

# The nature of a headquarter company: a comparative analysis\*

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## OPSOMMING

### Die Aard van 'n Hoofkwartiermaatskappy: Die Onderskeid tussen 'n Hoofkwartiermaatskappy en Soortgelyke Entiteite Werksaam in die Internasionale Sfeer

Ten einde Suid-Afrika as 'n poort vir belegging in Afrika te bevorder, het die Suid-Afrikaanse Nasionale Tesourie in 2011 die hoofkwartiermaatskappy reguleering bekendgestel. Dit behels dat, kragtens wysigings van belastingswetgewing, die bepaalde struikelblokke wat verhoed dat hoofkwartiermaatskappye na Suid Afrika gelok word, verwyder word. Maatskappye met sekere kwalifiserende strukturele eienskappe geniet spesiale belastingbehandeling ten einde belegging in die vorm van hoofkwartiermaatskappye te bevorder. Verskeie internasionale maatskappye se strukture stem egter ooreen met die eienskappe van hoofkwartiermaatskappye. In sommige gevalle word die funksies wat deur hierdie entiteite verrig word, gekombineer wat tot gevolg het dat dit die hoofkwartiermaatskappy-funksies van ander entiteite verrig en andersom. Dit skep die geleentheid vir sommige maatskappye, wat nie hoofkwartiermaatskappye is nie, om onbewustelik of bewustelik die voordele wat gemik is op hoofkwartiermaatskappye te verkry. 'n Hoofkwartiermaatskappy is onderskeibaar van verskeie ander vorme van maatskappye wat besigheid in die internasionale sfeer bedryf. Hierdie artikel bespreek die aard van 'n hoofkwartiermaatskappy en onderskei dit van ander soortgelyke entiteite. Dit dui aan dat, alhoewel daar verskeie en verskillende ooreenkoms tussen hoofkwartiermaatskappye en hierdie entiteite is, die funksie en struktuur van hoofkwartiermaatskappye hulle onderskei van die ander entiteite. Dit is belangrik dat die aard van 'n hoofkwartiermaatskappy nie met die van die ander entiteite verwarr moet word nie. Indien die hoofkwartiermaatskappy met ander entiteite verwarr word sal dit lei tot oningesigte besluite en dat eienskappe daaraan toegedig word wat tot belastingaanslae of verwagtinge in verskillende jurisdiksies kan lei.

## 1 Introduction

A company is a common vehicle for investors to conduct business operations. It is common cause that companies are used in both national and international business operations by investors to operate within or

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outside the country where the investor is resident. Various forms of companies can be formed to perform various functions. Investors choose the company variation that would best suit their interests both nationally or internationally. At an international level, an investor that seeks to centralise administrative and management functions of a group of companies would generally set up a headquarter company that would perform those functions. Headquarter companies are a common feature in international commerce and business operations. Their operations and successes are influenced by a myriad of frameworks, including the legal, regulatory and tax.

The South African National Treasury announced in the 2010 Budget review,<sup>1</sup> and reiterated in the 2011 Budget Review,<sup>2</sup> that it intends to promote South Africa as a gateway to investment into Africa. Furthermore legislation has been amended in order to remove any identified impediments to attracting headquarter companies to South Africa.<sup>3</sup> The 2011 tax laws amendments contain adjustments to the corporate tax laws and exchange control regulations that would enable South Africa to host headquarter companies.<sup>4</sup>

Companies with certain specific structural characteristics (“qualifying companies”) qualify for special tax treatment afforded for purposes of attracting investment in the form of headquarter companies. Various international companies’ structures have similar characteristics with headquarter companies. This makes it possible for some companies that are not headquarter companies to inadvertently or purposefully access the benefits aimed at headquarter companies. A headquarter company is distinguishable from various forms of companies conducting business in the international space. The main distinction relates to the characteristic functions of the companies. A headquarter company is a holding company designed for specific (management and administrative) purposes in a group of companies. Therefore this article starts off by outlining the nature of a holding company and its functions.

