
**WHAT SOUTH AFRICA CAN LEARN FROM MAURITIUS IN ORDER TO BE THE
PREFERED COUNTRY FOR MULTINATIONAL COMPANIES TO ESTABLISH A
HEADQUARTER COMPANY IN AFRICA**

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DECLARATION

I, Ayanda Success Masina, hereby declare that the work on which this dissertation is based on is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor part of it has been, is being, or is to be submitted for another degree in this or any other university. It is hereby presented in partial fulfilment of the requirements for the award of the Degree of Master of Laws in Taxation.

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Signature

15 March 2018

Date

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CHAPTER 1

1. INTRODUCTION

1.1 BACKGROUND

Part of the obligations of a government is to promote the progress of the economy of the country. One way to boost an economy is by attracting foreign investment from multinational companies. The government has the duty to ensure that it has all the necessary systems in place to make the country into an ideal investment location. These systems are one of the factors that multinational companies will consider when deciding on the best country to establish their holding company.

Prior to selecting a country in which to invest – a multinational company will consider various factors including the political stability of the country, the location of the country, its economy, its overall financial and professional sectors. As one can imagine, there are numerous countries that can qualify as an attractive location for a HQC, thus multinational companies then consider the tax systems of the preferred countries, to ascertain which has the least adverse impact on the investment it intends making.¹ Given this, it is pivotal that the government, together with the legislator, consider and develop the tax systems which will make the country an appealing location for investors.

Like most governments in Africa, the South African government realised that the rest of the world were slowly shifting their focus to Africa for purposes of investment, and as such that multinational companies would be looking for an African location in which to set up their headquarter companies. As early as 1997, it was acknowledged and recommended by the Katz Commission that South Africa (SA) should establish a Headquarter Company (HQC) regime that would provide tax incentives to encourage foreign investors to invest funds and skills into Africa via SA.²

¹ T Legwaila, 'The suitability of the South African Corporate Tax Regime for the Use of South African Resident Intermediary Holding Companies', Doctoral Dissertation, University of Pretoria (2010), available from: https://www.worldcat.org/title/suitability-of-the-south-african-corporate-tax-regime-for-the-use-of-south-african-resident-intermediary-holding-companies/oclc/956373358&referer=brief_results

² MM Katz, *Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa: fifth, interim report*. (1997).

In an attempt to promote the location of HQC's in SA, the legislator took steps in 2002 to include the definition of a HQC in section 1 of the Income Tax Act No. 58 of 1962 (IT Act). However, due to various factors, which will be discussed later in this dissertation, multinational companies were still not attracted to SA as a location for their HQC's and as such, the international headquarter company regime provisions were abolished in 2004.³

In 2010, the South African Government, together with National Treasury, decided to re-introduce the HQC provisions. The reasoning for this was elaborated upon in the 2010 Budget Review issued on 17 February 2010. The South African National Treasury explained that as SA was just beginning to recover from the deepest global economy recession in seven decades, and SA's first recession in 17 years - which caused a loss of over 900 000 jobs - the Government intended to develop a comprehensive package of economic reforms to address SA's structural poverty and unemployment.⁴

Included in those reforms was the re-introduction of the HQC provisions and the promotion of SA as a gateway into Africa for purposes of foreign investment. The South African National Treasury concluded that SA was an ideal location for multinational companies to establish a headquarter company for investment purposes in Africa.⁵ In reaching this conclusion, National Treasury considered SA's geographic position, strong financial services system and good banking infrastructure.⁶ As a result, the South African Government and National Treasury considered how to make SA an attractive location in which multinational companies could establish and expand their operations in Africa.⁷

In order to accomplish this initiative, the South African Government re-introduced the HQC provisions in the IT Act with the objective of attracting multinational companies that were interested in investing in Africa.⁸

³ AW Oguttu, 'Developing South Africa as a gateway for foreign investment in Africa: A critique of South Africa's Headquarter Regime' (2011) 36 *South African Yearbook of international law* 71.

⁴ South African National Treasury *Budget Review* (2010) Foreword.

⁵ National Treasury *Budget Review* (note 4 above) 78.

⁶ National Treasury *Budget Review* (note 4 above) 78.

⁷ National Treasury *Budget Review* (note 4 above) 78.

⁸ Explanatory Memorandum on the Taxation Laws Amendment Bill 2010.

1.2 PURPOSE OF THE STUDY

The establishment of a HQC in a country boosts the economy of the country by introducing investments and creating jobs. SA needed such a boost as the global recession not only affected the economy but also the livelihood of millions of South Africans, due to the significant loss in jobs.

SA has always been one of the preferred locations for foreign multinational companies to consider as the destination for establishing a HQC in Africa.⁹ This is due to its location, relatively stable political environment, sizeable economy, strong financial services system and extensive Double Tax Agreement (DTA) network.¹⁰ In spite of the aforementioned advantages, SA never managed to surpass Mauritius as the preferred location for a HQC in Africa. This is mainly due to the fact that Mauritius has a more advantageous tax system for foreign companies, and Mauritius has been considered a tax haven by many. While tax regimes should not be the sole determining factor of the structure or location of a business; it is clear in this case that lower taxes are an incentive when deciding between whether to locate a HQC in SA or Mauritius. The less advantageous tax environment found in SA was entrenched in the Income Tax legislation prior to the changes made in 2011. The IT Act contained strict provisions with regard to Controlled Foreign Company (CFC) rules, dividends tax and the thin capitalisation rules.¹¹ These provisions were regarded as barriers to making SA a more attractive choice as opposed to Mauritius, for purposes of establishing a HQC in Africa.

In light of the fact that SA was still not the preferred choice as a location for a HQC in Africa, despite its general attractiveness, the South African National Treasury took steps in 2011 to amend the legislation so as to remove the barriers which had given Mauritius a competitive advantage over SA, in attracting multinational companies that were interested in investing in Africa.¹²

The SA HQC provisions have been in force for almost six years now, yet Mauritius is still the preferred choice for a gateway into Africa for investment purposes – this is established in

⁹ Deloitte tax Publications, *Choosing a gateway into Africa: Comparison of South Africa's headquarter company regime with the Mauritius Global Business License Category 1 Company regime*, available on <https://www.taxpublications.deloitte.co.uk/tis/dtp.nsf/0/8838EE753F5825C880257A7C004064B8?OpenDocument> accessed 6 March 2017.

¹⁰ N Brown, *South Africa's international headquarter regime: features and benefits*, available on [https://uk.practicallaw.thomsonreuters.com/1511334?_lrTS=20170617015658955&transitionType=Default&context\(Data=\(sc.Default\)\)](https://uk.practicallaw.thomsonreuters.com/1511334?_lrTS=20170617015658955&transitionType=Default&context(Data=(sc.Default))), accessed on 11 November 2016.

¹¹ Explanatory Memorandum (see note 8 above) paragraph 5.4.

¹² Explanatory Memorandum (see note 8 above).

chapter 4 of this study. It might be time for National Treasury to reconsider the efficacy of these provisions.

The purpose of this dissertation is two-fold: Firstly, it will evaluate the SA HQC provisions as compared to its only competitor in Africa, the Mauritian Global Business Company 1 (GBC1). Secondly, as it is abundantly clear that Mauritius is still the preferred choice for multinational companies interested in investing in Africa, this dissertation will consider the lessons to be learnt by SA from Mauritius in this regard.

1.3 RATIONALE FOR STUDY

The rationale for this study is that there is still a pressing need to consider the current HQC provisions, despite the fact that the SA government has attempted to improve SA's tax system by removing the prior tax barriers. This study will provide suggestions as to how SA can learn from the Mauritian GBC1 regime, in order for SA to become the preferred location for a HQC for a multinational company that is interested in investing in Africa.

Multinational companies are aware that tax is an inevitable cost of running a business. Nevertheless, businesses still prioritise profitability and look for ways to do so while incurring as little tax as possible. As such, tax implications will always be a key factor when deciding the location of an investment for multinational companies. While governments aim to protect their economies, by implementing tax collection measures, a balance should be struck so as to not dissuade potential investors.

Furthermore, it is important to point out that two of SA's previous strengths (i.e. its political stability and economy) have now become weaknesses due to the following reasons:

- The humiliating and lengthy public investigation of the previous Finance Minister, Mr Pravin Gordon prior to his removal as the Finance Minister.
- The reshuffling of cabinet members during 2016, which led to a new Minister of Finance being appointed rather controversially, as he had no experience or education to hold the office of the Minister of Finance;
- The panic caused when the South African President, Mr Jacob Zuma changed SA's Minister of Finance twice in the space of a week in 2015, causing an economic backlash from the world;
- The downgrade of SA's credit rating to junk status in 2016;

- The technical recession that occurred in mid-2017;
- The constant strikes in the country due to unhappy employees, service delivery or students demanding no increases in university fees;
- The poor performance of SA's main trading partners in BRICS; and
- A vote of no confidence in President Zuma tabled in parliament in August 2017.

In light of the above, SA has suffered several blows to the important factors essential for a location for a HQC and as such, it is important that the tax regulations should not contribute any further in hindering potential economic growth that SA currently needs.

1.4 CONCEPTUAL/THEORETICAL FRAMEWORK

The theoretical framework of the study is based on the critical legal theory. The study will consider the legislation governing both regimes (SA and Mauritius) and will critically analyse the legislation in each jurisdiction. The choice of this theoretical framework is for purposes of providing recommendations to improve the stringent aspects of the legislation that places the SA HQC regime at a disadvantage, when compared to Mauritius.

With regard to the conceptual framework, the study will be a qualitative assessment, which will investigate, analyse and interpret documentary data.

1.5 METHODOLOGY

This study entails a review on research published by scholars and researchers and will make reference to the IT Act; statutes, journal articles, books, and thesis written by both Masters and PhD students.

The study will provide an analysis of the HQC provisions for SA and Mauritius, specifically considering how SA can improve its requirements and provisions by considering what makes Mauritius the preferred choice when companies consider having a HQC in Africa.

1.6 LITERATURE REVIEW

Although there is extensive research on international tax law, the subject relating to direct taxes of companies under international tax law has not been explored in depth and/or considered for purposes of improving tax legislation in SA. The research done merely provides a guide on how HQC are taxed. This is unfortunate as numerous foreign companies are interested in investing in Africa, given that it is a continent rich in resources and rising economies. However,

the tax implications to foreign companies with regard to HQC are often perceived as being excessively stringent.

Tax experts and professionals such as Michael Honiball, Anne Casey and Roxanna Nyiri have published writings on the subject dealing comprehensively with the comparisons between the two countries, where it is clear that Mauritius is the preferred country.¹³ These studies are outdated as the studies were considered and published more than 6 years when the new income tax provisions for headquarter companies were re-introduced in 2011. Due to the gap in the time since the last comparative study on this subject, a further study considering what lessons SA can take from Mauritius is merited.

