University of the Witwatersrand, Johannesburg

A research report submitted to the Faculty of Commerce, Law and Management in fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation)

An analysis of the income tax consequences attendant upon the transfer of contingent liabilities in the sale of a business as a going concern

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Date: 13 September 2017

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Abstract

The transfer of contingent liabilities as part of a sale of business transaction has always been a contentious issue. In particular, there is still a measure of uncertainty in whose hands, if any, contingent liabilities transferred as part of a sale of business may be deductible. Sale of business agreements may be structured in various ways, for example, the purchaser may acquire the seller’s business in exchange for cash, the creation of a loan account, or the assumption of liabilities. Furthermore, in the context of intra-group transactions to which the group roll-over relief provisions apply, the Income Tax Act 1962¹ (‘the Income Tax Act’) does not specifically address the transfer of contingent liabilities. This research report addresses the income tax consequences arising from the transfer of contingent liabilities from the seller to the purchaser, including an analysis of the relevant group roll-over relief provisions.

Key words: Ackermans Judgment, Actually Incurred, Contingent Liabilities, Free-standing Contingent Liabilities, General Deduction Formula, Group roll-over relief, Interpretation Note 94, Sale of Business Transaction, SARS.

¹ Act 58 of 1962.
1. Chapter 1: Introduction

The South African Revenue Service (‘SARS’) had previously published a discussion paper which set out its preliminary views regarding the income tax implications for the seller and the purchaser, where a portion of the purchase price of assets acquired as part of a going concern was settled by the assumption of contingent liabilities by the purchaser.

Following from this, during December 2015, SARS released the Draft Interpretation Note regarding the assumption of contingent liabilities in the acquisition of a going concern (‘Draft Interpretation Note’). Approximately a year later, the Draft Interpretation Note was finalised and Interpretation Note 94, dated 16 December 2016 (‘Interpretation Note’), was issued by SARS. The principles in the Interpretation Note are in line with those set out in the Draft Interpretation Note but does expand on the SARS position regarding the assumption of contingent liabilities pursuant to roll-over relief transactions. The Interpretation Note does not, however, address ‘alternative transactions’ in which the seller pays the purchaser to assume the contingent liabilities.

The Interpretation Note states that a contingent liability means:

an obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events and, if confirmed, will result in expenditure being incurred to settle the confirmed obligation.2

The Interpretation Note focuses on the tax treatment of contingent liabilities assumed as a mechanism for the part payment of the purchase price of a business acquired as a going concern. In such circumstances, the seller will usually cease trading once the sale of the business transaction has been concluded. Accordingly, the seller would seek to divest himself of all contingent liabilities, in order to ensure that his business is wound up with a ‘clean slate’.

Furthermore, the Interpretation Note makes reference to two concepts in respect of contingent liabilities, namely, ‘embedded’ obligations and ‘free-standing’ contingent liabilities.3 Importantly, the Income Tax Act in its current form does not make a distinction between ‘embedded’ and ‘free-standing’ contingent liabilities. In addition, the term ‘contingent liability’ is not defined in the Income Tax Act. It is therefore unclear whether

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2 Interpretation Note 94, dated 16 December 2016, page 3.
3 Interpretation Note, page 4.
these concepts are in fact applicable in sale of business transactions and the effect thereof on South African law.\(^4\)

In terms of the Interpretation Note, an ‘embedded contingent liability’ is embedded in and ‘inextricably linked to’ a particular asset and would be required to be transferred by the seller to the purchaser, that is, a legal obligation would exist for its transfer. The Interpretation Note states further that an ‘embedded contingent liability’ will have an effect on the market value of the relevant asset and will thus affect the purchase consideration under a sale of business transaction. An example of an embedded contingent liability is a rehabilitation obligation, which is linked to a specific mining right.

Conversely, a ‘free-standing contingent liability’ represents a distinct liability, which can be separately identified, that is, the liability is not linked to a specific asset. Free-standing contingent liabilities will not influence or suppress the market value of an individual asset. Accordingly, such a liability does not have to be transferred upon transfer of a specific asset in a sale of business transaction. Examples of such liabilities would include provisions for bonuses, leave pay provisions and warranties.

Notwithstanding the above distinction, the Interpretation Note addresses only the tax treatment of the seller and the purchaser in respect of the transfer of free-standing contingent liabilities when a business is transferred as a going concern.

The group roll-over relief provisions contained in sections 41 to 47 of the Income Tax Act provide for transferee companies to ‘step into the shoes’ of the transferor with respect to the assets acquired in terms of these provisions. Whilst a number of provisions in the Income Tax Act provide for the transfer of liabilities without compromising the application of group roll-over relief, the provisions do not explicitly provide that the transferee company ‘steps into the shoes’ of the transferor with respect to the liabilities assumed by the purchaser.

Moreover, from a commercial perspective, the assumption of liabilities as part of the acquisition of a business would arguably be no different if the transaction were to be effected in terms of the group roll-over relief provisions or effected outside of these provisions. Rather, the assumption of the liabilities by the purchaser would remain a mechanism for the discharge of the purchase price of the assets acquired from the seller.

\(^4\) Vermeulen, 2014.
In this regard, the Interpretation Note does not contain a detailed application of the group roll-over relief provisions to the transfer of contingent liabilities in a sale of business transaction. This is discussed in more detail in Chapter 5 of this report.

The general deduction formula contained in section 11(a) read with section 23(g) of the Income Tax Act contains certain prerequisites in order for a deduction to be claimed for income tax purposes. Accordingly, a taxpayer will ordinarily be permitted a deduction from his or her ‘gross income’, provided the requirements of section 11(a) of the Income Tax Act are satisfied and that such expenditure is not prohibited from being deducted in terms of section 23 of the Income Tax Act.

In the case of Ackermans Ltd v C:SARS7 (‘Ackermans judgment’), consideration was given to whether the seller had met the requirement of having ‘expenditure’ or ‘expenditure actually incurred’, as required by section 11(a) of the Income Tax Act. Importantly, the term ‘actually incurred’ requires an ‘undertaking of an obligation to pay’ or the ‘actual incurring of a liability’.8 It was held in the Ackermans judgment that the seller had not met this requirement, on the basis that an obligation had not been created in terms of the agreement of sale under consideration. Accordingly, the seller was not granted a deduction.

In this regard, the importance of the manner in which sale of business transactions are structured is highlighted.

1.1. Objective of the research

1.1.1. Research Statement

The research will provide a critical analysis on the income tax treatment in the hands of the seller and the purchaser upon the transfer of contingent liabilities, in the sale of a business as a going concern. Furthermore, consideration will be given to the group roll-over relief provisions in the context of the transfer of contingent liabilities.

1.1.2. Sub-problems

1.1.2.1. How is the transfer of contingent liabilities treated for income tax purposes from the perspective of the seller and the purchaser?

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5 As defined in section 1 of the Income Tax Act.
6 van Coller, 2011.
7 73 SATC 1.
8 van Coller, 2011.
1.1.2.2. Will the seller qualify for an income tax deduction, upon the transfer and materialisation of contingent liabilities?

1.1.2.3. Do the existing group roll-over relief provisions, as contained in the Income Tax Act in its current form, sufficiently provide for the transfer of contingent liabilities?

1.1.2.4. Does the transfer of an asset constitute an incurral of expenditure in respect of the related contingent liability?

1.1.3. **Research methodology**

This research has been performed using a qualitative approach. It relies on an extensive literature review, resulting in an analysis of the income tax considerations in a sale of business transaction. The analysis includes an examination of the Interpretation Note, the Income Tax Act, articles and other publications. In addition, the analysis extends to the group roll-over relief provisions, in the context of the transfer of contingent liabilities.

1.2. **Chapter Outline**

Chapter 2 will provide an analysis of the concept of contingent liabilities. In addition, an overview of the Interpretation Note as well as the position adopted therein will be performed. More specifically, the income tax treatment arising from the transfer of contingent liabilities in the hands of the purchaser and the seller will be analysed, as detailed in the Interpretation Note.

Furthermore, an analysis of certain judgments made reference to in the Interpretation Note will be performed.

In Chapter 3, the deductibility of contingent liabilities acquired in a sale of business transaction in the hands of the acquirer will be examined.

More specifically, the requirements of the general deduction formula as contained in section 11(a) read with section 23(g) of the Income Tax Act will be analysed, with a view of ascertaining whether the seller or the purchaser will have a deductible expense, where the contingent liability materialises.

In addition, certain provisions of the Income Tax Act will be analysed in Chapter 3 in order to determine the applicability and effect thereof on the seller and / or the purchaser in a sale of business transaction.

Chapter 4 will provide a summary of the facts contained in the *Ackermans* judgment and the findings laid down by the court. Specific analysis will be performed with reference to the general deduction formula and the meaning of the term ‘actually incurred’.
Chapter 5 will provide an analysis of the provisions aimed at facilitating the transfer of contingent liabilities, in the context of the group roll-over relief provisions, as contained in sections 41 to 47 of the Income Tax Act.

Where there are instances in which the group roll-over relief provisions do not specifically address the transfer of contingent liabilities or where there are inadequacies in the legislation, this will be identified.

Precedent provided by SARS in the form of advanced tax rulings will also be considered as part of Chapter 5.

Chapter 6 will provide a summary of the findings of the previous chapters in order to address the problem statement. Furthermore, future areas of research will be identified, where applicable. In closing, the chapter will provide concluding remarks with reference to the problem statement.

Please note that the terms ‘contingent liabilities’ and ‘provisions’ will be utilised interchangeably in this research report. Both terms are broadly defined to encompass liabilities which are not yet certain. Please refer to Chapter 2 for a detailed discussion of the meaning of this concept.
2. Chapter 2: The meaning of contingent liabilities

2.1. Introduction

The income tax treatment of contingent liabilities of the seller and the purchaser in the context of a sale of business as a going concern is not clear. In particular, different opinions have been expressed as to whether the seller or the purchaser will qualify for a deduction of such expenditure when it becomes unconditional.

Although the delegation liabilities, both actual and contingent, may form part of a sale-of-business agreement, the treatment thereof generally does not receive much attention in the sale agreement.9

From a legal perspective, ‘provisions’ in tax law generally relate to contingent liabilities, namely liabilities that will arise upon the happening of an uncertain future event. For tax purposes, provisions generally represent conditional amounts which have not yet been actually incurred by the seller from a tax perspective and are therefore not yet deductible for income tax purposes. In the ordinary course of business, where the liability materialises, the provision becomes a determined expense in respect of which the taxpayer may claim a deduction.10

As mentioned in Chapter 1, the term ‘contingent liability’ is not defined in the Income Tax Act. As such, regard should be had to the ordinary dictionary meaning of the phrase. The term ‘contingent’ is defined in the Concise Oxford Dictionary11 as:

‘dependent on; that can be anticipated or arise if a particular event occurs.’

The Merriam-Webster Dictionary defines the term ‘contingent’ as:

‘likely but not certain to happen; dependent on or conditioned by something else.’

Accordingly, an element of uncertainty exists as to whether, if at all, the liability in question will materialise.

As stated in Chapter 1, the Interpretation Note defines a contingent liability as:

‘an obligation whose existence will be confirmed only upon the occurrence or non-occurrence of one or more uncertain future events and, if confirmed, will result in expenditure being incurred to settle the confirmed obligation.’

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9 Rudnicki, 2010.
10 Ger and Chong, 2011.
12 Interpretation Note, page 3.
Having regard to SARS’s definition of the term ‘contingent liability’, the following distinguishing characteristics may be identified:

i. There must be a distinct obligation to pay an amount in respect of the liability under specific circumstances;

ii. The existence of the liability can only be confirmed at a future date; and

iii. To the extent that the liability is confirmed, it will result in expenditure being incurred to settle the liability.

Furthermore, SARS states that a contingent liability should be distinguished from a valuation provision. By way of example, SARS states that a taxpayer may elect to recognise a valuation provision in his or her accounting records, where the value of an asset has been impaired below its cost.

SARS states further that provisions may be distinguished from fixed or absolute liabilities as a fixed liability already exists and would represent an unconditional liability to a creditor.

The Interpretation Note clarifies that in a sale of business transaction, the business being disposed of as a going concern consists of various assets. Accordingly, the seller should allocate the total purchase price among the assets being disposed of. Where the purchase price comprises a combination of cash and the assumption of contingent liabilities by the purchaser, this will have to be allocated to the assets being transferred, by means of an appropriate ratio. Nevertheless, there is no clear guidance available as to how this ratio should be determined.

