

https://dspace.org/

A critical analysis of the corporate restructuring rules

Botha, Petrus Hendrik

2023-01
University of the Witwatersrand, Johannesburg
https://hdl.handle.net/10539/38596
Botha, Petrus Henrik (2023). The role of design houses [Master's dissertation PhD thesis, University of the Witwatersrand, Johannesburg]. Wiredspace.https://hdl.handle.net/10539/38596

Downloaded from a DSpace repository. https://dspace.org/



UNIVERSITY OF THE WITWATERSRAND

A CRITICAL ANALYSIS OF THE CORPORATE RESTRUCTURING RULES

APPLICANT:	Petrus Hendrik Botha
STUDENT NUMBER:	2419904
SUPERVISOR:	Mr Reinhard Rudd
DEGREE:	Master of Commerce (Specialising in Taxation)
DATE:	**January 2023**

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)

ABSTRACT

As a result of Covid-19, there is likely to be an increase in company restructuring in South Africa. The Income Tax Act 58 of 1962 contains group relief measures, also commonly referred to as the "corporate rules". The purpose of the corporate rules, considering the policy objectives of competitiveness, was twofold, firstly, to encourage domestic restructuring of South African companies to promote growth and, secondly, to alleviate unintended hardships caused by the introduction of capital gains tax, which was introduced at the same time. The corporate rules provide relief from capital gains tax and normal tax consequences. In addition, the corporate rules defer the payment of dividends tax, transfer duty, donations tax, securities transfer tax and value-added tax.

In this report the corporate rules contained in the Income Tax Act are critically analysed to ascertain whether the rules are economically and administratively efficient and whether the purpose and needs for which they were introduced, are met. In the current study, where the corporate rules are found to be inefficient, suitable recommendations are made.

In analysing the corporate rules, the recommendations made during March 2018 by the Davis Tax Committee in its report to the Minister of Finance, are considered. In addition, this research investigates whether successive transactions utilising the corporate rules could be implemented, as well as whether the general anti-avoidance rules contained in the Income Tax Act could apply to corporate rule transactions. A group company taxation regime, as an alternative to the corporate rules, is also briefly discussed.

The report concludes that the corporate rules currently achieve the purpose for which the rules were implemented, that is, to alleviate unforeseen hardship caused by the enactment of capital gains tax in 2001, as well as normal tax and to encourage domestic restructuring of South African groups of companies to promote growth.

Ultimately, the shortcomings of the corporate rules, such as the mechanical nature of the rules due to the rules being rules based, possible double taxation and the various complex anti-avoidance provisions should be considered further by the legislature.

Key Words: corporate rules, group restructuring, Income Tax Act 58 of 1962, ‘roll-over’ tax relief, capital gains tax, corporate income tax, successive corporate rule transactions, general anti-avoidance rules, Davis Tax Committee, group company tax.

DECLARATION

I declare that this research report is my own unaided work.

It is submitted in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in taxation) at the University of the Witwatersrand, Johannesburg.

It has not been submitted before for any other degree or examination in any other university.

_____

Petrus Hendrik Botha

Date: January 2023

ACKNOWLEDGEMENTS

I would like to thank Roy Blumenthal for guiding me during the initial stages of this research report.

I would also like to thank my supervisor, Reinhard Rudd, for his guidance and support. His insights and recommendations were of significant value in finalising this research report.

Lastly, I would not have been able to complete this research report and degree without the patience, love and support of my wife, Laken Folster-Botha.

TABLE OF CONTENTS

ABSTRACT ..... **i**

DECLARATION ..... **iii**

ACKNOWLEDGEMENTS ..... **iv**

LIST OF FIGURES ..... **x**

LIST OF ABBREVIATIONS ..... **xi**

CHAPTER 1: INTRODUCTION **1**

1.1 Problem Statement 4

1.2 Scope and Limitations 5

1.3 Research Methodology 5

CHAPTER 2: A GENERAL OVERVIEW OF THE CORPORATE RULES **7**

2.1 Introduction 7

2.2 Definitions contained in section 41 of the Act 7

2.3 Application of the corporate rules 13

2.4 Section 42 – Asset-for-share transactions 13

2.4.1 Domestic asset-for-share transactions *14*

2.4.2 Cross-border asset-for-share transactions *16*

2.4.3 Consideration other than equity shares *16*

2.4.4 Automatic application of section 42 ..... *17*

2.5 Section 43 – Substitutive share-for-share transactions 17

2.6 Section 44 – Amalgamation transactions 18

2.6.1 Resident company to resident company *19*

2.6.2 Foreign company to resident company *19*

2.6.3 Foreign company to foreign company *20*

2.6.4 Consideration other than equity shares *21*

2.6.5 Non-application of section 44 ..... *22*

2.6.6 Section 41(4) - Required liquidation or deregistration steps *23*

2.6.7 In the case of a liquidation or winding-up *23*

2.6.8 In the case of the deregistration of a company 24

2.6.9 Applicable to both liquidation and deregistration 24

2.7 Section 45 – Intra-group transactions 24

2.7.1 Domestic intra-group transactions 24

2.7.2 Cross-border intra-group transactions 25

2.7.3 Automatic application of section 45 26

2.7.4 Non-application of section 45 26

2.8 Section 46 – Unbundling transactions 27

2.8.1 Domestic unbundling transactions 28

2.8.2 Cross-border unbundling transaction 29

2.8.3 Non-application of section 46 30

2.9 Section 47 – Transactions relating to liquidation, winding-up and deregistration 31

2.9.1 Meaning of "liquidation", "winding-up" and "deregistration" 32

2.9.2 Domestic liquidation distribution transactions 32

2.9.3 Cross-border liquidation distribution transaction 32

2.9.4 Assumption of debt 33

2.9.5 Automatic application of section 47 33

2.9.6 Non-application of section 47 33

2.10 Conclusion 34

CHAPTER 3: TAX IMPLICATIONS OF THE CORPORATE RULES 35

3.1 Introduction 35

3.2 Income tax implications of section 42 asset-for-share transactions 35

3.2.1 Transferor 35

3.2.2 Acquiring company 36

3.2.3 Contracts 36

3.2.4 Contributed tax capital (CTC) 37

3.2.5 Anti-avoidance provisions in section 42 37

3.2.6 Other considerations 41

3.3 Income tax implications of section 43 substitutive share-for-share transactions 42
3.4 Income tax implications of section 44 amalgamation transactions 43
3.4.1 Amalgamated company 43
3.4.2 Resultant company 43
3.4.3 Shareholders of amalgamated company 43
3.4.4 CTC 44
3.4.5 Anti-avoidance provision in section 44 44
3.5 Income tax implications of section 45 intra-group transactions 45
3.5.1 Section 45(3A) - Funding of acquisition assets 46
3.5.2 Section 45(3B) – De-grouping after funding 46
3.5.3 Anti-avoidance provisions in section 45 47
3.6 Income tax implications of section 46 unbundling transactions 48
3.6.1 Dividends tax 49
3.6.2 CTC 49
3.6.3 Limitation of expenditure 50
3.7 Income tax implications of section 47 transactions relating to liquidation, winding-up and deregistration 51
3.7.1 Anti-avoidance provision in section 47 52
3.7.2 Dividends Tax 52
3.8 Relief from STT, transfer duty and VAT 52
3.8.1 Relief from STT 52
3.8.2 Relief from transfer duty 53
3.8.3 Relief from VAT 54
3.9 Conclusion 54
CHAPTER 4: SUCCESSIVE CORPORATE TRANSACTIONS 55
4.1 Introduction 55
4.2 Application of ‘capital asset’ definition 55
4.3 The capital or revenue nature of the sale proceeds 58
4.4 SARS’ view on successive corporate transactions 59

4.4.1 BPR 159 – Asset-for-share and amalgamation transactions 60

4.4.2 BPR 328 – Consecutive asset-for-share transactions 60

4.4.3 Other BPRs issued by SARS 61

4.5 Conclusion 61

CHAPTER 5: WHAT IMPLICATIONS WILL THE GAAR HAVE ON TRANSACTIONS WHICH ARE IMPLEMENTED IN TERMS OF THE CORPORATE RULES? 62

5.1 Overview of the issue 62

5.2 The GAAR requirements 62

5.2.1 The "arrangement" requirement 63

5.2.2 The 'tax benefit' requirement 63

5.2.3 The "sole or main purpose" requirement 64

5.2.4 The "abnormality" requirement 65

5.3 Practical example 66

5.4 Conclusion 67

CHAPTER 6: CRITICAL ANALYSIS OF THE CORPORATE RULES 69

6.1 Introduction 69

6.2 The DTC Report 69

6.2.1 First shortcoming: Mechanical nature of the provisions 70

6.2.2 Second shortcoming: Effective double taxation as a result of the "asset-for-share transaction" relief 71

6.2.3 Third shortcoming: The corporate rules are riddled with complex anti-avoidance provisions 72

6.2.4 Fourth shortcoming: Fragmented nature of the anti-avoidance rules 73

6.2.5 Fifth shortcoming: Limitations of unbundling transactions in relation to unlisted companies 74

6.2.6 Sixth shortcoming: Cross-border application of the corporate rules 74

6.3 Further shortcomings of the corporate rules 74

6.4 Group company taxation to enhance efficiency of SA's tax structure 75

6.5 Conclusion 76

CHAPTER 7: CONCLUSION 78

REFERENCES.....81

LIST OF FIGURES

Figure 1: Diagrammatical illustration of a basic group of companies.....12

Figure 2: Diagrammatical illustration of the workings of a simple domestic asset-for-share transaction.....15

Figure 3: Diagrammatical illustration of the workings of an amalgamation transaction 21

Figure 4: Diagrammatical illustration of the workings of a typical intra-group transaction 26

Figure 5: Diagrammatical illustration of the workings of an unbundling transaction.....30

Figure 6: Example from Edward Nathan Sonnenbergs Inc. 66

LIST OF ABBREVIATIONS

CIS	Collective investment scheme
CFC	Controlled foreign company
CGT	Capital gains tax
CGT Guide	Comprehensive Guide to Capital Gains Tax (Issue 9)
Commissioner	Commissioner for SARS
Companies Act	Companies Act 71 of 2008, as amended
Covid-19	Coronavirus disease 2019
CTC	Contributed tax capital
DTC Report	Report on '*The efficiency of South Africa's Corporate Income Tax System*', submitted by the Committee to the Minister during March 2018
Eighth Schedule	Eighth Schedule to the Act
Endumeni case	*Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] ZASCA 13
GAAR	General anti-avoidance rules contained in section 80A to section 80L of the Act
JSE	Johannesburg Stock Exchange Limited
Minister	Minister of Finance
PBO	Public benefit organisation
POEM	Place of effective management
SA	Republic of South Africa

SARS	South African Revenue Service
STT	Securities transfer tax
STT Act	Securities Transfer Tax Act 25 of 2007, as amended
the Act	Income Tax Act 58 of 1962, as amended
the DTC	The Davis Tax Committee
Transfer Duty Act	Transfer Duty Act 40 of 1949, as amended
Treasury	National Treasury
VAT	Value-added tax
VAT Act	Value-Added Tax Act 89 of 1991, as amended

CHAPTER 1: INTRODUCTION

Group restructuring can be described as the reorganisation of the legal, ownership, operational or other structures within a group of companies, with the goal or purpose of making it more profitable, or more effectively organised for its current needs (Davis Tax Committee, 2018, p. 53).

Because of the coronavirus 2019 (Covid-19) pandemic, South Africa (SA) is likely to experience an increase in corporate restructuring transactions. Before the outbreak of Covid-19, SA was already grappling with economic challenges and Covid-19 and the accompanying lockdowns have now put further pressure on businesses. Businesses have had to face many difficult decisions, including undergoing potential restructuring in response to the challenges presented by the pandemic (Webber Wentzel, in alliance with Linklaters. 2021).

Regardless of the negative effect which Covid-19 has had on SA companies, various other legitimate business reasons also exist to restructure businesses. Such reasons include company mergers to facilitate the acquisition of new businesses, the expansion or contraction of the business, or the need to rationalise or streamline the business operations of a group, disposals of existing businesses within the group and the need to reorganise ownership or the financial structure of companies comprising the group (Seligson, 2019:2).

For SA income tax purposes, a group of companies is not regarded as a single taxpayer, rather, each company in the group is regarded as a separate legal persona and a separate taxpayer (De Koker & Williams, 2021, para. 13.32).

The restructuring of a group of companies typically embraces an allocation of assets, businesses or functions within a group, reorganisation of debt, reorganisation of ownership of companies within a group and/or financial restructuring within a corporate group (Brunton, cited in Davis Tax Committee, 2018, p. 54).

Such restructuring transactions often result in the disposal of assets between group companies. By ordinary fiscal principles, a disposal of assets may result in the accrual or receipt of income or a capital gain or loss to the disposing company which could give rise to a liability for normal tax or capital gains tax (CGT).

Where such transactions merely involve a reshuffling of assets within a corporate group, an argument can be made, on economic grounds, that gains made in such circumstances should

not be taxed at that moment because to do so would operate as a deterrent to an economically and commercially rational reorganisation of assets held within the group (De Koker & Williams, 2021, para. 13.32).

The Income Tax Act 58 of 1962 (the Act) recognises that genuine commercial activity in the corporate sphere requires special corporate rules to facilitate the restructuring of groups of companies by providing 'roll-over' tax relief (Seligson, 2019:2).

