THE CORPORATE INCOME TAX EFFECT OF GROUP RESTRUCTURINGS IN SOUTH AFRICA

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A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Commerce (specializing in Taxation)

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1. **ABSTRACT**

Due to the vast number of groups of companies having many subsidiaries that are no longer viable from an economic perspective or that no longer gain the tax benefit that they were first created to achieve, there are many group restructurings occurring. These restructurings are to potentially simplify the group structure as well as achieve the maximum tax benefit. This research report will analyse how groups may be restructured in line with the provisions of the Income Tax Act (‘the Act’) as it stands currently by looking back at how restructurings were dealt with in the past and how that has now evolved. The research discusses the corporate rollover relief provisions that may be applied in order to simplify the restructuring process which is commonly used in today’s practice. The research suggests that there are many different ways to restructure a group in order to gain the maximum amount of benefit from a tax perspective.

**Key Words:** branch, capital gains tax (CGT), corporate income tax, corporate rollover relief, deregistration, foreign tax resident, general anti-avoidance rules (GAAR), liquidation, partnership, restructure, value-added tax.
2. DECLARATION

I declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation) at the University of Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other institution.

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Date:
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4. CONTENTS

List of abbreviations ........................................... 6
Chapter 1 – Introduction .................................... 7
Chapter 2 – The meaning of and reasons for group restructurings ... 11
Chapter 3 – The basic provisions of corporate rollover relief ....... 14
Chapter 4 – The corporate tax effect of a restructuring for a South African tax resident company, including income tax, capital gains tax, value-added tax and other consequences ... 25
Chapter 5 – The corporate tax effect of a restructuring for a foreign tax resident company ........................................... 37
Chapter 6 – The corporate tax effect of a restructuring for a partnership .................................................. 44
Chapter 7 – The corporate tax effect of a restructuring for a branch .................................................. 47
Chapter 8 – The corporate tax effect arising from the liquidation or deregistration of a company .................................................. 50
Chapter 9 – The effect of the general anti-avoidance rules (GAAR) on restructurings and the corporate rollover relief .................................................. 52
Chapter 10 – How to structure a group under the current tax regime .................................................. 54
Chapter 11 – Conclusion ........................................... 57
References .................................................. 60
## 5. LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Term</th>
<th>Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>Co.</td>
</tr>
<tr>
<td>General anti-avoidance rules</td>
<td>GAAR</td>
</tr>
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<td>Income Tax Act 58 of 1962</td>
<td>the Act</td>
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<td>Securities Transfer Tax Act 25 of 2007</td>
<td>the STT Act</td>
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<td>South Africa</td>
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<tr>
<td>South African Revenue Service</td>
<td>SARS</td>
</tr>
<tr>
<td>Tax Administration Act 28 of 2011</td>
<td>TAA</td>
</tr>
<tr>
<td>Transfer Duty Act 40 of 1949</td>
<td>the Transfer Duty Act</td>
</tr>
<tr>
<td>Value-Added Tax Act 89 of 1991</td>
<td>the VAT Act</td>
</tr>
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</table>
CHAPTER 1 - INTRODUCTION

There are many group structures in South Africa, each being structured in a certain way to gain the most economic and tax benefit. Some of these group structures were put in place many years ago under certain conditions that existed during that time. The corporate landscape, and the tax regime for that matter, however have evolved and therefore these group structures may not necessarily be relevant under current conditions.

The way a group is structured is an important part of any corporate environment. Even small business acquisitions or mergers should be structured in the most tax efficient way and the Act includes certain provisions which can assist with this (Haupt, 2013:349). Furthermore, the structure of a group of companies is continually changing due to many different factors including: the state of the economy in South Africa as well as globally; forecasts (budgets) that have been predicted for the group; profitability of the individual companies within the group; management of risk; ever-changing tax effects; and many other factors which are considered on a regular basis by any group.

Therefore, with any merger or acquisition, liquidation or deregistration which may occur in order to optimise the group structure and the benefits that can be derived, the tax consequences need to be considered beforehand. This may impact on the way in which a group is structured as, for example, the economic benefit from the restructuring may be outweighed by the tax benefit that could be derived.

The corporate rollover relief provisions contained in the Act were introduced to make it easier to restructure a group of companies under specific circumstances and with specific conditions before and after the transaction which must be applied. Since the introduction of these corporate rollover provisions (sections 41 to 47 in the Act) in 2002, more and more groups of companies are using these provisions in order to restructure the group in the most tax efficient way.

With these restructurings and the use of the corporate rollover relief comes some risk from a tax avoidance perspective which needs to be analysed and addressed before entering into these types of transactions.

As there are numerous groups of companies in South Africa and globally, restructurings are a constant reality for many groups of companies, the research into how a group can best be structured as well as how
to go about the restructuring (i.e. mergers and acquisitions, liquidation and deregistration, etc.) must address how tax efficiently these can be done and what risks may arise from the restructuring.

The statement of the problem

The research report will discuss the issues faced with structuring a South African group of companies in the most tax efficient way by using the corporate rollover relief provisions contained in the Act. The research will address the income tax, capital gains tax, value-added tax and other tax consequences that may arise with restructuring a group, specifically analysing a South African tax resident company, a foreign tax resident company, a branch and a partnership. The research will analyse these different types of restructurings taking into consideration what was previously done (i.e. just before 2002) in order to structure a group in the most tax efficient way to what tax provisions apply currently and the current practice in today’s large groups. The sub-problems are as follows:

The first sub-problem is to establish how groups were structured just prior to 2002. The research report will analyse the sections per the Act which governed how groups were structured and what the practice was of large groups in order to gain the most tax benefit from their group structure.

The second sub-problem is to establish what the Act now states with regards to group restructurings and where benefits can be gained from a tax perspective, if any. This analysis will look at different types of entities which may benefit as well as the effects of these provisions on a local and foreign entity.

The third sub-problem questions what difficulties there would be with regards to group restructurings, primarily focusing on the general anti-avoidance rules (sections 80A to 80L of the Act) and how these difficulties may arise should corporate rollover relief be applied.

The fourth sub-problem deals with determining what tax effects will result from liquidation or deregistration of an entity which is very likely to occur in many group restructurings.

The last sub-problem will address how a group is most tax efficiently structured under the current tax regime if a completely new group was being set up. This analysis will take into account the considerations arising from the above analysis.
Scope and limitations

In this research report, the following sections of the Act will not be discussed in detail:

- Section 31
- Section 43

Section 31 of the Act has been excluded due to the complexities around transfer pricing and thin capitalization which is not applicable to the research topic being discussed. Section 43 of the Act has not been discussed as the section is not used very widely in practice.

Furthermore, this report will not discuss the commercial or economic impact of a group restructuring and will only address the tax impact. Additionally, exchange control regulations will not be discussed in this research report.

With regards to Chapters 4 and 5, it must be noted that specific facts have been applied to the examples given. These facts are applied in order to be able to discuss each of the corporate rollover relief provisions without being repetitive.

Please note that in Chapter 10, a simple group structure will be analysed and discussed. It is important to note that in practice there are many different permutations with regards to group structures which will not be discussed in Chapter 10. Chapter 10 focuses on a simplistic view of a group structure.

Research methodology

The research method adopted is of a qualitative, interpretive nature, bases on a detailed interpretation and analysis of the literature.

An extensive literature review and analysis will be undertaken that includes the following sources –

- Books;
- Cases;
- Electronic databases;
- Electronic resources – internet;
- Journals;
• Magazine articles;
• Publications; and
• Statutes.

In collecting the data, relevant information was obtained by searching certain key words related to the research topic on the internet. The relevant sections in the Act were analysed as well as the relevant sections and certain topics related to the research topic in certain publications. Informal enquiries with regards to the topic were made with colleagues, specifically those in the mergers and acquisitions department of an audit firm.
7. CHAPTER 2 – THE MEANING OF AND REASONS FOR GROUP RESTRUCTURINGS

A group restructuring can be defined by breaking the phrase up into ‘group’ and restructuring’. A group in the context of this report is a group of companies. A basic group of companies would include a holding company (Company H), subsidiaries (Company A, Company C and Company D) and an associate (Company B) each being held by either the holding company or other subsidiaries in the group. Here is an example of a group of companies:

![Diagram of company structure]

There are also other types of entities that might make up a group of companies such as partnerships, branches and joint ventures. Furthermore, entities within the group may be South African resident or foreign resident companies, being South African tax resident or foreign tax resident respectively. These aspects, such as the different type of entity or type of residency they hold, will have a vital impact on how to restructure a group in the most tax effective way.

The Business Dictionary defines a ‘restructuring’ as ‘bringing about a drastic or fundamental internal change that alters the relationships between different components or elements of an organization or system’ (The Business Dictionary, n.d). Per the Oxford Dictionaries, a restructuring is defined as ‘an act of organizing something such as a system or a company in a new and different way’ (Oxford Dictionaries, n.d). Therefore a group restructuring would constitute altering or re-organising the group of companies to bring about a fundamental change.

The Act is continually changing and introducing new provisions or disallowances which make it more and more difficult for companies to keep their original group structures and gain the most tax benefit. For example, companies previously created new companies in tax havens or low jurisdictions. The new company would potentially manufacture or buy stock and sell to the South African company at a large
price. The South African company would then sell the stock in South Africa at a nominal price, deduct the cost incurred to purchase the stock from the other company and therefore the South African company would create a minimal profit whilst the majority of the profit would be made in the low tax jurisdiction company and minimal or no tax would be imposed. Due to the transfer pricing rules in section 31 of the Act which are continually changing and becoming more and more problematic for these types of group structures, in many circumstances it is no longer beneficial to operate in these tax havens. Therefore these subsidiaries are becoming more and more unwarranted and companies would therefore be more likely to move all operations back to South Africa where they can potentially incur less costs. Therefore a group might decide to rather move the assets of these companies (capital assets, allowance assets and trading stock) to other companies within the group to simplify the structure.

