P R E S S R E L E A S E

SOUTH AFRICA: Entering the South African market: Some considerations

There are many ways that a foreign company can establish a presence in South Africa, such as a joint venture, acquiring a controlling share in an SA company, registering an external company or incorporating a subsidiary. Each of these has its own prerequisites, pros and cons, but this article will focus on incorporating a subsidiary and on considerations regarding its capitalization.

If you have R1 million to invest in South Africa you may choose:

- To invest the full amount in the equity of the subsidiary, or
- To invest a nominal amount in the equity of the subsidiary and advance the remainder on loan account.

Investing in the equity of the subsidiary will give rise to an increase in the contributed tax capital of the subsidiary. This is relevant as it determines whether a distribution to shareholders is a dividend or a return of capital. If a distribution does not result in a reduction of the subsidiary's contributed tax capital then that distribution will be a dividend and be subject to a withholding tax of 15%[1.]
Dividends may be transferred to non-resident shareholders without prior SARB approval provided the shares have been endorsed "non-resident" as described above. Authorised Dealers will require documentary proof that the company has profits (e.g. audited financial statements) before authorizing the remittance of the dividends.

Advancing funds on loan account will result in the foreign company earning interest on the funds advanced. This interest payment will, similar to a dividend, also be subject to a withholding tax of 15%[1] when it is paid. The rate and terms at which interest may be remitted must be approved either by SARB or an Authorised Dealer at the time of introduction of the loan. Prior Exchange Control approval for the terms of repayment of the capital portion of the loan is also required. The interest rate charged on the funding must fall within certain prescribed limits. Generally, if the interest rate payable on the foreign loans is within the prescribed limits, the loans are approved.

From the subsidiary's point of view the interest payments will be deductible provided that:

- From a transfer pricing2 perspective the subsidiary is not thinly capitalized and the interest rate is not deemed excessive.

- The loan is not deemed to be a "hybrid debt instrument,"[3] which will see the interest payment being treated as a dividend in specie, or
- The interest payment is not deemed to be "hybrid interest,"[4] which will see the interest payment being treated as a dividend in specie.

The above is just the tip of the iceberg when considering a presence in South Africa and companies considering this are well advised to seek professional advice regarding the above and other considerations before committing to a plan of action.

Please contact Werner from ECOVIS ARB Auditors Inc. Regarding any further details regarding the above or to obtain more information on how we can assist you with income tax-related services.

[1] Without taking into account the provisions of any possible Double Taxation Agreements
[2] Section 31 of the Income Tax Act (Act 58 of 1962)
[3] Section 8F of the Income Tax Act (Act 58 of 1962)
[4] Section 8FA of the Income Tax Act (Act 58 of 1962)

"Entering the South African market by incorporating a subsidiary can be tricky; it's best to consult an expert to make sure you take the right steps."
Werner Botha, ECOVIS ARB Auditors Inc., Gauteng, South Africa

Author
Werner Botha
werner.botha@ecovis.com

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The name Ecovis, a combination of the terms economy and vision, express both its international character and its focus on the future and growth.

Contact at Ecovis

Julia Hanke
Agnes-Bernauer-Straße 90 , 80687 München, Germany
Tel.: +49 89 5898-266, Fax: +49 89 5898-280
E-Mail: julia.hanke@ecovis.com www.ecovis.com