation Laws Amendment Act 34 of 2019 with effect from the date of promulgation of that Act, namely 15 January 2020.

71 Inserted with effect from 15 January 2020.

Example 31 – Calculation of a capital gain and exchange differences in respect of a debt – Disposal of debt on or after 15 January 2020

Facts:

Company B, a headquarter company, acquired a foreign bond as a long-term investment during its first year of assessment when X$1,0000 = R1,0000 for X$100. At the end of the first year of assessment the exchange rate was X$1,0000: R1,4000 and at the end of the second year of assessment X$1,0000: R2,0000. On the last day of the second year of assessment Company B disposed of the bond for an amount received or accrued of X$120. Company B's functional currency is the rand.

Company B elected to apply the spot rate for purposes of paragraph 43(1A).

Result:

Determination of exchange difference under section 24I ***(Note 1)***

Year 1

Determination of exchange difference on translation date

The exchange difference is determined by multiplying the amount of the exchange item (debt) by the difference between the ruling exchange rates on transaction date and translation date as follows:

	R
Exchange difference [X$100 × (1,0000 – 1,4000)]	40

An exchange difference of R40 is determined on translation date which represents a foreign exchange gain that must be included in income under section 24I(3)(*a*).

Year 2

Determination of exchange difference on realisation date

The exchange difference is determined by multiplying the amount of the exchange item (debt) by the difference between the ruling exchange rates on translation date and realisation date as follows:

	R
Exchange difference [X$100 × (1,4000 – 2,0000)]	60

An exchange difference of R60 is determined on realisation date which represents a foreign exchange gain that must be included in income under section 24I(3)(*a*).

Determination of capital gain on disposal - Application of paragraph 43(1A)

Year 2	R
Amount received or accrued on disposal (X$120 × R2,0000 spot rate) **(Note 2)**	240
Less: Base cost of bond (X$100 × R1,0000 spot rate) **(Note 2)**	(100)
Capital gain determined in rand before eliminating double taxation under the proviso to paragraph 43(1A)	140
Less: Amounts of exchange differences previously included in income under section 24I(3)(*a*) (R40 + R60) [the proviso to paragraph 43(1A)]	(100)
Capital gain in rand to be included in taxable income	40

Notes:

(1) Section 24I applies to the headquarter company because the bond is an exchange item, namely an amount in foreign currency owed to Company B [see **4.2.4(b)**].

(2) The spot rate is applied in accordance with paragraph 43(1A).

Example 32 – Calculation of a capital loss and exchange differences in respect of a debt – Disposal of debt on or after 15 January 2020

Facts:

Company C, a headquarter company, acquired a foreign bond as a long-term investment during its first year of assessment when X$1,0000 = R1,0000 for X$100. At the end of the first year of assessment the exchange rate was X$1,0000: R1,4000 and at the end of the second year of assessment X$1,0000: R2,0000. On the last day of the second year of assessment Company C disposed of the bond for an amount received or accrued of X$80. Company C's functional currency is the rand.

Company C elected to apply the spot rate for purposes of paragraph 43(1A).

Result:

Determination of exchange difference under section 24I ***(Note 1)***

Year 1

Determination of exchange difference on translation date

The exchange difference is determined by multiplying the amount of the exchange item (debt) by the difference between the ruling exchange rates on transaction date and translation date as follows:

	R
Exchange difference [X$100 × (1,0000 – 1,4000)]	40

An exchange difference of R40 is determined on translation date which represents a foreign exchange gain that must be included in income under section 24I(3)(*a*).

Year 2

Determination of exchange difference on realisation date

The exchange difference is determined by multiplying the amount of the exchange item (debt) by the difference between the ruling exchange rates on translation date and realisation date as follows:

	R
Exchange difference [X$100 × (1,4000 – 2,0000)]	60

An exchange difference of R60 is determined on realisation date which represents a foreign exchange gain that must be included in income under section 24I(3)(*a*).

Determination of amount of foreign exchange gain included in income, to be deducted from income under section 24I(4)(b)

The amount deductible under section 24I(4)(*b*) is determined by multiplying the amount of the decrease in market value of the debt by the difference between the ruling exchange rates on transaction date and realisation date as follows:

	R
Decrease in market value (X$100 – X$80) × (1,0000 – 2,0000)]	(20)

Determination of capital loss on disposal - Application of paragraph 43(1A)

Year 2	R
Amount received or accrued on disposal (X$80 × R2,0000 spot rate) **(Note 2)**	160
Less: Base cost of bond (X$100 × R1,0000 spot rate) **(Note 2)**	(100)
Capital gain determined in rand before eliminating double taxation under the proviso to paragraph 43(1A)	60
Less: Amounts of exchange differences previously included in income under section 24I(3)(*a*) and deducted under section 24I(4) (R40 + R60 – R20) [proviso to paragraph 43(1A)]	(80)
Capital loss in rand to be off-set against other capital gains	(20)

Notes:

(1) Section 24I applies to the headquarter company because the bond is an exchange item, namely an amount in foreign currency owed to Company C [see **4.2.4(b)**].

(2) The spot rate is applied in accordance with paragraph 43(1A).

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

(a) Disposal of equity shares in a foreign company [paragraph 64B(2)]

Under paragraph 64B(2) a headquarter company must disregard a capital gain or capital loss on the disposal of equity shares in a foreign company if the headquarter company, whether alone or together with any other company forming part of the same group of companies as the headquarter company, immediately before that disposal held at least 10% of the equity shares and voting rights in the foreign company.

Paragraph 64B(2) does not apply to an interest contemplated in paragraph 2(2), namely, if 80% or more of the market value of the equity shares in a foreign company is directly or indirectly attributable to immovable property in South Africa held otherwise than as trading stock and the headquarter company (whether alone or together with any connected person in relation to that headquarter company), directly or indirectly, holds at least 20% of the equity shares in that company. Paragraph 64B(2) is also subject to paragraph 64B(4) [see **4.2.5(b)**].

Paragraph 64B(5) provides that paragraph 64B(2) does not apply to the disposal of equity shares in a portfolio comprised in an investment scheme carried on outside South Africa that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities.

Should a person dispose of equity shares in a foreign company in batches, the capital gain or capital loss will be disregarded provided the person held at least 10% of the equity shares and voting rights in the foreign company immediately before the specific

disposal. As soon as the holding falls below the 10% threshold, any further capital gains and capital losses on disposal of equity shares in the foreign company will not be disregarded despite those shares having been held at an earlier time when the threshold was exceeded.

Example 33 – Disposal of equity shares in a foreign company

Facts:

Company A's year of assessment end on the last day of February.

Company A, a headquarter company, acquired 100% of the equity shares and voting rights in Company B, a foreign company on 31 January year 1. The shares were held on capital account. Company A disposed of the shares on 31 May year 4 to Company C which is a connected person in relation to Company A.

Result:

Under paragraph 64B(2) Company A must disregard the capital gain or capital loss on disposal of the equity shares in Company B, since it held at least 10% of the equity shares and voting rights in Company B immediately before the disposal.

Note:

Paragraph 64B(2) applies even though the equity shares were disposed of to a connected person in relation to Company A.

(b) Disregarding of a capital gain resulting from a foreign return of capital [paragraph 64B(4)]

Paragraph 64B(4) provides that a person must disregard a capital gain on a foreign return of capital[72] received or accrued from a foreign company,[73] if that person, whether alone or together with any other company forming part of the same group of companies, holds at least 10% of the total equity shares and voting rights in that company. Such a capital gain could, for example, arise under paragraph 76B if a foreign return of capital exceeds the expenditure contemplated in paragraph 20 in respect of the share or shares in respect of which the foreign return of capital is received.

Paragraph 76B governs the CGT treatment of a foreign return of capital received by or accrued to a person in respect of a share on or after 1 April 2012. For example, paragraph 76B(2) provides that the base cost of a share must be reduced by the amount or market value of a foreign return of capital comprising a distribution of cash or an asset *in specie* received by or accrued to a holder of a share in respect of that share on or after 1 April 2012 but before disposal of the share. Should a foreign return of capital exceed the base cost of a share, the excess will be treated as a capital gain in the hands of the holder of the share under paragraph 76B(3).

Paragraph 64B(4) does not apply to an interest contemplated in paragraph 2(2), namely, if 80% or more of the market value of the equity shares in a foreign company is directly or indirectly attributable to immovable property in South Africa held otherwise than as trading stock and the headquarter company (whether alone or together with

[72] The term "foreign return of capital" is defined in section 1(1) and excludes a foreign dividend. See the Annexure.

[73] As defined in section 9D(1).

any connected person in relation to that headquarter company), directly or indirectly, holds at least 20% of the equity shares in that company.

Paragraph 64B(5) provides that paragraph 64B(4) does not apply to a foreign return of capital by a portfolio comprised in an investment scheme carried on outside South Africa that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities.

Example 34 – Disregarding of a capital gain arising from a foreign return of capital

Facts:

Company A's year of assessment ends on 31 March.

Company A, a headquarter company, holds 50% of the equity shares and voting rights in Company B, a foreign company. The base cost of the equity shares acquired on 1 June year 1 was R100 000. On 30 April year 3 Company A received a foreign return of capital of R130 000 from Company B.

Result:

Paragraph 76B(2) provides that the base cost of the equity shares must be reduced by the amount of the foreign return of capital. The base cost of the shares in Company B is therefore reduced to nil (R100 000 – R100 000). The excess of R30 000 (R130 000 – R100 000) is treated as a capital gain under paragraph 76B(3). The capital gain of R30 000 must, however, be disregarded under paragraph 64B(4), since Company A held at least 10% of the equity shares and voting rights in Company B.

4.2.6 Rebate or deduction for foreign taxes on income [section 6*quat*(1), (1A) and (1C) and section 64N(1)]

Foreign-sourced amounts derived by a resident, including a headquarter company, may sometimes be taxed by both the country of source and South Africa, resulting in juridical double taxation.

Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same taxpayer and on the same amount is normally granted by the residence country. Thus, the source country's right to tax has priority over the residence country's right to tax. In many instances, countries provide for relief from juridical double taxation under a tax treaty. One of the main purposes of a tax treaty is to protect taxpayers against double taxation by allocating the right to tax the amount of income (or capital) to one of the contracting states. However, in some instances both states have the right to tax such income or capital thus requiring relief from double taxation to be provided for by the state of residence of the taxpayer. This may be achieved through domestic legislation or the tax treaty itself. Domestic legislation will also cover situations when a tax treaty does not apply.

South Africa provides relief to its residents from double taxation in its domestic law mainly by way of two different rebate methods for foreign taxes on income or a deduction for foreign taxes on income. The rebate and deduction methods are supplemented by a number of exemptions for foreign-sourced amounts received by or accrued to residents (for example, the exemption of foreign dividends under section 10B – see **4.2.2**).

The following rebate methods are employed in South Africa:

- Section 6*quat*(1) which is the principal mechanism used to provide relief for foreign taxes proved to be payable on income derived from a foreign source that is included in a resident's taxable income. Foreign taxes falling within this category do not qualify for a deduction under section 6*quat*(1C) (see below). Section 6*quat*(1) provides for the deduction of a rebate calculated under section 6*quat*(1A) in respect of foreign taxes against normal tax payable.
- Section 64N which provides for relief from foreign taxes paid on foreign cash dividends paid by a foreign company in respect of its listed shares.[74] Section 64N(1) provides for the deduction of certain foreign taxes against dividends tax on such a dividend.[75]

Under section 6*quat*(1C) a resident may claim certain foreign taxes, that do not qualify for the rebate under section 6*quat*(1), as a deduction in determining taxable income. That is, essentially, foreign taxes payable on South African-sourced amounts.

See Interpretation Note 18 "Rebate or Deduction for Foreign Taxes on Income" for a discussion of section 6*quat* and the *Comprehensive Guide to Dividends Tax* for a discussion of section 64N.

4.3 Ring-fencing of interest and royalties incurred by headquarter companies (section 20C)

Section 20C governs the deductibility of –

- interest incurred on financial assistance[76] granted by a non-resident to a headquarter company; and
- royalties payable by a headquarter company to a non-resident.

4.3.1 Ring-fencing of interest incurred by headquarter companies

Section 20C(2) applies if –

- financial assistance is granted by a non-resident, and
- if that non-resident is a company, that directly or indirectly, whether alone or together with any company forming part of the same group of companies as that non-resident, holds at least 10% of the equity shares and voting rights in the headquarter company.

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[74] The term "listed share" is defined in section 1(1) and means a share that is listed on an exchange as defined in section 1 of the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act.

[75] The exemption from dividends tax under section 64F(1)(*a*) will apply to cash foreign dividends paid on listed shares if the beneficial owner is a headquarter company. Under sections 64G(2)(*a*) and 64H(2)(*a*) no dividends tax must be withheld if the relevant declarations of exemption and written undertakings contemplated in these sections are submitted timeously.

[76] The term "financial assistance" is defined in section 20C(1) and means financial assistance contemplated in section 31(1).

The consequences of applying section 20C(2) are that the deduction allowable on any interest incurred by the headquarter company in respect of that financial assistance is limited to so much of the interest received by or accrued to the headquarter company on the portion of that financial assistance that was directly applied by the headquarter company as financial assistance to a foreign company in which the headquarter company directly or indirectly, whether alone or together with any company forming part of the same group of companies as the headquarter company, holds at least 10% of the equity shares and voting rights.

An amount of interest that is disallowed as a deduction under section 20C(2) must –

- under section 20C(3)(*a*) be carried forward to the immediately succeeding year of assessment of the headquarter company; and
- under section 20C(3)(*b*)(i) be deemed to be an amount of interest actually incurred by the headquarter company during that succeeding year of assessment in respect of financial assistance granted to the headquarter company by a non-resident.

Example 35 – Ring-fencing of interest incurred by a headquarter company

Facts:

Company B's year of assessment ends on 31 December.

Company A, a foreign company, holds 20% of the equity shares and voting rights in Company B, a headquarter company. These companies are connected persons in relation to each other.[77] Company A advanced a loan of R5 million to Company B. Company B used the loan to fund the building of offices in South Africa.

Company B incurred interest of R500 000 on the loan from Company A for the year of assessment.

Result:

Section 31 must be evaluated in order to assess whether it applies to the loan of R5 million advanced to Company B. The exclusion in section 31(5)(*a*) does not apply to the financial assistance of R5 million granted by Company A to Company B because Company B did not on-lend the funds to a qualifying foreign company. Section 31 therefore applies.

The deduction for the interest of R500 000 incurred by Company B is limited under section 20C(2) to nil because Company B did not use the funds to make an advance to a foreign company in which Company B holds at least 10% of the equity shares and voting rights. The excess of R500 000 (R500 000 – Rnil) is carried forward to Company B's immediately succeeding year of assessment under section 20C(3)(*a*) and is deemed under section 20C(3)(*b*)(i) to be an amount of interest actually incurred by Company B during that year of assessment on financial assistance granted to Company B by a non-resident. The amount carried forward will be less than R500 000 if an adjustment was made under section 31.

[77] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

Example 36 – Ring-fencing of interest incurred by a headquarter company

Facts:

Company B's year of assessment ends on 31 December.

Company A, a foreign company, holds 20% of the equity shares and voting rights in Company B, a headquarter company. Company B holds 100% of the equity shares and voting rights in Company C, a foreign company. Company A and Company B are connected persons in relation to each other.[78] Company B and Company C are connected persons in relation to each other.[79]

Company A advanced a loan of R20 million to Company B. Company B in turn advanced R20 million (the first loan) to Company C. Company B also advanced a loan of R5 million (the second loan) to Company C which was not financed out of the funds obtained from Company A.

Company B incurred interest of R2,4 million on the loan from Company A for the year of assessment ending on 31 December year 1. Company B received interest of R1 million on the first loan and R250 000 on the second loan. During the year of assessment ending on 31 December year 2 no interest was incurred by Company B but interest of R1 million was received on the first loan and R250 000 on the second loan.

Result:

Year of assessment ending on 31 December year 1

Under section 31(5)(*a*) and (*b*), section 31 does not apply to the financial assistance of R20 million granted by Company A to Company B and the financial assistance of R25 million (R20 million + R5 million) granted by Company B to Company C.

The deduction allowed for the interest of R2,4 million incurred by Company B is limited under section 20C(2) to the interest of R1 million received from Company C on the first loan. The excess of R1,4 million (R2,4 million – R1 million) is carried forward to Company B's year of assessment ending on 31 December year 2 under section 20C(3)(*a*).

Year of assessment ending on 31 December year 2

The interest of R1,4 million brought forward from the year of assessment ending on 31 December year 1 is deemed under section 20C(3)(*b*)(i) to be an amount of interest actually incurred by Company B during the year of assessment ending on 31 December year 2. The deduction allowed is, however, limited under section 20C(2) to the interest of R1 million received from Company C on the first loan.

The excess of R400 000 (R1,4 million – R1 million) is carried forward to Company B's year of assessment ending on 31 December year 3 under section 20C(3)(*a*).

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78 Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

79 Under paragraphs (*d*)(i) and (*e*) of the definition of "connected person" in section 1(1). See Interpretation Note 67: "Connected Persons".

Note:

The interest received by Company B from Company C on the second loan is not brought into account for purposes of calculating the limit under section 20C(2) because it does not relate to the financial assistance provided by Company A to Company B which was subsequently advanced by Company B to Company C.

Example 37 – Ring-fencing of interest incurred by a headquarter company

Facts:

Company Y's year of assessment ends on 31 December.

Company X, a foreign company, holds 20% of the equity shares and voting rights in Company Y, a headquarter company. Company Y holds 50% of the equity shares and voting rights in Company Z and 5% of the equity shares and voting rights in Company T. Company Z and Company T are foreign companies. Company Y is a connected person in relation to Company X and Company Z.[80] Company Y and Company T are not connected persons in relation to each other.

Company X advanced R30 million at an interest rate of 12% per annum to Company Y. Company Y advanced R18 million to Company Z and R12 million to Company T

Company Y incurred and received the following amounts of interest during its year of assessment ending on 31 December year 1:

	R
Interest incurred on loan advanced from Company X	(3 600 000)
Interest accrued on loan advanced to Company Z	1 500 000
Interest accrued on loan advanced to Company T	1 000 000

Result:

Section 31 does not apply to R18 million of the loan received by Company Y from Company X that was subsequently advanced by Company Y to Company Z (section 31(5)(*a*) and (*b*) – see **4.2.3**).

Section 31 may apply to R12 million of the loan granted by Company X to Company Y that was subsequently advanced by Company Y to Company T. The exclusion from section 31 in section 31(5)(*a*) does not apply because Company Y holds only 5%, which is less than the required 10%, of the equity shares and voting rights in Company T. Depending on the detailed facts a transfer pricing adjustment could be made which means that the interest deduction on the R12 million portion of the loan, that is interest of R1 440 000 (R12 million × 12%), could be reduced.

The interest of R3,6 million incurred by Company Y is limited under section 20C(2) to interest of R1,5 million accrued from Company Z. The interest of R1 million accrued from Company T is not brought into account for purposes of calculating the limit under section 20C(2) because Company Y holds less than 10% of the equity shares and voting rights in Company T.

[80] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

The excess of R2,1 million (R3,6 million – R1,5 million) is carried forward under section 20C(3)(*a*) to Company Y's year of assessment ending on 31 December year 2 and under section 20C(3)(*b*)(i) is deemed to be an amount of interest actually incurred during that year of assessment on financial assistance granted to the headquarter company by a non-resident.

The allowable interest could be less than the interest expense of R3,6 million if an adjustment is made under section 31. This would have an impact on the R1,5 million claimed after applying section 20C(2) (see above) and the carry forward of R2,1 million (see above) which would be reduced.