2.2. Embedded versus free-standing contingent liabilities

As mentioned in Chapter 1, the Interpretation Note distinguishes between ‘embedded’ obligations and ‘free-standing’ contingent liabilities.

Embedded obligations are contingent liabilities which are embedded in an asset, which is, linked to a particular asset and are required to be transferred under law, should the related asset be transferred. An embedded obligation reduces the market value of the associated

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13 Interpretation Note, page 3.
14 Interpretation Note, page 5.
15 Bell, 2015.
asset which will be transferred. An example of an embedded obligation is a mining rehabilitation provision which is linked to a mining right.\(^{16}\)

The concept of an ‘embedded liability’ was the subject matter in the case of *Daishowa-Marubeni International Ltd v Canada*,\(^{17}\) in which the court held that the reforestation obligations in respect of a forest tenure is inextricably linked to the forest tenure. Accordingly, the cost of performing in terms of the reforestation obligation represents a future cost which is embedded in the asset, that is, the forest tenure and reduces the value of the forest tenure. SARS seems to accept this distinction in the Interpretation Note, where it states:

> In appropriate circumstances the principle enunciated in this case may find application in a South African context. SARS accepts that a distinction must be drawn between an embedded statutory obligation that depresses the value of an asset and a separately identifiable contingent liability.\(^{18}\)

Conversely, free-standing contingent liabilities are distinct obligations which are separately identifiable and may be separately recognised. The transfer of such a contingent liability is not required under law and the transfer may accordingly be contracted out of. Free-standing contingent liabilities do not have an impact on the market value of the related asset. Examples of free-standing contingent liabilities include employee-related provisions, such as bonus provisions and post-retirement medical aid provisions.

The Interpretation Note sets out the income tax consequences for the seller and the purchaser on the transfer and assumption, respectively, of free-standing contingent liabilities in the context of the sale of a business transaction. In addition, the Interpretation Note includes a discussion on the income tax treatment, upon realisation of the free-standing contingent liabilities, in the hands of the purchaser.\(^{19}\) This is discussed in more detail below.

### 2.3. The tax treatment for the seller

Where the purchase price of assets acquired as part of a going concern is partly settled by an amount paid in cash and partly by the purchaser assuming a free-standing contingent liability, the seller would be entitled to the following ‘benefits’ from the purchaser:

i. The cash; and

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\(^{16}\) Bell, 2015.

\(^{17}\) 2013 SCC 29.

\(^{18}\) Interpretation Note, page 3.

\(^{19}\) Bell, 2015.
ii. The benefit of the being relieved from the obligation to settle the free-standing contingent liability in circumstances where the contingent liability becomes unconditional in the future.

Accordingly, the seller will be required to account for tax arising from the above ‘benefits’.\(^{20}\)

From the seller’s perspective, the amount which would need to be included in gross income or proceeds would need to be determined. The inclusion in either gross income or proceeds of the seller would be determined by the nature of the specific asset being transferred to the purchaser.

In addition, it would need to be considered whether the seller would be entitled to a deduction for the amount of the contingent liability being transferred to the purchaser.

These aspects are considered below, having regard to SARS’s view on the matter, as contained in the Interpretation Note.

2.3.1. Inclusion in gross income and/or proceeds

The sale of a business will result in the disposal of each of the assets of the business of the seller. This would require the seller to allocate the purchase price to particular assets, that is, on an asset-by-asset basis. This will be the case even in circumstances where the purchaser has paid a lump sum for the acquisition of the business assets of the seller.\(^{21}\)

SARS states that it may review the purchase price allocation adopted by the taxpayer where an agreement of sale does not stipulate the purchase price allocation. In addition, SARS may request documentation in support of the allocation which has been made in respect of the sale of business transaction in question. It is important to note that the seller and the purchaser are required to adopt the same purchase price allocation.\(^{22}\)

For purposes of gross income, an ‘amount’ is more than just a monetary amount but includes every form of property earned by a taxpayer, whether corporeal or incorporeal, which has a money value.\(^{23}\) When a taxpayer becomes entitled to an amount of income in a non-monetary form, its monetary value must be included in the taxpayer’s gross income.

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20 Interpretation Note, page 7.
22 Interpretation Note, pages 5 to 6.
23 *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9.
income.\textsuperscript{24} The test is objective, not subjective.\textsuperscript{25} Therefore, the test is not whether the receipt or accrual is \textit{capable} of being turned into money.

Accordingly, the seller obtains a benefit by the purchaser assuming certain or all of the seller’s contingent liabilities, as the seller will not be required to settle the contingent liabilities, if and when they become unconditional. In terms of the Interpretation Note, the value of the benefit is required to be determined objectively and in accordance with arms-length principles. SARS is of the view that the value of the benefit is equal to the face value of the free-standing contingent liability, as stipulated in the agreement of sale and having regard to the particular circumstances and the intention of the seller and the purchaser. Importantly, no present value calculation needs to be performed to adjust the face value of the contingent liability in accordance with the expected settlement amount in future.\textsuperscript{26}

The Interpretation Note stipulates that the amount of the benefit should be determined at the earlier of the receipt or accrual, that is, the earlier of when the seller receives the amount or becomes unconditionally entitled to the amount.\textsuperscript{27} Where there are clauses in the agreement of sale between the seller and the purchaser so as to defer the receipt or accrual, these should be taken into consideration in order to determine the timing of the receipt or accrual.

The seller will thus be required to include the face value of the free-standing contingent liability which has been assumed by the purchaser in gross income or proceeds, when calculating the tax consequences arising from the disposal of the business assets. The inclusion in gross income or proceeds will depend on the nature of the asset disposed of by the seller, that is, where the asset represented an asset of a revenue nature in the hands of the seller, the seller will include the value in gross income for income tax purposes. In contrast, where the asset was of a capital nature in the hands of the seller, the value will be included in the proceeds of the seller for Capital Gains Tax purposes.

\subsection*{2.3.2. Deductibility of the contingent liability}

In terms of section 11(a) read with section 23(g) of the Income Tax Act, expenditure must have been ‘actually incurred’ by a taxpayer in order for such expenditure to qualify as a deduction from income. Accordingly, there must be an unconditional legal obligation or an

\textsuperscript{24} Mooi v SIR 1972 (1) SA 675 (A), 34 SATC 1.
\textsuperscript{25} CSARS v Brummeria Renaissance (Pty) Ltd and Others [2007] 4 All SA 1338 (SCA).
\textsuperscript{26} Interpretation Note, page 7.
\textsuperscript{27} Interpretation Note, pages 7 to 8.
absolute liability in order for an amount to qualify as expenditure ‘actually incurred’ and to be deductible by the seller.

In this regard, the seller will not ‘incur’ any expenditure in relation to the assumption of the free-standing contingent liability by the purchaser as the contingent liability will be conditional at the date of transfer and will simply represent anticipated expenditure. Accordingly, the seller will not be entitled to an income tax deduction in respect of the transfer of the free-standing contingent liability, irrespective of whether the purchase price is reduced as a result of the transfer of the contingent liability to the purchaser. In this regard, SARS states the following:

If a purchaser assumes a free-standing contingent liability as settlement or part settlement of a purchase price of an asset, the seller will not have incurred any expenditure on assumption of the free-standing contingent liability by the purchaser.\(^{28}\)

SARS states further that when a purchaser assumes a free-standing contingent liability in settlement or part settlement of the purchase price owing to the seller for an asset, it is clear that at the date of sale, the free-standing contingent liability itself would not have materialised in the seller’s hands.\(^{29}\) The free-standing contingent liability still exists and whether or not it will become unconditional is uncertain at the date of sale. Following the sale, the free-standing contingent liability no longer concerns the seller. Accordingly, the seller has not incurred and will not incur any expenditure in relation to the free-standing contingent liability assumed by the purchaser.

In light of the above, it would appear that SARS is of the view that if contingent liabilities are assumed as part settlement of the purchase price, this would not constitute expenditure actually incurred by the seller.

2.4. The tax treatment for the purchaser

From the purchaser’s perspective, it would need to be determined whether the purchaser is entitled to a tax deduction or an allowance in respect of the purchase price of the assets acquired from the seller. Where the purchaser qualifies for a tax deduction or allowance, the timing of the deduction or allowance will need to be considered. The aforementioned will need to be considered at the date of sale of the respective assets and once the free-standing contingent liability becomes unconditional.

\(^{28}\) Interpretation Note, page 9.
\(^{29}\) Interpretation Note, page 14.
2.4.1. Deductibility of the contingent liability

In determining whether the purchaser would qualify for a deduction or allowance at the date of sale, it would need to be considered whether the purchaser has incurred expenditure in relation to the acquisition of the contingent liability at the date of sale. At the date of sale, it is uncertain as to whether the contingent will materialise, and if so, what amount will materialise. Accordingly, the purchaser would not have incurred expenditure in the form of cash or assets, until such time as the contingent liability materialises. In this regard, the purchaser will only incur expenditure in relation to the free-standing contingent liability if and when the contingent liability becomes unconditional; the purchaser merely undertakes to incur expenditure in future.

In addition, the deductibility of the contingent liability would be dependent on the nature of the asset acquired by the purchaser, that is, the specific asset which purchase price was settled or partly settled by the assumption of the free-standing contingent liability. Where no allocation has been made in the agreement of sale between the seller and the purchaser, the purchaser will be required to make an allocation, on an appropriate basis, of the amount of contingent liabilities to be allocated to particular assets on the date of sale.

Accordingly, where the asset to which the contingent liability relates is a capital non-allowance asset in the hands of the purchaser, the purchaser will not be entitled to an income tax deduction when the contingent liability materialises and is settled by the purchaser. In such a scenario, neither the purchaser nor the seller may claim a deduction. To the extent that the contingent liabilities are allocated to capital assets on which allowances may be claimed or to trading stock, the purchaser may claim such allowances or deductions when the liability realises in the purchaser’s hands.

Conversely, where the asset to which the contingent liability relates is revenue in nature in the hands of the purchaser, the purchaser will be entitled to an income tax deduction. The deduction would need to be determined with regard to the relevant tax deduction or allowance provision, as contained in the Income Tax Act. For example, where the asset acquired was trading stock, then the purchaser would need to apply the provisions of section 11(a) of the Income Tax Act in order to claim a deduction.

SARS makes it clear in the interpretation Note that in instances where the purchaser acquires a capital allowance asset, in respect of which the allowance is claimable over a
number of years, the allowance which may be claimed in a particular year of assessment should be adjusted for prior years of assessment.\textsuperscript{30} Furthermore, the purchaser would need to consider the nature of the asset to which the free-standing contingent liability relates, from the purchaser’s perspective. Accordingly, the purchaser will be prohibited from treating the same amount of expenditure as both of a capital and revenue nature. This is specifically prohibited in terms of section 23B of the Income Tax Act, which prevents a taxpayer from claiming a ‘double’ deduction for income tax purposes.

The Interpretation Note suggests that the purchaser would only be entitled to a deduction when the contingent liability crystallises and to the extent that such liability was applied as consideration for the acquisition by the purchaser of an asset which is revenue in nature. Nevertheless, where such an allocation is made, the purchaser is deemed not to have incurred any expenditure in respect of the acquisition of such asset until the contingent liability materialises. Accordingly, upon realisation of the contingent liability, the purchaser would need to identify the specific asset to which the face value of the contingent liability in question was allocated.

This is important as it suggests that the deductibility of the expenditure arising from the realisation of the contingent liability would be dependent upon the nature of the asset to which such contingent liability was allocated and not on the nature of the expense in the hands of the purchaser.

In addition, SARS emphasises that the purchaser must satisfy all of the requirements of the relevant provision of the Income Tax Act which permits the relevant deduction or allowance, in order for the purchaser to qualify for a deduction.\textsuperscript{31}

\textbf{2.5. Issues not addressed in the Interpretation Note}

The Interpretation Note only considers the income tax implications arising from the assumption of contingent liabilities, where the liability in question is a free-standing contingent liability. Accordingly, the Interpretation Note does not consider the tax implications in instances where an embedded obligation is being transferred by the seller and assumed by the purchaser. It is not clear whether such an analysis would be required from a South African perspective, as the distinction between an ‘embedded’ obligation and

\textsuperscript{30} Interpretation Note, page 17.
\textsuperscript{31} Interpretation Note, page 13.
a ‘free-standing’ contingent liability is not currently recognised in South African law, as mentioned previously.