## 2 Holding Company

A holding company is generally defined as a company whose main purpose is to hold shareholdings in other companies.<sup>5</sup> “The term is

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1 National Treasury *Budget Review* (2010) 78-79

2 National Treasury *Budget Review* (2011) 73, 78-79. See also Lermer “2010 Budget Attracts SA Based Headquarter Companies” *Moneyweb* available at [http://www.moneyweb.co.za/mw/view/mw/en/page302588?oid=347864&s\\_n=2009%20Detail](http://www.moneyweb.co.za/mw/view/mw/en/page302588?oid=347864&s_n=2009%20Detail) (accessed 2012-04-01); Legwaila “The Tax Treatment of Holding Companies in Mauritius: Lessons for South Africa” 2011 *SA Merc LJ* 1

3 See Taxation Laws Amendment Act 7 of 2010; ss 9I, 10B ITA.

4 Ss 26, 27 Taxation Laws Amendment Act 24 of 2011. See also ss 1, 9I, 9D, 10(1)(k)(ii), 20C, 31(3), 41(1), par 64B ITA.

5 See International Bureau for Fiscal Documentation (IBFD) *International tax Glossary* (2005) definition of “holding company”.

sometimes used more loosely to refer to companies holding other assets, such as a patent, licence or similar investments.”<sup>6</sup> Holding companies typically hold substantial majority shareholdings in other companies to ensure control of the management, business and capital of the companies they hold.

There are many business-driven motives for establishing a holding company. A holding company can provide a means to own and manage a group of affiliates or subsidiaries in a particular region. The setting up of a holding company can also result in operational and financial efficiencies, in particular when bundled with other business functions, including broader regional headquarter and management functions, group shared services, financing, cash management, and/or intellectual property (IP) ownership and management.<sup>7</sup>

The reasons often cited for the formation of a holding company include<sup>8</sup> (i) the desire to consolidate the company’s current (and future) foreign subsidiaries under one foreign holding company structure for management and reporting purposes; (ii) the creation of a platform for future business acquisitions, joint ventures and other business opportunities; (iii) to act as a gateway for growth and expanding business operations in new markets and regions; increased financial flexibility and the creation of an efficient vehicle for the redeployment of cash among foreign operations, thereby facilitating the use of internal funding of operations and expansion; (iv) improved treasury efficiency and financial risk management, by permitting foreign cash, foreign currency receipts and disbursements, and inter-company loans and other transactions to be consolidated, netted and managed within the holding and financing structure; (v) facilitation of raising capital offshore thereby enhancing the enterprise’s capital structure; (vi) positioning the company to more effectively reduce foreign income taxes through, for example internal financing and leveraging; (vii) to better manage and exploit IP; (viii) enabling access to the European Community (EC) Directives and/or tax treaty networks reducing withholding taxes on dividend, interest and royalty flows; and (ix) facilitation of the preparation of a sub-consolidation of the combined foreign operations of the company for financial reporting purposes.<sup>9</sup>

As can be seen, a holding company can fulfil a wide variety of functions. The concept of a holding company covers such a wide range

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<sup>6</sup> *Ibid.*

<sup>7</sup> See IBFD “Introduction to Holding Activities” [http://online2.ibfd.org/collections/hold/html/hold\\_introduction.html](http://online2.ibfd.org/collections/hold/html/hold_introduction.html) (accessed 2012-09-22) par 1.1.

<sup>8</sup> *Ibid.*

<sup>9</sup> For a further discussion of the functions of a headquarter company in different country structures see Pfaar “Inbound Investment from a European Perspective” (2003) *Int Tax R* <http://www.internationaltaxreview.com/Default.asp?Page=17&PUBID=211&ISS=13163&SID=488044&SM=&SearchStr=%22intermediary%20holding%20company%22> (accessed 2012-10-28); see also Legwaila “Intermediary Holding Companies and Group Taxation” 2010 *De Jure* 308 313.

of attributes that it lacks specificity. This general nature makes it such that it can combine a host of characters of various holding companies established for specific functions. A headquarter company is a holding company established and discharging some of the specific functions outlined above.

### **3 Defining a Headquarter Company**

#### **3 1 Headquarter Company in General**

International headquarter companies are often formed where multinational groups of companies have significant economic interests in a region which is distant from its head office to oversee and co-ordinate the group's business interests in a particular region.

Such centres will usually provide the full range of administrative and management functions associated with a head office; for example, treasury and tax management, internal audit, public relations, market research and marketing, insurance and accounting.<sup>10</sup>

It is, therefore, not infrequent that a group of companies would have multiple international headquarters each serving group companies in contiguous countries within a particular region.

