Reinstatement of a deregistered company in the context of an amalgamation transaction

The South African Revenue Service recently released Binding Private Ruling No 237 (Ruling), which dealt with the reinstatement of a deregistered company in the context of the transfer of immovable properties in terms of an amalgamation transaction.

A company (Company) had previously sold its business as a going concern to another company (Applicant) in terms of an "amalgamation transaction" as defined in s44 of the Income Tax Act, No 58 of 1962 (Act). The assets of the business included certain immovable properties.

In order for a transaction to qualify as an "amalgamation transaction", the existence of the amalgamated company has to be terminated. Accordingly, the Company was deregistered with the Companies and Intellectual Properties Commission (CIPC).

Unfortunately, due to a bona fide error, the relevant immovable properties were never transferred from the Company to the Applicant prior to the Company's deregistration.

Accordingly, the Company was still reflected as the owner of the immovable properties in the deeds registry, despite the Company's deregisteration.

It appears that, in order to effect the transfer of the immovable properties to the Applicant, the Company's registration with the CIPC had to be reinstated. It was accordingly proposed that application would be made to the

CIPC for such reinstatement.

In order to reinstate the registration of the Company, the steps set out in the CIPC's Practice Note 6 of 2012, will have to be followed. These steps include:

- Receiving confirmation from National Treasury, as well as the Department of Public Works, that they have no objection to the reinstatement of the registration. This step is specifically intended to address the issue of the assets of a deregistered company being forfeited to the State as bona vacantia.
- Advertising the application for reinstatement of the Company in a local newspaper, giving third parties an opportunity to object.

It was further proposed that, once the Company's registration was reinstated, the immovable properties would be transferred to the Company. Thereafter the Company would again be deregistered.

From a tax point of view, the concern for the Applicant and the Company appeared to be whether they would still enjoy the relief provided by s44 of the Act, as well s8(25) of the Value-added Tax Act, No 89 of 1991 (VAT Act), in respect of the transfer of the immovable properties after reinstatement.

Specifically, s44(13)(b) of the Act provides that the relevant roll-over relief will be denied where any step taken to deregister the amalgamated company is withdrawn, or if anything is done to invalidate such step, with the result that the amalgamated company is not deregistered.

In addition, it appears that the process would cause the final deregistration of the Company, after transfer of the immovable properties, to only occur after the 36 month period allowed for in terms of s44(13)(a) of the Act.

In this regard SARS ruled that:

- the roll-over relief provided for in s44 of the Act would continue to apply;
- the reinstatement of the Company's registration, and subsequent deregistration after transfer of the immovable properties, will not be in breach of s44(13)(b) of the Act;
- the 36 month period provided for in s44(13)(a) of the Act would be extended;
- the transfer of the immovable properties would be treated as a non-supply in terms of s8(25) of the VAT Act; and
- the transfer of the immovable properties would be exempt from transfer duty in terms of s9(1)(l)(iB) of the Transfer Duty Act, No 40 of 1949.

by Heinrich Louw
This article forms part of [Tax and Exchange Control Alert – 24 June 2016:](#) [Download PDF](#)

All in one: another ruling regarding an amalgamation transaction

Author: Dries Hoek and Louis Botha (Cleffe Dekker Hofmeyr).

In our Tax and Exchange Control Alert of 20 May 2016, we discussed Binding Private Ruling 231 (Overruled: SARS expresses an interesting view on be an amalgamation transaction), in which the South African Revenue Service (SARS) ruled on whether the roll-over relief provisions in s44 of the Income Tax Act, No 58 of 1962 (Act) could be applied. In this article, we discuss Binding Private Ruling 232 (Ruling),

which also dealt with these provisions, although the context and facts of the Ruling are somewhat different. S44 states that parties to an amalgamation transaction will qualify for roll-over relief, whereby certain tax liabilities that would arise in the normal course are deferred, provided that the requirements of s44 are met.

Facts

The Applicant in this Ruling is a company incorporated in and a resident of South Africa (SA). There are three Co-Applicants in this ruling, namely the amalgamated companies (ACs), which are SA resident companies that will be wound-up as part of the amalgamation transaction, the shareholders (SHs) of the ACs, which are all SA resident companies and the resultant company (RC), which is also an SA resident company that will remain in existence after the amalgamation transaction.

Description and nature of the proposed transaction

The Applicant and the Co-Applicants decided to rationalise the

administration of their businesses, which have an identical underlying nature, by amalgamating the businesses in a single entity and terminating the existence of the existing companies. The Applicant and the Co-Applicants have significant interests in investments in fixed properties, which they hold individually or jointly. The nature of the investments is in each case similar, comprising of shares in companies that own fixed property which is let to derive rental income. The amalgamation will result in the transfer of the assets and liabilities of the ACs to the RC, in exchange for shares in its corporate structure. Those shares will be issued on behalf of the ACs, after which the ACs will be wound up.

The RC will issue shares of different classes. Each class of shares will be linked to a designated property investment. The holders of these shares will each be entitled to a distribution of income and capital, attributable to the income and capital generated by the designated property. The distributions will not be limited to specified amounts. In the event of a winding-up, if there is any surplus remaining after satisfying the interests of the shareholders of each class, each share shall be entitled to share equally in the surplus. The rights of each class of shareholder will be documented in the memorandum of incorporation.

The relevant legal provisions

The provisions in the Act that are relevant for this Ruling are s44(1) and 1(1).

S44(1)(a) defines an amalgamation transaction as a transaction where:

1. any resident company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably

anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) to another resident company by means of an amalgamation, conversion or merger; and
2. as a result of which the existence of that amalgamated company will be terminated.

S1(1) of the Act defines an equity share as any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution.

Ruling

SARS ruled that the disposal by the ACs of their businesses to the RC will meet the requirements of an amalgamation transaction as defined in s44(1). The shares of the different classes to be issued by the RC will each constitute an equity share as defined in s1(1).

Comment

There are two interesting observations to make with regard to this Ruling. Firstly, the definition of an amalgamation transaction in s44(1)(a) refers to the disposal of assets by "…a…company which is a resident…" Whereas this phrase in the definition might have suggested that there may only be one amalgamated company to qualify for the roll-over relief, this Ruling could provide support for the argument that the assets of more than one amalgamated company may be transferred to a resultant company. In other words, the Ruling could suggest that under certain circumstances, it might not be necessary for each amalgamated company to conclude a separate amalgamation transaction with the resultant company, to qualify for the roll-over relief in terms of s44.

Secondly, the Ruling regarding the shares of different classes issued by the RC is important, in the context of s44(2) and

s44(4) of the Act. S44(2) states, inter alia, that any capital gain that would have occurred had the property been disposed of in the normal course, will not trigger the payment of capital gains tax (CGT) and is deferred until the RC disposes of the property. However, s44(4)(a) states that this roll-over relief will only apply "…to the extent that such asset is so disposed of in exchange for consideration other than…an equity share or shares in the resultant company…" It is therefore crucial that the shares issued by the RC constitute equity shares as defined. In terms of the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010 (EM 2010), the definition of "equity share" was originally drafted to ensure that preference shares with limited dividend rights fall outside the definition and so that, inter alia, the benefits of s44 only apply where equity shares are issued as consideration for the capital asset received. The Ruling seems to confirm that this was the intention. Although the distribution of the income and capital received by the SH of a certain class of shares is dependent on the property investment to which the class of shares is linked, such shares still constitute equity shares, as defined, provided the distributions are not limited to specific amounts.

Taxpayers should still keep in mind that this Ruling is only binding on the parties to the transaction and that SARS will not necessarily adopt this approach in all similar instances.

Written by Dries Hoek and Louis Botha

Overruled: SARS expresses an interesting view on an amalgamation transaction

The South African Revenue Service (SARS) has traditionally adopted a conservative approach in issuing rulings which approve a tenuous interpretation of provisions of the Income Tax Act, No 58 of 1962 (Act), in favour of the taxpayer. However, in Binding Private Ruling 231 (Ruling), which was issued by SARS on 10 May 2016, SARS adopted an interesting interpretation of the corporate roll-over relief provisions in s44 of the Act, which raises a number of questions. The Ruling is quite long and therefore we will only discuss the manner in which SARS applied the provisions of s44, relating to corporate roll-over relief in the case of so-called amalgamation transactions (s44 transaction).

Facts

The Applicant in this case is a South African resident company that is held 74% by a foreign company (ForeignCo) and 26% by black economic empowerment (BEE) shareholders. ForeignCo is a wholly owned subsidiary of another foreign company (HoldCo). There are also a number of Co-Applicants, including three companies that are majority-owned by BEE shareholders (BeeCo1, BeeCo2 and BeeCo3). BeeCo2 is a wholly owned subsidiary of BeeCo1. BeeCo2 and BeeCo3 also each participate in two separate unincorporated joint ventures (UJV’s).

