UNIVERSITY OF THE WITWATERSRAND
School of Accountancy

A RESEARCH REPORT SUBMITTED TO THE FACULTY OF COMMERCE, LAW AND MANAGEMENT IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF COMMERCE SPECIALISING IN TAXATION

The level of group taxation in South Africa, corporate roll over provisions, key considerations, and challenges

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List of abbreviations and acronyms

BGR	Binding General Ruling
BPR	Binding Private Ruling
CGT	Capital Gains Tax
CIPC	Companies and Intellectual Property Commission
CIS	Collective Investment Scheme
Companies Act	Companies Act 71 of 2008
DMRE	Department of Mineral Resources and Energy
IAS	International Accounting Standards
Income Tax Act or sections in the Act	Sections of or Income Tax Act 58 of 1962, as amended
IFRS	International Financial Reporting Standards
JSCOF	Joint Standing Committee on Finance
PPA	Power Purchase Agreement
REIT	Real Estate Investment Trust
REIPPPP	Renewable Energy Independent Power Producer Procurement Programme
SACOB	South African Chamber of Business
SAICA	South African Institute of Chartered Accountants
SARS	South African Revenue Service
SPV	Special Purpose Vehicle
STTA	Securities Transfer Tax Act
TDA	Transfer Duties Act
VAT Act	Value Added Tax Act

ABSTRACT

Group taxation refers to a tax system that allows offsetting of losses against profits within qualifying related companies as well as the ability to transfer assets to fellow group companies without triggering any tax liability. Without group taxation, inefficiencies arise whereby at the first instance, some companies within a group may incur a large tax liability while others have large assessed losses that cannot be utilized because such companies continue to incur losses. Secondly, very often companies go through a reorganization of some sort which may include transfer of assets to other entities within the group where synergies may have been identified. These types of transactions often result in significant tax leakages if inter-group transfer of assets which is legally acceptable in terms of other legislations such as the Companies Act 71 of 2008 ("Companies Act"), is not allowed to be on a tax neutral basis.

In South Africa, however, group taxation is limited to roll over relief provisions contained in sections 41-47 of the Income Tax Act 58 of 1962 ("the Income Tax Act" or "the Act"), if conditions detailed therein are complied with. So far, there is no other group taxation is allowed.

This study seeks to define what group taxation is and what would be achieved if it is implemented, it also outlines the impact of the lack thereof. It examines the legal and regulatory implications of transactions covered by the roll over relief provisions with specific focus being the Income Tax Act, the Value Added Tax Act 89 of 1991 ("VAT Act"), the Companies Act, Transfer Duty Act 40 of 1949 ("Transfer Duty Act") and Securities Transfer Tax Act 25 of 2007 ("STT Act"). The study also looks at the detailed requirements to be met for each roll over provision to apply in terms of the Income Tax Act, the applicable exclusions and anti-avoidance provisions. It assesses how the roll over provisions are harmonized across the Income Tax Act, the VAT Act, other tax Acts and the Companies Act.

Key words:
group companies, roll-over relief provisions, asset for share transaction, substitutive share for share transaction, amalgamation transaction, inter-group transaction, unbundling transaction, liquidation distribution, roll-over relief provisions, capital gains, revenue income, ring-fencing, going concern.

DECLARATION

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

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Vhulahani Eunice Ngwenya

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I thank my kids and my sisters for the unwavering support and understanding my unavailability during the period where I was focused on the completion of this report.

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1. INTRODUCTION

1.1. <u>BACKGROUND TO THE STUDY</u>

One can define group taxation as a situation where taxes of a group of companies as defined in the Companies Act are considered on a consolidated basis just as they are considered so for accounting and financial reporting purposes. The implication will be that any inter group transactions will be eliminated and the group will be considered as a single entity. In South Africa however, group taxation generally only applies to a limited extent as defined in the corporate roll over relief provisions which are also referred to as corporate rules.

Corporate rules provisions are contained in sections 41-47 of the Income Tax Act. These provisions allow qualifying groups of South African resident companies consisting of a parent and subsidiaries that are at least 70% owned directly or indirectly as well as qualifying foreign controlled entities, to reorganize assets amongst themselves without bearing the tax implications at the time of transfer but rather defer such tax implications until such a time when the group company that received the assets in the intragroup transaction decides to sell to a third party or in cases where the group as defined in the Act ceases to exist.

There are prerequisites to be met for corporate rules to apply in a particular transaction. These are summarized here before going through detailed requirements: (a) “whether the companies being assessed meet the definition of a group, (b) that the shares owned in the affiliated companies are equity shares as defined and that they are not held for trading as that would indicate that the intention of the shareholding and therefore of the group is temporary”[1]. “Shares held are not as a result of a contractual obligation to sell or purchase the share”[2], and (c) “the parties intend for the corporate rules to apply”. This is because parties may jointly elect that they do not want relief provisions to apply and this is mostly dependent on how parties view the benefit of the relief or the lack thereof.

In order to qualify for the relief, the group has to be made up of South African resident companies or foreign controlled entities. However, not all South African resident companies qualify for the relief. The following entities are excluded i.e. “Co-operatives, non-profit

[1] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p737)
[2] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p737)

entities, foreign collective investment schemes, public benefit organizations, companies whose gross income is exempt from tax and companies that have the place of effective management outside of South Africa”[3]. Clearly when it relates to companies that have the place of effective management outside of South Africa, these companies would generally not fall within the scope of the South African tax legislation.

What is stated above are the high-level prerequisites, the detail thereof can be found in Sections 41-47 of the Income Tax Act. The most important prerequisite is that any transaction that leads to an inter group transfer of assets should be legally authorized in terms of the Companies Act before one can even consider the tax implications thereof.

1.2. <u>RESEARCH QUESTIONS</u>

1.2.1. Statement on Research Questions

There is some level of group taxation allowed in South Africa, however due to the limitation thereof, often group companies end up with an inefficient net tax position on an annual basis. These inefficiencies have a financial impact on the business which could hinder company growth and thus the economic activity. The limited group taxation principles also pose a challenge for group companies to implement some of their business strategies that may include reorganize their assets through intragroup transfer of assets due to tax leakages that could result where such transactions are not done on a tax neutral basis. The main question this research seeks to address is what are the implications of having limited group taxation principles in South African? The sub questions stemming from the above main question are as follows:

- What defines a group of companies and why do companies form themselves in a group structure?
- What are the general principles of group taxation and implications thereof?
- What are the specific provisions in the Income Tax Act that allow limited application of group taxation principles in South Africa?
- What are corporate rules and what is excluded from these provisions?
- What are other regulatory and legislative implications for transactions covered under sections 41-47 of the Income Tax Act?

[3] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p737)

1.3. <u>RESEARCH METHODOLOGY APPLIED</u>

This research will follow a qualitative research approach. As outlined by Bhandari P. (2022), the qualitative research method *"involves collecting and analyzing non-numerical data (e.g., text, video, or audio) to understand concepts, opinions, or experiences. It can be used to gather in-depth insights into a problem or generate new ideas for research"*. In this study, data will be collected through literature review of the relevant Tax Acts, textbooks and articles written on related topics as published on the internet where applicable. Such data will be analyzed to form an opinion on the research topic.

1.4. <u>CHAPTER OUTLINE</u>

Chapter 1: Introduction

This chapter entails the background to the research topic, the research question and sub questions, it also outlines research method used as well as the chapter outline.

Chapter 2: What defines a group of companies and why do companies form themselves in a group structure?

This chapter gives an overview of what constitutes a group of companies. It then gives an overview of why companies structure themselves as a group as well the advantages and disadvantages thereof.

Chapter 3: What are the general principles of group taxation and implications thereof?

This chapter will introduce the concept of group taxation and the implications of having a group taxations system.

Chapter 4: What are the specific provisions in the Income Tax Act that allow the limited application of group taxation principles?

This chapter provides an outline of Income Tax Sections that provide tax relief to group companies with a special focus on corporate roll over relief provisions. It also entails a detailed legislative review of Section 41 of the Income Tax Act- the General provisions of the corporate rules.

Chapter 5: This Chapter provides a detailed legislative review of the following sections of the Income Tax Act:

"Section 42-Asset for share transactions
Section 43- Substitutive share-for share transactions
Section 44- Amalgamation transactions"

The chapter will also look at what the corporate rules seek to achieve for each type of transaction covered above. It will also outline the applicable legislation i.e. VAT Act, Companies Act, Transfer Duty Act, and Securities Transfer Tax Act implications in as far as transactions covered in sections outlined above. It will also look at donations and dividend tax implications.

Chapter 6: This Chapter provides a detailed legislative review of the following sections of the Income Tax Act:
"Section 45- Intra-group transactions
Section 46- Unbundling transactions
Section 47-Liquidation, winding up and deregistration's"

This chapter will also look at what the corporate rules seek to achieve for each type of transaction covered above. It will also outline the applicable legislation i.e. VAT Act, Companies Act, Transfer Duty Act, and Securities Transfer Tax Act implications in as far as transactions covered in sections outlined above. As per chapter 5, it will also look into donations and dividend tax implications.

Chapter 7: Conclusion
This section summarises key findings of the research.

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2. CHAPTER 2: WHAT IS A GROUP OF COMPANIES AND WHY DO COMPANIES STRUCTURE THEMSELVES AS A GROUP

2.1. INTRODUCTION

It is common for companies to be organized into a group in order to manage their business for various reasons. This section seeks to outline what is considered to be a group of companies in an accounting and Companies Act context as well as the Income Tax Act context. It then explores reasons why companies structure themselves in a group as well as the advantages and disadvantages of doing so.

2.2. WHAT CONSTITUTES A GROUP OF COMPANIES IN ACCOUNTING TERMS AND IN LINE WITH THE COMPANIES ACT DEFINITION

In an accounting context, group structures are created by having a legal entity having significant or controlling interest in another legal entity.

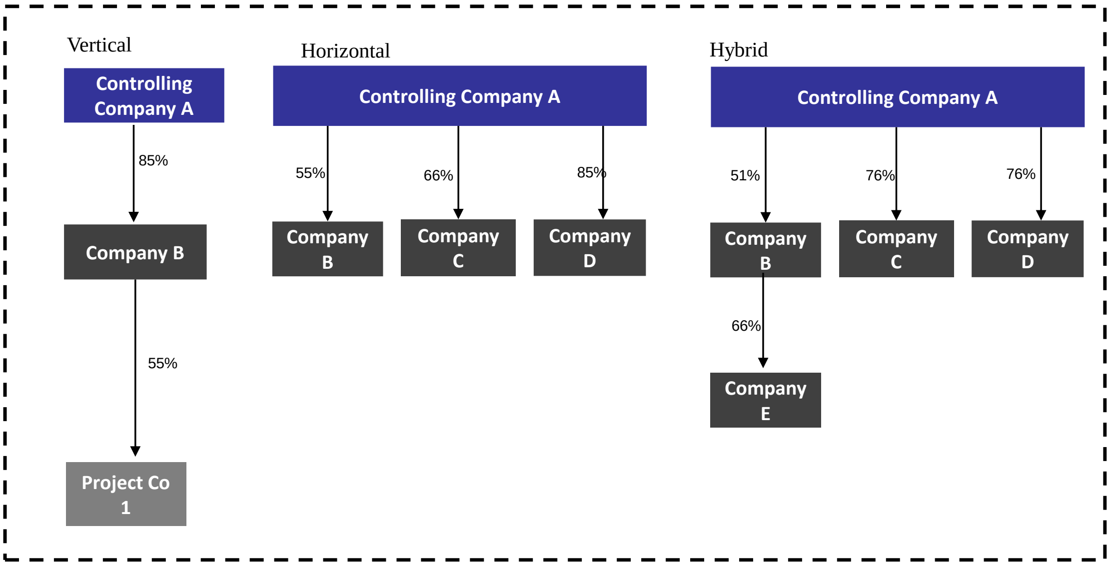
Significant interest is defined in International Accounting Standards ('IAS') 28 as *a "situation where an entity holds 20% or more of the voting power*[4] *(directly or through subsidiaries) in an investee company (referred to as an associate company)"*. "*Significant interest can be evidenced through board representation, participation in policy-making process, material transactions between the entity and the investee company, interchange of managerial personnel or provision of essential technical information*"[5].

To define a controlling stake, one needs to look at the definition of control. Control is defined in IAS 27 as "*the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities*"[6]. Furthermore, an entity is said to have acquired a controlling stake where a legal entity (referred to as a parent or holding company), acquires "*more than 50% of the voting rights of another entity" (a subsidiary)"*[7]. Control is evidenced through "*having more than one half of the voting rights by virtue of an agreement with other investors, being able to govern the financial and operating policies of an entity under a statute or an agreement, being able to appoint or remove majority of the board of directors or being able to cast majority votes at a meeting of board of directors*"[8].

[4] IAS 28(2011), para 5
[5] IAS 28(2011), para 6
[6] IAS 27, para 4
[7] IAS 27, para 13
[8] IAS 27, para 13

A group structure would normally involve two or more companies and there is no limit to the number of companies that can be involved. It can be a "*horizontal, vertical or hybrid group structure*"[9] as illustrated below:

Figure 1: Example of common group structures



According to the Companies Act, a group of companies is made up of "*two or more companies that share a holding company or subsidiary relationship*"[10]. This definition is aligned to the accounting definition in IAS 27 in as far as control is concerned.

2.3. <u>WHAT CONSTITUTE A GROUP OF COMPANIES IN INCOME TAX ACT TERMS</u>

In terms of the Income Tax Act, there are two definitions of the group of companies i.e. the definition contained in section 1 and the other definition that is contained in section 41.

<u>Definition of a group</u>

The Income Tax Act defines group companies slightly different from Accounting and the Companies Act definitions outlined in 2.2. above. As outlined below, the group is defined as:

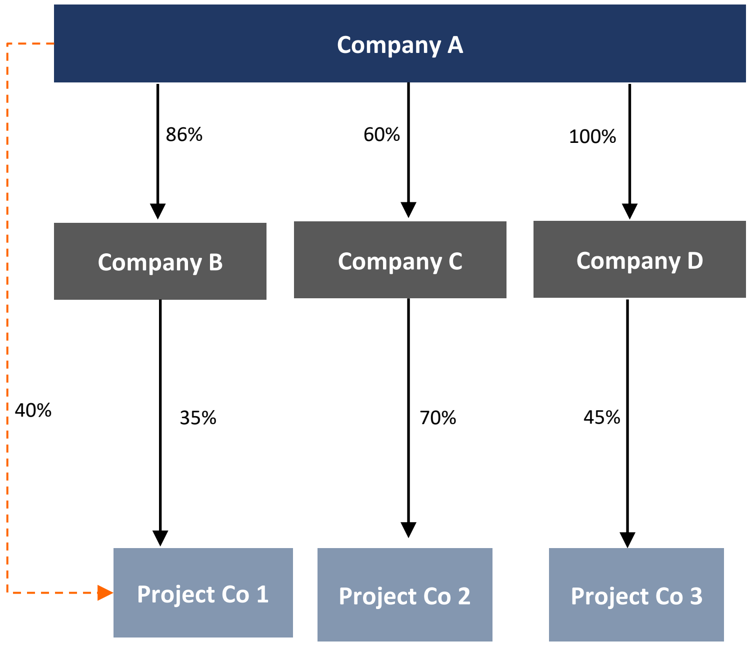
a) *"Where the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company"*[11]*, and*

b) *"At least 70% of equity shares in each controlled group company is held by the controlling group company, one or more other controlled group companies or a combination thereof*"[12].