The administrative requirements for qualifying as a Mauritian GBC1 are more burdensome than that of the SA HQC, whilst SA's substantive requirements appear more stringent.¹⁴ The majority of articles written on this subject provide a comparison between the SA and Mauritius HQC regimes, detailing the tax benefits and the administrative requirements that have to be met by the interested companies.

The history and background of the South African HQC is not researched in any detail and as such, it is difficult for many scholars who want to explore the subject in-depth to provide a substantial background to the subject.

Tracy Gutuza in the book *Tax, Law and Development*¹⁵ provide meaningful insight to the subject as they explore the history of the South African HQC. Their study reveals that the South African HQC provisions that were introduced in 2011 are a re-introduction of the HQC

¹³ M Honiball & R Killoran, *Is Mauritius Still Better Than South Africa For Headquarters Purposes?* available on, <https://www.thesait.org.za/news/news.asp?id=96251>, accessed on 26 September 2018.

A Casey, *Choosing a gateway into Africa: Comparison of South Africa's headquarter company regime with the Mauritius Global Business License Category 1 Company regime*, available on http://newsletters.usdbriefs.com/2012/Tax/WTA/120914_1.pdf, accessed on 26 September 2018.

R Nyiri, *Greater Incentives Needed to Make SA Compelling Gateway to Africa*, available on <https://www.bdo.co.za/en-za/news/articles/greater-incentives-needed-to-make-sa-compelling-ga>, accessed on 26 September 2018.

¹⁴ D Lessing, *Private Equity investments: SA Headquarter company vs. Mauritius GBC1 regime* available on <http://www.werksmans.com/legal-briefs-view/private-equity-investments-sa-headquarter-company-vs-mauritius-gbc1-regime>, accessed on 18 April 2016.

¹⁵ T Gutuza 'Economic development & the role of tax in Southern Africa: the South African headquarter company structure' in Y Brauner (ed.) & M Stewart (ed.) *Tax, Law and Development* (2013) 77 available on [https://books.google.co.za/books?hl=en&lr=&id=fo6-wRfbd9sC&oi=fnd&pg=PR1&dq=Y+Brauner+\(ed.\),+M+Stewart+\(ed.\),+Tax,+Law+and+Development,+Edward+Elgar+Publishing&ots=1DqvAsr_m1&sig=ot3MV2XRBckFuE3YjIXvg7tw36Y#v=onepage&q&f=false](https://books.google.co.za/books?hl=en&lr=&id=fo6-wRfbd9sC&oi=fnd&pg=PR1&dq=Y+Brauner+(ed.),+M+Stewart+(ed.),+Tax,+Law+and+Development,+Edward+Elgar+Publishing&ots=1DqvAsr_m1&sig=ot3MV2XRBckFuE3YjIXvg7tw36Y#v=onepage&q&f=false), accessed on 18 April 2016.

provisions.¹⁶ Their study concludes that notwithstanding the fact that prior to 2001, SA's source-based income tax system made SA a perfect location for multinational companies to establish a HQC in Africa, the HQC regime failed. The failure was caused by the racial separation brought about by the apartheid regime, which discouraged foreign investors from investing in SA.¹⁷ The first formal HQC structure in SA was brought about in 2001, with the introduction of the residence-based approach which was later repealed as the HQC regime did not attract foreign investors.¹⁸

The end of apartheid introduced a country that could benefit from the HQC regime and the introduction of the HQC provisions brought with it the possibilities of making SA a desired location for foreign investors to invest in Africa. The research in this dissertation will seek to provide suggestions for SA to take advantage of its unique position in Africa, by incorporating lessons learnt from Mauritius.

1.7 SCOPE OF THE STUDY

This study commences by explaining the background and benefits of a HQC, together with the reasons why the SA government decided to re-introduce the HQC regime.

The study further considers the benefits of the current HQC provisions versus the benefits of SA's most significant competitor, the Mauritian GBC1 regime - taking into consideration the history and background of the GBC1 regime.

As foreign investors still choose Mauritius over SA for investments, the study analyses the differences between the regimes, concentrating on the reasons as to why Mauritius is the preferred choice. The study will then look at what SA can learn from Mauritius in order to become the preferred choice as a location for a HQC for multinational companies, interested in investing in Africa.

The study concludes by providing suggestions as to what lessons can be learnt from Mauritius taking into consideration that the Fiscus and subsequently, SA's economy should not suffer from the lessons learnt. As such, the conclusion provides solutions that create a balance between the tax system and the economy of SA.

¹⁶ Gutuza (note 15 above).

¹⁷ Gutuza (note 15 above) 78.

¹⁸ Gutuza (note 15 above).

As there are various tax implications for the HQC and GBC1, the study is limited to dealing with dividends, double tax agreements and foreign credits. This study does not discuss the tax implications for any subsidiaries of the HQC or of the shareholders of the HQC. Furthermore, this study does not discuss the tax implications for the employees of the HQC. As this study is considering the tax implications for HQC, it does not discuss the non-tax reasons considered by multinational companies when choosing a location for a HQC.

CHAPTER 2

2. THE SOUTH AFRICAN HEADQUARTER COMPANY ('HQC')

2.1 INTRODUCTION

2.1.1 *History of HQC*

In 1997, South Africa (SA) had a source-based tax system, which meant that only income that was sourced in SA was taxed in SA. With that advantage, the Katz Commission - in its Fifth Interim Report - concluded that SA was the perfect location for establishing a head office for investing in Africa.¹⁹ This statement was made in contemplation of developing and improving the South African economy, as these factors would attract foreign investment into South Africa.

At the time that the Katz Commission report was issued, there were no specific HQC provisions in the Income Tax Act No. 58 of 1962 (the IT Act) however, there were other factors that made SA an ideal location for a HQC, like political stability and a thriving economy.

Much more was required in order to attract foreign investors to invest in SA and as such, the Katz Commission recommended the formation of a HQC regime in SA. 'The HQC regime would benefit SA's economy by encouraging South Africans companies to expand offshore without losing scarce human resources to offshore companies and to encourage foreign investment into Africa via SA'.²⁰

However, at the time of the Katz Commission recommendations, there were numerous factors that would affect the implementation of a successful HQC regime. The Katz Commission was concerned that foreign companies would be deterred by the following factors:

- The hostility of the investment climate prior to the democratisation of SA;
- The introduction of a worldwide tax system, whereby a South African resident will be taxed on its worldwide income, regardless of the country of source;
- The strict exchange control rules, which restricted cash flow in and out of SA; and

¹⁹ Katz (note 2 above) paragraph 2.2.5.

²⁰ Katz (note 2 above) paragraph 7.1.1.

- The fact that certain income generated by a SA HQC was taxed in SA as opposed to providing the HQC relief like HQC in other jurisdictions.²¹

In order to remove the obstacles preventing SA from attracting and benefiting from foreign investment, the Katz Commission concluded that SA had to have an extensive double tax agreement (DTA) network, an exemption from foreign dividend tax and low or no withholding tax on dividends.²²

It took the Government several years to implement the Katz Commission recommendations and finally in 2001, the South African government, together with National Treasury, introduced SA's first HQC regime.²³ The HQC regime was implemented with the introduction of the definition of International HQC (IHC) in section 1 of the IT Act.²⁴ This definition had the effect of providing a special exemption from worldwide taxation and foreign dividend tax.²⁵

The favourable tax treatment resulted in the IHC enjoying the following tax relief:

- The exclusion of the IHC subsidiaries' income in the IHC's taxable income;
- The IHC was not taxed on any dividends that it received from its foreign subsidiaries or income received from a foreign source; and
- The IHC was not liable for Secondary Tax on Companies on dividends declared as an IHC was a not a South African tax resident and only SA companies were liable for STC.²⁶

Due to the fact that multi-national companies were not enticed enough to invest in SA to establish their IHC in SA, the definition of an IHC was deleted in 2004, only 3 years after it was implemented.²⁷ According to the Legislators, it deleted the definition of an IHC as the regime provided favourable tax treatment for foreign controlled taxpayers to the detriment of isolating South African companies from the same tax concessions.²⁸

²¹ Katz (note 2 above) paragraph 7.1.1.

²² Katz (note 2 above) paragraph 7.1.4 and 7.1.5.

²³ Revenue Laws Amendment Act 2000, clause 2, subparagraph (f).

²⁴ Revenue Laws Amendment Act (note 23 above).

²⁵ Explanatory Memorandum (see note 8 above) Clause 12, subparagraph (g).

²⁶ Explanatory Memorandum Revenue Laws Amendment Bill (2000) 5.

²⁷ Revenue Laws Amendment Act (note 23 above) paragraph (g) of clause 12.

²⁸ Explanatory Memorandum on the Revenue Laws Amendment Bill, (2003) Clause 12, subparagraph (g).

The Legislators also found that the IHC regime was ineffective as the South African Reserve bank restricted 90 per cent of the currency flow of the foreign-owned South African subsidiaries. Furthermore, the IHC did not have access to certain DTA's that SA was a part of as the IHC was not a South African resident for tax purposes. As a result of these restrictions, the IHC regime was repealed.²⁹ Some scholars have however, attributed the failure of the initial IHC regime mainly to the barriers or disadvantages in the South African tax system at that time.³⁰

As SA had a thriving economy, was politically stable, had a strong financial services system and had a reasonably good DTA network, National Treasury was of the view that SA would be a suitable country for housing a regional holding company for a foreign multinational company that is interested in investing in Africa.³¹ As a result, in 2010, National Treasury reintroduced the HQC provisions into the Income Tax Act.

2.2 BARRIERS TO SUCCESSFUL HQC REGIME

On 1 January 2011, National Treasury considered the rules that were barriers to the implementation and development of a successful HQC regime, the following barriers were considered:

2.2.1 Controlled Foreign Company (CFC) rules

South African taxpayers are desirous of investing and expanding in foreign jurisdictions. However, often the intention of moving funds outside SA is for purposes of obtaining a tax benefit from the low tax rate in that other country or no tax that is enjoyed in that foreign country.³² The foreign investments by South African taxpayers have resulted in SA losing revenue and eroding the South African tax base. In order to prevent and discourage taxpayers

²⁹ Explanatory Memorandum on the Revenue Laws (note 28 above).

³⁰ S Phumaphi, 'Do the South African Headquarters Provisions provide a Competitive Alternative for a Gateway into Africa for International Companies' (Masters dissertation) University of Cape Town (2014), 23, available from: https://open.uct.ac.za/bitstream/handle/11427/9160/thesis_law_2014_phumaphi_s.pdf?sequence=1

³¹ Phumaphi (note 30 above).

