

# Striking the Balance

## *Ownership & Development*



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## Equity Equivalent Investment Programmes for Multinationals

Africa is a highly popular investment destination for Multinational organisations; in some cases, South Africa is the point of entry into the African market. Unlike other markets that are mature and slow growing, the African market is rapidly expanding due to the emerging middle class and the affluent. Essentially, Africa presents 54 markets for Multinational organisations, each with their own level of complexity as a result of their unique social, cultural and political ecosystems. The potential of the African market is clear, as the continent spans the size of the US, Europe, China, India, and Japan combined<sup>1</sup>.

Whether or not Multinational organisations enter the South African market as a springboard to the African market, they contribute to innovation, consumer choice, skills transfer, development, job creation and a hefty sum into our GDP. As welcomed investors in our economy, Multinational organisations are, more often than not, dominant market leaders in many of our economic sectors.

One of the core challenges facing Multinational organisations entering or operating in the South African market is B-BBEE. The core challenge is that of Ownership, which is mainly due to their global practice against Sale of Equity. Consequently, the B-BBEE score of Multinational organisations is affected as they not only forfeit Ownership points, but fall foul to the Discounting Principle, whereby their overall status is discounted by Status Level 1.

In recognising the Ownership challenges of Multinational organisations, in May 2015 The Department of Trade and Industry (DTI) published Statement 103, Code Series 100 as 'The Recognition of Equity Equivalents for Multinationals', as an alternative to direct Sale of Equity in return for Ownership points. However, an Equity Equivalent Investment Programme (EEIP) is only considered where evidence is presented of existing global policies that limit Sale of Equity.

An EEIP is a programme targeting investment or any other programme that promotes socio-economic advancement or development within the South African economy. The Minister of Trade and Industry must approve an EEIP proposal following consultation with the sectoral Line Ministry, Premiers or other stakeholders in any government department, both provincial and local with respect to their EEIP proposal. They may further include projects that support Government's strategic economic development policies and programmes, such as:

- > The Industrial Policy Action Plan (IPAP) and the Black Industrialists Development Programme;
- > The New Growth Path (NGP);
- > The National Skills Development Strategy; and
- > The National Development Plan.

Furthermore, EEIPs must promote and advance:

- > Enterprise and Supplier Development;
- > Research and Development; and
- > Critical and core Skills.

The Beneficiaries of EEIPs must be Exempt Micro Enterprises (EMEs) and/ or Qualifying Small Enterprises (QSE) holding a Status Level 1. Such Beneficiaries must represent Natural Persons, Designated Groups, Co-operatives or Communities. Beneficiary criteria are as follows:

- > Natural persons who are 'Black' People must be at least 75% of the total beneficiaries; and
- > The Economic Interest or Benefit allocated to the Beneficiaries must be at least 75%.

In the case of a Co-operative, 'Black' Women must hold more than 30% Ownership. The requirements for the Recognition of Equity Equivalent are recorded in Statement 103 gazetted on the 6<sup>th</sup> of May 2015.

## Contribution and Duration

Points stemming from an EEIP may only be used under the Ownership elements and no other. The EEIP Ownership Points Certificate awarded will be valid for an agreed investment period. Contributions to Equity Equivalent programmes are measured as actual contributions made using the general principle set out in code series 400 and 500 against any of the following targets:

- > 25% of the value of the South African operations of the Multinational, determined using a Standard Valuation Method; or
- > 4% of Total Revenue from its South African operations annually over the period of continued measurement.

Should a Multinational want to retain the EEIP Ownership points following the expiry date of the Certificate, the Topping-Up Principle will apply. This necessitates a reinvestment and an additional contribution to a new EEIP, which is illustrated in the Technical Assistance Guide in the Amended Codes.

Partial contributions to an EEIP on a proportional ratio basis for the recognition of Ownership points are allowed. However, Ownership points will be awarded and determined in terms of the provisions of both Statement 100 and Statement 103. The minimum partial contributions must be at least 40% of the compliance target for the Ownership scorecard.

The investment periods, which must be agreed upon for total contributions, are set out as follows:

- > More than R100m can be considered for an investment period of up to 10 years;
- > Between R75m and R100m can be considered for an investment period of up to seven years;
- > Between R50m and R75m can be considered for an investment period of up to five years; and
- > Less than R50m can be considered for an investment period of up to three years.