[9] Rogan, H., n.d, *Group Structures*: Available at https://www.weightmans.com/insights/group-structures, [date accessed: 08 April 2021]
[10] Companies Act-Definitions
[11] Section 1 of the Income Tax Act
[12] Section 1 of the Income Tax Act

This can be better illustrated in the example below:

Figure 2: Group of companies structure, as defined in the Income Tax Act



- Company A, Company B, Company D and Project Co1 qualify as a group because Company A is a controlling company in this case and it holds 86% of company B and 100% of D, thus it meets the 70% threshold. Company A and Company B together own 75% of Project Co1 which again is above the threshold.
- Company A and Company C don't qualify as a group because shares held in Company C don't meet the minimum threshold required. However, Company C and Project Co2 qualify as a group because Company C shareholding is at least 70%. It should be noted that even though in accounting principles, Project Co2 would be considered a subsidiary and accounting principles would require that it be consolidated in Company A, this does not apply in tax legislation because the effective shareholding of Company A in Project Co2 is less than 70% and thus it does not qualify as a group.
- Project Co3 would also not be recognised as part of the group in terms of group of companies' definitions.

2.4. <u>THE IMPORTANCE OF THE TYPE OF SHARE HELD</u>

From the Act's definition of a group, it is clear that for a company to be considered as part of the group it must hold an equity share and thus it is then important for one to look into what constitutes "an equity share".

What constitutes a share?

First of all, the term share is defined in section 1 of the Income Tax Act as meaning, "*in relation to any company, any unit into which proprietary interest in that company is divided*"[13]. This definition is in line with the definition in terms of the Companies Act. However, the Companies Act does not prescribe the designation of the class of shares to be used by a company in order to qualify as a share other than stating that "*a company's memorandum of incorporation must set out the classes of shares, and the number of shares of each class, that the company is authorised to issue*"[14]. The company is also required to "*set out a) the distinguishing designation for that class and b) the preferences, rights, limitations and other terms associated with each class*"[15]. "*Where information outlined in b) is not specified, this can be specified by the Board of Directors, provided that such shares will not be issued until such information is specified*"[16]. It is however, common to come across classes such as ordinary shares, common shares, preference shares or even Class A or B shares in practice. The Companies Act and Income Tax Act definitions appear to be aligned and any share described in a company's memorandum of incorporation also constitutes a share in terms of the Income Tax Act. However, a share as defined in the Companies Act will not necessarily constitute "*an equity share*".

What constitute "*an equity share*"?

For the Income Tax Act, shares that are relevant to assess whether companies qualify as a group or not, are equity shares. An equity share is defined in section 1 of the Income Tax Act as "*any share in a company, excluding any share that, neither in respect of dividends nor returns of capital, carries any right to participate beyond a specified amount in a distribution*". This means that any class of share in the company which has the right to participate in capital returns and distributions of the company beyond a specified amount and therefore without limitations, would qualify as "*an equity share*".

Rights of certain classes of shares may be limited such that it could be questionable whether holders of such shares truly participate in ownership of the company. "*Shares that present the holder with limited rights to participate in the return of capital and dividends are likely to provide the holder with limited ownership exposure and such rights can generally be associated to a debt instrument*"[17]. As such, any such

[13] Section 1 of the Income Tax Act
[14] Section 36(1) (*a*) of the Companies Act
[15] Section 36(1) (*b*) of the Companies Act
[16] Section 36(1) (*c*)-(*d*) (iii) of the Companies Act
[17] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p722)

shares are excluded from equity shares classification and they will not count in assessing whether or not companies form a group of companies or not. For example, a fixed rate redeemable preference share would normally meet a definition of a non-equity share in that the holder's participation is limited to the rate applicable to the preference share.

As indicated above only equity shares are taken into account in assessing qualifying group of companies. This means for example that a company can hold more than 70% of any class of shares in a company and unless if such shares meet the definition of equity shares, the company cannot form part of a group as defined.

2.5. REASONS WHY COMPANIES FORM THEMSELVES IN A GROUP

Forming a group of companies as opposed to divisionalising a business has its pros and cons. The section below outlines some of the reasons why companies structure themselves as a group as well as the advantages and disadvantages.

2.5.1. Reasons for operating as a group

a) **Ringfencing of assets and liabilities in a special purpose vehicle (SPV)**: A common reason for entities to form SPV's is to have certain operations in a separate entity which is incorporated specifically to ringfence specific operations in order to protect financiers interests or in cases where an entity undertakes a risky project an SPV may be created to protect the parent company from the risks of failure which may result from the particular project which may sink the parent if not isolated.

b) **Regulatory requirements**: Certain companies may exist because they hold certain non-transferable licences that will be lost should a company be deregistered. It may also be a requirement for a certain contract with a customer.

c) **Compactualise business lines while having centralised administration**: Where a company has several lines of businesses it may choose to structure the business into entities which specialise in those business lines while managing administrative costs by having administrative functions held in a separate entity. This helps the business to separately manage performance since the results are isolated.

d) **Growth opportunity that requires club funding**: In this case the company may spin out a particular business line to a separate company, invite other investors to invest in that separate entity to jointly pursue business opportunities.

e) **To access goodwill created by other entities**: This involves buying other well-established businesses as part of the growth strategy which a company may continue to run as a subsidiary.

2.5.2. Advantages and disadvantages

The list below is not exhaustive:

Advantages	Disadvantages
• It facilitates transaction structuring as risks or assets can be ringfenced in separate entities. • Subsidiaries can operate independently which allows them to focus on specific strategies. • It ensures accountability • Performance management is easily implementable as it is easy to identify star performers and non-performers.	• Having multiple entities increases administrative cost such as accounting, auditing, maintenance of regulatory compliance such as CIPC annual returns. • Complex management structures as each entity should have its executive management and directors, making it difficult to manage centrally. • Inefficient procurement expenses if not properly managed. Having several different entities recognised separately by suppliers and thus affecting the negotiation leverage as compared to everything done in a single entity • In the South African context this results in inefficient net tax position if some entities in the group are profit making while others are not.

2.6. CONCLUDING REMARKS

The Income Tax Act definition of a group of companies differs substantially from the Companies Act and accounting definitions in that for the tax Act there is a requirement to meet a 70% threshold by the controlling company against at least one controlled entity which is more stringent when compared to the Companies Act and accounting standards requirements of just more than 50% of interest to be controlled for companies to form part of the group. The resulting effect is that transactions are accounted for differently for tax purposes as compared to accounting purposes i.e while the accounting treatment requires transactions to be consolidated and inter-group transactions eliminated, tax treatment requires each company to be assessed separately and so should their transactions and taxes. This then requires companies to spend considerable amount of time considering tax implications of their structures before implementing them.

3. CHAPTER 3: WHAT ARE THE GENERAL PRINCIPLES OF GROUP TAXATION AND THE IMPLICATIONS THEREOF

3.1. INTRODUCTION

This chapter examines the definition of group taxation and its principles. In this chapter the history and the implications of a group taxation system from a South African context were considered.

3.2. WHAT CONSTITUTES GROUP TAXATION

As indicated earlier, "group taxation can be defined as a tax system that enable companies to compute the tax liability of related corporations on a consolidated basis"[18]. "The term is broadly defined to encompass not only full consolidation, but also transfer of particular tax attributes between the members of a corporate group"[19]. The latter would mean a group of companies are treated and taxed as a single entity where income and losses are consolidated. Practically speaking, group taxation would result in subsidiaries being accounted as divisions and thus any intra-group transactions would be eliminated and have no tax implication.

3.3. WHAT WORK WAS DONE IN THE PAST TO TRY AND IMPLEMENT "GROUP TAXATION" IN SOUTH AFRICA

Group taxation has been looked at in various instances in the past, firstly dating back in 1986, the Margo Commission of enquiry investigated the matter. Subsequently, the matter was investigated by the Katz Commission of Enquiry in 1994. These Two (2) commissions had differing recommendations as outlined below.

3.3.1. Work done by "the Margo Commission of Enquiry"

This Commission advised against group taxation, stating reasons such as:

- Potential loss of income to the state;
- That it may result in prejudice of minority shareholders; and
- That it is complex and will result in an administrative burden to the State.

The result was that "*the current system or position was left despite bodies and corporations making written representations to the Margo Commission arguing strongly in favor of the group taxation system*"[20].

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[18] Omar, S., 2009, *Group taxation in South Africa : a contextual analysis*, Available at https://open.uct.ac.za/handle/11427/9268, [date accessed: 26 April 2021]

[19] Masui, Y., 2004, International Fiscal Association 2004 Vienna Congress, General Report: Group Taxation, Cahier de droit fiscal international, Volume 89b, pp. 21-67, Available at https://ssrn.com/abstract=2056735, [date accessed: 26 April 2021]

[20] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*: Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]

3.3.2. Work done by the Katz Commission of Enquiry in 1994-95

Though the findings were not implemented, the Katz Commission recommendations were in favor of the implementation of a group taxation system. However, this did not come without challenges as the following challenges were identified:

- **Group taxation is a complex matter**[21]: To this effect the Katz Commission recommended "a gradual approach to the introduction of a system of group taxation beginning with a simplified consolidation method" (Katz Commission Report-Third Report-1996). Features of "the simplified consolidation method" included the following:
    - "*For the purposes of qualifying for group tax relief, a group should comprise a holding company and all its wholly owned subsidiaries. The term 'wholly-owned' should be defined to refer to both direct and indirect interests held by the holding company, determined on the equity share capital of the companies concerned, with allowance for equity shares to be held by full-time employees, including executive directors, in terms of share incentive schemes, not exceeding 10% of the company's equity share capital.*
    - *The consolidation tax liability of a group will be calculated from sub-returns required for each member company in which taxable income or assessed loss will be determined on the basis of the current tax regime, save for a number of limited proposed adjustments.*
    - *The initial assessed losses of the member companies will be ring-fenced, and any loss incurred by a company in the group in a subsequent year of assessment will only be available to be set off against income from another company in the group in the same year of assessment"*[22]
- ***"Costs to the fiscus is high***[23]*: It was recommended that progress towards a full consolidation system, based on principles of loss offset and adjustments to taxable income which are widely followed internationally, was to be deferred until the impact of the shift to group taxation on the fiscus can be evaluated and the problems of administration have been identified and addressed".*
- ***"Specific anti-avoidance legislation would have had to be considered****, together with application of anti-avoidance measures"*[24].

[21] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*, (P.48): Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]
[22] Katz Commission Report, Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, 1996, (Para12)-Available at http://www.treasury.gov.za/publications/other/katz/default.aspx, [date accessed: 25 June 2021]
[23] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*, (P.48): Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]
[24] Katz Commission Report, Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, 1996, (Para12)-Available at http://www.treasury.gov.za/publications/other/katz/default.aspx, [date accessed: 25 June 2021])

Katz recommendation clearly did not include a complete consolidation given that this required sub-returns to be prepared, the system did not extend to VAT, there was also still ring fencing of losses and limitation of the ability to utilized “assessed losses[25].

The Katz Commission’s recommendations were also supported by the Joint Standing Committee on Finance (JSCOF)[26].

3.4. <u>IMPLICATIONS OF GROUP TAXATION</u>

As indicated in the earlier chapters, implications of group taxation are full consolidation of tax matters of all entities within the group thus allowing companies within the group to be assessed as one economic unit. This would align the tax and accounting treatment of transactions and most importantly provide an accurate view of the overall profitability and tax liability of a group.

Other implications are however, as accurately reflected in the findings of the Margo Commission, the netting off of group company losses with those that are making profit will likely lead to reduced income base for the fiscus from both VAT and Corporate tax perspective. However, this conclusion is incomplete if one doesn’t factor in the possibilities of those impacted group of companies applying the resulting tax savings that would materialize from group taxation to grow the business which will then grow the country’s economy and thus increase the fiscus revenue base due to the multiplying effect of the economic activity that would result from invested tax savings.

3.5.<u>CONCLUDING REMARKS</u>

Under the South African tax legislation, each company is treated separately and it is assessed and taxed independently. As a result, a company that is in a loss-making position can only utilize losses against future profits that it specifically makes, any such losses may not be offset against any other group company’s profit. The resulting effect is that, some companies in the same group of companies may be making losses and waiting to utilize such losses in future

[25] Katz Commission Report, Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, 1996, (Para12)-Available at http://www.treasury.gov.za/publications/other/katz/default.aspx, [date accessed: 25 June 2021]

[26] Katz Commission Report, Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, 1996, (Para12)-Available at http://www.treasury.gov.za/publications/other/katz/default.aspx, [date accessed: 25 June 2021]

profits while there maybe companies within the same group that are making a profit and are liable for taxes. This results in an inefficient group tax position. Whilst group taxation was considered in the past, challenges of implementing the same must be considered and addressed to ensure that this does not introduce high cost to the state and that there isn't an administrative burden. It is however, clear that group taxation will benefit companies which may also benefit the economy.

4. CHAPTER 4: WHAT ARE SPECIFIC PROVISIONS IN THE INCOME TAX ACT THAT ALLOW THE LIMITED APPLICATION OF GROUP TAXATION PRINCIPLES IN SOUTH AFRICA?

4.1. INTRODUCTION

In South Africa, as much as each company is treated as an independent legal entity in as far as the provisions of income tax are concerned, there are specific tax relief provisions that apply to qualifying group of companies. Implications of such provisions are that qualifying group of companies are treated as a single economic unit for certain transactions and tax relief is provided for those specific transactions. The objective of such tax relief provisions is deferring of tax consequences until either the group of companies no longer qualify as a group or until such an asset is transferred to a third party.

This chapter provides an outline of instances where a group of companies are treated as a single economic unit and it also outlines specific provisions in the Income Tax Act where tax relief is provided.

4.2. AN OUTLINE OF INCOME TAX ACT PROVISIONS THAT ALLOW THE LIMITED APPLICATION OF GROUP OF TAXATION

Tax relief provisions provided to group of companies are outlined in the following sections of the Income Tax Act:

a) "Corporate Roll Over Relief provisions" covered in sections 41 to 47 of the Income Tax Act and as outlined by Stiglingh, M., et al, 2019 (page 736), *b) "section 24BA(4) of the Income Tax Act which exempts the application of the value mismatch provisions in section 24BA if the parties involved form part of the same group of companies immediately after the transaction c) section 56(1)(r) of the Income Tax Act which exempts a company from donations tax in instances where the company in question donates to another company that forms part of the same group of companies d) section 24O of the Income Tax Act which allows the deduction of interest incurred in respect of debt incurred for the purposes of acquiring equity shares to become the controlling company in relation to another company and e) section 19 of the Income Tax Act and par 12A of the Eighth Schedule to the Income Tax Act which provide relief from the tax implications of concessions or compromises in respect of debt for persons who form part of the same group of companies"*[27].