³² H B Hoosen, *South Africa: Controlled Foreign Companies And The Concept Of Effective Management* available on <http://www.mondaq.com/southafrica/x/234000/Corporate+Tax/Controlled+Foreign+Companies+And+The+Concept+Of+Effective>, accessed on 4 September 2016.

from shifting their money from SA into lower tax jurisdictions, the legislators introduced anti-avoidance CFC rules.³³

A CFC is a non-resident company that has one or more South African shareholders holding at least 50 per cent of the voting and participation rights in that non-resident company.³⁴ The CFC rules dictate that income that accrues to or is received by the CFC forms part of the South African company's taxable income. The amount included in the South African resident's taxable income will be equal to the proportion of the participation rights that the South African resident has in the CFC.

The issue was that where CFC rules were applicable, there was double taxation on the income accrued or received by the HQC's foreign shareholders where the shareholder's home country also had CFC rules.³⁵

2.2.2 Withholding taxes on dividends

Prior to 2012, SA imposed STC on all South African tax resident companies where such South African companies paid out any dividends to its shareholders, including any foreign dividends paid to its shareholders.³⁶

In 2012, Dividends Tax replaced STC. The change was to ensure that the beneficial owners, and not the companies that issued the dividends, would bear the liability of the tax payable.

The main objectives for replacing STC with Dividends Tax were to align South African dividends tax with the international practice of imposing liability of tax on the recipient of the dividend and to increase SA's attractiveness as an international investment destination by ensuring that additional tax in the form of STC was removed from SA company tax.³⁷

³³ Hoosen (note 32 above).

³⁴ Section 9D of the IT Act - Amendment Act.

³⁵ Explanatory Memorandum on the Taxation Laws Amendment Bill (2010) Paragraph 5.4.

³⁶ Explanatory Memorandum on the Taxation Laws (note 35 above).

³⁷ Stanlib advisers, *Dividends Tax came into effect on 1 April 2012. The rate is set at 15%. Following are a few questions and answers which may help you understand Dividends Tax and how it affects you*, available on <http://www.stanlib.com/Advisers/ToolsandCalculators/Documents/DividendsTaxFAQ.pdf>, accessed on 5 September 2016.

HQC's were burdened with an additional 10 per cent charge where it issued dividends to foreign investors even if such funds originated from a foreign country, for example, income from a SA holding company's foreign subsidiary.³⁸

2.2.3 *Thin capitalisation and transfer pricing rules*

2.2.3.1 *Transfer pricing*

Transfer pricing legislation qualifies as anti-avoidance legislation as it prevents parties from deriving a tax benefit by opting for a jurisdiction with a lower tax rate when conducting cross-border transactions between connected parties who are usually a resident and a non-resident. Where a transaction between connected parties provides a tax benefit that is not enjoyed by parties in an arm's length transaction, the transaction will be treated as an arm's transaction so as to ensure that the parties involved do not obtain an undue tax benefit. The legislation ensures that the correct amount is included in taxable income and taxed accordingly.³⁹

2.2.3.2 *Thin capitalisation*

The thin capitalisation rules are applicable where a non-resident company assists a South African resident financially who in turn on-lends the funds to its foreign subsidiaries, and the transactions are not at arm's-length. In this situation, the Commissioner for SARS will disallow the interest deduction and deem the loan from the South African Company to the foreign subsidiaries as an interest-bearing loan.⁴⁰

Thin capitalisation rules were introduced to protect the South African tax base by preventing multinational companies from shifting profits from SA to low tax jurisdictions, in order to reduce the group of companies' effective tax rate.⁴¹

³⁸ Explanatory Memorandum on the Taxation Laws Amendment Bill (2010) Paragraph 5.4.

³⁹ P Haupt, *Notes on South African income tax* 35 ed (2016) 594.

⁴⁰ Haupt (note 39 above).

⁴¹ PWC African tax alert, *South Africa releases draft guidance on thin capitalization*, available on <https://www.pwc.com/us/en/tax-services-multinationals/newsletters/african-newsalert/assets/pwc-thin-capitalization-draft-guidance.pdf>, accessed on 1 October 2016.

Where the foreign investor made loans to the HQC, and the HQC on-lent those funds to another foreign company, thin capitalisation rules were applicable. As a result, the interest income earned on the loan was included in the HQC's taxable income with no option of deducting any interest incurred on the loan.⁴²

2.3 ADVANTAGES OF THE SOUTH AFRICAN HQC

The benefits enjoyed by a South African HQC are as follows:

2.3.1 CFC rules

In terms of section 9D (2) of the IT Act, where a HQC holds more than 50per cent in a foreign company, the CFC's income will not form part of the HQC's taxable income.

2.3.2 Dividends tax

Since a HQC is a resident in SA for tax purposes, it is taxed on its worldwide income. Therefore, as a general rule, the HQC's local and foreign dividends received or accrued to it should be included in the HQC's gross income.

2.3.2.1 Local dividend

Dividends issued by a South African resident forms part of the recipient's gross income as contemplated in the definition of gross income.⁴³ As a result, any dividend paid by a HQC should be included in each of its shareholder's gross income.

2.3.2.2 Foreign dividend

The general rule is that dividends paid by a South African company are included in the recipient's gross income, however, section 10B (2) of the IT Act exempts any dividends paid by or declared by a HQC. The exemption is applicable where the recipient of the dividend holds not less than 10 per cent of the HQC's voting and equity shares.

A HQC may not levy withholding tax on any dividends that it pays out to its shareholders.⁴⁴

⁴² Explanatory Memorandum on the Taxation Laws Amendment Bill (2010) Paragraph 5.4.

⁴³ Paragraph (k) of the definition of gross income in Section 1(1) of the IT Act.

⁴⁴ Section 10 of the IT Act.

2.3.3 *Transfer pricing/Thin capitalisation*

2.3.3.1 *Transfer pricing*

In terms of section 31 of the IT Act, income derived by a HQC in the form of management fees paid by the HQC's foreign subsidiaries will be subject to transfer pricing rules and that income will form part of the HQC's taxable income.⁴⁵ There was limited relief from the thin capitalisation rules prior to January 2017, as an HQC could use a foreign tax rebate as envisaged in section 6quin of the IT Act.⁴⁶

2.3.3.2 *Thin capitalisation*

The thin capitalisation rules are not applicable to–

- financial assistance provided by a non-resident company to a HQC and such HQC subsequently grants the funds to a non-resident company in which that HQC is a shareholder.⁴⁷
- financial assistance provided by a HQC to a non-resident company in which the HQC holds shares.⁴⁸
- royalties received by a HQC from a non-resident company in which that HQC holds shares.⁴⁹

The exemptions from thin capitalization are applicable where the HQC holds 10per cent or more of the shareholding in the non-resident company.

⁴⁵ Phumaphi (note 30 above).

⁴⁶ Phumaphi (note 30 above).

⁴⁷ Section 31(5) of the IT Act.

⁴⁸ Section 31(5) of the IT Act.

⁴⁹ Section 31 of the IT Act (note 47 above).

2.3.4 Capital Gains Tax (CGT)

Where a HQC sells equity shares in a non-resident company, in which that HQC held 10 per cent or more of the shareholding immediately before the disposal, such sale does not qualify as a disposal for capital gains tax purposes.⁵⁰

2.3.5 Exchange Control

Exchange control rules by themselves do not have any tax implications but are an important and inseparable factor from tax when considering international tax. Exchange control rules are mainly for purposes of regulating money in and out of SA. The rules are there to discourage the movement of cash and assets from SA to other jurisdictions and limit certain tax efficient transactions.⁵¹

A HQC is a resident for exchange control purposes and must abide by the exchange control rules. However, the South African Reserve Bank (SARB) deems a HQC to be a non-resident company for exchange control purposes (except for reporting purposes).⁵²

As the HQC is a deemed non-resident company for exchange control purposes, an HQC can transact freely for offshore investments and offshore borrowing with foreign companies without being restricted by the exchange control rules.⁵³

The HQC will qualify as a non-resident for exchange control purposes provided that it meets the following criteria:⁵⁴

- The debt or shares of the HQC is not listed on the Johannesburg Stock Exchange (JSE);
- The HQC's shareholders do not hold debt or shares listed on the JSE;
- All the HQC's shareholders have 10 per cent or more shareholding in the HQC;
- None of the South African resident shareholders hold more than 20 per cent shareholding in the HQC; and
- The HQC's assets must consist of not less than 80 per cent of foreign assets. The assets must not include money, cash equivalents and monies owed for less than 12 months.

⁵⁰ Paragraph 64B (2) of the Eighth Schedule to the IT Act.

⁵¹ Legwaila (note 1 above) 13.

⁵² South African Reserve Bank, Exchange Control Manual, section O10.

⁵³ South African Reserve Bank, Exchange Control manual, section O.

⁵⁴ South African Reserve Bank, Exchange Control Circulars No. 2/2011.

2.3.6 DTA

SA currently has 87 double tax treaties currently in force.⁵⁵ SA has numerous treaties with some of the largest economies in Africa such as Kenya, Nigeria, Tanzania and Uganda. 'SA's treaty network is vast as it provides double tax relief in numerous continents including Africa, Australia, America and Europe'.⁵⁶

2.3.7 Foreign tax rebate

Where a HQC derives income from a foreign source, such income may, in certain circumstances be taxed by both SA and the country in which the source of income originated, which may result in double taxation.⁵⁷

Generally, the residence country grants relief, under a DTA, to a taxpayer who has paid tax twice on the same amount, as both a residence country and a source country would have levied tax on the same amount.⁵⁸

The relief from double taxation may be achieved either unilaterally via domestic legislation, or bilaterally via a tax treaty agreement. Where a tax treaty is not applicable, domestic legislation will be applicable.⁵⁹

SA provides a reprieve from double taxation by granting the taxpayer a deduction or a rebate for any taxes paid on income in a foreign country.

Prior to 1 January 2016, SA used the following methods to provide relief from double taxation:

➤ Rebate method

- Section 6quat (1) of the IT Act provides a credit for foreign tax where a South African tax resident has paid both foreign tax on foreign income and South

⁵⁵ Double taxation agreements and protocols available on <http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx>, accessible on 1 October 2016.

⁵⁶ D Lessing & D Malan, *Private equity investments: SA headquarter company vs Mauritius GBCI regime – an update* available on <http://www.werksmans.com/wp-content/uploads/2014/08/Tax-Treaties-August-2014.pdf>, accessed on 1 October 2016.

⁵⁷ South African Revenue Service Interpretation Note 87 (Issue 2) 19 February 2016.