The relevant legal framework

In terms of s44(2) of the Act, a company will qualify for

certain corporate roll-over relief, in that the transfer of capital assets or trading stock will not trigger the inherent tax gain, if the transaction constitutes a s44 transaction in terms of s44(1)(a) or (b).

Section 44(1)(a) defines an amalgamation transaction as a transaction where:

1. any resident company (amalgamated company);
2. disposes of all of its assets (other than assets it elects to use to settle any debts by it incurred in the ordinary course of its trade, and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up); or
3. to another resident company, which is a SA resident (resultant company) in terms of an amalgamation, conversion or merger.

Section 44(1)(b) contains the exact same wording, the only difference being that the amalgamated company is a foreign company and that the shares in the amalgamated company are held as capital assets. Section 44(2)(a) contains a further requirement for the corporate roll-over relief in that the shares must be acquired by the resultant company as capital assets or as trading stock, as the case may be.

Description and purpose of the transaction

The Applicant and the relevant subsidiary Co-Applicants intend to rationalise and simplify its South African group structure by entering into four separate transactions which will eliminate the unincorporated joint ventures (UJV’s) and unnecessary companies in its structure. Transactions 1, 2 and 4 entail s44 transactions, whereas Transaction 3 constitutes an asset-for-share transaction in terms of s42 of the Act.

We will only discuss SARS’s Ruling with respect to

Transactions 1 and 2.

In Transaction 1, the group wishes to eliminate the intermediate holding of the Applicant’s shares by ForeignCo. To do this, ForeignCo will dispose of its shares in the Applicant for a new issue of shares in the Applicant in terms of a s44 transaction. The new shares in the Applicant will be distributed by ForeignCo to its sole shareholder, HoldCo, in terms of the relevant amalgamation agreement. ForeignCo will then be liquidated in terms of that amalgamation agreement. In Transaction 2, a similar approach will be followed. BeeCo1 will dispose of its shares in BeeCo2 for a new issue of shares in BeeCo2 in terms of a s44 transaction. The new shares in BeeCo2 will be distributed by BeeCo1 to its shareholders in terms of the relevant amalgamation agreement and BeeCo1 will then be liquidated in terms of that amalgamation agreement.

SARS’s Ruling

With respect to Transaction 1, SARS ruled that the transfer by ForeignCo of its shares to the Applicant under the amalgamation agreement will constitute a s44 transaction in terms of s44(1)(b) of the Act and will be qualify for the corporate roll-over relief and that the repurchased shares of the Applicant will also be cancelled upon repurchase.

There will also be no dividends tax payable on the distribution of the newly-acquired shares of the Applicant to HoldCo.

With respect to Transaction 2, SARS ruled that the transfer of assets by BeeCo1 to BeeCo2 under the amalgamation agreement between them, will constitute a s44 transaction terms of s44(1)(a) of the Act and will qualify for the corporate roll-over relief. The repurchased shares of BeeCo2 will also be cancelled upon repurchase. No dividends tax will be payable on the distribution of the newly-acquired BeeCo2 shares by BeeCo1 to its shareholders.

Comments

Although SARS rulings often do not include all the facts provided to it by the applicants, it is possible that ForeignCo and HoldCo might be liable to pay capital gains tax (CGT) in terms of paragraph 2(1)(b)(i) of the Eighth Schedule to the Act, if it disposed of its shares outside of the ambit of the corporate roll-over relief provisions in the Act. Paragraph 2 of the Eighth Schedule states that a non-resident company will be liable for CGT in South Africa if on disposal, it holds more than 20% of the shares in a South Africa resident company and 80% of the market value of the South Africa resident company's shares are directly or indirectly attributable to immovable property. This might explain why the parties wish to make use of the roll-over relief in s44. Upon closer scrutiny, it appears that some of the requirements of s44 might not have been met.

Section 44(2)(a)(i) states that where an amalgamated company disposes of a capital asset, the resultant company will only qualify for the roll over relief if the resultant company "…acquires it as a capital asset…" In Transaction 1, ForeignCo concludes a s44 transaction in exchange for the Applicant issuing new shares to it. It is the subsequent cancellation of these repurchased shares which raises issues. The cancellation is an unavoidable outcome and therefore, regardless of the intention of the Applicant, it could never have held the shares as capital assets. Should s44(2) or (3) of the Act not apply, the repurchase might constitute a 'dividend' and potentially trigger a dividend withholding tax charge. A further consequence of s44(2) or (3) not applying is that the distribution of shares by the amalgamated company will not be income tax and dividends tax neutral.

Section 41 of the Act defines a capital asset as any asset as defined in the 8th Schedule, except an asset that constitutes trading stock. The 8th Schedule defines an asset essentially as any property or any right in such property. The definitions

of trading stock in s1 and s41 of the Act essentially state that trading stock is anything acquired by the taxpayer for the purposes of sale or the proceeds of which would form part of the taxpayer’s gross income upon disposal. The shares of the Applicant and the shares of BeeCo2 that are bought back in terms of Transactions 1 and 2 are therefore not acquired as capital assets or as trading stock in terms of the repurchase transactions. In terms of s44(6)(c) of the Act, the transfer of capital assets or trading stock to the shareholders of the amalgamated company will only qualify for the roll-over relief, if the requirements of s44(2)(a) are met. As it appears that these requirements have not been met, a capital gain will potentially be triggered when ForeignCo disposes of the newly issued shares of the Applicant to HoldCo.

This argument is supported by the fact that a company cannot acquire rights against itself and by s35(5) of the Companies Act, No 71 of 2008, which states that once shares have been repurchased by a company, they no longer have the status of issued shares, but have the same status as authorised unissued shares. In commercial terms, these shares are thus not reflected on the balance sheet of a company as assets.

The same comments apply to Transaction 2, in terms of which BeeCo1, the amalgamated company, disposes of its shares in BeeCo2, the resultant company, in exchange for the issue of new shares in BeeCo2.

Written by Dries Hoek and Louis Botha

Merger of controlled foreign

companies

Author: Heinrich Louw

A South African incorporated and resident company (Applicant) had two subsidiaries that were incorporated and resident in foreign countries, and were CFCs. The first subsidiary (CFC 1) was a listed passive holding company. The second subsidiary (CFC 2) was a privately held intermediate holding company.

In order to consolidate some of the group's investments, it was proposed that all the assets and liabilities of CFC 1 be transferred to CFC 2 by way of a merger. As a result of the merger, the assets and liabilities of CFC 1 would become that of CFC 2 by operation of law, and CFC 1 would automatically cease to exist.

CFC 2 would issue a single ordinary share at nominal value, ranking pari passu with all other issued ordinary shares, to the Applicant as consideration for the transfer of the assets and liabilities.

SARS ruled that the proposed transaction would constitute an amalgamation transaction in terms of paragraph (c) of the definition of 'amalgamation transaction' in s44(1) of the Act.

The definition refers to a transaction:

"(c) (i) in terms of which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in

the ordinary course of its trade) to a resultant company which is a foreign company, by means of an amalgamation, conversion or merger;

(ii) if –

(aa) immediately before that transaction –

(A) that amalgamated company and that resultant company form part of the same group of companies (as defined in section 1);

(B) that resultant company is a controlled foreign company in relation to any resident that is part of the group of companies contemplated in subitem (A); and

(C) any shares in that amalgamated company that are directly or indirectly held by that resultant company are held as capital assets; and

(bb) immediately after that transaction, more than 50 per cent of the equity shares in that resultant company are directly or indirectly held by a resident (whether alone or together with any other person that is a resident and that forms part of the same group of companies as that resident); and

(iii) as a result of which the existence of that amalgamated company will be terminated.”

CFC 1, and therefore the Applicant, would enjoy roll-over relief in respect of the transfer of the assets and liabilities (s44(2) and (3) of the Act).

The Applicant would also enjoy roll-over relief in respect of the disposal of its shares in CFC 1, and would establish a base cost in the consideration share issued by CFC 2 equal to the base cost it had in its shares in CFC 1. The issue of the consideration share would also not be treated as a dividend in respect of the shares in CFC 1 (s (6)(c) of the Act).

Since the proposed transaction would constitute an

‘amalgamation transaction’ as defined, s9H(6)(a) of the Act would also apply to provide relief from any exit charge that could arise as a result of CFC 1 ceasing to be a CFC.

