The tax implications of statutory mergers

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1. Concept of a Statutory Merger

The purpose of this note is to discuss aspects of the relationship between the provisions of the Companies Act, No 71 of 2008 (“Companies Act”) and the Income Tax Act, No 58 of 1962 (“ITA”) in relation to statutory mergers.

1.1 The Companies Act defines an “amalgamation or merger” as —"a transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in —

(a) the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or

(b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement”.

A statutory merger is neither a sale of business nor a sale of assets. It is a unique transactional mechanism introduced by the Companies Act. A statutory merger involves the creation of a new company pursuant to a merger agreement, or a surviving company that continues in existence after the transaction.

2. Consequences of a Statutory Merger
2.1 A statutory merger will take effect in accordance with, and subject to any conditions set out in the merger agreement that governs the transaction.

2.2 Section 116(7) of the Companies Act provides that –

“When an amalgamation or merger agreement has been implemented –

(a) the property of each amalgamating or merging company becomes the property of the newly amalgamated, or surviving merged, company or companies; and

(b) each newly amalgamated, or surviving merged company is liable for all of the obligations of every amalgamating or merging company,

3 in accordance with the provisions of the amalgamation or merger agreement, or any other relevant agreement, but in any case subject to the requirement that each amalgamated or merged company must satisfy the solvency and liquidity test....”

3.1 A merger transaction in terms of the Companies Act has the result that the assets and liabilities of a merging company vest in, or become the asset and liabilities of, a surviving company by operation of law. This, in principle, also extends to tax liabilities. This, however, is not the case in relation to assessed tax losses of the merging company which fall away after the transaction.

3.2 Income Tax Act

A provision of the ITA which appears to be aimed at dealing with statutory mergers, is section 44 of the ITA.

Put simply, the provision states that if parties enter into an “amalgamation agreement” and meet certain requirements, the transaction may be implemented free of immediate tax consequences. The term “amalgamation” refers, among other things, to the concepts “amalgamation” and “merger”. But
these terms are not defined and it is generally accepted that for tax purposes the concepts are not limited to statutory mergers in terms of the Companies Act.

Section 44 of the ITA provides for two requirements in relation to amalgamation transactions:

(i) first, the merging company must transfer all of its assets to the surviving company by means of a merger and;

(ii) second, the merging company must be terminated within 36 months. These two requirements mirror the provisions of sections 116(7)(a) and 116(5)(b) of the Companies Act.

Sections 44(2)-(3) of the ITA provide, put simply, that if the requirements are met, the assets of the merging company may be transferred to the surviving company free of capital gains tax and income tax. Although favourable, these provisions, however, only apply where the assets are being disposed of for equity shares or the assumption of debt. The difficulty therefore lies in the fact that to the extent that the consideration under a statutory merger is cash, property other than shares, or shares in another company, the transaction will not receive the benefits under section 44(2)-(3) of the ITA.

As noted above, as a statutory merger is not expressly defined in the ITA, the tax effects of section 44 of the ITA could be achieved by way of a sale, distribution and deregistration or scheme of arrangement, rather than a statutory merger in terms of the Companies Act; provided that the requirements are fulfilled in each case. Notably, there is no requirement that the merged and surviving companies form part of the same group of companies.

It should be noted that section 44 of the ITA is not the only provision in the ITA that may provide tax relief in the case of a statutory merger. The corporate tax relief provisions in sections 42, 45, 46 and 47 of the ITA could also be used in
the case of statutory mergers; provided the transactions are structured correctly.

Conclusion

Parties to a statutory merger must carefully consider the tax consequences of the merger, particularly to the extent that the parties wish to apply section 44 of the ITA.