Proposed amendments to clarify income tax treatment of statutory mergers

Sections 113 and 115 of the Companies Act, 2008 provide for an automatic statutory merger of two companies. The transfer occurs by way of operation of law, and barring any express prohibition to the contrary in a contractual arrangement, no third party consent is generally required to implement the merger. This type of transaction may typically give effect to a desired corporate reorganisation, in terms of which an existing company is liquidated, wound up and/or deregistered.

The corporate reorganisation provisions contained in sections 42 to 47 of the Income Tax Act, 1962 largely afford relief in circumstances where companies engage in internal restructure transactions. Certain of the reorganisation rules require a company to be liquidated, wound up and/or deregistered. For example, In the context of liquidation distributions in terms of section 47 of the Income Tax Act, section 47(6) of the Income Tax Act provides that the rollover relief under section 47 will not apply where, *inter alia*:

the liquidating company has not, within a period of 36 months after the date of the liquidation distribution, or such further period as the Commissioner may allow, taken the steps contemplated in section 41 (4) to liquidate, wind up or deregister; or has at any stage withdrawn any step taken to liquidate, wind up or deregister that company, [] or does anything to invalidate any step so taken, with the result that the company will not be liquidated, wound up or deregistered

Section 41(4) of the Income Tax Act provides that a company must be deemed to have taken steps to liquidate, wind up or deregister, where:

(*a*) in the case of a liquidation or winding-up

(*i*) that company has lodged a resolution authorising the voluntary winding-up of that company in terms of

(*aa*) section 80 (2) of the Companies Act in the case of a company to which that section applies; []; and

(*ii*) that company has disposed of all assets and has settled all liabilities (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);

(*b*) in the case of a deregistration of a company, that company has lodged a request for the deregistration of that company in the prescribed manner and form

(*i*) to the Companies and Intellectual Property Commission in terms of section 82 (3) (*b*) (*ii*) of the Companies Act in the case of a company to which that section applies; []

(*c*) that company has submitted a copy of the resolution contemplated in paragraph (*a*) (*i*) or the request contemplated in paragraph (*b*) to the Commissioner; and

(*d*) all the returns or information required to be submitted or furnished to the Commissioner in terms of any Act administered by the Commissioner by the end of the relevant period within which the steps contemplated in this subsection must be taken, have been submitted or furnished or arrangements have been made with the Commissioner for the submission of any outstanding returns or furnishing of information.

In terms of the statutory merger provisions contained in the Companies Act, specifically section 116(5)(*b*), the Companies and Intellectual Property Commission (the **CIPC**) must, after receiving a notice of amalgamation or merger (form CoR89), deregister any of the amalgamating or merging companies that did not survive the amalgamation or merger. In effect, this notification serves the same purpose as a notice or request filed with CIPC in terms of section 80(2) or 82(3)(*b*)(*ii*) of the Companies Act (all three resulting in the company being wound up or deregistered).

It therefore appears that section 41(4) of the Income Tax Act effectively contains an unintended cross-referencing error or oversight, as the provision refers only to sections 80 and 82 of the Companies Act in the context of steps deemed to have been taken as part of a companys liquidation, winding up or deregistration. As stated above, a notice or request filed with the CIPC in terms of section 80(2) or 82(3)(*b*)(*ii*) of the Companies Act is not required for a company to be deregistered as a result of a statutory merger. Arguably, therefore, any transaction that gives rise to the automatic extinction of the transferor entity, may be unable to qualify for income tax relief under the reorganisation provisions.

Although a number of Advance Tax Rulings have been published by the South African Revenue Service (**SARS**) regarding the application of sections 41 to 47 of the Income Tax Act to mergers, none provides sufficient detail to confirm that (1) the statutory merger provisions of the Companies Act have been utilised to implement those mergers, and (2) if so, SARS were satisfied that section 41(4) was compiled by way of the automatic termination of the company rather than by way of the filing of the notices or requests explicitly referenced in section 41(4).

On 20 February 2019, the 2019 Budget Review was released, wherein the following was stated:

In some corporate reorganisation rules, to qualify for the tax-neutral transfer of assets, one or more of the companies involved should cease to exist after the transaction. The legislation lists steps that show a taxpayer meeting this requirement. However, the steps do not take into account deregistration by operation of law. It is proposed that the rules be amended to include this option.

It is therefore apparent that the fiscus has become aware of the oversight in the reorganisation rules, and intends to rectify this.

In addition to the above, a particularly interesting question that arises in this context is the impact of statutory mergers on certain carve outs to the de-grouping provisions, where the de-grouping in question occurs by way of a group companys liquidation, winding up or deregistration. Arguably, these terms do not include a companys extinction by operation of law.

A pertinent example of such a carve out is contained in section 45(4)(*c*) of the Income Tax Act, which provides relief to companies from the relatively harsh six-year de-grouping rule contained in section 45(4)(*b*) in circumstances where the transferor and transferee company cease to form part of the same group of companies in relation to one another as a result of the transferor or transferee companys liquidation, winding up or deregistration. Should the recognition of a companys liquidation, winding up or deregistration be restricted to circumstances in which a notice or request is filed with CIPC in terms of section 80(2) or 82(3)(*b*)(*ii*) of the Companies Act, the application of the carve out to the de-grouping rules where such a liquidation, winding up or deregistration occurs by operation of law, leads to uncertainty for taxpayers.

The manner in which it is intended for this oversight to be addressed will be seen from the draft tax Bills which are due to be released during the course of this year.

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