Another potential reason for a group restructuring would be where a company is making significant assessed losses and another company in the group is making significant profits. The company making significant profits might dispose of all assets (including capital assets, allowance assets and trading stock) to the company which has a significant assessed loss and rather operate from that company in order to utilise the assessed loss and pay less tax. It must be noted that section 103(2) should be taken into account in this instance which deals with transactions or agreements which have been entered into solely for the purpose of utilizing an assessed loss or capital loss in order to avoid or reduce the tax liability of the company. Where the Commissioner is satisfied that section 103 may apply, the offset of the assessed loss against any taxable income will be disallowed. Therefore the taxpayer will be required to justify the reason for the agreement or transaction.

The corporate rollover relief provisions contained in sections 41 to 47 of the Act were introduced in 2002 in order to neutralise a group restructuring for tax purposes where the companies involved form part of the same group of companies (Revenue Laws Amendment Bill, 2002:16). Just before 2002 any disposal of assets between 2 group companies or a merger or amalgamation would result in normal income tax and capital gains tax implications as per the Act (i.e. any capital gains or recoupments that arise would be included in the company’s taxable income).

These corporate rollover relief provisions enable a group of companies to structure their group in the most efficient way without being imposed with material tax implications. As stated in Issue 9 of Taxgram ‘the basis for the provisions is that where the group or the shareholders have retained a substantial interest in the assets transferred it is appropriate to permit the tax-free and CGT-free transfer of assets to the entity where they can be most efficiently used for business purposes’ (Silke, J & Stretch, R, 2014).
The corporate rollover relief provisions are being widely used in many group restructurings. Furthermore every group will be restructured in some way at some point in time and therefore these corporate rollover relief provisions may be a very useful way in executing the most tax beneficial transaction to gain a solid group structure.

It must be noted that these sections do include anti-avoidance provisions which will be discussed in a later chapter. These anti-avoidance provisions must be considered for each transaction entered into in order to effect the corporate rollover relief provisions.
8. CHAPTER 3 – THE BASIC PROVISIONS OF CORPORATE ROLLOVER RELIEF

The corporate rollover relief provisions were introduced in 2002. The provisions per the Act are included in the following sections:

- Section 41 – General
- Section 42 – Asset-for-share transactions
- Section 43 – Substitutive share-for-share transactions
- Section 44 – Amalgamation transactions
- Section 45 – Intragroup transactions
- Section 46 – Unbundling transactions
- Section 47 – Transactions relating to liquidation, winding-up and deregistration

Section 41 - General

Section 41 per the Act sets out the introduction for the corporate rules section. It firstly discusses the definitions to be applied to certain words or phrases as used in the corporate rules. One of the more important definitions to note is the definition of group of companies for purposes of the corporate rules.

The definition of group of companies for purposes of the corporate rules is limited compared to the definition as set out in section 1 of the Act. Per section 1 of the Act, a group of companies is defined as:

two or more companies in which one company (hereinafter referred to as the ‘controlling group company’) directly or indirectly holds shares in at least one other company (hereinafter referred to as the ‘controlled group company’), to the extent that at least 70 per cent 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 the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company.

The definition per section 41 of the Act states that a group of companies means a group of companies as defined in section 1 of the Act, however certain companies are excluded:

- A co-operative, a company formed for the benefit of the general public, and a foreign collective investment scheme in securities or participation bonds
- Any non-profit company as defined in section 1 of the Companies Act
• Any company which enjoys any of the exemptions contained in section 10 of the Act by virtue of its status
• Any company that is a public benefit organisation
• Any company incorporated in a foreign country unless it has its place of effective management in South Africa and is therefore deemed to be South African tax resident in terms of the definition of ‘resident’ in section 1 of the Act
• Any company that has its place of effective management outside the Republic of South Africa, even if it is incorporated in South Africa

The definition of ‘group of companies’ was amended in 2008 to include within its ambit foreign incorporated companies that are effectively managed in South Africa (Deloitte, 2008).

Other definitions included in section 41 of the Act include allowance asset, asset, base cost, capital asset, company, date of acquisition, disposal, equity share, hold, listed company, market value, trading stock, and unlisted company.

Section 41 of the Act overrides the normal rules of the Act other than section 24BA of the Act, the anti-avoidance provisions in sections 80A to 80L and section 103(2) and paragraph 11(1)(g) of the Eighth Schedule of the Act. Section 24BA of the Act refers to where shares are issued by a company in return for assets with a value different from the value of the shares. The anti-avoidance provisions are discussed in Chapter 9. Paragraph 11(1)(g) of the Eighth Schedule of the Act refers to the value-shifting rule which will not be discussed further.

Section 42 – Asset-for-share transaction

Section 42 of the Act begins with the definition of an asset-for-share transaction. Section 42(1)(a)(i) of the Act deals with the definition of an asset-for-share transaction from the sellers point of view. This is defined as a transaction in which an asset (other than a restraint of trade or personal goodwill) is disposed of by any person to a South African resident company at base cost or more than base cost if it is a capital asset, at tax cost or more than tax cost if it is trading stock, in exchange for the issue of one or more equity shares in that company and that person either at the close of the day on which the asset is disposed of holds a qualifying interest in that company or is a natural person who will work on a full time basis in the business of that company of rendering any service.
It is important to note at this stage that a qualifying interest is defined in section 42(1) of the Act of a person is:

(a) An equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that equity share;
(b) An equity share held by that person in a portfolio of a collective investment scheme in securities;
(c) Equity shares held by that person in a company that constitute at least 10 per cent of the equity shares and that confer at least 10 per cent of the voting rights in that company; or
(d) An equity share held by that person in a company which forms part of the same group of companies as that person.

Section 42(1)(a)(ii) of the Act on the other hand relates to the acquiring company. For the acquiring company, where the asset that has been acquired is trading stock, the acquiring company must acquire and hold that asset as trading stock. The same applies where the asset is a capital asset, the acquiring company must acquire and hold that asset as a capital asset.

Equity shares in foreign companies are dealt with in section 42(1)(b) of the Act which requires that the equity shares must have been held as a capital asset and the market value of the equity shares must exceed its base cost. On the day of the transaction, more than 50% of the equity shares in the foreign company must be directly or indirectly held by a South African resident or at least 70% of the equity shares in the other foreign company (i.e. the transferor) are directly or indirectly held by a resident. This was introduced in 2011 (BDO,2013).

In the hands of the company that is transferring the capital asset (i.e. the transferor company), the company is deemed to have transferred the asset for its base cost if this is equal to or less than its market value. This results in a nil capital gain arising. If the assets base cost is more than its market value, then this section cannot apply. The transferor company is then also deemed to have acquired the equity shares at the same base cost as the capital asset transferred. Furthermore the transferor company is deemed to have acquired the equity shares at the same time that the original asset was acquired. The equity shares are in effect replacing the capital asset transferred. Where trading stock is transferred the same principals apply.

In the hands of the company who is receiving the capital asset or trading stock (i.e. the transferee company) the transferee and transferor companies are deemed to be one and the same and therefore the transferee company acquires the capital asset at the same original cost of that capital asset and at the same time that that asset was originally acquired by the transferor company.
Where allowance assets are transferred over, the allowances and potential recoupments are merely transferred over to the transferee company.

It is also important to note that this can be done on an asset by asset basis whereby section 42 of the Act may apply to certain assets and not to others.

One must also consider section 42(8) of the Act where debts are transferred in terms of an asset-for-share transaction. Section 42(8) provides that a portion of the debt assumed by the transferee company as part of an asset-for-share transaction will constitute an amount received by or accrued to the transferor company in respect of the disposal of any of the shares in the transferee company acquired in terms of the asset-for-share transaction, should such shares be disposed of by the transferor company. Essentially, section 42(8) of the Act provides that the transferor company will have additional proceeds upon the disposal of the shares equal to a proportional amount of the debt that was assumed by the company (Minaar, 2014).

There are certain anti-avoidance rules which can apply. These rules are as follows:

- Where a person ceases to hold a qualifying interest within 18 months after the asset-for-share transaction unless the person ceases to hold the qualifying interest due to a section 45 of the Act intra-group transaction, a section 46 of the Act unbundling transaction, a section 47 of the Act liquidation distribution, an involuntary disposal contemplated in paragraph 65 of the Eighth Schedule of the Act or a disposal that would have constituted an involuntary disposal contemplated in that paragraph had that asset not been a financial instrument. In this case, the person is deemed to have sold the shares he holds in that company at the market value at the original date of the asset-for-share transaction and reacquired these shares at the same market value.

- Where the company disposes of the capital asset within 18 months of the asset-for-share transaction. In this case the capital gain may not be offset against any assessed loss or capital loss of that company but is rather recognised immediately as part of the net capital gain and is subjected to the inclusion rate. This also applies in respect of allowance assets but instead a recoupment is recognised which cannot be offset against any assessed loss.

Section 43 – Substitutive share-for-share transaction
Section 43 of the Act is a relatively new section, coming into effect from 1 January 2013. A substitutive share transaction is defined as a transaction between a shareholder and a company whereby the shareholder disposes of an equity share interest in that company which is a linked unit and acquires another equity share interest in the same company which is not a linked unit. A linked unit is where a share and a debenture in a company are linked and traded together as a single unit.

This section provides that where a substitutive share-for-share transaction occurs, the person disposing of the linked unit is deemed to have disposed of that equity share for an amount equal to the expenditure incurred by that person in respect of that equity share so disposed of and acquired that other equity share for a cost equal to the expenditure incurred by that person as previously mentioned.

This section is not widely used and therefore it will not be discussed further.

Section 44 – Amalgamation and merger transactions

Section 44 of the Act begins with certain definitions which specifically apply to this section. An amalgamation transaction is defined as a transaction either where a resident company disposes of its assets to another resident; or a foreign company disposes of its assets to a resident; or a foreign company disposes of its assets to another foreign company within the same group of companies. The company disposing of its assets is referred to as the amalgamated company and must be wound-up at the time of the transaction. The company acquiring the assets is referred to as the resultant company. Where the resultant company is a foreign company, it must be a controlled foreign company in relation to any resident within the same group of companies.