In addition, the Interpretation Note does not address all of the requirements of the general deduction formula in detail. In this regard, refer to Chapter 3 for a more detailed discussion of the requirements of the general deduction formula, as contained in section 11(a), read together with section 23(g) of the Income Tax Act.

Furthermore, the Interpretation Note does not address the tax implications which may arise where an ‘alternative arrangement’ may be entered into by the seller and the purchaser. In this regard, SARS comments only on the income tax implications which may arise in circumstances where the acquirer assumes certain free-standing contingent liabilities of the seller, in exchange for assets of the seller. In practice, however, the seller may elect to pay the purchaser in cash for assuming certain contingent liabilities. The latter scenario is not addressed in the Interpretation Note. In this regard, SARS specifically states:

There are alternative ways to structure transactions....This Note does not deal with the situation in which the agreement is that the seller pays the purchaser to take over a free-standing contingent liability and this liability is set off against the liability owed by the purchaser to the seller for the acquisition of the going concern...

Accordingly, the tax treatment of such a transaction from a tax perspective in the hands of the seller and the purchaser remains unclear. The receipt by the purchaser of the amounts from the seller to settle the contingent liabilities when they are realised would likely be of a capital nature and would therefore not be included in the purchaser’s income. It may therefore be viewed as inequitable in circumstances where neither the seller nor the purchaser would be permitted a tax deduction in respect of the acquisition of capital non-allowance assets.

Apart from the inequity, the position set out in the Interpretation Note raises administrative concerns in that it requires the purchaser to keep track of the allocation of contingent liabilities in relation to allowance assets and trading stock, notwithstanding the fact that the contingent liabilities may only materialise in the hands of the seller in years following the sale.

In addition, SARS is of the view that one has to look at the specific facts of a particular transaction and determine the tax consequences having regard to those specific facts.

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32 Interpretation Note, footnote 29 on page 12.
Accordingly, each transaction should be analysed on a case-by-case basis. This may lead to inconsistencies in the tax treatment of the transfer and assumption of contingent liabilities, between taxpayers.
3. Chapter 3: The general deduction formula

3.1. Requirements of the general deduction formula

Section 11(a) of the Income Tax Act states:

For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived -

(a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature...

Section 23(g) of the Income Tax Act prohibits the deduction of any amounts claimed as a deduction from income derived from trade, to the extent that such amounts were not laid out or expended for the purpose of trade. The provisions of section 23(g) of the Income Tax Act limit the ability of a taxpayer to claim any amounts as deductions, to the extent that the expenditure was not incurred in respect of the taxpayer’s profit-making activities.\(^3\)

Accordingly, the following requirements of the general deduction formula, as set out in section 11(a) read with section 23(g) of the Income Tax Act, must be satisfied by a taxpayer in order to be permitted a deduction from income derived from carrying on any trade:\(^4\)

i. There must be expenditure and losses;
ii. actually incurred during the year of assessment;
iii. incurred in the production of income;
iv. not of a capital nature; and
v. laid out or expended for the purposes of trade.

In this regard, each of the above elements of the general deduction formula are dealt with below, with particular emphasis on the requirement of ‘actually incurred’.

3.1.1. Expenditure ‘actually incurred’

Expenditure ‘actually incurred’ does not mean ‘actually paid’\(^5\) during the year of assessment, but means all expenditure for which a legal liability\(^6\) had been incurred during the tax year, whether such liability had been discharged during the year or not. Where expenditure is so closely connected with the act of performing the business, such

\(^3\) van Coller, 2011.
\(^4\) As contained in section 11(a) read with section 23(g) of the Income Tax Act.
\(^5\) Port Elizabeth Electric Tramway Co Ltd v CIR 1936 CPD 241, 8 SATC 13 at 15.
\(^6\) Edgars Stores Ltd v CIR 1988 (3) SA 876 (AD), 50 SATC 81 at 90.
expenditure may be regarded as part of the operational costs of the business and would generally be deductible.

Based on case law, it is evident that for expenditure to be ‘actually incurred’ during a year of assessment, the taxpayer must have incurred an absolute and unconditional legal obligation to pay an amount.\(^{37}\) If the obligation is conditional upon the happening of an event, the taxpayer would not have an absolute and unconditional legal obligation to pay an amount.\(^{38}\) Accordingly, the taxpayer in such instance would not have actually incurred the expenditure.\(^{39}\)

In determining whether a taxpayer may deduct an amount from his gross income in terms of the general deduction formula, the starting point is to consider whether the particular expense has been ‘actually incurred’ in the particular year of assessment in which the deduction is sought.

Tax is assessed on an annual basis. In order for an expense to be deductible in a particular year of assessment, that expense must have been actually incurred during that particular year of assessment. In this regard, the Appellate Division case of *CIR v Golden Dumps (Pty) Ltd*\(^{40}\) stated the following in respect of the annual basis of assessing the taxability of a taxpayer:

In *Caltex Oil (SA) Ltd v Secretary for Inland Revenue 1975(1) SA 665(A)*, Botha JA referred at pp 673H to 674B to certain provisions of the [Income Tax] Act (to which I shall return), and said at 674B-E:

> It is clear from these provisions that income tax is assessed on an annual basis in respect of the taxable income received by or accrued to any person during the period of assessment, and determined in accordance with the provisions of the [Income Tax] Act...It is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment (cf Port Elizabeth Electric Tramway Co Ltd v Commissioner for Inland Revenue 1936 CPD 241 at 244, and Commissioner for Inland Revenue v Delfos 1933 AD 242 at 257).

From the above, it is clear that it is only at the end of the year of assessment that a taxpayer can determine whether an expense has been actually incurred during that year of assessment.

The well-known case of *Port Elizabeth Electric Tramway Company Ltd v CIR*\(^{41}\), stated that the words of the statute are ‘actually incurred’ and not ‘necessarily incurred’. The court

\(^{37}\) *Nasionale Pers Bpk v KBI* 1986 (3) SA 549 (A), 48 SATC 55 at 69.

\(^{38}\) *Edgars Stores Ltd v CIR* 1988 (3) SA 876 (AD), 50 SATC 81 at 95.

\(^{39}\) *ITC 1444* (1987) 51 SATC 35 (T) at 39 and 40.

\(^{40}\) 55 SATC 198 (A).

\(^{41}\) 1936 CPD 241, 8 SATC 13.
stated that the use of the word ‘actually’ as contrasted with the word ‘necessarily’ may widen the field of deductible expenditure. The court stated the following in this regard:

   For instance, one man may conduct his business inefficiently or extravaganty, actually incurring expenses which another man does not incur; such expenses therefore are not ‘necessary’ but they are actually incurred and therefore deductible.

At page 15, the court stated further that expenses ‘actually incurred’ do not mean those expenses which have been ‘actually paid’. As long as the liability to make payment thereof has been incurred, the expenses may be deductible.

The word ‘incurred’, as stated in *ITC 1587,* means the following:

   ‘Incurred’ is not limited to defrayed, discharged or borne, but does not include a loss or expenditure which is no more than impending, threatened or expected.

In the judgment of an Australian case, namely *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation,* Dixon J said at 207 that the word ‘incurred’:

   …does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon.

In the case of *Caltex Oil (SA) Ltd v SIR* (referred to in the quoted judgment of the *Gold Dumps* case supra), the court dealt with the situation where the appellant company imported certain products from companies in the United Kingdom, the purchase price of which was to be settled in pounds sterling. The appellant received the invoices in pounds sterling and translated the amount into rands at the rate of exchange prevailing on the day of the shipment, and recorded that amount in its books.

The pound sterling devalued and the liability to the overseas companies was reduced, however, the amount reflected in the books of the appellant remained unchanged. The Secretary for Inland Revenue sought to include the difference between the amount actually paid to the United Kingdom companies and the amount reflected in the appellant’s books, in the appellant’s gross income as a ‘profit on the devaluation of the sterling’. The appellant objected to the Secretary’s assessment and the court determined that the real issue in dispute was whether the amount actually incurred by the appellant should have been reduced by the difference between the actual price paid and the amount reflected in the books as the cost of the products.

Botha JA, who delivered the judgment of the Appellate Division of the Supreme Court, said (at page 12):

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42 57 SATC 97, at page 103.
43 (1938) 61 CLR 179 (High Court of Australia).
The expression “expenditure actually incurred” in s 11(a) does not mean expenditure actually paid during the year of assessment, but means all expenditure for which a liability has been incurred during the year, whether the liability has been discharged during that year or not (Port Elizabeth Electric Tramway Co v Commissioner for Inland Revenue (supra) at 244 and IT Case 542, 13 SATC 116 at 118). It is in the tax year in which the liability for the expenditure is incurred, and not in the tax year in which it is actually paid (if paid in a subsequent year), that the expenditure is actually incurred for the purposes of s 11(a).

In a similar vein, Corbett JA, as he then was, delivering the judgment of the majority of the Appellate Division in *Edgars Stores Ltd v CIR* stated the following:

Thus it is clear that only expenditure (otherwise qualifying for deduction) in respect of which the taxpayer has incurred an unconditional legal obligation during the year of assessment in question may be deducted in terms of section 11(a) from income returned for that year. The obligation may be unconditional ab initio or, though initially conditional, may become unconditional by fulfilment of the condition during the year of assessment; in either case the relative expenditure is deductible in that year. But if the obligation is initially incurred as a conditional one during a particular year of assessment and the condition is fulfilled only in the following year of assessment, it is deductible only in the latter year of assessment (the other requirements of deductibility being satisfied).

The question of whether or not expenditure has been ‘actually incurred’ for purposes of section 11(a) of the Income Tax Act was clearly summarised by Ackermann J in *CIR v Edgars Stores Ltd* as follows:

Another well-established principle, not challenged in this appeal, is that a distinction must be drawn between:

(a) the case where the existence of the liability itself is conditional and dependent upon the happening of an event after the tax year in question, in which event the liability is not incurred in the tax year in question; and

(b) the case where the existence of the liability is certain and established within the tax year in question, but the amount of the liability cannot be accurately determined at the tax year-end, in which event the liability is nevertheless regarded as having been incurred in the tax year in question.

This principle was supported on appeal by the *Edgars Stores Ltd* case to the Appellate Division, which held that the lower court (Transvaal Provincial Division) had reached the correct conclusion.

The *Golden Dumps* case (supra), with reference to what constitutes a contingent or conditional obligation, stated the following at page 206:

A liability is contingent in that sense in a case where there is a claim which is disputed, at any rate genuinely disputed and not vexatiously or frivolously for the purposes of delay. In such a case the ultimate outcome of the situation will be confirmed only if the claim is admitted or if it is finally upheld by the decision of a court or arbitrator. Where at the end of the tax year in which a deduction is claimed, the outcome of the dispute is undetermined, it cannot be said that a liability has been actually incurred. The taxpayer could not properly claim the deduction

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44 1988 (3) SA 876 (A), 50 SATC 81 at 90.
45 1986 (4) SA 312 (T), 48 SATC 89.
in that tax year, and the receiver of revenue could not, in the light of the onus provision of s 82 of the [Income Tax] Act, properly allow it.

In the case of *Nasionale Pers Bpk v KBI* 46, the court had to decide whether the taxpayer’s provision for bonuses at year-end were deductible for tax purposes and whether they had been ‘actually incurred’ in that year of assessment. It is important to note, as in most instances regarding an assessment of the deductibility of expenditure, such a determination is dependent upon the facts of each case.

In this case, the taxpayer sought a deduction of its provision for staff bonuses in respect of its 31 March year-end, which bonuses were to be paid out on 30 September, that is, six months later. The deductions were disallowed by the Commissioner on the grounds that such bonus provisions were not ‘actually incurred’ for the purposes of the general deduction formula, to which the taxpayer objected.

The bonus policy introduced by the taxpayer stated that bonuses would be only be payable to qualifying employees in the taxpayer’s employ on 31 October and that the full amount of the bonus would be reclaimed from any employee giving notice, after receipt of bonus, of intention to resign before 31 October. The practice of the taxpayer, based on the evidence provided to the court, was to pay bonuses on 30 September while retaining the right to recover the bonus paid to an employee, if they were no longer in the service of the appellant on 31 October, or if a notice of resignation had been received before then.

In giving evidence, the taxpayer conceded that no employee could demand their bonus payment on 31 March, that is, at year-end, however, it did state that at 31 March the taxpayer had contractually bound itself to make payment of the bonuses and as such were ‘actually incurred’ within the meaning of section 11(a) of the Income Tax Act.