⁵⁸ SARS (note 57 above).

⁵⁹ SARS (note 57 above).

African tax on the same income. The credit is available where the taxpayer has proved that the foreign taxes are payable on foreign-sourced income.

- Section 6quin of the IT Act provided a special tax credit in respect of withholding tax that was paid both in SA, and in the foreign country on foreign income where such income was from a South African source. The credit was intended to assist South African tax residents by providing the taxpayer with relief from double taxation on cross-border services provided by a South African HQC to its foreign subsidiaries.

➤ Deduction method

- Section 6quat(1C) of the IT Act provides a deduction where a South African tax resident has paid both foreign tax and South African tax on foreign income where such income was from a South African source.

2.4 REPEAL OF SOUTH AFRICAN FOREIGN INCOME TAX REBATE

2.4.1 Section 6quin tax Credit/Rebate

In 2015 National Treasury proposed the deletion of the tax rebate contained in section 6quin of the IT Act.⁶⁰

National Treasury deleted section 6quin of the IT Act as the tax credit was a departure from rules governing international tax and DTA principles which allowed countries that did not have taxing rights to tax income that is sourced in other countries.⁶¹ South Africa was the only country that provided a tax concession of that nature.⁶²

The concession contributed to the deterioration of the South African tax base as it forced SA to provide credits for taxes paid in foreign countries, which did not have taxing rights on that income. SA's tax base was being eroded whilst other countries unduly benefitted from SA's

⁶⁰ Taxation Laws Amendment Bill (2015).

⁶¹ Explanatory Memorandum on the Taxation Laws Amendment Bill (2015).

⁶² Explanatory Memorandum on the Taxation Laws Amendment Bill (2015).

special tax credit. The special tax credit for service fees has been withdrawn, effective from 1 January 2016.

2.5 SUMMARY

The Katz Commission recognized that SA was a powerhouse that had numerous advantages that made it an ideal location for multinational companies to establish a company that would provide services for its subsidiaries in Africa. Even though there were numerous advantages, the country's tax laws were not favorable and as such National Treasury had to step up and consider the tax laws, in order to incentivize foreign investors into SA.

The Government finally implemented the laws that would see SA become one of the African countries suitable for a thriving headquarter regime with the intention of developing and improving SA's economy by attracting foreign investors to establish their headquarter companies in SA. This would result in job creation, and the import of highly skilled individuals who would increase the tax base with the income they would receive for the services they would render to their employers. The headquarter companies would also increase the tax base as these companies would be liable to corporate income tax.

An increase in foreign investors would be beneficial now more than ever as SA's economy suffers severely due to the various non-tax issues, specifically the political and economic instability that SA has experienced over the last 2 to 3 years.

It is however clear that the concessions provided to HQC's can erode SA's tax base and economy where SA ends up with a high volume of HQC's. The predicament of more foreign investors versus the disadvantage to the economy necessitates the importance of investigating and considering a successful HQC regime, to ascertain how a balance can be struck in order to ensure that South Africa's economy is not prejudiced by the foreign investment.

The next two chapters will consider the Global Business Company 1 regime in Mauritius, as it is the most successful HQC regime in Africa, in order to ascertain what lessons can be learnt from Mauritius to ensure that SA can have a successful HQC regime which will boost SA's economy.

CHAPTER 3

3. THE GLOBAL BUSINESS COMPANY 1 (GBC1) IN MAURITIUS

3.1 INTRODUCTION

Mauritius has the most successful headquarter company regime in Africa.

Mauritius has managed to sustain a successful headquarter regime for approximately 10 years, and still has a thriving economy after the global recession of 2008.⁶³ As such, Mauritius is the most ideal African country to study and consider as a model which South Africa can learn from in ensuring that the HQC regime in SA can attract more foreign investors.

3.1.1 History of Mauritius economy

Mauritius is an island rich in agriculture and can attribute the development of its powerful economy to the sugar industry that contributed the most to its GDP back in the 1970's.⁶⁴ It was at this point that Mauritius adopted an export-led strategy that saw the growth of the economy of the island with an exponential increase in tourism, manufacturing and financial services.⁶⁵

Mauritius began to grow exponentially economically in the late 1980's, when the Mauritian government developed a strategy to establish Mauritius as an international financial services centre by establishing its first offshore bank in 1989.⁶⁶ Over the years, Mauritius has taken advantage of the growth of the offshore services and capitalised on that growth by encouraging foreign investors and international companies to set up companies in Mauritius that would be used as headquarter companies for investment purposes in Africa.

The Mauritian government has, since the 1970's, advertised Mauritius as a favourable jurisdiction through which foreign investors can set up holding companies,⁶⁷ this is due to the

⁶³ *Doing business in Mauritius*, available on http://www.ocra.com/solutions/mauritius_overview.asp, accessed on 21 October 2016.

⁶⁴ M Hampton (ed.) & J Abbott (ed.), *Offshore Finance Centers and Tax Havens – The rise of Global Capital* (1999) 230.

⁶⁵ Hampton & Abbott (note 64 above).

⁶⁶ Hampton & Abbott (note 64 above) 231.

⁶⁷ T Legwaila 'The tax treatment of holding companies in Mauritius: Lessons for South Africa' (2011) 23 *SA Mercantile Law Journal*, 2.

fact that Mauritius is a low tax jurisdiction and offers attractive tax incentives for foreign investors.

The tax treatment of and benefits to foreign investors have been highly relaxed and made favourable to the extent that Mauritius has been accused of being a tax haven by many observers of the Organisation for Economic Co-operation and Development (OECD).⁶⁸

Mauritius' success as the preferred location for foreign investment could also be attributable to its practice of regularly reviewing its tax system to improve and increase its attractiveness as a destination for foreign investors.⁶⁹

Over and above the tax incentives for a foreign investor, Mauritius has non-tax reasons that are paramount for a location that is ideal for the establishment of a HQC. These include the political stability of Mauritius, a powerful and growing economy as well as its sophisticated financial/banking systems.⁷⁰

3.1.2 Introduction of the GBC

Coupled with the attractive non-tax benefits, Mauritius introduced legislation in 2007 that provided tax incentives for foreign investors interested in investing in Africa. The Mauritian government introduced the Global Business Licences Companies in 2007.⁷¹ These companies are companies incorporated in Mauritius but are owned by foreigners for investment purposes into Mauritius.

There are two types of Global Business Licences Companies, namely GBC1 and GBC2.

3.1.3 GBC2

GBC2's are owned by non-residents and operate exclusively outside Mauritius and have various benefits such as an exemption from corporate income tax and no dividends tax where

⁶⁸ Legwaila (note 67 above) 14.

⁶⁹ Oguttu (note 3 above) 69.

⁷⁰ Doing business in Mauritius, available on http://www.ocra.com/solutions/mauritius_overview.asp, accessed on 21 October 2016.

⁷¹ Financial Services Act 14 of 2007.

dividend is paid by GBC2's to its shareholders.⁷² Furthermore, there is no tax on interest, royalties and other payments made by GBC2's to non-residents.⁷³

There are no doubts that there are numerous tax benefits for GBC2's and the regime is flexible however due to the fact that the GBC2 is not a Mauritian resident, it cannot benefit from any of the double tax agreements that Mauritius has in place.⁷⁴

3.1.4 GBC1

In order for an investor to benefit from forming a HQC in Mauritius, that HQC must be licensed as a GBC1. A GBC1 is considered a resident for tax purposes in Mauritius, and must obtain a Tax residence certificate, which allows it to access the Mauritian tax treaties, which has the effect of reducing the tax rate which a GBC1 would be liable to pay under Mauritian law.

3.2 ADVANTAGES OF GBC1

3.2.1 *Controlled Foreign Company ('CFC')*

There are no CFC rules in Mauritius.⁷⁵ Where a GBC1 owns more than half of the shares of the participation or voting rights in a non-resident company, the non-resident's income will not form part of the GBC1's taxable income.

3.2.2 *Dividends tax*

3.2.2.1 *Local dividend*

Mauritius does not impose dividends tax on local dividends paid to a Mauritian company's shareholders.⁷⁶ Therefore there is no tax payable on any dividend paid by a GBC1.

⁷²Corporate tax guide – Mauritius 2014, available on http://www.into-sa.com/uploads/download/file/410/Corporate_Tax_Guide_-_Mauritius_2014_.pdf, accessed on 25 September 2018.

⁷³ Ernest & Young (note 72 above).

⁷⁴ Legwaila (note 67 above) 5.

⁷⁵ Lessing & Malan (note 56 above).

⁷⁶ Lessing & Malan (note 56 above).

3.2.2.2 *Foreign dividend*

Where a GBC1 receives dividend income from foreign investments, the dividends will be subject to tax at the rate of 3 per cent, which may be reduced to an effective tax rate of nil.⁷⁷ This can be achieved by the GBC1 claiming underlying taxes paid in the source country on corporate profits out of which the dividends have been declared.⁷⁸

Mauritius does not impose any withholding tax on dividends.⁷⁹

3.2.3 *Transfer pricing/Thin capitalisation*

3.2.3.1 *Transfer pricing*

The Mauritian Income Tax Act No. 16 of 1995 (Income Tax Act), provides transfer pricing rules by charging an amount of tax on transactions between related parties and treats it as though it is a transaction conducted between unconnected parties.⁸⁰

3.2.3.2 *Thin capitalisation*

The Mauritian Income Tax Act contains an anti-avoidance provision, which disallows interest paid on debentures issued to a GBC1's shareholders as a deductible expense.⁸¹

3.2.4 *CGT*

Where the GBC1 disposes of its shares in a foreign company or where there is a disposal of shares in the GBC1, there will be no CGT implications for the GBC1 and the shareholders of the GBC1 respectively as Mauritius does not impose CGT on foreign capital gains.⁸²

⁷⁷ Lessing & Malan (note 56 above).

⁷⁸ Taxation & Tax Treaties, available on <https://www.mauriexperta.com/en/why-mauritius/taxation-tax-treaties>, accessed on 26 September 2018.

⁷⁹ Lessing & Malan (note 56 above).

⁸⁰ Tax summaries available on <http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mauritius-Corporate-Group-taxation>, accessed on 21 October 2016.

⁸¹ Tax summaries (note 80 above).

⁸² Lessing & Malan (note 56 above).

3.2.5 *Exchange control*

There are no exchange controls regulations in Mauritius,⁸³ therefore, the flow of money in and out of the country for purposes of foreign investments is not restricted.