Where a resident disposes of its assets to another resident, the resident company must transfer all of its assets to the other resident company by means of an amalgamation, merger or conversion in exchange for equity shares in the resultant company. The amalgamated company must then transfer the equity shares in the resultant company to its shareholders by way of a dividend *in specie* and must then be wound-up or deregistered within 18 months of the amalgamation.
Where a foreign company disposes of its assets to a resident company, the foreign company must likewise dispose of all of its assets and liabilities to the other company by means of an amalgamation, merger or conversion. The same steps which apply where both companies are South African residents, will apply in this case as well. The only additional provision included in this case is that where a resultant company holds shares in the amalgamated company, it must hold these shares as capital assets. This was introduced in 2011 (BDO, 2013).

Where a foreign company disposes of its assets to another foreign company, the amalgamated company must transfer all of its assets and liabilities to the resultant company. Immediately before the amalgamation, the amalgamated company and the resultant company must be part of the same group of companies and the resultant company must be a controlled foreign company in relation to any other company part of that group. Immediately after the amalgamation, more than 50% of the equity shares in the resultant company must be directly or indirectly held by a resident. The amalgamated company must then transfer its equity shares in the resultant company to its shareholders by way of a dividend in specie and must be wound-up or deregistered within 18 months after the amalgamated transaction occurs.

The tax rollover relief that applies in this case is that the amalgamated company is deemed to have disposed of any capital asset at its base cost and the resultant company acquires these assets at its base cost. In the case of trading stock, the amalgamated company is deemed to have disposed of the trading stock at its tax value. With regards to allowance assets, the amalgamated company is deemed to have disposed of the allowance asset at its tax value and the amalgamated company and the resultant company are seen to be one and the same person with regards to the allowances that the resultant company may claim once acquired the assets. This will result in any recoupments being transferred to the resultant company.

As in section 42 of the Act, where the resultant company disposes of an asset within 18 months after the amalgamated transaction, firstly a portion of the capital gains may not be set off against capital losses or assessed losses. Furthermore, any capital losses which arise must be disregarded. In the case of trading stock, a portion of the profits and losses from the disposal of that trading stock must be deemed to be from a separate trade and cannot be set off against the losses and profits derived by the company from its other activities or assessed losses. In respect of allowance assets, a portion of the recoupments must be deemed to be from a separate trade and cannot be set off against any losses made or any assessed losses brought forward.
Section 42 of the Act will not apply unless the amalgamated company takes the steps to liquidate, wind-up or deregister within 36 months of the transaction. Other instances where section 42 of the Act will not apply is where the transaction constitutes a liquidation in terms of section 47 of the Act (discussed below); where the resultant company is a co-operative or a company formed for the benefit of the public; where the resultant company is a collective investment scheme and the amalgamated company is not; where the resultant company is a non-profit company; where the resultant company is a foreign company or a foreign collective investment scheme and does not have it place of effective management in South Africa; or where the resultant company is an exempt company or a public benefit organization or a recreational club. It must also be noted that if both parties can only elect out of section 44 of the Act and therefore if an amalgamation transaction occurs and there is no election out of section 44 of the Act, this section will automatically apply.

Section 45 – Intra-group transactions

As in the other corporate rules discussed above, this section begins with the definition of an intra-group transaction. An intra-group transaction is defined as a transaction whereby an asset is disposed of by one company (i.e. the transferor company) to another company that is a resident (i.e. the transferee company) and both of these companies form part of the same group of companies on the day of the transaction. This transaction results in the transferee company acquiring a capital asset where the transferor company holds it as a capital asset and trading stock where the transferor company holds it as trading stock.

An intra-group transaction is also defined as a transaction whereby an equity share in a foreign company is transferred by one company to another in exchange for the issue of debt or non-equity shares in the transferee company. In this case the transferee company acquires the asset as a capital asset. This will only apply where the transferor company and transferee company form part of the same group of companies as defined in section 1 of the Act and the transferor company and transferee company are either a resident or a controlled foreign company in relation to one or more residents that form part of the same group of companies. This was introduced in 2012 (BDO, 2013).

The rollover over provisions that apply in this case is that the transferor company is deemed to have disposed of a capital asset at its base cost if the transferee company acquires it as a capital asset. In the case of trading stock, the asset is disposed of at its tax value where the transferee company acquires it as trading stock. Where an allowance asset is disposed of, the transferor has no recoupment as the transferee acquires the asset at its tax value.
The transferee company and transferor company are deemed to be one and the same in respect of the date of acquisition of the asset, the amount and date of incurrence of expenditure and the valuation of the asset at 1 October 2001 where applicable.

There are certain anti-avoidance rules which may apply. The first is the de-grouping whereby if the transferor company and transferee company, within 6 months after the date of the section 45 transaction, no longer form part of the same group of companies then the transferee company is deemed to have disposed of the assets acquired in terms of the section 45 transaction and is liable for tax on the deemed disposal. This will only apply where both the transferor company and transferee company are South African residents.

A deemed de-grouping can also occur where a transferor company or any other company forming part of the same group of companies as the transferor company, disposes of the consideration received in terms of a section 45 transaction, within the two years from the section 45 transaction to any person who does not form part of the same group of companies, for no consideration, a consideration that does not reflect an arm’s length price or by means of a distribution. The section 45(4) of the Act de-grouping provision would then apply as explained above.

Another anti-avoidance rule is the 18-month rule whereby if the assets transferred are disposed of by the transferee company within 18 months from the date of the intra-group transaction then in the case of capital assets transferred the capital gain may not be offset against any assessed loss or capital loss of that company but is rather recognised immediately as part of the net capital gain and is subjected to the inclusion rate. This also applies in respect of allowance assets but instead a recoupment is recognised which cannot be offset against any assessed loss.

It is important to note that section 45 of the Act will automatically apply to all intra-group transactions unless the transferor company and transferee company jointly elect out of the provisions of section 45 of the Act. Furthermore if the transferor disposes of assets in exchange for shares or the transferor disposes of shares to the transferee or the assets disposed of by the transferor are in terms of a liquidation then sections 42, 46 and 47 of the Act will apply and section 45 of the Act will no longer apply.

Section 46 – Unbundling transactions
An unbundling transaction is defined as a transaction whereby an unbundling company transfers its equity shareholding in an unbundled company to its shareholders in accordance with the effective interest in the unbundling company. Section 46 of the Act allows for there to be a neutral tax effect for both the unbundled and unbundling company. This section will apply either where both companies are South African residents or where the unbundling company is either a South African resident or a controlled foreign company and the unbundled company is a foreign company.

Where both companies are South African resident, then either the equity shares of the unbundled company are listed or will become listed shares within 12 months of the distribution or the shareholder to which the distribution will be made forms part of the same group of companies as the unbundling company. Neither of these two situations need to apply if the distribution is made pursuant to an order in terms of the Competition Act. Furthermore, if the unbundled company is an unlisted company immediately before the distribution, then the unbundling company must hold more than 50% of the equity shares of the unbundled company. Where the unbundled company is listed, then the unbundling company must hold more than 35% of the equity shares in the unbundled company or more than 25% of the equity shares in the unbundled company where no other shareholder holds more equity shares in the unbundled company as the unbundling company.

Where an unbundling company distributes its shares in terms of an unbundling transaction, then it must disregard the distribution for purposes of determining its taxable income. The shares in the unbundled company acquired by the shareholders of the unbundling company are deemed to have been acquired on the same date that the unbundling company acquired the shares. The cost of shares now held by the shareholders of the unbundling company must be determined as cost of shares held by unbundling company in unbundled company multiplied by the market value of the shares at the end of the day of the transaction divided by the sum or market value of shares at end of the day of unbundling.
Unbundling does not apply if immediately after the distribution of the shares in the unbundled company 20% or more of those shares are held by a disqualified person. A disqualified person is defined in section 46(7)(b) as:

(i) A person that is not a resident;
(ii) The government of the Republic in the national, provincial or local sphere;
(iii) A public benefit organisation;
(iv) A recreational club
(v) A company or trust formed for closure rehabilitation (for mining purposes in terms of section 37A)
(vi) A fund contemplated in section 10(1)(d)(i) or (ii); or
(vii) A person contemplated in section 10(1)(cA) or (t).

Section 47 – Transactions relating to liquidation, winding-up and deregistration

A liquidation distribution means any transaction in terms of which any resident company (i.e. the liquidating company) disposes of all of its assets to its shareholders in anticipation of or in the course of the liquidation, winding-up or deregistration of that company. The liquidating company may keep back assets which would be seen as reasonable in order to settle any liabilities or cover any costs in during the liquidation, winding-up or deregistration process.

Section 47 of the Act will also apply where the liquidating company is a controlled foreign company and the liquidating company disposes of all of its assets to its shareholders. Where the assets are disposed of to its holding company, the shares have to be held by holding company have to be held as capital assets and immediately after the transaction, where the holding company is a controlled foreign company more than 50% of the equity shares in the holding company have to be held directly or indirectly by a resident.

Similarly to the above corporate rules, where the liquidating company disposes of a capital asset, it will be deemed to have disposed of that asset at its base cost. Where it disposes of trading stock, it is deemed to have been transferred at its tax value. Where it disposes of an allowance asset, it is deemed to have transferred that asset at its tax value. In this case no allowance is recovered or recouped.

From the holding company’s point of view, where capital assets, trading stock or allowance assets are acquired through a liquidation distribution, the liquidating company and the holding company are seen as one and the same with regards to the date of acquisition of the asset and the amount of expenditure for that asset.
Once again there are anti-avoidance rules which may apply. If the assets transferred to the holding company are sold by the holding company within 18 months after the liquidation distribution occurs, a portion of the capital gain made cannot be set off against any assessed loss or capital loss of the holding company and any capital loss must be disregarded.

Both the holding company and the liquidating company must elect in writing if section 47 of the Act does not apply to the liquidation, winding-up or deregistration. Furthermore section 47 of the Act will automatically not apply where the holding company is either an approved public benefit organization, recreational club or exempt entity as contemplated in sections 10(1)(cA), (cP), (d), (e) or (t) of the Act. Section 47 of the Act will also not apply where the liquidating company has not taken the necessary steps to liquidate, wind-up or deregister within 36 months of the liquidation, winding-up or deregistration.