The taxpayer contended that the condition that the employees had to be in the employ of the taxpayer as at 31 October in order to be eligible to receive the bonus was a resolutive condition, in the sense that the liability existed and merely the passage of time governed the payment thereof and that the obligation ceased only if the employee’s service was terminated voluntarily or by reason of his misconduct.

The taxpayer contended that the entire bonus pool would be distributed among its employees in the following year, and that the bonus provision was not linked to any single employee. Accordingly, the entire bonus provision should be seen as actually incurred as

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46 1986 (3) SA 549 (A), 48 SATC 55.
the entire amount would be paid out, irrespective of whom the employee was that would receive that payment.

The court, in its judgment, reaffirmed the principle that, for purposes of section 11(a) of the Income Tax Act, expenditure had to be ‘actually incurred’ in the tax year in which the liability legally arose and not in the tax year in which actual settlement of the debt occurred.

The court stated that in reality the taxpayer had concluded obligations with its employees on an individual basis and not collectively and accordingly, such obligations could not be lumped together. Cumulatively, the taxpayer’s liability to its employees as a group was nothing more than the obligations which the taxpayer concluded with its individual employees.

The court, after concluding that the taxpayer had obligations to each of its employees individually, stated further that it was unnecessary to decide whether the condition to pay the bonuses was suspensive or resolutive, and that the predominant fact was that the question as to whether the employee would be in the employ of the taxpayer at 31 October, was an uncertain future event. The question of whether the taxpayer had an unconditional legal obligation to pay the bonuses to its employees could only be answered on 31 October and not 30 September, or even 31 March. The court accordingly found in favour of the Commissioner on the basis that the provision for bonuses claimed as a deduction by the taxpayer was not ‘actually incurred’ in the year of assessment in question.

In light of the law cited above, it appears to be trite law that the words ‘actually incurred’ do not mean that expenditure must be due and payable at the end of the year of assessment. As long as a clear legal liability to make payment exists at the end of the year, the expenditure is deductible even though actual payments may fall due only in a later year.

It is important to note that an expense that meets all the other requirements of the general deduction formula must be deducted at the time that the expense is ‘actually incurred’ by the taxpayer. Failure to do so would potentially lead to the expenditure being non-deductible for tax purposes to the extent that the expenditure is claimed in another year of assessment.

47 Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A).
This is, however, subject to section 23H of the Income Tax Act. Section 23H of the Income Tax Act aims to spread the deduction of certain expenditure over the period that the goods, services or other benefits are received or enjoyed by the taxpayer, if the period extends beyond the year of assessment.

Having regard to the above, it is submitted that the following established principles can be extracted from the law relating to the term ‘actually incurred’ in the context of section 11(a) of the Income Tax Act:

— It is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment;

— Only expenditure in respect of which the taxpayer has incurred an unconditional legal obligation during the year of assessment in question may be deducted in terms of section 11(a) of the Income Tax Act for income tax purposes;

— The obligation incurred may be unconditional ab initio or, though initially conditional, may become unconditional by fulfilment of the condition during the year of assessment; and

— Where the existence of the liability is certain and established within the tax year in question, but the amount of the liability cannot be accurately determined at the tax year-end, the liability is nevertheless regarded as having been ‘actually incurred’ in the tax year in question. In this instance, the expense should be estimated for purposes of section 11(a) of the Income Tax Act and deducted in the year in which it was incurred.

3.1.2. In the production of income

In terms of the general deduction formula, any expenditure which has not been incurred for the purpose of producing income, is not allowed as a deduction. The income referred to as ‘income’ is as defined in section 1 the Income Tax Act, namely gross income less exempt income.48

48 An apportionment is possible between the productive and non-productive purposes for which an expense is incurred. In this regard, different methods have been accepted by the courts for purposes of apportionment, provided the method is reasonable.
Generally, two questions need to be answered in the affirmative in establishing whether expenditure is incurred ‘in the production of income’, namely:

— is the act entailing the expenditure incurred for the purpose of earning income; and if so

— is the expenditure so closely linked or connected to the taxpayer’s business or the act of earning the income that it may be regarded as part of the cost of performing it.

Each of these questions is analysed in more detail below:

3.1.2.1. Purpose of the expenditure

Section 1 of the Income Tax Act defines ‘income’ as:

the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II.

In the case of *Sub-Nigel Ltd v CIR*, it was acknowledged that expenditure would be incurred in the production of income even if it produced no income during a particular year of assessment, provided it was incurred for the purpose of earning income.

3.1.2.2. Closeness of connection of the expenditure to trade

In evaluating the closeness of the connection between the expenditure incurred and the income-earning operations of the taxpayer, it was decided in the case of *Port Elizabeth Electric Tramway Co v Commissioner for Inland Revenue* (supra) that income is produced by a series of acts, and that expenditure is attendant upon such acts. It was held further that expenses will be deductible if they are so closely linked to such acts as to be regarded as part of the cost of performing them.

In considering whether the expenditure incurred is so closely linked to the act that produces the income, both the purpose of the expenditure and what it actually effects must be considered. All expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation.

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49 1948 (4) SA 580 (A).
50 *Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241, 8 SATC 13 at 16.
51 *COT v Rendle* 1965 (1) SA 59, 26 SATC 326 at 331.
52 *Joffe & Co (Pty) Ltd v CIR* 1946 AD 157, 13 SATC 354 at 357.
53 *CIR v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A), 45 SATC 241 at 256.
income to have actually been produced in order for the attendant expenditure to be
incurred in the production of income.\(^{54}\)

### 3.1.3. Not of a capital nature

It is often difficult to distinguish between ‘capital’ and ‘revenue’ expenditure. Although
there are a mass of judicial decisions on the issue, it is almost impossible to extract a
universal test that will apply equally to all situations. The courts have, however, given some
guidelines as to this distinction.

In this regard, it has been held that where the expenditure is more closely related to the
establishment, improvement or maintenance of the taxpayer’s income-producing
structure than to the working of its income-earning operations, it is capital expenditure.\(^{55}\)

In considering whether expenditure is linked to the income-producing capital structure or
the income-producing activities of the taxpayer, the distinction between fixed capital and
floating capital is useful. Generally, the acquisition cost of fixed assets is capital in nature
and non-deductible, whereas expenditure incurred in relation to floating capital employed
in a business for the purpose of making a profit would be of a revenue nature.\(^{56}\)

In each instance, regard must be had to all the surrounding circumstances attendant upon
each particular set of facts.\(^{57}\)

Where the above test is not conclusive, the test can also be supplemented by subsidiary
tests laid down by our courts, namely:

— whether the expense creates an enduring benefit. In terms of the enduring benefit
test, the question is whether the taxpayer obtained an enduring benefit\(^{58}\) by
incurring the expenditure or as a result of the expenditure.\(^{59}\) If so, the expense is
capital in nature;\(^{60}\) and

— whether the expense is incurred once and for all. Recurrence of expenditure could
be indicative of a revenue nature. It is submitted that this test could, at best, serve
as an indicative factor in determining the nature of an expense, as the mere fact

\(^{54}\) *Sub Nigel Ltd v CIR* 1948 (4) SA 580 (A), 15 SATC 381 at 394.

\(^{55}\) *CIR v George Forest Timber Co Ltd* 1924 AD 516, 1 SATC 20 at 25.

\(^{56}\) *New State Areas Ltd v CIR* 1946 AD 610, 14 SATC 155 at 164.

\(^{57}\) *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A), 37 SATC 193 at 220.

\(^{58}\) *Heron Investments (Pty) Ltd v Secretary for Inland Revenue* 1971 (4) SA 201 (A), 33 SATC 181 at 189.

\(^{59}\) *Palabora Mining Co Ltd v SIR* 1973 (3) SA 819 (A), 35 SATC 159 at 173.

\(^{60}\) *ITC 1528* 54 SATC 243 at 247.
that an amount is paid as a lump sum, does not per se mean that that expense is
of a capital nature (and vice versa).\textsuperscript{61}

3.1.4. Carrying on a trade and incurring expenses for purposes of trade

The requirements of section 11(a) read together with 23(g) of the Income Tax Act are
qualified by the fact that the taxpayer should be ‘carrying on a trade’. Section 11(a) read
together with section 23(g) of the Income Tax Act will, as a starting point, permit a taxpayer
a deduction only if such taxpayer is carrying on a trade.

The ‘carrying on of a trade’ requirement is inextricably linked to the further requirement
(contained in section in section 23(g) of the Income Tax Act) that the expenditure must be
laid out or expended ‘for purpose of trade’.

The term ‘trade’ is very widely defined in section 1 of the Income Tax Act and includes,
inter alia, ‘…every profession, trade, business, employment, calling, occupation or
venture…’

In order to determine whether a taxpayer is ‘carrying on a trade’, an objective test is used.
The mere fact that a taxpayer intends to trade is insufficient to meet this requirement and
active steps must be taken to evidence the ‘carrying on’ of a trade.

In terms of case law, the phrase ‘carrying on of a trade’ suggests that the taxpayer has a
system or a plan and that continuity in the operation is intended.\textsuperscript{62} The presence of a profit
motive is not imperative,\textsuperscript{63} however, the absence thereof may indicate that the taxpayer
contemplated a purpose other than trade.\textsuperscript{64} A further factor in support of an argument
that a taxpayer is ‘carrying on a trade’ would be the fact that a taxpayer bears the risks and
rewards normally associated with conducting a business. It has been held that the mere
fact that losses are anticipated by a taxpayer should not deprive a taxpayer of the right to
claim a deduction, provided the activities of trade continue during the loss-making period.

\textsuperscript{61} New State Areas Ltd v CIR 1946 AD 610, 14 SATC 155 at 170.
\textsuperscript{62} Modderfontein Deep Levels Ltd v Feinstein 1920 TPD 288.
\textsuperscript{63} De Beers Holdings (Pty) Ltd v CIR 1986 (1) SA 8 (A), 47 SATC 229 at 260.
\textsuperscript{64} If the taxpayer has no profit-making motive, the taxpayer may still be ‘carrying on a trade’, provided its
activities have another commercial purpose, that is:

...a transaction entered into with the purpose of not making a profit must, in order to satisfy s 23 (g),
be shown to have been so connected with the pursuit of trade so as to justify the conclusion that,
despite absence of profit motive, the moneys were indeed paid out wholly and exclusively for the
purposes of trade...

(De Beers Holdings (Pty) Ltd v CIR 1986 (1) SA 8 (A), 47 SATC 229 at 250). In other words, a taxpayer’s non-profit
making intention must be connected with the pursuit of the taxpayer’s trade.
3.2. Application of the general deduction formula to the assumption of contingent liabilities

Generally, an expense cannot be deducted by a taxpayer for income tax purposes unless the expense has, inter alia, been ‘actually incurred’. Accordingly, any provision which has been raised by a taxpayer will generally not be deductible until such taxpayer incurs an obligation to settle the provision. The difficulty therefore arises when the liability has been transferred to the purchaser before the liability materialises.

In a New Zealand case, Commissioner of Inland Revenue v. New Zealand Forest Research Institute Ltd, the facts of the case were as follows:

As per the sale agreement, the purchaser of a business assumed the vendor’s (seller’s) liabilities to its employees, such as their entitlement to paid leave. Such liabilities were taken into account in calculating the cash consideration paid by the purchaser. The purchaser claimed a deduction for the amounts paid to settle such obligations. The court was asked to decide whether later payments satisfying those liabilities were deductible expenses. The court a qua held that the expenditure was deductible but after an appeal from the revenue authorities (from the New Zealand Court of Appeal) to the Privy Council, the original judgment was overruled and the deduction of the later payments was disallowed. The Privy Council held that the payment was part of the capital consideration paid for the business and was hence of a ‘capital nature’ and therefore not deductible in the hands of the purchaser.

The above case does not constitute binding authority in the South African legal context and as such is not binding on South African courts. Nevertheless, the New Zealand case was decided in what appears to be the highest forum at that stage in New Zealand and it is possible that a South African court could take account of its findings, as it is by no means uncommon for a South African court to refer to international precedent.

As mentioned previously, from a tax perspective, a contingent liability must be ‘actually incurred’ in order to qualify for a deduction in terms of section 11(a) of the Income Tax Act. As mentioned above, an expense will be ‘actually incurred’ where there is an unconditional legal obligation to make payment. This is notwithstanding the fact that payment may be made only in future, that is, when the contingent liability materialises.