4.3.2 Ring-fencing of royalties incurred by headquarter companies

Under section 20C(2A) the deduction for royalties[81] incurred by a headquarter company in a year of assessment that are –

- payable to a non-resident, and
- if that non-resident is a company, that directly or indirectly, whether alone or together with any company forming part of the same group of companies as that non-resident, holds at least 10% of the equity shares and voting rights in the headquarter company,

is limited to amounts received by or accrued to the headquarter company on –

- the use or right of use of or permission to use any intellectual property;[82] or
- the imparting of or the undertaking to impart scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information,

from any foreign company in which the headquarter company directly or indirectly, whether alone or together with any other company forming part of the same group of companies as the headquarter company, holds at least 10% of the equity shares and voting rights.

An amount of royalties disallowed under section 20C(2A) must –

- under section 20C(3)(*a*) be carried forward to the immediately succeeding year of assessment; and
- under section 20C(3)(*b*)(ii) be deemed to be an amount actually incurred by the headquarter company during that succeeding year of assessment that constitutes a royalty payable to a non-resident.

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[81] The term "royalty" is defined in section 20C(1) and means any amount that is, before taking into account section 49D(*c*), subject to withholding tax on royalties under Part IVA (see **5.2.2**).

[82] As defined in section 23I(1) [see **3.2.3(b)**].

Example 38 – Ring-fencing of royalties incurred by a headquarter company

Facts:

Company B's year of assessment ends on 31 January.

Company A, a foreign company, granted the right of use of a patent to Company B, a headquarter company in which it holds 20% of the equity shares and voting rights. Company A and Company B are connected persons in relation to each other.[83] Company B granted this right of use of the patent to Company C, a South African subsidiary.

Company B paid royalties of R2 million to Company A during the year of assessment and received royalties of R1 million from Company C.

Result:

Section 31 must be evaluated in order to assess whether it applies to the granting of the right of use of the patent by Company A to Company B. The exclusion in section 31(5)(*c*) does not apply because Company B did not grant the right of use of the patent to a qualifying foreign company.

Under section 20C(2A), the deduction for royalties of R2 million incurred by Company B is limited to Rnil.

The excess of R2 million (R2 million – Rnil) is carried forward under section 20C(3)(*a*) to Company B's immediately succeeding year of assessment and under section 20C(3)(*b*)(ii) is deemed to be an amount actually incurred in that year which constitutes a royalty payable by Company B to a non-resident. The amount carried forward will be less than R2 million if an adjustment was made under section 31.

Example 39 – Ring-fencing of royalties incurred by headquarter companies

Facts:

Company B's year of assessment ends on 31 January.

Company A, a foreign company, granted the right of use of a patent to Company B, a headquarter company in which it holds 20% of the equity shares and voting rights. Company B granted this right of use of the patent to Company C, a foreign company, in which Company B holds 40% of the equity shares and voting rights. Company B paid royalties of R2 million to Company A during the current year of assessment and received royalties of R1 million from Company C. Company B is a connected person in relation to Company A and Company C.[84]

[83] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

[84] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1) read with section 31(4). See Interpretation Note 67: "Connected Persons".

Result:

Under section 31(5)(*c*) and (*d*), section 31 does not apply to the granting of the right of use of the patent by Company A to Company B and by Company B to Company C, since the right of use of the patent was granted by Company B only to a foreign company (Company C) in which Company B holds at least 10% of the equity shares and voting rights.

Under section 20C(2A), the deduction for royalties of R2 million incurred by Company B is limited to the royalties of R1 million received from Company C.

The excess of R1 million (R2 million – R1 million) is carried forward under section 20C(3)(*a*) to Company B's immediately succeeding year of assessment and under section 20C(3)(*b*)(ii) is deemed to be an amount actually incurred in that year which constitutes a royalty payable by Company B to a non-resident.

5. Relief from other taxes

5.1 The law

The relevant sections of the Act are quoted in the **Annexure**.

5.2 Application of the law

5.2.1 Withholding tax on interest [section 50D(1)(*a*)(i)(*cc*)]

Under section 50B(1) withholding tax on interest[85] is imposed at the rate of 15% of the amount of interest that is paid by any person to or for the benefit of a foreign person[86] to the extent that the amount is regarded as having been received or accrued from a source within South Africa under section 9(2)(*b*). A foreign person to which an amount of interest is paid is liable for withholding tax on interest, however any person who pays interest to or for the benefit of a foreign person must, subject to some exceptions, withhold the withholding tax on interest from the payment.[87]

Section 50B(2) provides that interest is deemed to be paid on the earlier of the date on which the interest is paid or becomes due and payable.

Under section 9(2)(*b*) interest is received by or accrues to a person from a source within South Africa if that amount is –

- attributable to an amount incurred by a resident, unless the interest is attributable to a permanent establishment which is situated outside South Africa; or
- received or accrues for the utilisation or application in South Africa by any person of any funds or credit obtained under any form of interest-bearing arrangement.

[85] Legislation on withholding tax on interest is contained in Part IVB of Chapter II of the Act and applies to interest that is paid or becomes due and payable on or after 1 March 2015.

[86] The term "foreign person" is defined in section 50A(1) and means any person that is not a resident.

[87] Sections 50C(1), 50D and 50E.

Interest paid to a foreign person will be exempt from withholding tax on interest if, amongst others,[88] the interest is paid by a headquarter company on the granting of financial assistance[89] to which section 31 does not apply as a result of the application of section 31(5)(*a*).[90]

Section 31(5)(*a*) provides that section 31 will not apply to –

- so much of the financial assistance granted by a non-resident to a headquarter company,
- that is directly applied as financial assistance to,
- a foreign company in which the headquarter company directly or indirectly, whether alone or together with any company forming part of the same group of companies as the headquarter company, holds at least 10% of the equity shares and voting rights.

Under section 50E(3), withholding tax on interest must be withheld at a reduced rate if the foreign person to or for the benefit of which the payment is to be made, has submitted to the person making the payment before the interest is paid –

- a declaration, in such form as may be prescribed by the Commissioner, that the interest is subject to a reduced rate of tax as a result of the application of a tax treaty; and
- a written undertaking to inform the person making the payment in writing should the circumstances affecting the application of the tax treaty change or should the interest no longer be for the benefit of that foreign person.

See the draft Interpretation Note "Withholding Tax on Interest" for more information on withholding tax on interest.

Example 40 – Withholding tax on interest

Facts:

Company B's year of assessment ends on 30 June.

Company A, a foreign company, holds 20% of the equity shares and voting rights in Company B, a headquarter company. Company B holds 20% of the equity shares and voting rights in Company C and in Company D. Company C and Company D are foreign companies. Company B is a connected person in relation to Company A, Company C and Company D.[91]

Company A advanced R50 million to Company B on 5 July year 1. Company B advanced R20 million of this loan to Company C and R10 million of the loan to Company D on 6 July year 1.

[88] See section 50D.
[89] As defined in section 31(1).
[90] Section 50D(1)(*a*)(i)(*cc*).
[91] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1). See Interpretation Note 67: "Connected Persons".

Interest of R5 million was paid by Company B to Company A and interest of R2 million and R1 million was received by Company B from Company C and Company D respectively on 30 June year 2.

Result:

Application of section 31 (transfer pricing)

Under section 31(5)(*a*) section 31 does not apply to the amount of R30 million (R20 million + R10 million) advanced by Company A to Company B because R30 million was subsequently advanced to foreign companies (Company C and Company D) in which Company B held at least 10% of the equity shares and voting rights.

Section 31, however, applies to the remaining portion of R20 million (R50 million – R20 million – R10 million) that was not advanced by Company B to a foreign company in which it held at least 10% of the equity shares and voting rights.

Interest exempt from withholding tax on interest under section 50D(1)(a)(i)(cc)

Under section 50E(2)(*a*) Company B was not required to withhold withholding tax on interest from the portion of the interest paid to Company A relating to the portion of the loan that Company B subsequently advanced to Company C and Company D because of the exemption provided for in section 50D(1)(*a*)(i)(*cc*). The calculation is as follows:

Portion of loan advanced to qualifying foreign companies / total amount of loan from Company A × interest paid to Company A

[R30 million / R50 million × R5 million] = R3 million.

Therefore, withholding tax on interest was not withheld from interest of R3 million paid to Company A.

Interest subject to withholding tax on interest under section 50B(1)

Company B had to withhold withholding tax on interest from the portion of the interest paid to Company A relating to the portion of the loan that Company B did not subsequently advance to a foreign company in which it held at least 10% of the equity shares and voting rights. The calculation of this portion of the loan is as follows:

Portion of loan not advanced to a qualifying foreign company / total amount of loan from Company A × interest paid to Company A

[R20 million / R50 million × R5 million] = R2 million.

Therefore, withholding tax on interest of R300 000 (R2 million × 15%) had to be withheld from the interest of R2 million paid to Company A.

The total interest payable to Company A was R5 million of which R3 million was not subject to withholding tax on interest. Interest of R2 million was subject to withholding tax on interest of R300 000.

Interest subject to ring-fencing under section 20C(2)

Section 20C(2) and whether the interest of R5 million is subject to ring-fencing must also be considered [see **4.3.1**].

5.2.2 Withholding tax on royalties [section 49D(*c*)]

The term "royalty" is defined in section 49A as follows:

> " **'[R]oyalty'** means any amount that is received or accrues in respect of—
>
> (*a*) the use or right of use of or permission to use any intellectual property as defined in section 23I; or
>
> (*b*) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information."

See **3.2.3(b)** for the definition of "intellectual property" in section 23I(1).