This report focuses on provisions outlined in section 41 to 47 of the Income Tax Act, other provisions listed above fall outside the scope of this research.

[27] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p736)

4.3. GENERAL PROVISIONS OF CORPORATE ROLL OVER RELIEF PROVISIONS

4.3.1. Introduction

Companies structure themselves as a group for various reasons and it is likely that once the objective has been met for which the Special Purpose Vehicle (SPV) was incorporated, the group will have to be restructured. The transactions may involve *"the reorganization of the ownership of the company, reallocation of assets, business or functions within a group, reorganization of debt within the group or a financial restructuring i.e. replacing debt with equity or vice versa"*[28].

For example, in the case of the Renewable Energy Independent Power Producer Procurement Programme ("REIPPPP") that the national Department of Minerals Resources and Energy ("DMRE") is currently implementing, SPVs enter into a 20 year Power Purchase Agreement ("PPA") and thus the end of the PPA term means an end of the project life and if no further PPA can be entered to, owners of the SPV have to reorganize the entity which may include intra-group selling or transfer of assets.

It is important for these types of transactions to be implemented in a tax effective manner for which corporate roll over relief provisions (hereafter referred to as "roll over provisions" or "corporate rules") contained in sections 41-47 of the Income Tax Act were introduced to fulfil this purpose.

4.3.2. History of corporate rules

Corporate rules came into effect on 6 November 2002[29], following the introduction of capital gains tax in 2001[30]. "*The objective of introducing corporate rules was to ensure that the introduction of capital gains tax does not obstruct businesses from structuring their affairs in the most efficient economic manner*"[31]. The paragraph below outlines the general provisions of the corporate rules which are covered in Section 41 of the Income Tax Act

[28] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p517)
[29] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p518)
[30] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p735)
[31] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p735)

4.3.3. General provisions-Section 41

Important provisions are found in section 41 of the Income Tax Act. These general provisions include important definitions that guide the applicability or none thereof for corporate rules to apply. These definitions override any definitions that could be contained elsewhere in the Act. It also contains important considerations for companies to qualify for relief in relation to liquidation, winding up or deregistering[32]; information regarding instances where the Commissioner may require the company to furnish a special return[33]; definition of an amount that is considered to be a recoupment[34] and the fact that where "the seller in a transaction done in accordance with Sections 42, 44, 45 or 47 had selected the roll over provisions in terms of Paragraphs 65 or 66 of the Eighth Schedule and then subsequently disposes off the replacement asset under section 42, 44, 45 and 47, the buyer effectively takes over the characteristics of applying roll over provisions"[35].

The subsection below focuses on clauses that are deemed to be important throughout the corporate rules i.e. a) the narrow definition of group of companies b) additional considerations for equity share definitions, c) nature of asset and classification, d) steps required in winding up a company and e) overall impact of applying the roll over provisions.

4.3.3.1. Narrow definition of a group

The definition of a group contains exclusions of companies that would have qualified to be part of a group if section 1 definition was applied. For the purposes of roll over provisions, the following companies are excluded as outlined by Stiglingh, M., et al, in SILKE 2019:

"*A co-operative, a company formed for the benefit of the general public and a foreign investment scheme in securities or participation bonds or investment schemes in property that qualifies as REIT…, any non-profit company as defined in the Companies Act, a company whose gross income is exempt from tax in terms of Section 10 of the Income Tax Act, a public benefit organisation or a recreational club approved by the Commissioner in terms of Sections 30 and 30A of the Income Tax Act, any company incorporated in a foreign country unless if it has its place of effective management in South Africa and a company that has its place of effective management outside of South Africa even though it was incorporated in South Africa*"[36].

[32] Section 41(4) of the Income Tax Act
[33] Section 41(5) of the Income Tax Act
[34] Section 41(7) of the Income Tax Act
[35] Section 41(9) of the Income Tax Act
[36] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p737)

When analysing the theme of exclusions from group definitions, with an exception of a co-operative, it is clear that the exclusions are focused on companies that would not ordinarily be taxed in South Africa and not excluding these would present an opportunity for these entities being used as part of the structure to avoid tax. It is not entirely clear why co-operatives are excluded especially those who do not qualify for tax exemption.

4.3.3.2. Definition of equity shares

Exclusions

Equity share definition is aligned to what has already been defined in this paper and thus there is no need to repeat it.

Inclusions

The definition includes "*a participatory interest in a portfolio of a collective investment scheme in securities*"[37].

4.3.3.3. Asset classification and corporate rules implications

Corporate rules apply to various types of transactions that results in the sale and transfer of assets as outlined in more detail in each of the Sections 42 to 47 of the Act. In order to assess whether the relief is available or not, it is imperative to first assess the nature of an asset involved in the particular transaction, how it was classified by the seller versus how the buyer intends to classify it. The nature of the asset impacts tax implications i.e. a) base cost characteristics are transferred to the buyer where a capital asset is being sold whereas if a trading stock is being sold, characteristics relevant for purposes of application of section 22 or section 11(*a*) are transferred, b) if the asset is an allowance asset, historical recoupment is transferred to the buyer. The following definitions are necessary for the proper allocation of assets:

- **Trading stock:** definition as per section 1 of the Act applies however it is expanded for purposes of roll over relief provisions to include livestock or produce[38].

[37] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p519)
[38] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p738)

- **Allowance Asset**: is defined as any "*capital asset qualifying for an allowance or deduction under the Income Tax Act other than for purposes of determining capital gains, as well as any debt contemplated in section 11(i) or (j)*"[39].
- **Capital Asset:** This definition is broad in that the capital asset is supposed to be any asset that is not trading stock[40]**.**

4.3.3.4. Steps required in winding up of a company or close corporation

Requirements for corporate rules to apply in relation to an "*amalgamation transaction concluded in terms of section 44"* is that the liquidation, winding up or deregistration of the amalgamating company needs to occur within 36 months where the company in question is a resident company and 18 months where the amalgamating company is a foreign entity[41]. The section below provides details in what is considered to form part of steps required to provide evidence that the company is in the process of being liquidated, wound up or deregistered within the required timeline. It should be noted that where these steps are not taken, the relief afforded is reversed. Furthermore, steps to be taken depend on whether the objective is to liquidate, wind up or deregister:

<u>In case of a liquidation or winding-up, the following steps must be taken:</u>

"*The company, in the case of a resident company, must lodge a shareholder's resolution authorising the voluntary liquidation or winding up with the Companies and Intellectual Property Commission (CIPC). In the case of a foreign company, the equivalent procedure is to be followed with the relevant authority. The company must also dispose of all assets and settle its liabilities, with the exception of assets required to satisfy liabilities reasonably expected to arise from any sphere of government and the costs of liquidation or winding-up. A copy of the resolution must have been submitted to SARS, and in cases of collective investment schemes (CIS) in property, an authorised person like a manager, trustee or custodian must have applied for the winding up thereof"'*[42].

<u>In case of a deregistration</u>

"*The company, in a case of locally incorporated company, lodge a request for deregistration of the company or close corporation in prescribed manner and form with the CIPC. In case of a foreign company, the equivalent procedure is to be followed with the relevant authority and a copy of the written request must have been submitted to SARS*"

[39] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p520)
[40] Section 41(1) definitions, of the Income Tax Act
[41] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p522 & 534)
[42] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p521-522)

In both instances, the company needs to comply with tax submissions and the provision of the necessary information as may be requested by SARS within the relevant period during which these steps must be taken, failing which arrangements for the submission of outstanding returns or information must have been made with SARS during the period stipulated above[43].

4.3.3.5. Application of Corporate Rules

As already stated above, "*corporate rules override normal rules in the Income Tax Act other than sections 24BA (where shares are issued by a company in return for assets with a value different from the value of the shares), the anti-avoidance provisions in sections 80A to 80L and sections 103(2) (general anti-avoidance provision in respect of assessed losses) as well as paragraph 11(1)g on the Eighth Schedule (value shifting rule)[44]. They also do not apply to transactions in terms of which an asset is disposed of to a long-term insurer as defined in section 29A of the Income Tax Act if that insurer will hold that asset in its untaxed policy holder funds*"[45].

4.4.<u>CONCLUDING REMARKS</u>

This chapter only outlined an introduction and the general provisions which can be found in Section 41 of the Act. Detailed discussions of the provisions are outlined in Chapters 5 to 6 of this report.

[43] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p521)
[44] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p521)
[45] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p521)

5. CHAPTER 5: ASSET FOR SHARE TRANSACTIONS, SUBSTANTIVE SHARE FOR SHARE TRANSACTION AND AMALGAMATION TRANSACTIONS

5.1. INTRODUCTION

The purpose of this chapter is to outline the provisions in Section 42"*Asset for share transactions*", Section 43- "*Substitutive share-for share transactions" and Section 44- "Amalgamation transactions*". The analysis covers what the Act seeks to achieve for each type of transaction covered in these sections. It will also analyses what the VAT Act, Companies Act, Transfer Duty Act, and Securities Transfer Tax Act implications are for transactions covered in these sections are concerned and concludes on whether there is harmonization in these legislations.

5.2. SECTION 42-ASSET FOR SHARE TRANSACTIONS

5.2.1. Introduction

In an asset for share transaction, a person who can be an individual, a company or a trust (referred to as seller or transferors),sells an asset to another company (referred to as buyer/transferee), and as a consideration instead of receiving cash, the seller receives equity shares in that company (buyer/transferee) to which the asset is sold to. This section of the Act allows this type of a transaction to be income tax free, without recoupments and capital gains tax in the hands of the seller provided prerequisites specified in this section of the Act are met.

5.2.2. Requirements to be met to qualify for relief

A transaction may involve two domestic companies or it may be a cross border transaction. The requirements specified in this section are divided into those applying in domestic transactions and those applying in cross border transactions. These requirements are as follows:

In case of domestic transactions:

a) "*A person disposes of/transfers an asset other than a restraint of trade or personal goodwill*"[46]. There are two things to note with this requirement. Firstly, that the Income Tax Act doesn't place a restriction on the type of a person transferring an asset. This means any entity can be a seller in this transaction including individuals. There is also no prerequisite for the company to be part of the group of companies before the transaction. Secondly, that there are exclusions in the type of assets that can be sold i.e. personal goodwill and restraint of trade. The exclusions sound logical because these assets only apply to individuals and it would

[46] Section 42(1)(*a*)(i) of the Income Tax Act

not make an economic sense to sell them to a company. As specified in the Act, the buyer will always be a legal entity which can issue equity shares.

b) "The market value of the asset equals or exceeds the base cost in the case of a capital asset and the tax cost in the case of a trading stock"[47]. From this requirement it is clear that section 42 does not cover situations where the market value does not exceed the cost or where the asset is sold at a loss. It follows then that in the case where the market value has gone down, the transaction will be recorded at market value with the seller recognising capital losses or trading losses as the case maybe and set off such losses against gains (capital losses against capital profit, losses from sale of trading stock would be set off against company profits).

c) The buyer is a resident company[48].

d) The buyer issues equity shares in itself to the seller as consideration for the asset sold to it[49]. It should be noted that section 42 also covers instances where an asset for share transaction include an assumption of debt, however there are requirements that must be met for the debt to be allowed and this is covered below[50]. An asset for share transaction may also result in the purchase price being settled in means other than an equity share and this may include cash, shares that are not equity shares and section 42 requires that an apportionment be applied and that corporate rules only apply to the part that results in an issue of equity shares by the buyer[51].

e) At the end of the business day on which the asset is transferred, the seller should either hold a qualifying interest in that buyer/transferee[52] or "*in cases where the seller is an individual or a natural person, he/she should be engaged on a full time basis in the business of that company, a controlled group company in relation to that company, of rendering a service*"[53]. Given the requirement to hold a qualifying interest by close of the day, the shares must be issued on the same day the asset is transferred so to ensure that this requirement can be met. The section below discusses what constitutes a qualifying interest.

f) The buyer must retain the asset classification, where the asset was accounted or treated for by the transferor as a trading stock, the acquirer must retain the nature of the asset as a trading stock. In cases where the asset was accounted for in its books as a capital asset, the

[47] Section 42(1)(*a*)(i) of the Income Tax Act
[48] Section 42(1) (*a*)(i) of the Income Tax Act
[49] Section 42(1) (*a*)(i) of the Income Tax Act
[50] Section 42(8) of the Income Tax Act
[51] Section 42(4)(*b*) of the Income Tax Act
[52] Section 42(1) (*a*)(i)(A) of the Income Tax Act
[53] Section 42(1) (*a*)(i)(B) of the Income Tax Act

acquirer can hold it as either a capital asset or trading stock if the company and the seller do not form part of the same group of companies[54]. In terms of this section, the buyer cannot change an asset that was trading stock to a capital asset. This in itself is an anti-avoidance provision to avoid a situation where the asset is converted from trading stock to capital asset and thereby reducing tax implications due to the capital gain inclusion rate that is lower than that of 100% which would be applicable to a trading stock.

The requirement to retain the nature of an asset does not apply in cases where "*the asset being disposed of is an equity share in a listed company or a portfolio of a CIS in securities or in a portfolio of a hedge fund CIS and after disposal together with any other transaction that is concluded on the same terms as that transaction and within 90 days after that disposal, the transferee holds at least 35% of equity shares in the listed company, or minimum of 25% of equity shares of that listed company or portfolio provided the transferee company's share represents the highest single shareholding in the listed company or portfolio in question*"[55]. This is because listed shares are assumed to have been transferred at fair value. Refer to 4.3.4.3 below.

<u>Discussion:</u>
One of the important requirements is that the seller must hold a qualifying interest in the transferee company the day the asset is transferred and it is thus important to pay special attention on how the qualifying interest is defined in the Income Tax Act. The qualifying interest is defined as follows:

"Equity share is held in a listed company or the company that will become listed 12 months after the transaction has been concluded,
At least 10% of equity shares that confer at least 10% of the voting rights,
An equity share held by that person in a portfolio of a collective investment scheme in securities,
An equity share held by that person in a company that forms part of the same group of companies as that person, or
Equity share held by a portfolio of a hedge fund collective investment scheme"[56].

An interesting observation with this section is that though the definition of equity share should exclude trading stock, as per some of the literature[57], it is not a requirement for qualifying interest shares to not be trading stock. However, by virtue of trading stock being excluded from equity share definition, holding any such trading shares will lead to the transaction being excluded from corporate rules.

[54] Section 42(1)(*a*)(ii) of the Income Tax Act
[55] Section 42(1)(*a*)(ii)(i) of the Income Tax Act
[56] Section 42(1)(*b*) of the Income Tax Act
[57] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p737)

In the case of cross border transactions:

a) For the transaction to qualify, the asset under consideration can only be an equity share held by the transferor in a foreign entity (hereafter referred to as a target company) as a capital asset[58]. It should be noted that this subsection does not place special requirements on the transferor and thus the transferor can be a local entity or foreign entity.

b) Only in instances where the market value of the transferred asset equals to or exceeds the base cost can it be relevant for application of corporate rules and such an asset needs to have been sold to another foreign entity in exchange of equity shares in that foreign entity (the transferee)[59].

c) Immediately before the transaction , "*the transferor and the transferee form part of the same group as defined in section 1 of the Act and that the transferee is a controlled foreign entity in relation to any resident company that forms part of the group of companies*"[60].

d) "*At the close of the day on which the asset is transferred, more than 50% of shares in the foreign entity where the shares are held before the transaction (target company), are held by a resident (whether alone or together with any company forming part of the same group of companies with the resident) or at least 70% of the foreign entity that is acquiring the asset (transferee company) is directly or indirectly held by a resident (whether alone or together with any company forming part of the same group of companies with the resident)*"[61].