Section 47 of the Act will be discussed in more details in Chapter 8.
9. CHAPTER 4 – THE CORPORATE TAX EFFECT OF A RESTRUCTURING FOR A SOUTH AFRICAN TAX RESIDENT COMPANY, INCLUDING INCOME TAX, CAPITAL GAINS TAX, VALUE-ADDED TAX AND OTHER CONSEQUENCES

This chapter will set out and discuss an example of a restructuring for a South African tax resident company and the tax effects thereof including:

- Setting out the background facts, including the group structure and restructuring transactions applied; and
- Discussion around the income tax, capital gains tax, value-added tax and other tax consequences.

Background facts

Company H holds 100% in Company A. Company A holds 30% in Company B and 100% in Company C and Company D.

- Company H is a holding company whilst Company A, Company B, Company C and Company D are operating companies.
- All companies are South African tax resident.
- Company H is a listed company on the Johannesburg Stock Exchange.
- The group would like to simplify its group structure and have a single operating company within the group.
- Company A, Company B, Company C and Company D have a mix of capital assets, trading stock and allowance assets.
- The other shareholders of Company B, each hold less than 30% of the equity shares in Company B.
• Company C has a significant assessed loss. Company C also has allowance assets, which if sold at market value, would result in a recoupment. Company C would like to enter into an intra-group transaction with Company A and utilised the maximum of the assessed loss.
• The group would like to merge Company D with Company A. The group does not want to merge any other of the companies in the group.

Discussed below is how each company should be restructured in the group in order to allow for the most tax efficient structure.

Company B

Per the group of companies definition in section 41 of the Act which refers to the definition in section 1 of the Act, a group of companies is where there is a controlling group company (i.e. Company H) which holds directly or indirectly at least 70% of the equity shares in each of the controlled group companies and the controlling group company holds at least 70% of at least one of the controlled group companies.

Per the above definition, Company H does not directly or indirectly hold at least 70% of the equity shares in Company B as Company A, which is a wholly owned subsidiary of Company H, only holds 30% of the equity shares in Company B. Therefore as Company B does not form part of the same group of companies as Company H, A, C and D, sections 44 of the Act (amalgamations and mergers transactions) and section 45 of the Act (intra-group transactions) cannot apply as these section specifically provide that the companies involved in these types of transactions are required to be part of the same group of companies on the day of the transaction.

Therefore, as section 43 of the Act is not being discussed and section 47 of the Act is being discussed separately in Chapter 8, section 42 or section 46 of the Act are the only corporate rollover relief provisions that can be applied in this case.

Section 42 will be discussed first. Company B and Company A will enter into an asset-for-share transaction whereby Company B will dispose of all of its assets to Company A in exchange for equity shares in Company A. For section 42 of the Act to apply, Company B, at the end of the transaction must hold a qualifying interest in Company A. As Company A and Company B form part of the same group of companies, Company B will hold a qualifying interest in Company A as defined in section 42 of the Act.
The provisions of section 42 of the Act will result in a tax free transaction as Company A and Company B will be seen as one and the same. Therefore all capital assets of Company B will be transferred over to Company A at base cost, trading stock at tax value and allowance assets at tax value. Company A will be seen as having acquired these assets on the original date that Company B acquired these assets and at the cost these assets were transferred over at. Company B will then acquire the shares in Company A at the same base cost as the assets transferred to Company A.

It must be noted that the assets transferred to Company A in terms of section 42 of the Act must not be sold within 18 months of the intra-group transaction in order to ensure the benefits of section 42 of the Act remain.

Should Company B decide to rather enter into an unbundling transaction in terms of section 46 of the Act, Company A, who holds 30% of the equity shares in Company B, will transfer their shareholding in Company B to Company H. As Company A holds more than 25% of the equity shares in Company B (an unlisted company) and no other shareholder holds more than 25% of the equity shares in Company B an unbundling transaction may be entered into.

In this case Company B must disregard the distribution for purposes of determining its taxable income. The shares in Company B acquired by Company H are deemed to have been acquired on the same date that the Company A acquired the shares. The cost of shares now held by Company H must be determined as cost of shares held by Company A in Company B multiplied by the market value of the shares at the end of the day of the transaction divided by the sum or market value of shares at end of the day of unbundling.

**Company C**

Firstly Company C forms part of the same group of companies as Company A as they are wholly owned by Company A which is wholly owned by the controlling group company, Company H. Therefore as Company A and Company C form part of the same group of companies, section 44 of the Act (amalgamation and merger transactions) and section 45 of the Act (intra-group transactions) can be used in this restructuring. Per the background facts, an intra-group transaction in terms of section 45 of the Act will be considered. It should also be noted that in an intra-group transaction, certain assets may be disposed of using section 45 of the Act whilst others can be disposed of without using this corporate rollover relief in order to maximize the tax benefits available.
As noted above, Company C has a significant assessed loss. Therefore it would be best to structure the transaction in order to utilize the maximum amount of this assessed loss. It must be noted at this stage that section 103(2) may apply where the Commissioner is of the view that this transaction took place for the sole purpose of utilizing the assessed loss and thereby reducing the tax payable. Therefore in order for this transaction to be entered into without section 103(2) applying, Company C would need to justify further the reasoning behind the restructuring (i.e. to simplify the group structure).

Per the background facts above, the disposal of certain of Company C’s allowance assets will result in a recoupment in terms of section 8(4)(a) of the Act. A recoupment in terms of section 8(4)(a) of the Act occurs where there were allowances relating to these allowance assets which were previously allowed as a deduction from taxable income and the selling price (limited to the cost of asset) of these assets is greater than the tax value of these assets at the date of sale. Therefore where there are recoupments on the sale of certain of Company C’s assets, it would be best for Company C to dispose of these allowance assets without using the provisions of the rollover relief of section 45 of the Act. Instead Company C should sell these allowances assets to Company A under a normal sale agreement (i.e. not a section 45 intra-group transaction) and utilize the assessed loss available to Company C by offsetting the recoupments arising on this sale. It must be noted that per section 45(6)(g) of the Act that Company A and Company C must agree in writing that section 45 of the Act does not apply to the disposal of these specific assets.

As section 45 of the Act does not apply to the disposal of these allowance assets, capital gains tax would need to be considered as well. In order for a capital gain to arise there firstly needs to be a disposal event which occurs in this case. Paragraph 3 of the Eighth Schedule of the Act defines a capital gain which arises when the proceeds are greater than the base cost. Alternatively, in terms of paragraph 4 of the Eighth Schedule of the Act, a capital loss arises when the base cost is greater than the proceeds. As Company A and Company C are considered to be connected persons in terms of section 1 of the Act as they form part of the same group of companies (Company C is wholly owned by Company A), paragraph 38 of the Eighth Schedule of the Act needs to be considered which provides that transactions between connected persons are deemed to take place at market value. It is assumed in this case that the assets in Company C have been sold to Company A at market value. Therefore Company C must include in their taxable income a capital gain that arises on the sale of these assets to Company A.

It must be noted that in terms of paragraph 39 of the Eighth Schedule of the Act, Company C must disregard any capital loss determined in respect of the disposal of an asset to a connected person (i.e.
Company A). The capital loss can only be utilised against capital gains included in taxable income arising from disposals to that same connected person in the future.

Any other assets in Company C (trading stock and capital assets) may be disposed of in terms of section 45 of the Act. In this case, Company C will dispose of any capital assets at their base cost, any trading stock at their tax value and any other allowance assets at their tax value to Company A. Company A will be seen as one and the same with Company C and will be seen as acquired the assets on the original date that Company C acquired the assets. Therefore no recoupments or capital gains tax will arise for Company C on the sale of these assets. Once again, it must be noted that the assets transferred to Company A in terms of section 45 of the Act must not be sold within 18 months of the intra-group transaction in order to ensure the benefits of section 45 of the Act will remain.

Furthermore, Company A and Company C must remain part of the same group of companies for 6 years for the section 45 of the Act benefit to remain. An amount equal to the lesser of, the greatest amount that would have been determined if the asset was sold within the 6 year period, or the amount that would be determined if the asset was disposed of on the date of the de-grouping for an amount equal to the market value on that date would be included in determining the taxable income of the transferee company on de-grouping in respect of the various assets concerned. The base cost or cost as the case may be of the asset for the transferee company is increased by that amount, if the capital asset is an allowance asset then the cost of the asset must be increased by 66.6% of the deemed capital gain. An amount equal to the greater of, the greatest amount that would have been determined if the asset was sold within the 6 year period, or the amount that would be determined if the asset was disposed of on the date of the de-grouping for an amount equal to the market value on that date would be included in determining the taxable income of the transferee company on de-grouping in respect of the various assets concerned. The cost or value of the asset for purposes of any deductions allowable in respect of that asset for the transferee company must be increased by this amount. An amount equal to the lesser of, the greatest amount (excluding any taxable capital gains and inclusions in gross income) that would have been determined if the asset was sold within the 6 year period, or the amount (excluding any taxable capital gains and inclusions in gross income) that would be determined if the asset was disposed of on the date of the de-grouping for an amount equal to the market value on that date would be included in determining the taxable income of the transferee company on de-grouping in respect of the various assets concerned. The cost as the case of the asset for the transferee company must be increased by this amount.
A deemed de-grouping can also occur where a Company C or any other company forming part of the same group of companies as the Company C, disposes of the consideration received in terms of a section 45 of the Act transaction, within the two years from the section 45 of the Act transaction to any person who does not form part of the same group of companies, for no consideration, a consideration that does not reflect an arm’s length price or by means of a distribution. This will result in a de-grouping in terms of section 45(4) of the Act being applied.

**Company D**

Company D forms part of the same group of companies as Company A as they are wholly owned by Company A which is wholly owned by the controlling group company, Company H. Therefore as Company A and Company D form part of the same group of companies, section 44 of the Act (amalgamation and merger transactions) and section 45 of the Act (intra-group transactions) can be used in this restructuring. As stated per the background facts, a merger transaction in terms of section 44 of the Act will be applied.

For an amalgamation or a merger to occur, the amalgamated company, Company D in this case, must transfer *all* of its assets to the resultant company, Company A. Furthermore the rollover relief only applies to the extent that the transfer of the assets is in exchange for equity shares in the resultant company and/or the assumption of debt. Company D must then transfer any equity shares in Company A to its shareholders (i.e. in this case it would be to Company A) so that Company D can then be wound-up. In this case it is assumed that Company A assumed Company D’s debt in exchange for the assets. Company D must then be wound-up or deregistered within 18 months of the transaction.