The corporate rules that provide for 'roll-over' tax relief are contained in sections 41 to 47 in Part III of Chapter II of the Act. The term 'roll-over' tax relief refers to relief in the form of a deferral of a tax liability, with the aim of ensuring that there is no immediate fiscal cost for the implementation of a restructuring transaction (De Koker, & Williams, 2021, para. 13.32).

The corporate rules were introduced not only with a policy objective of competitiveness, but also to promote growth through domestic restructuring. Furthermore, the enactment of the corporate rules was meant to alleviate the unintended hardships caused by the introduction of CGT in 2001 (Parliamentary Monitoring Group, as cited in Davis Tax Committee, 2018, p. 54).

The corporate rules are founded on the view that where shareholders have retained a significant interest in the asset transferred, it is fitting to allow for the tax-free transfer of assets to the entity where the assets can most efficiently be used for business purposes. The policy objective for which the corporate rules were introduced is in line with the neutrality principle (National Treasury, as cited in Davis Tax Committee, 2018, p. 54). The neutrality principle means that the tax system should strive to ensure that decisions are made by taxpayers on their economic merits and not for tax reasons (Furman, 2008).

To remain competitive, SA must make sure that corporate groups of companies on the Johannesburg Stock Exchange (JSE) enjoy the same advantages as corporate groups of companies on stock exchanges in other parts of the world, such as the stock exchanges of New York and London (Parliamentary Monitoring Group, as cited in Davis Tax Committee, 2018, p. 54). Accordingly, the SA tax system takes into account the ebbs (combinations) and flows (unbundlings) naturally occurring on the JSE, similar to tax systems in other parts of the world (Finance Standing Committee, 2001).

The SA corporate rules relate to various types of transactions, all of which are discussed in more detail below. It should be noted that the corporate rules are very detailed and specific, containing numerous anti-avoidance measures to curtail their use for the purpose of avoiding tax, which makes them exceedingly complex. In addition to the anti-avoidance measures contained in section 42 to section 47 of the Act, the application of the general anti-avoidance rules (GAAR) contained in section 80A to section 80L of the Act should also be considered in the event of a restructuring transaction.

The 'roll-over' tax relief may cover one or more of the following types of taxes:

- CGT on the disposal of capital assets;
- income tax on the disposal of allowance assets or trading stock;
- secondary tax on companies, which tax was replaced by dividends tax on 1 April 2012, as well as dividends tax, under an amalgamation transaction and an unbundling transaction; and
- transaction taxes, that is:
    - securities transfer tax (STT), provided for in section 8(1)(a) of the Securities Transfer Tax Act 25 of 2007 (STT Act);
    - transfer duty, provided for in section 9(1)(l) of the Transfer Duty Act 40 of 1949 (Transfer Duty Act); and
    - value-added tax (VAT), provided for in section 8(25) of the Value-Added Tax Act 89 of 1991 (VAT Act),

(Davis, Olivier, & Urquhart, 2020).

During March 2018, the Davis Tax Committee (the DTC) submitted to the Minister of Finance (the Minister) its report on *"The efficiency of South Africa's corporate income tax system"* (the DTC Report).

The DTC was established on 17 July 2013. The purpose of the DTC was to inquire into the role of SA's tax system in encouraging inclusive economic growth, the creation of employment, economic development, and fiscal sustainability (Davis Tax Committee, 2018, p. 1).

The DTC was required to consider the long-term objectives of the National Development Plan as well as recent domestic and international developments (Davis Tax Committee, 2018, p. 1).

In the DTC Report, the DTC reviewed other facets of the SA corporate income tax structure that have an influence on its efficiency. The DTC also provided recommendations for reform where the current structure is seen to be inefficient, both from an economic and administrative perspective (Davis Tax Committee, 2018, p. 1).

In this research report, the corporate rules are critically analysed in light of the recommendations made by the DTC. Furthermore, this research also highlights the need to test any proposed group restructure against the GAAR.

Another aspect to be considered is successive corporate transactions where assets are transferred between multiple companies in a group in quick succession as part of a restructuring. Successive corporate transactions are often implemented in group restructuring transactions (Cliffe Dekker Hofmeyr, 2016). The 'roll-over' tax relief provisions in sections 42, 44, 45, 46 and 47 generally require that the acquiring company must acquire and hold the asset as trading stock where the transferor held an asset as trading stock. The acquiring company must acquire and hold the asset as a capital asset where the transferor held the asset as a capital asset. In this research report, the tax implications of successive corporate transactions are analysed, taking into account the various anti-avoidance provisions contained within the rules.

Lastly, this research briefly summarises the DTC's view as to whether the efficiency of SA's tax structure will be improved by the introduction of group company taxation.

1.1 Problem Statement

In light of the recommendations made by the DTC, this research critically analyses the various corporate restructuring rules as contained in the Act. The critical analysis is conducted with reference to the following sub-questions:

- First Sub-Question: What are the requirements of the SA corporate rules?
- Second Sub-Question: What are the tax implications if the SA corporate rules apply?
- Third Sub-Question: What issues or shortcomings were highlighted by the DTC in the DTC Report relating to the SA corporate rules?
- Fourth Sub-Questions: What other shortcomings exist in respect of the corporate rules?
- Fifth Sub-Question: Do the corporate rules apply to successive transactions?

- Sixth Sub-Question: What implications will the GAAR have on transactions which are implemented in terms of the corporate rules?
- Seventh Sub-Question: What amendments to the legislation, if any, should be recommended to address the shortcomings identified?

1.2 Scope and Limitations

In this research report, the following sections of the Act are discussed in detail:

- section 24BA – Transactions where assets are acquired as consideration for shares issued;
- section 40CA(b) – Acquisition of assets in exchange for shares;
- section 41 – General;
- Section 42 – "asset-for-share transactions";
- Section 44 – "amalgamation transactions";
- Section 45 – "intra-group transactions";
- Section 46 – "unbundling transactions";
- Section 47 – "transactions relating to liquidation, winding-up and deregistration"; and
- Section 80A to section 80L – GAAR.

Section 43 of the Act, providing 'roll-over' tax relief for substitutive share-for-share transactions is not discussed in detail in this research report as this section had a very specific focus and is currently not utilised often in practice.

Furthermore, this research only focuses on the SA corporate rules. Lastly, this research does not deal with the commercial implications of a group restructuring transaction but only with the tax implications.

1.3 Research Methodology

The research method adopted for this study is of a qualitative, interpretive nature and is based on a detailed interpretation and analysis of the available literature. An extensive literature review and analysis is undertaken. This review and analysis includes, but is not limited to, the following sources:

- Books;
- Case law;
- Electronic databases;

- Electronic resources – internet;
- Journals;
- Magazine articles;
- Publications; and
- Statutes.

In the collection of data, relevant information was obtained by searching certain key words related to the research topic on the internet. The relevant sections in the Act were analysed as well as the relevant sections and certain topics related to the research topic in certain publications.

CHAPTER 2: A GENERAL OVERVIEW OF THE CORPORATE RULES

2.1 Introduction

The corporate rules were inserted into the Act by the Second Revenue Laws Amendment Act 60 of 2001 and substituted by the Revenue Laws Amendment Act 74 of 2002. The corporate rules are deemed to have come into operation on 6 November 2002 and are applicable to transactions entered into, on or after that date.

The corporate rules provide 'roll-over' tax relief for the following types of transactions:

- section 42 – "asset-for-share transactions";
- section 43 – "substitutive share-for-share transactions";
- section 44 – "amalgamation transactions";
- section 45 – "intra-group transactions";
- section 46 – "unbundling transactions"; and
- section 47 – "transactions relating to liquidation, winding-up and deregistration".

Section 41 of the Act contains important definitions for purposes of the corporate rules. The different types of corporate rule transactions listed above are discussed in more detail below.

2.2 Definitions contained in section 41 of the Act

The definitions which are applicable for the purposes of Part III of the Act, that is, section 41 to section 47, are contained in section 41(1) of the Act. It is important to note that the definitions of words and expressions contained in section 1(1) of the Act apply, as well as the definitions contained in section 41(1). For example, the term "trading stock" is defined in both section 1(1) and section 41(1) of the Act. In this case, the definition in section 41(1) applies and not the definition in section 1(1). Furthermore, the definitions in section 41(1) are, in certain instances, more specific than the definitions in section 1(1). By way of example, the term "group of companies" as defined in section 41(1) refers to the definition of the term in section 1(1) but excludes, for purposes of Part III, certain companies, such as non-resident companies.

The following definitions contained in section 41(1) are discussed in more detail below:

- asset;
- debt;
- equity share;
- group of companies;
- listed company;
- market value; and
- trading stock.

Note that section 41(1) contains definitions for the following terms which are not discussed in detail in this report: Allowance asset, base cost, capital asset, company, date of acquisition, disposal, and unlisted company.

Definition of "asset"

An "asset" as defined in section 41(1) refers to the definition of this term as defined in paragraph 1 of the Eighth Schedule to the Act (Eighth Schedule). A very wide meaning is ascribed to this term in the Eighth Schedule. An "asset" is defined in paragraph (1) of the Eighth Schedule to include:

> "(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
>
> (b) a right or interest of whatever nature to or in such property".

In the Comprehensive Guide to Capital Gains Tax (Issue 9) (CGT Guide), it is stated that "property" refers to "anything that can be disposed of and turned into money". Excluded from the definition of "property" are things that are incapable of private ownership (McAllister, 2020, p. 45).

Definition of "debt"

The definition of "debt" in section 41(1) of the Act does not state explicitly what this term means. It merely states that it "includes any contingent liability". The term "debt" is not defined in section 1(1) of the Act and the ordinary meaning of this term must therefore be considered.

The court in *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] ZASCA 13 (*Endumeni* case) held that "the general rule is that the words used in a statute are to be given their ordinary grammatical meaning unless they lead to absurdity". Furthermore, words must be interpreted in their context to ascertain what the true intention of the legislature was. In its judgement, the court stated that "a sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document". (Haupt & Haupt, 2022, p. 12).

The term "debt" is defined in the Oxford Learners Dictionaries as "a sum of money that somebody owes" (Oxford Learners Dictionaries, n.d).

In the case of *Leviton & Son v De Klerk's Trustee* 1914 CPD 691 the court held that the term 'debt' should be taken in a wide and general sense as representing whatever is owing from any obligation.

Based on the above, it is submitted that the concept of debt, as defined in section 41(1) of the Act, includes not only an existing substantive obligation to pay another party, but also contingent liabilities.

A contingent liability is deemed to be a debt actually incurred in terms of section 41 (De Koker & Williams, 2021, para. 13.32). In the Cambridge Dictionary the term 'contingent liability' is defined as a debt which may occur in the future if a particular event transpires (Cambridge Dictionary, n.d). The ordinary meaning of the term "debt" is therefore extended to include contingent liabilities (Davis *et al*., 2020).

The definition of "debt" was inserted into the Act by the Taxation Laws Amendment Act 17 of 2017. As per the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017, the reason for inserting the definition into the Act is that the concept of debt as it was contemplated prior to the insertion of the definition into the Act, referred to an existing and real obligation to pay another party. Contingent debts, however, could have a significant impact on a sale

transaction and should therefore be allowed as acceptable consideration under the corporate rules (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017, paragraph 1.6).

Definition of "equity share"

Section 1(1) of the Act defines an "equity share" as "any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution".

A wider definition for this term applies to section 42 and section 44 of the Act. For purposes of these two sections, a "participatory interest in a portfolio of a hedge fund CIS" and a "portfolio of a CIS in securities" are included in the definition (Haupt & Haupt, 2022, p. 506).

Note that this wider definition does not apply to the other corporate rules. For all other purposes, the definition of the term "equity share" in section 1(1) applies.

In simple terms, an equity share is a share that does not limit the participation of its holder in profits distributed or, if it limits its holder's participation in profits, it does not limit the holder's return of capital.

By way of example, ordinary shares are typically equity shares. In the Draft Interpretation Note on section 22B of the Act and paragraph 43 of the Eighth Schedule, it is, however, stated that certain preference shares could meet the definition of equity shares. An example of a preference share that qualifies as an equity share is a participating preference share that provides its holder with an unlimited right to profits but a limited right to capital. On the other hand, a non-participating preference share will ordinarily not qualify as an equity share as the holder is normally only entitled to a fixed dividend and a fixed right to a return of capital (South African Revenue Service, 2022).

Definition of "group of companies"

In 2007 the definition of "group of companies" in section 41(1) of the Act was amended by the Taxation Laws Amendment Act 3 of 2008 to exclude certain companies from the list. The

reason for this was to only allow SA resident domestic companies that are fully within the SA tax net to participate in the relief provided by the corporate rules (Davis *et al*., 2020).

A "group of companies" in section 41(1) of the Act refers to "a group of companies as defined in section 1", but specifically excluding the following types of companies:

- Companies incorporated outside SA (unless their respective places of effective management (POEM) are in SA), co-operatives, SA public interest organisations, SA CIS in securities and foreign CIS;
- companies that have their POEM located outside of SA;
- non-profit companies as defined in section 1 of the Companies Act;
- companies, any portion of the gross income of which is or would be exempt from income tax in terms of section 10 of the Act, for example, companies that receive only dividends. The intention is not to exclude companies from a group merely if it, for example, receives an exempt dividend. A company will only be excluded from this definition if all of its other receipts and accruals are exempt from income tax; and
- approved public benefit organisations (PBO) and recreational clubs.