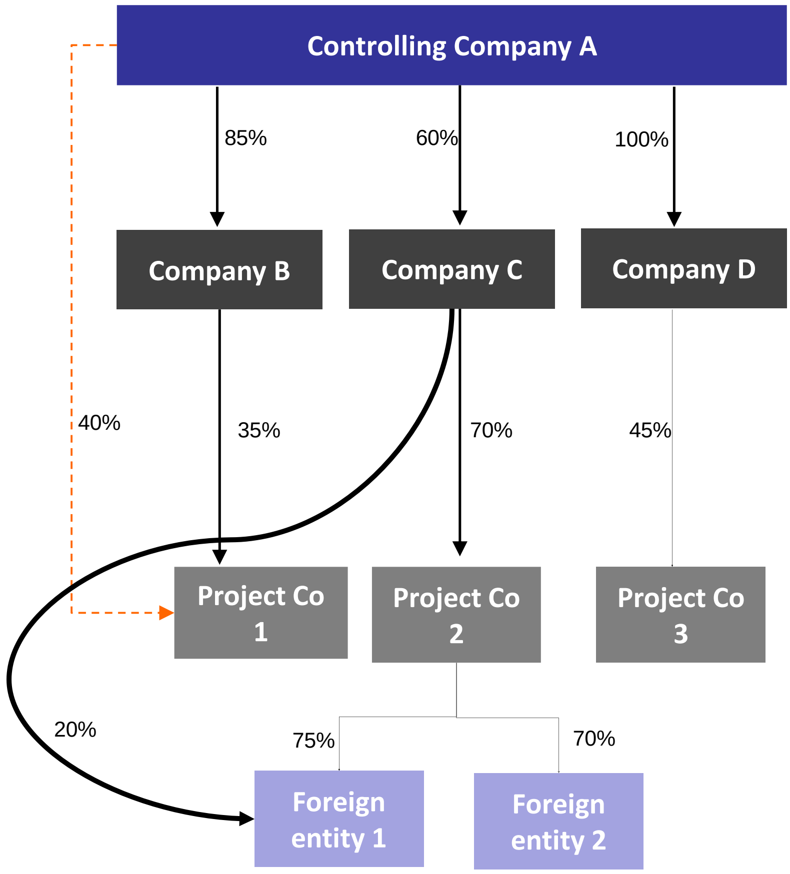
Discussion:

The definition applicable to foreign transactions only allows for roll-over treatment in respect of the restructuring shareholdings in foreign companies between companies in the same group as defined in terms of section 1 of the Act. The scope of the transactions that qualify is narrowed because the transferee must form part of the group before the transaction. Another observation is that there is a restriction in the type of assets being transferred i.e. an equity share while in the case of domestic entities this restriction is not applicable.

The structure below illustrates the requirements in cases of a cross border transaction:

[58] Section 42(1)(*b*) of the Income Tax Act
[59] Section 42(1)(*b*) of the Income Tax Act
[60] Section 42(1)(*b*) of the Income Tax Act
[61] Section 42(1)(*b*)(ii) of the Income Tax Act

Figure 3: Cross-border transaction structure



Notes:

- Foreign company 1 is the target company where Project Co 2 (a resident company) holds 75% of equity shares. Project Co 2 in this case sells 20% shareholding in Foreign entity 1, which it held as a capital asset, to Foreign entity 2 in exchange for shares in Foreign Entity 2. Both foreign entities 1 and 2 are controlled foreign entities as defined. At the end of the day in which the 20% of equity shares is sold to foreign entity 2, more than 50% of foreign entity 1 is still held by a resident entity. This transaction will qualify as an asset for share transaction provided that the market value of the shares is higher or equal to the base cost.

5.2.3. Relief provided for asset for share transaction

Where the seller sells the capital asset and the asset is transferred as a capital asset to the buyer, such an asset will be deemed to have been sold at the price equal to its base cost and in case of a trading stock, the seller is deemed to have sold the asset at the price equal to the cost taken into account in terms of section 11 and thus no profit will arise in the hands of a person who has applied the roll over relief provisions. The buyer steps in the shoes of the seller. The main requirement of the section is that the transferee must maintain the nature of an asset. The overall relief is that the acquirer and the seller are treated as one and the same person until the affected asset is disposed to a third-party buyer i.e. a person that does not form part of the group as defined[62].

In the case of an equity share, the seller is deemed to have acquired it at the price that is equal to the cost of the asset disposed per the paragraph above and such a cost then represents the contributed tax capital. "*The acquisition of shares is deemed to be on the same date as the date on which the asset was disposed of except as per provisions of section 42(2)(b)*", where

"*the asset being transferred is an equity share in a listed company or in a portfolio of a CIS in securities and the transferee holds at least 35% of equity shares in the listed company or portfolio company after the transaction in question, then the company is deemed to have acquired the asset at market value and not at cost. The 35% holding requirement can be reduced to 25% if no other person other than the transferee company holds an equal or greater share than 25%*"[63].

It should also be noted that in calculating shareholding percentage stated in the quote above, asset for share transactions that took place 90 days after the transaction may be taken into account[64].

The effect of the exclusion of listed shares from the ambit of section 42(2)(*b*) is that "listed shares are deemed to have been acquired at fair value"[65]. Though listed shares are deemed to have been acquired at market value, where all requirements have been met, the seller is still deemed to have transferred the shares at base cost or cost in terms of section 11 in the case

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[62] Section 42(2)(*a*)-(*b*) of the Income Tax Act
[63] Section 42(2)(*b*) of the Income Tax Act
[64] Section 42(2)(*b*)(cc)(B)(ii) of the Income Tax Act
[65] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p526)

where shares were held as trading stock, unless if as corporate rules allow where parties to the transaction jointly elect for corporate rules not to apply.

5.2.4. Anti-avoidance provisions

18-month rule:

a) If within 18 months of the transaction taking place more than 50% of the market value of assets sold to the buyer as allowance assets and or trading stock is sold to a party outside the group, this triggers a tax liability. Part of the selling price (up to market value at the beginning of the 18 months i.e when the transaction occurred) will be treated as income and the other part will be treated as a capital gain (the amount in excess of the market value when the transaction took place). The part that is income will be included in taxable income and taxed at the applicable tax rate whilst the capital gain part will be included in income by applying the inclusion rate[66].

b) In terms of section 42(6)(*a*), if the transferor of the asset in the asset for share transaction ceases to hold a qualifying interest in the transferee company or ceases employment where an individual is involved, the transferor is then deemed to have disposed of the shares in the transferee company on the day the shareholding falls below a qualifying interest or the day the person leaves employment. It should be noted that where the transferor sold only a portion of the shares, this sub section deems the transferor to have sold the remaining shares at the market value at the beginning of the 18 months and reacquired such shares at the same market value. The implication is that the market value when the original transaction took place at the beginning of an 18 months period will be included in taxable income and it resets the base cost of the shares going forward should the shares be sold at a later date at a different price[67].

c) Similar to section 42(6)(*a*), in section 42(6)(*b*) where a foreign entity is involved and the requirements regarding the holding of at least 50% of shares in the target company, or at least 70% of the transferee company are no longer met due to the portion thereof being sold within 18 months from the date on which the asset for share transaction was concluded, the company will be deemed to have sold shares which it still holds for the market value at the time of the original asset for share transaction and repurchased at the same market value. The effect then is that step up in the base cost and that step up being taxed as capital gains tax[68].

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66 Section 42(5) of the Income Tax Act

67 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p528)

68 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p529)

d) In terms of section 42 (7) where the seller/transferor sells an asset it had acquired as a capital asset to a third party within 18th months of the original transaction being concluded, a portion of a capital gain (which is calculated based on the market value at the date the asset for share transaction was concluded) may not be set off against any assessed losses or capital losses. Instead such gains will be recognised immediately as part of the net capital gain and is subject to the applicable inclusion rate. The implication of this provision is that only the growth in value from the beginning of the 18 months period until such time the asset is disposed of can be set off against capital losses, which is punitive[69].

e) Section 42 (7)*(b)*(i), "*states that if the buyer sells trading stock acquired in terms of the an asset for share transaction within 18 months of the original transaction, a portion of profit made (calculated based on the market value at the date of the asset for share transaction less the cost to the transferor) will be deemed to have been generated from a separate trade and thus it cannot be set off against assessed losses unless if the stock is regularly disposed of by the company in ordinary course of business*"[70].

f) Similar to section 42 (7*)(b)*(i), section 42 (7*)(b)*(ii) states that "*if an allowance asset that was acquired through an asset for share transaction is disposed within 18 months of that transaction, the amount of recoupment is deemed to be attributable to a separate trade, provided that the recoupment in question is limited to the amount that would have applied if the asset was sold for its value at the date of the asset for share transaction*"[71].

In all the above instances, relief is provided where the transaction is concluded in terms sections 45, 46, 47 and in the case of involuntary disposal in terms of paragraph 65 of the Eighth Schedule or death of a person[72].

g) Section 42(8) provides that where a person disposes of any asset in terms of an asset for share transaction and the transferee company pays through issuing shares and taking over debt which is secured by the asset or attributable undertaking, and that person (the transferor) will have to account for a proportionate share of the debt as proceeds from sale of a capital asset where shares were held as a capital asset and as income where the share was held as trading stock[73]. As pointed out by ENS in the Integritax Newsletter Issue 185 (2015:1-4), the application of this clause is meant to ensure that the transferor

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[69] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p530)
[70] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p530)
[71] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p531)
[72] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p528)
[73] Section 42(8) of the Income Tax Act

is taxed on the growth in value in the asset, however it may be detrimental in the following situation: a) Though roll over relief maybe provided for subsequent qualifying transactions, this will not be available to gains triggered by section 42(8) (*b)* where the debt in question was not utilised to fund fixed assets and maybe such debt was used to fund working capital, in that case the base cost may not equate to the debt and thus resulting in further taxes for the transferor.

5.2.5. Applicable exclusions

Relief that is provided by section 42 will not be available in the following instances:

- Where disposal would result in a loss to the transferor/seller[74]. It goes without saying that in such instances the seller would rather utilise the loss to either set off against a capital gain or trading profit as the case maybe rather than roil over the loss,
- Where the asset is held as trading stock by the transferor and the acquirer holds it as a capital asset[75], this is because the transaction does not meet the requirements of section 42 *(a)*(ii) i.e. the transferee must maintain the nature of the asset,
- Where parties to the transaction jointly elect for roll over relief provisions not to apply[76]. The election which is usually made based on the taxpayer's tax position, for example the seller may have tax losses to which they wish to apply profits resulting from this transaction and at the same time the buyer may want the cost of the acquired asset to be recorded at the market value[77].
- The disposal is being made by a non-taxable entity.
- Not applicable to share buyback transactions or the capitalisation of debts owing by the company. Asset that constitutes debt owing by or a share in the company to which the asset is disposed is also excluded[78].

5.2.6. Relationship between Income Tax Act and other tax legislations

5.2.6.1.Securities Transfer Tax Act (STTA)

[74] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p532)
[75] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p532)
[76] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p749)
[77] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p749)
[78] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p749)

Section 8 of the STT exempts transactions that involve the sale of marketable securities in terms of section 42 of the Act[79], provided "*the Public Officer of the company makes a sworn affidavit or solemn declaration that section 42 applies to the transaction*"[80].

5.2.6.2.Transfer Duty Act (TDA)

In as far as the TDA is concerned, there are two sections that provide an exemption i.e. section 9(1)(*l*) which provides a blanked exemption for asset for share transactions and section 9(15A) which provides an exemption where "*the asset for share transaction involves the sale of physical fixed property and both the transferor and transferee are registered as VAT vendors*"[81].

5.2.6.3.Value-added tax Act (VAT Act)

"*Section 8(25) of the VAT Act provides an exemption to asset for share transactions where both parties to the transaction are VAT vendors. Another requirement is that the supply has to be a supply of an enterprise or part of an enterprise which is capable of separate operation and where the supplier and the recipient have agreed in writing that such enterprise or part thereof is disposed of as a going concern*"[82].

5.2.6.4. Donations Tax

There is no specific exemption for Asset for Share transactions. Generally, "*if an asset is sold for the price that is less that its market value, donations tax will arise for the shortfall*"[83] and SARS may deem the shortfall to be donation to the transferee and levy donations tax, unless where the transaction involves companies that are members of the same group[84].

5.2.6.5. Dividends Tax

Normal dividend tax provisions will apply to any dividends received as part of the asset for share transaction.

5.2.7. Companies Act

There are no specific requirements in relation to asset for share transactions in the companies Act except that if assets being sold constitute all or greater part of the company's assets, provisions of section 112 must be complied with in that the transaction must be approved by

[79] Section 8 of STT Act
[80] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p532)
[81] Section 9 of TDA
[82] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p532)
[83] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p532)
[84] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p532)

way of a special resolution and such special resolution must comply with requirements of section 115[85].

5.2.8. Summary of observations of section 42 of the Act relationship with other legislation

Section 42 of the Act seems to be fully harmonized with the STTA, TDA, and the Companies Act. Donations tax is not aligned to the section 42 as donations tax may still be levied. The additional requirements under the VAT Act may make it difficult to qualify for relief if the requirements are not met, therefore meaning the VAT act is not fully aligned to section 42 of the Act.

5.3. SECTION 43- SUBSTANTIVE SHARE FOR SHARE TRANSACTION

A substitutive share-for-share transaction refers to a transaction in which a "*person who is already a shareholder, disposes of an equity share in the form of a linked unit in the company, and acquires an equity share (other than a linked unit) in the same company"*[86]. Stiglingh, M., et al, (SILKE 2019:755) define a linked unit as "*a holding that comprises of a share and a debenture in a company, where these instruments are linked and traded as a single unit*". The transaction being referred to thus involves a share swap within the same entity and it is deemed to be at the cost of acquiring the initial shares at the base cost of the share being disposed of if all conditions of this section are met.

In cases where the shareholder receives other consideration over and above the equity share, corporate rules will only apply to the proportion in relation to which an equity share has been received[87].

As per Phillip Haupt in Notes on South African Income Tax (2017: 533), the purpose of this section is to facilitate the conversion of linked units into equity shares in the same company, without any tax implications. There is however limited application of this section and thus the section is not discussed further.

5.4. SECTION 44- AMALGAMATIONS

5.4.1. Introduction

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[85] Section 112 and 115 of the Companies Act
[86] Section 43(1)-(2) of the Income Tax Act
[87] Section 43(4) of the Income Tax Act

Amalgamation and merger transactions are one of the methods corporates utilize to restructure their businesses. Reasons behind this restructuring may include realization of synergy benefits through cost savings, to eliminate competition or for the purposes of having the economies of scale which may in turn lead to financial benefits.