SARS also ruled that s24BA of the Act, which attempts to curb value mismatches in transactions where assets are transferred in return for the issue of shares, would not apply. Unfortunately it is not clear on what basis SARS ruled that s24BA of the Act would not apply, and specifically whether it was because there would be no value mismatch, the parties would transact at arm’s length, or one of the exemptions in s24BA(4) would apply.

Sale of business agreements: the implied restraint on canvassing customers

A recent decision of the Western Cape High Court has highlighted some critical considerations to be borne in mind when dealing with restraint of trade and non-solicitation clauses contained in, for example, sale of business agreements, if such sales include the goodwill of the business *(Grainco (Pty) Ltd v Van Der Merwe and Another* 2014 (5) SA 444 (WCC) (11 July 2014)).

The decision, which criticises but ultimately follows the position expressed by the Supreme Court of Appeal in the early 1980s, makes it clear that a seller of a business should not be under the impression that the absence, or expiry,

of an express contractual restraint of trade clause in the agreement means that he then has *carte blanche* to canvass and solicit the customers of the business as at the time of the sale. Even in the absence of a contractual restraint, there is an obligation (implied by law) on the seller to not deprive the purchaser of the goodwill that was sold to the purchaser.

The facts of the Grainco case resemble a common sale and transfer of business structure/scenario and are worth setting out briefly in order to appreciate the implications of the judgement. Messrs Van der Merwe and Kitshoff formed a company (Old GrainCo) which ran a grain-trading business. Old GrainCo ultimately sold the business and its goodwill to BKB Ltd (BKB). Under the sale agreement Old GrainCo, Van der Merwe and Kitshoff bound themselves for five years to not compete with BKB or to canvass any of its customers. BKB immediately on-sold the business and goodwill to the applicant GrainCo (Pty) Ltd (New GrainCo). The sale agreement included a cession of all of BKB's rights in
respect of the business to New GrainCo. New GrainCo subsequently employed Van der Merwe and Kitshoff. Their employment agreements incorporated the restraints in the Old GrainCo-BKB sale agreement. More than five years later, ie after the restraint lapsed, Van der Merwe resigned and formed Perdigon (Pty) Ltd which also ran a grain-trading business. Thereafter Kitshoff resigned from New GrainCo and Perdigon employed him. A few months on, New GrainCo applied to a high court to interdict Van der Merwe, Kitshoff and Perdigon from canvassing the customers of its business. It relied on a term the law implies into a contract to sell a business with its goodwill: that the seller may not later canvass persons who were customers of the business at the time of the sale ('the implied prohibition').

The court considered the following issues:

Could New GrainCo enforce the implied prohibition?

The court held that indeed, it could: BKB had ceded its right to enforce the prohibition to New GrainCo.

The scope of the implied prohibition

The implied prohibition applied only to the seller of the business and its goodwill. It did not prohibit the canvassing of those persons who had been customers before the sale who –

- did not intend to resume trading with the business;
- were unlikely to resume trading with the business; or
- the purchaser had chosen to stop trading with.

The court also held that the prohibition did not bar the seller from canvassing persons who became customers of the business after the sale. A person was a ‘customer’ if the business supplied goods or services to it for consideration. Furthermore, and importantly, the prohibition only prevented a seller from canvassing a customer – it did not prevent a seller from dealing with a customer. Thus if a seller had unlawfully canvassed a customer and had commenced dealing with him, the purchaser’s remedy would be to sue for damages for breach of the prohibition, not to interdict the seller from dealing with the customer.

The effect and implications of the express contractual restraint on the applicability of the implied common-law prohibition: are they mutually exclusive?

The court had to accept that there was Appellate Division authority that an express restraint on competition would not exclude the implied prohibition which otherwise existed at law, even where the express restraint included within its scope a prohibition against canvassing customers (*Becker & Co (Pty) Ltd v Becker and Others* 1981 (3) SA 406 (A)). The court in Grainco felt that this rule might warrant reconsideration: where a purchaser and seller agreed to an express restraint of a specified period, geographical area, etc the stronger argument is that they intended to have exhaustively regulated

the protection that the purchaser would have regarding the acquired customer base.

However, on the principle of *stare decisis* (ie that courts are bound by precedents), the High Court was bound by the decision in Becker. Therefore the court concluded that the implied prohibition was not excluded from the Old GrainCo-BKB sale agreement, and that BKB ceded the right to enforce it to New GrainCo. But, very importantly, the common-law prohibition bound only the seller of the business with its goodwill, Old GrainCo, and not Van der Merwe or Kitshoff (or the vehicle that they used, Perdigon). And Van der Merwe and Kitshoff only began to compete with New GrainCo after the expiry of the express contractual restraints that bound them.

Grainco serves as a reminder that, insofar as canvassing the customer base is concerned, the seller is not necessarily ‘out of the woods’ as soon as, and merely because, the contractual restraint/non-solicitation clause in the sale of business agreement has expired. If the seller is desirous of canvassing the customers after the restraint expires, this must be made clear in the agreement, otherwise the common law principles around the protection of goodwill will apply. The drafting of the relevant contractual provisions in this regard becomes absolutely crucial.

Corporate and Commercial Alert – 20 October 2014 (86KB)

Big decisions: Executives

rely more on experience and advice than data to make business-defining choices: EIU/PwC report finds

· Highly data-driven companies are three times more likely to report significant improvement in making big decisions, but only 1 in 3 executives say their organisation is highly data-driven
· Many executives sceptical or frustrated by the practical application of data and analytics for big decisions, especially in emerging markets

The majority of executives around the world (94%) say management of their company is prepared to make significant decisions about the strategic direction of their business, but barely one-third relied primarily on data and analytics when they made their last big decision. Executives' intuition or experience and the advice or experience of others in their organisation was the decision making modes of choice for 58% of executives. However, the 43% of executives that say their companies are highly data-driven report the biggest improvements in decision making over the last two years. All executives said top priority over the next two years is to make investments in the quality of data analysis to make better decisions.

According to *Gut and gigabytes: Capitalising on the art & science in decision making*, a new survey report by the Economic Intelligence Unit (EIU), sponsored by PwC, executives make big decisions frequently and review them often. More than three-fourths of executives make a big decision each quarter and 43% review them every month.

The EIU carried out interviews with 1,135 executives, of whom 54% were C-level executives or board members across Europe, North America, Asia-Pacific, Africa, the Middle East, and Latin America.
Johan Potgieter, PwC Technology Leader for South Africa, says: "A company's success today is tied to how it is at making big decisions. While executives say they continue to rely on experience, advice, or their own gut instinct, they also see investment in data and analytics as critical to success. Experience and intuition and the use of data and analytics are not mutually exclusive. The challenge for business is how best to marry the two. The survey found that the five most important decisions facing executives in the next 12 months are, in order: growing the existing business, collaborating with competitors, shrinking the existing business, entering a new industry or starting a new business, and corporate financing.

"Growth is once again top of the corporate agenda. Business leaders will be prioritising mergers and acquisitions (M&As), entering new markets, and launching new products, to drive profitability and revenue. PwC research shows that South African CEOs are optimistic about the opportunities in new geographic markets, with a large majority planning to expand into other parts of Africa. Nigeria is often cited as an investment destination," says Potgieter.
Growth is also high on the agenda for technology companies, already seen by the recent spate of large acquisitions. The chief motivation for business leaders in this industry is keeping up with technology-driven changes. "Our research also shows that for South African CEOs technological advances are seen as the important trend that will advance their businesses over the next five years. Business leaders are exploring better ways of using and managing big data."

Big decisions are a regular fixture for senior executives. According to the survey findings, the single largest group of

executives (44%) expects to make a big decision at least once a month, while a further 35% will do so on a quarterly basis.

Executives also said the appearance of a business opportunity they could not ignore was the most common motivation for considering a big decision (30%). Other reasons: making decisions that were previously delayed (25%), strategic fit (18%), testing ideas (15%), reacting to external factors (9%), and regulation (4%).
Despite executives' comfort in relying on gut instinct, nearly two-thirds said the use of data has changed how their company makes decisions and they expect it to have more impact in the future. The top three changes executives plan in decision making include the number of people involved in making a decision, greater use of specialised and enhanced analytics and data analysis, and the use of dedicated data teams to inform strategic decisions.

Potgieter says: "With so much at stake when it comes to the impact of big decisions on profitability, and the lack of predictability and frequency of when decisions are required, companies are trying to increase their decision making speed and sophistication. Better decision making requires the use of newly accessible data and analytic techniques, as well as clarifying accountability and the decision making processes."