Section 1(1) of the Act contains the wider definition for a "group of companies" and defines this term as follows:

> "two or more companies in which one company (hereinafter referred to as the 'controlling group company') directly or indirectly holds shares in at least one other company (hereinafter referred to as the 'controlled group company'), to the extent that—
>
> *(a)* at least 70 per cent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
>
> *(b)* the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company".

The figure below (Figure 1) diagrammatically illustrates a basic "group of companies" (De Koker & Williams, 2021, para. 13.32).

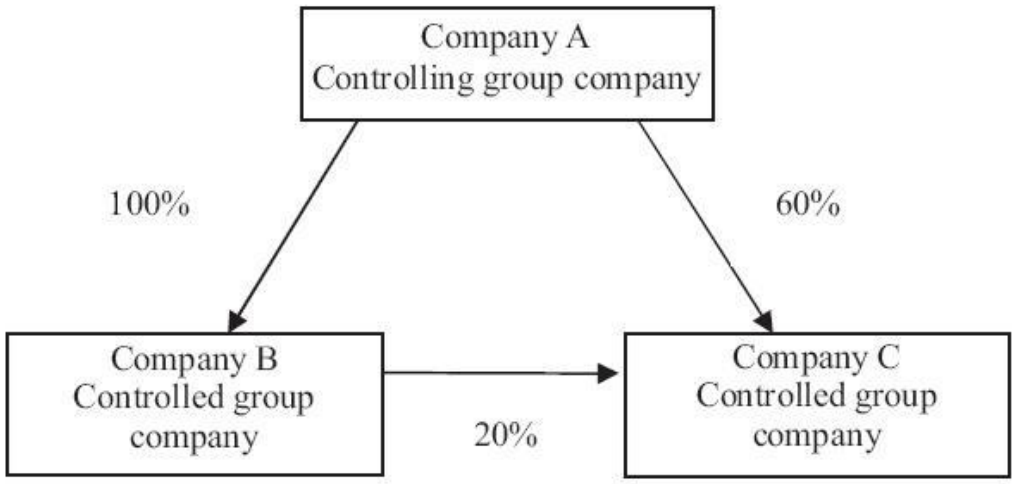


Figure 1: Diagrammatical illustration of a basic group of companies

Definition of "listed company"

The definition of "listed company" in section 41(1) refers to "a company as contemplated in paragraph *(a)* of the definition of 'listed company' in section 1". Essentially, a listed company, for purposes of the corporate rules, refers to a company that is listed on a SA stock exchange, such as the JSE.

Definition of "market value"

Section 41(1) defines "market value" as "the price which could be obtained upon a sale of that asset between a willing buyer and a willing seller dealing at arm's length in an open market".

Definition of "trading stock"

The definition of "trading stock" in section 41(1) is wider than the definition in section 1(1). The definition in section 41(1) specifically includes produce and livestock as per paragraphs 5(1) and 9 of the First Schedule to the Act. The definition of "trading stock" in section 1(1) includes "anything produced, manufactured, construed, assembled, purchased or in any other manner acquired for purposes of manufacture, sale or exchange …".

The definition in section 1(1) further includes "anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income". Excluded from this part of the definition is the proceeds from the disposal of capital assets by a mine and a plantation by a

farmer, a key-man policy payment and a recoupment as provided for in section 8(4)(a) of the Act.

Specifically excluded from the definition of "trading stock" in section 1(1) of the Act is a foreign currency option contract and a forward exchange contract.

2.3 Application of the corporate rules

Section 41(2) of the Act, dealing with the application of the corporate rules, provide that the corporate rules must apply "notwithstanding any provision to the contrary contained in the Act", other than certain specifically listed provisions. In other words, the corporate rule provisions override most other provisions of the Act. The specified provisions which will apply irrespective of the application of the corporate rules are section 24BA (assets acquired as consideration for shares issued), section 24I (foreign exchange gains and losses), section 25BB(5) (capital gains or losses of a REIT or a controlled company), section 40CA(b) (adding of a deemed capital gain to the base cost of certain assets), Part IIA of Chapter III (the GAAR), paragraph 11(1)(g) of the Eighth Schedule (a value shifting arrangement resulting in the decrease of a person's interest in a company, trust or partnership), section 103 (anti-avoidance provision relating to assessed losses) and any adjusted gain or adjusted loss on the transfer or redemption of an instrument as defined in section 24J(1).

Furthermore, section 41(3) provides that the corporate rules do not apply to a transaction "in terms of which any asset is disposed of to an insurer as defined in section 29A if the asset is to be held in the insurer's untaxed policyholder fund". Section 29A refers to long-term insurers.

2.4 Section 42 – Asset-for-share transactions

A specific form of 'roll-over' tax relief is available when an asset is exchanged under an asset-for-share transaction. In this regard, section 42 of the Act aims to prevent tax considerations from discouraging the transfer of assets to a newly incorporated business (De Koker & Williams, 2021, para 13.33).

Section 42(1) of the Act defines the term "asset-for-share transaction" to include domestic asset-for-share transactions and cross-border asset-for-share transactions. In other words, 'roll-over' tax relief is available for transfers to SA resident companies as well as transactions where a SA company disposes of equity shares in a foreign company which it held as capital assets,

to another foreign company. Each of the types of asset-for-share transactions are discussed below.

2.4.1 Domestic asset-for-share transactions

Paragraph (a)(i) of the definition of "asset-for-share transaction" provides for 'roll-over' tax relief in the case of domestic asset-for-share transactions.

In essence, a domestic asset-for-share transaction is a transaction in terms of which an asset (other than a restraint of trade or goodwill), is disposed of by any person to a SA resident company, at an amount equal to or greater than base cost if it was held as capital asset or at an amount equal to or greater than tax cost if it was held as trading stock, in exchange for the issue of one or more equity shares in that company (in full or part payment) (Haupt & Haupt, 2022, p. 510). Personal goodwill and restraint of trade payments are excluded from an asset-for-share transaction as its value could easily be manipulated by the holder.

In addition to the above, at the end of the day on which the asset is disposed of, the seller must hold a "qualifying interest" in the company issuing the shares (Haupt & Haupt, 2022, p. 510). Where the seller does not hold a qualifying interest in the company, the tax relief can also apply where that person "is a natural person who will be engaged on a full-time basis in the business of that company, or a controlled group company in relation to that company, of rendering a service" (Haupt & Haupt, 2022, p. 510). The reason why these qualifying conditions were put in place is to ensure that only long-term and substantial transfer of assets in exchange for shares benefit from the 'roll-over' tax relief, as well as to support the incorporation of professional service firms (Shepstone & Wylie Attorneys, 2015).

A "qualifying interest" in relation to a person is defined in section 42(1) of the Act as:

> "(a) an equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that share;
>
> (b) an equity share held by that person in a portfolio of a CIS in securities;
>
> (c) equity shares held by that person in a company that constitute at least 10 per cent of the equity shares and that confer at least 10 per cent of the voting rights in that company;

(d) an equity share held by that person in a company which forms part of the same group of companies as that person; or

(e) any equity share held in a portfolio of a hedge fund CIS.*"*

A further requirement is that the resident company acquiring the asset must acquire and hold the asset as trading stock where the seller held it as trading stock, and as a capital asset where the seller held it as a capital asset (Haupt & Haupt, 2022, p. 510).

This requirement does not apply where the acquiring company acquires equity shares in a listed company or in a portfolio of a CIS in securities or in a portfolio of a hedge fund CIS where the acquiring company holds at least 35% of the equity shares in the listed company or CIS immediately after the acquisition, or 25% where no other person holds an equal or greater number of equity shares in the listed company or CIS (Haupt & Haupt, 2022, p. 510). When calculating the aforementioned percentages, any further acquisition by the acquiring company of the listed shares or portfolio may be taken into account when doing the calculation, provided that the terms of the further acquisition are on the same terms as the previous acquisition. This requirement also does not apply where an asset is disposed of to a portfolio of a hedge fund CIS (Haupt & Haupt, 2022, pp. 510 - 511).

The figure below (Figure 2) diagrammatically illustrates the workings of a simple domestic asset-for-share transaction (De Koker & Williams, 2021, para. 13.33).

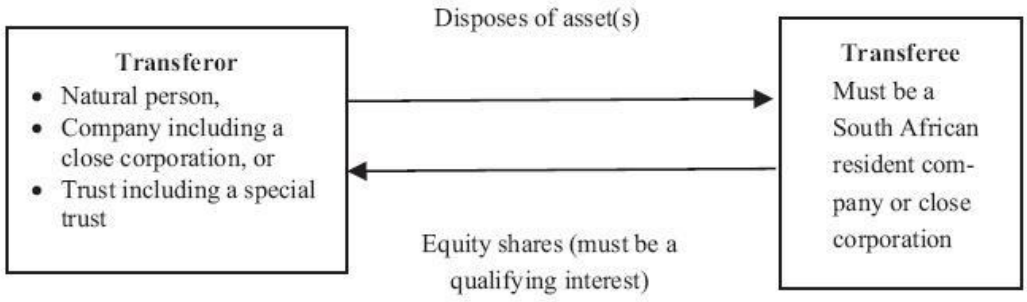


Figure 2: Diagrammatical illustration of the workings of a simple domestic asset-for-share transaction

2.4.2 Cross-border asset-for-share transactions

Paragraph (b)(ii) of the definition of "asset-for-share transaction" provides for cross-border asset-for-share transactions.

Prior to 1 January 2012, the relief provided by section 42 was mainly limited to transactions between SA residents. From this date, the relief was extended to cover the transfer of foreign company equity shares to CFCs. The effect is that section 42 now provides for intra-group foreign share-for-share transactions. The relief provided by section 42 was extended to foreign companies as the transaction should not result in the tax-free externalisation of corporate value outside of the SA group (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011, paragraph 4.6).

A cross-border asset-for-share transaction can be described as a transaction in terms of which equity shares in a foreign company are disposed of by a company (the transferor) to another foreign company (the transferee company) in exchange for equity shares in the transferee company.

In order for the 'roll-over' tax relief to apply, the market value of the equity shares must be equal to or exceed their base cost on the date of disposal, the transferor and the foreign transferee company must, immediately after the disposal, form part of the same "group of companies" as defined in section 1(1), that is, the wider definition of "group of companies" and the transferee company must be a controlled foreign company (CFC), as defined in section 9D of the Act, in relation to any SA resident.

Lastly, at the end of the day on which the asset is disposed of, more than 50% of the equity shares in the foreign company (being transferred) must be directly or indirectly held by a resident (whether alone or together with any company forming part of the same "group of companies" as the resident) or at least 70% of the equity shares in the other foreign company (the transferee) must be directly or indirectly held by a resident (whether alone or together with any other company forming part of the same "group of companies" as that resident) (Haupt & Haupt, 2022, p. 511).

2.4.3 Consideration other than equity shares

Section 42(4) provides that where a person receives, in exchange for an asset, equity shares as well as any other consideration, such as cash, then the asset-for-share transaction relief will

only apply to the portion of the disposal that relates to the equity shares received and, in certain instances, certain qualifying debt. In other words, an apportionment must be made and the portion relating to the other consideration will be taxed in accordance with the normal income tax rules.

2.4.4 Automatic application of section 42

Section 42(8A)(a) provides that, if a transaction meets all of the requirements of section 42, section 42 will apply automatically, unless the transferor and the company specifically agree in writing that section 42 should not apply.

In addition, section 42 will not apply in the following circumstances:

- the disposal is not taken into account in the determination of the taxable income or assessed loss of the person disposing of the asset. This would be the case, for example, where the disposing party is tax exempt or otherwise not subject to tax in SA (Davis et al., 2020);
- the disposal would not give rise to any imputation under section 9D (relating to CFCs). As a result, if the relief in para 64B (that is, dealing with the disposal of equity shares in foreign companies) applies to a foreign reorganisation, then the relief in section 42 will not be available (Davis, Olivier & Urquhart, 2020); or
- the asset constitutes a debt owing by or a share in that company. The effect of this exclusion is that if a loan is waived in exchange for shares by a person that is owed money by the company, section 42 will not apply. Section 42 will also not apply where a person's share in a company is cancelled and replaced with the issue of a new share (Haupt & Haupt, 2022, p. 518).

2.5 Section 43 – Substitutive share-for-share transactions

Section 43 had a very specific focus and is currently not utilised often in practice. For this reason, this section is only discussed on a very high-level in this report.

A "substitutive share-for-share transaction" is defined in section 43(1) as:

> "a transaction between a person and a company in terms of which that person disposes of an equity share in the form of a linked unit in that company and acquires an equity share other than a linked unit in that company".

A ‘linked unit’, in turn, is defined in section 1(1) as “a unit comprising a share and a debenture in a company, where that share and that debenture are linked and are traded together as a single unit”.

In essence, this section could apply, for example, where there has been a share split, consolidation of different share classes or an exchange of nominal or par value shares for no par value shares (De Koker & Williams, 2021, para. 13.33A).

2.6 Section 44 – Amalgamation transactions

An “amalgamation transaction”, as defined in section 44, envisages three types of transactions, as discussed in more detail below, in terms of which an amalgamated company merges all of its assets into a resultant company. Following the merging, the amalgamated company will be terminated (Haupt & Haupt, 2022, p. 520).

In *Silke: South African Income Tax 2021*, the following is stated relating to the terms “amalgamation” and “merger”:

> “The terms ‘amalgamation’ and ‘merger’ in relation to companies are broad terms, encompassing a wide variety of arrangements. In general parlance, a ‘merger’ connotes an arrangement between two or more existing companies, involving the merging of their respective assets without the creation of a new participating company. In general terms, an ‘amalgamation’ connotes an arrangement that involves a company (that the Income Tax Act conveniently calls ‘the resultant company’) which may be a new company, formed for the purpose, to which the other participating company or companies (which the Income Tax Act calls the ‘amalgamated’ company or companies) will dispose of assets and liabilities.”