3.2.6 *Foreign tax credit*

Even though GBC1's are taxed at the normal corporate income tax rate of 15 per cent, the Mauritian government has provided unilateral relief in its Income Tax Act for resident companies by availing tax credits on foreign-source income received by the GBC1.⁸⁴

There are three types of credits available for relief from double taxation for Mauritian resident companies. Two of the credits are applicable to tax that has actually been paid or is payable by the taxpayer. The third type of tax credit is a deemed tax credit. The GBC1 has access to the following tax credits:

3.2.6.1 *Underlying tax credit*

An underlying tax credit reduces or eliminates double taxation where one's income is taxed by two or more countries.⁸⁵ Where a taxpayer pays foreign taxes on foreign-source income, Mauritian taxes that are payable are reduced by the tax already paid by the taxpayer in the foreign country.⁸⁶

3.2.6.2 *Deemed tax credit*

A deemed tax credit is not based on tax paid, but rather on tax presumed to be paid. Mauritius will presume tax to have been paid where the taxpayer claims that tax was paid in another country but cannot produce any records of such payment or liability.⁸⁷

Where a GBC1 elects not to provide written evidence to the FSC to prove the foreign tax charged, 80 per cent of the income accrued or received by the GBC1 will be presumed to have

⁸³ Lessing (note 14 above).

⁸⁴ Legwaila (note 67 above) 7.

⁸⁵ Legwaila (note 67 above).

⁸⁶ Legwaila (note 67 above).

⁸⁷ Legwaila (note 67 above) 8.

been taxed in the foreign country. This results in only 20 per cent of the income being subject to Mauritian tax.⁸⁸

3.2.6.3 *Tax Sparing credit*

Tax sparing is contained in tax treaties and provides for a situation where the taxpayer's residence country provides a credit for tax that was not paid in the source country, which has also granted a credit to the taxpayer.⁸⁹ The taxpayer will receive two credits for an amount due but not paid to the source country. The purpose of tax sparing clauses in DTA's is to incentivise the taxpayer to invest in the source country.

A GBC1 can use a combination of the foreign tax credits in order to obtain significant tax relief provided the foreign tax credits do not exceed the Mauritius tax payable on the foreign source income.⁹⁰

3.2.7 *Double Taxation Agreement (DTA)*

Mauritius has 43 DTA's currently in force.⁹¹ Even though Mauritius has less DTA's than SA, some of Mauritius' DTA's are more beneficial than SA's DTA's.⁹² The table below highlights the differences between DTA's SA has with Egypt, Congo and the United Arab Emirates*:

⁸⁸ Legwaila (note 67 above) page 9.

⁸⁹ HA Shannon 'Tax Incentives and Tax Sparing' (1992) 20 *InterTax* 86.

⁹⁰ *Doing business in Mauritius* available on http://www.ocra.com/solutions/mauritius_overview.asp, accessed on 21 October 2016.

⁹¹ Double taxation agreements and protocols available on <http://www.mra.mu/index.php/taxes-duties/double-taxation-agreements> accessed on 21 October 2016.

⁹² Lessing & Malan (note 56 above).

DTA	Dividends	Interest	Royalties
Mauritius-Egypt ⁹³	Between 5 per cent – 10 per cent	Not exceeding 10 per cent	Not exceeding 12 per cent
South Africa-Egypt ⁹⁴	Between 10 per cent – 15 per cent	Not exceeding 12 per cent	Not exceeding 15 per cent
Mauritius-Congo ⁹⁵	Between 0 per cent – 5 per cent	Not exceeding 5 per cent	Exempt from tax
South Africa-Congo ⁹⁶	Between 5 per cent – 15 per cent	Not exceeding 10 per cent	Not exceeding 10 per cent
Mauritius–United Arab Emirates ⁹⁷	If the recipient is the beneficial owner of the dividends, the dividend is taxable only in the other State. It is exempt from tax in Mauritius.	If the recipient is the beneficial owner of the interest, interest is taxable only in the other State. It is exempt from tax in Mauritius.	If the recipient is the beneficial owner of the royalties, royalties are taxable only in the other State. It is exempt from tax in Mauritius.
South Africa-United Arab Emirates ⁹⁸	Between 5 per cent – 15 per cent	Not exceeding 10 per cent	Not exceeding 10 per cent

* The information reflected in the table is the general relief provided in a DTA where the taxpayer would be taxed in both contracting states that are party to the DTA.

⁹³ GN 72 of GG 30, 30/06/2013.

⁹⁴ GN 90 of GG 19706, 22/01/1999.

⁹⁵ GN 48, 2011.

⁹⁶ GN 866 of GG 35805,24/10/2012.

⁹⁷ GN 14, 2007.

⁹⁸ GN 618 of GG 40496, 15/12/2016.

3.3 SUMMARY

Mauritius has always been transparent about the benefits it provides to foreign investors in order to attract foreign investment into Mauritius.

It is no secret that Mauritius is a low tax jurisdiction and provides various benefits for multinational companies with headquarter companies in Mauritius. In fact, Mauritius's previous finance minister Xavier-Luc Duval has stated that a decrease in tax rates results in an increase in tax revenues,⁹⁹ proving that the low tax rate attracts investment. This directly translates to an increase in Mauritius' tax base.

It is clear that Mauritius has been able to strike a balance between the tax benefits provided to foreign investors and the benefits from the investments to the Fiscus. SA can take lessons from Mauritius on how to use tax to entice foreign investors into SA and grow the economy without prejudicing the Fiscus.

⁹⁹ S Bracking & G Ware, *Is Mauritius a tax haven?* available on <http://www.theafricareport.com/North-Africa/is-mauritius-a-tax-haven.html>, accessed on 25 September 2018.

CHAPTER 4

4. LESSONS FROM MAURITIUS

4.1 INTRODUCTION

It is clear from the previous chapters that Mauritius has numerous benefits that make it the preferred location to establish a headquarter company in Africa for multinational companies who wish to invest in Africa. It is also clear that the benefits offered by South Africa (SA) to non-resident companies are enticing and make SA an ideal location as a gateway into Africa for investment by multinational companies.

The difference in the number of foreign investors in Mauritius and SA has increased over the last couple of years. Mauritius has managed to attract more foreign investors in these past years as opposed to five years ago when SA and Mauritius were actively competing to be considered as the gateway into Africa.¹⁰⁰ However, since then Mauritius has managed to attract the majority of the foreign investment in Africa for various reasons that will be discussed in this chapter.

The question remains as to what makes Mauritius preferable to SA considering that both countries have competing benefits. This chapter will explore why Mauritius is seemingly the preferred option and the lessons that SA can learn from Mauritius in becoming the preferred choice for the establishment of a HQC by multinational companies who wish to invest in Africa.

Mauritius' success is and has always been attributed to the fact that Mauritius is a jurisdiction favourable for the establishment of a holding company as it has both tax and non-tax advantages for foreign investors. These factors include political stability, ease of administration, a useful treaty network, flexible exchange control rules and great tax benefits.¹⁰¹

¹⁰⁰ *Mauritius gaining ground as the gateway to Africa*, available on <https://it-online.co.za/2017/08/29/mauritius-gains-ground-as-the-gateway-to-africa/>, accessed on 29 November 2017.

¹⁰¹ P Jain, *Global tax management for emerging transnational corporations* available on <http://www.mondaq.com/x/61050/Corporate+Tax/Global+Tax+Management+For+Emerging+Trans+National+Corporations>, accessed on 29 November 2017.

SA, on the other hand has an unstable economy,¹⁰² a volatile labour force and a failed attempt at a successful HQC regime.¹⁰³ Further to this, SA has been experiencing an adverse financial environment caused by political instability over the past 3 years.¹⁰⁴ This has affected most of the investment opportunities destined for SA as foreign investors are sceptical or cautious about the unstable South African rand.¹⁰⁵ With all the disadvantages and difficulties experienced by SA, it is worth considering whether the tax incentives that the South African HQC regime is currently offering would be sufficient motivation for a foreign investor to establish its HQC in SA.

4.2 THE SUCCESS OF THE MAURITIUS GLOBAL BUSINESS COMPANY 1

Numerous people, including politicians, economists and scholars have classified Mauritius as being a tax haven due to its low taxes and various benefits that it offers to foreign investors.¹⁰⁶ Many believe that the reason why Mauritius has had such a successful HQC regime is due to the fact that Mauritius provides a multinational with the opportunity of paying low or no tax when it sets up its HQC in Mauritius. Whether or not Mauritius is a tax haven is irrelevant as it does not form part of this study.

The purpose of this study is to consider the tax benefits provided by Mauritius to HQCs and this chapter will investigate –

- the factors that play a role in the success of the Mauritian GBC1; and
- whether SA can adopt similar approaches, to not only improve its attraction of foreign investors into SA, but to become the preferred choice for a location for a HQC in Africa.

¹⁰² L, Peyper, *SA economy no longer stable - Fragile States Index*, available on <https://www.fin24.com/Economy/sa-economy-no-longer-stable-fragile-states-index-20170625>, accessed 30 January 2018.

¹⁰³ Gutuza (note 15 above).

¹⁰⁴ M Vanek, *This is the impact of the #CabinetReshuffle on S.A's sovereign ratings*, available on <https://www.cnbcAfrica.com/trending/cabinet-reshuffle-17/2017/04/03/impact-cabinetreshuffle-s-sovereign-ratings/>, accessed on 30 January 2018.

¹⁰⁵ F Bhoor, *How to explain why the South African rand keeps falling*, available on <https://qz.com/596693/how-to-explain-why-the-south-african-rand-keeps-falling/> accessed on 30 January 2018.

¹⁰⁶ The Indian government has accused Mauritius of being a tax haven. This statement was published in *is Mauritius a tax haven*, available on <http://africamoney.info/is-mauritius-a-tax-haven/>, accessed 30 January 2018.

TAX REASONS FOR THE SUCCESS OF THE MAURITIUS GLOBAL BUSINESS COMPANY 1

4.2.1 low tax jurisdiction or tax haven

In 2000, former Deputy Prime Minister and Finance Minister of Mauritius, Xavier-Luc Duval explained that the rationale behind moves to lower taxes in Mauritius were for legitimate reasons as every time the Mauritian government decreased the tax rates, there was an increase in tax revenue.¹⁰⁷ The tax base was increased by the very fact that the taxes are low and as such, the jurisdiction gains more revenue. This rationale makes commercial sense in that a low tax jurisdiction with benefits to foreign investors attracts foreign investment that will not only create jobs and import skilled individuals who will contribute to the tax base, but it will also increase the corporate tax base.

Xavier-Luc Duval also explained that since Mauritius does not have hefty government expenditure, there is no need for Mauritius to overburden the population with taxation.¹⁰⁸ This is an important factor to consider as SA has a substantial government expenditure which overburdens the revenue collected. A further factor to consider is the fact that the two jurisdictions have different economies, employment rates, including the amount of persons dependant on the state to support them in relation to the persons who contribute to the tax base.