The survey findings affirm a balanced approach to using data and analytics to make speedy and sophisticated big decisions for competitive advantage:
· Mapping decisions to shareholder value by pinpointing decisions that have the biggest effect on the company's future;
· Linking the strategic alternatives to business impacts by simulating how mega trends, industry trends and the strategic alternatives affect the business and operating model;
· Applying a value and results lens by quantifying the expected improvement in metrics associated with improving decision making; and

· Adopting a structured test and learn approach by specifying changes to the organisation, process, technology and culture that are needed to improve decision making.

"Looking ahead, a significant number of companies plan to change decision making because of big data. The hardest battle may be to convince senior executives at the top of an organisation that data and analysis can be a benefit to their role.

"Executives know the right questions to ask. Now they need to know and have the desire to know how to get the right answers from the data. Those who do not, should consider learning how. Those who resist doing so will gradually be lagging behind on timely change of business strategies, as the next generation of data savvy executives and future senior managers come through," concludes Potgieter.

SARS takes another stab at interpreting the 'group of companies' definition

Author: Lisa Brunton (DLA Cliffe Dekker Hofmeyr)

In our Tax Alert of 15 March 2013 we reported on the South African Revenue Services' (SARS') draft Interpretation Note on the interaction between the definition of a 'group of companies' as it appears in s1 and s41(1) of the Income Tax Act, No 58 of 1962 (Act).

SARS embellished the draft Interpretation Note somewhat with the release on 24 October 2013 of Interpretation Note No 75

(IN 75) dealing with the exclusion of certain companies and shares from a ‘group of companies’ as defined in s41(1) of the Act. IN 75 has now been superseded by the release of Issue 2 of IN 75 on 22 September 2014.

The definition of a ‘group of companies’ in s1 of the Act is broader than the definition in s41(1) and the interpretation and interaction of the two definitions is critical in determining whether a particular transaction or distribution qualifies for tax relief under the corporate rules.

Given the circuitous interaction between the definition of a ‘group of companies’ in s1 and its definition in s41(1), it is helpful to restate them here:

A ‘group of companies’ is defined in s1 of the Act as meaning two or more companies in which one company, the controlling group company, directly or indirectly holds shares in at least one other company, the controlled group company,‘to the extent that – (a) at least 70% of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and (b) the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.’

For purposes of s41(1) a ‘group of companies’ is defined as meaning ‘a group of companies as defined in section 1: Provided that for purposes of this definition –

(i) any company that would, but for the provisions of this definition, form part of a group of companies shall not form part of that group if…’ that company is:

- A co-operative, a company established in South Africa for the specified benefit of the general public or a sector thereof, or a foreign collective investment scheme in participation bonds or securities.
- A non-profit company as defined in s1 of the Companies

Act, No 71 of 2008.

- A company the gross income of which is exempt from tax in terms of s10 of the Act.
- A public benefit organisation or recreational club approved as such in terms of s30 or s30A of the Act.
- A foreign incorporated association, corporation, company or body corporate unless it has its place of effective management in South Africa.
- A company that has its place of effective management outside South Africa.

Paragraph (i)(ff) of the proviso to s41(1) of the Act became operative on 1 January 2013 and applies to transactions entered into on or after that date. The reference to the exclusion of such companies from the definition of a s41(1) ‘group of companies’ is the only substantive addition. For the rest it resembles its predecessor, released on 24 October 2013.

The second proviso deems certain equity shares not to be equity shares if they are held as trading stock; or any person is under a contractual obligation to sell or purchase them, or holds an option to sell or purchase them other than at their market value at the time of sale or purchase.

In brief IN 75 provides as follows:

- The corporate rules contained in ss41 – 47 of the Act provide tax relief for certain transactions (eg asset-for-share, substitutive share-for-share, amalgamation, intra-group, unbundling) and distributions on liquidation, winding-up and deregistration between companies within a ‘group of companies’ as defined in s41(1) of the Act.
- In order for a transaction or distribution between companies to qualify for tax relief under the corporate rules, the companies in question must form part of a more restrictively defined s41(1) ‘group of companies.’

- Since the s41(1) definition commences with reference to the s1 definition of a ‘group of companies’, in applying the law and interpreting the s41(1) proviso, one must first ascertain whether the companies in question comprise a s1(1) ‘group of companies’ as defined. Assuming that they do, one proceeds to the s41(1) proviso to determine whether it operates to exclude any company or shares from consideration. If by operation of the s41(1) proviso, a company, for example a controlling group company, is excluded by virtue of its foreign incorporation and place of effective management, one must return to the s1 ‘group of companies’ definition to establish whether the remaining companies constitute a s1 ‘group of companies.’ If there is another controlling group company among the remaining companies that has not been excluded by operation of the s41(1) proviso, one may still have a s(1) ‘group of companies’ that qualifies for tax relief under the corporate rules. However in the absence of a controlling group company, a ‘group of companies’ can no longer exist. As such the remaining companies will not qualify for tax relief in terms of the corporate rules.
- Legal precedent is cited in IN 75 in support of the principle that when interpreting the meaning of legislation, one must construe the enacting clause (s1), the saving clause (s41(1)) and the proviso (s41(1) proviso) together.
- In addressing whether it may be discriminatory from a tax perspective to deny tax relief under the corporate rules to companies, the controlling group company of which is, for example, foreign incorporated and effectively managed; when similar companies with a South African resident controlling group company may well be afforded such relief; IN 75 categorically asserts that such denial, by virtue of the exclusion of such companies by operation of the s41(1) proviso, does not constitute tax discrimination under South Africa’s tax

treaties. The assertion is founded on the equality of treatment argument. South African resident companies that are exempt from South African income tax, as are foreign incorporated and effectively managed companies (other than on their South African sourced income and capital gains on the disposal of South African immovable property and/or assets of any permanent establishment they may have in South Africa), are similarly excluded from benefitting from such tax relief by operation of the s41(1) proviso.

IN 75 places beyond doubt SARS' rejection of the interpretation of the interaction between s1 and s41(1) proposed by the South African Institute of Chartered Accountants (SAICA). SAICA previously submitted that s41(1) requires only the determination of whether a 'group of companies' exists for purposes of the definition in s1(1) of the Act, from whence one must establish whether the s41(1) proviso operates to exclude certain specified companies from that group of companies for s41(1) purposes. SAICA asserts that there is no requirement to reapply the s1 'group of companies' definition to the companies remaining after the exclusion of specified companies by operation of the s41(1) proviso to establish whether a 'group of companies' still exists. However if one applies SAICA's proposed interpretation to the example above, after the exclusion of the foreign incorporated and effectively managed controlling group company from the s1 established 'group of companies' by operation of the s41(1) proviso, one would end up in the incongruous situation of one or more controlled group companies without a controlling group company, still constituting a 'group of companies.' Such conclusion would seem to neutralise the deliberate narrowing of the s1 'group of companies' definition by the s41(1) proviso.

Proposed simplification of foreign business establishment exemption for controlled foreign companies

Author: Heinrich Louw of Cliffe Dekker Hofmeyer

In terms of s9D of the Income Tax Act, No 58 of 1962 (Act), a South African tax resident can be taxed on the 'net income' of its controlled foreign companies (CFC). However, various exemptions exist in this regard.

For example, in terms of the second proviso to the definition of 'net income' in s9D(2A) of the Act, the net income of a CFC will be deemed to be nil if the taxes payable by that CFC in foreign jurisdictions are at least equal to 75% of the tax that the CFC would have paid had it been a South African tax resident. This is often referred to as the high-tax exemption. In performing the calculation regard must be had to any international treaties for the avoidance of double taxation, and tax credits or rebates.

Further exemptions are contained in s9D(9) of the Act, which effectively excludes certain amounts from being taken into account when determining a CFC's net income. The most notable exemption is the so-called foreign business establishment exemption, which excludes amounts attributable to any foreign business establishment that a CFC has from the net income calculation.

When performing the calculation for the net income of a CFC, it should first be determined whether the high-tax exemption

applies and deems the net income of the CFC to be zero, before potentially proceeding with disregarding the relevant amounts excluded in terms of s9D(9) of the Act from net income. Testing for whether the high-tax exemption applies can however be quite onerous, especially when a resident has multiple CFCs and the income in respect of those CFCs are in any event attributable to foreign business establishments.

In terms of the draft Taxation Laws Amendment Bill 2014 (Bill) that was released earlier this year, it is proposed to simplify the process where the foreign business establishment exemption applies to all the income of the relevant CFC. The Bill proposes that, similar to the high-tax exemption, the net income of a CFC also be deemed to be zero where 'all the receipts and accruals' of the CFC is attributable to a foreign business establishment.