(De Koker & Williams, 2021, para. 13.34).

Provided that all the relevant requirements are met, section 44 may afford tax ‘roll-over’ relief to the extent that the amalgamated company disposes of all its assets in exchange for equity shares of the resultant company or the assumption of certain debts by the resultant company. Note that the provisions of section 44 also apply where the amalgamated company disposes of all its assets to the resultant company for no consideration.

The following three types of transactions are covered in the definition of "amalgamation transaction":

- "A SA resident company transfers its assets to another resident company.
- A foreign company transfers its assets to a SA resident company.
- A foreign company transfers its assets to another foreign company (in the same group)".,

(Haupt & Haupt, 2022, pp. 520 - 521).

2.6.1 Resident company to resident company

To obtain the 'roll-over' tax relief provided for by section 44, a resident company (the amalgamated company) must dispose of all of its assets to another resident company (the resultant company) by means of amalgamation, conversion, or merger as a result of which the existence of the amalgamated company will be terminated. Note that the amalgamated company may retain assets it elects to settle any debts incurred in the ordinary course of trade.

In addition, the resultant company must acquire the asset as a capital asset where the amalgamated company disposes of a capital asset, and the resultant company must acquire the asset as trading stock where the amalgamated company disposes of trading stock.

It is important to note that the assets can only be disposed of for consideration in the form of equity shares of the resultant company, or for the assumption of certain debts by the resultant company, or for no consideration.

Lastly, the amalgamated company must, within 36 months of the "amalgamation transaction", take the steps to liquidate, wind up or deregister, as provided for in section 41(4).

2.6.2 Foreign company to resident company

This provision was included into section 44 of the Act as, ultimately, it broadens the SA tax net. As provided for in paragraph 2 of the Eighth Schedule, CGT is applicable to foreign companies in very limited circumstances. Therefore, by allowing a foreign company to dispose of its assets to a resident company, CGT will be payable in the future when the resident company disposes of the assets which it acquired from the foreign company (if the proceeds of the assets exceed the base cost).

To obtain the tax 'roll-over' relief provided for by section 44, the foreign company (the amalgamated company) must dispose of all its assets (other than assets it elects to settle any debts incurred in the ordinary course of trade) to a resident company (the resultant company) and any shares in the amalgamated company immediately before the transaction must be held as capital assets (Haupt & Haupt, 2022, p. 521).

In addition, the amalgamated company must have taken the steps contemplated in section 41(4) to liquidate, wind up or deregister within 36 months of the "amalgamation transaction" after which the equity shares in the resultant company will be transferred to the shareholder of the amalgamated company (Haupt & Haupt, 2022, p. 521).

2.6.3 Foreign company to foreign company

With effect from 1 January 2012, section 44 was amended to cover the amalgamation, merger, or conversion of a foreign company into certain resultant foreign companies. As stated in the Explanatory Memorandum to the Taxation Laws Amendment Act, 2011, many SA multinationals looked to restructure their offshore operations. It is further stated that the corporate restructuring transactions often occurred when multinationals acquired foreign companies with inconveniently located subsidiaries and looked to move these foreign subsidiaries into more efficient locations within the group, thereby keeping SA multinationals globally competitive (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011, paragraph 4.6).

To obtain the tax 'roll-over' relief provided for by section 44, the foreign company (the amalgamated company) must dispose of all its assets (other than assets it elects to settle any debts incurred in the ordinary course of trade) to a foreign company (the resultant company). Immediately prior to the transaction, the amalgamated company and resultant company must form part of the same "group of companies" as defined in section 1(1) (that is, the wider definition), the resultant company must be a CFC in relation to any resident group company and any shares which the resultant company held directly or indirectly in the amalgamated company, must be held as capital assets (Haupt & Haupt, 2022, pp. 521 - 522).

In addition, immediately after the transaction, more than 50% of the equity shares in the resultant company must be held directly or indirectly by a resident (whether alone or together

with any other resident that forms part of the same "group of companies" as the resident (Haupt & Haupt, 2022, p. 522).

Lastly, the amalgamated company must have taken the steps contemplated in section 41(4) to liquidate, wind up or deregister within 36 months of the "amalgamation transaction" after which the equity shares in the resultant company will be transferred to the shareholder of the amalgamated company (Haupt & Haupt, 2022, p. 522).

The figure below (Figure 3) diagrammatically illustrates the workings of an amalgamation transaction (De Koker & Williams, 2021, para 13.34).

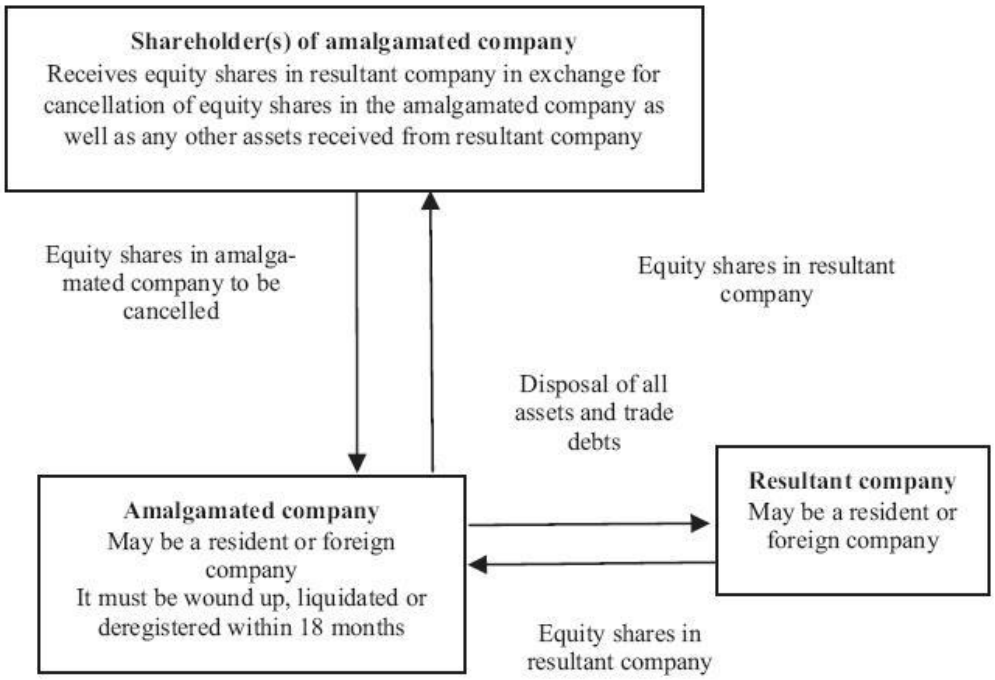


Figure 3: Diagrammatical illustration of the workings of an amalgamation transaction

2.6.4 Consideration other than equity shares

Section 44(4) provides that the tax 'roll-over' relief provided by section 44 is only available to the extent that the amalgamated company receives equity shares in the resultant company and/or assumes the certain qualifying debt in the amalgamated company in exchange for the assets disposed of by the amalgamated company (Haupt & Haupt, 2022, p. 522).

Qualifying debt, for the purposes of section 44 is debt which complies with the following requirements:

- "It must have been incurred more than 18 months before the disposal.

- If incurred within a period of 18 months before the disposal, then to the extent that the debt constitutes the refinancing of debt incurred or is attributable to and arose in the ordinary course of a business undertaking disposed of as a going concern to the resultant company as part of the amalgamation transaction.
- No debt can be assumed and qualify for 'rollover relief' if it was incurred for the purpose of procuring, enabling, facilitating, or funding the acquisition by the resultant company of any asset in terms of the amalgamation transaction. The effective consequence is that no debt can be created in the resultant company in order to pay for assets transferred under the amalgamation transaction. If such 'new' debt is created, then the assets which it finances will not be subject to 'rollover relief'. Instead, the sale of these assets will be subject to tax, and any funds arising out of the sale which are paid to shareholders as a dividend, will be subject to the dividends tax."

(De Koker & Williams, 2021, para 13.34).

2.6.5 Non-application of section 44

Section 44(14)(a) provides that the amalgamation provisions will also not apply to a transaction that constitutes a "liquidation distribution" as defined in section 47(1) of the Act.

In addition, section 44(14)(b) to (f) provides that the amalgamation provisions will not apply in respect of any transaction where the resultant company is:

> "(b) if the resultant company is a co-operative or an SA association formed for a purpose beneficial to the public;
>
> (bA) if the resultant company is a CIS in securities, but the amalgamated company is not;
>
> (bB) if the resultant company is a portfolio of a hedge fund investment scheme in securities; but the amalgamated company is not;
>
> (c) if the resultant company is a non-profit company contemplated in s 1 of the Companies Act;
>
> (d) if under a South African company amalgamation, the resultant company is a foreign company with a place of effective management outside South Africa;

(e) if the resultant company has or will have gross income any portion of which is or would be exempt from income tax in terms of s 10 of the Act; or

(f) if the company is an approved public benefit organisation or recreational club approved by the Commissioner; and

(g) if the amalgamated company formed part of the same group of companies before and after the transaction",

(Davis *et al*., 2020).

Lastly, section 44(14)(g) provides that section 44 will not apply where the resultant company and shareholder of the amalgamated company form part of the same "group of companies" immediately before and after the disposal, and the amalgamated company, resultant company and shareholder jointly elect for the section to not apply ((De Koker & Williams, 2021, para. 13.34).

2.6.6 Section 41(4) - Required liquidation or deregistration steps

Section 41(4) sets out when a company is deemed to have taken steps to liquidate, wind-up or deregister. In terms of section 41(4) and for purposes of an amalgamation transaction, a company must be deemed to have taken steps to liquidate, wind up or deregister within 36 months of the transaction as set out below:

2.6.7 In the case of a liquidation or winding-up

Section 41(4)(a)(i) provides that the company must have lodged a resolution authorising the voluntary winding-up of that company in terms of section 80(2) of the Companies Act in the case of a company to which that section applies, Regulation 21 of the Regulations under the Co-operatives Act 14 of 2005, in the case of a co-operative or a similar provision contained in any foreign law relating to the liquidation of companies, in the case where that company is incorporated in a country other than SA, if such foreign law so requires.

In addition, section 41(4)(a)(ii) requires that the company "must have disposed of all its assets and settled all its liabilities (other than assets kept to settle anticipated liabilities for tax or liabilities to any government department in SA or elsewhere, and liabilities for the costs of administration relating to the liquidation or winding up of the entity)" (Haupt & Haupt, 2022, p. 509).

2.6.8 In the case of the deregistration of a company

Section 41(4)(b) provides that the company must have lodged a request for the deregistration of that company in the prescribed manner and form to the Companies and Intellectual Property Commission in terms of section 82(3)(b)(ii) of the Companies Act in the case of a company to which that section applies.

2.6.9 Applicable to both liquidation and deregistration

Section 41(4)(c) requires that the company must have submitted a copy of the resolution as contemplated in the requirements for a liquidation or winding up (above) or the request for deregistration as contemplated in the requirements for a deregistration (above) to the Commissioner for the South African Revenue Service (the Commissioner) (SARS).

Lastly, section 41(4)(d) requires that "all the returns and information required to be submitted in terms of any Act administered by the Commissioner must have been submitted or arrangements must have been made with SARS for the submission of outstanding returns or information" (Haupt & Haupt, 2022, p. 509).

2.7 Section 45 – Intra-group transactions

Section 45 of the Act allows the tax-free transfer of assets within a group of companies and has become an important manner to achieve commercially driven group restructuring in a tax-efficient way.

If all of the requirements of section 45 are met, 'roll-over' tax relief may apply in respect of income to the extent of the disposal of the assets by the transferor. The underlying rationale for roll-over relief in terms of section 45 is that a gain or loss from such a disposal of an asset should be deferred whilst that asset is held by that transferee company (De Koker & Williams, 2021, para. 13.35).

Section 45 of the Act makes provision for domestic intra-group transactions and cross-border intra-group transactions, each of which is discussed in more detail below.

2.7.1 Domestic intra-group transactions

Within the context of domestic transactions, the 'roll-over' tax relief in terms of section 45 only applies to the extent that a company (the transferor), disposes of an asset to another company (the transferee) and both companies form part of the same "group of companies" (as

defined in section 41). A further requirement is that the transferee must acquire the assets as a capital asset where the transferor held it as a capital asset, and as trading stock where the transferor held it as trading stock.

It should be noted that the issue of preference shares as consideration for assets transferred under section 45 is allowed while this is not the case in section 42 asset-for-share transactions (De Koker & Williams, 2021, para. 13.35).

2.7.2 Cross-border intra-group transactions

Within the context of cross-border transactions, the 'roll-over' tax relief provided for by section 45 only applies to the extent that a company (the transferor) disposes of an equity share in a foreign company held as a capital asset to another company (the transferee) in exchange for the issue of shares other than equity shares or debt, as a result of which the transferee acquires the asset from the transferor as a capital asset.

In addition, immediately before and at the end of the day of the intra-group transaction, the transferor and transferee form part of the same "group of companies" (as defined in section 1(1)), the transferor is a resident company or a CFC in relation to one or more resident companies forming part of the same "group of companies" and the transferee is a resident company or CFC in relation to one or more resident companies that form part of the same "group of companies".