Withholding tax on royalties[92] is levied under section 49B(1) at the rate of 15%[93] of the amount of a royalty that is paid by a person to or for the benefit of any foreign person[94] to the extent that the amount is regarded as having been received by or accrued to that foreign person from a source within South Africa under section 9(2)(*c*), (*d*), (*e*) or (*f*). A foreign person to which a royalty is paid is liable for withholding tax on royalties, however, any person who pays a royalty to or for the benefit of that foreign person must, subject to some exceptions, withhold the withholding tax on royalties from the payment.[95]

An amount is received by or accrues to a person from a source within South Africa if that amount –

- constitutes a royalty that is attributable to an amount incurred by a resident, unless that royalty is attributable to a permanent establishment which is situated outside South Africa [section 9(2)(*c*)];
- constitutes a royalty that is received or accrues for the use or right of use of or permission to use any intellectual property[96] in South Africa [section 9(2)(*d*)];
- is incurred by a resident and is received or accrues for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the providing of or undertaking to provide assistance or service in connection with the application or use of such knowledge or information, unless the amount so received or accrued is attributable to a permanent establishment which is situated outside South Africa [section 9(2)(*e*)]; or

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92 Withholding tax on royalties legislation is contained in Part IVA in Chapter II of the Act and applies to royalties paid or that become due and payable on or after 1 July 2013 and only to the extent that the amount of the royalties was not subject to tax under section 35. Section 35 previously dealt with withholding tax on royalties in respect of royalties received or accrued before 1 July 2013.

93 The rate increased from 12% to 15% in respect of royalties that were paid or that became due and payable on or after 1 January 2015.

94 The term "foreign person" is defined in section 49A and means any person that is not a resident.

95 Sections 49C(1) and 49E(1).

96 As defined in section 23I.

- is received or accrues for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information for use in South Africa, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information [section 9(2)(*f*)].

Under section 49B(2) a royalty is deemed to be paid on the earlier of the date on which the royalty is paid or becomes due and payable.

A foreign person is exempt from withholding tax on royalties if, amongst other things,[97] a royalty is paid by a headquarter company for the granting of the use, right of use or permission to use intellectual property to which section 31 does not apply as a result of the exclusion contained in section 31(5)(*c*) (see **4.2.3**).[98] Withholding tax on royalties must not be withheld from the payment of a royalty if the foreign person to which the royalty is paid is exempt from withholding tax on royalties under section 49D(*c*).[99]

Under section 31(5)(c), section 31 will not apply to so much of the granting of the use, right of use or permission to use intellectual property[100] by a non-resident to a headquarter company as is directly granted by the headquarter company to any foreign company in which the headquarter company directly or indirectly holds at least 10% of the equity shares and voting rights[101] and the headquarter company does not use it otherwise.

Under section 49E(3), withholding tax on royalties must be withheld at a reduced rate if the foreign person to or for the benefit of which the payment is to be made has submitted to the person making the payment before the royalty is paid –

- a declaration, in such form as may be prescribed by the Commissioner, that the royalty is subject to a reduced rate of tax as a result of the application of a tax treaty; and
- a written undertaking to inform the person making the payment in writing should the circumstances affecting the application of the tax treaty change or should the royalty no longer be for the benefit of that foreign person.

See the draft Interpretation Note "Withholding Tax on Royalties" for more information on withholding tax on royalties.

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97 See section 49D.

98 Section 49D(*c*).

99 Section 49E(2)(*a*).

100 As defined in section 23I(1).

101 The headquarter company may hold that interest alone or together with any other company forming part of the same group of companies.

Example 41 – Exemption from withholding tax on royalties

Facts:

Company B's year of assessment ends on 30 June.

Company A, a foreign company, holds 20% of the equity shares and voting rights in Company B, a headquarter company. Company B holds 40% of the equity shares and voting rights in Company C, a foreign company. Company B is a connected person in relation to Company A and Company C.[102]

Company A granted the right of use of a patent to Company B on 1 July year 1. On 1 July year 1 Company B granted this right of use of the patent to Company C. This was the only use of the patent. Company B paid royalties of R2 million to Company A during its year of assessment ending on 30 June year 2 and received royalties of R1 million from Company C.

Result:

Under section 31(5)(*c*), section 31 did not apply to the granting of the right of use of the patent by Company A to Company B, since the right of use of the patent was granted by Company B to a foreign company (Company C) in which Company B held at least 10% of the equity shares and voting rights. Under section 49D(*c*) Company A was exempt from withholding tax on royalties on the royalty payment of R2 million received from Company B.

The royalties paid of R2 million may have been subject to ring-fencing under section 20C(2A). Company B must consider if the requirements of that section were met (see **4.3.2**).

5.2.3 Relief from dividends tax [section 64E(1)]

Dividends declared and paid by a headquarter company are not subject to dividends tax (see Example 24 in **4.2.2**).

6. Anti-avoidance provisions

6.1 The law

The relevant sections of the Act are quoted in the **Annexure**.

6.2 Application of the law

6.2.1 A company that becomes a headquarter company (section 9H)

Section 9H(3)(*a*) provides that when a resident company becomes a headquarter company in respect of a year of assessment, that company must be treated as having disposed of each of that company's assets to a resident on the date immediately before the day on which the company became a headquarter company and as having reacquired each of those assets on the day on which that company became a

[102] Under paragraphs (*d*)(v) and (*e*) of the definition of "connected person" in section 1(1). See Interpretation Note 67: "Connected Persons".

headquarter company, for an amount equal to the market value[103] of each of those assets.

Section 9H(3)(*c*)(i) provides that in the year of assessment that a company becomes a headquarter company that year of assessment must be deemed to have ended on the date immediately before the day on which that company became a headquarter company. Under section 9H(3)(*c*)(ii) the headquarter company's next succeeding year of assessment must be deemed to have commenced on the day on which the company became a headquarter company.

Section 9H(3)(*c*)(iii) provides that a company must, on the date immediately before the day on which the company became a headquarter company, for the purposes of section 64EA(*b*), be deemed to have declared and paid a dividend that consists solely of a distribution of an asset *in specie*. The amount of the distribution of the asset *in specie* must under section 9H(3)(*c*)(iii)(*aa*) be deemed to be equal to –

- the sum of the market values of all the shares in that company on that date,
- *less* the sum of the contributed tax capital[104] of all the classes of shares in the company as at that date.

Under section 9H(3)(c)(iii)(*bb*) the dividend is deemed to have been declared and paid to the persons holding shares in that company in accordance with the effective interest of those persons in the shares in the company as at the date immediately before the day on which the company became a headquarter company.

In applying section 9H(3)(*c*)(iii) it is apparent that the requirements of section 64E(1) and 64EA(*b*) have been met and that, in the absence of an exemption or a reduced rate of dividends tax applying, the deemed dividend will be subject to dividends tax at a rate of 20%. A resident company will not qualify for an exemption from dividends tax under section 64FA(1) or a reduced rate of dividends tax under section 64FA(2) on a deemed dividend *in specie* which arises under section 9H(3)(*c*)(iii). For section 64FA(1) or (2) to apply, the beneficial owner must submit the declaration and written undertaking referred to in that section to the company that is deemed to have declared and paid the deemed dividend *in specie*. The term "beneficial owner" is defined in section 64D and means "the person entitled to the benefit of the dividend attaching to a share." A recipient of a deemed dividend *in specie* under section 9H(3)(*c*)(iii) is not entitled to the benefit of the dividend because there is no benefit. There is no benefit because the deemed dividend *in specie* is a figure calculated for tax purposes only which has resulting dividends tax implications. A benefit does not arise and is not deemed to arise under section 9H(3)(*c*)(iii) for the holder of shares for the purposes of section Part VIII of the Act.

In the absence of a "beneficial owner" as defined in section 64D, the requirements for an exemption from dividends tax under section 64FA(1) or a reduced rate of dividends tax under section 64FA(2) cannot be met. Without a beneficial owner it is irrelevant whether the requirements of section 64F as referred to in section 64FA(1) or the

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[103] The term "market value" is defined in section 9H(1) and means in relation to an asset, the price which could be obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market.

[104] The term "contributed tax capital" is defined in section 1(1) and means, in simplified terms, the consideration received by a company for the issue of its shares. See the *Comprehensive Guide to Dividends Tax* for a detailed interpretation of the definition of "contributed tax capital".

specific requirements[105] in a potentially applicable tax treaty for purposes of section 64FA(2) are met.

Under section 9H(4) the following assets of a company that becomes a headquarter company are excluded from section 9H(3):

- Immovable property situated in South Africa.
- A right to acquire a marketable security contemplated in section 8A.

Example 42 – A company that becomes a headquarter company

Facts:

Company A's year of assessment ends on 31 December.

Company A holds 10% of the equity shares and voting rights in foreign companies. The equity shares and voting rights in Company A are held equally by Company B and Company C that both are residents.

On 1 July year 3 Company A elected to be a headquarter company for its year of assessment ending on 31 December year 2. This election was made on completion of the ITR14 return for that year of assessment. The balance sheet of Company A reflected the following assets and liabilities as at 31 December year 1:

	R
Cash in bank	200 000
Equity shares in foreign companies @ market value	3 000 000
Loans receivable from the foreign companies	7 000 000
Total assets	10 200 000
Long term loans	6 000 000
Total liabilities	6 000 000
Share capital	1 000 000
Retained earnings	3 200 000
Share capital and retained earnings	4 200 000

The contributed tax capital of Company A on 31 December year 1 was R1 million.

Result:

Under section 9I(3), the election by Company A on 1 July year 3 to be a headquarter company for its year of assessment ending on 31 December year 2, was effective from the commencement of that year of assessment, namely 1 January year 2.

CGT implications

Company A is deemed under section 9H(3)(*a*) to have disposed of all its assets to a resident at market value on the day before it became a headquarter company, namely on 31 December year 1 and to have reacquired those assets at the same market value on the day that it became a headquarter company, namely on 1 January year 2.

[105] Specific requirements include, for example, the tax treaty definition of "dividend" and the possible requirement for a specific holding in the capital or voting rights of a company.

The capital gain or capital loss on the deemed disposal of the equity shares in the foreign companies must be disregarded under paragraph 64B(2) since Company A held at least 10% of the equity shares and voting rights in the foreign companies [see also **4.2.5(a)].** The base cost of the cash in bank and the debt owing to Company A is equal to its market value, therefore the capital gain on its deemed disposal was nil (R7,2 million – R7,2 million).