The effect of the proposal is that it becomes unnecessary for a resident to first determine the hypothetical tax position of each of its CFCs and to only thereafter apply the foreign business establishment exemption if the high-tax exemption does not apply. Where all of a CFC's receipts and accruals are attributable to a foreign business establishment, the net income of the CFC will automatically be deemed to be zero and it would not be necessary to do any calculations in respect of the high-tax exemption.

This is a welcomed amendment to s9D of the Act.

Merger and takeover law –

impact on private companies

By Basil Mashabane

Impact on private companies

This is a follow-up to the article ‘Mergers and takeovers under the new Companies Act’ (2011 (Sept) *DR* 30) where I discussed the fact that South African mergers and acquisitions are experiencing a paradigm shift following the enactment and implementation of the new Companies Act 71 of 2008 (the Act) on 1 May 2011, replacing the old order.

The Act has been in existence almost three years and it has already brought enormous changes to the way mergers and takeovers are regulated in South Africa. There is no denying, however, that there exists a number of uncertainties on a few issues pertaining to the Act and its application to mergers and takeovers.

Application of mergers and takeover laws on private companies

The main subject of this article is one of the major changes that the law has introduced that has caused some consternation in business but, at the same time, appears to be enjoying support among the stakeholders it is meant to protect, namely the minority shareholders in companies. The change relates to the application of the Act and the takeover regulations to private companies registered under South African law.

The merger and takeover provisions of the Act apply to regulated companies only and s 118(1) of the Act lists and defines three types of regulated companies, namely –

- public companies (listed or unlisted);
- state-owned companies (unless exempted); and
- private companies.

Under s 118(1)(*c*) of the Act a private company is regulated only if –

‘(i) the percentage of the issued securities of the company that have been transferred, other than by transfer between or among related or inter-related persons, within the period of 24 months immediately before the date of a particular affected transaction or offer exceeds the prescribed percentage in terms of subsection (2) or;

(ii) the Memorandum of Incorporation of that company expressly provides that the company and its securities are subject to this Part, Part C and the Takeover Regulations, irrespective of whether the company falls within the criteria set out in subparagraph (i).’

For a private company to be regarded as regulated, certain steps must have taken place and this stems from the realisation that private companies are by nature, small and tightly held business entities and, to a large degree family controlled, making it easy for the parties to reach agreement on major issues relating to the company and its business, such as acquisitions and/or transfer of the business of the company.

Rationale for the application of the Act to private companies

It could be argued that the Act therefore envisages that a private company, which is regulated, would be a large company with a sizeable number of shareholders and with sizeable corporate activity taking place, including entering into buying and selling of shares, business transactions or other corporate activity events necessitating the involvement and/or intervention of a regulator such as the Takeover Regulation Panel to ensure that the rights of the company’s minority shareholders are protected.

What is clear however, is that the majority of the matters involving private companies that the Takeover Regulation Panel (the panel) deals with involve fairly small private companies in which shareholders range between two and ten in number. These shareholders are usually party to the sale of shares or disposal of assets agreements being entered into and would proceed with these agreements unhindered, except when a private company entered into a transaction in the past 24 months in which shares exchanged hands, resulting in it being regulated and therefore required to comply with certain statutory requirements before concluding and implementing the particular sale of shares or disposal of assets agreement with another party.

These statutory requirements that a private regulated company is required to meet include the preparation of a circular in terms of the regulations with the purpose of fully explaining and disclosing to shareholders all the aspects of the merger or takeover transaction or agreement that the company is involved in and to also prepare an independent expert report (at its expense) for a valuation of the company’s shares or assets in order to determine, for the benefit of the shareholders, whether the offer to acquire the shares or to effect the disposal of the company’ assets, is fair or unfair to the shareholders of the company.

An argument could be made that the only rationale for regulating mergers and takeover transactions involving private companies is to protect shareholders regardless of the number of shareholders that are involved and whether or not the shareholders are fully in support of the merger or takeover transaction.

The question therefore becomes whether it is proper and rational for these provisions to exist, taking into account the nature of private companies and the transactions regulated by South African merger and takeover law.

Exemption of private companies

In recognition of what could at times appear to be an absurdity, the drafters of the Act and the regulations had the foresight to include a provision in the Act to the effect that the panel has powers to grant an exemption to an offerer to an affected transaction to an extent that doing so is not prejudicial to the interest of any party to the transaction; that the cost of compliance is disproportionate to the value of the transaction or that doing so (ie, granting the exemption) would be both reasonable and justifiable.

Based on the nature of private companies and the type of transaction entered into by these companies, the panel continues to be inundated with applications for exemptions from legal practitioners acting for these companies requesting that the parties involved in these transactions be exempted from compliance with the provisions of the Act and the takeover regulations.

The fact that the panel is, under certain circumstances, allowed to provide an exemption from its requirements should not create the impression that the panel has become a rubber stamp and fortuitously grants exemptions to parties involved in transactions with these regulated companies, particularly where, at face value, it appears that granting an exemption

would be correct thing to do.

This is certainly not the case when one considers that the panel would still require a letter from the parties applying for the exemption detailing the nature of the transaction, explaining the basis on which the company is regulated, taking into account s 118(1)(*c*), together with a motivation as to why an exemption should be granted based on the factors indicated above, which are found in
s 119(6), and with supporting documents including written agreements attached.

In addition to these requirements, the offerer and the party applying for the exemption would also be required to attach waiver letters from shareholders in the regulated company in which the shareholders indicate that they are aware of the offerer's obligations to comply with the provisions of the Act and the takeover regulations on mergers and takeovers, but that they are prepared to allow the offerer to obtain an exemption through them waiving their rights.

Lastly, the waiver letters must be signed in original form by all the shareholders in the regulated company in order for the application to be considered.

Conclusion

There is a prevailing argument in some quarters that the application of the Act and the regulations to private companies is cumbersome and to some extent unnecessary, taking

into account the nature of the majority of private companies registered in South Africa. However, there is a counter-argument that the provisions apply to select private companies meeting certain requirements as prescribed only and it is indeed in these companies where such application of the requirements would be necessary.

Further, and in support of the counter-argument that the Act and the regulations do provide an ‘escape clause’ in terms of s 119(6) wherein the requirements for applying for and obtaining an exemption are all encompassing and not difficult to satisfy if and when adhered to and, lastly, that the panel has not abrogated its role and still ensures that it plays its regulatory role and function with the same amount of interest and close inspection as it would when it deals with a major takeover transaction for purposes of ensuring that the interests of shareholders are protected.

It should never be taken for granted that a large number of small businesses in South Africa have been incorporated as private companies and most of them acquire their legal services from small and medium-sized law firms.

It has been my experience over the years at the panel that practitioners in these firms hardly get exposure to merger and takeover law work and these changes to the law will inadvertently ensure that these practitioners are exposed to the world of mergers and acquisitions as they provide advice to their clients, albeit that these changes were not motivated by the desire to create more work for practitioners but to simplify the law and to also enhance shareholder protection.

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The impact of statutory mergers on current tax legislation (part 2)

by **Robert Gad** and **Janel Strauss**

We have previously written on the mismatch between the statutory merger provisions in section 113-116 of the new Companies Act 71 of 2008 ("Companies Act") and the current tax legislation. In part 1 of this article we considered the interplay between statutory merger provisions and the tax rollover relief provisions contained in sections 41 to 47 of the Income Tax Act 58 of 1962 ("ITA") and explained how a statutory merger transaction may not necessarily qualify for the tax rollover relief. We also considered the implications that the transfer of administrative tax obligations from a target company or companies ("TargetCo") to the acquiring company or companies ("AcquireCo") may have on parties entering into an "amalgamation or merger," as this term is defined in the Companies Act.

In part 2 of the article we focus on the possible income tax, capital gains tax ("CGT"), value-added tax ("VAT"), transfer duty and securities transfer tax ("STT") effects of a statutory merger on the assumption that the tax rollover

relief to corporates does not apply. In our discussion we will continue the distinction we made in part 1 regarding the two possible underlying legal causes for the transfer of property and liabilities in terms of section 116(6) and (7) of the Companies Act. Whichever of these two possible scenarios is the correct interpretation could have far-reaching tax implications for both TargetCo and AcquireCo. To recap, the two possible causes are:

- **Scenario 1**: the typical contractual causes for the transfer of assets and liabilities (i.e. sale, cession, delegation etc.) as per the agreement between the parties; or
- **Scenario 2**: the automatic operation of law alone where assets and liabilities pass *ex lege*.