In terms of the proviso to section 45(2)(a), the section 45 relief will not apply where the transferor company is a CFC, the transferred is a SA tax resident and the base cost of the equity share exceeds the market value of the share at the time of disposal (Haupt & Haupt, 2022, p. 531).

The figure below (Figure 4) diagrammatically illustrates the workings of a typical intra-group transaction (De Koker & Williams, 2021, para 13.35).

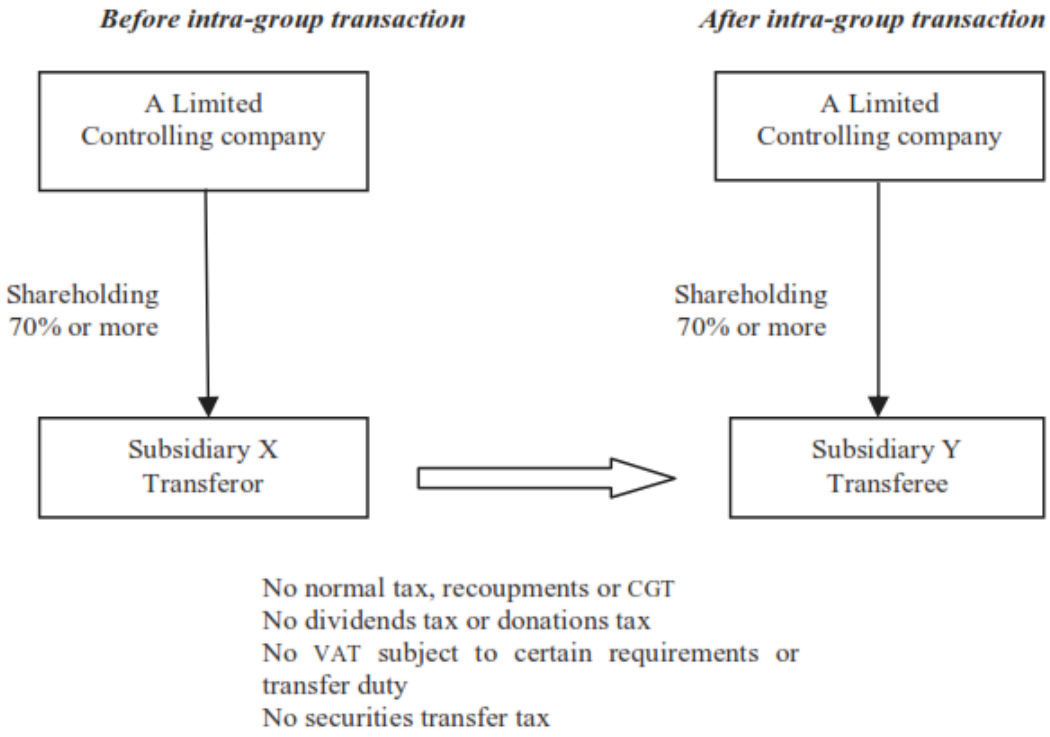


Figure 4: Diagrammatical illustration of the workings of a typical intra-group transaction

2.7.3 Automatic application of section 45

Where all of the requirements of section 45 are met, section 45(6)(g) provides that the section will apply automatically unless the parties opt out of it in writing.

The automatic application of section 45 could result in unforeseen and incorrect tax positions for both parties to the transaction if this section applies inadvertently. It is therefore important for parties to a transaction to make sure whether section 45 will apply to the transaction or not (AJM Tax, 2022).

2.7.4 Non-application of section 45

Section 45(6) provides that section 45 will not apply in respect of the disposal of an asset if:

- "the receipts and accruals of the transferee company are exempt from tax under s 10(1)(cA) (certain public interest institutions, boards or bodies), s 10(1)(cN) (approved PBOs), s 10(1)(cO) (approved recreational clubs), s 10(1)(cP) (mining

rehabilitation trusts), s 10(1)(d) (pension and other funds) and s 10(1)(t) (the CSIR and other public benefit corporations or councils);

- an asset is transferred by a transferee company in exchange for equity shares issued in the transferor company. The object is to confine such transactions to s 42;
- a share is distributed by a transferor company to a transferee company. The object is that share distributions should be covered by s 46 or 47;
- the asset is disposed of by a transferor company to a transferee company in terms of a section 47 liquidation distribution, even if it was elected that
- s 47 did not apply and regardless of whether the transferee company acquired the asset as trading stock or a capital asset;
- the asset is a share in the transferee company;
- the transferee and transferor companies jointly agree in writing that s 45 does not apply.",

(Davis *et al*., 2020).

2.8 Section 46 – Unbundling transactions

Section 46 provides 'roll-over' tax relief where an 'unbundling company' distributes its equity shares in an 'unbundled company' to its shareholder in accordance with the definition of an "unbundling transaction" as defined in section 46(1)(a) or (b) of the Act.

Regarding the economic benefits of unbundling transactions, the following is stated in *Silke: South African Income Tax 2021:*

> "The major commercial benefits of an unbundling transaction are the unlocking of value for shareholders and the de-concentration of ownership. An unbundling allows the group to separate different investment profiles, thereby allowing investors a greater measure of choice, for example, in relation to dividend yields. An unbundling transaction can enhance competitiveness within the national economy by diversifying ownership. Unbundling transactions thus have significant economic as well as fiscal benefits, not only for the particular company and its shareholders, but for the national economy."

(De Koker & Williams, 2021, para. 13.36).

Section 46 of the Act envisages the following types of unbundling transactions:

> "(a) Both the unbundling company and the unbundled company are South African resident companies. The equity shares of a resident company ('the unbundled company') are held by another company ('the unbundling company'), which distributes all those equity shares ('the unbundled shares') to its shareholders in accordance with their effective interest in the shares of the unbundling company (s 46(1)(a)).
>
> (b) The unbundling company is a South African resident company or a CFC, and the unbundled company is a foreign company. A resident unbundling company or a CFC distributes all the equity shares ('the unbundled shares') in a foreign unbundled company (s 46(1)(b)",
>
> (De Koker & Williams, 2021, para. 13.36).

2.8.1 Domestic unbundling transactions

Section 46(1)(a) provides for domestic unbundling transactions.

A domestic unbundling transaction can be described as a transaction in terms of which a company (the unbundling company), which is a resident, distributes the equity shares (the unbundled shares) in another resident company (the unbundled company).

All the equity shares must be distributed to the shareholder(s) of the unbundling company in accordance with his or their effective interest in the shares of the unbundling company.

The unbundled shares must be distributed to the shareholder(s) in pursuance of one of the following three transactions:

- Where the unbundled shares are listed shares - all the shares in the unbundled company are listed shares or will become listed shares within twelve months after the distribution in accordance with the effective interest of the shareholder(s) concerned;
- where the unbundled shares are unlisted shares. The 'roll-over' tax relief applies only to those shares distributed by the unbundling company to companies which form part of the same "group of companies" (as defined in section 41(1)) as the unbundling company; or
- pursuant to an order made by the Competition Tribunal or the Competition Appeal Court in terms of the Competition Act 89 of 1998.

Where the unbundled company is a listed company immediately prior to the distribution of the shares or the shares will become listed shares within 12 months after the distribution, the unbundling company must hold more than 25% of the equity shares in the unbundled company, provided no other shareholder holds an equal or greater amount of its equity shares or, in any other situation, at least 35% of its equity shares. Where the unbundled company is unlisted immediately prior to the distribution, the unbundling company must hold more than 50% of the equity shares in the unbundled company (De Koker & Williams, 2021, para. 13.36).

The relief provided by this section will not apply unless all of the shares in the unbundled company are distributed by the unbundling company.

2.8.2 Cross-border unbundling transaction

Section 46(1)(b) provides for cross-border unbundling transactions.

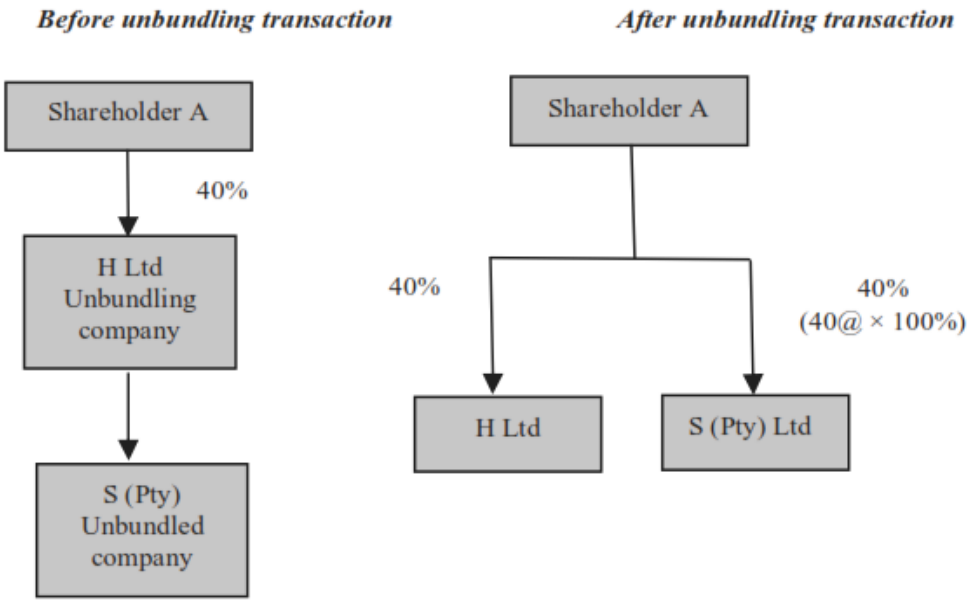
A cross-border unbundling transaction can be described as a transaction where a resident unbundling company or a CFC distributes all the equity shares (the unbundled shares) in a foreign unbundled company.

To rely on the relief provided by section 46, the taxpayer must distribute all of the equity shares to the shareholder(s) of the unbundling company in accordance with its or their effective interest in the shares of the unbundling company. Furthermore, the shareholder of the unbundling company must form part of the same "group of companies" (as defined in section 1(1)) if it is a resident company.

If the shareholder of the unbundling company is not a resident, it must be a CFC in relation to any resident that forms part of the same "group of companies" (as defined in section 1(1)) as the unbundling company.

Lastly, immediately before the distribution of the equity shares, the unbundling company must hold more than 50% of the equity shares of the unbundled company and the equity shares of the unbundled company must be held by the unbundling company as a capital asset and, immediately after the distribution of the equity shares, more than 50% of the equity shares of the unbundled company must be directly or indirectly held by a resident (whether alone or together with any other resident forming part of the same "group of companies" as that resident) (De Koker & Williams, 2021, para. 13.36).

The figure below (Figure 5) diagrammatically illustrates the workings of an unbundling transaction (De Koker & Williams, 2021, para 13.36).



> "*For example, say H Ltd, the holding company of a wholly-owned subsidiary, S (Pty) Ltd, unbundles its group structure. Both companies are residents and A directly holds 40% of the shares of H Ltd. Prior to the unbundling transaction, A has an indirect shareholding of 40% (40% × 100%) in S. Thereafter it has a direct shareholding of 40% of the issued share capital of both H and S (in other words, the equity shares in the unbundled company (S) are distributed by the unbundling company (H) in accordance with A's effective shareholding in H). The group structure and changes in shareholding may be illustrated diagrammatically as follows:*"

Figure 5: Diagrammatical illustration of the workings of an unbundling transaction

2.8.3 Non-application of section 46

Section 46(6A) provides that the unbundling rules will not apply where the unbundling company is a REIT or a controlled company (as defined in section 25BB of the Act).

Furthermore, section 46(7) provides that the unbundling rules will not apply where equity shares are distributed by an unbundling company to a shareholder that is a "disqualified person" and, that "disqualified person" holds at least 5% of the equity shares in the unbundling company immediately before the unbundling transaction. The effect of this provision is to prevent 'roll-over' tax relief provided by section 46 to move shares from a taxable position to a tax-free position (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012, para. 5.2).

A "disqualified person" is defined in section 46(7) as:

"(i) a person that is not a resident;

(ii) the government of the Republic in the national, provincial or local sphere, contemplated in section 10(1)(a);

(iii) a public benefit organisation as defined in section 30 that has been approved by the Commissioner in terms of that section;

(iv) a recreational club as defined in section 30A that has been approved by the Commissioner in terms of that section;

(v) a company or trust contemplated in section 37A;

(vi) a fund contemplated in section 10(1)(d)(i) or (ii); or

(vii) a person contemplated in section 10(1)(cA) or (t)."

Lastly, section 46(8) provides that where an unlisted unbundling company disposes of shares in an unlisted unbundled company to a shareholder, and the shareholder is part of the same group as the unbundled company (immediately before and after the disposal), section 46 will not apply if the shareholder and the unbundling company agree in writing that the section will not apply (Haupt & Haupt, 2022, p. 542).

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

In general, section 47 of the Act, which deals with "liquidation distributions", provides for the tax-free transfer of assets within a group of companies in anticipation of liquidation, and it has proven to be a useful tool for achieving commercially driven group reform in a tax-efficient manner. Section 47 of the Act may provide 'roll-over' tax relief in respect of income tax and/or CGT, provided that the relevant requirements of the section are met.

Section 47 of the Act makes provision for domestic transactions relating to liquidation, winding-up and deregistration and cross-border transactions relating to liquidation, winding-up and deregistration, each of which is discussed in more detail below.

2.9.1 Meaning of "liquidation", "winding-up" and "deregistration"

The terms "liquidation" and "deregistration can be used interchangeably. The term "winding-up" would include a winding-up as provided for in the Companies Act, and a "liquidation" would be the process following the winding up order or resolution (Davis, Olivier & Urquhart, 2020).