Dividends tax implications

The amount of the dividend *in specie* deemed to have been declared and paid by Company A under section 9H(3)(*c*)(iii) for the purposes of section 64EA(*b*) is calculated under section 9H(3)(c)(iii)(*aa*) as follows:

	R
Market value of shares in Company A (R10,2 million – R6 million)	4 200 000
Less: Contributed tax capital	(1 000 000)
Amount of dividend *in specie* deemed to have been declared and paid by Company A	3 200 000

The deemed dividend of R3 200 000 is subject to dividends tax at the rate of 20%.

A company ceasing to be a headquarter company

There are currently no provisions in the Act dealing specifically with a company ceasing to be a headquarter company.

The election to be a headquarter company for a specific year of assessment can be made only at or after the end of that year of assessment if the requirements of section 9I(2) have been met. If any of the requirements in section 9I(2) has not been met for a specific year of assessment, a company cannot elect to be a headquarter company for that year of assessment. In addition, a company may meet the requirements and decide not to elect to be a headquarter company. If a company, for example, qualified as a headquarter company and elected to be one for a year of assessment, but does not meet the requirements of section 9I(2) for the next year of assessment, it cannot elect to be a headquarter company for that next year of assessment. The company would then be taxed as a normal company for the next year of assessment. This means that the company would no longer qualify for the relief listed below, but would also not be subject to the special anti-avoidance rules aimed at headquarter companies, also listed below:

- Exclusion from the CFC legislation (see **4.2.1**).
- Relaxation of the transfer pricing rules under section 31(5) (see **4.2.3**).
- Ring-fencing of interest and royalties incurred (see **4.3**). Amounts carried forward under section 20C(3) to a year of assessment that a company did not elect to be a headquarter company because it chose not to or did not qualify as one and therefore could not make the election, will be forfeited.
- Relaxation of the income tax and CGT treatment of foreign exchange transactions under sections 24I(3), 25D(4) and (7) and paragraph 43(1A) (see **4.2.4**).
- Disregarding of the capital gain or capital loss on the disposal of equity shares in a foreign company under paragraph 64B(2) and disregarding of the capital gain on a foreign return of capital received from a foreign company under paragraph 64B(4) (see **4.2.5**).

- Exemption for a foreign person from withholding tax on interest under section 50D(1)(*a*)(i)(*cc*) on the interest paid by a headquarter company on so much of the financial assistance to which section 31 did not apply as a result of the application of section 31(5)(*a*) (see **5.2.1**).
- Exemption for a foreign person from withholding tax on royalties under section 49D(*c*) on the granting of the use, right of use or permission to use intellectual property to which section 31 does not apply as a result of the application of section 31(5)(*c*) (see **5.2.2**).
- Exclusion from dividends tax legislation under section 64E(1) (see **5.2.3**) and treatment as a foreign dividend (see **4.2.2**).
- Disqualification from the relief provided for under the corporate restructuring rules under sections 41 to 47 (see **6.2.2**).

6.2.2 The corporate restructuring rules (section 41(1) – Definition of "company")

Section 41(2) provides that, subject to section 41(3), with regard to the transactions to which they apply, the corporate restructuring rules in sections 42 to 47 override other provisions in the Act, except sections 24BA, 24I, 25BB(5) and 103 and Part IIA of Chapter III and paragraph 11(1)(*g*) and any adjusted gain or loss on transfer or redemption of an instrument as defined in section 24J(1). If applicable, the corporate restructuring rules offer relief in the form of a deferral of the tax consequences, which would otherwise arise, until a later date.

A number of the corporate rules require, amongst other things, that the person transferring the asset or the person to whom the asset is transferred is a company as defined in section 41(1). A headquarter company is excluded from the definition of "company" in section 41(1) for purposes of the corporate restructuring rules and therefore when a headquarter company is involved often the transaction will not qualify for relief under these rules.

The election to be a headquarter company is effective from the commencement of the year of assessment for which it is made. It is therefore possible that an election to be a headquarter company will mean that a person will not be entitled to tax relief under the corporate rules on a transaction conducted during the year for which an election under the corporate rules is made, but before the election to be a headquarter company was made, and on which that person had anticipated being entitled to relief.

On a case-by-case basis it is also important to consider the impact that an election to be a headquarter company will have on previous transactions, if any, which were subject to the corporate rules. Issues to consider when a company becomes a headquarter company within the timeframes prohibited under the corporate rules, include the impact of a possible –

- de-grouping as a result of the headquarter company no longer being part of the group of companies;
- deemed disposal of the company's assets under section 9H(3)(*a*); and
- deemed dividend declared and paid by the company under section 9H(3)(*c*)(iii).

Asset-for-share transactions

Section 42 provides for relief from income tax and CGT if a transaction qualifies as an “asset-for-share transaction”. The term “asset-for-share transaction” is defined in section 42(1) and means, amongst other things, a transaction under which a person disposes of an asset to a resident company, in exchange for equity shares in that company.

Section 42 will not apply if a person disposes of an asset to a headquarter company in exchange for equity shares in that headquarter company.

Substitutive share-for-share transaction

Section 43 provides for relief from income tax and CGT if a transaction qualifies as a “substitutive share-for-share transaction”. The term “substitutive share-for-share transaction” is defined in section 43(1) and means a transaction between a person and a company under which that person disposes of an equity share in the form of a linked unit in that company and acquires an equity share other than a linked unit in that company.

Substitutive share-for-share transactions are unlikely to apply to headquarter companies.

Amalgamation transactions

Section 44 provides for relief from income tax, CGT and dividends tax under an “amalgamation transaction”. The term “amalgamation transaction” is defined in section 44(1) and means, amongst other things, a transaction under which a company disposes all of its assets to another resident company, by means of an amalgamation, conversion or merger, and as a result of which the amalgamated company’s existence will be terminated.

Section 44 will not apply if a company disposes of all of its assets to a resultant company which is a headquarter company, or if the amalgamated company is a headquarter company.

Intra-group transactions

Section 45 provides for relief from income tax and CGT under an “intra-group transaction”. The term “intra-group transaction” is defined in section 45(1) and means, amongst other things, a transaction under which an asset is disposed of by one company to another resident company, and both companies form part of the same group of companies as at the end of the day of that transaction.

Section 45 will not apply if a company disposes of an asset to a transferee company which is a headquarter company, or if the transferor is a headquarter company.

Unbundling transactions

Section 46 provides for relief from income tax, CGT and dividends tax under an “unbundling transaction”. The term “unbundling transaction” is defined in section 46(1) and means, amongst other things, a transaction under which all the equity shares of a resident company (the unbundled company) that are held by a company (the unbundling company) which, if listed, is a resident, are distributed by that unbundling company to the holders of shares of the unbundling company.

Section 46 will not apply if the unbundled or unbundling company is a headquarter company.

Transactions relating to liquidation, winding-up and deregistration

Section 47 provides for roll-over relief from CGT and dividends tax under a "liquidation distribution". The term "liquidation distribution" is defined in section 47(1) and means, amongst other things, a transaction under which a company distributes all its assets to its holders of shares in anticipation of or in the course of the liquidation, winding up or deregistration of the company, but only to the extent to which those assets are so disposed of to another resident company.

Section 47 will not apply if the assets are disposed of by or to a headquarter company.

7. Conclusion

A company that meets the requirements and elects to be a headquarter company under section 9I for a specific year of assessment will be entitled to the relief outlined in this Note.

A headquarter company potentially qualifies for the following relief:

- Exclusion from the CFC legislation under section 9D(2).
- Exemption from normal tax on foreign dividends received by or accrued under section 10B(2)(*a*) and (3).
- Relaxation of the transfer pricing rules under section 31(5), but accompanied by ring-fencing of interest incurred under section 20C(2) and ring-fencing of royalties incurred under section 20C(2A).
- Relaxation of the income tax and CGT treatment of foreign exchange transactions under section 24I(3), 25D(4) and (7) and paragraph 43(1A).
- Disregarding of the capital gain or capital loss on the disposal of equity shares in a foreign company under paragraph 64B(2) and disregarding of the capital gain on a foreign return of capital received from a foreign company under paragraph 64B(4).
- A possible rebate for foreign taxes under section 6*quat*(1) or a deduction for foreign taxes under section 6*quat*(1C).
- Exemption for a foreign person from withholding tax on interest under section 50D(1)(*a*)(i)(*cc*) on the interest paid by a headquarter company on so much of the financial assistance to which section 31 did not apply as a result of the application of section 31(5)(*a*).
- Exemption for a foreign person from withholding tax on royalties under section 49D(*c*) on the granting of the use, right of use or permission to use intellectual property to which section 31 does not apply as a result of the application of section 31(5)(*c*).
- Exclusion from dividends tax legislation under section 64E(1).

Although a headquarter company qualifies for certain tax relief, anti-avoidance provisions have been introduced to protect the South African tax base:

- A company that becomes a headquarter company is subject to CGT on the deemed disposal of some of its assets under section 9H(3)(*a*), and to dividends tax on a dividend *in specie* deemed to have been declared and paid by that company under section 9H(3)(*c*)(iii) for purposes of section 64EA(*b*). The deemed dividends under section 9H(3)(*c*)(iii) do not qualify for an exemption from or a reduced rate of dividends tax. The deemed disposal and deemed dividend are deemed to have taken place on the day before becoming a headquarter company.
- A headquarter company does not qualify for the relief provided for under the corporate restructuring rules in sections 41 to 47.