#### **3 2 South African Headquarter Company**

For South African purposes a company qualifies as a headquarter company if it satisfies the five main requirements, four of which are substantive and one is administrative.<sup>11</sup> The four main substantive requirements are as follows:

Firstly, the company must be a South African resident company.<sup>12</sup> For South African tax purposes a company is tax resident if it is incorporated, established or formed in the Republic or has its place of effective management in the Republic.<sup>13</sup> However, the definition excludes a company which is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation.<sup>14</sup>

Secondly, each shareholder in the company must have held at least 10 per cent of the equity shares and voting rights in that company for the duration of that year of assessment and of all previous years of assessment of the company. The 10 per cent holding can be either alone

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10 Ogley *Principles of International Tax: A Multinational Perspective* (1993) 137.

11 S 9(1) ITA.

12 S 9(1)(a) ITA.

13 Par (b) s 1 ITA definition of "resident".

14 Proviso to s 1 ITA definition of "resident".

or together with any other company forming part of the same group of companies as that shareholder.<sup>15</sup>

Thirdly, at the end of the year of assessment and of all previous years of assessment of that company, 80 per cent or more of the cost of the total assets of the company must be and must have been attributable to one or more of the following: (i) interest in equity shares in; (ii) an amount loaned or advanced to; or (iii) an IP as that is licensed by that company to, a foreign company.<sup>16</sup> The foreign company must hold at least 10 per cent of the equity shares and voting rights (whether alone or together with any other company forming part of the same group of companies as that company). In determining the total assets of the company, any amount in cash or in the form of a bank deposit payable on demand is not taken into account.<sup>17</sup>

Fourthly, where the gross income of that company for that year of assessment exceeds R5 million, 50 per cent or more of that gross income must have consisted of amounts in the form of one or both of: (i) rental, dividend, interest, royalty or service fee paid or payable by any foreign company or (ii) proceeds from the disposal of any interest or of any IP.<sup>18</sup>

Fifthly, from an administrative point of view, in order to be a headquarter company, a qualifying company has to make an election to be treated as such for tax purposes for the year of assessment of that company. An election has to be made in a form and manner determined by the Commissioner.<sup>19</sup>

## 4 Distinction between a Headquarter Company and Other Similar Entities

As has been stated above, various international companies' structures have similar characteristics with headquarter companies. However, a headquarter company is distinguishable from various forms of companies conducting business in the international space. In the discussion that follows, corporate forms that have substantially similar structural or functional characteristics with headquarter companies at an international level are examined in order to draw clear distinctions between these corporate forms and headquarter companies.

### 4.1 Intermediary Holding Company

The primary functions of an intermediary holding company are to acquire, manage and sell investments in group companies, mainly its subsidiaries and in general to provide transactional and organisational

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15 S 9I(2)(a) ITA.

16 S 9I(2)(b) ITA.

17 Proviso to s 9I(2)(b) ITA.

18 S 9I(2)(c) ITA.

19 S 9I(1)(b) ITA.

flexibility in a group of companies.<sup>20</sup> In the context of a group's business, an intermediary holding company in an appropriate jurisdiction enhances the group's transactional flexibility and assists in establishing a robust offshore group structure. The intermediary holding company also serves to provide a means to centralise and manage international cash flows. It serves as a focal point to deploy one entity's earnings to other entities within the global enterprise.<sup>21</sup>

These functions are not tax-related. The tax is an element that is considered and provided for in order to ensure that it does not make the achievement of the group's economic purpose more expensive than it should be. As a result, in practice, the decision to form an intermediary holding company is made by financial managers rather than tax managers.

Enhanced flexibility within a group caters for acquisitions, reorganisations, disposals, offshore listing, reducing the impact of exchange control rules and free flow of funds. As an addition to these benefits, the intermediary holding company can also offer a maximisation of after-tax fund flows. However, it should be noted that the goals of the group may necessitate the interposition of an intermediary holding company even if that would result in an increased tax liability for the group. In this case the benefit of interposing an intermediary holding company will be weighed against the additional tax liability. Depending on the specific functions required to be performed by the intermediary holding company, it is often beneficial to the group to incorporate the intermediary holding company in a jurisdiction where the operations of the group take place.