## Administration and Evaluation

The administration of EEIPs may be either outsourced or administered within the confines of the Multinational, whereby the following will apply:

### Outsourced Administration of EEIP

- > The economic interest and voting rights of the administrator must be at least 51% 'Black'-owned;

- > The administrator must be B-BBEE compliant and a superior B-BBEE contributor;
- > The EEIP administration fee must not exceed 15%;
- > The administrator must possess the appropriate and necessary skill and experience;
- > The programme manager responsible for overseeing the implementation of the EEIP must be in possession of the B-BBEE Management Development Programme;
- > The programme manager must sign off on all reports to the Multinational and/or DTI.
- > All goods and services procured to implement this programme must be sourced and procured from Service Providers that have at least a Status Level 4.

### In-house Administration of EEIP

- > Employees assigned to the administration of the EEIP must possess the appropriate and necessary skills and experience;
- > The programme manager responsible for overseeing the implementation of the EEIP must be in possession of the B-BBEE Management Development Programme;
- > The administration fee for the programme must not exceed 15%;
- > All goods and services procured to implement the EEIP must be sourced and procured from Service Providers that have at least a Status Level 4; and
- > The programme manager and the CEO must sign off on all reports to the DTI;

In both cases the DTI reserves the right to request the B-BBEE Certificate of any Service Provider of goods and services.

## Calculation Considerations

Any contributions towards the Ownership element are measurable against the value of the Multinational's operations in South Africa. In calculating their Ownership score, the Exclusion Principle must be applied to any portion of the business value of their South African operations gained from non-South African sources. A Standard Valuation Method must be used to determine the value of the South African operations.

In calculating the Ownership score, Sale of Equity Instruments in non-South African organisations to 'Black' People are allowed on the following basis:

- > The non-South African organisation and the Multinational in South Africa must form part of the same chain of Ownership and be owned by the same ultimate parent organisation;
- > The transaction must comply with South African exchange control requirements;

- > The percentage of the value of the Equity Instruments - in the non-South African organisation - sold to or held by 'Black' People in the non-South African organisation to the value of the Multinational based in South Africa represents the recognisable 'Black' claim to Economic Interest;
- > The percentage of Exercisable Voting Rights ceded to the buyers of the Equity Instruments in the Multinational represents the recognisable 'Black' right to Exercisable Voting Rights; and
- > The Rights of Ownership in the Equity Instruments are comparable to rights that would have accrued to 'Black' People had the Equity Instrument been held in the Multinational in South Africa.

## The Application Process

The implementation and monitoring of an EEIP is expensive and can be an administrative nightmare. However, it makes financial sense as it provides Multinationals with an opportunity to obtain a competitive B-BBEE Certificate, which leads to further investment into the South African economy.

An EEIP application must include a full description of the programme objectives and projected outcomes, as well as any sponsors participating. Additional requirements are any qualification criteria for participation, as well as timelines for implementation and delivery with milestones against which progress can be measured included. Critical to a successful application is research and development.

The EEIP application process is a long-winded and complex one. The three phases of an EEIP process which includes the application for exemption, evaluation and monitoring of progress, are set out as follows:

### Phase 1 | Application for Exemption of Ownership

Phase 1 commences with the submission of the application form and Letter of Intent, together with supporting documentation, to the DTI for consideration. After that, the DTI presents a sound case to the EEIP Committee regarding the Multinational's global practice on Sale of Equity. This will include a list of the Multinational's business interests in other countries, which may be supported by audited Annual Financial Statements and Reports. If the EEIP Committee decision allows for an exemption, a recommendation will be made to the Deputy-Director General.

### Phase 2 | Evaluation of Proposal

A detailed business plan of the EEIP must be submitted, and linked to the contributions as per valuation. The EEIP Committee evaluates the feasibility of the proposal. Following this, a Memorandum of Agreement is entered into and a recommendation is made to the Minister of Trade and Industry.

The final step of this phase is to calculate the points that will be allocated in return for the EEIP. Once the Minister of Trade and Industry approves the EEIP and contribution, a Certificate is issued confirming the points awarded for Ownership.

### Phase 3 | Monitoring

This is a continuous process throughout the duration of the EEIP. Progress against the original proposal must be monitored and reported to the DTI as required.

## SARS

In Binding Private Ruling BPR 113, SARS equally indicated that expenditure associated with B-BBEE would be deductible. One of the issues was that the applicant would not subscribe for any shares in the companies in which investments were made. SARS indicated that the equity equivalent expenditure was deductible, even though it was apportioned over a seven-year period in terms of s23H of the Income Tax Act, No 58 of 1962 (Act) given the fact that the benefit would be enjoyed over a seven-year period.

In conclusion for a Multinational to have a 'Stake in the Game' demonstrates their continued commitment to the South African market. By the same token, having an alternate avenue for Ownership demonstrates Government's willingness to embrace the global policies of Multinational organisations. One has to ponder if Multinational organisations that upped and left South Africa in recent years on short notice would have done so in such haste if they had invested in an EEIP?

Source of reference

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