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Annexure – The law

Section 1(1) – Definition of "controlled foreign company"

"controlled foreign company" means a controlled foreign company as defined in section 9D, and includes any reference in this Act, prior to the amendment thereof by the Revenue Laws Amendment Act, 2002, to a controlled foreign entity;

Section 1(1) – Definition of "foreign company"

"foreign company" means any company which is not a resident;

Section 1(1) – Definition of "foreign return of capital"

"foreign return of capital" means any amount that is paid or payable by a foreign company in respect of any share in that foreign company where that amount is treated as a distribution or similar payment (other than an amount that constitutes a foreign dividend) by that foreign company for the purposes of the laws relating to—

(*a*) tax on income on companies of the country in which that foreign company has its place of effective management; or

(*b*) companies of the country in which that foreign company is incorporated, formed or established, where that country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable to the extent that the amount so paid or payable—

(i) is deductible by that foreign company in the determination of any tax on income of companies of the country in which that foreign company has its place of effective management; or

(ii) constitutes shares in that foreign company;

Section 1(1) – Definition of "headquarter company"

"headquarter company", in respect of any year of assessment means a company contemplated in section 9I(1) in respect of which an election has been made in terms of that section;

Section 6*quat*(1), (1A) and (1C)

6*quat*. Rebate or deduction in respect of foreign taxes on income.—(1) Subject to subsection (2), where the taxable income of any resident during a year of assessment includes—

(*a*) any income received by or accrued to such resident from any source outside the Republic; or

(*b*) any proportional amount contemplated in section 9D; or

(*c*) . . . . . .

(*d*) . . . . . .

(*e*) any taxable capital gain contemplated in section 26A, from a source outside the Republic; or

(*f*) any amount—

(i) contemplated in paragraph (*a*) or (*b*) which is received by or accrued to any other person and which is deemed to have been received by or accrued to such resident in terms of section 7;

(ii) of capital gain of any other person from a source outside the Republic and which is attributed to that resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule; or

(iii) contemplated in paragraphs (*a*), (*b*) or (*e*) which represents capital of a trust, and which is included in the income of that resident in terms of section 25B(2A) or taken into account in determining the aggregate capital gain or aggregate capital loss of that resident in terms of paragraph 80(3) of the Eighth Schedule,

in determining the normal tax payable in respect of that taxable income there must be deducted a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment) by—

(*a*) such resident in respect of—

(i) any income contemplated in subsection (1)(*a*); or

(ii) . . . . . .

(iii) any amount of taxable capital gain as contemplated in subsection (1)(*e*); or

(*b*) any controlled foreign company, in respect of such proportional amount contemplated in subsection (1)(*b*), subject to section 72A(3); or

(*c*) . . . . . .

(*d*) . . . . . .

(*e*) . . . . . .

(*f*) any other person contemplated in subsection (1)(*f*)(i) or (ii) or any trust contemplated in subsection (1)(*f*)(iii), in respect of the amount included in the taxable income of that resident as contemplated in subsection (1)(*f*),

which is so included in that resident's taxable income: Provided that—

(i) where such resident is a member of any partnership or a beneficiary of any trust and such partnership or trust is liable for tax as a separate entity in such other country, a proportional amount of any tax payable by such entity, which is attributable to the interest of such resident in such partnership or trust, shall be deemed to have been payable by such resident; and

(ii) for the purposes of this subsection, the amount so included in such resident's taxable income must be determined without regard to section 10B(3).

…

(1C) (*a*) For the purpose of determining the taxable income derived by any resident from carrying on any trade, there may at the election of the resident be allowed as a deduction from the income of such resident so derived the sum of any taxes on income (other than taxes contemplated in subsection (1A)) paid or proved to be payable by that resident to any sphere of government of any country other than the Republic, without any right of recovery by any person other than in terms of a mutual agreement procedure in terms of an international tax agreement or a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment.

(*b*) Where, during any year of assessment, any amount was deducted in terms of this subsection from the income of a resident and, in any year of assessment subsequent to that year of assessment, that resident receives any amount by way of refund in respect of the amount so deducted or is discharged from any liability in respect of that amount, so much of the amount so received or so much of the amount of that discharge as does not exceed that amount must be included in the income of that resident in respect of that subsequent year of assessment.

Section 9(2)(*a*) – (*f*)

(2) An amount is received by or accrues to a person from a source within the Republic if that amount—

(*a*) constitutes a dividend received by or accrued to that person;

(*b*) constitutes interest as defined in section 24J where that interest—

(i) is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or

(ii) is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement;

(*c*) constitutes a royalty that is attributable to an amount incurred by a person that is a resident, unless that royalty is attributable to a permanent establishment which is situated outside the Republic;

(*d*) constitutes a royalty that is received or accrues in respect of the use or right of use of or permission to use in the Republic any intellectual property as defined in section 23I;

(*e*) is attributable to an amount incurred by a person that is a resident and is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information, unless the amount so received or accrued is attributable to a permanent establishment which is situated outside the Republic;

(*f*) is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information for use in the Republic, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information;

Section 9D(1) – Definition of "controlled foreign company"

"controlled foreign company" means—

(*a*) 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: Provided that—

(i) no regard must be had to any voting rights in any foreign company—

(*aa*) which is a listed company; or

(*bb*) if the voting rights in that foreign company are exercisable indirectly through a listed company;

(ii) any voting rights in a foreign company which can be exercised directly by any other controlled foreign company in which that resident (together with any connected person in relation to that resident) can directly or indirectly exercise more than 50 per cent of the voting rights are deemed for purposes of this definition to be exercisable directly by that resident; and

(iii) a person is deemed not to be a resident for purposes of determining whether residents directly or indirectly hold more than 50 per cent of the participation rights or voting rights in a foreign company, if—

(*aa*) in the case of a listed company or a foreign company the participation rights of which are held by that person indirectly through a listed company, that person holds less than five per cent of the participation rights of that listed company; or

(*bb*) in the case of a scheme or arrangement contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1 or a foreign company the participation rights of which are held and the voting rights of which may be exercised by that person indirectly through such a scheme or arrangement, that person—

(A) holds less than five per cent of the participation rights of that scheme or arrangement; and

(B) may not exercise at least five per cent of the voting rights in that scheme or arrangement,

unless more than 50 per cent of the participation rights or voting rights of that foreign company or other foreign company are held by persons who are connected persons in relation to each other; or

(*b*) any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements, as contemplated in IFRS 10, of any company that is a resident other than a headquarter company;

Section 9D(1) – Definition of "participation rights"

"participation rights" in relation to a foreign company means—

(*a*) the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share, or any interest of a similar nature, in that company; or

(*b*) in the case where no person has any right in that foreign company as contemplated in paragraph (*a*) or no such rights can be determined for any person, the right to exercise any voting rights in that company; and

Section 9D(2) before subparagraphs

(2) There shall be included in the income for the year of assessment of any resident (other than a resident that is a headquarter company) who directly or indirectly holds any participation rights in a controlled foreign company—

Proviso B to section 9D(2)

Provided that this subsection shall not apply—

(B) to the extent that the participation rights are held by that resident indirectly through any company (other than a company that is a headquarter company) which is a resident; or

Section 9H(1), (3) and (4)

9H Change of residence, ceasing to be controlled foreign company or becoming headquarter company.—(1) For the purposes of this section—

"asset" means an asset as defined in paragraph 1 of the Eighth Schedule; and

“market value”, in relation to an asset, means the price which could be obtained upon a sale of that asset between a willing buyer and a willing seller dealing at arm’s length in an open market.

…

(3) (*a*) Where a company that is a resident ceases during any year of assessment of that company to be a resident or where a company that is a resident becomes a headquarter company in respect of a year of assessment, that company must be treated as having —

(i) disposed of each of that company’s assets to a person that is a resident on the date immediately before the day on which that company so ceased to be a resident or became a headquarter company; and

(ii) reacquired each of those assets on the day on which that company so ceased to be a resident or became a headquarter company,

for an amount equal to the market value of each of those assets.

(*b*) Where a controlled foreign company ceases, otherwise than by way of becoming a resident, to be a controlled foreign company during any foreign tax year of that controlled foreign company, that controlled foreign company must be treated as having—

(i) disposed of each of the assets of that controlled foreign company, to a person that is a resident, on the date immediately before the day on which that controlled foreign company so ceased to be a controlled foreign company; and

(ii) reacquired each of the assets disposed of as contemplated in subparagraph (i) on the day on which that controlled foreign company so ceased to be a controlled foreign company,

for an amount equal to the market value of each of those assets.

(*c*) Where a company that is a resident ceases to be a resident or becomes a headquarter company during any year of assessment of that company as contemplated in paragraph (*a*)—

(i) that year of assessment must be deemed to have ended on the date immediately before the day on which that company so ceased to be a resident or became a headquarter company;

(ii) the next succeeding year of assessment of that company must be deemed to have commenced on the day on which that company so ceased to be a resident or became a headquarter company; and

(iii) that company must, on the date immediately before the day on which the company so ceased to be a resident or became a headquarter company and for the purposes of section 64EA(*b*), be deemed to have declared and paid a dividend that consists solely of a distribution of an asset *in specie*—

(*aa*) the amount of which must be deemed to be equal to the sum of the market values of all the shares in that company on that date less the sum of the contributed tax capital of all the classes of shares in the company as at that date; and

(*bb*) to the person or persons holding shares in that company in accordance with the effective interest of that person or those persons in the shares in the company as at that date.

(*d*) Where a controlled foreign company ceases to be a controlled foreign company during any foreign tax year of that controlled foreign company as contemplated in paragraph (*b*)—

(i) that foreign tax year must be deemed to have ended on the date immediately before the day on which that controlled foreign company so ceased to be a controlled foreign company; and

(ii) the next succeeding foreign tax year of that controlled foreign company must be deemed to have commenced on the day on which that controlled foreign company so ceased to be a controlled foreign company.

(*e*) Where a company ceases to be a resident as contemplated in paragraph (*a*), the amount of any capital gain disregarded in terms of paragraph 64B of the Eighth Schedule that was determined in respect of a disposal of an equity share by that company within three years immediately preceding the date on which that company ceases to be a resident, must be deemed, in respect of the year of assessment of that company ending as contemplated in paragraph (*c*), to be an amount of net capital gain derived by that company from that capital gain.

(*f*) Where a company ceases to be a resident as contemplated in paragraph (*a*), the amount of any foreign dividend that was exempt from normal tax only in terms of section 10B(2)(*a*) within the three years immediately preceding the date on which that company ceases to be a resident, must be deemed to be a foreign dividend received by or accrued to that company in respect of the year of assessment of that company ending as contemplated in paragraph (*c*) that is not exempt in terms of section 10B(2).