Where an amalgamation or merger transaction occurs, Company D will dispose of any capital assets at their base cost, any trading stock at their tax value and any other allowance assets at their tax value to Company A. Company A will be seen as one and the same with Company D and will be seen as acquired the assets on the original date that Company D acquired the assets. Therefore no recoupments or capital gains tax will arise for Company D on the sale of these assets. Company A will additionally assume any debt in Company D. The 18-month anti-avoidance provision also applies to amalgamations and mergers in terms of section 44 of the Act.

**Other tax consequences**
Value-added tax, securities transfer tax and transfer duty consequences

In the case of section 42 of the Act (asset-for-share transaction), section 44 of the Act (amalgamation and merger transaction) and section 45 of the Act (intra-group transaction), value-added tax, securities transfer tax, and transfer duty will, in most cases, not apply.

In terms of section 8(25) of the Value-Added Tax Act (‘the VAT Act’), any transfers of goods or services ordinarily subject to value-added tax are deemed to be non-supplies if both parties are value-added tax vendors and the supply is of a going concern. In terms of section 11(1)(e) of the VAT Act, subject to conditions and requirements, the supply of a going concern, may be zero rated for VAT purposes. The supplier and the recipient are seen to be one and the same person in regards to any value-added tax effects and therefore the supply in terms of section 42, section 44 and section 45 of the Act are regarded as a non-supply for value-added tax purposes. Please note that for section 42 of the Act (asset-for-share transaction) and section 45 of the Act (intra-group transaction) the supplier and the recipient need to agree in writing that the goods or services are supplied as a going concern.

Securities transfer tax is a tax levied on every transfer of a security which includes the transfer of shares in a company per the Securities Transfer Tax Act (‘the STT Act’). The tax rate is 0.25%, to be applied to the taxable amount in respect of any transfer of a security. The taxable amount on which securities transfer tax is payable in respect of the transfer of unlisted securities is:

- The amount or market value of the consideration given for the transfer of the security.
- Where there is no consideration given or the consideration is less than the market value of the security, the market value of the security.
- Where the security is cancelled or redeemed, the market value of that security immediately before the cancellation or redemption must be determined (market value must be determined as if the security was never cancelled or redeemed).

The taxable amount on which securities transfer tax is payable in respect of the transfer of listed securities is:

- The amount of the consideration for that security declared by the person who acquires that security
• Where there is no consideration or if the amount so declared is less than the lowest price of the security, the closing price of that security.

Section 8 of the STT Act exempts any transfer of a security from securities transfer tax if the transfer is in terms of an asset-for-share transaction in terms of section 42 of the Act, an amalgamation transaction in terms of section 44 of the Act or an intra-group transaction in terms of section 45 of the Act.

In terms of section 2 of the Transfer Duty Act (‘the Transfer Duty Act’), transfer duty will be levied on the value of any property acquired by any person. Property is defined in the Transfer Duty Act as a real right in land, any rights to minerals, a share in a residential property company, a share in a holding company if that entity is a residential property company, a contingent right in a discretionary trust which holds residential property, or a share in a share block company.

Section 9(1)(l) of the Transfer Duty Act exempts any transfer of fixed property (including a transfer of shares in a residential property company) from transfer duty if the transfer is in terms of section 44 (amalgamation transaction) or section 45 (intra-group transaction) of the Act. There is however no automatic exemption for section 42 (asset-for-share transaction) of the Act. The only exemption that may apply with regards to an asset-for-share transaction in terms of section 42 of the Act is section 9(15A) of the Transfer Duty Act which only applies to the transfer of actual fixed property and it only applies if both the transferor and transferee are registered value-added tax vendors and the property is in the value-added tax net (i.e. section 8(25) of the VAT Act applies).

**Acquisition of asset funded by debt instrument**

In terms of section 24O of the Act where an acquisition transaction is entered into on or after 1 January 2013, and debt is issued, assumed or used by a company, for the purposes of financing the acquisition by the company of an equity share in an operating company, the interest incurred by that company must be deemed to have been incurred in the production of income for the purposes of trade and incurred in respect of an amount received or accrued that constitutes income. An acquisition transaction in this case is defined as a transaction where one company acquires equity shares in another company (an operating company) and as a result the acquirer becomes a controlling group company of that operating company (i.e. the acquiring company holds 70% or more of the equity shares in the operating company at the close of day of the transaction).
Where the operating company, however, ceases to be an operating company, or where the holding company is no longer a controlling group company in relation to that operating company, the interest incurred in any period is not deductible.

Section 23K of the Act limited the deduction of interest resulting from either an acquisition transaction (as defined in section 24O as a transaction where one company acquires equity shares in another company (an operating company) and as a result the acquirer becomes a controlling group company of that operating company) or a reorganisation transaction. A reorganisation transaction is defined as a section 45 (intra-group transaction) of the Act and is entered into on or after 3 June 2011 or a section 47 (liquidation transaction) of the Act and is entered into on or after 3 August 2011. It must however be noted that section 23K of the Act was deleted on 31 March 2014. In either of these transactions interest was disallowed in terms of debt issued for the purpose of procuring, enabling, facilitating or funding the acquisition by the acquiring company of any asset in terms of a reorganisation transaction or in terms of debt issued for the purpose of financing the acquisition of an equity share in a company in terms of an acquisition transaction.

There is a provision included in section 23K of the Act whereby the acquiring company could apply for a directive from the Commissioner allowing the deduction of the interest and it was up to the Commissioner’s discretion whether to allow this interest after considering the regulations specified in section 23K(7) of the Act which includes the amounts of the debt, interest, terms of the debt and any other factors as may be prescribed by the Minister.

With effect from 1 April 2014 section 23K of the Act is replaced by section 23N of the Act.

In terms of section 23N of the Act, where an amount of interest is incurred by an acquiring company in terms of debt issued or assumed in terms of a reorganisation transaction (section 45 (intra-group transaction) of the Act or section 47 (liquidation transaction) of the Act) that is entered into on or after 1 April 2014, the amount of interest that could be deducted may, in respect of the year in which the transaction took place and 5 years immediately following the transaction, not exceed the sum of:

- the amount of interest received by or accrued to the acquiring company, plus
- 40% of the amount of adjusted taxable income of the acquiring company;
and reduced by any amount of interest incurred by the acquiring company. This applied before changes were made to the section which came into effect on 1 January 2015. The section now states that the interest allowed as a deduction must not exceed the sum of:

- the amount of interest received by or accrued to the acquiring company, and
- the percentage as contemplated in subsection 4 of the adjusted taxable income of the acquiring company.

The percentage as contemplated in subsection 4 is:

\[
A = B \times \frac{C}{D}
\]

whereby

- \( A \) = percentage to be determined
- \( B \) = the number 40
- \( C \) = the average repo rate plus 400 basis points
- \( D \) = the number 10

Therefore if the repo rate is 6% then the percentage is 40%. If the repo rate is 10% then the percentage of adjusted taxable income allowed will be 56%. There is however a cap at 60%. Adjusted taxable income will be the taxable income of the company less any interest income, controlled foreign company income per section 9D(2) of the Act and recoupments on disposal of assets; plus interest expenditure, allowances on capital assets, 75% of receipts or accruals from letting immovable property and any assessed loss.

**Reportable arrangements**

The group will need to take into account whether there are any reportable arrangements that are required to be reported to the South African Revenue Service (‘SARS’) with regards to the group restructurings. A reportable arrangement is defined in section 35 of the Tax Administration Act (‘TAA’) as an arrangement where a person is a participant to the arrangement and the arrangement –

- Contains provisions in terms of which the calculation of interest (section 24J of the Act), finance costs, fees or any other charges is wholly or partly dependent on the assumptions relating to the tax treatment of that arrangement (otherwise than by reason of any change in the provisions of a tax Act);
• Has any of the characteristics contemplated in s80C(2)(b) of the Act, or substantially similar characteristics (please refer to Chapter 9 where the general anti-avoidance rules are discussed);
• Gives rise to an amount that is or will be disclosed by any participant in any year of assessment of or over the term of the arrangement as –
  i. a deduction for purposes of the Act but not as an expense for purposes of financial reporting standards; or
  ii. revenue for purposes of financial reporting standards but not as gross income for purposes of the Act;
• Does not result in a reasonable expectation of a pre-tax profit for any participant;
• Results in a reasonable expectation of a pre-tax profit for any participant that is less than the value of that tax benefit to that participant if both are discounted to a present value at the end of the first year of assessment when that tax benefit is or will be derived or is assumed to be derived, using consistent assumptions and a reasonable discount rate for that participant; or
• If the Commissioner has listed the arrangement in a public notice.

It must be noted that a notice was issued by SARS relating to reportable arrangements on 16 March 2015 where certain specific transactions are regarded as reportable arrangements. These include:

• transactions in terms of section 8E of the Act (hybrid equity instrument) and section 8F of the Act (hybrid debt instrument);
• share buy-backs for an aggregate amount of at least R10 million, if the company issued any shares within 12 months of entering into the buy-back agreement;
• an arrangement in which a resident contributes to or acquires a beneficial interest in a non-resident trust, where the value of contributions or payments (whether made before or after this notice) to the trust exceed or will reasonably exceed R10 million;
• an arrangement where one or more persons acquire a controlling interest in a company that has or expects to carry forward an assessed loss exceeding R50 million from the preceding year of assessment or expects an assessed loss exceeding R50 million in the year of assessment in which the relevant shares are bought; or
• an arrangement involving payments by a resident to a foreign insurer exceeding R5 million, if any amounts payable to any beneficiary are determined with reference to the value of particular assets or categories of assets held by or on behalf of the insurer or another person.
Therefore if the group restructuring falls in either of the above reportable arrangements, they would be required to report the arrangement to SARS. There are certain excluded arrangements such as:

- a debt in terms of which –
  i. the borrower receives or will receive an amount of cash and agrees to repay at least the same amount of cash to the lender at a determinable future date; or
  ii. the borrower receives or will receive a fungible asset and agrees to return an asset of the same kind and of the same or equivalent quantity and quality to the lender at a determinable future date;
- a lease;
- a transaction undertaken through an exchange regulated in terms of the Securities Services Act, 2004; or
- a transaction in participatory interests in a scheme regulated in terms of the Collective Investment Schemes Control Act, 2002.