Generally, intermediary holding companies are not engaged in commercial trade or business. Where their functions are extended, they would normally be for the purposes of reinvesting excess dividends at the level of the intermediary holding company to obviate the need to remit the dividends to the ultimate holding company or shareholders, where such action has tax and exchange control disadvantages.<sup>22</sup>

The main difference between a headquarter company and an intermediary holding company is that the purpose of the intermediary holding company is not to provide management and administrative services to the group. Its role is limited to financial and structural

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20 The basis of the discussion on the functions of a holding company emanates from a discussion on this topic with Mr Serge de Reus, Partner/Director of Corporate International Tax at PriceWaterhouseCoopers on 2008-09-19 in Sunninghill, Johannesburg.

21 Global Strategies (Supplement – Energy 2002) *Int Tax R* <http://www.internationaltaxreview.com/?Page=17&PUBID=211&ISS=13174&SID=487921&SM=&SearchStr=%22intermediary%20holding%20company%22> (accessed 2012-11-12).

22 Olivier & Honiball *International Tax – A South African Perspective* (2011) 690.

functions. However, its functions can be combined with those of an international headquarter company. As Ogley<sup>23</sup> states,

[w]here a multinational holds overseas investments through an intermediate holding company, it makes good commercial sense to arrange for any regional co-ordination function to be undertaken by that company as this will lend substance and help demonstrate that it is indeed resident in that country.

Following Ogley, the fact that an intermediary holding company may undertake the regional co-ordination functions of a headquarter company demonstrates that the two are distinct entities.

## 4.2 International Holding Company

An international holding company is a company that controls one or more companies in jurisdictions other than the jurisdiction in which it is resident.<sup>24</sup> Such company is generally accepted to be resident in a country where it is tax-resident in terms of the laws of that country after taking into account any treaties applicable.<sup>25</sup> Where such company is incorporated in a country which has no tax treaties, or has no tax treaties with the investor's country and its subsidiaries' countries, double taxation problems may arise.<sup>26</sup> Similarly, where a headquarter company is not regarded as a resident in a country from which it operates and therefore cannot access tax treaty benefits, double taxation problems exist.

A pure international holding company is confined to managing and holding investments while a mixed international holding company also engages in other commercial activities.<sup>27</sup> The latter helps global tax planning and may help defer payment of dividends to the home country.<sup>28</sup>

The fundamental and foremost distinction between an international holding company and a headquarter company is that an international holding company can be an ultimate holding company of a group of companies whereas a headquarter company is interposed between operating subsidiaries and a company normally based in the investor's jurisdiction. A headquarter company could also only be held indirectly and ultimately by a company in the investor's jurisdiction.

International holding companies are mostly used within multinational company groups to centralise the management of the group companies

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23 Ogley 137.

24 Holmes *International Tax Policy and Double Tax Treaties* (2007) 23

25 *Ibid.* See also Importer's Database *Holding Companies* [http://www.export-import-companies.com/holding\\_company\\_-\\_definition.htm](http://www.export-import-companies.com/holding_company_-_definition.htm) (Accessed 2012-06-14).

26 Holmes 23.

27 Rohatgi *Basic International Taxation* (2001) 238.

28 *Ibid.*

in a certain geographical area. In such cases they take the form of international management companies.<sup>29</sup>

### **4.3 Offshore Holding Company**

An offshore holding company is almost identical to an international holding company. The essential difference between the two is that the emphasis of an offshore holding company is that it is located outside the country of residence of the investor.<sup>30</sup> It is not focused on holding controlling rights in companies in other jurisdictions. It also lacks the central location of control of multinationals that is a feature of headquarter companies.<sup>31</sup>

Olivier and Honiball submit that “[t]he term ‘offshore holding company’ is usually used for holding companies incorporated in a tax haven”.<sup>32</sup> In this form, the main reason for removing the control of the company would be to benefit from the often lax tax system in the tax haven. Such use of the offshore holding company is probably minimal and limited as countries generally relentlessly enact provisions to combat the erosion of their tax bases in this way. Furthermore, countries heed to put international pressure not to conduct business with companies located in tax havens. Controlled foreign companies legislation, transfer pricing rules and the United States’ recently introduced Foreign Account Tax Compliance Act<sup>33</sup> are examples of such provisions.

### **4.4 Foreign Financial Instrument Holding Company**

A foreign financial instrument holding company is a purely South African domestic tax system creation. It is compared to a headquarter company in this article due to the fact that the headquarter company that forms the subject of this article is expected to operate within South Africa. It is therefore important to distinguish the headquarter company from a foreign financial instrument holding company.