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As contingent liabilities are uncertain in that they are dependent upon the occurrence of a future event, there is no unconditional legal obligation to make payment. Accordingly, in the context of the general deduction formula, contingent liabilities constitute amounts which have not yet been ‘actually incurred’ by a taxpayer and which may not be deducted from income.

Accordingly, it is only once the contingent liability materialises, is there expenditure ‘actually incurred’.

As mentioned above, the difficulty arises where the seller disposes of his business as a going concern to the purchaser, prior to the materialisation of the contingent liability or liabilities.

As discussed in Chapter 2, the Interpretation Note makes it clear that the seller will not be entitled to a tax deduction in respect of contingent liabilities transferred to the purchaser, on the basis that the seller will not have expenditure ‘actually incurred’. Nevertheless, there are several compelling arguments which may be made in favour of the seller claiming a deduction. Each of these arguments are mentioned in brief below:

i. The only reason that the seller may not claim a tax deduction is due to the timing of materialisation of the contingent liability. Accordingly, where the seller had decided not to dispose of his business, he would have been entitled to a tax deduction, upon materialisation of the relevant contingent liabilities. This is based on the assumption that the relevant requirements for deductibility, as envisaged in the Income Tax Act, would have been satisfied by the seller. The seller is thus placed in an anomalous position having decided to sell his business.

ii. As part of the sale transaction, the seller will forego a portion of the purchase price. This results from the purchaser agreeing to assume certain or all of the seller’s contingent liabilities as part of the sale transaction. Accordingly, the amount which has been foregone by the seller, that is, the amount of the contingent liabilities, may arguably constitute a loss ‘actually incurred’ by the seller.
In the case of *Joffe and Co (Pty) Ltd v CIR*,\(^{66}\) it was held that where there had been a diminution in a taxpayer’s patrimony, the taxpayer would have incurred a deductible loss. Accordingly, as the seller would have paid the purchaser to assume the contingent liabilities of the seller, there would be a loss incurred by the seller and the seller should qualify for a deduction equal to such loss.\(^{67}\)

iii. Where set-off takes place, the seller would be entitled to a net purchase price, equal to the difference between the value of the assets and the liabilities assumed by the purchaser. Accordingly, the seller will receive an amount which is less than what it would have received, had the seller not paid any purchase consideration to the purchaser to assume the contingent liabilities. Accordingly, an amount of expenditure or a loss must have been incurred by the seller equal to the amount of the contingent liabilities and should thus be deductible by the seller.

### 3.3. Section 7B of the Income Tax Act

Section 7B of the Income Tax Act was inserted on 1 March 2013 and governs the tax treatment of ‘variable remuneration’ payable to employees, such as overtime pay, bonuses, commission, an allowance or leave pay. In terms of section 7B of the Income Tax Act, a deduction in respect of variable remuneration may only be claimed once an actual payment for the overtime pay, bonus, commission, allowance or leave pay has actually been made.

‘Variable remuneration’ is defined as:

- a) overtime pay, bonus or commission contemplated in the definition of ‘remuneration’ in paragraph 1 of the Fourth Schedule to the Income Tax Act;
- b) an allowance or advance paid in respect of transport expenses as contemplated in section 8(1)(b)(ii); or
- c) any amount which an employer has during any year of assessment become liable to pay to an employee in consequence of the employee having during such year become entitled to any period of leave which had not been taken by the employee during that year.

\(^{66}\) 1946 AD 157.

\(^{67}\) *Ger and Chong*, 2011.
In terms of section 7B of the Income Tax Act, in determining the taxable income derived by any person during a year of assessment, any amount to which an employee becomes entitled from an employer in respect of variable remuneration is deemed to constitute expenditure incurred by the employer, on the date during the year of assessment in which the amount is paid to the employee by the employer.

Accordingly, the income tax deduction for the employer is deferred until the date of payment of the variable remuneration. This may be problematic in the context of the transfer of contingent liabilities in the sale of a going concern.

The problem which arises in the context of the sale of a business transaction is that the seller may have incurred an unconditional legal obligation prior to the disposal, which obligation may only be settled after the disposal. Consequently, the seller would not be entitled to a deduction of employee-related expenditure when the seller disposes of his or her business to the purchaser.

Following from the above, the question which arises is whether the purchaser could be entitled to an income tax deduction in relation to the contingent liabilities assumed from the seller. In this regard, it is important to note that the purchaser would not be entitled to an income tax deduction, in circumstances where the employee-related liability was applied as a reduction of, or was applied in settlement of, the purchase consideration.

In such circumstances, the question which arises is whether the purchaser would be entitled to deduct the expense when it becomes unconditional and is actually paid as contemplated in section 7B of the Income Tax Act.

The issue at hand in respect of the above is whether it may be argued that the expenditure incurred is expenditure incurred in the production of the purchaser’s income, given that the original liabilities, albeit contingent, arose in the hands of the seller.

In this regard, an argument exists that as the purchaser would be deriving the future benefit of the business of the seller as a going concern (including the employees) then such expenditure should arguably be in the production of the purchaser’s income. Accordingly, assuming all of the remaining requirements of the general deduction formula are met, the related expenditure should be allowed as a tax deduction in the purchaser’s hands.
Further support for this argument can be found in the Labour Relations Act.\textsuperscript{68} Section 197 of the Labour Relations Act provides that the new employer, that is, the purchaser, will be deemed to have stepped into the shoes of the old employer, that is, the seller.\textsuperscript{69}

\textsuperscript{68} Act 66 of 1995.  
\textsuperscript{69} Germishuys and McGregor, 2014.
4. Chapter 4: The Ackermans Judgment

4.1. An overview of the Ackermans Judgment

The Supreme Court of Appeal in the Ackermans judgment was required to consider the meaning of ‘expenditure incurred’ in the context of free-standing contingent liabilities.

In terms of the facts of the case, the taxpayer (Ackermans) sold its retail business as a going concern to Pepkor during its 2004 year of assessment. The sale included various business assets of Ackermans, certain contracts as well as liabilities in the amount of R329 million. In addition, the purchase price was to be discharged by the purchaser assuming agreed liabilities, which included three free-standing contingent liabilities in the amount of R17 million, made up as follows:

- Circa R10 million in respect of post-retirement medical aid benefits;
- Circa R6 million in respect of a bonus provision; and
- Circa R1 million in respect of a repair obligation undertaken by the seller under certain property leases.

The purchase price was defined in the contract of sale as the sum of R800 million plus the rand amount of the liabilities, which totalled R1.129 billion.

Ackermans claimed a section 11(a) deduction equal to the amount of the contingent liabilities of R17 million in its tax return for the 2004 year of assessment, on the basis that by foregoing a portion of the purchase price, it had incurred expenditure equal to the amount of the contingent liabilities of R17 million.

The result was that Ackermans freed itself of liabilities by accepting a lower purchase price than what it would have received had it retained its liabilities. Cloete JA disagreed with the taxpayer’s contentions, stating the following:

To my mind, “expenditure incurred” means the undertaking of an obligation to pay or (which amounts to the same thing) the actual incurring of a liability. No liability was incurred by Ackermans to Pepkor in terms of the sale agreement. The manner in which the purchase price was discharged by Pepkor did not result in the discharge of any obligation owed by Ackermans to Pepkor. Ackermans owed Pepkor nothing in terms of the sale agreement and one looks in vain for a clause in that agreement that has this effect. It is for this very reason that the appellant in its oral submissions abandoned any reliance on set-off, which would have been the inevitable effect if there had been these reciprocal obligations.

...It is clear that what occurred, as is usually the case in transactions of this nature, is that the nett asset value of the business - the assets less the liabilities - was calculated and that this
valuation dictated the purchase price. In the ordinary course of purchasing the business as a going concern on this basis it would follow that the liabilities would be discharged by the purchaser. The journal entries relied on by the appellants do not equate to expenditure actually incurred. On the contrary, the mechanism employed in the agreement of sale resulting in the journal entries was to facilitate the sale.

The fact that Ackermans rid itself of liabilities by accepting a lesser purchase price than it would have received had it retained the liabilities, does not mean in fact or in law that it incurred expenditure to the extent that the purchase price was reduced by the liabilities. At the effective date no expenditure was actually incurred by Ackermans.

Accordingly, SARS argued that the contingent liabilities in the amount of R17 million did not constitute ‘expenditure’ or ‘expenditure actually incurred’ and had not been incurred in the ‘production of income’ of Ackermans. In addition, Pepkor did not have an obligation in terms of the agreement of sale to make payment to Ackermans.

It was held by the court that ‘expenditure incurred’ meant the undertaking of an obligation to pay or the actual incurring of a liability. In terms of the agreement of sale, no liability had been incurred by Pepkor and the manner in which the purchase price had been discharged did not result in any obligation owed by Ackermans to Pepkor.

The fact that Ackermans chose to rid itself of its liabilities by accepting a lower purchase price than it would have, had it retained its liabilities, did not mean that it had incurred expenditure to the extent of the reduced purchase price.

Accordingly, Ackermans could not rely on the mechanism of set-off, as the agreement of sale did not create an obligation on the part of Pepkor to make payment of R1.129 billion to Ackermans and an obligation on the part of Ackermans to pay Pepkor R329 million. It was held further by the court that the liabilities could be deducted by Pepkor, as and when they became unconditional.

The court did not consider the remaining requirements of the general deduction formula on the basis that the requirement of having ‘expenditure incurred’ had not been satisfied.

In addition, as mentioned above, the court noted that no reliance could be placed on the mechanism of set-off, as set-off will only apply in circumstances where two parties are mutually indebted to each other and both debts are liquidated and fully due. Ordinarily, the legal effect of set-off is to substitute the payment of a debt, resulting in the debt reduced proportionately from the perspective of both parties.70

70 van Coller, 2011.
Whilst the substance of the agreement of sale between Ackermans and Pepkor did in fact intend for the mechanism of set-off to apply to the sale transaction, this was not explicitly provided for in the agreement.

It was the intention for the parties to the transaction to apply set-off as it was the intention for Ackermans to pay Pepkor to assume its contingent liabilities. Nevertheless, no amount was paid by Ackermans to Pepkor to assume its contingent liabilities. The agreement of sale provided for a purchase price of R800 million plus the Rand amount of the liabilities. The total purchase price thus amounted to approximately R1.1 billion, being the R800 million plus the liabilities of approximately R311 million. In effect, no amount was actually paid to Pepkor by Ackermans, for Pepkor to assume its liabilities. Instead, the net purchase price was paid to Ackermans by Pepkor.

Accordingly, Ackermans received an amount of approximately R800 million and the court held that set-off did not take place, despite Ackermans being released from its future obligation to pay the abovementioned contingent liabilities.

The court appears to have dismissed the arguments which were raised by Ackermans, without providing valid reasons as to why this was the case. In this regard, the court’s views on the aspect of ‘expenditure’ may have been too narrow in that the general deduction formula also provides for the element of a ‘loss’.

Whilst it is a requirement that expenditure stems from a legal liability, the term ‘loss’ does not have a similar requirement. A loss may arise where the taxpayer has suffered a reduction in patrimony and the reduction may not necessarily arise from a legal liability. Despite the fact that this argument was raised by Ackermans, the court did not give this argument due consideration, as the judge stated that the he ‘could not accept it’.

From the perspective of the purchaser, that is, Pepkor, the court stated that:

there would be no bar to Pepkor deducting the [assumed] liabilities as and when they became unconditional, as Counsel representing the Commissioner rightly conceded.

4.2. Application of the Ackermans Judgment by SARS

Applying the above principles, SARS is of the view that in order for an amount to constitute ‘expenditure’, a taxpayer must outlay or expend cash or assets in a form other than cash,
or must have an unconditional legal liability to outlay or expend cash or assets in a form other than cash.

Whether the outlaying of such cash or other assets results in a change in a taxpayer’s overall or net asset position will depend on the particular reason for the outlay – in some situations there will be a dilution in total assets and in other situations merely a shift of assets. For example, if a taxpayer purchases an asset and settles the purchase price by transferring shares held in another company to the purchaser, although the taxpayer has incurred expenditure in acquiring the asset, the taxpayer’s overall asset position will be the same, assuming the value of the asset outlaid equals the value of the asset acquired.

SARS states further that when a purchaser assumes a free-standing contingent liability in settlement or part settlement of a purchase price owing to a seller for an asset, it is clear that at the date of sale the free-standing contingent liability itself would not have materialised in the seller’s hands.