5.4.2. Definitions

Companies Act definition:

"a transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in— (a) the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or (b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement"[88].

Section 44 of the Act defines amalgamation in the following manner:

- Where a company (amalgamating company or the transferring company) disposes all its assets to another company (transferee) in exchange for an equity share in the resultant company and in the end, the amalgamated companies get liquidated. The amalgamation transaction can involve a resident company transferring assets to another resident company, a foreign company transferring its assets to a resident company or the foreign company transferring its assets to another foreign company (note further requirements below regarding foreign companies)[89].
- In both cases, the transferor can transfer its assets other than those it elects to use to settle debts incurred in ordinary course of its trade as well as to settle "*any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding up, to another resident company (the resultant company)"*[90].

As it can be seen the Companies Act definition differs from that of the Act in that in terms of the Act, no amalgamating company survives the process as a legal entity. Instead, a completely new entity is formed to house the combined assets and liabilities of the amalgamated

[88]Section 1 of the Companies Act
[89] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533)
[90] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533-534)

companies. This as opposite to sub section (b) of the amalgamation definition in the Companies Act which states that there could be a surviving entity from the amalgamated entities.

Section 44 of the Act allows an amalgamation to be done on a tax neutral basis provided that provisions within this section of the Act have been met. Section 44 covers the three amalgamation scenarios: a) "*a South African resident company transfers its assets to another resident company; a foreign company transfers its assets to a South African resident company or a foreign company transfers its assets to another foreign company within the same group*"[91].

The section below discusses each of the amalgamation scenarios outlined above.

5.4.3. Requirements to be met for an amalgamation transaction to qualify for relief in terms of section 44

In the event where the South African company enters into an amalgamation transaction with another South African entity, section 44 (*a*) (i)-(ii) requirements are as per below:

- The amalgamating company must transfer all its assets to the resultant company, as a going concern, *"except those assets that are necessary to enable the company to settle debts incurred in the ordinary course of its business, or satisfy any reasonably anticipated liability to any sphere of government of any country and the costs of administration of the liquidation or winding-up*"[92],
- The amalgamating entity must receive equity shares and cash or assets in the new company,
- The amalgamated company must transfer the "*equity shares and assets which it has acquired in the resultant company to its shareholders as dividend in specie so its existence can be terminated"*[93], and
- The amalgamated company must be wound up or deregistered within 36 months of the amalgamated transaction[94].

It should be noted that for this section to apply, the business has to be transferred as a going concern which would probably be the case if there is a business case for the amalgamation in the first place. Again, shares involved must be equity shares as per section 41.

Where a foreign company transfers to a resident, section 44(*b*)(i)-(ii) requirements are as per below:

- The requirements to transfer all assets to a new entity and the requirement to distribute the dividend in specie are similar to what is required when a resident company is amalgamating

[91] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533)
[92] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533)
[93] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533)
[94] Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p533)

with another resident company, however the timeline required to dissolve the amalgamated company is half of that which is required for transactions which involve South African resident entities , and

- "*Immediately before the transaction, if the resultant company owns any shares in the amalgamated company, these must be held in a capital account*"[95].

An observation here is that this section does not cover instances where a South African resident entity transfers its entity to a non-resident entity. The reason being that once the resident entity transfers to a non-resident entity, the transaction will fall outside the scope of the Act.

Where a foreign company transfers to another foreign company, section 44(*c*)(i)-(iii) requirements are as per below:

- The requirements to transfer all assets to a new entity through amalgamation, conversion or merger and winding of the old company as well as the requirement to distribute the dividend in specie are similar to what is required when a resident company is amalgamating with another resident company, in addition to these requirements, the following is required:

Immediately before the transaction

i) "*The amalgamated company and resultant company form part of the same group of companies (in terms of section 1), immediately before the transaction"*[96],

ii) *"The resultant company is a controlled foreign company in relation to a resident that forms part of the same group of companies"*[97],

iii) *"Any shares in that amalgamated company that are directly or indirectly held by the resultant company are held as capital assets*"[98].

Immediately after the transaction:

i) More than 50% of the equity shares of the resultant company are directly or indirectly held by a resident (alone or with companies that form part of the same group of companies)[99], thereby making it a controlled foreign entity

Discussions

Again, there is a limitation of scope for these transactions to fall into the Act since entities involved must have formed part of the same group of companies in terms of section 1 prior to the transaction taking place

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95 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p534)
96 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p534)
97 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p534)
98 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p534)
99 Haupt, P, 2017, *Notes on South African Income Tax*, Hedron Publishers, Cape Town (p534)

5.4.4. Roll over relief provided in terms of section 44 of the Income Tax Act

Generally, the main requirement is that the resultant company must retain the nature of the asset that has been acquired through the amalgamation process for the roll over provisions to apply i.e. where an asset was held as a trading stock, capital asset or allowance asset must be retained.

Relief provided by section 44 affects three parties i.e. the amalgamating company, the resultant company and the shareholders differently and for ease of reference this section has been structured to address relief per the affected party. These are all as outlined in Stiglingh, M., et al, 2019. *SILKE: South African Income Tax*, LexisNexis Publishers: Durban (pp 758-760).

a) <u>The amalgamated company</u>

- Assets are deemed to have been transferred at cost i.e. in the case of a capital asset the base cost would apply and in the case of a trading stock, costs applicable in terms of section 11 would apply. What is important to note is that any amount higher than the cost will not attract tax in the books of the amalgamated company[100]. Furthermore, no recoupments in the case of allowance assets as per the application of the roll-over mechanism as per section 44(2) and 44(3),
- Where a contract is disposed as part of the going concern in a transaction, and section 24 (24C or 20P) allowances were received, the amalgamated company does not have to include such allowances in its taxable income,[101]
- Similarly to other sections, where roll over relief provisions apply, the amalgamated company and the resultant company are assumed to be the same party and the resultant company basically takes the position of the amalgamated company in all assets listed above,
- In terms of section 44 (4), where debt is assumed as part of the consideration, the following must be complied with:

[100] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p758)
[101] Section 44(3)(b) of the Income Tax Act

  - Such debt must have been incurred by the amalgamating entity more than 18 months before the disposal[102],
  - "If debt was incurred within 18 months before the disposal, that debt must constitute refinancing of the debt that was incurred more than 18 months prior to the transaction, or debt that arose in the ordinary course of the amalgamated company's business which is disposed of as a going concern to the resultant company"[103].
  - The resultant company should not incur new debt for the purposes of acquiring assets that are transferred through the amalgamated transaction because if this is the case, this may represent a divestment transaction, which does not qualify for roll-over relief and thus attract tax in a normal way and any funds paid to shareholders will attract dividend tax[104].
- If the consideration includes any other components (for example cash consideration) the roll-over relief will not apply to the transaction to the extent of those other components of the consideration[105]. Some form of apportionment will apply.
- In terms of section 44 (8), "*the amalgamated company must disregard the disposal of any equity shares in the resultant company in terms of this section for purposes of determining its taxable income or assessed loss*"[106].

b) <u>The resultant company</u>

The tax implications for the resultant company are that:

- Resultant company steps in the shoes of the amalgamating company in as far as the asset is concerned[107],
- Not just the asset is transferred "*but also the characteristics of the asset in the hands of the amalgamating company are transferred to the resultant company*"[108],
- In terms of section 44 (4A), the contributed tax capital of the resultant company is based on the contributed tax capital of the amalgamated company. This amount is determined as

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[102] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[103] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[104] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[105] Section 44(6)(d) of the Income Tax Act
[106] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[107] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[108] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)

"*the contributed tax capital of the amalgamated company at the time of termination of its existence multiplied by the ratio of the value of the amalgamated company shares held by shareholders other than the resultant company divided by the total value of all its shares*"[109].

This effectively this ensures that the contributed tax capital of the amalgamated company, to the extent not already attributable to the resultant company, is effectively transferred to the resultant company's contributed tax capital when an amalgamation transaction takes place.

c) <u>Shareholders in the amalgamated company:</u>

Tax implications to the shareholder are as follows:

- The implications of the amalgamation transaction are that shareholders of the amalgamated company will ultimately exchange their shares in the amalgamated company for shares in the resultant company by virtue of the shares held in the amalgamated company and in pursuance of the amalgamation transaction, without incurring tax[110]. Basically, shareholders are deemed to have had a tax free share swap.
- Implications of the relief provisions is as follows (s 44(6)(*a*)(i) and (ii)):
    - "*The shareholder is deemed to have disposed of the equity shares held in the amalgamated company for an amount equal to its tax cost (s 44(6)(b)(i))*"[111]. No gain or loss should arise on the disposal of the amalgamated company shares at the time of the transaction if all conditions are met.
    - *"The shareholder is deemed to have acquired the equity shares in the resultant company on the same date that it acquired the shares in the amalgamated company and for cost equal to the expenditure incurred in respect of the tax cost of those shares in the amalgamated company"*.
- *"An equity shares in the resultant company that is acquired by the shareholder is deemed not to be an amount transferred or applied for the benefit of the shareholder by the amalgamated company (s 44(6)(c))*". Thus, "*no dividend or return of capital will arise*"[112].

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[109] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p759)
[110] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p760)
[111] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p760)
[112] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p760)

- Where a shareholder received part consideration as cash or other assets and equity shares in the resultant company during the amalgamation transaction, section 44(6)(*e*) provides for the apportionment. This is due to cash or other asset being deemed to be an unqualifying asset and as such roll over relief does not apply to this portion of the transaction[113]. An interesting observation is that there is no requirement on what percentage of the consideration must be in equity shares i.e. there are no minimum requirements for the Act to apply which give flexibility in how transactions are structured.

5.4.5. Anti-avoidance provisions in section 44

<u>18 months rule</u>

In terms of section 44(5), where the resultant company disposes of an asset that was acquired through an amalgamation transaction within 18 months of the transaction date, a portion of the gain or loss (calculated as the difference between the market value at the date of the amalgamation transaction and the deemed cost on that date), will be ring-fenced as follows[114]:

- *"A portion of the capital gains may not be set off against capital losses or assessed losses from the current year or carried forward from previous years"*[115],
- "*Losses from trading stock must be deemed to be from a separate trade except for assets that constitute trading stock that is regularly and continuously disposed of by the resultant company in ordinary course of business"*[116],
- *"Recoupments from an allowance asset must also be deemed to be from a separate trade and cannot be set off against any losses made in the current year or brought forward, and*
- *However, such loss can be set off against any gains resulting from a sale of assets that were acquired through the same amalgamation transaction*"[117].

18 months aligns to what is required for other parts of the roll over relief.

5.4.6. Applicable exclusions

In terms of section 44(14), provisions of section 44 do not apply if:

- When the resultant company and shareholder of the amalgamated company are part of the same group of companies as defined and the shareholders, resultant company and the amalgamated company agree in writing that section will not apply.

[113] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p760)
[114] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p536)
[115] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p536)
[116] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p536)
[117] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p536)

- *"The amalgamation transaction constitutes a liquidation distribution as defined in section 47(1)"* and thus section 47 applies[118].
- Where the resultant company is a co-operative or formed for the benefit of the public[119], it is excluded from section 44.
- Where the "resultant company is a CIS in securities and the amalgamated company is not"[120].
- Where the resultant company is a portfolio of a hedge fund investment scheme and the amalgamated company is not[121].
- Association not for gain[122].
- Where "the resultant company is a foreign company and it doesn't have a place of effective management in South Africa"[123]. This is because it will not be an SA company for tax purposes.
- Resultant company's gross income is exempt from income tax in terms of section 10 of the Income Tax Act[124].
- Resultant company is a public benefit organisation[125].

For roll over relieve provisions to apply, the market value of the assets must be higher than the cost.[126] In this case there will be no reason to apply the roll over relief provisions as there will not be any taxable profit and where there are losses, the amalgamating entity will prefer to benefit from utilizing the loss resulting from the transaction as a tax deduction.

5.4.7. Relationship between the Act and other tax legislations in South Africa

5.4.7.1.STTA implications

Section 8 of the STT Act exempts any share transfer that takes place in term of an amalgamated transaction from a securities transfer tax[127]. To qualify for this exemption, the Public Officer of the company must make a sworn affidavit or solemn declaration that section 44 applies to the transaction[128].

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118 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
119 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p539)
120 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
121 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
122 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
123 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
124 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p538)
125 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p539)
126 Section 44(2) of the Income Tax Act
127 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p539)
128 Section 8 of the STTA

5.4.7.2.TDA implications

Section 9 (1) (*l*) exempts any transaction that involves the transfer of a fixed property including shares in a residential property company from transfer duty if the transaction was concluded in terms of section 44 amalgamation transaction[129].

5.4.7.3.VAT Act implications

Section 8(25) of the VAT Act exempts amalgamation transaction done in accordance with section 44 in cases where the transferor and the transferee are VAT Vendors. The VAT Act regards the "two vendors to be one and same person for purposes of goods supplied"[130].

5.4.7.4.Donations tax implications

In terms of SARS binding public ruling 320, transactions that meet the requirements of section 44 are exempt from donations tax[131].

5.4.7.5.Dividend tax implications

Beneficial shareholders of the amalgamated company would be exempt from dividends tax in terms of the section 64FA(1)(*b*) of the Income Tax Act because they would have received a dividend in specie[132].

5.4.8. Companies Act requirements

The overriding companies act requirement is that companies may merge or amalgamate provided that after the merger, each of the amalgamated companies will meet the solvency and liquidity test unless where the transactions are pursuant to a business rescue plan[133].

Discussions:

It is clear that where the transaction is concluded in terms of Section 44 of the Act and it complies with the companies Act, such a transaction will benefit from the Act, the VAT Act,

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[129] Section 9 of the TDA

[130] Section 8 (25) of the VAT Act

[131] SARS, 2019, BPR 320-Conversion of Association to Private Company (p6), Available at https://www.sars.gov.za/legal-counsel/legal-advisory/published-binding-rulings/binding-private-rulings-bprs, [date accessed: 12 April 2021]

[132] Section 64FA of the Income Tax Act

[133] Section 113(6) of the Companies Act

STTA and TDA as all these are harmonized. This is provided the parties to the transaction do not violate the 18th months rule.

6. CHAPTER 6: INTRA-GROUP TRANSACTIONS, UNBUNDLING TRANSACTIONS AND LIQUIDATION, WINDING-UP AND DEREGISTRATIONS

6.1.INTRODUCTION

This Chapter provides a detailed legislative review of Section 45-intra-group transactions, Section 46- Unbundling transactions 47- liquidation, winding-up and deregistration. The analysis covers what the corporate roll over relief provisions seek to achieve for each type of transaction covered above. It will also outline the applicable legislation i.e. VAT Act, Companies Act, Transfer Duty Act, and Securities Transfer Tax Act implications in as far as transactions covered in sections outlined above are concerned.

6.2.Section 45- Intra-group transactions

6.2.1. Introduction

This section involves any intra-group transactions and if these are done in a way that meets the requirements of section 45, they then qualify for roll over relief.

6.2.2. Definitions

The Income Tax defines an intra-group transaction as the one where:

- *"A company disposing of an asset to another company who is a resident company and both companies form part of the same group at the end of the transaction day*[134]*. Where the transferee company retains the nature or use of an asset for what it was used for by the transferor company i.e. where the company was held by the transferor as a capital asset, the transferee holds it as a capital asset and so is the case if the asset was used as a trading stock*"[135].