We also mention briefly the impact that the imminent Tax Administration Bill ("TAB") may have on the tax obligations and liabilities of the parties involved.

consequences if no rollover relief applies

1. **income tax**

<table>
<tr><td>1.1</td><td colspan="2">If trading stock of TargetCo is transferred to AcquireCo, the definition of "gross income" in section 1 of the Act requires that any "amount, in cash or otherwise, received by or accrued to or in favour of" TargetCo, must be included in its "gross income".</td></tr>
<tr><td></td><td>1.1.1</td><td>In the case of scenario 1, TargetCo will accrue an amount equal to the value of its liabilities which AcquireCo assumes (plus any other consideration given).</td></tr>
</table>

<table>
<tr><td></td><td>1.1.2</td><td>As the operation of law is the causa of the transaction in scenario 2, assets and liabilities are transferred automatically and not in return for a quid pro quo. Arguably TargetCo will not become entitled to something in return for the transfer of its assets. This argument however ignores the ordinary meaning of the word “amount” which does not implicitly involve the concept of a quid pro quo. However, in determining the revenue or the capital nature of a receipt, it is practically necessary to have regard to the nature of the asset which is disposed of in return therefor. There could therefore be conceptual difficulties in dealing with any “amount” accruing to Targetco in the form of relief from liabilities, without connecting this to the disposal of assets of either a capital or revenue nature.</td></tr>
<tr><td>1.2</td><td colspan="2">Even though it was recently announced in the 2012 Budget Review that government is considering removing the anti-avoidance connected-person rules relating to the sale of trading stock, these rules currently still apply and their impact must therefore be considered. In terms of section 22(8) of the ITA, if a “taxpayer has disposed of trading stock, other than in the ordinary course of his trade, for a consideration less than the market value thereof … the taxpayer shall be deemed to have recovered or recouped … an amount equal to the market value of such trading stock”.</td></tr>
<tr><td></td><td>1.2.1</td><td>In the context of scenario 1, section 22(8) will only apply to TargetCo in instances where the market value of the trading stock exceeds the amount accrued to TargetCo in terms of the agreement. Should section 22(8) apply, TargetCo would have a deemed accrual of an amount equal to the market value of the trading stock at the date of the disposal.</td></tr>
</table>

	1.2.2	In scenario 2 it should first be considered if TargetCo can be said to “dispose” of trading stock. The word “disposed” is not defined in the ITA (except for purposes of the Eighth Schedule to the ITA, which does not apply in this context). Ordinarily the words “dispose” and “disposal” envisage the *actions* of bestowing, making over, dealing out, dispensing, distributing, formally assigning or handing over, getting rid of, dealing conclusively with or transferring something into the hands of another care or possession, for example by sale or bequest[1]. Although these meanings seem to be very wide, it seems that the words presuppose a voluntary or positive action on the part of the person disposing, which may suggest a narrowed interpretation. The decision of Shell’s Annandale Farm (Pty) Ltd v Commissioner for South African Revenue Service 62 SATC 97 (“Shell’s Annandale”) may be noteworthy here. In this case the court considered the ordinary meaning of a “supply” in the context of VAT. In his judgement, Davis J emphasised that, as supplies are made in the course or furtherance of an enterprise for purposes of VAT, “supply” must be interpreted in an active manner and that an expropriated property by operation of law excluded any positive action on the part of the vendor. The “disposal” of trading stock could arguably also presuppose a positive action, as trading stock is ordinarily disposed of in the course of a scheme of profit making[2] and should therefore also be interpreted in an active manner. Such an interpretation would be in line with the ordinary meaning of “disposal” discussed above. It is debatable whether the *ex lege* transfer of trading stock in accordance with the statutory merger provisions and an ex lege expropriation of property are analogous (i.e. that both necessarily exclude a positive action on the part of the transferee). Arguably, the mere fact that a TargetCo voluntarily entered into an amalgamation or merger agreement may in itself constitute a positive action. Moreover, by stating that the disposal must be “*other than in the ordinary course of his trade*” in the proviso to section 22(8), it may well be that section 22(8) includes a disposal that involves no positive action.

	1.2.3	Should it be assumed that TargetCo "disposed" of trading stock, such disposal will, arguably, be for no consideration as the transfer of trading stock will be effected by force of law, rather than by a reciprocal agreement[3]. Section 22(8) will apply, as the consideration (i.e. nil) would be less than the market value of the trading stock. TargetCo would therefore have a deemed accrual of an amount equal to the market value of trading stock at the date of the disposal.
1.3	Next, we consider whether AcquireCo will be allowed to claim deductions in respect of the acquisition of trading stock. In terms of section 11(a) of the ITA, deductions from income are, generally, only allowed in respect of "expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature". In this context, the word "expenditure" arguably includes outlays of amounts in a form other than cash. This follows from the case of Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A), in which it would appear that, in a transaction of barter, the value of the commodity promised in satisfaction of the obligation incurred, would constitute expenditure incurred.	
1.4	According to Meyerowitz[4], "where the expenditure is not in cash, the expenditure will be the cost to the taxpayer e.g. of the asset transferred, and where the asset had not been previously purchased by the taxpayer, its value. Where the asset consists of trading stock its value is its market value at the date of acquisition in terms of section 22(4) of the Act. Where it is not trading stock its value, it is considered, is its market value as at the date it is given in consideration."	
	1.4.1	AcquireCo in scenario 1 would therefore be able to deduct as expenditure in accordance with the timing rules of section 22 the cost paid for trading stock, in terms of the agreement.
	1.4.2	AcquireCo in scenario 2 will arguably acquire trading stock for no consideration. Section 22(4) will therefore deem the cost of the trading stock to be equal to the current market price thereof. Section 22(4) applies where "trading stock has been acquired by any person for no consideration or for a consideration which is not measurable in terms of money." Should AcquireCo acquire any revenue assets which do not fall within the definition of "trading stock", it seems that no deduction will be allowed in respect thereof.
1.5	If TargetCo previously claimed allowances in respect of capital assets, those amounts may be recovered or recouped by TargetCo in terms of section 8(4)(a) of the ITA. In Omnia Fertilizer Ltd v C SARS 65 SATC 159 ("Omnia"), the court considered the meaning of "recovered or recouped" within the context of section 8(4)(a) and held that it essentially meant to "return to the taxpayer's pocket" something which had previously been an expense. In this regard section 8(4)(k) may also be relevant. This section will apply where the specific requirements of this section have been met (the outcome of which would vary from a case to case basis).[5]	

<table>
<tr><td></td><td>1.5.1</td><td>Assuming that the consideration received for the transfer of assets exceeds the written down value of such assets, TargetCo in scenario 1 will have recoupments in respect of all allowances previously claimed in respect of those assets. If section 8(4)(k) applies, TargetCo will be deemed to have disposed of the assets for market value and the recoupment must then be determined accordingly.</td></tr>
<tr><td></td><td>1.5.2</td><td>It is unclear if TargetCo in scenario 2 “returns” anything to its “pocket” when the assets are transferred ex lege. However, it should be noted that in the Omnia case, it was held that the taxpayer concerned “returned” something to its pocket by merely reversing an expense for accounting purposes, without actually receiving anything. The court also noted that, as long as an amount previously expended in the eyes of the tax law has reverted to the taxpayer’s pocket for all practical purposes, such taxpayer recouped those amounts. Arguably, this occurs when AcquireCo assumes the liabilities of TargetCo by operation of law. According to the Omnia case, the legal cause for the extinction of a liability is not necessarily decisive in determining whether an amount has been recouped or not. The court held that in this regard, one should rather look at the meaning of the words “recovered or recouped” in section 8(4)(a), than, for example, at the words “prescription, agreement or otherwise, i.e. extinction of the liability”. Section 8(4)(m) of the ITA should also be considered. This section specifically deals with the scenario where a taxpayer is “relieved from the obligation to make payment of any expenditure actually incurred”. Only once the amounts are no longer legally enforceable, due to “prescription, waiver or release of a claim for payment”, are they recouped under section 8(4)(m). It may be argued that TargetCo is per se released from a claim for payment of its incurred liabilities when these liabilities are automatically transferred to AcquireCo. (To the extent that section 8(4)(k) may also apply, the value of such recoupments must be calculated with reference to the market value of the relevant assets.)</td></tr>
<tr><td>1.6</td><td colspan="2">Where AcquireCo acquired capital assets from TargetCo, AcquireCo may be entitled to claim capital allowances in respect of these assets. The majority of capital allowances are calculated with reference to the “cost” of the asset or the “expenditure actually incurred” in respect of the asset.</td></tr>
<tr><td></td><td>1.6.1</td><td>AcquireCo in scenario 1 should be able to allocate a cost to each asset acquired from TargetCo (which would typically be the purchase consideration in respect of the asset) and should be entitled to claim allowances accordingly.</td></tr>
</table>

	1.6.2	AcquireCo in scenario 2 will arguably incur no expenses or cost in respect of assets acquired, as ownership was transferred to AcquireCo by mere operation of law, without AcquireCo having to give anything (i.e. a consideration) for the acquisition, with consequential implications for claiming of capital allowances.