Any arrangement is an excluded arrangement if the aggregate tax benefit which is or may be derived from that arrangement by all participants to that arrangement does not exceed R5 million.

If an arrangement is regarded as a reportable arrangement, then the following information must be submitted in the prescribed form and manner and by the date specified:

- a detailed description of all its steps and key features, including, in the case of an arrangement that is a step or part of a larger arrangement, all the steps and key features of the larger arrangement;
- a detailed description of the assumed tax benefits for all participants, including but not limited to, tax deductions and deferred income;
- the names, registration numbers, and registered addresses of all participants;
- a list of all its agreements; and
- any financial model that embodies its projected tax treatment

Should a taxpayer fail to report a reportable arrangement to SARS, a penalty of between R50 000 and R350 000 per month may be imposed by SARS.
This chapter will set out and discuss an example of a restructuring where there are foreign companies within the group and the tax effects thereof including:

- Setting out the background facts, including the group structure and restructuring transactions applied
- Discussion around the income tax, capital gains tax, value-added tax and other tax consequences

Background facts

Company H holds 100% in Company A. Company A holds 70% in Company B, 100% in Company C and Company D, 5% in Company E and 8% in Company F.

- Company H is a holding company whilst Company A, Company B, Company C, Company D, Company E and Company F are operating companies.
- Company H and Company A are South African tax resident companies, whilst Company B, Company D, Company E and Company F are foreign tax resident companies and Company C is a controlled foreign company.
- Company H is a listed company on the Johannesburg Stock Exchange.
- The group would like to simplify its group structure and have a single operating company within the group.
Company A, Company B, Company C and Company D have a mix of capital assets, trading stock and allowance assets.

Company B does not want to enter into a merger or amalgamation transaction nor an intra-group transaction.

The group would like to merge Company C with Company D. The group does not want to merge any other of the companies in the group.

Company A would then like to enter into an intra-group transaction with Company C whereby Company A will acquire all the assets in Company C in exchange for the equity shares in Company F held by Company A as well as the issue of preference shares in Company A.

Company A holds the equity shares in Company E as a capital asset. The market value of the equity shares Company A holds in Company E is greater than the base cost of these shares. The remaining equity shares in Company E are held by other foreign tax resident companies.

Company A holds the equity shares in Company F as a capital asset. The market value of the equity shares Company A holds in Company F is less than the base cost of these shares. The remaining equity shares in Company F are held by other foreign tax resident companies.

Discussed below is how each company should be restructured in the group in order to allow for the most tax efficient structure.

Company B

As discussed in Chapter 4 per the group of companies definition in section 41 of the Act which refers to the definition in section 1 of the Act, a group of companies is where there is a controlling group company (i.e. Company H) which holds directly or indirectly at least 70% of the equity shares in each of the controlled group companies and the controlling group company holds at least 70% of at least one of the controlled group companies.

Therefore Company A and Company B are part of the same group of companies and therefore we can apply either section 42, section 44, or section 45 of the Act in order to restructure Company B (Section 43 of the Act is not being discussed in this report and section 47 of the Act is discussed in Chapter 8). As per the background facts, Company B does not want to enter into a merger or amalgamation transaction in terms of section 44 of the Act nor an intra-group transaction per section 45 of the Act. Therefore section 42 (asset-for-share transaction) of the Act and section 46 (unbundling transaction) may apply in this case.
Section 42 will be discussed first whereby Company B will dispose of all of its assets to Company A in exchange for equity shares. The equity shares referred to in this example will constitute the equity shares Company A holds in Company E, a foreign tax resident company. As noted above, Company B is a foreign tax resident company as well.

As Company B is a foreign tax resident company for purposes of this example and Company B will exchange the equity shares it holds in Company E which is also a foreign tax resident company, section 42(1)(b) of the Act will be applied. For section 42(1)(b) of the Act to apply, Company A must hold the equity shares in Company E as capital assets. In this case this provision applies as per the background facts above. Secondly the market value of the shares in Company E exceeds their base cost. Furthermore as stated above Company A and Company B form part of the same group of companies as Company A holds 70% of the equity shares in Company B. Lastly, per section 42(1)(b)(ii) of the Act, either one of the following conditions must apply at the close of the day of the transaction:

- more than 50% of the shares in Company E must be directly or indirectly held by a South African resident company or a number of South African resident companies which are part of the same group of companies; or
- at least 70% of the equity shares in the other foreign company (i.e. Company B) are directly or indirectly held by a resident.

As at the close of the day of the transaction, Company E will be fully owned by foreign resident companies and therefore the first part of the section 42(1)(b)(ii) of the Act does not apply. The second part however does apply as Company A, at the close of the day of the transaction, which is a resident company, will still hold 70% of the equity shares in Company B.

The provisions of section 42 of the Act will result in a tax free transaction as Company A and Company B will be seen as one and the same. Therefore all capital assets of Company B will be transferred over to Company A at base cost, trading stock at tax value and allowance assets at tax value. Company A will be seen as having acquired these assets on the original date that Company B acquired these assets and at the cost these assets were transferred over at. Company B will then acquire the shares in Company E at the same base cost as the assets transferred to Company A.

It must be noted that the assets transferred to Company A in terms of section 42 of the Act must not be sold within 18 months of the intra-group transaction in order to ensure the benefits of section 42 of the
Act will remain. Furthermore, per section 42(6)(b) of the Act a deemed disposal may occur whereby Company B is deemed to have disposed of the shares it holds in Company E (even though these shares are still held by Company B), for their market value at the date of the original asset-for-share transaction in terms of section 42 of the Act took place and then to have repurchased them at the same market value. Therefore their base cost will be adjusted for to the market value and will no longer be the same base cost that Company A incurred. This provision could apply where either requirement that the 50% of the shares in Company E being directly or indirectly held by a South African resident company or 70% of the equity shares in the other foreign company (i.e. Company B) are directly or indirectly held by a resident no longer applies.

In order for an unbundling transaction in terms of section 46 of the Act to apply in this case where the unbundled company (Company B) is a foreign company, Company H (the shareholder of the unbundling company, Company A) must form part of the same group of companies as Company A as Company H is a resident. This applies in this case. Furthermore, Company A holds more than 50% of the equity shares in Company B before the transaction.

Therefore the unbundling transaction will result in Company B disregarding the distribution for purposes of determining its taxable income. The shares in Company B acquired by Company H are deemed to have been acquired on the same date that the Company A acquired the shares. The cost of shares now held by Company H must be determined as cost of shares held by Company A in Company B multiplied by the market value of the shares at the end of the day of the transaction divided by the sum or market value of shares at end of the day of unbundling.

**Company D**

Company D will be discussed before Company C as the group would like to merge Company C and Company D and then action the intra-group transaction between Company A and Company C.

Company D forms part of the same group of companies as Company C as both companies are wholly owned by Company A which is wholly owned by the controlling group company, Company H. Therefore as Company C and Company D form part of the same group of companies, section 44 of the Act (amalgamation and merger transactions) and section 45 of the Act (intra-group transactions) can be used in this restructuring. As stated per the background facts above, a merger transaction in terms of section 44 of the Act will be applied.
Part (c) of the definition of an amalgamation transaction per section 44(1) of the Act will apply in this case as Company D, a foreign tax resident company, will dispose of all of its assets to Company C, a controlled foreign company and both companies form part of the same group of companies before the transaction takes place. Furthermore, after the transaction more than 50% of the shares in the resultant company are held by a South African resident as Company C is wholly owned by Company A, a South African resident.

For an amalgamation or a merger to occur, the amalgamated company, Company D in this case, must transfer all of its assets to the resultant company, Company C. Furthermore the rollover relief only applies to the extent that the transfer of the assets is in exchange for equity shares in the resultant company and/or the assumption of debt. Company D must then transfer any equity shares in Company C to its shareholders (i.e. in this case it would be to Company A) so that Company D can then be wound-up. In this case it is assumed that Company C assumed Company D’s debt in exchange for the assets. Company D must then be wound-up or deregistered within 18 months of the transaction.

Where an amalgamation or merger transaction occurs, Company D will dispose of any capital assets at their base cost, any trading stock at their tax value and any other allowance assets at their tax value to Company A. Company A will be seen as one and the same with Company D and will be seen as acquired the assets on the original date that Company D acquired the assets. Therefore no recoupments or capital gains tax will arise for Company D on the sale of these assets. Company A will additionally assume any debt in Company D. The 18-month anti-avoidance provision also applies to amalgamations and mergers in terms of section 44 of the Act.

Company C

Firstly Company C forms part of the same group of companies as Company A as they are wholly owned by Company A which is wholly owned by the controlling group company, Company H. Therefore as Company A and Company C form part of the same group of companies, section 44 of the Act (amalgamation and merger transactions) and section 45 of the Act (intra-group transactions) can be used in this restructuring. As stated per the background facts, an intra-group transaction in terms of section 45 of the Act will be considered.
In this case, Company C, will dispose of its capital assets, trading stock and allowance assets in exchange for the Company F equity shares held by Company A. Part (b) of the definition of an intra-group transaction in section 45(1) of the Act will apply as Company A is disposing of its equity shares in Company F, a foreign tax resident company, to Company C, a controlled foreign company. Furthermore the base cost of the Company F equity shares transferred by Company A to Company C is more than their market value on the date of the transaction as per the background facts.

Company C will dispose of any capital assets at their base cost, any trading stock at their tax value and any other allowance assets at their tax value to Company A. Company A will be seen as one and the same with Company C and will be seen as acquired the assets on the original date that Company C acquired the assets. Therefore no recoupments or capital gains tax will arise for Company C on the sale of these assets.

Once again, it must be noted that the assets transferred to Company A in terms of section 45 of the Act must not be sold within 18 months of the intra-group transaction in order to ensure the benefits of section 45 of the Act will remain.