<u>Discussion</u>

From the definition, it seems that SARS is not concerned with what the nature of the consideration is. The focus seems to be more on the fact that the transaction must be entered into by companies forming the same group and the nature of the asset must be retained. In fact, the companies need only form part of the group at the end of the transaction day.

- Where an asset that constitutes a transfer of an equity share held by the transferor as a capital asset, in a foreign company, is disposed of by that transferor company to the transferee company in exchange of issue of debt or shares other than equity shares by the transferee company[136]. The outcome of the transaction is that the transferee company buys

[134] Section 45(1)(*a*)(i) of the Income Tax Act
[135] Section 45(1)(*a*)(ii) of the Income Tax Act
[136] Section 45(1)(*b*)(i) of the Income Tax Act

the asset as a capital asset provided that immediately before the transaction, and at the end of the day of the transaction[137]:

- Both the transferor and the transferee company must form part of the same group, The transferee company is either is a resident company or a controlled foreign entity in relation to one or more residents that form part of the same group of companies, and the provisions of section 45 apply provided the base cost of the asset under consideration is not exceeding the market value thereof[138].

<u>Discussion</u>
The nature of the asset is prescribed in as far as cross border transactions are concerned and the consideration for the asset is clearly defined and secondly the foreign entity must have formed part of the group immediately prior to the transaction.

6.2.3. Roll over relief provided by section 45 of the Income Tax Act

- Again, like what we have seen in other roll over provisions, implications are that a "capital asset is deemed to have been sold at base cost, trading stock at tax value and no recoupment is applicable in a case of an allowance asset"[139]. Furthermore, if a contract is transferred as part of the disposal as a going concern, any section 24 allowance or any section 24C allowance claimed by the transferor company claimed previously is not claimed back, i.e. not added into taxable income[140].
- Section 45(3A) states that where the transaction is funded by issuance of debt instrument or issuance of shares other than equity shares, the debt or share instrument is issued by a company that forms part of the same group of companies as the transferee or transferor company and such debt or share is issued or used for the purposes of directly or indirectly facilitating or funding the intra-group transaction, the following shall apply[141]:
  - "*The holder of the debt or share instrument is deemed to have acquired the debt or share for an amount of nil*" [142] provided that the holder is part of the same group of companies as the issuer,
  - "*Where the holder receives capital repayment in respect of the debt from a company that forms part of the same group such a repayment doesn't give rise to capital or income gain or receipt*"[143],

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[137] Section 45(1)(*b*)(i) of the Income Tax Act
[138] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p763)
[139] Section 45(1)(*a*)-(*b*) of the Income Tax Act
[140] Section 45(3)(*b*) of the Income Tax Act
[141] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p543)
[142] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p543)
[143] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p543)

- Similarly, *"where repayment in respect of the capital subscribed for the share is received, no capital or income gain is accounted for in respect instances where the amount accrues to the holder from a company which is part of the same group"*.

6.2.4. Anti-avoidance provisions

6.2.4.1.18 months rule

Section 45(5) deals with a situation where the transferee company disposes of an asset it acquired through an intra-group transaction within 18 months of the transaction taking place. The anti-avoidance provision in this section is similar to that applied in the section 42 transaction where it ring-fences a portion of the gains and losses in respect of the assets when realized in the hands of the transferee company if it disposes of the assets within 18 months of the intra-group transaction. This anti-avoidance provision does not apply to involuntary disposals as contemplated in par 65 of the Eighth Schedule. It also does not apply to disposals that would have constituted involuntary disposals if the asset had not been a financial instrument.

6.2.4.2.Degrouping

Introduction

Degrouping refers to instances where companies that formed part of a group of companies as defined cease to be a group. Ceasing of a company to be part of the same group is referred to as the degrouping event[144]. An exception applies, however where the transferor company or the transferee company is liquidated, wound up or deregistered and a resident company (holding company) holds at least 70% of the equity shares of that company, the holding company and the company that is liquidated, wound up or deregistered must be deemed to be one and the same person. This is because the liquidation transaction will be covered in section 47[145].

In terms of section 45(4)(*c*), the effect of this is that the de-grouping event will only occur if the holding company and remaining counterparty to the intra-group transaction cease to form part of the same group of companies.

[144] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p544)
[145] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p544)

Discussion

Section 45 tax relief is premised on the fact that the taxpayers form part of the same economic unit. It is therefore logical that when either of the parties to the intra-group transaction ceases or departs from the group that the relief gets retracted.

Section 45(4)(*a*)(i) outlines the de-grouping rules and these affect a transferee company that acquired an asset in terms of an intra-group transaction. It does not matter how many intra-group transactions an asset has been through, parties who have implemented a transaction in terms of this section will no longer enjoy the benefit of section 45 as soon as they can no longer be considered as a group, thus these degrouping provisions will apply[146].

Application of the degrouping rule

Implications differ per nature of asset dur to the different taxation regimes of different types of assets. Stiglingh, M., et al, (SILKE: 2019) (p765) clearly outlines what rules apply to the transferee company as outlined below:

Capital Asset:

- A deemed capital gain arises and this is calculated as the highest gain that would have been determined for any disposal of the affected asset in the six years preceding the de-grouping event, determined as if the roll-over relief had not applied, capped at the capital gain that would have resulted when using the market value at the de-grouping event. This means though the highest capital gains in the past six years is utilised, it never exceeds the capital gain based on the market value at the de-grouping date[147]. For example, if the capital gain at the degrouping event is R100m whilst the highest capital gain in the past six years is R120m, R100m will be included in the taxable income at the inclusion rate. This provision is therefore not the most punitive and it actually protects the parties involved where the value of the asset is volatile in that where the highest capital gain in the past 6 years is lower than the capital gain at the degrouping event, the lower value will apply.
- When the capital gain worked out above is included in the transferee's taxable income using the appropriate inclusion rate, the base cost is bumped up by this deemed capital

[146] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p765)
[147] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p765)

gain amount. This ensures that the gain is not taxed again when the transferee actually disposes of the asset in future[148].

Allowance asset:

- In this case a recoupment arises and this is calculated as the greatest recoupment that would have been determined in respect of the disposal of the affected asset during the six years preceding the de-grouping event, calculated as if the roll-over relief had not applied. Again, applying a cap that would arise in using the market value at the de-grouping event[149].
- If the asset is an allowance asset, the cost or value on which allowances are based is also increased by 50% of the calculated profit. Therefore, future tax value indicates that the tax relief was retracted and avoid double taxation[150].
- The rules under an allowance asset also apply to trading stock acquired by the transferee entity in terms of this section of the Act. However, these rules do not apply with regard to trading stock that was acquired in accordance with this section of the act if such trading stock is regularly and continuously disposed of by the transferee company[151]. This is probably because the entity trades in such stock in ordinary course of business and that it will be unreasonable to expect the transferee entity to hold the asset for a long period.

6.2.4.3. Disguised sales transactions

This provision is aimed at curbing schemes where provisions of section 45 are used to transfer an asset for cash while abusing the provisions of this section. These are dealt with as follows:

- Where a scheme of arrangement includes disposing part of the form of consideration to an external party-in terms of section 45 (4B), a de-grouping event is "*deemed to take place if the intra-group transaction forms part of a transaction, scheme or operation in terms of which the consideration received or accrued in respect of the intra-group transaction, or more than 10% of any amounts derived directly or indirectly from such consideration is disposed of by the transferor (or other company that forms part of the same group of companies as the transferor), within 2 years of the intra-group transaction, to a*

[148] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p765)
[149] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p765)
[150] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p765)
[151] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p765)

person outside the group of companies for no consideration, non-arm's length consideration or in the form of a distribution"[152].

The key consideration here is that the disposal by the transferor needed to either be at no consideration or at an amount that is not arm's length therefore degrouping will not apply where these prerequisites are not met.

- Section 45(3A)(*a*) and (*b*) state that where the consideration for assets is a share other than an equity share and debt, the tax value of this consideration is nil. This therefore implies that if the transferor was to sell such instrument outside the group, the tax value would be zero and capital gain of revenue profit will arise when anti-avoidance provisions are triggered[153].

6.2.5. Exclusions

Provisions of this Act do not apply in the following instances:

- At the time of the disposal, parties to the transaction agree in writing that section 45 of the Act should not apply as provided for in section 45(6). Again, this may be driven by the tax position of the transferor company e.g. the transferor company may have tax losses it wishes to set-off against gains that will result from this transaction[154],
- To avoid the burden of the onerous anti-avoidance rules relating to these types of transactions, some of which apply for up to six years from the date of the transaction[155],
- In cases where all the receipts and accruals of the transferee are exempt from tax on one of the following bases[156]:
    - "*An entity contemplated in s 10(1)(cA)*
    - *An approved public benefit organisation (s 10(1)(cN))*
    - *It is an approved recreational club (s 10(1)(cO))*
    - *It is a retirement fund, benefit fund or other entity contemplated in s 10(1)(d)*

[152] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p767)
[153] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p767)
[154] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[155] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[156] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)

- *It is an entity contemplated in s 10(1)(t)"*[157].

- "*The asset was disposed of by the transferor company in exchange for equity shares issued by the transferee company*" (s 45(6)(*c*)) as this would make it an asset for share transaction. This exclusion ensures that there is no overlap between the relief is s 45 and the relief in s 42[158].
- "*The asset constitutes a share that is distributed by the transferor company to the transferee company*" (s 45(6)(*d*)). This exclusion ensures that there is no overlap between the relief in ss 45 and 46[159].
- "*The asset was disposed of by the transferor company to the transferee company in terms of a liquidation distribution*", as contemplated in s 47, this exclusion applies irrespective of whether the relief applied or of the purpose for which the transferee company acquired the asset (s 45(6)(*e*)). This exclusion ensures that there is no overlap between the relief in s 45 and 47[160].
- "*The asset constitutes a share in the transferee company*" (s 45(6)(*f*)). This exclusion ensures that the relief does not apply to a share buyback transaction[161].

6.2.6. Relationship between Income Tax Act and other tax legislations in South Africa

6.2.6.1. Donations Tax

Section 56 (1) (*r*) of the Income Tax Act exempts a donation from donations tax if the donor and the recipient are members of the same group of companies and the recipient is also a South African resident company[162]. The observation here is that this exemption would not apply in cases where a foreign entity is involved.

6.2.6.2. Dividend Tax

South African registered entities are generally exempt from dividends tax. Over and above the general exemption, section 64(F)(1)(*a*) and section 64(F)(1)(*b*) exempts companies from dividends tax where companies are part of the same South African Group[163].

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[157] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[158] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[159] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[160] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[161] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p769)
[162] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p547)
[163] Section 64 of the Income Tax Act

6.2.6.3. STTA

Security transfer transactions concluded in terms of a section 45 intra-group transaction enjoy an STT exemption in terms of section 8 of the STT Act[164].

6.2.6.4. Transfer duty

Section (9)(1)(*l*) of the Transfer Duty Act exempts any transfer of fixed assets (including a transfer of shares in a residential property company) from transfer duty if the transaction is concluded in terms of section 45- Intra-group transaction[165].

For both transfer duty and STT exemptions to apply, the Public Officer must make a sworn affidavit or solemn declaration that section 45 applies[166].

6.2.6.5. VAT Act

Qualifying intra-group transactions are not subject to VAT in terms of section 8(25) where the following conditions are met:

- Where such goods and services are being transferred as part of the enterprise as a going concern[167].
- The supplier and recipient have agreed in writing that section 8(25) must apply[168]

In this case then the transferor and transferee will be deemed to be one and the same person and such the transaction will be deemed to be a non-supply for VAT purposes[169].

<u>Discussion:</u>

The requirement for a good or service to form part of a going concern limits transactions that can benefit from the exemption from the VAT Act. For instance, where one company in a group transfers a property which it utilized as an owner-occupied property to another fellow subsidiary that will use the asset to generate rental income, this transaction will not qualify for VAT exemption because the asset is not transferred as part of a going concern. For exemption to apply, the asset needs to have been transferred as a business meaning that the transferor must have had tenants and transfer the asset with the business. In this case, it was found that the

[164] Section 8 of the STTA
[165] Section 9 of the TDA
[166] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p547)
[167] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p548)
[168] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p548)
[169] Section 8 of the VAT Act

transaction did not qualify for exemption and thus the transaction was a vatable transaction. This disadvantages groups in that they either have to conclude such transfers at a nominal amount to avoid VAT which on its own has negative accounting or financial consequences for the stand-alone group entities or incur VAT in the process which is inefficient from a group perspective.

6.3.Section 46- Unbundling transactions

6.3.1. Introduction

Unbundling in general terms involves a process of selling off or spinning off some of its assets that may be non-core assets, product lines, divisions, or subsidiaries. The goal is normally to create a better-performing company by creating focus in products or operations thus unbundling may also refer to offering products or services separately that had previously been bundled together.

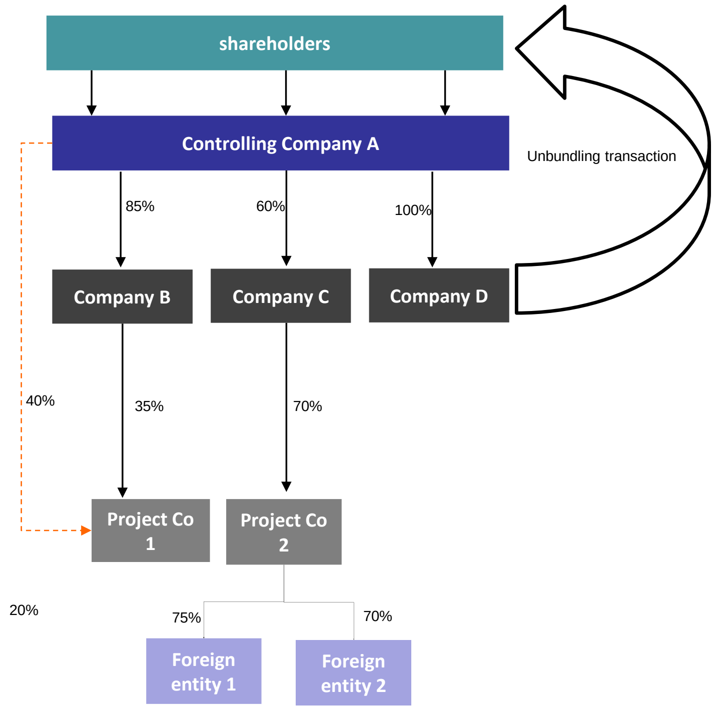
6.3.2. Definition

For tax purposes, unbundling is described as a situation where a company (unbundling company) offloads its entire equity shareholding in one of its subsidiaries (an unbundled company) to its shareholders in accordance with the effective shareholding of the unbundled company. The purpose of an unbundling transaction is "to enable the shareholders of any listed company of a group of company shareholders of unlisted company to acquire directly, by way of a dividend, *in specie*, all the equity shares held by the listed or unlisted company"[170].