As mentioned in Chapter 3, the free-standing contingent liability still exists and whether or not it will become unconditional is not known as at the date of sale. After the sale, the free-standing contingent liability no longer concerns the seller. Accordingly, the seller has not incurred and will not incur any expenditure in relation to the free-standing contingent liability assumed by the purchaser.

Given the above, it would appear that SARS is of the view that if contingent liabilities are assumed as part settlement of the purchase price, this would not constitute expenditure actually incurred in the hands of the seller.

In addition, based on the Interpretation Note issued by SARS, the purchaser would only be entitled to a deduction when the contingent liability crystallises and to the extent that such liability was applied as consideration for the acquisition by the purchaser of a revenue asset, for example, trading stock. Nevertheless, if such an allocation is made, the purchaser is deemed not to have incurred any expenditure in respect of the acquisition of the trading stock until the contingent liability crystallises.
5. Chapter 5: The group roll-over relief provisions

5.1. Introduction

As mentioned in Chapter 1, the Interpretation Note does not consider the application of the group roll-over relief provisions as contained in sections 41 to 47 of the Income Tax Act, in the context of the transfer of contingent liabilities, in great detail. SARS does, however, consider in the Interpretation Note, the deductibility of contingent liabilities, upon realisation, in the transferee (or acquiring) company’s hands. In this regard, SARS states:\(^73\)

…it is necessary to assess whether the requirements of the relevant deduction section have been met. The principles for deductibility discussed in this [Interpretation] Note apply equally in these circumstances.

SARS states further that the circumstances under which the contingent liability arose in the hands of the transferor company (the seller) and the transferee company (the purchaser) should be taken into account in determining the deductibility of the expenditure. In addition, the nature of the going concern business carried on by the transferor before the transfer and the transferee after the transfer would need to be considered. Accordingly, no regard must be had to the fact that the assumption of the contingent liabilities by the transferee formed part of the consideration for the acquisition of the assets of the transferor.

5.2. The provisions of sections 42 to 47 of the Income Tax Act

In South Africa, certain group reorganisation transactions can be done on an income tax neutral basis by applying the so-called ‘corporate rules’ or ‘group roll-over relief’ provisions. The corporate rules are set out in sections 41 to 47 of Part III of Chapter II of the Income Tax Act. It is important to note that the income tax consequences which would ordinarily arise upon the sale or distribution of assets or businesses are simply deferred until the asset is disposed of outside the group.

The corporate rules make provision for the following transactions:\(^74\)

— Section 42: Asset-for-share transactions;
— Section 43: Substantive share-for-share transactions (this section has not been considered in this report);

\(^73\) Interpretation Note, page 22.
\(^74\) For purposes of this research report, the provisions of section 43 have not been considered.
— Section 44: Amalgamation transactions;
— Section 45: Intra-group transactions;
— Section 46: Unbundling transactions; and
— Section 47: Liquidation, winding up and deregistration transactions.

The broad purpose of each of the corporate rule provisions is set out below:

— Section 42 envisages the disposal of assets (including shares) in exchange for ‘equity shares’\textsuperscript{75} in the acquiring company.

— Section 44 facilitates merger transactions whereby the seller disposes of its business to another company, in exchange for shares in the purchasing company or in exchange for the assumption of debt, after which the seller’s existence is terminated.

— Section 45 facilitates the sale of assets between companies forming part of the same ‘group of companies’ as defined for income tax purposes, that is, instances where a company (holding company) holds at least 70% of the equity shares in another company (subsidiary), and the companies in the group are South African residents.

— Section 46 allows a company to distribute its investment in shares to its shareholders in terms of a so-called unbundling transaction. The unbundling company continues to exist after the unbundling transaction.

— Section 47 facilitates the distribution by a company of all its assets to its shareholders in anticipation of its liquidation, winding up or deregistration.

In the circumstances set out below and where the requirements of the relevant section are met, the group roll-over relief provisions will apply automatically, unless the taxpayers elect out of the section. In this regard, there are no formal requirements for election prescribed by SARS.

Importantly, the corporate rules contain certain anti-avoidance provisions. Although the anti-avoidance provisions are not addressed in detail as part of this research report, should these anti-avoidance provisions apply, the tax consequences will crystallise at the time

\textsuperscript{75} The term ‘equity share’ is defined in section 1 of the Income Tax Act as: any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution.
when the provisions are breached, and thus result in an immediate taxing event. As such, it is important that cognisance be taken of these provisions. Refer to Appendix A for a brief summary of the anti-avoidance provisions (excluding section 43).

5.2.1. Section 42 of the Income Tax Act

5.2.1.1. General overview

Section 42 of the Income Tax Act essentially provides for the transfer of assets, in a tax neutral manner, from a transferor company, to a tax resident company (the acquiring company), in exchange for the issue by the acquiring company of equity shares to the transferor company. The effect of applying the roll-over relief is that any capital gains tax and income tax which would ordinarily have been triggered in the hands of the transferor company upon the disposal of such assets, are effectively ‘rolled forward’ to the acquiring company. The provisions of section 42 of the Income Tax Act apply to any person, including, inter alia, a company, individual or trust.\(^\text{76}\)

It is important to note that section 42 operates on an asset-by-asset basis and accordingly must be applied to each individual asset that is transferred in order to ascertain whether the requirements of the section are met.\(^\text{77}\) Each asset will be disposed of in exchange for the issue of at least one equity share. Accordingly, the implementation of the section would need to be carefully considered.

There are four important requirements which need to be satisfied in order for the roll-over relief as contemplated in section 42 of the Income Tax Act to apply to a transaction:\(^\text{78}\)

i. A person must dispose of an asset to a company which is a South African tax resident.

ii. The market value of the asset disposed of must exceed the base cost of the asset on the date of disposal, where the asset is held as a capital asset.

iii. The consideration must be in the form of an ‘equity share’\(^\text{50}\) or shares or ‘prescribed debt’.

iv. The person disposing of the asset must hold a ‘qualifying interest’ in the company at the close of day of the transaction or must be a natural person that is engaged on a full-time basis to render services in that company or a

\(^{76}\) Rudnicki, 2015.

\(^{77}\) In terms of section 42(2)(a)(i) of the Income Tax Act.

\(^{78}\) Rudnicki, 2015.
The term ‘controlled group company’. The term ‘qualifying interest’ is defined in section 42(1) to mean:

(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 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.

(e) any equity share held in a portfolio of a hedge fund collective investment scheme.

5.2.1.2. The transfer of liabilities under section 42

Section 42(4) of the Income Tax Act provides that the provisions of section 42 may only be applied to the extent that the consideration for the asset concerned is in the form of either:

— Equity shares issued by the acquiring company; or


Accordingly, certain ‘qualifying debt’ of the transferor company may be assumed by the acquiring company as part of the section 42 transaction, without triggering any immediate adverse tax consequences.

‘Qualifying debt’ in essence constitutes the following debt of the transferor company which may be assumed by the acquiring company:

1) Any debt which is secured by an asset where that asset is transferred in terms of the section 42 transaction and that debt was incurred by the transferor company:

— more than 18 months before that disposal; or

— within 18 months before that disposal, and

i. that debt was incurred at the same time as that asset was acquired by the transferor company, or

79 The term ‘controlled group company’ is defined in the definition of ‘group of companies’ in section 1 of the Income Tax Act as a company which is essentially owned by another company where the shareholding is at least 70%.
ii. that debt constitutes the refinancing of any debt in respect of that asset incurred as contemplated in 1(a) or 1(b)(i) above, and the acquiring company assumes that debt or an equivalent amount of debt that is secured by that asset; or

2) Where the transferor company disposes of any business undertaking as a going concern to the acquiring company in terms of section 42 and that disposal includes any amount of debt that is attributable to, and arose in the normal course of that business undertaking.

The practical application of this section is difficult and the acquiring company will have to keep accurate records of the specific liabilities assumed and shares issued in exchange for the transfer of each asset, as the acquiring company will have to possibly account for these liabilities as proceeds upon a future sale of that specific equity share in the acquiring company.

In addition, it is unclear whether the transfer of contingent liabilities as part of a sale of business transaction will constitute ‘qualifying debt’, as envisaged in section 42 of the Income Tax Act.

In this regard, in terms of the Interpretation Note, SARS states:

Free-standing contingent liabilities generally represent potential debt which may or may not arise depending on the occurrence or non-occurrence of one or more uncertain future events. However, in the context of a transfer of a going concern, SARS accepts that “debt” as used in section 42(8)(b) includes free-standing contingent liabilities. In this regard, section 42(8)(b) specifically deals with the transfer of a business as a going concern and it is submitted that the legislature clearly envisaged that such a transfer would include the assumption of free-standing contingent liabilities as other consideration.

The terms ‘debt’ and ‘incurred’ are not defined in the Income Tax Act. Accordingly, based on the general principles of the interpretation of statutes, the ordinary dictionary meaning of these terms will need to be considered.

The Merriam-Webster dictionary defines the term ‘debt’ as:

‘something owed...the common-law action for the recovery of money held to be due’.

The Dictionary of Legal Words and Phrases, second edition, refers to the definition of ‘debt’ when considering the meaning of the term ‘debt incurred’. In this regard, it refers to the

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80 Interpretation Note, page 22.
81 Rudnicki, 2015.
following statement of Kotze J in *Leviton & Son v De Klerk’s Trustee*\(^{82}\) in respect of ‘debt’ and ‘debt incurred’:

I am disposed to take the word debt in a wide and general sense as denoting whatever is due – debitum – from any obligation.

Applying a similarly wide meaning to ‘debt incurred’, the words would denote whatever is due from any obligation. Accordingly, any legitimate liability should represent a ‘debt incurred’ for purposes of section 47(3A)(b) of the Income Tax Act.

Nevertheless, Rudnicki,\(^{83}\) is of the view that a contingent liability does not constitute a ‘debt’. This is contradictory to SARS’s interpretation of the term ‘debt’, as discussed above.

Importantly, where debt is transferred in accordance section 42(8)(a) or (b) of the Income Tax Act, as consideration for the asset(s) transferred under the section 42 transaction, section 42(8) contains a provision which applies upon the subsequent disposal by the transferor company of any equity share acquired in terms of the section 42 transaction. In this regard, the transferor company will be required to treat so much of the face value of that debt assumed as relates to that equity share as capital or revenue proceeds upon the disposal of that share (depending on whether that share is held as a capital asset or as trading stock, that is, revenue).

Accordingly, the face value of the debt will need to be added to the proceeds on the disposal of the equity shares, for capital gains tax or normal income tax purposes. This provision seeks to tax what would have been taxed if the assets disposed of for consideration in the form of the delegation of liabilities was not afforded the relief under section 42 of the Income Tax Act. The deeming provision can thus be regarded as a ‘penalty provision’ as the rolled-over capital or revenue gain will be deferred to the purchaser of the assets, upon its subsequent disposal.\(^{84}\)

### 5.2.2. Section 44 of the Income Tax Act

#### 5.2.2.1. General overview

The purpose of section 44 of the income Tax Act is to facilitate intra-group transactions in respect of amalgamations or mergers of group companies on a tax neutral basis. In the absence of group relief, the disposal of each individual asset would result in the recognition

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\(^{82}\) 1914 CPD 691.

\(^{83}\) 2015.

\(^{84}\) Rudnicki, 2015.
of income tax or capital gains tax consequences in respect of the disposals. The section 44 intra-group provisions allow for such tax consequences to be deferred, that is, rolled-over.

The provisions of section 44 are restricted to ‘companies’, as defined in section 1 of the Income Tax Act. The term ‘company’ is defined in section 1 of the Income Tax Act to include, inter alia:

any association, corporation or company...incorporated or deemed to be incorporated by or under any law ... in the Republic...

Accordingly, the provisions of section 44 do not apply to individuals and trusts.85

Furthermore, the provisions of section 44 of the Income Tax Act are restricted to the disposal of assets among South African resident companies, as defined.86

There are three important criteria which need to be satisfied in order for the roll-over relief as contemplated in section 44 of the Income Tax Act to apply to a transaction:87

i. A resident company (the amalgamated company) must dispose of all of its assets to another resident company (the resultant company), in terms of an ‘amalgamation transaction’, ‘conversion’ or ‘merger’. The amalgamated company may retain certain assets required to settle debts incurred in the ordinary course of its trade. The amalgamated company may also be a ‘foreign company’88 which disposes of all of its assets to a resident resultant company or to a foreign resultant company, in certain prescribed circumstances.

ii. The consideration for the disposal of assets by the amalgamated company to the resultant company must be in the form of an ‘equity share’50 or shares or prescribed debt in the resultant company.

iii. The amalgamated company must take steps within 36 months after the date of the amalgamation transaction to terminate its existence.