Mauritius has never been secretive about encouraging foreign investment by providing tax incentives to foreign investors. In fact, Mauritius has adjusted its tax system specifically to attract foreign investment via the interposition of companies in Mauritius for investment elsewhere.¹⁰⁹

These adjustments to the law have contributed to making Mauritius the preferred location for multinational companies that are interested in investing in Africa.

¹⁰⁷ *Mauritius: a tax haven or just a low-tax jurisdiction*, available on <http://eltoma-global.com/guidelines/is-mauritius-a-tax-haven-or-just-a-low-tax-jurisdiction.html>, accessed 11 December 2017.

¹⁰⁸ Ibid (note 107 above).

¹⁰⁹ Legwaila (note 1 above).

4.2.2 *Benefits to low or no taxes*

The tax implications of a GBC1 have been explored in detail in Chapter 3. However, it is important to note all the benefits that emanate from the low or no tax system for non-residents in Mauritius.

The income tax rate for a GBC1 is one of the lowest corporate income tax rates in the world, which varies between 3 per cent and 15 per cent on the taxable income of the GBC1.

Mauritius does not impose dividends tax on local dividends paid by a GBC1 and where a GBC1 receives dividend income from foreign investments, the dividends will be subject to tax at the rate of 3 per cent, which may be reduced to an effective tax rate of nil.¹¹⁰

There is no withholding tax on dividends in Mauritius¹¹¹ and this benefit coupled with the fact that there is no capital gains tax (CGT) highlights the attractiveness of Mauritius, making it appealing for foreign investors, especially considering that, unlike SA, in Mauritius the investors do not need to worry about special circumstances in order for the dividends or capital gains to receive tax-free treatment.¹¹²

SA, on the other hand, levies tax, in terms of section 5(1)(d) of the IT Act read with paragraph 3 of Schedule I to the Rate and Monetary Bill¹¹³, on corporate taxpayers at the rate of 28 per cent on the taxable income of the corporates with no favourable dispensation to HQCs.

Any dividend paid by a South African HQC may in terms of section 10B (2) of the IT Act be exempt from dividend tax provided the recipient of the dividend holds not less than 10 per cent of the HQC's voting and equity shares.

One benefit enjoyed by a South African HQC is that there is no withholding tax on any dividends that it pays out to its shareholders.¹¹⁴

¹¹⁰ Lessing & Malan (note 56 above).

¹¹¹ Lessing & Malan (note 56 above).

¹¹² Legwaila (note 1 above).

¹¹³ Bill B26—2017 was promulgated as Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2017 (Act No. 14 of 2017) on 14 December 2017.

¹¹⁴ Section 10 of the IT Act.

South African HQC's receive a dispensation for CGT. There are no CGT implications where a HQC sells the equity shares in a non-resident company, in which that HQC held 10 per cent or more of the shareholding immediately before the disposal.

One of the most competitive benefits that Mauritius has to offer in the GBC1 regime is the combination of the tax credits that a GBC1 is entitled to use in the determination of taxable income. This benefit can result in the GBC1's effective tax rate in certain circumstances being nil.

4.2.3 Fiscal security

Another factor that gives Mauritius the lead is the fact that local taxpayers are not disadvantaged by the tax incentives for foreign investors as most of these tax incentives are also available to the local taxpayers. Mauritius does not have to be concerned about the balance between the erosion of its tax base and tax incentives that are exclusive to foreign investors as the foreign investment contributes significantly to the country's revenue and consequently, its economy.

SA does not have this advantage as it is clear that the revenue received by SA is used not only for economic growth but also to cover hefty government expenditure and to support the large number of unemployed South Africans who are financially dependent on the State. The two countries, although much alike, differ drastically when it comes to the use of the revenue and the expenditure incurred by both countries tipping the playing field in Mauritius' favour.

It is therefore important to consider whether HQC tax provisions result in a benefit to the Fiscus in SA as it is clear that Mauritius benefits from foreign investment via the GBC1 regime in Mauritius.

NON-TAX REASONS FOR SUCCESS OF THE MAURITIUS GLOBAL BUSINESS COMPANY 1

4.2.4 Political and socio-economic stability

In December 2015, the President of SA, Jacob Zuma recalled the then Minister of Finance, Nhlanhla Nene, causing the beginning of the decline of the South African Rand which ended

in SA experiencing a technical recession in 2017. There were other factors that contributed to the recession, such as the credit downgrades and decline in investment into South Africa. A decline in investment is generally caused by lack of confidence and positive expectations of the country's future. President Jacob Zuma's administration doesn't instil confidence.¹¹⁵

The credit downgrades were, according to S&P Global Ratings and Fitch Ratings Ltd. As a result of by policy uncertainty, political turmoil and slow economic growth.¹¹⁶ There is a link between the technical rescission and the actions of President Jacob Zuma as his actions implied that there was political turmoil and this may have caused a decline in investor confidence.

This incident in December 2015 caused the South African Rand to plummet to R15 to the US Dollar. The South African Rand was able to recover once President Zuma regained investor confidence and the support of South Africans after replacing Minister Nene's unknown replacement with Minister Nene's predecessor, Pravin Gordhan.

Pravin Gordhan was SA's Minister of Finance from 2009-2014 and again in 2015 when President Zuma used him as a quick-fix to the December 2015 incident. This move by President Zuma returned the economy's stability. However, it may have caused investors to be wary of investing in SA as the actions by President Zuma revealed the political instability in SA.

After Minister Gordhan took over, there was hope that 2016 would be a good year and SA would recover economically. However, this was not the case as 'the growth of the economy in 2016 marked the lowest rate in the past 16 years, apart from the 2009 recession.'¹¹⁷ There was however further hope that the economy would pick up in 2017.

¹¹⁵ J Rossouw, *South Africa's in a recession. Here's what that means*, available on <https://theconversation.com/south-africas-in-a-recession-heres-what-that-means-78953>, accessed on 25 September 2018.

¹¹⁶ A Gumede & T Dzonzi, *SA avoids credit downgrade to junk as Fitch, Moody's grant respite*, available on <https://www.biznews.com/sa-investing/2016/11/26/fitch-outlook-takes-sa-closer-to-junk-status-but-its-safe-for-now>, accessed on 25 September 2018.

¹¹⁷ *Developments in individual OECD and selected non-member economies*, available on <http://www.oecd.org/eco/outlook/economic-forecast-summary-south-africa-oecd-economic-outlook-june-2017.pdf>, accessed 13 December 2018.

To the dismay of South Africans and investors, the economic situation did not improve in 2017 as President Zuma made an unprecedented and unexplained move yet¹¹⁸ again when in March 2017, President Zuma reshuffled his cabinet yet again and recalled Minister Gordhan, replacing him with Malusi Gigaba, a man with no financial background or experience. This reshuffle was one of the events that led to SA experiencing a technical recession, which was caused by a lack of business confidence and policy uncertainty. To add to the economic mayhem, the constant labour protests, political infighting, corruption and the financial burden caused by state owned entities like Eskom and South African Airways added significantly to a weakened Rand and consumer confidence in SA.¹¹⁹

All of these non-tax factors have contributed to South Africans, foreign investors and businesses looking to invest in more attractive neighbouring states such as Mauritius, Botswana or Namibia.¹²⁰

In contrast to the economic landscape in SA, Mauritius is a country that has political stability, economic growth, a well-developed infrastructure, an educated workforce and the most efficient goods market and strong institutions.¹²¹ Mauritius has enjoyed this political stability from its independence in 1968.¹²²

It is notable that Mauritius has had its independence for 26 years longer than South Africa, thus Mauritius will always have an advantage over South Africa as it has been a more attractive location for foreign investment.

This study is a comparative study between these two countries as Mauritius is the most popular country in Africa in which foreign multinationals establish headquarter companies in Africa for investment purposes.¹²³ One of the reasons could be attributable to the fact that it is much easier to do business in Mauritius than it is in SA as Mauritius was ranked 1st and SA

¹¹⁸ Old Mutual, *Cabinet reshuffle in South Africa – and what it means* available on https://www.oldmutual.co.za/docs/default-source/default-document-library/omcustomer_cabinet-reshuffle-31mar2017.pdf?sfvrsn=0, accessed on 26 September 2018.

¹¹⁹ *Mauritius overtakes South Africa in World Bank rankings*, available on <https://businesstech.co.za/news/business/212619/mauritius-overtakes-south-africa-in-world-bank-rankings/>, accessed on 30 November 2017.

¹²⁰ Ibid (note above 119).

¹²¹ Ibid (note above 119).

¹²² *Inside Mauritius: The tropical paradise with a booming economy*, available on <http://edition.cnn.com/2015/01/22/africa/mauritius-tropical-paradise-booming-economy/index.html> accessed on 14 December 2017.

¹²³ Nyiri (note 13 above).

was ranked 4th in sub-Saharan Africa on the World Bank's Ease of Doing Business 2016 index.¹²⁴

'The success of the Mauritius economy has been attributed largely to the political and socio-economic stability, coupled with good governance and a pro-investment climate'.¹²⁵

4.2.5 *Pro-investment Climate*

The pro-investment climate is achieved via the availability of tax incentives for foreign investors. However, the tax incentives for foreign investors that are available in Mauritius are extremely favourable as opposed to many African countries to the extent that many consider Mauritius a tax haven. As already explored in this Chapter, Mauritius' tax friendly environment for foreign investors is specifically to attract and promote investment from foreign investors.

Xavier-Luc Duval's statement that a decrease in tax rates results in an increase in tax revenue together with Mauritius' pro-investment climate illustrates that Mauritius was strategic in its plans to attract investment into the country.¹²⁶ Mauritius has always advertised its pro-investment climate in order to attract foreign investors. It is this aggressive and unapologetic advertising of the low tax climate in Mauritius that has always put Mauritius in the lead as the preferred African country to establish a HQC in.

4.3 ANALYSIS AND COMPARISONS OF TAX INCENTIVES

The South African HQC may not have the same tax benefits as the Mauritian GBC1, but it does have numerous tax benefits that are sufficient to be attractive to foreign investors interested in investing in Africa. The important issue at hand is whether despite these benefits, SA still needs to learn anything from Mauritius regarding a successful HQC regime.

¹²⁴*Fact Sheet: Doing Business 2016 in Sub-Saharan Africa*, available on <http://www.worldbank.org/en/region/afr/brief/fact-sheet-doing-business-2016-in-sub-saharan-africa>, accessed on 13 December 2018.

¹²⁵*Key benefits for registering a company in Mauritius*, available on <http://eltoma-global.com/jurisdictions/mauritius/key-benefits.html>, accessed on 30 November 2017.