In terms of deregistration of a company, the company is deprived of its legal personality and its corporate status because it has ceased to carry on business or to operate. The Registrar of Companies cancels its registration of the memorandum and articles of the company (Davis, Olivier, & Urquhart, 2020).

2.9.2 Domestic liquidation distribution transactions

A domestic "liquidation distribution", as provided for in section 47(1)(a), can be described as "a transaction in terms of which a resident liquidating company disposes of all its assets to its shareholder(s) in anticipation of or in the course of its liquidation, winding up or deregistration, other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding up, but only to the extent to which the assets are so distributed to its holding company, which must also be a resident. The holding company, on the date of disposal, must form part of the same group of companies as the liquidating company" (De Koker & Williams, 2021, para 13.38).

2.9.3 Cross-border liquidation distribution transaction

Prior to 1 January 2012, liquidation rollover relief only covered the liquidation of companies into domestic holding companies. With effect from this date, section 47 was amended to allow for liquidation into group CFCs.

A cross-border "liquidation distribution", as provided for in section 47(1)(b), can be described as "any transaction in terms of which a liquidating company, which is a CFC in relation to any resident, disposes of all its assets to its shareholders in anticipation of or in the course of its liquidation, winding up or deregistration, to the extent to which the assets are disposed of to a holding company which is a resident and forms part of the same group of companies as the

liquidating company immediately before the distribution, or is a CFC in relation to any resident (De Koker & Williams, 2021, para 13.38).

2.9.4 Assumption of debt

Section 47(3A) provides that the 'roll-over' tax relief will only apply to the extent that equity shares held by the holding company in the liquidating company are disposed of as a result of the liquidation, winding-up or deregistration of the liquidating company and the holding company has not assumed any debt of the liquidating company which was incurred by the liquidating company within a period of 18 months before that distribution, unless the debt:

> "(i) constitutes the refinancing of any debt incurred in more than 18 months before that disposal; or
>
> (ii) is attributable to and arose in the normal course of a business undertaking disposed of, as a going concern, to that holding company as part of that liquidation distribution."

2.9.5 Automatic application of section 47

Section 47(6)(b) provides that section 47 will apply automatically unless the parties agree in writing that the section shall not apply.

2.9.6 Non-application of section 47

Section 47(6)(a) provides that the relief provided by section 47 will not apply where the holding company is:

> "(i) a public benefit organisation as defined in section 30 that has been approved by the Commissioner in terms of that section;
>
> (ii) a recreational club as defined in section 30A that has been approved by the Commissioner in terms of that section; or
>
> (iii) a person contemplated in section 10(1)(cA), (cP), (d), (e) or (t)."

Section 47(6)(c) provides that the section will also not apply if the liquidating company has not taken the steps referred to in section 41(4) to liquidate, wind up, or deregister within 36 months of the date of the liquidation distribution, or within such further period as the Commissioner may allow, or if the liquidating company has invalidated any step to liquidate, wind up or deregister.

2.10 Conclusion

In this chapter of the research report, the corporate rules as contained in sections 42 to 47 were discussed in detail. The manner in which the corporate rules operate as well as the reason for the inclusion of the different corporate rules in the Act were discussed. In addition, the most important definitions contained in section 41 which are applicable to the corporate rules, were also discussed.

In the next chapter, the tax implications of the corporate rules are discussed.

CHAPTER 3: TAX IMPLICATIONS OF THE CORPORATE RULES

3.1 Introduction

In this chapter, the tax implications of the corporate rules, as well as the various anti-avoidance rules contained within the corporate rules, are discussed.

3.2 Income tax implications of section 42 asset-for-share transactions

The tax implications for each of the transferor and acquiring company are as follows:

3.2.1 Transferor

Section 42(2)(a) provides that the transferor will be deemed to have disposed of the capital assets or trading stock for an amount equal to its base cost or tax value, respectively. As a result, no capital gain or capital loss will arise as a result of the disposal.

The transferor has essentially exchanged the capital asset or trading stock that was disposed of with the acquiring company's equity shares.

The transferor is deemed to have acquired the new shares at the same time and for the same amount as the original capital asset or trading stock. The transferor's respective base cost or tax value in the capital asset or trading stock disposed of is 'rolled over' to the new shares acquired).

The ‘roll-over’ rules do not apply in determining the date of acquisition of an equity share issued to the transferor for purposes of section 9C of the Act in the case of an asset, other than an equity share disposed of in terms of the transaction. In Interpretation Note 43 (Issue 5), it is stated that the effect of this exclusion is that the date of the acquisition of the equity shares by the transferor is the date of the transaction, and not the same date of acquisition as the asset disposed of, which would normally be the position with section 42 asset-for-share transactions. This is not the case when the asset which is transferred is an equity share (South African Revenue Service, 2014).

Section 42(3)(a) provides that where allowance assets are disposed of, the allowances and potential recoupments are carried over from the transferor to the company, if the company acquires the asset as an allowance asset (Haupt & Haupt, 2022, p. 513).

Section 42(3)(b) provides that the transferor will not have a recoupment where the asset is an allowance in the transferor's hands and it will be trading stock in the company's hands (Haupt & Haupt, 2022, p. 513).

3.2.2 Acquiring company

Section 42(2)(b)(aa) provides that where an asset is acquired by a company as a capital asset where the transferor held the asset as a capital asset, the company and that person are deemed to be one and the same person with regards to the cost of the asset, the time of acquisition by the transferor and any valuation of the asset done by the transferor (Haupt & Haupt, 2022, p. 510).

Section 42(2)(b)(bb), dealing with trading stock, provides that where trading stock is disposed of by a person at cost or at a profit to a company which will hold it as trading stock, and not as capital assets, the company and that person are deemed to be one and the same person with regards to the date of acquisition of the trading stock, as well as the costs of trading stock and the date of incurral of those costs (Haupt & Haupt, 2022, p. 512).

Where the transferee company acquires an asset as trading stock where the transferor held the asset as a capital asset, section 42(2)(b)(cc) deems the cost of the trading stock to be the base cost of the asset in the hands of the transferor (Haupt & Haupt, 2022, p. 512).

Section 42(3)(a) provides that where allowance assets are transferred, then the allowances as well as possible recoupments are carried over to the company from the transferor. Where the company acquires an allowance asset which will be used as trading stock by it, section 42(3)(b) provides that the transferor will not be allowed to claim a recoupment (Haupt & Haupt, 2022, p. 513).

3.2.3 Contracts

Where a contract is disposed of to a company in terms of an asset-for-share transaction and the contract is disposed of as part of the disposal of a business as a going concern, section 42(2)(3)(c) will allow any section 24 debtors allowance, section 24C future expenditure on contracts allowance and/or section 24P future ship repairs, to be transferred to the company.

3.2.4 Contributed tax capital (CTC)

Section 42(3A) deals with the CTC of the company acquiring the asset where the person disposing of the asset holds a 10% "qualifying interest" in the company acquiring the assets, as provided in paragraph (c) of the definition of "qualifying interest", or will be a full-time employee of the company.

If the asset constitutes trading stock, then the CTC will be an amount equal to the tax cost of the trading stock to the person disposing of the asset. If the asset constitutes a capital asset, then the CTC will be equal to the base cost of the asset.

Where the asset being transferred is a share in a listed company, or a portfolio of a CIS, and the acquiring company, on the same terms as the asset-for-share transaction and within 90 days after the disposal, holds at least 35% of the equity shares in the listed company or portfolio of a CIS, then the CTC will be equal to the market value of the listed shares or units received. The 35% requirement is reduced to 25% if no other person holds an equal amount or more of the listed shares or units immediately after the transaction (Davis *et al*., 2020).

This section will also not apply where assets are acquired by a hedge fund CIS.

The exclusion mentioned above is the same as the exclusion contained in section 42(2)(b), as mentioned above. In *Silke: South African Income Tax 2021*, the reasoning for the inclusion of this exclusion is that, as a matter of practical reality, the rule is virtually impossible to comply with within a listed environment owing to the wide spectrum of shareholders. The same applies to an 'equity' CIS (De Koker & Williams, 2021, para 13.33).

3.2.5 Anti-avoidance provisions in section 42

Section 42(5) - Disposal of shares subsequent to asset-for-share transaction

Section 42(5) contains an anti-avoidance provision which will apply where the shares that were acquired in terms of the asset-for-share transaction are disposed of within 18 months from the date of acquisition. This anti-avoidance rule provides that, if immediately before to the disposal more than 50% of the market value of all the assets disposed of to the transferee company was attributable to allowance assets, trading stock or both, the transferor must, to the extent that any amount received or accrued is less than or equal to the market value of the shares at the beginning of the 18-month period, include that amount in his income (De Koker & Williams, 2021, para 13.33).

This anti-avoidance provision was included in the Act to prevent taxpayers from exchanging allowance assets or trading stock for equity shares which are then sold for a capital gain by the taxpayer for a capital gain where section 42 'roll-over' relief was obtained (Davis *et al*., 2020).

Section 42(5) will not apply if a person disposes of such shares by way of a section 45 "intra-group transaction", a section 46 "unbundling transaction" or a section 47 "liquidation distribution".

Section 42(6)(a) - Ceasing to hold a qualifying interest or be engaged on a full-time basis in business

Where a person ceases, within 18 months, to hold a "qualifying interest" in the company to which it has transferred its assets, or, within that 18-month period, that person ceases to be employed by the company on a full-time basis, section 42(6)(a) provides for a deemed disposal by that person.

If this section applies, the person will be deemed to have disposed of all the equity shares and immediately acquired these shares for an amount equal to the market value as at the date of the asset for share transaction.

The effect of this provision is that the proceeds will be income in the person's hands, even if the original shares were held for more than three years. Any excess will be treated as a capital gain.

Section 42(6)(a) will not apply if the person ceases to hold a "qualifying interest" as a result of:

> *"*(a) an intra-group transaction contemplated in section 45, an unbundling transaction contemplated in section 46 or a liquidation distribution contemplated in section 47;
>
> (b) an involuntary disposal contemplated in paragraph 65 of the Eighth Schedule or a disposal that would have constituted an involuntary disposal contemplated in that paragraph had that asset not been a financial instrument; or
>
> (c) the death of that person."

Section 42(6)(b) - Ceasing to comply with the requirements in respect of a holding in a foreign company

Where a person disposed of an equity share in a foreign company to another foreign company and, within a period of 18 months after the date of disposal and, whether or not as a result of the disposal of shares in that foreign company, the 50% or 70% requirement (whichever applied at the time) is no longer met, a special rule applies (De Koker & Williams, 2021, para 13.33).

Where the above applies, section 42(6)(b) of the Act deems the company to have disposed of the shares which it still holds for their market value at the time of the original asset-for-share transaction, and then to have repurchased them at the same market value. There is effectively a step-up in base cost with the step-up being taxed as a capital gain.

This step-up rule does not apply if the 50% or 70% shareholding is no longer met as a result of the same transactions, excluding death, as referred to above in section 42(6)(a).

Section 42(7) - Disposal of assets acquired

The purpose of section 42(7) is to prevent taxpayers from utilising the 'roll-over' relief provisions to transfer or shift 'built-in gain assets' to a transferee with excess losses. The aforementioned enables the transferee company to immediately dispose of the transferred assets and set-off any resultant capital gains against its tax losses (De Koker & Williams, 2021, para 13.33).

In respect of capital assets, section 42(7) provides that where a capital asset is disposed of by a company within 18 months after acquiring the asset in terms of an asset-for-share transaction, the portion of any capital gain that may arise may not be set-off against any assessed loss or capital loss of the company. Instead, after applying the applicable inclusion rate, that portion of the capital gain is 'ring-fenced' and recognised immediately as part of the net capital gain In *Silke: South African Income Tax 2021*, it is stated that "80% of the gain is included in the company's taxable income even if it has an assessed capital loss for the year of assessment or an assessed capital loss brought forward from its previous year of assessment" (De Koker & Williams, 2021, para 13.33).

In respect of trading stock, section 42(7)(b)(i) provides that, where the transferee disposes of the trading stock within a period of 18 months from the date of acquisition, a portion of the

profit cannot be set-off against the transferee's assessed loss. This rule does not apply to trading stock that is regularly and continuously disposed of by the company (Haupt & Haupt, 2022, p. 517).

In respect of allowance assets, section 42(7)(b)(ii) provides that, where the transferee disposes of an allowance asset within 18 months from the date of acquisition, the amount of the recoupment is deemed to be from a separate trade, to the extent that it does not exceed what the recoupment would have been if the asset was disposed of for an amount equal to its market value at the beginning of the 18-month period. The taxable from the separate trade may accordingly not be set off against any assessed loss or balance of assessed loss of the company (Haupt & Haupt, 2022, p. 517).

Section 42(8) - Disposal of debt

Section 42(8) applies where any asset which secures any debt to a company in terms of an asset-for-share transaction is disposed of, and:

- "the transferor incurred the debt more than 18 months before the date of the disposal; or
- within 18 months before the date of the disposal and the debt was incurred at the same time as the transferor acquired the asset or the debt constitutes a refinancing of a debt referred to,
- to the extent that the 'amount of debt' is attributable to and arose in the normal course of a business undertaking disposed of as a going concern to the company in terms of the asset-for-share transaction".

(De Koker & Williams, 2021, para 13.33).