A foreign financial instrument holding company is defined in the Act for the purposes of the foreign business establishment exemption<sup>34</sup> in section 9D(1) and in section 41(1) for group reorganisation rules in section 42 to 47 of the Act.<sup>35</sup>

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29 <http://www.b2bfreezone.com/product-search/international-management-company.htm> (accessed 2013-01-16).

30 Olivier & Honiball 297

31 Olivier & Honiball 297.

32 See also Olivier & Honiball 689. See also “Why Choose an Offshore Company?” <http://www.icsl.com/pages/why.html> (accessed 2012-07-31).

33 See details of the Foreign Account Tax Compliance Act on <http://www.irs.gov/businesses/corporations/article/0,,id=236667,00.html> (accessed 2012-10-20).

34 The business establishment exemption has been replaced by the foreign business establishment exemption by s 9(1)(a) Revenue Laws Amendment Act of 2006.

35 The s 9D(1) ITA definition refers to a foreign financial instrument holding company as defined in s 41 ITA.

A foreign financial instrument holding company is defined as

a foreign company where more than the prescribed portion of all the assets of that company, together with the assets of all its influenced companies in relation to that foreign company, consists of financial instruments ...<sup>36</sup>

Simply put, it is a foreign company where more than 50 % of the market value or two-thirds of the actual cost of the company and all controlled group companies consist of financial instruments<sup>37</sup> (subject to certain exclusions).<sup>38</sup> Thus, a foreign company would be a foreign financial instrument holding company if in aggregate all its assets together with those of all influenced companies consist of financial instruments.<sup>39</sup>

In determining whether the prescribed portion consists of financial instruments the following are not taken into account:

- (a) Firstly, financial instruments that consist of debts due to the foreign company, or to any controlled group company in relation to the foreign company, in respect of goods sold or services rendered by that foreign or controlled group company, as the case may be, where (a) the amount of the debt is or was included in either the foreign company or controlled group company; and (b) the debt is an integral part of a business conducted as a going concern by the foreign company or controlled group company.<sup>40</sup>
- (b) Secondly, any financial instrument arising from the principal activities of the foreign company or of a controlled group company in relation to the foreign company which is a bank, insurer, dealer or broker with a licence or registration that allows the foreign company or the controlled group company to operate in the same manner as a company that mainly conducts business with clients who are residents in the same country of residence as the foreign company. To qualify for the exemption, the foreign company or controlled group company has to either regularly accept deposits or premiums for the general public or effect transactions with the general public or derive more than 50 % of its income or gains arising from principal trading activities with persons who are connected persons to the foreign company.<sup>41</sup>

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<sup>36</sup> See s 41(1) ITA.

<sup>37</sup> See the definition of "Foreign Financial Instrument Holding Company" in s 41 ITA.

<sup>38</sup> See definition of "prescribed portion" in s 41(1) ITA.

<sup>39</sup> This allows the foreign holding company to escape the foreign financial instrument holding company tag even if it has assets that consist only of financial instruments, provided, when aggregated with those of its subsidiaries, the prescribed portion does not consist of financial instruments.

<sup>40</sup> Par (a) definition of "Foreign Financial Instrument Holding Company" in s 41 ITA.

<sup>41</sup> Par (b) definition of "Foreign Financial Instrument Holding Company" in s 41 ITA.

- (c) Thirdly, any financial instrument held by a controlled group company in relation to the foreign company if the foreign company is a specified controlled group company.<sup>42</sup>

In the calculation of the market value or actual cost of the assets, shares held in another company in the same group and inter-group financial instruments consisting of a loan, advance or debt are disregarded.

The foreign financial instrument holding company rules have been designed to curb tax avoidance. The tax treatment of a foreign financial instrument holding company excludes it from deriving the tax benefits that ordinary companies derive. Two disadvantages of qualifying as a foreign financial instrument holding company are worth mentioning. Firstly, paragraph 64B of the Eighth Schedule to the Act, which provides for an exclusion of gains (or losses) from the disposal of any interest in the equity share capital of a foreign company where the disposing company holds more than 20 % of the shares in the foreign company whose shares are disposed, does not apply where the company whose shares are disposed is a foreign financial instrument holding company.<sup>43</sup> Secondly, the net income of a foreign financial instrument holding company is not eligible for the foreign business establishment exemption in the hands of its South African resident shareholders in terms of section 9D(9)(b)(iii) of the Act.