¹²⁶*Mauritius: a tax haven or just a low-tax jurisdiction?*, available on <http://eltoma-global.com/guidelines/is-mauritius-a-tax-haven-or-just-a-low-tax-jurisdiction.html>, accessed on 25 September 2018.

4.3.1 SA's benefits

SA is equipped to be a great location for a HQC regime by providing the following essential tax benefits:

- The exemption of a South African HQC from the Controlled Foreign Company (CFC) rules, resulting in the exclusion of the profits and gains of the foreign company from the South African's taxable income.¹²⁷
- The exemption of dividends tax for dividends received by the South African HQC from its foreign subsidiaries.¹²⁸
- The exemption of dividends withholding tax for dividends declared by a South African HQC.¹²⁹
- The exemption of CGT where the South African HQC sells equity shares in a non-resident company, in which that HQC held 10 per cent or more shares in immediately before the disposal.¹³⁰
- The availability of foreign tax rebates.¹³¹

To add to the above advantages, the South African National Treasury has relaxed the exchange control regulations, which were previously a major deterrent to the success of the South African HQC regime.

The most advantageous benefit is the vast DTA network that SA has with approximately 87 countries. The DTA network provides much required double tax relief when a company does business or has tax presence in two or more countries.

Although there are many tax benefits for a South African HQC, the HQC regime is made undesirable by the non-tax factors. SA is continuously disappointed by its economic and

¹²⁷ Section 9D (2) of the IT Act.

¹²⁸ Section 10B of the IT Act.

¹²⁹ D Lessing & D Malan, *Private Equity Investments: SA Headquarter Company vs Mauritius GBCI Regime*, available on <https://www.werksmans.com/wp-content/uploads/2013/04/peinvest.pdf>, accessed on 10 December 2017.

¹³⁰ Paragraph 64B (2) of the Eighth Schedule to the IT Act.

¹³¹ Section 6quat (1) and 6quin of the IT Act.

political stability, as well as a volatile labour force that has the ability to stifle the economy. These non-tax factors contribute immensely to the very slow growth of the number of HQC's that are set up in SA as these are the reasons that foreign investors who are interested in investing in a country consider.

Not much can be done by SA's National Treasury when it comes to the main reasons that are barring SA from becoming the best location for a HQC in Africa. These factors are in the hands of the politicians and the corporate sector.

National Treasury can however amend the law in order to make SA a more attractive location for foreign investors when they consider SA as a potential location for investment in Africa. The question remains whether or not it is necessary for National Treasury to make any amendments to tax legislation.

It is important to note that the success of the headquarter companies will be accomplished by a combination of factors like a sound economy, exchange rates and monetary policy, not only tax.¹³² In order to accomplish this, "the South African government would have to revisit their various growth initiatives and plans and take due cognisance of monetary and fiscal policy measures to assist in these. Focusing purely on tax or fiscal incentives to fuel economic growth without ensuring that the economic fundamentals are adequately addressed will not be the answer".¹³³

4.3.2 Mauritius' benefits

Thabo Legwaila states that 'Mauritius is one of the most beneficial holding company regimes in the world as a result of the following:

- The low corporate tax rate of 15 per cent, which can be reduced to 3 per cent in certain instances.
- No tax on dividends and capital gains.
- Tax losses that are carried forward indefinitely.

¹³² Nyiri (note 13 above).

¹³³ Nyiri (note 13 above).

- A combination of the foreign tax rebates.¹³⁴

In addition to the above-mentioned benefits, Mauritius does not have CFC rules or transfer pricing rules.

4.3.3 Analysis and comparisons of the tax regimes

Upon comparing and analysing both the South African HQC regime and the Mauritius GBC1 regime, it is clear that Mauritius has the best non-tax benefits, which attract foreign investment into Mauritius. The economic and political stability, sophisticated financial services, ease of doing business and its accessibility to foreign investors make it the perfect location for foreign investment. These attractions are the main reasons that most foreign investors decide to invest in Mauritius. The tax incentives are an added advantage when companies are looking for a location in which to establish a HQC.

Even though Mauritius surpasses SA with the non-tax benefits, when it comes to the tax benefits that each of the countries has to offer to foreign investors in the HQC regime, SA is a sure contender to being the best country in which to establish a HQC for foreign investors interested in investing in Africa.

From a tax perspective, SA has managed to overcome the past barriers to a successful HQC regime and to offer an attractive location for the establishment of a HQC. The vast tax benefits coupled with a good financial services system, a good economy and political stability would make SA the location for a HQC. The tax portion of the SA HQC regime does not require any further amending as the tax benefits provided by the HQC regime are on par with the tax benefits offered by the Mauritian GBC1. The factors that require improvement are the non-tax factors. These factors cannot be improved by legislation or influenced by the tax factors.

A good headquarter regime must have certain attributes and the success of the regime can be judged by whether or not the regime offers any of these attributes. According to the Katz Commission, 'the ideal tax system must have the following attributes:

¹³⁴ Legwaila (note 1 above).

- A good double tax agreement network
- Exemption of foreign dividend income
- Exemption of other foreign income
- Absence of capital gains tax
- Absence of withholding taxes on dividends paid to shareholders
- An efficient tax rulings system.’¹³⁵

SA has a great double tax agreement network, being the country with the most DTA’s in Africa. It is only rivalled by Mauritius, which has approximately half the number of DTA’s as SA, however Mauritius’ DTA’s are more beneficial as is discussed in detail in paragraph 3.2.7 of this study. It is notable that the reason for Mauritius’ reason for having more beneficial DTA’s could be attributed to the fact that Mauritius uses the credit method and not the deduction method for foreign taxes paid by a resident taxpayer on foreign-source income.¹³⁶

The deduction method, used by SA is the least generous method of granting relief from double taxation and foreign investors prefer the credit method as it reduces domestic taxes payable by the amount of the foreign tax.¹³⁷

Whereas under the deduction method, taxpayers are allowed to make a deduction for foreign taxes paid when calculating their taxable income.¹³⁸ “The deduction method has the effect of treating the foreign taxes as an expense of doing business or earning income in the foreign Jurisdiction”.¹³⁹ As such the deduction method is not an attractive method for double tax relief.

Any foreign dividends received by a SA HQC are exempt from dividends tax, provided certain requirements are met and there are no withholding taxes on dividends paid by the SA HQC to its shareholders. Mauritius in the other hand does not have an exemption from dividend tax for any dividend income received from foreign investments. The dividend tax rate is relatively low at 3 per cent and may be reduced to nil. Mauritius also does not impose any withholding tax on dividends.

¹³⁵ Fifth Interim Report, 1997, Paragraph 7.1.4.

¹³⁶ Oguttu (note 3 above).

¹³⁷ Oguttu (note 3 above).

¹³⁸ Oguttu (note 3 above).

¹³⁹ Oguttu (note 3 above).

Mauritius does not have capital gains tax, not only for the GBC1's but for all its taxpayers. SA however has capital gains tax, with an exemption for HQC's where the HQC meets certain requirements.¹⁴⁰

Both countries do not have CFC rules. The SA HQC is exempt from CFC rules and Mauritius does not have CFC rules. Therefore, any income received in the underlying structure is not taxed in the GBC1 and the SA HQC. Any interest received by the GBC1 is taxed at a maximum rate of 3 per cent, which can be reduced by withholding taxes. Where the SA HQC receives any interest, it may be subject to tax at the corporate tax rate of 28 per cent, where the transfer pricing rules are applicable.

Both countries have foreign tax rebates that are beneficial in reducing the taxable income of the headquarter company.

Considering the comparison of the tax benefits of both SA and Mauritius, it is evident that SA's tax incentives are comparable to the tax incentives offered by Mauritius. There is one major advantage that Mauritius has that SA is unlikely to compete with.

The major difference with regard to tax factors is the corporate income tax rate. With non-tax factors, Mauritius currently has the upper hand on SA especially with regard to the promotion of the GBC1 regime.

It should also be noted that SA has been able to provide great tax incentives, taking into consideration the vast difference in the two economies and population of each country. SA cannot be too generous in the benefits it provides to HQC's as the revenue it collects is used extensively for the sizable government expenditure and more importantly, the thousands of individuals who depend on the State for social grants.

As discussed earlier in this study, the non-tax factors are now the major barriers to the success of SA. It is also clear from the discussion that the tax factors are not an issue for a successful SA HQC regime. Approximately 3 to 4 years ago, the non-tax reasons in SA were not a barrier,

¹⁴⁰ Where the SA HQC sells equity shares in a non-resident company in which it holds not less than 10 per cent shares in, such sale will not qualify as a disposal for capital gains tax purposes.

in fact these factors made SA a good contender to being the preferred location for foreign investment into Africa. The drastic change in SA's political stability and good economy has set SA backwards as a gateway into Africa. The improvements to the tax reasons have made a difference to SA's success as a location for a HQC regime, however, the sudden change with the non-tax factors has negatively affected the improvement of the HQC regime.

It is clear from the study in this chapter that with regard to the tax factors, SA is a competitor rivalling Mauritius as a location for the establishment of a HQC for multinational companies, which begs the question as to why SA is still lagging at second place. The answer lies in the knowledge and marketing of each of the regimes.

4.4 LESSONS FROM MARITIUS

Thabo Legwaila concludes in his thesis that the South African tax system in general is not based on attracting foreign direct investment and that too much relaxation of the tax laws would compromise SA's tax base and revenue.¹⁴¹

It would, therefore, not be ideal for SA to relax tax legislation to match Mauritius' tax incentives in order to attract foreign investment into SA. However, there are certain issues one should consider in order to determine whether SA could learn anything from Mauritius in improving the South African HQC regime.

4.4.1 Decrease of corporate income tax rate

The difference in the two corporate income tax rates provides Mauritius with an immense advantage over SA. In learning from Mauritius regarding a low corporate income tax rate, it would require SA to either reduce the rate for the HQC's specifically or reduce the rate for all companies.¹⁴²

¹⁴¹ Legwaila (note 1 above) page 359.

¹⁴² Legwaila (note 1 above) page 340.

However, prior to any adjustment of the corporate income tax rate being considered as an incentive to encourage multinationals to establish HQC's in SA, it is important to consider the tax consequences of each scenario.

A reduction in SA's corporate tax rate for HQC's only would amount to unfair tax competition as the percentage would be lower than majority of the countries that SA does business with and the decrease could result in most taxpayers restructuring their businesses in order to avail themselves of the lower rate.¹⁴³ This would further disadvantage SA as certain company groups would look to establishing intermediary companies outside of SA in order to hold shares in the South African company.¹⁴⁴

The better option would be a reduction applicable to all companies in SA. However, this could lead to adverse consequences as previously, a reduction of 1 per cent from 30 per cent to 29 per cent in 2005 reduced tax revenue by R2 billion.¹⁴⁵

From the discussion above, a decrease in the corporate income tax rate for all taxpayers would not be beneficial to the Fiscus and ultimately not ideal for SA. However, the decrease of the corporate income tax rate for HQC's only, although unfair to other taxpayers, could attract foreign investors and still protect the Fiscus.