85 Rudnicki, 2014.
86 Rudnicki, 2015.
87 Rudnicki, 2014.
88 The term ‘foreign company’ is defined in section 1 of the Income Tax Act as, ‘any company which is not a resident.’
5.2.2.2. The transfer of liabilities under section 44

The relief from taxation provided for in section 44 only applies to the extent that assets are disposed of by the amalgamated company in exchange for:

— equity shares in the resultant company; or

— the assumption by the resultant company of a qualifying debt of the amalgamated company.

The quantum of the debt assumed does not have to equal the market value of the assets in order for the provisions of section 44 of the Income Tax Act to apply. The difference between the two values will merely result in an accounting adjustment as, for tax purposes, the base costs\(^{89}\) of the capital assets\(^{90}\) will not be influenced by the value of the debt.

Furthermore, where the assets are disposed of in exchange for the assumption of debt, the debt must constitute ‘qualifying debt’ as prescribed by section 44, that is, the debt must have been incurred by the amalgamated company:

— more than 18 months before the conclusion of the amalgamation transaction; or

— where the debt was incurred by the amalgamated company within a period of 18 months before the conclusion of the amalgamation transaction, the debt must either:

  - constitute the refinancing of debt incurred more than 18 months before the conclusion of the amalgamation transaction; or

  - have arisen in the normal course of a business undertaking disposed of, as a going concern, to that resultant company as part of the amalgamation transaction; and

  - such debt must not have been incurred by the amalgamated company for the purpose of procuring, enabling or facilitating or funding the acquisition by the resultant company of any asset acquired as part of the amalgamation transaction.

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\(^{89}\) This includes all costs and expenditure incurred in respect of the acquisition of an asset to be taken into account for capital gains tax purposes.

\(^{90}\) A capital asset is any asset, excluding stock that is defined in paragraph 1 of the Eighth Schedule to the Income Tax Act. In terms of paragraph 1, an asset includes property of whatever nature, excluding currency (cash).
SARS states in the Interpretation Note\textsuperscript{91} that, similar to the interpretation of section 42(8)(b), debt in the context of section 44(4)(b)(i)(bb)(B) should be interpreted to include free-standing contingent liabilities which are assumed as other consideration for assets acquired as part of the acquisition of a going concern.

As mentioned above, this is contradictory to the views of Rudnicki,\textsuperscript{92} wherein he states:

\ldots contingent liabilities are not ‘debts’ as contemplated in section 44 – until the condition crystallises and the obligation is unconditional. This means that the assets acquired by the [resultant company] for consideration in the form of contingent liabilities are unlikely to meet the roll-over relief provisions under section 44, and are thus likely to be subject to tax under normal tax principles.

5.2.3. Section 45 of the Income Tax Act

5.2.3.1. General overview

The purpose of section 45 of the Income Tax Act is to facilitate intra-group transactions that may not otherwise have been undertaken due to the adverse tax implications thereof. In brief, the effect of applying this section is to defer any tax consequences until a subsequent disposal of the asset by the transferee group entity, that is, the seller. Stated differently, upon the disposal of an asset by a group company (the seller) to another group company (the purchaser) in terms of the provisions of section 45 of the Income Tax Act, neither party should have adverse tax implications arising from such disposal.

In order for companies to qualify for the income tax and capital gains tax roll-over relief provided for in section 45 of the Income Tax Act, the following requirements must be met:

i. An asset or assets must be disposed of;
ii. To another company which is a resident;
iii. Both the company disposing of the asset(s) (referred to in the Income Tax Act as the transferor company) and the company acquiring the asset(s) (referred to in the Income Tax Act as the transferee company) must form part of the same ‘group of companies’\textsuperscript{93} as at the end of the day of the transaction; and

\textsuperscript{91} Interpretation Note, page 21.
\textsuperscript{92} 2014.
\textsuperscript{93} Section 1 of the Income Tax Act defines a ‘group of companies’ as:

\ldots 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-

(a) at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
iv. Where the transferor company held the asset as either a capital asset, trading stock or as an allowance asset, the transferee company must acquire it in such capacity.

5.2.3.2. The transfer of liabilities under section 45

Section 45 of the Income Tax Act only provides for roll-over relief in respect of the transfer of assets and does not address the tax treatment upon the transfer of liabilities, including contingent liabilities.

5.2.4. Section 46 of the Income Tax Act

5.2.4.1. General overview

An ‘unbundling transaction’ is defined in section 46(1) of the Income Tax Act. In essence, an unbundling transaction is one where all the equity shares of a company which is a resident (referred to as the ‘unbundled company’) that are held by a company (referred to as the ‘unbundling company’) are distributed by that unbundling company to its shareholder.

Where the unbundling company is a listed company, it is required to be South African tax resident. Where the unbundling company is unlisted, it appears as though the unbundling company need not be a resident company for the purposes of section 46 of the Income Tax Act. In circumstances where the unbundling company is an unlisted company, the distribution must be made to any shareholder of that unbundling company that forms part of the same ‘group of companies’ as that unbundling company. This is provided that more than 50% of the equity shares of that unbundled company are distributed.

In order to qualify for the roll-over relief as contemplated in section 46 of the Income Tax Act, the following requirements, inter alia, must be met:

i. All of the equity shares of the company (‘Unbundled Company’) which are held by the company that is distributing the shares (‘Unbundling Company’) must be distributed to the shareholders.

ii. Both the Unbundling Company and the Unbundled Company must be companies that are tax resident in South Africa.

(b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company.

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iii. The shares of the Unbundled Company must be distributed by the Unbundling Company to its shareholders in accordance with the effective interests of the respective shareholders in the Unbundling Company.

iv. Where the Unbundling Company is an unlisted company, it may only distribute the shares to a shareholder that forms part of the same South African group of companies as the Unbundling Company or to any company, where all of the shares of the Unbundled Company will become listed shares within 12 months after the distribution.

5.2.4.2. The transfer of liabilities under section 46

Section 46 of the Income Tax Act does not address the transfer of liabilities in the context of an unbundling transaction.

5.2.5. Section 47 of the Income Tax Act

5.2.5.1. General overview

Section 47 of the Income Tax Act addresses the disposal by a liquidating company of all of its assets (other than those earmarked for the settling of any liabilities) in anticipation of, or in the course of the liquidation, winding-up or deregistration of that company.

If the requirements of section 47 are met, the provisions of the section will apply automatically and no recoupments or capital gains tax will arise from the disposal of the assets to its shareholders in the hands of the liquidating company.

In terms of section 47, the income tax implications will effectively be rolled over to its shareholder or holding company until a subsequent disposal by that shareholder to an entity outside the group of companies. In addition, no capital gains tax will arise for the shareholder upon the disposal of its shares in the liquidating company.

Section 47 of the Income Tax Act provides ‘roll-over’ relief to the liquidating company in respect of capital and allowance assets as well as trading stock distributed to its holding company as part of a liquidation distribution. To the extent that the distribution qualifies as a ‘liquidation distribution’ for purposes of section 47, the liquidating company is, broadly speaking, deemed to have disposed of the respective assets at their tax cost and the holding company is deemed to have acquired the assets at the liquidating company’s tax cost.
The following requirements must be satisfied in order for the relief provided for in section 47 of the Income Tax Act to apply:

i. The liquidation distribution must be made by a ‘company’, as defined in section 1 of the Income Tax Act.

ii. All the assets of that company must be distributed to the holding company, other than assets it elects to use to settle any debts incurred in the ordinary course of its trade.

iii. The distribution must be made to a holding company and that holding company and the liquidating company must form part of the same ‘group of companies’, as defined in section 1 of the Income Tax Act.

iv. The distribution must be made in anticipation of, or in the course of the liquidation, winding-up or deregistration of the company and must result in the equity shares held by the holding company in the liquidating company being disposed of as a result of the liquidation, winding up or deregistration of the liquidating company.

5.2.5.2. The transfer of liabilities under section 47

Section 47(3A) provides for the assumption by the holding company of debt with certain qualifying features. In this regard, the holding company must not assume any debt of the liquidating company which was incurred within 18 months prior to the liquidation distribution, unless that debt –

— constitutes the refinancing of any debt incurred more than 18 months before the liquidation distribution; or

— is attributable to or arose in the normal course of the business undertaking disposed of, as a going concern, to that holding company as part of a liquidation distribution.

Accordingly, the holding company may, subject to certain conditions, assume the debt of the liquidating company as part of the liquidation distribution.

Whilst the term ‘going concern’ is not defined in section 47 or for purposes of the Income Tax Act, it is submitted that the ordinary meaning should be ascribed to the term.
5.3. Summary of group roll-over relief provisions

The table below summarises the provisions of sections 42 to 47 (excluding section 43) of the Income Tax Act:

<table>
<thead>
<tr>
<th>Provision in the Income Tax Act</th>
<th>Transfer of debt addressed?</th>
<th>Section reference</th>
<th>Summary of relevant provision to transfer of debt</th>
<th>Inadequacies identified in the legislation</th>
</tr>
</thead>
</table>
| Section 42                      | Yes                         | 42(4)(b) read with section 42(8) | • A person may dispose of debt that is attributable to, and arose in the normal course of the business undertaking being disposed of as a going concern; or  
  • Any asset which secures debt and the debt was incurred by the disposing company:  
    o More than 18 months before that disposal; or  
    o Within a period of 18 months before that disposal and  
      - The debt was incurred more than 18 months before that disposal of the asset; or  
      - Within a period of 18 months before the disposal and the debt is linked to the acquisition of that asset or the debt is | Not applicable |


in respect of the re-financing of debt linked to the asset acquisition.

- Importantly, where the debt was acquired in the circumstances contemplated above, the debt will be deemed to form part of the proceeds on disposal of the ‘equity shares’, where the shares are held as capital assets by the disposing company.

<table>
<thead>
<tr>
<th>Section 44</th>
<th>Yes</th>
<th>44(4)(b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The resultant company may assume debt of the resultant company which was incurred:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- More than 18 months before the disposal; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Within a period of 18 months before the disposal, where the debt constitutes:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- The refinancing of debt incurred more than 18 months before the disposal; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Is attributable to and arose in the ordinary course of the business undertaking being disposed of as a going concern.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- In addition, the debt should not be incurred for the</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Section</td>
<td>Yes/No</td>
<td>Ref</td>
</tr>
<tr>
<td>---------</td>
<td>--------</td>
<td>-----</td>
</tr>
<tr>
<td>45</td>
<td>No</td>
<td>Not applicable</td>
</tr>
<tr>
<td>46</td>
<td>No</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>
| 47      | Yes    | 47(3A)(b) | The holding company may only assume debt which was incurred by the liquidating company within a period of 18 months before the disposal, where:  
- The debt constitutes the refinancing of debt incurred more than 18 months before the disposal or  
- Is attributable to and arose in the normal course of the business undertaking being disposed of as a going concern. |

5.4. Advanced Tax Rulings issued by SARS

5.4.1. Binding Class Ruling 029

During May 2011, SARS issued Binding Class Ruling 029. The purpose of the ruling is to promote consistency and certainty in the interpretation and application of questions
regarding the deductibility of contingent liabilities assumed by the purchaser.\textsuperscript{94} The ruling seeks to address the matter of whether the purchaser will qualify for a deduction of the contingent liabilities acquired from the seller when the contingent liabilities are actually incurred.

The factual background of the ruling states that the two companies concerned (the purchaser and the seller) form part of the same group of companies and that the proposed transaction was to be implemented in accordance with the amalgamation provisions as contained in section 44 of the Income Tax Act. The rationale for the disposal of assets and liabilities as a going concern was to streamline the operations of the two companies as the client base of the two companies was largely similar.\textsuperscript{95} In addition, the ruling states that there are various commercial and administrative reasons for the amalgamation transaction.

As part of the amalgamation transaction, the disposing company sought to transfer all of its assets and liabilities to the acquiring company, as a going concern. This excluded assets which the disposing company elected to use to settle existing liabilities. The acquiring company would issue shares to the disposing company, in exchange for the transfer of the business by the disposing company to the acquiring company. The shares which would be issued by the acquiring company would be equal to the net asset value of the transfer.