A significant feature of a foreign financial instrument holding company that distinguishes it from a headquarter company is that while the assets of a foreign financial instrument holding company and its subsidiaries consist of financial instruments, the assets of a headquarter company's subsidiaries do not primarily consist of financial instruments. Subsidiaries of a headquarter company are mainly operating companies that carry on business other than holding and trading in financial instruments. Therefore, its assets would generally consist of tangible assets, such as plant and machinery.

#### 4 5 Foreign Base Holding Company

The notion of a foreign base company emanates from the idea or existence of base countries. A foreign base company is an element in the concept of a base country.<sup>44</sup> An ideal foreign base of incorporation is a country which imposes only negligible income or capital tax, or no taxes at all, on income or certain of the income of its domestic corporations derived from sources outside the base country.<sup>45</sup> The purpose of such

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42 Par (c) definition of "Foreign Financial Instrument Holding Company" in s 41 ITA.

43 The exemption is subject to certain further requirements which are beyond the scope of this article.

44 "Foreign Holding Company Income Changes (International Taxation)" <http://www.nysscpa.org/cpajournal/old/07950850.htm> (accessed 2012-07-28).

45 See De Broe *International Tax Planning and Prevention of Abuse* (2008) 41–46; Gibbons "Tax Effects of Basing International Business Abroad" 1956 *Harv LR* 1207.

base companies is to conduct third-country operations. Third-country operations include conducting business through agents or branches with holding companies deriving passive income from foreign subsidiaries.<sup>46</sup>

The essential element of a foreign base company is that it is used as a shareholder of companies conducting businesses outside the base country.

This business may either be outside the ‘home country’ where the shareholders or other beneficial owners live or are resident (in third countries other than the home country), or it may even be business within the home country<sup>47</sup>

of the shareholders or the beneficial owners.

The essential characteristics of a base company are as follows:<sup>48</sup>

- (a) Two or more interstate relationships;
- (b) Legal or factual control; this can be control by two or more persons together;
- (c) The economic interests lie wholly or mainly outside the base country. The (economic) function of the base is that of a circuit or at least a roundabout;
- (d) A (very) advantageous fiscal climate;
- (e) The tax factor dominates the choice of location;
- (f) The base enterprise must have either a legal personality, or, at least, the capacity of being the owner of rights, like a *Liechtenstein Ansatz*, which may not have legal personality;
- (g) Base enterprises should be a separate taxable subject. They must not be subjected to the worldwide taxation basis of another (high) tax jurisdiction; and
- (h) In principle, only those functions can be attributed to a base enterprise which could in an economic sense be a separate division or part, in country A, of a firm having its residence in the same country A.

In German literature a distinction is drawn between typical base companies (*typische Basisgesellschaften*), where foreign investment is involved, and atypical base companies (*atypische Basisgesellschaften*), where only home country investment is involved.<sup>49</sup> For South African purposes this distinction might have a serious effect on whether the income of the base company is attributable in terms of the Controlled Foreign Companies (CFCs) diversionary rules, if the base company is a CFC.<sup>50</sup>

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46 Rotterdam Institute for Fiscal Studies (RIFS) *International Tax Avoidance, Volume A, General and Conceptual Material* (1979) 50.

47 *Ibid.*

48 *Idem* 51–52. See also De Broe 41–50

49 RIFS 51.

50 The diversionary rules are contained in s 9D(9) ITA.

The Rotterdam Institute for Fiscal Studies states that

[t]he general conclusion is that, under the heading of these broad definitions, there are many possible kinds of base companies, some with a single function, some with several functions, and some which combine base-company functions with 'normal' industrial or commercial activities.<sup>51</sup>

The essential requirements of low tax and the fact that the tax factor dominates the choice of location might pose problems in many jurisdictions. Furthermore, the fact that the base country levies no or minimal taxes on the income of the base companies may result in the country being regarded as a tax haven and thus disadvantage the position of the base country. Such are not essential elements of a headquarter company and are central to the distinction between base companies and headquarter companies. Furthermore, the headquarter company does not conduct its primary business through agents.