In the event of the special roll-over rule applying, the base cost of the transferred asset will be equal to the base cost of that asset in the hands of the transferee. The transferor will not realise an immediate gain on the transfer.

When the transferor disposes of any of the equity shares acquired in terms of the asset-for-share transaction, the transferor must treat a proportionate amount of the face value of the debt, where the equity share is held as a capital asset, a return of capital in respect of that equity share that accrues to that person immediately before the disposal by that person of that equity

share, or where the equity share is held as trading stock, as income to be included in his income immediately before that equity share is disposed of (De Koker & Williams, 2021, para. 13.33).

Prior to 1 January 2022, the reference to 'return of capital' above where the equity share was held as a capital asset, referred to 'an amount received or accrued'. The reason why this provision was amended is to immediately trigger a capital gain before the disposal, even if the share was disposed of in terms of another transaction utilising the corporate rules relief (Haupt & Haupt, 2022, p. 518).

3.2.6 Other considerations

Section 24BA – Value mismatches in asset-for-share transactions

Section 24BA(2) provides that section 24BA applies where there is a value mismatch between the shares issued by the company and the value of the asset which the company received in exchange for the issue of the shares (Haupt & Haupt, 2022, p. 518). A second requirement that must be met before section 24BA will apply is that the value of the consideration in respect of the exchange must be different from consideration that would have applied had the asset been acquired in exchange for the issue of those shares in terms of a transaction between independent persons dealing at arm's length (Davis, Olivier, & Urquhart, 2020).

Section 24BA(3)(a) provides that, if the market value of asset immediately before the disposal exceeds the market value of the issued shares immediately after the issue, the difference is deemed to be a capital gain in the hands of the company issuing the shares. The person to whom the shares were issued must reduce, by the same amount, their base cost in the shares, if the shares will be held as capital assets, or the cost of the shares, if the shares will be held as trading stock.

Section 24BA(3)(b) provides that, if the market value of shares immediately after the issue exceeds the market value of the asset immediately before the disposal, the difference is deemed to be a dividend *in specie* paid by the company on the date of the issue of the shares.

Section 24BA(4) provides that this section will not apply where the person holds all of the shares in the company immediately after it acquires the asset, where the company issuing the shares and the company disposing of the asset forms part of the same "group of companies" immediately after the company acquires the asset, or the transaction is between connected persons and deemed to be at market value in terms of paragraph 38 of the Eighth Schedule.

Therefore, a non-arm's length consideration will result in either a deemed capital gain for the company issuing the shares or a deemed dividend *in specie* distributed by it. As section 24BA overrides section 42, it is important for the value of the shares issued to be equal to the value of the asset received (De Koker & Williams, 2021, para. 13.33).

Section 40CA(b) – Acquisition of assets in exchange for shares

Section 40CA of the Act deals with the acquisition of assets by a company in exchange for shares issued by that company. Section 40CA applies to determine the cost of the asset to the company issuing the shares, but only where section 42 does not apply, as 42 overrides 40CA(a). The cost of the asset is equal to the market value of the shares received in exchange for the asset. The reason for this is that the issue of shares does not constitute "expenditure actually incurred" and, as a consequence, the asset would not have a base cost. In *CSARS v Labat* (669/10) [2011] ZASCA 157, the court held that "expenditure" requires a diminution, even temporarily, of the person who expends.

Section 40CA(b) came into effect on 1 January 2022 and applies in respect of the acquisition of any asset by a company in exchange for shares on or after this date. Section 40CA(b) provides that, for purposes of section 42, section 43 and section 44, where a section 24BA(3)(a) capital gain, as discussed above, arises, as a result of the acquisition of an asset in exchange of shares issued by that company, such deemed capital gain must form part of the base cost of the asset which is acquired by the company. The reason why section 40CA(b) was inserted into the Act is to prevent effective double taxation where the company in the future disposes of the asset for more than its deemed base cost in terms of the corporate rules (Haupt & Haupt, 2022, p. 547).

3.3 Income tax implications of section 43 substitutive share-for-share transactions

Section 43 provides that where a person disposes of an equity share interest, in the form of a linked unit, in exchange for another equity share interest in a company, not being a linked unit, that person is deemed to have disposed of his equity share interest at base cost if they were held as capital assets, or at cost if they were held as trading stock. The equity share interest which is acquired in exchange will be deemed to be acquired at the same base cost or cost, as the case may be.

This section is not used often in practice and is accordingly not discussed further in this report.

3.4 Income tax implications of section 44 amalgamation transactions

Section 44 provides 'roll-over' tax relief to the amalgamated company, the resultant company, and the amalgamated company's shareholders, as follows:

3.4.1 Amalgamated company

Section 42(2)(a) provides that the amalgamated company is deemed to have disposed of any capital asset for an amount equal to its base cost. As a result, there will be no capital gain or loss as a result of the transaction. Furthermore, section 44(2)(b) provide that the amalgamated company is deemed to have disposed of any trading stock and allowance assets at tax value.

Section 44(8) provides that when calculating its taxable income or assessed loss, an amalgamated company must ignore the disposal of shares in the resultant company (which it acquired as part of the “amalgamation transaction”) to its shareholders.

3.4.2 Resultant company

For the purposes of determining the date of acquisition of the asset as well as the base cost of the asset in the hands of the resultant company, the resultant company and the amalgamated company will effectively be treated as “one and the same person”.

Where the asset disposed of constitutes trading stock, in terms of section 44(2)(b), the resultant company and the amalgamated company is deemed to be “one and the same person” as far as the acquisition date of the trading stock, as well as any costs or expenses incurred in respect of the cost of acquisition of the stock, are concerned.

Regarding allowance assets, section 44(3)(a) provides that, as far as claiming allowances on assets and recoupments are concerned, the resultant company and the amalgamated company are considered to be "one and the same person”.

3.4.3 Shareholders of amalgamated company

Section 44(6) of the Act applies to a person that has acquired a share in the resultant company by virtue of that person holding a share in the amalgamated company. Section 44(6)(b) provides that that person is deemed to have disposed of the equity share in the amalgamated company for an amount equal to its base cost and acquired the equity share in the resultant company at the same time and for the same amount that the equity share in the amalgamated company was acquired.

The in-specie distribution of the shares of the resultant company is not considered an amount transferred or applied by the amalgamated company for the benefit of its shareholders under section 44(6)(c) of the Act. As a result, the in-specie distribution is not considered a dividend or a return of CTC and has no tax implications for the amalgamated company or its shareholders.

3.4.4 CTC

Section 44(4A) governs the additional CTC which will be created if the resultant company issue shares as part of the amalgamation transaction. The additional CTC which will be created is based on the CTC of the amalgamated company and can be calculated as follows:

"CTC of amalgamated company when it is wound up	x	Value of shares held in the amalgamated company by shareholders other than the resultant company / Value of all shares in the amalgamated company"

Consequently, if the resultant company held no shares in the amalgamated company at the time of the amalgamation transaction, the CTC of the amalgamated company is essentially transferred to the resultant company.

3.4.5 Anti-avoidance provision in section 44

Disposal of assets acquired – section 44(5)

Section 44(5) of the Act provides that where a resultant company disposes of a capital asset within 18 months after acquiring such asset in terms of an amalgamation transaction, the following will apply:

- A portion of any capital gain that may arise may not be set-off against any assessed loss or capital loss of the resultant company and may also not be brough forward from previous years.
- A portion of any capital loss that may arise must be disregarded.
- A portion of any profits and losses from trading stock must be deemed to be from a separate trade and cannot be set-off against the losses and profits derived by the company from its other activities or assessed losses brought forward from previous years.

- A portion of any recoupments from allowance assets must be deemed to be from a separate trade and cannot be set-off against any losses made or any assessed losses brought forward from previous years.
- Instead, that portion of the capital gain is 'ring-fenced' and recognised immediately as part of the net capital gain after applying the applicable inclusion rate, and the capital loss is disregarded.

3.5 Income tax implications of section 45 intra-group transactions

To the extent that the 'roll-over' tax relief in section 45(2) apply, in respect of capital assets, such assets are deemed to be disposed of by the transferor company at their respective base costs. The transferor and transferee company will effectively be treated as "one and the same person" for purposes of determining the date of acquisition of the asset by the transferee company, the amount and date of incurral of any expenditure as well as any valuation of the asset facilitated by the transferee company.

In respect of trading stock, section 45(2) provides that such trading stock is deemed to have been disposed of by the transferor company for an amount equivalent to the amount taken into account for purposes of sections11(a), 22(1) or (2) of the Act and the transferor and transferee company will be treated as "one and the same person" for purposes of determining the taxable income of the transferee company from a trade carried on by it with reference to the date of acquisition of the asset concerned and the amount and date of incurral of any cost/expenditure in respect of the asset.

In respect of allowance assets, section 45(3) provides that the transferor and transferee company will be treated as "one and the same person" to determine any allowance or deduction that the transferee company in entitled to, as well as to determine how much of any allowance or deduction must be recovered or recouped or included in income relating to that asset (Haupt, P & Haupt, E, 2022, p. 531).

Where a contract, disposed of to the transferee company, which imposed an obligation on a person and in terms of which a section 24 or 24C allowance was available to the transferor company, section 45(3) provides that no allowance granted to the transferor company must be included in its income for the year of transfer. Also, the transferor and transferee company will be treated as "one and the same person" for purposes of determining the amount of any allowance to which the transferee company becomes entitled in respect of the contractual

obligation and the amount to be included in the transferee company's income by virtue of the obligation.

3.5.1 Section 45(3A) - Funding of acquisition assets

The intention of section 45(3A) of the Act is for tax to be accounted on the disposal of the debt or shares to a person not forming part of the same "group of companies" as the company (Haupt & Haupt, 2022, p. 532).

Section 45(3A) applies where an asset is acquired by the transferee company in terms of an intra-group transaction and the asset is funded by issuing debt, or a share other than an equity share. In addition, the debt or share must be issued by a company forming part of the same "group of companies" as the transferee or transferor. Lastly, the debt or share must be used or issued, as the case may be, to directly or indirectly facilitate or fund that intra-group transaction.

Where the requirements of section 45(3A)(a) are met, the holder of the debt, which forms part of the same "group of companies" as the issuer, is deemed to have acquired the debt for an amount of R nil. Therefore, if the debt were to be disposed of, the proceeds would be taxable and, where a company that forms part of the same "group of companies" repays the debt, such repayment will not give rise to a capital gain or a receipt for purposes of taxable income of that holder. The effect of the above is that where the holder of the debt or share disposes of it to a person not forming part of the same "group of companies", tax must be accounted for on the disposal.

It should be noted that the relief applies only in respect of local intra-group transactions and not where a transferor disposes of equity shares in a foreign company to a transferee.

3.5.2 Section 45(3B) – De-grouping after funding

The purpose of section 45(3B) is to reinstate the base cost of the debt or shares for the holder, essentially placing the holder in the same position as if the intra-group transaction was not implemented (Haupt & Haupt, 2022, p. 532).

This section applies where section 45(3A) applies to debt or shares issued, and the transferor and transferee cease to form part of the same "group of companies". The implications of section 45(3B) applying to debt is that the holder of the debt is deemed to have incurred expenditure equal to the face value of the debt, reduced by all capital repayments up to date. Relating to shares, the holder of the shares is deemed to have incurred expenditure equal to the initial

subscription price for the share, reduced by any returns of capital received until the time of de-grouping (Haupt & Haupt, 2022, p. 532).

For years of assessment commencing on or after 1 January 2022, this section was amended to also provide for the position where the transferee and transferor companies are still part of the same "group of companies" on the 6th anniversary of the acquisition date, or the transferee company disposes of the assets within 18 months of acquiring the assets in terms of section 45. For both these cases, the holder of the debt or share is deemed to have incurred expenditure equal to the face value of the debt outstanding or the initial subscription price reduced by any return of capital that reduced the base cost of that share, as the case may be (Haupt & Haupt, 2022, p. 533).

The proviso to section 45(3B) provides that where the transferee company disposes of the asset within 18 months from the date of the section 45 transaction, the base cost of the asset in its hands will be limited to the extent to which the debt or share "facilitated the funding of the acquisition of the asset" (Haupt & Haupt, 2022, p. 533).

3.5.3 Anti-avoidance provisions in section 45

Section 45(4) - De-grouping charge

The transferor and any controlling group company in relation to the transferor, and transferee company must remain part of the same "group of companies" for a period of at least six years from the date of the section 45 transaction, failing which, the 'de-grouping' rules in section 45(4) would be triggered, which would give rise to a tax cost in the transferee company. However, in terms of section 45(4)(c), the de-grouping rules will not apply where the transferor or transferee company are liquidated or deregistered within the 6-year period, provided that the holding company and the remaining transferor/transferee remain part of the same "group of companies" for the 6-year period.

Section 45(4B) includes certain deeming provisions which will also deem a 'de-grouping' event to occur in further circumstances. These provisions relate to the manner in which a transferor company utilises the consideration arising from a sale of assets to a transferee company.

In general terms, section 45(4B) will apply where the transferor company disposes of the consideration received outside of the "group of companies" within two years of the section 45

transaction taking place by way of a distribution to a company or for no consideration, or for a consideration which does not reflect an arm's length price.

The result of de-grouping is that the transferee company is liable for tax on the deemed disposal of assets subject to the original section 45 transaction which are still on hand. Section 45 sets out a basis on which this charge is calculated across different categories of assets. (To the extent that this issue arises, the transferee company obtains a 'step up' in tax value or base cost of certain assets.)