Furthermore, Company A and Company C must remain part of the same group of companies for 6 years for the section 45 of the Act benefit to remain (i.e. a de-grouping should not occur).

In terms of section 45(3A) of the Act, where an asset is acquired in terms of an intra-group transaction and the consideration is funded directly or indirectly by an issue of debt or shares other than an equity share, and that debt or share is issued by a company that forms part of the same group of companies, the debt or share must be deemed to have been acquired by the transferor company for an amount of expenditure of nil for purposes of paragraph 20 of the Eighth Schedule of the Act and sections 11(a), 22(1) and 22(2) of the Act. For this reason, the preference shares in Company A acquired by Company C shall be deemed to have a base cost of nil in the hands of the Company C. Any amount received, however, by Company C other than a dividend from a company within the group and applied in reduction of the capital subscribed for in that share, must be disregarded in determining Company C’s capital gain or taxable income.

Other tax consequences

*Value-added tax, securities transfer tax and transfer duty consequences*
In the case of a section 42 asset-for-share transaction, an amalgamation and merger transaction in terms of section 44 of the Act and a intra-group transaction in terms of section 45 of the Act, value-added tax, securities transfer tax, and transfer duty will, in most cases, not apply. The same principles as discussed in Chapter 4 above will apply in this case as well.

*Acquisition of asset funded by debt instrument*

The same principles as discussed in Chapter 4 above with regards to sections 23K, 23N and 24O of the Act will apply in this case as well.

*Reportable arrangements*

The same principles as discussed in Chapter 4 above with regards to reportable arrangements will apply in this case as well.
11. CHAPTER 6 – THE CORPORATE TAX EFFECT OF A RESTRUCTURING FOR A PARTNERSHIP

This chapter will set out and discuss an example of a restructuring for a partnership and the tax effects thereof including:

- Setting out the background facts, including the group structure and restructuring transactions applied
- Discussion around the income tax, capital gains tax, value-added tax and other tax consequences

Background facts

Company H holds 100% in Company A. Company A holds 100% in Company B and Company C and Company B and Company C are partners in Partnership D.

- Company H is a holding company whilst Company A, Company B and Company C are operating companies.
- Company H, Company A and Company B are South African residents, Company C is a foreign company and Partnership D is a South African partnership.
- Company H is a listed company on the Johannesburg Stock Exchange.
- The group would like to simplify its group structure and have a single operating company within the group.
- Company A, Company B, Company C and Partnership D have a mix of capital assets, trading stock and allowance assets.
Partnership D would like to dispose of all of its assets. Partnership D owns a building of R500 000, a machinery of R200 000, trading stock of R100 000 and motor vehicles of R200 000 which it would like to dispose of. The market value of these assets on the date of disposal is R500 000 for the building, R210 000 for the machinery, R100 000 for the trading stock and R150 000 for the motor vehicles. The tax values of these assets on the date of disposal is R500 000 for the building, R150 000 for the machinery, R100 000 for the trading stock and R180 000 for the motor vehicles.

Discussed below is how Partnership D should be restructured in the group in order to allow for the most tax efficient structure.

Partnership D

Using the example above it needs to be determined whether the corporate rollover relief provisions may apply in the case of a partnership.

Per the definitions in section 1 of the Act, a person is defined as an insolvent estate; the estate of a deceased person; a trust; and any portfolio of a collective investment scheme. A partnership is not defined as a person in the Act. Partnerships are not recognised as separate entities for income tax purposes and are fiscally transparent. The partnership themselves are not subject to tax. The partners are taxable in their own individual capacities.

As the transactions contained in the corporate rules refer to transactions between companies or persons, the rules cannot be applied directly to a partnership. Therefore the partnership will first need to be dissolved and then the corporate rules may be applied to the partners.

The effect of dissolution of the partnership would be that the partners would first need to agree on how to split the assets within the partnership. In this example it will be assumed that the assets are split according to the interest each of the partners hold in the partnership (i.e. Company B will acquire 60% of the assets whilst Company C will acquire 40% of the assets in Partnership D). Therefore it will be assumed that Company B and Company C agreed that Company A will acquire the building of R500 000 and the trading stock of R100 000 whilst Company C will acquire the machinery of R200 000 and the motor vehicles of R200 000 in the dissolution of the partnership.
As Company B and Company C are connected persons the dissolution will be deemed to have taken place at market value in terms of paragraph 38 of the Eighth Schedule. Therefore the building and the trading stock are deemed to have been disposed of by Company C to Company B for R500 000 and R100 000 respectively whilst the machinery and motor vehicles are deemed to have been disposed of by Company B to Company C for R210 000 and R150 000. There is no tax effect for Company C as the market value, tax value and base cost are equal for the building and trading stock. Company B will however be required to include any capital gains or recoupments that arise on the disposal of the machinery and motor vehicles. With regards to the machinery there will be a capital gain of R10 000 (R210 000 proceeds less R200 000 base cost) and a recoupment of R50 000 (R200 000 cost less R150 000 tax value). The motor vehicles will however have no capital gains tax as proceeds (market value) are less than cost. There will however be a scrapping allowance that may be claimed of R30 000 (R180 000 less tax value).

Per the above Company B will acquire a building with a value of R500 000 and trading stock with a value of R100 000 whilst Company C will acquire machinery with a value of R210 000 and motor vehicles with a value of R150 000. Once these assets have been brought into the respective companies, the corporate rollover rules may be applied in order to restructure the group. Any of the corporate rollover relief provisions may be applied (section 42 of the Act asset-for-share transaction, section 44 of the Act amalgamation transaction, section 45 of the Act intra-group transaction or section 47 of the Act liquidation or deregistration transaction).
12. CHAPTER 7 – THE CORPORATE TAX EFFECT OF A RESTRUCTURING FOR A BRANCH

This chapter will discuss an example of a restructuring for a South African branch and the tax effects thereof including:

- Setting out the background facts, including the group structure and restructuring transactions applied
- Discussion around the income tax, capital gains tax, value-added tax and other consequences

Background facts

Company H holds 100% in Company A. Company A holds 100% in Company B and Company B has a branch in South Africa, Branch C.

- Company H is a holding company whilst Company A and Company B are operating companies and Branch C is a branch of Company B.
- Company H and Company A are South African residents, Company B is a foreign company and Branch C is a branch in South Africa.
- Company H is a listed company on the Johannesburg Stock Exchange.
- The group would like to simplify its group structure and have a single operating company within the group.
- Company B and Branch C have a mix of capital assets, trading stock and allowance assets.
• Branch C would like to dispose of all of its assets. Branch C owns trading stock of R100 000 and motor vehicles of R200 000 which it would like to dispose of. The market value of these assets on the date of disposal is R100 000 for the trading stock and R150 000 for the motor vehicles. The tax values of these assets on the date of disposal is R100 000 for the trading stock and R180 000 for the motor vehicles.

Discussed below is how Branch C should be restructured in the group in order to allow for the most tax efficient structure.

Branch C

Using the example above it needs to be determined whether the corporate rollover relief provisions may apply in the case of a partnership.

Per the definitions in section 1 of the Act, a person is defined as an insolvent estate; the estate of a deceased person; a trust; and any portfolio of a collective investment scheme. A branch is not defined as a person in the Act. Branches are not recognised as a separate legal entity however they give rise to a permanent establishment in South Africa and therefore are liable for tax in South Africa on the income earned in South Africa.

As the transactions contained in the corporate rules refer to transactions between companies or persons, the rules cannot be applied directly to a branch. Therefore the branch will first need to dispose of its assets and then the corporate rules may be applied to holding company, Company B in this case. Secondly the branch and its holding company are already seen as one and the same legal entity.

The effect of the ‘disposal’ of the assets in the branch would have no effect as the branch is not a separate legal entity and therefore the assets are actually owned by Company B. Therefore there would be no tax effect for the branch to dissolve. The assets are part of Company B’s assets and Company B would then be able to apply the provisions of the corporate rollover relief.

Any of the corporate rollover relief provisions may be applied (section 42 of the Act asset-for-share transaction, section 44 of the Act amalgamation transaction, section 45 of the Act intra-group transaction or section 47 of the Act liquidation or deregistration transaction). Company B, however, is a foreign
resident and therefore there are certain provisions contained in the corporate rollover relief provisions which would result in this relief not being allowed. This has been discussed in Chapter 5.
13. CHAPTER 8 – THE CORPORATE TAX EFFECT ARISING FROM THE LIQUIDATION OR DEREGISTRATION OF A COMPANY

This chapter will discuss an example of a liquidation or deregistration of a company and the tax effects thereof including:

- Using some of the background facts as discussed in Chapter 4
- Discussion around the income tax, capital gains tax, value-added tax and other consequences

**Background facts**

Company H holds 100% in Company A. Company A holds 100% in Company B.

- Company H is a holding company whilst Company A and Company B are operating companies.
- All companies are South African tax resident.
- Company H is a listed company on the Johannesburg Stock Exchange.
- The group would like to simplify its group structure and have a single operating company within the group.
- Company A and Company B have a mix of capital assets, trading stock and allowance assets.
- The group would like to liquidate Company B.

Discussed below is how to liquidate Company B in order to allow for the most tax efficient structure.

As Company A and Company B are South African tax residents, and would like to liquidate, the provisions of section 47 of the Act liquidation, winding-up and deregistration provisions may be used. Furthermore Company A and Company B form part of the same group of companies as Company B is wholly owned by Company A which in turn is wholly owned by the controlling group company,
Company H. In order for this section to apply, all of the assets in Company B are required to be distributed to Company A, apart from the assets it retains in order to settle any debts or cover any liquidating costs.

Company B will dispose of its capital assets to Company A at their base costs, trading stock at their tax value and allowance assets at their tax value. Company A will then acquire the capital assets at the base cost, trading stock at their tax value and allowance assets at their tax value. Company A will be seen as one and the same with Company B and will therefore be regarded as having acquired these assets on the date Company B originally acquired these assets.