#### **4 6 Foreign Group Finance Company**

A foreign group finance company is a company located in a foreign jurisdiction for the purpose of controlling the finances of the group of companies.<sup>52</sup> It can be referred to as the treasury of the group or the finance house. The main assets of the foreign group finance company are finances and financial instruments. This company can provide the group with finances from its own capital or may borrow and lend on the finances to group companies.<sup>53</sup> In this way it intermediates between lenders and borrowers. It also serves for the transmission of loans from one country to another. Mostly foreign group finance companies have higher credibility to borrow and are located in jurisdictions where lending practices are not strictly regulated.<sup>54</sup>

Referring to the foreign group finance company, Honiball and Olivier state that:

[t]he fiscal purposes here are the payment of little or no tax on the interest receipts, entitlement of tax deductibility for interest paid in high-tax jurisdictions, and the reduction or annihilation of withholding taxes on interest through the operation of tax treaties.<sup>55</sup>

The authors furthermore state as follows:

Reasons for having such a centralised finance entity include funding and monitoring the fixed and floating capital requirements of group companies, providing centralised exchange rate and interest rate risk, financial management services to group companies, managing group liquidation

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51 RIFS 52.

52 *Idem* 84.

53 *Ibid.*

54 *Ibid.*

55 Olivier & Honiball 672.

through the use of specialised products like bonds, and managing the repatriation of funds throughout the group.<sup>56</sup>

A foreign group finance company may be established as a fellow subsidiary to the group companies to which it provides treasury support or it can be the holding company of those companies. Where it is the holding company of some group companies (the foreign group holding finance company) some of its activities may resemble those of an intermediary holding company and/or a headquarter company. However, the foreign group finance company does not have the purpose of providing transactional and organisational flexibility in a group of companies, something that is key to the functions of the intermediary holding company. It also does not provide the full range of administrative and management functions associated with a head office as does a headquarter company.<sup>57</sup>

There are considerable similarities between a foreign group finance company and a foreign base holding company and a foreign financial service centre company.

#### **4.7 Foreign Financial Services Centre Companies**

Foreign financial services centre companies derive their name from the jurisdictions that provide for such entities, the foreign financial services centres. The objective of these centres is mostly to provide global financial services with tax benefits for transactions undertaken outside the country of residence of the financial services centre company.<sup>58</sup> Rohatgi<sup>59</sup> states that

[f]or example, [these centres] permit international investors to form tax-beneficial entities in their jurisdictions for various business objectives. These entities may act as holding companies managing overseas investments and activities of a multinational enterprise, or they may accumulate capital lawfully for reinvestment abroad.

Within the Southern African Development Community (SADC), Mauritius and Botswana are the most commonly used financial services centres. In Mauritius the concept of Global Business Licence (GBL) has been adopted to allow resident companies to conduct offshore business with non-residents of Mauritius and in currencies other than the Mauritian rupee. The GBL holders are taxable at the tax-incentive rate of 15% which, coupled with the deemed or presumed foreign tax credit of 80%, reduces the effective tax rate to 3% for these companies.<sup>60</sup>

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56 *Ibid.* See also Spitz *International Tax Havens Guide* (1999) 37.

57 See Ogleby 137.

58 Rohatgi 4.

59 *Ibid.*

60 "Category 1 Global Business Company" <http://www.alliance-mauritius.com/gbl1.php> (accessed 2012-06-22).

In Botswana, the Income Tax Act provides the Botswana Minister of Finance with the powers to provide for the establishment, marketing and operation of an international financial services centre company.<sup>61</sup> This empowers the Minister to issue a tax certificate certifying that the activities of a company are approved financial operations. The approved financial operations include banking and financing operations transacted in foreign currency, the broking and trading of securities denominated in foreign currency, investment advice, and accounting and financial administration.<sup>62</sup>

The tax incentives available to the international financial services centre company are *inter alia* the following:<sup>63</sup>

- (a) Dividends received by the international financial services centre company in respect of qualifying foreign participation are exempt;
- (b) An international financial services centre company is entitled to deduct interest on any loan including debentures or debenture stock;
- (c) An international financial services centre company is entitled to deduct the amount of certain foreign exchange losses;
- (d) An international financial services centre company is granted foreign tax credit on taxes paid in any other countries on income sourced outside Botswana against tax chargeable under the Botswana Income Tax Act; and
- (e) There are no withholding taxes on any payment of interest, royalty or management or consulting fee by an international financial services centre company or dividends to a non-resident of Botswana.