2. CGT

2.1	CGT is determined with reference to the "disposal" of an asset. The ordinary meaning of the word "disposal" (as discussed above) will not apply here, as the Eighth Schedule to the ITA[6] defines "disposal" for purposes of CGT as "any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset". Due to this wide definition, TargetCo will in both our scenarios "dispose" of assets (whether by means of a sale or by the operation of law) by way of the amalgamation or merger transaction.
2.2	The capital gain (or loss) of TargetCo will be the difference between the "proceeds" from the disposal and the "base cost" of the asset. In terms of paragraph 35, "the proceeds from the disposal of an asset by a person are equal to the amount received by or accrued … in respect of that disposal". Paragraph 38 applies where a person "disposes of an asset by means of a donation, or for a consideration not measurable in money, or to a person who is a connected person in relation to that person for a consideration which does not reflect an arm's length price.

	2.2.1	TargetCo in scenario 1 will therefore have proceeds equal to the consideration value received or accrued as stated in the agreement, which might include any debt assumed. Depending on the facts, paragraph 38 may apply to deem the disposal proceeds to equal the market value of the asset.

	2.2.2	TargetCo in scenario 2, however, will arguably have no proceeds. The words “from” and “in respect of” envisage a direct or causal relationship between the disposal and the proceeds[7], and such a causal link may be absent if the disposal is caused by operation of law and the agreement is silent. The application of paragraph 38 should be considered to determine if TargetCo may be deemed to have proceeds. The disposal to AcquireCo will not be a donation, as a donation envisages an entirely separate causa. However, TargetCo will arguably dispose of assets for no consideration as a quid pro quo. This lack of consideration, however, remains measurable (i.e. nil). Accordingly, paragraph 38 should only apply in those instances where AcquireCo is a connected person in relation to TargetCo, as the nil consideration would probably not reflect an arm’s length price. Should paragraph 38 apply, the disposal will be deemed to take place for proceeds equal to the market value of the assets.

2.3	From AcquireCo's perspective, the base cost of assets acquired must be determined (for the purpose of a possible future disposal). Paragraph 20 deals with the base cost of an asset, which generally consists of "expenditure actually incurred in respect of the cost of acquisition" and "amounts actually incurred as expenditure directly related to the acquisition".	
	2.3.1	AcquireCo in scenario 1 should be entitled to treat the consideration, in terms of the agreement, as the base cost of the assets acquired from TargetCo.
	2.3.2	In our view, the wording of paragraph 20 may prevent AcquireCo in scenario 2 from having any base cost, as AcquireCo will arguably incur no actual expenses or costs as a consideration for the assets acquired. Arguably, nothing will be incurred "in respect of" or "directly related" to the acquisition, as AcquireCo automatically becomes the owner of the assets by virtue of statute. (It should be noted that paragraph 38 could also deem AcquireCo to acquire the assets for expenditure equal to their market value in certain circumstances.) Much will turn on the drafting of the merger agreement. The case we have described here might well be on the extreme end of the spectrum.

3. **VAT**

<table>
<tr><td>3.1</td><td colspan="2">The Value-Added Tax Act No. 89 of 1991 (“VAT Act”) levies output VAT on the supply of goods and services by a vendor in the course or furtherance of an enterprise. “Supply” is widely defined and includes any “performance in terms of a sale, rental agreement, installment credit agreement, and all other forms of supply, whether voluntary, compulsory or by operation of law”.</td></tr>
<tr><td></td><td>3.1.1</td><td>Provided that TargetCo in scenario 1 is a vendor, a “supply” will be made to AcquireCo in respect of goods sold for a consideration.</td></tr>
</table>

	3.1.2	The transfer of goods to AcquireCo will also constitute a “supply” in scenario 2, as the definition of “supply” specifically includes performances “by operation of law”. It should be noted that this inclusion was the result of legislative intervention in response to the Shell’s Annandale decision, which we briefly discussed above. To refresh, land was expropriated from a vendor in this case and the court had to consider whether such an ex lege transfer would constitute a “supply”. The court held that, since supplies are made in the course or furtherance of an enterprise, the word “supply” suggests an active interpretation. Expropriation excluded any positive act on the part of the vendor and therefore no “supply” was made. However, in light of the subsequent amendments to the definition of a “supply”, a different conclusion would be reached today.

3.2	Once a transfer constitutes a “supply”, the VAT Act further requires that the value of such supply must be determined with reference to its “consideration”. The VAT Act essentially envisages “consideration” as payments (whether in cash or otherwise) *in respect of* or *in response to* a supply[8]. Even if there is no consideration, in certain specific circumstances in terms of section 10(4) of the Vat Act, the consideration for the supply is deemed to be the open market value of the supply, if all of the following requirements are met: - the supply must be made for no consideration or for a consideration which is less than the open market value of the supply; - the supplier and recipient must be connected persons in relation to each other; and - the recipient may not be entitled to make a deduction of the full amount of VAT in respect of the supply if VAT was charged.	
3.3	Whether section 10(4) applies should be determined on a case by case basis, especially taking into account whether or not AcquireCo would be entitled to deduct the full input credit (which is discussed in more detail below).	
	3.3.1	TargetCo in scenario 1 will levy VAT on the amount of consideration received in exchange for the goods. (It should be considered with reference to the facts whether section 10(4) applies to adjust the value of the consideration).

	3.3.2	In scenario 2, supplies will arguably have no consideration, as the supplies are caused by operation of law and arguably AcquireCo will not be required to give anything “in respect of” or “in response to” such supplies. However, if section 10(4) applies to the facts, it may deem TargetCo to make the supply for a “consideration” equal to the open market value of the supply. In these scenarios the supplier may have an output tax liability.
3.4	If the transaction was subject to VAT, AcquireCo may claim an input credit. However, this input credit will be limited in certain circumstances. The issue of payment is particularly important in property transactions. Problems in deducting the full amount of VAT charged will especially arise where TargetCo makes a mixed supply, i.e. a supply that is partially subject to VAT and partially exempt from VAT, as only the portion of input tax that relates to taxable supplies can be claimed by AcquireCo. The statutory merger rules do not eliminate this exposure. If TargetCo is not a vendor and for this reason no VAT was charged, AcquireCo may still be eligible for a notional input credit. Broadly speaking, this special credit is allowed where a non-vendor supplies second-hand goods by way of a sale.	

	3.4.1	Provided that the requirements of the relevant sections are met, AcquireCo in scenario 1 could claim this credit with reference to the consideration paid in terms of the agreement.
	3.4.2	AcquireCo in scenario 2 should also be able to claim a credit, but the value of its credit will be nil. This follows from the definition of “sale” in section 1 of the VAT Act which includes “any transaction or act whereby or in consequence of which ownership of goods passes”. As the ex lege transfer of goods by means of an amalgamation or merger transaction is a transaction in consequence of which ownership of the goods passes, the transaction should accordingly qualify as a “sale” for VAT purposes. The amount to be claimed should then be calculated as the tax fraction of either the *lesser* of “any consideration in money given” or “the open market value of the supply”. As the consideration given by AcquireCo in terms of scenario 2 would arguably be nil, the notional input credit would also be nil.

<table>
<tr><td>3.5</td><td colspan="2">Where an asset is disposed of as part of an enterprise as a going concern, the supply may be zero-rated provided the requirements of section 11(1)(e) are met. For the zero-rating to apply (i) the parties must agree in writing that the enterprise will be an income-earning activity on the date of transfer thereof, (ii) the parties must agree in writing that the consideration for the supply will be inclusive of VAT at the rate of zero percent, and (iii) all assets necessary for carrying on such enterprise must be disposed of.</td></tr>
<tr><td></td><td>3.5.1</td><td>Depending on the facts and provided the specific requirement of section 11(1)(e) are met, assets supplied as part of an enterprise as a going concern may be zero rated in the case of scenario 1.</td></tr>
</table>

	3.5.2	As previously mentioned, supplies will arguably have *no* consideration in scenario 2 as they are caused by operation of law. Parties may therefore struggle to meet the second requirement of section 11(1)(e) mentioned above, i.e. that it must be agreed that the *consideration* for the supply will be inclusive of VAT at the rate of zero percent., in circumstances where the merger agreement does not stipulate any consideration. Apart from this challenge there seems to be no reason in principle that zero rating could not be applicable to a qualifying disposal of a going concern.