The structure below illustrates the concept:

[170] Section 46(1) of the Income Tax Act

Figure 4: Unbundling transaction structure



Notes:

As per above, company A is the unbundling company and company D is the unbundled company. Company A is distributing its shareholding in company D to its own shareholders.

Like most of the roll over provisions, the definition covers two scenarios a) both the unbundling company and the unbundled company are South African resident companies b) the unbundling company is a South African resident or a controlled foreign entity however the unbundled company is a foreign company.

6.3.2.1.Domestic unbundling transaction

A domestic unbundling transaction occurs if the following requirements are met:

- "*A resident company (unbundling company) makes a distribution*"[171].
- "*The distribution consists of all the equity shares that the unbundling company holds in another resident company (unbundled company)*"[172].

[171] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)
[172] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)

- "*The distribution of the equity shares in the unbundled company is made to any shareholder of the unbundling company in accordance with its effective interests in the unbundling company"*[173].
- *"The distribution is made in one of the following circumstances*"[174]:

"*All the equity shares of the unbundled company are listed on a South African exchange or will be listed on a South African exchange within 12 months of the unbundling transaction; the shareholder to which the distribution is made forms part of the same group of companies as the unbundling company, or the distribution is made in pursuance of an order by the Competition Tribunal or the Competition Appeal Court"*[175].

Discussion

It is clear from the definition above that when it comes to the unbundling of unlisted shares, this section only applies where the shareholders to whom the shares are distributed to, are companies as there is a requirement for the shareholder to form part of the same group.

- In terms of section 46 (1)(*a*)(ii) of the Act, equity shares in the unbundled company constitute a substantial shareholding in one of the following ways:
    - *"Equity shares distributed represents more than 50% of the equity shares of the unbundled company, where the unbundled company is not a listed company immediately before the distribution"* [176].
    - *"The threshold depends on whether any other person holds the same or more shares than the unbundling company where the unbundled company is a listed company immediately before the distribution. Where another person holds the same number of shares or more than the unbundling company, the equity shares distributed must be more than 35% of the equity shares of the unbundled company. Otherwise, the equity shares distributed must be more than 25% of the equity shares of the unbundled company*"[177].

6.3.2.2. Cross-border unbundling transaction

In terms of section 46(*b*)(i), the following requirements must be met:

- *"Equity shares in a foreign unbundled company are held by – a resident company, or – a controlled foreign company (unbundling company)*[178].

[173] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)
[174] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)
[175] Section 46(*a*)(i)(aa)-(bb) of the Income Tax Act
[176] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)
[177] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p768)
[178] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p769)

- *Immediately before the distribution, the unbundling company holds more than 50% of the equity shares of the unbundled company and all the shares are held as capital assets*[179].
- *All the equity shares in the unbundled company that are held by the unbundling company are distributed to any shareholder of the unbundling company in accordance with its effective interests in the unbundling company*[180].
- *The shareholder to whom the distribution is made: – is a resident and forms part of the same group of companies as the unbundling company as defined, or – is not a resident, but is a controlled foreign company in relation to any resident that forms part of the same group of companies (per definition in section 1 of the Income Tax Act) as the unbundling company"*[181].

In summary, the following transactional scenarios are envisaged in section 46:

- Unbundling of listed shares of an unbundling company
- Unbundling of unlisted shares of an unbundled company
- Unbundling that is pursuant to an order in terms of Companies Act, made by the Competition Tribunal or Competition Appeal Court.
- Distribution to shareholders must be in accordance with the effective interest held by shareholders in the unbundling company. Therefore, should the distribution not mirror the effective shareholding, then it would not fall within the ambit of this section of the Act.

6.3.3. Roll over relief provided by section 46 of the Income Tax Act

Tax relief can be divided into that which is provided to the unbundling company and what is provided to its shareholders.

6.3.3.1.Tax relief provided to the unbundling company

The income tax implications of an unbundling transaction for the unbundling company that distributes the shares it holds in the unbundled company are normally as follows:

- In terms of section 46(2), recoupment or capital gain that would normally result in the hands of a transferor during the sale of assets would not apply[182].

[179] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p769)
[180] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p769)
[181] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p769)
[182] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p769)

- In terms of section 46(3A)(*a*), the contributed tax capital of the unbundling company will be reduced proportionately to reflect the unbundled value. It should be by applying the ratio between the value of the unbundling company shares immediately after the unbundling transaction relative to the value of its shares immediately before the distribution[183].
- Furthermore, in terms of section 46(5), the distribution made in terms of the unbundling transaction are dividends in specie and thus must be disregarded for the purposes of dividends tax[184].

6.3.3.2. Tax relief provided to shareholders of the unbundling company

The income tax implications of an unbundling transaction in the hands of the shareholder that acquires the shares in the unbundled company are:

- The shareholder is to replace the portion of the tax cost of the shares held in the unbundling company to the shares that it receives in terms of the unbundling transaction. The same apportionment of any valuation obtained for the unbundled company shares for CGT purposes is required[185].
- In terms of section 46(3)(*a*)(i) and (v), the following ratio is applicable in apportioning the shares of the unbundling company in the unbundled company[186]:

  "*market value of the unbundled company shares at the end of the day/ sum of the market values of the unbundled company and unbundling company shares at the end of that day*"

- In terms of section 46(3)(*a*)(iv)), "*the expenditure is deemed to have been incurred the same date the shareholder would have acquired the unbundled company*". Section 46(3)(*a*)(ii) states that this does not apply "*when determining whether the unbundled company is a qualifying share for purposes of the three-year holding period in accordance with section 9C*"[187].
- Section 46A states that if the unbundling company shares were acquired by the shareholder "*during the two-year period preceding the unbundling from a connected person in whose hands any amount is received in respect of the disposal of the shares was not subject to tax*", a

[183] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p770)
[184] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p770)
[185] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p770)
[186] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p770)
[187] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p770)

limitation applies in respect of the expenditure to which the above allocation rules apply. This is to ensure that the expenditure is not inflated[188].

- The shareholder must retain the nature of the asset as it was held in the unbundled company hands. In other words, shares that were capital in nature must retain their nature and so is shares held as trading stock. This is in line with section 46(3)(*a*)(iii)[189].
- Implications of the above provisions is that there will not be any capital gain or dividends tax implications due to section 46(5A) of the Act being applicable to the transaction[190].

6.3.4. Anti-avoidance provisions

This section seems to be focused on the unbundling transaction itself. There is no 18 months rule and thus the shareholder has a flexibility to do whatever it wants with the share after the unbundling transaction. It goes without saying that normal tax rules will apply to the return that may arise in any transaction post the unbundling process.

However, as pointed out by Nyasha Musviba in her article dated June 2019, "*section 46(3)(a)(v) of the Act neutralises the tax value discrepancies which may occur by requiring that share value ratio be based on market values of the unbundled unbundling shares, at the end of the day that the distribution takes place*"[191].

6.3.5. Exclusions

Provisions relating to unbundling transactions do not apply in the following instances:

- In terms of section 46(6A), where an *"unbundling company is a REIT or a controlled company as defined in section 25BB"* i.e. REIT subsidiary as defined by IFRS[192].
- In terms of section 46(7)(*a*), unbundling rules cannot apply where *"immediately after the distribution of shares in the unbundled company, 20% or more of those shares are held by a disqualified person"* and in calculation the 20%, holdings of other disqualified persons connected to the disqualified person must be taken into account. Disqualified person is defined as follows[193]:

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[188] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p771)
[189] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p771)
[190] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p771)
[191] Musviba, N., 2019, *SARS issues binding class ruling regarding unbundling transaction,* Available at https://www.sataxguide.co.za/sars-issues-binding-class-ruling-regarding-unbundling-transaction, [date accessed: 29 April 2021]

[192] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
[193] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)

- "*A non-resident person*[194],
- *The government of South Africa in national, provincial, or local sphere as contemplated in section 10(1)(a)*[195],
- *A public benefit organisation as defined in section 30 that has been approved by the commissioner*[196],
- *A recreational club as defined in section 30A, as approved by the Commissioner,*
- *Closure rehabilitation company or trust*[197],
- *Certain public entities as contemplated in section 10(1)(cA)*[198]

- *In terms of section 46(8), provisions of section 46 will not apply where an unlisted unbundling company disposes of shares in an unlisted unbundled company to a shareholder that forms part of the same group as the unbundled company (immediately before or after the transaction) and the shareholder and the unbundled company agree in writing that section 46 will not apply"*[199].

6.3.6. Relationship between Income Tax Act and other tax legislations in South Africa

6.3.6.1. Donations Tax

Because in transactions that fall within the ambit of section 46, shareholders are getting the same value which they held in the unbundled company through the unbundling company prior to the transaction, there is no element of donation and thus donations tax is irrelevant.

6.3.6.2. Dividend Tax

Section 46(5) states that where shares are distributed by an unbundling company to a shareholder in terms of an unbundling transaction, the distribution must be disregarded for dividends tax purposes as this then falls within the definition of a dividend in specie[200].

6.3.6.3. STTA

In terms of section 8(1)(*a*) of the STT Act, Security transfer transactions concluded in terms of section 46 unbundling transactions, is exempt from STT provided "*the Public Officer of the company makes a sworn affidavit or solemn declaration that section 46 applies to the transaction*"[201].

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194 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
195 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
196 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
197 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
198 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)
199 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p552)
200 Section 46(5) of the Income Tax Act, Phillip Haupt, 2017. Notes on South African Income Tax (p551)
201 Section 8 of the STTA, Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p551)

6.3.6.4. TDA

The unbundling transaction in terms of section 46 does not involve the transfer of asset and thus transfer duty is not applicable.

6.3.6.5. VAT Act

The distribution of shares to shareholders of the unbundling company would constitute a financial services transaction which is exempt for VAT purposes in terms of section 12 of the VAT Act[202].

6.4.Section 47- Liquidation, winding up and deregistration- Liquidation distribution

6.4.1. Introduction

Companies are sometimes set up for a specific purpose or transaction i.e. special purpose vehicles (SPV) for example where an asset is set up to preserve funding or operations from being affected from the performance of the rest of the group. Thus, when the purpose has been served which may in certain instances mean the end of a project life for a project that was ring-fenced, the company becomes redundant. In order to reduce company administrative costs such as audit, CIPC annual return fees, the holding company may decide to liquidate and deregister such SPV. In the process of liquidation, the company can decide to either transfer assets to the shareholders of the company or sell them. If the company decides to transfer assets to the shareholders of the company as a result of the liquidation, winding-up or deregistration of a company may in some instances be done in a tax neutral manner using the corporate rules if the transfer is done in terms of a liquidation distribution.

6.4.2. Definition

Definition is broken down into a liquidation involving a domestic company and a liquidation which involves cross border transactions.

<u>Domestic liquidation distribution as per section 47(1)(*a*)</u>

In the case of a domestic or residential company, a transaction is a liquidation distribution in terms of section 47 of the Act if all the following requirements are met:

- "*A resident company (liquidating company) disposes of all its assets*[203].
- *The assets are disposed of by the shareholders of the company in anticipation of or in the course of the liquidation, winding-up or deregistration of the company*[204].

[202] Section 12 of the VAT Act
[203] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p553)
[204] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p553)

- *The transaction is however, liquidation distribution to the extent that the assets are disposed of to another resident company (holding company) that forms part of the same group of companies as the liquidating company on the date of the disposal"*[205].

<u>Discussion:</u>
For this section only applies when companies are involved. It doesn't apply to an individual or other person who don't qualify as companies in terms of the Companies Act. This therefore means that a Trust and Partnership would not qualify for this section to apply.

<u>Cross-border liquidation distribution as per section 47(1)(*b*)</u>

In a cross-border context, a transaction is a liquidation distribution if all the following requirements are met:

- *"A controlled foreign company in relation to a resident dispose of all its assets, other than those used to settle debts that arose in the ordinary course of its business, and anticipated liabilities and administration costs relating to its liquidation or winding-up*[206].
- *The assets are disposed of by the shareholders of the company in anticipation of or in the course of the liquidation, winding-up or deregistration of the company*[207].
- *Immediately before the disposal, each of the shares in the liquidating company that is held by the holding company is held as a capital asset*[208]*. The transaction is, however, only a liquidation distribution to the extent that the assets are disposed of to one of the following companies (holding company)*
    - *a resident company that forms part of the same group of companies in terms of the wider definition of group of companies as defined in section 1 of the Income Tax Act, as the liquidating company on the date of the disposal*[209]*, or*
    - *a controlled foreign company in relation to any resident and, immediately after the transaction, more than 50% of the equity shares of the holding company are held by a resident"*[210].

6.4.3. Tax relief provided in relation to liquidation distribution in terms of section 47 of the Income Tax Act

The relief measures can be broadly categorized to those that apply to the liquidating company and the holding company/recipient of dividend in specie .

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205 Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p553)
206 Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p773)
207 Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p773)
208 Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p773)
209 Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p773)
210 Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax,* Lexis Nexis Publishers: Durban (p773)

- The income tax implications of a liquidation distribution for the liquidating company that disposes of its assets to the holding company are as follows:

- o In terms of section 47 (2) and 47 (3), *"no gain in relation to trading stock and no capital gain in terms of a capital asset or recoupment arise in the hands of the liquidating company as a result of application of the roll-over mechanism described in this section"*[211].

- In general, the roll over relief principles stated in section 47(2) and 47(3) are such that "*the holding company and the liquidating company are deemed to be one and the same company*"[212]. The following specific tax implications arise for the Holding company:
  - o "*The tax cost or base cost of the asset in the hands of the holding company is based on the tax cost or base cost of the asset in the hands of the liquidating company,*
  - o *The holding company is assumed to have bought the asset the same date the asset was bought by the liquidating company*,
  - o *In addition, the characteristics of the asset in the hands of the liquidating company are transferred to the holding company*". These include the date of acquisition, the amount and date of incurral of any expenditure, any valuation of the asset as at valuation date. The same principles apply in the case of an allowance asset.
  - o In terms of section 47 (5)(*a*), the holding company must disregard the disposal of the shares held in the liquidating company as a result of the liquidation, winding-up or deregistration of that liquidating company when determining its taxable income, assessed loss or aggregate capital gain or capital loss.
  - o In terms of section 47 (5)(*b*), It must similarly disregard any return of capital by way of a distribution of cash or an asset in specie by the liquidating company in anticipation of or in the course of its liquidation, winding-up or deregistration.
  - o As per section 47(3A), section 47 applies to the disposal of an asset by a liquidating company to its holding company to the extent that equity shares held by the holding company in the liquidating company are disposed of as a result of a liquidation and the holding company doesn't assume debt in the liquidating company which was incurred within 18 months before the disposal to the holding company.
  - o It should be noted that however debt that occurred within the 18 months period is acceptable if debt results from refinancing of older debt or it arose in ordinary course of business and it was transferred as part of a going concern.