The defining characteristics of these companies are that their countries modify their tax laws to create a fertile environment for an international financial services centre company to operate. Furthermore, these companies' main operations are financial services. This may coincide with other headquarter company operations and result in the headquarter company being a "mixed" headquarter company where such operations are undertaken by the headquarter company. However, it is the above defining characteristics that distinguish the foreign financial services centre companies from headquarter companies.

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61 S 137(1) Botswana Income Tax Act 12 of 1995.

62 S 137(2) Botswana Income Tax Act 12 of 1995. The other operations are management and custodial functions in relation to collective investment schemes, insurance and related services, registrars and transfer agency services, exploitation of intellectual property, and other operations that the minister may declare by order from time to time to be approved financial operations for the purposes of s 137. See also <http://www.kpmg.co.za/content> (accessed 2012-03-16).

63 "International Financial Services Centre Companies in Botswana Tax Law" [http://www.armstrongs.bw/publications/docs/international\\_financial\\_services\\_centre.doc](http://www.armstrongs.bw/publications/docs/international_financial_services_centre.doc) (accessed 2012-03-17).

## 4 8 Intellectual Property Holding Company

The simplest way of defining an IP holding company is that it is a holding company in which IP or rights thereto are held. These are also often referred to as patent holding companies.

These companies have as their purpose and activity the acquisition, exploitation, licensing or sublicensing of patents, trademarks, copyrights, brand names, or other industrial property rights, like 'know-how' on technical or administrative matters.<sup>64</sup>

The purpose of an IP holding company is mainly to minimise or avoid the tax liability on royalty payments by usage of tax treaties and/or low rates in tax havens.<sup>65</sup> Centralised ownership of IP assets offers many advantages which include: Centralised strategic planning; the ability to manage legal, marketing and administrative matters through a single team; co-ordinated policies; around protection and enforcement and cost savings on administrative and maintenance functions.<sup>66</sup>

The essence of an intellectual property holding company is not to hold shares or controlling power in other group companies, but to hold intellectual property normally beneficial to the other group companies. In this guise it is therefore not a holding company in accordance with the use of the term in this article. It must be noted, however, that these functions could be combined with headquarter company functions in a group of companies to achieve the ultimate tax savings.<sup>67</sup>

## 4 9 Personal Holding Company

A personal holding company is generally a company owned by natural persons, normally a small number of individuals. It engages in investment activities in that it owns shares in other companies.<sup>68</sup> It is used to defer tax by trapping dividends interest, rent and royalties where the tax burden for companies is less than that of individuals on receipt of such payment. It can either be resident in the country of residence of its shareholders or outside such country depending on the origin of the amounts on which tax is to be avoided.<sup>69</sup>

What immediately distinguishes a personal holding company from a headquarter company is that a personal holding company is owned by individuals. Furthermore, a personal holding company does not form

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64 Rohatgi 87.

65 Ibid.

66 *Intellectual Property Holding Companies and R&D Credits* <http://www.polity.org.za/article/intellectual-property-holding-companies-and-rdtax-credits-2012-06-05> (accessed 2012-06-22).

67 Fairbairn *Intellectual Property Holding Companies can Create Significant Tax Savings and Protect Valuable Assets* [http://www.fredlaw.com/articles/ip/inte\\_0304\\_kks.html](http://www.fredlaw.com/articles/ip/inte_0304_kks.html) (accessed 2012-0622).

68 IBFD definition of "Personal Holding Company".

69 See <http://www.allbusiness.com/glossaries/foreign-personal-holding-company/4951392-1.html> (accessed 2012-06-14).

part of a group of companies with any other companies. On the other hand a headquarter company is owned by an ultimate holding company in a group of companies.

## 5 Conclusion

There are numerous similarities between headquarter companies and other forms of corporations as discussed above. The essential characteristic of a headquarter company is that it owns a substantial participation in the shares of other companies, usually operating subsidiaries, established outside the country in which the headquarter company is established even though the headquarter company may perform other functions and own other assets. Its main function is to provide the full range of administrative and management functions associated with a head office; for example, treasury and tax management, internal audit, public relations, market research and marketing, insurance and accounting. However, headquarter companies are more often formed to perform a conglomerate of functions – some of which are peculiar to certain of these other corporations. Still, the nature of a headquarter company should not be confused with these other entities. Confusing the headquarter company with other entities may result in misinformed decisions and attributions of the resulting tax assessments or expectations in different jurisdictions.