The ruling which was made by SARS states that the purchaser would be entitled to deduct the expenditure actually incurred in respect of the contingent liabilities assumed by the purchaser, upon the occurrence of the uncertain future events upon which materialisation of the contingent liability was dependent.

Accordingly, the ruling confirms that the seller will not be permitted a deduction of the contingent liabilities upon the transfer thereof to the purchaser. This is notwithstanding any reduction in the purchase price arising from the assumption of contingent liabilities by the purchaser.\textsuperscript{96}

In terms of the ruling, it is highlighted that the contingent liabilities which were to be transferred by the seller included leave pay and bonus provisions as well as warranty obligations and contract cost overruns. Provisions for future costs eligible for allowances

\textsuperscript{94} van Coller, 2011.

\textsuperscript{95} Napier, 2011.

\textsuperscript{96} van Coller, 2011.
under section 24C of the Income Tax Act did not form part of the transfer. In addition, the ruling states that the contingent liabilities would ordinarily have been deductible, upon materialisation, when they were incurred by the disposing company, had the liabilities not have been disposed of under the amalgamation transaction.

In addition, the ruling confirms that there must be expenditure actually incurred by the purchaser in order for the purchaser to qualify for a deduction of the contingent liabilities in terms of section 11(a) read with section 23(g) of the Income Tax Act. This is in line with the decision made in the Ackermans judgment, as discussed in Chapter 4.

5.4.2. Binding Private Rulings

In addition to the above ruling, there are various binding private rulings (‘BPR’) which have been issued by SARS which address the matter of the transfer of contingent liabilities. These include, inter alia, BPR 210, BPR 122 and BPR 185. Whilst these rulings are specific to a taxpayer and cannot be relied on by all taxpayers in general, the rulings provide insight into the tax treatment adopted by SARS.

In addition, these rulings may arguably form the basis for the application of future binding private rulings by taxpayers, where there is uncertainty as to how the transfer and assumption of contingent liabilities should be treated from a tax perspective.

In general, the above rulings confirm that the debts assumed by the purchaser would constitute ‘debts’ for the purposes of the group roll-over relief provisions. The rulings also confirm that the seller will not be entitled to a tax deduction for the transfer of the contingent liabilities. The purchaser will only be entitled to deduct expenditure actually incurred upon materialisation of the contingent liabilities, provided the requirements of the relevant provisions of the Income Tax Act are satisfied.

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97 Napier, 2011.
6. Chapter 6: Conclusion

As discussed in this research report, a great deal of uncertainty currently prevails in South Africa as to how contingent liabilities assumed by a purchaser from a seller in terms of a sale of business transaction should be treated from an income tax perspective. In this regard, the recent Ackermans judgment and the Interpretation Note released by SARS does provide some guidance.

In order for a taxpayer to qualify for a deduction in terms of the general deduction formula, the requirements of section 11(a), read with section 23(g) of the Income Tax Act are required to be satisfied. In particular, this will require the expenditure or loss to have been ‘actually incurred’ during the year of assessment. Accordingly, a purchaser will only be permitted to deduct expenditure actually incurred in respect of the assumption of a contingent liability.

The expression ‘expenditure actually incurred’ has been considered in a number of judgments and does not mean ‘expenditure actually paid’ during the year of assessment but means all expenditure for which a liability has been incurred during the year, whether that liability has been discharged during that year or not. Moreover, case law has also confirmed that only expenditure for which an unconditional legal obligation to make payment exists, will be regarded as being ‘actually incurred’.

Until the recent Ackermans judgment, there was no clear guidance on firstly, whether contingent liabilities delegated would be deductible and secondly, in whose hands the deduction, if any, would be allowed. Accordingly, it was unclear whether the seller or the purchaser would qualify for an income tax deduction.

As mentioned in Chapter 4, the recent Ackermans judgment provided some clarity in respect of the delegation of contingent liabilities for tax purposes. In its original appeal to the Income Tax Court, the seller essentially contested that the provisions claimed qualified as a deduction for income tax purposes in terms of the general deduction formula set out in the Income Tax Act.

In this regard, the court held that the expenditure, being the amount of the contingent liabilities in question, did not meet the requirements of the general deduction formula in the seller’s hands. Accordingly, the seller was not permitted to deduct any of the contingent liabilities transferred to the purchaser under the sale transaction. This was notwithstanding any reduction in the purchase price arising from the assumption of
contingent liabilities by the purchaser. The expenditure would need to be actually incurred by the seller in order to qualify for a deduction. This would require an undertaking by the seller to pay or the actual payment by the seller of the liability in question.\textsuperscript{98}

Nevertheless, the obiter dictum in the \textit{Ackermans} judgment stated that the purchaser should be able to claim a deduction in respect of the contingent liabilities which had been assumed by the purchaser in terms of the sale transaction.

The Interpretation Note which was released by SARS during December 2016 focuses on the income tax treatment of contingent liabilities assumed as a mechanism for the part payment of the purchase price of a business acquired as a going concern. In this regard, it is submitted that the Interpretation Note should be expanded upon in future to include a comprehensive discussion of all of the alternatives available to taxpayers in order to fully understand the tax consequences associated with the various structuring alternatives. This should include an analysis of the tax considerations both from the perspective of the seller and the purchaser.

SARS distinguishes between ‘embedded’ liabilities and ‘free-standing’ contingent liabilities in the Interpretation Note. Nevertheless, the Income Tax Act in its current form does not distinguish between these two concepts. In addition, the Interpretation Note in its current form only provides for the income tax consequences arising from the transfer of free-standing contingent liabilities.

In this regard, it is submitted that the Interpretation Note should be revised to provide more clear guidance to taxpayers where an embedded obligation forms part of a sale of business transaction.

In the context of the group roll-over relief provisions, the Interpretation Note does not provide much guidance. In addition, whilst certain of the group roll-over relief provisions provide for the transfer of ‘debt’, the Income Tax Act in its current form does not specifically address the transfer of contingent liabilities. Nevertheless, the Interpretation Note states that the transfer of contingent liabilities does constitute ‘debt’ for purposes of sections 42 and 47 of the Income Tax Act. Accordingly, the transfer of contingent liabilities may be subject to group roll-over relief, provided the requirements of the relevant section are satisfied.

\textsuperscript{98} van Coller, 2011.
Notwithstanding the above and due to the limited nature of the Interpretation Note, it may be best for the parties to the sale transaction to ensure that there are minimal contingent liabilities which need to be transferred, however, this may not be possible or practical from a commercial perspective.

In addition, it would be important to ensure that a proper review of the agreement of sale be performed. From a tax perspective, the parties to the sale transaction often overlook the transfer of liabilities and the attendant income tax consequences. It is submitted that specific regard should be had to the transfer of contingent liabilities and the deductibility thereof. In particular, it would be important that the agreement of sale be reflective of the intention of the parties, specifically having regard to the transfer of contingent liabilities.
7. REFERENCE LIST

7.1. Statutes
South Africa:

7.2. Cases
South African case law:
Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (AD), 37 SATC 1.
CIR v George Forest Timber Co Ltd 1924 AD 516, 1 SATC 20.
CIR v People’s Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353 (A), 52 SATC 9.
COT v Rendle 1965 (1) SA 59, 26 SATC 326.
CSARS v Brummeria Renaissance (Pty) Ltd and Others [2007] 4 All SA 1338 (SCA).
De Beers Holdings (Pty) Ltd v CIR 1986 (1) SA 8 (A), 47 SATC 229.
Edgars Stores Ltd v CIR 1988 (3) SA 876 (AD), 50 SATC 81.
Heron Investments (Pty) Ltd v Secretary for Inland Revenue 1971 (4) SA 201 (A), 33 SATC 181.
ITC 1528 54 SATC 243.
Joffe & Co (Pty) Ltd v CIR 1946 AD 157, 13 SATC 354.
Modderfontein Deep Levels Ltd v Feinstein 1920 TPD 288.
Mooi v SIR 1972 (1) SA 675 (A), 34 SATC 1.
Nasionale Pers Bpk v KBI 1986 (3) SA 549 (A), 48 SATC 55.
Natal Estates Ltd v SIR 1975 (4) SA 177 (A), 37 SATC 193.
New State Areas Ltd v CIR 1946 AD 610, 14 SATC 155.
Palabora Mining Co Ltd v SIR 1973 (3) SA 819 (A), 35 SATC 159.
Port Elizabeth Electric Tramway Co Ltd v CIR 1936 CPD 241, 8 SATC 13.
Sub Nigel Ltd v CIR 1948 (4) SA 580 (A), 15 SATC 381.

Foreign case law:

7.3. Publications


7.4. Books

7.5. Journal Articles


7.6. Articles accessed online


7.7. Dissertations


7.8. Websites

### Appendix A

The phrase 'ss' as used in Appendix A refers to subsections and not sections.

<table>
<thead>
<tr>
<th>Roll-over relief avoidance rules and triggers</th>
<th>Roll-over relief section in the Income Tax Act (excluding section 43)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>S42</td>
</tr>
<tr>
<td>Ring-fencing rule applies where a person disposes of an asset acquired under these provisions <strong>within 18 months</strong> of such transaction.</td>
<td>Yes ss(7)</td>
</tr>
<tr>
<td>Deemed income inclusion rules can apply where a person disposes of an asset securing certain debt incurred.</td>
<td>Yes ss(8)</td>
</tr>
<tr>
<td>Parties to a transaction may <strong>jointly elect</strong> and enter in a written agreement that the section will not apply to their transaction.</td>
<td>Yes ss(8A)</td>
</tr>
<tr>
<td>This section will not apply to the extent that any consideration is received <strong>other than</strong> equity shares.</td>
<td>Yes ss(4)</td>
</tr>
<tr>
<td>Income inclusion on disposal of equity shares (acquired in an asset-for-share transaction) <strong>within 18 months</strong> and before that disposal <strong>more than 50% of the market value</strong> of the assets were attributable to trading stock and/or allowance assets (disposals under sections 45, 46 and 47 permitted).</td>
<td>Yes ss(5)</td>
</tr>
<tr>
<td>Deemed disposal of remaining shares if, <strong>within a period of 18 months</strong>, a person ceases to hold a ‘qualifying interest’ in a company that received an asset in an asset-for-share transaction.</td>
<td>Yes ss(6)</td>
</tr>
<tr>
<td>Section will not be applicable where the asset transferred constitutes a debt owing or shares in the company acquiring the asset.</td>
<td>Yes ss(8A) (debt or shares)</td>
</tr>
<tr>
<td>Not applicable where disposal is not taken into account in determining taxable income.</td>
<td>Yes ss(8A)</td>
</tr>
<tr>
<td>Exclusion where the transaction falls within scope of another roll-over relief section.</td>
<td>N/A</td>
</tr>
<tr>
<td>Description</td>
<td>N/A</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>-----</td>
</tr>
<tr>
<td>Failure to effect liquidation steps or any withdrawal of the liquidation steps towards the proposed transaction <strong>within 36 months.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td>The resultant company or holding company must not assume any debt which is not <strong>qualifying debt</strong> of the liquidating company which was incurred <strong>within 18 months prior</strong> to the distribution disposal, unless the debt was incurred in the ordinary course of the business.</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Not applicable to ‘exempt’ entities as listed in the Income Tax Act.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>No roll-over relief for shareholder where the shareholder receives consideration other than equity shares in the resultant company.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Where the transferee ceases, within a period of 6 years after acquiring an asset in terms of an ‘intra-group transaction’, to form part of any group of companies in relation to the transferor company (other than as a result of certain liquidations), the transferee is deemed to have disposed of the section 45 assets.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>The transferee is deemed to have de-grouped where, any group company within a period of 2 years after conducting a transaction within section 45, disposes of or transfers the consideration received or accrued in respect of that disposal, or more than 10% of any amount derived directly or indirectly from such consideration, outside of the group for either no consideration or for a consideration not reflecting an arm’s-length price or by means of a distribution.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>In an intra-group transaction, the holder of the debt is deemed to have acquired the loan for an amount of expenditure of nil, if that debt is issued by a company that forms part of the same group of companies to the parties in the transaction and the debt is for purposes of directly or indirectly facilitating or funding that intra-group transaction.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Restrictions on 'company' that can access the relief.</strong></td>
<td>N/A</td>
</tr>
<tr>
<td><strong>This section 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’.</strong></td>
<td>N/A</td>
</tr>
</tbody>
</table>