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[211] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p774)
[212] Stiglingh, M., Koekemoer, A.D., van Heerden, L. Wilcocks J.S. & van der Zwan, P, 2019, *SILKE: South African Income Tax*, Lexis Nexis Publishers: Durban (p774)

6.4.4. Anti-avoidance provisions

6.4.4.1.18 months rule

- In terms of section 47(4)(*a*), the capital gain that would have arisen had the asset been sold at its value at the beginning of the 18 months will not be set off against capital losses or assessed losses of the holding company, except where capital losses arise from other assets disposed in terms of the liquidation[213].
- Similarly, any losses that would have arisen had the asset been sold for its value at the beginning of the 18 months is to be disregarded[214].
- Section 47(4)(*b*) deals with trading stock or allowance assets and in terms of this section in that any profit or recoupment that would have arisen had an asset been sold at its value at the beginning of the 18 months, is treated as if it relates to a separate trade and as such it cannot be set off against any assessed losses or balance of assessed loss of the holding company, except where such trading stock constitute trading stock that is regularly and continuously disposed by the holding company[215].
- It must be noted however that such gain can be set off against gains made from sale of other assets that were acquired in terms of the distribution, provided such sales are made in the same year when the losses are incurred or in the later year of assessments.

6.4.5. Exceptions

Provisions of this section do not apply where the following is true:

- *"The holding company is a public benefit organisation as defined in section 30 and it has been approved by the Commissioner in terms of that section, a recreational club in terms of section 30A and an entity contemplated in section 10(1)(cA)(cP)(d)(e) or (t)"*
- *"The liquidating company has not taken the steps to liquidate, windup or deregister the company after 36 of the transaction occurring, or has taken steps to invalidate steps taken to liquidate, wind up or deregister the company"*

6.4.6. Relationship between Income Tax Act and other tax legislations in South Africa

6.4.6.1. Donations Tax

This section relates to a distribution to the holding company, no asset is being sold for a consideration less than its value and therefore no donations tax is applicable.

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[213] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p554)
[214] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p554)
[215] Haupt, P, 2017, *Notes on South African Income Tax,* Hedron Publishers, Cape Town (p555)

6.4.6.2. Dividend Tax

Distribution normally raises dividends tax. In instances of a liquidation distribution, it can be in cash or a dividend in specie and these have different tax implications as outlined below.

Cash distributions out of profits

- Cash distributions paid out of profits to shareholders are treated as dividends and attracts dividends tax at the rate of 20%, however, it will be exempt from dividends tax in terms of section 64F(1)[216] of the Act if the beneficial owner which in this case is the holding company, is a company that is a South African resident.
- Dividend received by the holding company referred to in the paragraph above, is exempt from normal tax in terms of section 10(1)(*k*)(i)[217] of the Act in the holding company's books.

Cash distributions out of share capital against a share that is held as a capital asset

- Cash distributions made to shareholders out of the share capital is treated as a return of capital and the liquidating company is required, in terms of paragraph 76(4) of the Eighth Schedule to the Income Tax Act, to notify the holding company in writing what the amount of the liquidation distribution constitutes a return of capital. "*And in terms of paragraph 76B(2)*[218]*, the base cost of the share held by the shareholder should be reduced by the amount of the return of capital received or accrued,*
- *if the return of capital exceeds the base cost of the share, paragraph 76B(3) provides that the difference between the base cost and the return of capital received will be regarded as a capital gain in determining the aggregate capital gain or aggregate capital loss of the shareholder for the year of assessment in which that return of capital is received by or accrues to the holder of that share*"[219].

Cash distributions out of share capital against a share that is held as a trading stock

- Cash distribution made to shareholders out of share capital will still be treated as a return in capital, however as Alexa Muller rightfully points out in her article: South Africa: The Income Tax Implications Of A Return Of Capital (12 October 2017)[220],

[216] Section 64(F)(1) of the Income Tax Act
[217] Section 10(1)(*k*)(i) of the Income Tax Act
[218] Paragraph (76) of the Eighth Schedule of the Income Tax Act
[219] Section 76B of the Income Tax Act
[220] Muller, A., 2017, *South Africa: The Income Tax Implications Of A Return Of Capital*, Available at https://www.mondaq.com/southafrica/capital-gains-tax/636592/the-income-tax-implications-of-a-return-of-capital, [date accessed: 25 April 2021]

there isn’t a clear provision dealing with return of capital for shares held as trading stock. Alexa argues that because any contributory tax capital would represent gross profit in the hands of the holder of such shares and that the provisions of paragraph 76(4) of the Eighth Schedule would result in a deduction from the base cost and thus resulting in double taxation, it is thus logical to accept that the following tax implications should arise in terms of general South African tax principles:

“the shareholder should reduce the tax cost at which the relevant share is held by the amount or value of the capital received by or accrued to them. To the extent that the return of capital exceeds the tax cost of the relevant share in the hands of the shareholder, such excess should be included in the gross income of such shareholder”

The above application sounds reasonable so as Income Tax Act implications don’t result in double taxation.

Distribution of assets

- The distribution of an asset to a shareholder is treated as a dividend *in specie*. Section 64FA(1)(*b*) of the Act provides a dividends tax exemption if the beneficial owner of a distribution of an asset *in specie* forms part of the same group of companies as defined in section 41 of the Income Tax Act[221],
- The dividend *in specie* received by the holding company from the liquidating company will therefore be exempt from normal tax as it fits this definition.

The summary of the dividend tax implications is that there is no roll over relief for cash distribution. Where cash is distributed out of profit normal dividend rules apply and where it is distributed out of share capital, it may result in capital gains tax or normal tax depending on whether the share resulting in this dividend was capital in nature or trading stock.

6.4.6.3. STTA

Per section 8(1)(*a*)(v) of the STT Act, no securities transfer tax will arise on the transfer of the shares for transactions that take place under the ambit of section 47 of the Act[222]. Furthermore, implications of paragraph 11(2)(*b*)(i) of the Eighth Schedule to the Act is that “*the transfer from*

[221] Section 64 FA of the Income Tax Act
[222] Section 8 of the STTA

the subsidiary to the holding company and the subsequent cancellation of the shares so received by that company will not constitute a disposal"[223].

6.4.6.4. TDA

Liquidation distribution done in terms of section 47 of the Act does not attract any transfer duty in terms of section 9(l) of the TDA[224].

6.4.6.5. VAT Act

Section 8(25) of the VAT Act provides that where any goods or services are supplied by a vendor to another vendor, those vendors must for purposes of that supply or subsequent supplies of those goods or services, be deemed to be one and the same person provided the provisions of section 47 of the Income Tax Act are complied with[225].

Discussion

Other tax legislations allow for roll over relief; however, dividend tax only provides partial relief i.e. where an asset is distributed and not when cash is distributed as this attracts normal dividend. Whilst the distribution from profit may still qualify for exemption under section 64F(1), the distribution from capital results in tax implications however one can argue that this is fair because return of capital it is almost like partial disposal of shares.

[223] Paragraph 11(2)(*b*)(i) of the Eight Schedule to the Income Tax Act
[224] Section 9 of the TDA
[225] Section 8(25) of the VAT Act

7. CHAPTER 7: CONCLUSION

Overview of roll over relief provisions

7.1. <u>Asset for Share Transactions</u>

Provisions of section 42 of the Income Tax Act provide an effective way of allowing not only group companies but also companies outside the group umbrella to transfer assets to each other on a tax neutral basis. Firstly, the scope is reasonably wide where South African residents transfer to each other because there is no requirement to be part of the same group before the transaction is concluded thus allowing entities that were not relating to each other to become part of the transaction as long as a qualifying interest and other detailed provisions contained in the section are met.

Secondly, there is no restriction in whether a legal entity or an individual transfers asset and thus giving a flexibility to individuals to move assets to legal entities in exchange for equity. This section is basically a tool that allows a person who wants to invest their assets in a different structure with a long-term view of longer than 18 months, the flexibility to move assets around.

The scope involving foreign entities is limited in that entities involved must form part of a group of companies before the transaction takes place and that the asset involved is an equity share held in another foreign entity, which is held as a capital asset. This appears to be very limited in nature and this is a common theme in corporate rules. For example, it does not allow companies or individuals to move local assets to foreign entities in exchange of shares and thus if a person's objective is to externalize their assets, they have to look at other avenues.

While there are limitations, this section provides a good tool for entities that meet the definition of the group to restructure their businesses.

Whilst section 42 provides relief, relief is also provided by the STTA, TDA. Donations tax will still apply and the VAT Act requires that the disposed of asset must be enterprise or part of an enterprise which is capable of separate operation or be disposed of as part of a going concern which is more stringent.

7.2. Amalgamated transactions

Provisions of section 44 of the Income Tax Act provide an efficient opportunity for local companies to restructure themselves as long as all assets are transferred with an exception of adequate assets to settle liabilities and cover liquidations and that the amalgamated company is terminated in the end. The scope of local transactions is again wide with companies not having to have a specific relationship before the transaction. With foreign entities, not only do they have to form part of the same group before the transaction but they are also allowed a shorter period to liquidate and deregister the company compared to local entities. Relief provisions in amalgamated transactions are similar to those of an asset for share transaction.

In this instance roll over relief is also provided by the VAT Act without additional requirements as long as parties to the transaction are VAT vendors, STTA, TDA, donations Tax and dividend tax.

7.3. Intra-group transactions

Section 45 appears to have been introduced in order to cover instances where assets are sold in exchange of shares that are not equity shares and the transferee company assuming debt. The scope of this section is however narrow in that the transferor needs to be a company and it must form part of the same group of companies with the transferee. Parties that are not a group cannot utilize this section. Parties enjoying this roll over provision must also be prepared for a six-year investment because anti-avoidance provisions cater for a six-year period.

In order for relief to be provided from the VAT Act, the asset must have been transferred as part of a going concern which again makes the provisions stringent. There is however, alignment between this section of the Act and other taxation legislations such as donations tax, dividend tax STTA and TDA.

7.4. Unbundling transactions

Provisions of section 46 apply in an unbundling transaction implementation. Once the transaction has been implemented, shareholders are free to do whatever they see fit as there is no anti-avoidance rule that requires minimum holding term. Thus, shareholders may dispose of the shares, however normal tax consequences will apply to that disposal.

Donations tax and TDA are not applicable in these types of transactions, however no VAT arises, no dividend or STT.

7.5. Liquidation distribution

This section allows a subsidiary to move its assets through distributing all its assets as a dividend in specie, to its holding company in a tax neutral basis. This allows companies to remove conduit companies that are no longer of any use in the holding structure and then liquidate the company that is of no use any longer.

The STTA, VAT Act, TDA and dividend tax is aligned to this section the Act. Donations tax is not applicable.

Advantages and disadvantages of a group taxation system

The following advantages and disadvantages have been identified through the literature review:

7.6. Advantages of having a group taxation system

a) Simple to administer for both the state and companies.

b) The country is lagging behind industrial countries and therefore less investor friendly. Implementing group taxation will allow the country to move towards being more investment friendlier country which will grow the economy.

c) Doing away with many anomalies introduced by lack of group taxation system. Lack of group taxation can result in a number of anomalies which would not exist if the group was treated as a single economic unit and intra-group transactions were eliminated:

- The obvious one is that a group could be making losses on a consolidated basis, however, some group companies are in a profit-making position and therefore liable for tax.
- Some intra-group transactions may create additional anomalies as identified in detail by J.S. Wilcocks & S.N. Middelmann (Evaluation of the need to introduce a system of group taxation in South Africa, 2004) (25 June 2021):
  - **The timing mismatches of income and expenditure between group companies:** Where one entity in the group advances payment to a fellow subsidiary for services to be rendered in the following year of assessment. Such advanced payment will be recognised as in come provided it meets the definition of gross income in the company receiving it while limited deduction will be allowed in terms of Section 23H given that the expenditure relates to

services still to be rendered. This would not be the case if consolidation is allowed because such transactions will be eliminated[226].

- **The taxability versus timing of deductibility mismatches due to capital versus revenue differences of the same transaction[227]:** In the instance where one of the group companies specialises in manufacturing of certain manufacturing equipment which is then sold to the fellow subsidiary in the group, the seller will recognise income in the year of sale as it is revenue in nature while the buyer would have to capitalise the asset and deduct tax allowances over the Five (5) years in terms of section 12c. This creates a timing difference and worse so if the Income Tax Act allows no tax allowance deductions for a particular asset, in that case proceeds income would be taxed in the seller whilst no deduction is allowed in the hands of the acquirer.
- **A shift of income and expenditure between taxable and loss-making entities[228]:** Management may engage in financial engineering the result of which would be an introduction of income to a loss-making entity within the group for the utilisation of assessed losses that may exist in that company. The common one in practice is the shifting of income through management contracts.

Schemes implemented must, however pass the anti-avoidance provisions contained in Section 103(1&2) of the Income Tax Act. Section 103 (1) allows the Commissioner to set aside, for the purposes of calculating tax, any transactions that have not been entered 'in a manner which would not normally be employed for bona fide business purposes' [229], whilst Section 103 (2) prohibits the utilisation of an assessed loss in a company by introducing income into that company through an agreement or any change in shareholding in a company solely or mainly for the purpose of utilising any assessed loss, any capital loss or any assessed capital loss. However, section 103(2) only applies when the change of shareholding or an agreement is carried or entered into

[226] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*: Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]
[227] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*: Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]
[228] Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*: Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021])
[229] Section 103 (1) of the Income Tax Act

solely or mainly to utilise the assessed loss and thereby to reduce or avoid tax. Therefore, if it can be proven that a company was acquired or an agreement was entered into for good commercial reasons and that the setting-off of income against the assessed loss was merely incidental to the main purpose, section 103(2) does not apply[230].

All the above can be avoided where group taxation is allowed.

7.7. Disadvantages of having a group tax system

a) It may result in less money for the fiscus, companies are assessed on a consolidated basis and thus companies that would have ordinarily paid tax if assessed independently may not be taxed on a group basis because income would have been netted off with loss making businesses.

7.8. Conclusion

There is no real group taxation in South Africa except in limited instances outlined in sections 42, 44-47 with very strict rules to be adhered to. The relief provided therein is retracted where entities that formed part of the group, cease to be part of that group or an asset is subsequently sold to other parties outside the group. It can however be noted that the tax legislation is harmonized throughout in that transactions that qualify for relief are also exempt from STTA, TDA and dividend tax. In certain instances, like an asset for share transaction, donations tax is still applied whilst requirements from the VAT Act makes it difficult to qualify for VAT relief in both the asset for share transaction and intragroup transactions. Perhaps starting off making sure that donations tax is exempt for section 42 and removing the requirement for assets to be transferred as a going concern or separate enterprise from the VAT Act in terms of sections 42 and 45 would assist in ensuring that entities benefit from total relief from the current limited relief provisions.

Based on literature reviewed, one can conclude that it will be more advantageous for the country to move towards a group taxation system. The overall implication of lack of group taxation system is that companies invest significant resources to implement financial

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[230] Section 103 (2) of the Income Tax Act; Wilcocks, J.S. & Middelmann, S.N., 2004, *Evaluation of the need to introduce a system of group taxation in South Africa*: Available at https://repository.up.ac.za/handle/2263/14475, [date accessed: 25 June 2021]

engineering strategies that will enable them to be as tax efficient as possible within the group. The tax efficient status that companies seek is to be as close as possible to the practical tax base of the group i.e. what would have been achieved if the group was treated as a single economic unit. At the end of the day, if group taxation was to be implemented, this will ease the burden of having to invest resources in financial engineering and rather invest in growing the business which will be both beneficial to the economy and the fiscus.

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