Global tax guide to doing business in South Africa

Overview

South Africa has a residence-based tax system. Companies are considered to be residents in South Africa if they are incorporated or have their place of effective management in South Africa.

Income tax is imposed under the Income Tax Act (ITA). Non-residents who carry on business in South Africa, are employed in South Africa or sell immovable property (or an interest in such) are also subject to South African income tax.

The ITA imposes a 20% tax, known as dividends tax (effectively) on non-residents who receive dividends. Furthermore, the ITA imposes a 15% withholding tax on non-residents who receive certain interest payments or royalties from South Africa. The South African payer of any such amount is liable for withholding and remitting this tax on behalf of the non-resident recipient.

South Africa has an extensive double-taxation treaty (DTT) network, which will reduce or eliminate the 20% /15% withholding tax rates on such types of income.

Other relevant taxes in South Africa are value-added tax (VAT), donations tax and securities transfer tax (STT).

South Africa is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and has agreed to adopt the minimum standards (principal purpose test and dispute resolution) as well as certain optional provisions. The ratification process has not yet been completed.

In this chapter

Legal system

South Africa operates under a common law legal system.

Taxation authorities

The tax system in South Africa is administered by the South African Revenue Service (SARS).

Business vehicles

A non-resident may either establish a South African business vehicle to carry on business in South Africa or operate directly through a foreign entity (with or without a South African permanent establishment). South African business vehicles are companies (private or public) and partnerships (general or limited). While it is also possible to use a trust to carry on business in South Africa, due to a number of complexities, a trust is rarely utilized for these purposes.

Partnerships

A partnership (whether general or limited) is generally treated as fiscally transparent for South African income tax purposes. Although partnerships are required to file annual income returns, it is the partners of the partnership, rather than the partnership itself, that are subject to income tax under the ITA. However, the ability of a limited partner to deduct losses incurred by a limited partnership may be restricted to the extent the losses exceed the limited partner's "at-risk amount."

The tax residence of a partnership is not a decisive factor, but that of the respective partners is.

Companies

A company does not require any capital to have been received by it for its establishment. However, in order to issue shares, a nominal amount of capital must be received by the company.

The South African Companies Act does not provide for the incorporation of an unlimited liability company.

Foreign company (with or without a South African branch)

A foreign company that carries on business in South Africa is subject to tax under the ITA in respect of its taxable income that is regarded to be from a South African source. Codified source rules apply for many types of income.

The Companies Act requires a foreign company to register as an "external company" if it has a fixed place of business in South Africa.

The determination of whether a company is carrying on business in South Africa is generally made in accordance with common law principles.

Where the foreign company is resident in a country with which South Africa has a DTT pursuant to which the company may claim treaty benefits, the company will generally be exempt from South African taxation on its business profits, except to the extent that the profits were earned through a permanent establishment situated in South Africa.

A company that operates through a South African permanent establishment (such as a branch) will be subject to South African income tax, which is taxed as a branch tax (see details below).

Financing a corporate subsidiary

Exchange Controls

South Africa has an exchange control regime in place that regulates the cross-border flow of funds, including capital flows. Generally speaking, shares issued to a non-resident must be fully paid up and the share certificate must be endorsed as "non-resident." Debt funding is subject to approval and interest rate limits, which are generally up to 2% above the interbank rate for arms' length loans, while non arms' length loans are typically limited to the interbank rate that applies to the currency in question.

Proceeds from the sale of shares and also dividends will not be repatriable without the above endorsement. Capital repayments are allowed provided the original inflow was approved.

Equity financing

Contribution for shares

Where an equity investment is made into a South African company in exchange for shares, the amount of the investment is added to the company's "stated capital" account. Subject to certain adjustments, a company's stated capital is generally the same as its paid-up capital for tax purposes. The latter concept is defined as the company's contributed tax capital (CTC).

CTC is relevant for the characterization, for tax purposes, of distributions made by a South African resident company.

Contributions without taking additional shares

The Companies Act does not provide for equity contributions made by a shareholder to a South African incorporated company without the issuance of additional shares.

Distributions of paid-up capital (or CTC)

A company is permitted to make distributions of its CTC to a non-resident shareholder without incurring any South African withholding tax. However, CTC distributions can only be made proportional to the respective shareholding of its shareholders. Disproportional distributions are designated as dividend distributions and are thus exposed to dividends tax.

A company distribution that is not designated as a return of capital (CTC) is classified as dividends by default and is thus exposed to dividends tax.

Debt financing

Withholding tax implications

South African companies are permitted to borrow funds from related or third parties without tax implications on the inflow. Furthermore, there are no South African tax implications on the repayment of the principal amount of such debt. Interest payments made by a South African resident company to a non-resident are subject to a withholding tax of 15%. As previously mentioned, the withholding tax rate can be reduced or eliminated under an applicable DTT. For example, the South Africa-United States Tax Convention eliminates withholding tax on cross-border, non–arm's length interest payments (other than participating interest).

Thin capitalization

If the South African subsidiary is to be financed with debt, it may be subject to the thin capitalization rules contained in the ITA. These rules restrict the deductibility of interest paid or payable by a resident company. A safe haven of a 3:1 debt equity ratio that previously applied has been withdrawn. SARS has issued guidelines on these matters. In essence, a transfer pricing standard (based on the Organisation for Economic Cooperation and Development literature) is applied and a comparable measure would be relevant for related party debt funding. To the extent that the debt exceeds this ratio, there will be a proportionate denial of the interest deduction and any payment of interest that is subject to restriction under these rules is deemed to be a payment of a dividend for the purpose of withholding tax obligations.