(4) Subsections (2) and (3) do not apply in respect of an asset of a person where that asset constitutes—

(*a*) immovable property situated in the Republic that is held by that person;

(*b*) ……

(*c*) any asset which is, after the person ceases to be a resident or a controlled foreign company as contemplated in subsection (2) or (3), attributable to a permanent establishment of that person in the Republic;

(*d*) any qualifying equity share contemplated in section 8B that was granted to that person less than five years before the date on which that person ceases to be a resident as contemplated in subsection (2) or (3);

(*e*) any equity instrument contemplated in section 8C that had not yet vested as contemplated in that section at the time that the person ceases to be a resident as contemplated in subsection (2) or (3); or

(*f*) any right of that person to acquire any marketable security contemplated in section 8A.

Section 9I

9I. Headquarter companies.—(1) Any company that—

(*a*) is a resident; and

(*b*) complies with the requirements prescribed by subsection (2),

may elect in the form and manner determined by the Commissioner to be a headquarter company for a year of assessment of that company.

(2) A company complies with the requirements contemplated in subsection (1)(*b*) for a year of assessment of that company if—

(*a*) for the duration of that year of assessment, each holder of shares in the company (whether alone or together with any other company forming part of the same group of companies as that holder) held 10 per cent or more of the equity shares and voting rights in that company: Provided that in determining whether a company complies with the requirements prescribed by this paragraph in relation to any year of assessment of that company during which the company commenced the carrying on of trade, no regard must be had to any period during that year before which the company so commenced the carrying on of trade;

(*b*) at the end of that year of assessment and of all previous years of assessment of that company, 80 per cent or more of the cost of the total assets of the company was attributable to one or more of the following:

(i) any interest in equity shares in;

(ii) any debt owed by; or

(iii) any intellectual property as defined in section 23I(1) that is licensed by that company to,

any foreign company in which that company (whether alone or together with any other company forming part of the same group of companies as that company) held at least 10 per cent of the equity shares and voting rights: Provided that in determining—

(*aa*) the total assets of the company, there must not be taken into account any amount in cash or in the form of a bank deposit payable on demand; and

(*bb*) whether a company complies with the requirements prescribed by this paragraph in relation to any year of assessment of that company, no regard must be had to any such year of assessment if the company did not at any time during such year of assessment own assets with a total market value exceeding R50 000; and

(*c*) where the gross income of that company for that year of assessment exceeds R5 million, 50 per cent or more of that gross income consisted of amounts in the form of one or both of the following:

(i) any rental, dividend, interest, royalty or service fee paid or payable by any foreign company contemplated in paragraph (*b*); or

(ii) any proceeds from the disposal of any interest contemplated in paragraph (*b*)(i) or of any intellectual property contemplated in paragraph (*b*)(iii):

Provided that in determining the gross income of the company, there must not be taken into account any exchange difference determined in terms of section 24I in respect of any exchange item as defined in that section to which that company is a party.

(3) An election made by a company in terms of subsection (1) is effective from the commencement of the year of assessment in respect of which that election is made.

(4) A headquarter company must submit to the Minister an annual report providing the Minister with the information that the Minister may prescribe within such time and containing such information as the Minister may prescribe.

Section 10(1)(*k*)(i)

10. Exemptions.—(1) There shall be exempt from normal tax—

(*k*) (i) dividends (other than dividends paid or declared by a headquarter company) received by or accrued to any person: Provided that this exemption shall not apply—

Section 10B

10B. Exemption of foreign dividends and dividends paid or declared by headquarter companies.—(1) For the purposes of this section, "foreign dividend" means any—

(*a*) foreign dividend as defined in section 1; or

(*b*) dividend paid or declared by a headquarter company.

(2) Subject to subsection (4), there must be exempt from normal tax any foreign dividend received by or accrued to a person—

(*a*) if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in the company declaring the foreign dividend;

(*b*) if that person is a foreign company and the foreign dividend is paid or declared by another foreign company that is resident in the same country as that person;

(*c*) who is a resident to the extent that the foreign dividend does not exceed the aggregate of all amounts which are included in the income of that resident in terms of section 9D in any year of assessment, which relate to the net income of—

(i) the company declaring the foreign dividend; or

(ii) any other company which has been included in the income of that resident in terms of section 9D by virtue of that resident's participation rights in that other company held indirectly through the company declaring the foreign dividend,

reduced by—

(*aa*) the amount of any foreign tax payable in respect of the amounts so included in that resident's income; and

(*bb*) so much of all foreign dividends received by or accrued to that resident at any time from any company contemplated in subparagraph (i) or (ii), as was—

(A) exempt from tax in terms of paragraph (*a*), (*d*) or (*e*); or

(B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D:

Provided that for the purposes of this paragraph, the net income of any company contemplated in subparagraphs (i) and (ii) must be determined without regard to subsection (3);

(*d*) to the extent that the foreign dividend is received by or accrues to that person in respect of a listed share and does not consist of a distribution of an asset *in specie*; or

(*e*) to the extent that the foreign dividend is received by or accrues to a company that is a resident in respect of a listed share and consists of the distribution of an asset *in specie:*

Provided that paragraphs (*a*) and (*b*) must not apply to any foreign dividend to the extent that the foreign dividend is deductible by the foreign company declaring or paying that foreign dividend in the determination of any tax on income on companies of the country in which that foreign company has its place of effective management: Provided further that paragraph (*a*) must not apply to any foreign dividend received by or accrued to that person in respect of a share other than an equity share.

(3) In addition to the exemption provided for in subsection (2), there must be exempt from normal tax so much of the amount of the aggregate of any foreign dividends received by or accrued to a person during a year of assessment as—

(*a*) is not exempt from normal tax in terms of subsection (2) for that year of assessment; and

(*b*) does not during the year of assessment exceed an amount determined in accordance with the following formula:

$$A = B \times C$$

in which formula:

(i) "A" represents the amount to be exempted for a year of assessment in terms of this paragraph;

(ii) "B" represents—

(*aa*) where the person is a natural person, deceased estate, insolvent estate or trust, the ratio of the number 25 to the number 45;

(*bb*) where the person is—

(A) a person other than a natural person, deceased estate, insolvent estate or trust; or

(B) an insurer in respect of its company policyholder fund, corporate fund and risk policy fund,

the ratio of the number 8 to the number 28; or

(*cc*) where the person is an insurer in respect of its individual policyholder fund, the ratio of the number 10 to the number 30; and

(iii) "C" represents the aggregate of any foreign dividends received by or accrued to the person during a year of assessment that is not exempt from normal tax in terms of subsection (2).

(4) Subsections (2)(*a*) and (2)(*b*) do not apply in respect of any foreign dividend received by or accrued to any person—

(*a*) if—

(i) (*aa*) any amount of that foreign dividend is determined directly or indirectly with reference to; or

(*bb*) that foreign dividend arises directly or indirectly from,

any amount paid or payable by any person to any other person; and

(ii) the amount so paid or payable is deductible from the income of the person by whom it is paid or payable and—

(*aa*) is not subject to normal tax in the hands of the other person contemplated in subparagraph (i); and

(*bb*) where that other person contemplated in subparagraph (i) is a controlled foreign company, is not taken into account in determining the net income, contemplated in section 9D(2A), of that controlled foreign company,

unless the amount so paid or payable is paid or payable as consideration for the purchase of trading stock by the person by whom the amount is paid or payable; or

(*b*) from any portfolio contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1.

(5) The exemptions from tax provided by subsections (2) and (3) do not apply in respect of any portion of an annuity or extend to any payments out of any foreign dividend received by or accrued to any person.

(6) Subsections (2) and (3) do not apply to any foreign dividend received by or accrued to a person in respect of—

(*a*) services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office, other than a foreign dividend in respect of a share held by that person; or

(*b*) a restricted equity instrument as defined in section 8C that was acquired in the circumstances contemplated in that section if that foreign dividend is derived directly or indirectly from, or constitutes—

(i) an amount—

(*aa*) transferred or applied by a company as consideration for the acquisition or redemption of any share in that company; or

(*bb*) received or accrued in anticipation or in the course of the winding up, liquidation, deregistration or final termination of a company; or

(ii) an equity instrument that does not qualify, at the time of the receipt or accrual of that foreign dividend, as a restricted equity instrument as defined in section 8C.

(7)(*a*) The Minister may announce in the national annual budget contemplated in section 27(1) of the Public Finance Management Act, that, with effect from a date or dates mentioned in that announcement, the numbers contemplated in subsection (3)(*b*)(ii)(*aa*) and (*cc*) will be altered to the extent mentioned in the announcement.

(*b*) If the Minister makes an announcement of an alteration contemplated in paragraph (*a*), that alteration comes into effect on the date or dates determined by the Minister in that announcement and continues to apply for a period of 12 months from that date subject to Parliament passing legislation giving effect to that announcement within that period of 12 months.

Section 20C

20C Ring-fencing of interest and royalties incurred by headquarter companies.—(1) For the purposes of this section—

"financial assistance" means financial assistance contemplated in section 31(1); and

"royalty" means any amount that is, before taking into account section 49D(*c*), subject to the withholding tax on royalties in terms of Part IVA.

(2) Where a headquarter company has during any year of assessment incurred any interest in respect of any financial assistance granted to that headquarter company by a person—

(*a*) that is not a resident; and

(*b*) if that person is a company, that directly or indirectly (and whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the equity shares and voting rights in that headquarter company,

the amount of that interest in respect of which a deduction is allowable to that headquarter company in that year of assessment is limited to so much of the amount of interest received by or accrued to the headquarter company as relates to any portion of that financial assistance that is directly applied as financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights.

(2A) Where a headquarter company has during any year of assessment incurred any amount that constitutes a royalty payable to a person—

(*a*) that is not a resident; and

(*b*) if that person is a company, that directly or indirectly (and whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the equity shares and voting rights in that headquarter company,

the amount of that royalty in respect of which a deduction is allowable to that headquarter company in that year of assessment is limited to so much of any amounts received by or accrued to the headquarter company in respect of—

(i) the use or right of use of or permission to use any intellectual property as defined in section 23I; or

(ii) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information,

from any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights.