4. **Transfer Duty**

4.1	Transfer duty is imposed on the transfer of immovable property. Generally, either transfer duty or VAT will apply to a transaction, but not both. AcquireCo may in certain circumstances incur a transfer duty liability in respect of its acquisition of immovable property.	
	4.1.1	If transfer duty is levied in scenario 1, AcquireCo will be liable for a duty equal to 8% of the consideration paid for the property or the market value, whichever is higher.

	4.1.2	AcquireCo in scenario 2 will arguably acquire immovable property for no consideration. Accordingly, if transfer duty is levied, it will be calculated with reference to the fair market value of the property.

5. **STT**

5.1	In terms of the Securities Transfer Tax Act ("STT Act"), STT is payable on every *transfer* of a security at a rate of 0,25% of the higher of the market value or the consideration paid for the security. The tax is payable by the company which issued that security. The STT Act defines "transfer" widely to include "the transfer, sale, assignment or cession, or disposal in any other manner, of a security or the cancellation or redemption of that security", but specifically excludes "any event that does not result in a change of beneficial ownership". The STT Act does not define the term "beneficial ownership" in relation to a security and its exact meaning in this context is a contentious issue. It seems that the concept of "beneficial ownership" may relate to the economic ownership of a share (i.e. to the person who is entitled to the pecuniary benefits attached to the share), rather than the registered owner of the shares[9]. Through this exclusion it may be intended that only a transfer of the economic ownership of a security will be subject to STT.

<table>
<tr><td></td><td>5.1.1</td><td colspan="2">There is a change in beneficial ownership of the shares in scenario 1, TargetCo will “transfer” shares to AcquireCo in terms of the underlying agreement and STT will be payable at a rate of 0,25% of the higher of the market value or the consideration paid for the security,</td></tr>
<tr><td></td><td>5.1.2</td><td colspan="2">In scenario 2, it seems quite clear that there is a change in beneficial ownership of the shares, triggering an STT liability.</td></tr>
<tr><td>5.2</td><td colspan="3">Interestingly, section 113(2) of the Companies Act provide, amongst other things, that:</td></tr>
<tr><td></td><td></td><td colspan="2">“Two or more companies proposing to amalgamate or merge must enter into a written agreement setting out the terms and means of effecting the amalgamation or merger and, in particular, setting out …</td></tr>
<tr><td></td><td></td><td>(c)</td><td>the manner in which the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property;</td></tr>
</table>

impact of the tax administration bill (‘TAB’)

One effect of the statutory merger rules is to transfer certain (inter alia, tax) obligations to the merged entity. In part 1 of this series of articles we considered how tax obligations imposed by the ITA on the TargetCo, may become

enforceable against the AcquireCo. The commercial exposure of the transfer of tax obligations and liabilities may be intensified by the imminent TAB.

The TAB is a legislative initiative to incorporate certain generic administrative provisions which are currently duplicated in the different tax acts. Once incorporated, the TAB will replace the current administrative provisions of the tax acts, including the ITA.

The TAB retains most of the tax obligations that taxpayers currently have under the administrative provisions of the ITA. In addition thereto, the TAB substantially supplements SARS's powers to gather information regarding taxpayers and to collect outstanding tax debts. The corresponding obligations of taxpayers (and of other persons) are extended likewise. One example is the provisions dealing with the strengthening of SARS's powers to collect tax debts from so-called "responsible third parties". Essentially these provisions provide that:

- any third party who holds or owes or will hold or owe any money (including a pension, salary, wage or other remuneration), for or to a taxpayer, may by notice by a senior SARS official be required to pay such amounts to SARS. Should the third party fail to pay the money as so required in the notice, the third party will be held personally liable of the money (clause 179);
- any person who controls or is regularly involved in the management of the overall financial affairs of a taxpayer with outstanding tax debts may be held personally liable for such debts where a senior SARS official is satisfied of negligence or fraud on the part of such person in respect of the payment of tax debt of the taxpayer (clause 180);
- where shareholders received assets from an unlisted company with outstanding tax debts within one year of its winding-up, such shareholders will be held jointly and severally liable to pay the unpaid (clauses 181 and

184);

- where a person (i.e. the "transferee") receives an asset from a taxpayer (i.e. the "transferor") who is his connected person without consideration or for consideration below the fair market value of the asset, the transferee may be held liable for the tax debt of the transferor limited to, inter alia, the market value of the assets at the time of the transfer less the consideration paid for the asset (clause 182); and
- SARS will have the same powers of recovery against the assets of the abovementioned "responsible third parties", as it had against the assets of the defaulting taxpaying (clause 184).

In dealing with the effects of a statutory merger it will be immediately apparent that these types of obligations may give rise to difficulties and the results may be quite unexpected. We will deal with them in a future article.

The TAB has been approved by Parliament and is awaiting the consent of the President. Interestingly, the TAB reserves the President with the power to determine different dates for different provisions of the TAB to come into operation and it seems likely to become effective in this manner. In his 2012 Budget Review, the Minister of Finance announced that the Bill is expected to be promulgated and most of its provisions brought into force in 2012. Unfortunately it remains uncertain exactly when the Bill will become operative.

conclusion

Should an "amalgamation or merger" wholly or partly fall outside the ambit of the tax rollover relief provisions of the ITA, the implementation of the transaction may lead to unexpected income tax, CGT, VAT, transfer duty and STT consequences in the hands of any parties involved, depending on whether or not scenario 1 or scenario 2 correctly describes the *causa* of the transaction. Should the amalgamation or

merger be governed by the underlying contract (i.e. scenario 1), the tax implications of the transaction would be dictated by the type of agreement used (e.g. the transfer of business agreement) and should be in line with the usual tax implications arising from such agreements.

Should assets and liabilities fuse *ex lege* (i.e. scenario 2) this alternative mechanism may become useful in effecting an amalgamation or merger. However, assets will arguably not be transferred *in return for* anything (e.g. cash, shares or the assumption of debt) and the transaction would arguably take place for *no consideration*. Various anti-avoidance provisions in the respective tax acts, which are aimed at non-arm's length transactions between connected persons, may be triggered. Typically, these provisions deem a transaction to have taken place at market value. The acquisition of fixed or trading assets without a cost can also be problematic if the tax roll-over rules do not apply to the specific case.

A key mismatch between the tax and company law is that the statutory merger rules, on the one hand, envisage the new AcquireCo stepping into the shoes of the old TargetCo, with the position of third parties *vis-a-vis* the TargetCo simply transferring to the AcquireCo. On the other hand, there are no explicit rules in the ITA treating or deeming these parties to be one and the same person for tax purposes. In this series of articles we have identified some of the anomalies arising in this regard. In his 2012 Budget Review, the Minister of Finance acknowledged the existence of anomalies between the Companies Act and the ITA and announced that the government will hold a series of workshops to review the nature of company mergers, acquisitions and other restructures to better understand their practical use. He also added that these workshops will lay the foundation for tax changes (and possibly changes to company law) over a two year period. The legislature's immediate focus area is expected to be share-for-share recapitalisations of a single company and it is

therefore anticipated that it may be some time before the other issues raised in this article will be addressed.

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[1] Black's Law Dictionary 9th Edition; Shorter Oxford Dictionary 5th Edition

[2] Trading stock is defined in section 1 of the Act to include "anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale of exchange" and "anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income"

[3] At 722, Clayden FJ held in Barnett v Commissioner of taxes 1959 (2) SA 713 (FC) that "the word [consideration] has an ordinary legal meaning, and that would clearly include a reciprocal undertaking."

[4] Meyerowitz on Income Tax (2007-2008 edition at paragraph 11.32)

[5] Section 8(4)(k) applies where a person has "(i) donated any asset; (ii) in the case of a company, transferred in whatever manner or form any asset to any shareholder of that company; or (iii) disposed of any asset to a person who is a connected person in relation to that person, in respect of which a deduction or an allowance has been granted".

[6] All references to paragraphs will refer to the paragraphs of the Eighth Schedule to the Act, unless stated otherwise.

[7] In Khaled v Durban Corp 1940 NPD 129 the court held that a tax could not be said to be a tax in respect of a transfer unless it had a direct or causal relationship with such transfer.

[8] Section 1 of the VAT Act defines "consideration in relation to the supply of goods or services" to include "any payment made or to be made… in respect of, in response to, or for the inducement of, the supply of any goods or services".

[9] Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd 1976 (1) SA 441 (A); Commissioner for South African Revenue Service v Metlika Trading Ltd and Others 66 SATC 345 at 350; as read with the Explanatory Memorandum on the Securities Transfer Tax Bill 2007 and dictionary meanings of “beneficial” and “owner”.

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