The decrease in corporate income tax coupled with the great tax incentives that SA already has in place could attract more foreign investors, resulting in a successful HQC regime. A successful HQC regime could result in an increase in the tax base as there may be an increase in taxpayers as foreign multinationals start to use SA as the preferred location for investment in Africa. There would be no loss to the Fiscus, only the benefit of an increased tax base, leading to a possible increase in the revenue, especially where the SA HQC employs highly skilled individuals who will also increase the tax base.

¹⁴³ Legwaila (note 1 above).

¹⁴⁴ Legwaila (note 1 above).

¹⁴⁵ National Treasury *Budget Review* (2005) 83.

4.4.2 *Promotion of the South African HQC*

Mauritius realised and capitalised on the idea of attracting foreign investment as it was clear that multinational companies were interested in investing in Africa. In capitalising on the idea, the Mauritian government structured its tax and financial system creating a tax environment that is favourable to HQC operations.¹⁴⁶

The Mauritian government has created a tax favourable environment by adjusting its tax system in order to make it an even more attractive country to invest in.¹⁴⁷ These constant and beneficial adjustments are a combination of recommendations considered by tax and economic experts who consider incentives that are attractive to foreign investors.¹⁴⁸

By ensuring that the tax law benefits the foreign investors, Mauritius is able to attract foreign investment and it also ensures that foreign investors are aware of the benefits of having a HQC in Mauritius by actively encouraging foreign investment.¹⁴⁹

Mauritius is specifically focused on foreign investment and has promoted foreign investment as Mauritius' best attraction to the international community. The idea has been promoted so much so that Mauritius has been the most successful headquarter company regime for more than 20 years.¹⁵⁰

SA, on the other hand has been unsuccessful in developing a successful HQC regime to the extent that National Treasury had to scrap the first HQC regime and amend tax legislation in order to develop SA into a more attractive location for foreign investment.

National Treasury's second attempt at establishing a successful HQC regime has been more successful as SA is now one of the top two countries that are ideal locations for the establishment of a HQC for multinational companies interested in investing in Africa. One of the major barriers to the success of the HQC regime is the poor marketing and promotion of the HQC regime.

¹⁴⁶ Legwaila (note 1 above) page 336.

¹⁴⁷ Legwaila (note 1 above) page 198.

¹⁴⁸ Legwaila (note 1 above) page 198.

¹⁴⁹ Legwaila (note 1 above) page 196.

¹⁵⁰ Legwaila (note 1 above) page 195.

The current tax provisions for HQCs are conducive for the establishment and development of a successful HQC regime. As the environment is conducive, National Treasury should take this opportunity and follow in the footsteps of Mauritius by promoting and advertising the tax incentives offered by the South African HQC regime. The HQC regime has been severely under-utilised due to the fact that there is insufficient promotion of the tax incentives of the HQC regime.

Upon optimising and capitalising on the tax incentives available to HQC's, National Treasury will be placing SA on the same playing field as Mauritius in being the perfect location for the establishment of a HQC for multinational companies interested in investing in Africa.

4.5 SUMMARY

The comparison between SA and Mauritius illustrates that there are not many differences with regard to the tax incentives offered by each jurisdiction. The most advantageous tax incentive is Mauritius' low corporate income tax rate. It is not advisable however for SA to decrease its corporate income tax rate for all SA companies as this could result in a loss in revenue as has been proven by SA's previous attempt at decreasing the corporate income tax rate in 2005. It could however be beneficial for SA if it decreased the corporate income tax rate for HQC's only. The decrease coupled with the great tax incentives for HQCs as discussed above would attract more foreign investors into SA.

The tax incentives available for South African HQCs may be amended to decrease the corporate income tax rate so as to attract foreign investors. The other tax incentives discussed above are on par with Mauritius' tax incentives and do not need to be amended in order to make SA a more attractive location for multinational companies interested in investing in SA.

The main lesson that SA can learn from Mauritius is the targeted and relentless promotion of the tax incentives offered by the HQC regime. By promoting the tax incentives provided by the HQC regime, SA will be able to compete with Mauritius in being the preferred location for the establishment of a HQC for multinational companies interested in investing in Africa.

CHAPTER 5

5. CONCLUSION

5.1 INTRODUCTION

Mauritius is currently the preferred country for the establishment of a HQC regime for multinational companies that are interested in investing in Africa. For this reason, it was only logical to consider and analyse Mauritius for a comparative study between Mauritius and SA in determining the factors required to improve SA's HQC regime. With its successful GBC1 regime and similarities to SA, Mauritius is the most ideal country which SA can learn from in developing and establishing a successful HQC regime.

The comparison and analysis of the legislation and literature on the tax incentives offered by HQC regimes in Mauritius and SA shows that these countries are competitive in the benefits that each country offers. One of the objectives of the study was to determine whether SA can learn from Mauritius' GBC1 regime in becoming the preferred country in which to establish a successful and thriving HQC regime. It is apparent from the study that the tax provisions governing the SA's HQC regime are no longer a barrier to the success of SA's HQC regime

As the South African tax legislation provides the necessary tax incentives to establish a thriving HQC regime, the main question remained as to the reasons why Mauritius still had an advantage over SA as the most preferred country for the establishment of a HQC in Africa.

5.2 RATIONALE OF THE STUDY

The main objective of this research was to establish whether SA could learn from the Mauritian GBC1 regime, in order to become the preferred country for the establishment of a HQC for multinational companies interested in investing in Africa.

In responding to the research question, the legislation of both countries was discussed and analysed in chapters 2 and 3 of this research. Due to the fact that there were numerous tax incentives that each country offered, the study focused on dividends tax, the DTA network and the foreign tax rebates. The focus was on these tax incentives as both countries offered substantial benefits with regard to these specific incentives, making the comparison between

the two countries a fair comparison and one worth analysing as opposed to incentives where one of the countries had a clear advantage, like CGT implications.

Thereafter, a comparison and analysis of the two countries was discussed in chapter 4 of this study. The analysis revealed that Mauritius is the best country for a HQC regime when one considers the non-tax factors for a HQC regime. However, SA is a sure competitor for Mauritius with regard to the tax incentives that each country offers in its HQC regime.

From a tax perspective, National Treasury has been able to elevate SA to a standard where it is able to compete with Mauritius for the perfect location for the establishment of a HQC for multinational companies interested in investing in Africa. National Treasury was able to get it right the second time around by ensuring that SA is able to provide certain concessions that are enticing to foreign investors. The study discusses two major lessons that SA can consider from Mauritius' successful GBC1 regime when looking at how it can improve the current SA HQC regime.

The first lesson discussed was the decrease of the corporate income tax rate in order to close the gap of 13 per cent between the SA corporate income tax rate of 28 per cent and Mauritius' corporate income tax rate of 15 per cent. In certain circumstances, the difference is greater as the Mauritius rate can decrease to 3 per cent. The issue with a decrease of the corporate income tax rate for SA is that such decrease can lead to a loss of revenue, as has happened previously when SA decreased the tax rate in 2005.

It would also not be beneficial for SA to only decrease the corporate income tax rate for HQCs as this could result in most taxpayers restructuring their businesses in order to avail themselves of the lower rate.¹⁵¹ This would further disadvantage SA as certain company groups would look to establishing intermediary companies outside of SA in order to hold shares in the South African company.¹⁵²

The second lesson discussed was the focused and aggressive promotion of the HQC regime. The international community is well aware and informed of Mauritius' tax incentives for the

¹⁵¹ Legwaila (note 1 above).

¹⁵² Legwaila (note 1 above).

GBC1. This is evidenced by the fact that Mauritius is the leading country for the establishment of a HQC, regardless of whether or not Mauritius is considered a tax haven.

The Mauritian government capitalised on its location and non-tax factors by ensuring that its tax laws are enticing to foreign investors. The non-tax factors are the reason that companies decide on a location for a HQC, however the tax factors are an added advantage. Tax is a cost of doing business, but if there are great tax incentives, these incentives are a consideration that can push the business into choosing one country over another country. There are other African countries that have great non-tax factors, but none offer the great tax incentives that Mauritius offers.

If SA can take the same approach of informing the international community of the tax incentives offered by the HQC regime, the regime could accelerate in its development and thrive as SA has great tax incentives, especially considering how Mauritius has constantly had to defend itself against allegations of being a tax haven.

5.3 SUMMARY

SA's tax provisions regarding HQCs do not need to be improved as they no longer create the barriers that had previously discouraged foreign investors from establishing HQCs in SA with the intention of investing in Africa. In fact, the tax provisions provide tax incentives that rival and compete with those provided by the most successful HQC regime in Africa.

The tax provisions are not only enticing to foreign investors but also beneficial to SA as they do not erode the tax base by compromising the amount of revenue that SA receives. The tax provisions are also beneficial in that they are not relaxed to the point where SA can be considered a tax haven, unlike Mauritius. The tax provisions are not a deterrent to enticing foreign investment, in fact if the decision to establish a HQC were only based on tax incentives, SA would be a sure contender in being the most attractive country in which to do so. The non-tax factors are however an issue.

National Treasury should focus and work towards the aggressive promotion of the HQC regime with specific focus on the tax incentives that SA offers in the HQC regime. It will be beneficial for SA where the international community is not only made aware of the extensive tax incentives but also the fact that SA does not have the risk of being considered a tax haven.

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10 January 2019

Ms Ayanda Success Masina (206508425)
School of Law
Howard College Campus

Dear Ms Masina,

Protocol reference number: HSS/0695/016M

New project title: What South Africa can learn from Mauritius in order to be the preferred country for multinational companies to establish a headquarter company in Africa

Approval Notification – Amendment Application

This letter serves to notify you that your application and request for an amendment received on 11 December 2018 has now been approved as follows:

- Change in Title

Any alterations to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form; Title of the Project, Location of the Study must be reviewed and approved through an amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for period of 3 years from the date of original issue. Thereafter Recertification must be applied for on an annual basis.

Best wishes for the successful completion of your research protocol.

Yours faithfully



.....
Dr Rosemary Sibanda (Chair)

/ms

Cc Supervisor: Mr Chris Schembri and Dr Shannon Bosch
Cc Academic Leader Research: Dr Freddy Duncan Mnyongani
Cc School Administrator: Mr Pradeep Ramsewak

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