In addition, new legislation further limits deductions to an amount determined by a formula. This amount roughly equals 40% of taxable income (with adjustments largely intended to match cash flow, subject to a ceiling of 60%). The new limitation applies from 1 January 2015.

Securities transfer tax

South Africa does not impose a securities transfer tax (STT) in respect of debt or equity financing but only on the transfer of securities.

Corporate income tax

For 2020, the corporate tax rate on general taxable income is set at 28%.

Income tax rate

Capital gains

A South African resident company, including a South African subsidiary of a foreign company must include 80% of all capital gains (referred to as “taxable capital gains”) in its taxable income. Taxable capital gains are taxed in the same manner as ordinary income. Capital losses can be used to offset taxable capital gains in the year. To the extent that allowable capital losses exceed taxable capital gains in a year, the excess may generally be carried forward indefinitely to be applied against taxable capital gains in future years.

A non-resident is only taxed on gains arising from the disposal of immovable property or an interest therein. Included in this would be the disposal of shares in a so-called “property rich company”. This means that an interest in fixed property includes a direct or indirect interest of at least 20% in a resident or non-resident company if, at the time of disposal of the interest, 80% or more of the market value of the assets of the company is attributable to fixed property located in South Africa that is held as capital assets.

A capital gain is equal to the amount by which the proceeds of the disposal of an asset exceeds the base cost of the asset. A capital loss arises if the base cost exceeds the proceeds of the disposal. Capital losses may offset capital gains, and regular income losses may offset net capital gains. However, net capital losses may not offset regular income

Special types of companies

Gold mining companies may elect to have their mining income taxed under a special formula, while the non-mining income of such companies is taxed at a rate of 28%.

Petroleum and gas production is taxed in accordance with the usual provisions of the ITA, as modified by a special schedule applicable to prospecting and development expenses, as well as to farm-ins. A fiscal stability regime can be agreed to with the Minister of Finance. The tax rate is capped at a maximum of 28% for both South African-resident and non-resident companies. Dividends tax need not be withheld from dividends paid out of oil and gas income, and interest withholding tax need not be withheld from interest paid with respect to loans used to fund oil and gas exploration and post-exploration capital expenditure.

Life assurance companies are subject to special rules that separate the taxation of policyholders’ and corporate funds and apply different tax rates to such items.

Small business corporations (SBCs) are taxed at staggered reduced rates on their taxable income.

A headquarter company regime was introduced to encourage foreign companies to use South Africa as their base for investing in Africa. Generally, headquarter companies are exempt from withholding taxes on dividends, interest and royalties.

Branch tax

The ITA imposes a tax equal to 28% of South African after-tax profits earned by a branch of a non-resident company.

Computation of taxable income

Taxable base

The assessment of tax is based on taxable income determined in accordance with the ITA. Taxable income normally approximates profit calculated in accordance with International Financial Reporting Standards, before adjustment for specific allowances and non-deductible items.

Deductions

A taxpayer is generally permitted to deduct its current expenses in computing taxable income. To be eligible for deduction, expenditures must be incurred in the production of income and for purposes of trade and must not be of a capital nature.

As a general rule, capital expenses are not deductible. However, the ITA provides for various capital cost allowances, based on the nature of the asset.

South African resident companies and non-resident companies that carry on business in South Africa or that dispose

Income tax reporting

of taxable South African property are required to file an annual corporate income tax return.

Cross-border payments

Transfer pricing

South Africa's transfer pricing regime generally conforms to the arm's length principle of the Organisation for Economic Co-operation and Development (OECD). The ITA permits SARS to impose a transfer pricing adjustment in respect of a transaction that is not made on arm's length terms or conditions. South African taxpayers are also required to maintain contemporaneous documentation in respect of transactions subject to the transfer pricing rules.

Withholding tax on passive income

The ITA imposes a 20% tax, known as dividends tax (effectively on) non-residents who receive dividends. It furthermore imposes a 15% withholding tax on non-residents who receive certain interest payments or royalties from South Africa. The South African payer of any such amounts is liable for withholding and remitting this tax on behalf of the non-resident recipient.

Payroll taxes

Employees tax

Employers paying remuneration to employees are liable to withhold employees' tax at set rates. These withholdings are effectively an advance payment of the income tax liability of the employee concerned. The amount withheld is balanced against the income return of the employee concerned, and may result in a refund or additional tax, depending on the difference.

Indirect taxes

Value-added tax (VAT)

VAT is imposed on a wide range of goods and services, at the standard rate of 15%. Certain goods and services are zero rated. The system operates as a self-assessment down the supply chain, and registered vendors are allowed to offset their output VAT against input VAT. Certain supplies, such as financial services, are deemed exempt, which may impact the ability to claim input VAT credits for those engaged in this sector.

The final domestic consumer thus bears the final liability. Specific rules with respect to the place of supply exist to determine whether a supply is deemed to be made in South Africa.

Transfer duty

A transfer duty is payable on any acquisition of real property.

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