(3) Any amount that is disallowed as a deduction in any year of assessment of a headquarter company in terms of subsection (2) or (2A) must—

(*a*) be carried forward to the immediately succeeding year of assessment of the headquarter company; and

(*b*) where that amount is disallowed as a deduction—

(i) in terms of subsection (2), be deemed to be an amount of interest actually incurred by the headquarter company during that succeeding year in respect of financial assistance granted to that headquarter company by a person that is not a resident; or

(ii) in terms of subsection (2A), be deemed to be an amount actually incurred by the headquarter company during that succeeding year that constitutes a royalty payable to a person that is not a resident.

Section 24I(1) – Paragraphs (*a*) – (*d*) of the definition of "local currency"

"local currency" means in relation to—

(*a*) any person in respect of an exchange item which is attributable to any permanent establishment outside the Republic, the functional currency of that permanent establishment: Provided that for purposes of this paragraph any exchange item shall be deemed not to be attributable to any such permanent establishment if the functional currency of that permanent establishment is the currency of a country which has an official rate of inflation of 100 per cent or more throughout the relevant year of assessment;

(*b*) any resident, other than a headquarter company, a domestic treasury management company and an international shipping company as defined in section 12Q(1), in respect of an exchange item which is not attributable to a permanent establishment outside the Republic, the currency of the Republic;

(*c*) any person that is not a resident in respect of any exchange item which is attributable to a permanent establishment in the Republic, the currency of the Republic;

(*d*) any headquarter company in respect of an exchange item which is not attributable to a permanent establishment outside the Republic, the functional currency of that headquarter company;

Section 24I(3) and (4)

(3) In determining the taxable income of any person contemplated in subsection (2), there shall be included in or deducted from the income, as the case may be, of that person—

(*a*) any exchange difference in respect of an exchange item of or in relation to that person, subject to subsection (10A); and

(*b*) (i) any premium or like consideration received by, or paid by, such person in terms of a foreign currency option contract entered into by such person; or

(ii) any consideration paid by such person in respect of a foreign currency option contract acquired by such person.

(4) Subject to section 11, in determining the taxable income of any person contemplated in subsection (2) in respect of a debt owing to that person as referred to in paragraph (*b*) of the definition of "exchange item"—

(*a*) to the extent that on realisation the debt was irrecoverable by reason of becoming bad; or

(*b*) the realisation of the debt resulted in a loss determined in the foreign currency due to a decline in the market value of that debt,

the amount of—

(i) any foreign exchange gain, relating to the debt as described in paragraph (*a*) or (*b*), that is or was included in the income of that person in the current or any previous year of assessment must be deducted from the income of that person; and

(ii) the amount of any foreign exchange loss, relating to the debt as described in paragraph (*a*) or (*b*), that is or was deducted from the income of that person in the current or any previous year of assessment must be included in the income of that person.

Section 25D(4) and (7)

(4) Where, during any year of assessment—

(*a*) any amount—

(i) is received by or accrued to; or

(ii) of expenditure is incurred by, a headquarter company in any currency other than the functional currency of the headquarter company; and

(*b*) the functional currency of that headquarter company is a currency other than the currency of the Republic,

that amount must be determined in the functional currency of the headquarter company and must be translated to the currency of the Republic by applying the average exchange rate for that year of assessment.

(7) Any amounts received by or accrued to, or expenditure incurred by—

(*a*) a headquarter company contemplated in subsection (4);

(*b*) a domestic treasury management company contemplated in subsection (5); or

(*c*) an international shipping company contemplated in subsection (6),

during any year of assessment in a functional currency that is a currency other than the currency of the Republic must be translated to the currency of the Republic by applying the average exchange rate for the relevant year of assessment.

Section 31(5) and (6)

(5) Where any transaction, operation, scheme, agreement or understanding has been entered into between a headquarter company and—

(*a*) any other person that is not a resident and that transaction, operation, scheme, agreement or understanding is in respect of the granting of financial assistance by that other person to that headquarter company, this section does not apply to so much of that financial assistance that is directly applied as financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights;

(*b*) any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights and that transaction, operation, scheme, agreement or understanding comprises the granting of financial assistance by that headquarter company to that foreign company, this section does not apply to that financial assistance;

(*c*) any other person that is not a resident and that transaction, operation, scheme, agreement or understanding is in respect of the granting of the use, right of use or permission to use any intellectual property as defined in section 23I(1) by that other person to that headquarter company, this section does not apply to the extent that the headquarter company—

(i) grants that use, right of use or permission to use that intellectual property to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights; and

(ii) does not make use of that intellectual property otherwise than as contemplated in subparagraph (i); or

(*d*) any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights and that transaction, operation, scheme, agreement or understanding comprises the granting of the use, right of use or permission to use any intellectual property as defined in section 23I(1) by that headquarter company to that foreign company, this section does not apply to that granting to that foreign company.

(6) Where any transaction, operation, scheme, agreement or understanding that comprises the granting of—

(*a*) financial assistance; or

(*b*) the use, right of use or permission to use any intellectual property as defined in section 23I,

by a person that is a resident (other than a headquarter company) to a controlled foreign company in relation to that resident or in relation to a company that forms part of the same group of companies as that resident, this section must not be applied in calculating the taxable income or tax payable by that resident in respect of any amount received by or accrued to that resident in terms of that transaction, operation, scheme, agreement or understanding if—

(i) ……;

(ii) that controlled foreign company has a foreign business establishment as defined in section 9D(1); and

(iii) the aggregate amount of tax payable to all spheres of government of any country other than the Republic by that controlled foreign company in respect of any foreign tax year of that controlled foreign company during which that transaction, operation, scheme, agreement or understanding exists is at least 67,5 per cent of the amount of normal tax that would have been payable in respect of any taxable income of that controlled foreign company had that controlled foreign company been a resident for that foreign tax year: Provided that the aggregate amount of tax so payable must be determined—

(*aa*) after taking into account any applicable agreement for the prevention of double taxation and any credit, rebate or other right of recovery of tax from any sphere of government of any country other than the Republic; and

(*bb*) after disregarding any loss in respect of a year other than that foreign tax year or from a company other than that controlled foreign company.

Section 41(1) – Definition of "company"

"company" does not include a headquarter company and, for the purposes of sections 42 and 44, includes any portfolio of a collective investment scheme in securities or any portfolio of a hedge fund collective investment scheme;

Section 49D(*c*)

49D Exemption from withholding tax on royalties.—A foreign person is exempt from the withholding tax on royalties if—

(*c*) that royalty is paid by a headquarter company in respect of the granting of the use or right of use of or permission to use intellectual property as defined in section 23I to which section 31 does not apply as a result of the exclusions contained in section 31(5)(*c*) or (*d*).

Section 50D(1)(*a*)(i)(*cc*)

50D. Exemption from withholding tax on interest.—(1) Subject to subsection (2), there must be exempt from the withholding tax on interest any amount of interest—

(*a*) if that amount of interest is paid to any foreign person—

(i) by—

(*cc*) a headquarter company in respect of the granting of financial assistance as defined in section 31(1) to which section 31 does not apply as a result of the exclusion contained in section 31(5)(*a*); or

Section 64E(1)

64E. Levy of tax.—(1)(*a*) Subject to paragraph 3 of the Tenth Schedule, there must be levied for the benefit of the National Revenue Fund a tax, to be known as the dividends tax, calculated—

(i) at the rate of 20 per cent; or

(ii) at such rate as the Minister may announce in the national annual budget contemplated in section 27(1) of the Public Finance Management Act, with effect from a date mentioned in that Announcement,

of the amount of any dividend paid by any company other than a headquarter company.

(*b*) If the Minister makes an announcement contemplated in paragraph (*a*)(ii), that rate comes into effect on the date determined by the Minister in that announcement and continues to apply for a period of 12 months from that date subject to Parliament passing legislation giving effect to that announcement within that period of 12 months.

Section 64N(1)

64N. Rebate in respect of foreign taxes on dividends.—(1) A rebate determined in accordance with this section must be deducted from the dividends tax payable in respect of a dividend contemplated in paragraph (*b*) of the definition of "dividend" in section 64D.

Paragraph 35(3)(*a*)

(3) The proceeds from the disposal, during a year of assessment, of an asset by a person, as contemplated in subparagraph (1) must be reduced by—

(*a*) any amount of the proceeds that must be or was included in the gross income of that person or that must be or was taken into account when determining the taxable income of that person before the inclusion of any taxable capital gain;

Paragraph 43(1A)

(1A) Where, during any year of assessment, a person disposes of an asset (other than a disposal contemplated in subparagraph (1)) for proceeds in a foreign currency or after having incurred expenditure in respect of that asset in a foreign currency, that person must, for the purposes of determining the capital gain or capital loss on the disposal of that asset, translate—

(*a*) the proceeds into the local currency at the average exchange rate for the year of assessment in which that asset was disposed of or at the spot rate on the date of disposal of that asset; and

(*b*) the expenditure incurred in respect of that asset into the local currency at the average exchange rate for the year of assessment during which that expenditure was incurred or at the spot rate on the date on which that expenditure was incurred:

Provided that the amount of any capital gain or capital loss determined under this subparagraph in respect of an exchange item contemplated in section 24I must be taken into account in terms of this paragraph only to the extent to which it exceeds the amounts determined in respect of that exchange item under section 24I.

Paragraph 64B(2) and (4)

(2) Subject to subparagraph (4), a headquarter company must disregard any capital gain or capital loss determined in respect of the disposal of any equity share in any foreign company (other than an interest contemplated in paragraph 2(2)) if that headquarter company (whether alone or together with any other person forming part of the same group of companies as that headquarter company) immediately before that disposal held at least 10 per cent of the equity shares and voting rights in that foreign company.

(4) A person must disregard any capital gain determined in respect of any foreign return of capital received by or accrued to that person from a "foreign company" as defined in section 9D (other than an interest contemplated in paragraph 2(2)) where that person (whether alone or together with any other person forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in that company.