In order for the benefits of section 47 of the Act to remain, Company A cannot dispose of the assets it acquired from Company B within 18 months of the liquidation transaction. Furthermore section 47 of the Act will not apply if Company B has not taken the necessary steps to liquidate, wind-up or deregister within 36 months from the date of the transaction.
Even though the corporate rules (sections 41 to 47 of the Act) have been promulgated in order to provide taxpayers rollover relief, these sections are still open for abuse and potentially the general anti-avoidance rules (‘GAAR’) contained in Part IIA of the Act (section 80A to 80L of the Act) may apply. The GAAR has essentially taken over from the previous section 103(1) of the Act which introduces a number of new components, while retaining certain conceptual elements of section 103(1) of the Act (Clegg, D. & Stretch, R., 2014:26).

Per the article Corporate Restructuring Rules – Issue 9 (Edward Nathan Sonnenbergs Inc, 2007), the question arises as to whether GAAR will apply to a company using the corporate rollover relief which is still relevant today. In this article the following example was given.

Should one for instance take a scenario of a holding company wishing to declare dividends to its shareholders, it is possible for Holdco (Holdco) to create cash by entering into a transaction making use of the provisions of section 45 of the Act dealing with intra-group transactions. Essentially Holdco will transfer its entire business to Subco on the basis that there will be no negative tax consequences associated with such transfer. Value-added tax will also not be payable as Holdco and Subco will be deemed to be one and the same person. Subco, however, can fund the acquisition of the assets at market value by obtaining funding from a financial institution. The interest payable on such debt would be deductible in view of the fact that the debt has been used to acquire assets. The proceeds from the sale of the business can be used by Holdco to declare a dividend.

Per section 80A of the Act an avoidance arrangement is an impermissible avoidance arrangement if its sole purposes was to obtain a tax benefit and it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes other than obtaining a tax benefit or it lacks commercial substance in whole or in part taking into account the provisions of section 80C of the Act.

Per section 80C of the Act an anti-avoidance arrangement lacks commercial substance if it would result in a significant effect upon either the business risks or net cash flows of the party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of Part IIA of the Act.
Therefore in the above example, one would need to consider whether the disposal of all the assets in Holdco to Subco lacks commercial substance in terms of section 80C of the Act. Should SARS consider the arrangement to lack commercial substance or consider the arrangement to have been entered into purely for the purposes of obtaining a tax benefit, the tax consequences would be either of the following:

- Disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
- Disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;
- Deeming person who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;
- Reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
- Re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
- Treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such a manner as in the circumstances of the case the Commissioner deems appropriate to ensure the consistent treatment of all parties to the impermissible avoidance arrangement.

It is imperative to consider the general anti-avoidance rules for each and every transaction that is entered into.
A high level analysis of a group of companies with a combination of South African entities and foreign entities will be discussed in this chapter. Please note this chapter discusses a simple group structure. It is important to note that in practice there are many different permutations with regards to group structures which will not be discussed in this chapter which focuses on a simplistic view of a group structure.

If one were to setup a new group of companies, the best way would be to keep the group structure as simple as possible. This is obviously dependent on what type of industry the group would be in (i.e. if it was say in a mining industry with numerous different mines in different provinces, it may be best to create a different company for each mine as it would be easier to manage), or the strategy of the group (i.e. if the group would rather have centralized or decentralized operations, this would affect the number of subsidiaries needed).

In order to gain the most benefit from a tax perspective, it would be to keep the group as simple as possible (i.e. a holding company and one operating company). The benefit of having one operating company would be that all revenue received which would be taxed can be offset by the expenses incurred. If say a group had numerous operating companies where one company was making significant profits whilst another had significant losses, these profits and losses could not be offset.

Furthermore, if say a group had the following group structure:

![Group Structure Diagram]

Assume that Company A is a foreign tax resident and Company B is South African tax resident. Furthermore, assume that Company B has significant profits which it then declares as a dividend to Company A. Company A has significant assessed losses. Company B will pay income tax on the
significant profits incurred in South Africa. The dividend income is exempt from income tax however dividend withholding tax will be imposed in terms of Part VIII of the Act at a rate of 15% (depending on whether the rate could be reduced in terms of the relevant Double Taxation Agreement between South Africa and the relevant foreign country) which Company B will be liable to withhold and pay over to SARS. Please note that Company A is ultimately liable for the withholding tax on dividends should Company B fail to withhold and pay to SARS. Therefore the assessed loss would not be utilised, unless management fees, royalties or license fees were paid by Company B to Company A and both Company A and Company B would be paying tax in South Africa. If it is assumed that management fees, royalties or license fees are paid by Company B to Company A, then section 31 of the Act relating to transfer pricing will come into effect whereby Company B would need to assess whether the management fees, royalties or license fees are paid over to Company A at an arm’s length price. Please note transfer pricing has been excluded from the scope of this research report and therefore this will not be discussed further.

It is important to note here that there may be exchange control regulations that may need to be considered. Discussions around exchange control regulations has however been excluded from the scope of this research report.

If say Company A was South African tax resident, then dividends tax would not be applicable however the dividend income would be exempt for income tax purposes and so the assessed loss would not be utilised. Furthermore, if Company A incurred costs, these costs would not be deductible if the company was only earning exempt income (in the form of dividends). Another issue to note in this respect is that, if Company A was receiving income in the course of its trade, the costs would need to be proportioned between the trading income and the dividend income which may be a difficult exercise to perform. This is evident in the judgement by the Supreme Court of Appeal in Commissioner for the South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd (‘Holdings’) where Holdings earned exempt income (dividend income) and incurred certain expenses including audit fees. Although the primary activities of Holdings is that of a holding company, there were interest free loans granted by Holdings to its subsidiaries. Therefore Holdings deducted the full amount of the audit fees as the majority of the audit was spent on the review of these loans. The Commissioner firstly apportioned the audit fee, by allowing 2 to six per cent of the audit fee to be deducted from taxable income. Holdings then appealed to the Special Income Tax Court where the deduction was then increased to 50% of the audit fee. Ultimately the Supreme Court of Appeal ruled that only 10% of the audit fee was deductible. Therefore this judgement shows that it may be a very difficult exercise to apportion certain expenses between exempt income and taxable income.
Therefore in the above examples, the most tax effective structure would be to have one operating company whereby all income and all expenses were received and incurred in that one company and there would be a reduced income tax effect as well as no dividend withholding tax effect.
16. CHAPTER 11 - CONCLUSION

The way a group is structured is an important part of any corporate environment. A group of companies may have been structured in a certain way in the past that is no longer the most tax efficient structure. The Act introduced certain corporate rollover relief provisions in order to allow for tax-free restructurings between intragroup company. These corporate rollover relief provisions are as follows:

1. Section 42 of the Act – asset for share transaction whereby an asset or assets are disposed of in exchange for shares. There are certain provisions which need to apply in order for this transaction to be tax-neutral. If all necessary provisions apply, there will be no income tax or capital gains tax effect.

2. Section 43 of the Act – a substitutive share-for-share transaction whereby the shareholder disposes of an equity share interest in a company which is a linked unit and acquires another equity share interest in that same company which is not a linked unit. This section was however not discussed in this report.

3. Section 44 of the Act – an amalgamation or merger transaction whereby either a resident company disposes of its assets to another resident; or a foreign company disposes of its assets to a resident; or a foreign company disposes of its assets to another foreign company within the same group of companies. The amalgamated company must then be liquidated, wound-up or deregistered within 36 months of the amalgamation. There are certain provisions which need to apply in order for this transaction to be tax-neutral. If all necessary provisions apply, there will be no income tax or capital gains tax effect. Furthermore there is a specific provision relating to the de-grouping or deemed de-grouping which would result in the section 45 of the Act transaction no longer being tax-neutral. There are also provisions relating to the consideration received by the transferor company from the transferee company in order to avoid any tax avoidance implications.
5. Section 46 of the Act – an unbundling transaction whereby an unbundling company transfers its equity shareholding in an unbundled company to its shareholders in accordance with the effective interest in the unbundling company. This section was however not discussed in this report.

6. Section 47 of the Act – a liquidation, winding-up or deregistration transaction in which any resident company (i.e. the liquidating company) disposes of all of its assets to its shareholders in anticipation of or in the course of the liquidation, winding-up or deregistration of that company. The liquidating company may keep back assets which would be seen as reasonable in order to settle any liabilities or cover any costs in during the liquidation, winding-up or deregistration process.

In all the transactions above, there is a provision which states that where the assets transferred are disposed of within 18 months after the transaction occurs, there is no longer a tax-neutral effect and any recoupments or capital gains which would have applied if the transaction did not take place in terms of the corporate rollover relief provisions will now be applied.

It was noted in the examples of the corporate rollover relief transactions above that each transaction needs to be assessed for the most tax efficient structure. For example where a company has large assessed losses, it would be more beneficial to not apply the corporate rules where recoupments and capital gains arising from the disposals can be utilised against the assessed loss. In cases where the corporate rollover provisions are not necessary and have been agreed by both parties will not be used, must be agreed in writing as the corporate rollover provisions apply automatically.

With regards to the restructuring of a partnership within the group, the corporate rollover provisions may not be used as a partnership is not considered to be a person or legal entity and therefore the partnership is transparent for tax purposes and is taxed in the individual partner’s hands. Therefore disposal of assets by the partnership will be seen as a normal sale and capital gains tax and recoupments will apply in the hands of the individual partners. Once the assets are transferred over to the individual partners, the corporate rollover relief provisions may be applied when these individual partners dispose of the assets.

In addition to the anti-avoidance provisions included in the relevant corporate rollover relief provisions, section 80A to 80L of the Act must also be considered. These provisions of the Act include the general anti-avoidance rules which must be considered with every transaction made. The corporate rollover relief provisions, when abused, may be seen as tax avoidance in terms of GAAR as the transaction may lack commercial substance or have been entered into purely to gain a tax benefit. This must be considered for
each individual transaction entered into. The group is further required to determine if the restructuring is considered to be a reportable arrangement which would need to be reported to SARS in a specified time frame to avoid penalties on non-disclosure.

In conclusion a group of companies should be, where possible, structured as simply as possible. Where there are too many operating companies in one group, there may be forfeited tax benefits (i.e. assessed losses which cannot be utilised). If there are group structures which have numerous subsidiaries and the group is wanting to simplify this group structure, the corporate rollover relief provisions are very useful and tax beneficial.
17. REFERENCES

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