Disposal of assets by transferee company within 18 months – section 45(5)

Section 45(5) applies where the transferee company disposes of an asset which was acquired in terms of an intra-group transaction, within 18 months after the acquisition of such asset. In essence, a portion of the recoupments and/or capital gains realised by the transferee on the subsequent disposal will be ring-fenced and not be allowed to be offset against any assessed loss or capital loss existing in the transferee's hands at that time. However, these provisions do not apply to trading stock that is regularly or continuously disposed of by the transferee company.

This provision does not apply to a REIT.

3.6 Income tax implications of section 46 unbundling transactions

Section 46 provides 'roll-over' tax relief to the unbundling company as described below and regulates the allocation of the base cost and CTC of the shares in the 'unbundled company' and the 'unbundling company'.

Where the requirements of an 'unbundling transaction' are met, section 46(2) provides that the unbundling company must disregard the distribution for purposes of determining its taxable income or assessed loss. The effect of section 46 applying is that the unbundled shares are deemed to be transferred at cost or trading stock value if the shares were held as trading stock, and at base cost if held as capital assets.

Section 46(3) provides that a shareholder who acquires shares in terms of an 'unbundling transaction' must allocate a portion of the expenditure (that is, the base cost) and any market value attributable to the shares held in the 'unbundling company' to the shares acquired in the 'unbundled company' in accordance with the following formula:

"Y = A / A + B x C

Where:

Y = The cost to be attributed to the unbundled shares;

A = The market value of the unbundled shares at the close of the day after the unbundling transaction;

B = The market value of the unbundling shares at the close of the day after the unbundling transaction; and

C = the cost to the shareholder of his holding of shares in the unbundling company at their cost or trading stock value, if held as trading stock, or at their base cost, if held as a capital asset"

(De Koker & Williams, 2021, para. 13.36).

Furthermore, section 46(5A) provides that paragraph 76B of the Eighth Schedule, which provides for the reduction in base cost of equity shares as a result of a distribution, does not apply to the distribution where section 46 applies.

3.6.1 Dividends tax

Where equity shares are distributed as an "unbundling transaction", such distribution by that unbundling company must be disregarded in terms of section 46(5) in determining any liability for dividends tax.

3.6.2 CTC

Section 46(3A) requires that the CTC of the unbundled company and of the unbundling company to be adjusted immediately after the unbundling. The following is stated in *Silke: South African Income Tax 2021*, relating to the CTC of the unbundling company and the unbundled company, respectively:

CTC of the unbundling company

> "The CTC of the unbundling company is deemed to be an amount which bears to the CTC immediately before distribution the same ratio as the aggregate market value, immediately after the distribution, of the shares bears to the aggregate market value of the shares immediately before the distribution."

(De Koker & Williams, 2021, para. 13.36).

CTC of the unbundled company

> "The CTC of the unbundled company immediately after the distribution is deemed to be an amount equal to the sum of:
>
> - an amount which bears to the CTC of the unbundling company immediately before the distribution the same ratio as the aggregate market value of the distributed shares before the distribution bears to the aggregate market value of the shares in the unbundling company immediately before the distribution; and
> - an amount which bears to the CTC of the unbundled company immediately before the distribution the same ratio as the shares held in that company immediately before the distribution by persons other than the unbundling company bear to all shares held in that company immediately before the distribution."

(De Koker & Williams, 2021, para. 13.36).

3.6.3 Limitation of expenditure

Section 46A is an anti-avoidance measure which limits the base cost of shares received in an unbundling if the shares in the unbundling company are preceded by untaxed connected-person disposals.

The below example explains the workings of section 46A of the Act:

> "… it provides that where a taxpayer (A) acquires shares in an unbundled company in terms of an unbundling transaction and within a period of two years preceding the unbundling B, a connected person in relation to A, held a share in the unbundling company at any time during that period, and any amount received by or accrued to B in respect of the disposal of the share at any time during that period would not have been subject to normal tax or would not have been taken into account for purposes of determining B's 'net income' as defined in s 9D, the expenditure incurred by A in respect of any share will, for purposes of the Act, not exceed an amount determined in accordance with subsection (2)."

(De Koker & Williams, 2021, para 13.36).

In the event of section 46A applying, the expenditure incurred by the taxpayer for the acquisition of the share in the unbundling company is limited to:

- "the cost of the share to the 0erson (or the first connected person who held the share); less
- any deduction allowed to the person (and other connected persons); plus
- any recoupments of that deduction by the person (and other connected persons); plus
- any capital gain made on the disposal of the share by the person (and other connected persons)",

(Davis, Olivier, & Urquhart, 2020).

3.7 Income tax implications of section 47 transactions relating to liquidation, winding-up and deregistration

To the extent that the 'roll-over' tax relief in sections 47(2) and 47(3) apply:

- In respect of capital assets, section 47(2)(a)(i) provides that the asset is deemed to be transferred to the transferor at its base cost and in respect of trading stock, section 47(2)(b)(i) provides that such trading stock is deemed to have been disposed of by the transferor company for an amount equal to the tax value of the trading stock, for the purposes of section 11(a) or section 22(1) or (2). The proviso to section 47(2) provides that where a CFC distributes an asset to a resident holding company, forming part of the same "group of companies", section 47 does not apply, if, at the time of disposal, the base cost exceeds the market value of a capital asset, or the tax value exceeds the market value of trading stock. The effect of the proviso is that losses cannot be transferred into SA. Where the holding company is a SA tax resident, the relief provided will not apply in respect of any asset with a cost in excess of its market value (De Koker & Williams, 2021, para 13.38).
- In respect of allowance assets, section 47(3)(a) provides that, where the liquidating company disposes of an allowance asset, which is acquired as an allowance asset by the holding company, no allowance will be required or recouped by the holding company.
- Where a contract, disposed of to the transferee company, which imposed an obligation on a person and in terms of which a section 24 or section 24C allowance was available to the transferor company, no allowance granted to the transferor company must be included in its income for year of transfer. Furthermore, the transferor and transferee company will be treated as "one and the same person" for purposes of determining the amount of any

allowance to which the transferee company becomes entitled in respect of the contractual obligation and the amount to be included in the transferee company's income by virtue of the obligation.

The distribution of the assets by the liquidating company to its shareholder will be exempt from normal tax in the shareholder's hands in terms of section 10(1)(k) of the Act.

Furthermore, to the extent that the distribution constitutes a return of capital, the shareholder must disregard the return of capital in determining its taxable income, assessed loss, aggregate capital gain or aggregate capital loss.

The disposal by the shareholder of its equity shares in the liquidating company (as a result of the liquidation thereof) must be disregarded in determining the shareholder's taxable income, assessed loss, aggregate capital gain or aggregate capital loss.

3.7.1 Anti-avoidance provision in section 47

Section 47(4)(a) provides that, where the shareholder disposes of capital assets within 18 months after acquiring such assets in terms of a "liquidation distribution", a portion of any capital gain or capital loss that may arise may not be taken into account in determining the net capital gain or net capital loss of the shareholder. The portion of the capital gain which may not be taken into account is deemed to be from a separate trade (that is, ring-fenced) and is equal to market value of the asset on the date that the "liquidation distribution" took place, less the base cost of the asset (Haupt & Haupt, 2022, pp. 544 - 545).

3.7.2 Dividends Tax

The *in-specie* distributions by the liquidating company should be exempt from dividends tax in terms of section 64FA(1)(b), where the liquidating company and the shareholder form part of the same 'group of companies' as defined in section 41(1).

3.8 Relief from STT, transfer duty and VAT

3.8.1 Relief from STT

STT is levied on the transfer of shares of companies incorporated in SA.

Section 8(1)(a)(i), (ii), (iii), (iv) and (v) of the STT Act provides that any securities that are transferred in terms of an "asset-for-share transaction" as contemplated in section 42, an

"amalgamation transaction" as contemplated in section 44, an "intra-group transaction" as contemplated in section 45, an "unbundling transaction" as contemplated in section 46 and a "liquidation distribution" as contemplated in section 47, respectively, will be exempt from STT.

Relating to a section 47 liquidation distribution, the definition of "transfer", as contained in section 1 of the STT Act, specifically excludes "a cancellation or redemption of a security if the company which issued the security is being wound up, liquidated or deregistered or its corporate existence is being finally terminated". Consequently, there will be no STT on the cancellation of the shares in the liquidating company on winding up.

The aforementioned exemption will only apply provided that the public officer of the company which issued the security being transferred has made a sworn affidavit or solemn declaration to this extent.

3.8.2 Relief from transfer duty

The Transfer Duty Act contains two provisions that provide for the exemption from transfer duty where the transfer of the property takes place by way of a section 42 "asset-for-share transaction".

Where the transfer of property complies with the provisions of section 42, no transfer duty will be payable in terms of the exemption contained in section 9(1)(l)(i) of the Transfer Duty Act. Where both the transferor and the transferee are VAT vendors, and the provisions of section 8(25) of the VAT Act apply, section 9(15A) of the Transfer Duty Act also provides an exemption from transfer duty where the acquisition of property takes place by way of an "asset-for-share transaction", provided that the public officer of the acquiring company makes a sworn affidavit or solemn declaration that the supplier and recipient of that property are deemed to be one and the same person in terms of section 8(25) of the VAT Act.

Section 9(1)(l)(iB), (ii) and (iii) of the Transfer Duty Act provides an exemption from transfer duty where a property has been acquired by a company in terms of a section 44 "amalgamation transaction", a section 45 "intra-group transaction" or a section 47 "liquidation distribution", respectively.

The exemptions provided for in section 9(1)(l) of the Transfer Duty Act will only apply if the public officer of the acquiring company makes a sworn affidavit or solemn declaration that

such acquisition of property complies with the provisions of section 9(1)(l) of the Transfer Duty Act.

3.8.3 Relief from VAT

Section 8(25) of the VAT Act provides that where goods or services are supplied by a vendor to another vendor, and section 42, section 44, section 45, or section 47 of the Act is complied with, the vendors must for the purposes of that supply or subsequent supply be deemed to be "one and the same person". Consequently, there will be no VAT levied on the transaction.

The supply, however, is required to be a supply of a going concern in order to qualify for VAT relief, specifically relating to section 42 and section 45 transactions. Where the transfer includes the supply and leaseback of fixed property, there is no need for the property to be transferred as a supply of a going concern for it to be VAT neutral under section 8(25). This supply is exempt as the supplier and recipient are deemed to be one and the same person (Haupt & Haupt, 2022, para 18.3).

Relating to a section 46 unbundling transaction, the disposal of the unbundled shares should not be subject to VAT, as it is considered to be the supply of a "financial service", which is exempt in terms of section 12 of the VAT Act.

3.9 Conclusion

In this chapter, the income tax, STT, VAT and transfer duty implications of the corporate rules were discussed in detail.

Where the corporate rules apply, no tax implications arise as the acquiring company effectively "steps into the shoes" of the transferring company.

Certain anti-avoidance rules apply where the requirements of the specific corporate rule are subsequently no longer met.

In the next chapter, it is considered whether the corporate rules apply to successive transactions, as well as what the tax implications are of successive transactions.

CHAPTER 4: SUCCESSIVE CORPORATE TRANSACTIONS

4.1 Introduction

In group restructuring transactions, companies often implement successive corporate transactions, such as a section 42 "asset-for-share transaction" shortly after a section 45 "intra-group transaction" (Cliffe Dekker Hofmeyr, 2016).

A requirement of the corporate rules is generally that the acquiring company must acquire and hold an asset as trading stock if the transferor held it as trading stock, and if the transferor held it as a capital asset, the acquiring company must acquire and hold it as a capital asset (hereinafter referred to as the 'Capital/Trading Stock Requirement'). The 'roll-over' tax relief provisions do not apply to the transfer of an asset to the extent that it constitutes "trading stock" in the hands of the person disposing of the asset, and that asset is acquired by the acquiring company as a "capital asset".

This chapter focuses on the application of the corporate rules to successive corporate transactions, as well as the tax implications of such transactions, taking into account that group restructuring transactions are often implemented through successive corporate transactions where assets may be transferred multiple times within the group within a short period of time.

4.2 Application of 'capital asset' definition

The term "capital asset" is, for purposes of sections 42, 44, 45, 46 and 47, defined in section 41(1) as "an asset as defined in paragraph 1 of the Eighth Schedule, which does not constitute trading stock".

The definition of an "asset" as contained in paragraph 1 of the Eighth Schedule includes "property of whatever nature, whether movable or immovable, corporeal or incorporeal" as well as "a right or interest of whatever nature to or in such property".

Accordingly, the assets which are generally transferred in terms of a corporate transaction should fall within the definition of an "asset" as defined in paragraph 1 of the Eighth Schedule.

It follows, from the definitions above, that the assets transferred will only constitute "capital assets" in the transferors' hands if these assets do not fall within the definition of "trading stock" as defined in terms of section 41(1).

The definition of "trading stock" as contained in section 41(1) incorporates the definition of "trading stock" as contained in section 1. The definition of this term in section 1 provides that:

> *"*'trading stock' includes - (a)(i) anything… purchased or in any other manner acquired by a taxpayer for the purposes of… sale or exchange by the taxpayer or on behalf of the taxpayer' and '(a)(ii) anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income*"*.

The shares and/or assets transferred should fall within the meaning of "anything" as described in this definition.

Based on a literal interpretation of the above definition, all assets acquired by a taxpayer for the purpose of sale or exchange would fall within the definition of "trading stock". Thus, where a taxpayer acquires an asset with the intention of selling or exchanging such asset, even in the absence of any profit motive, such asset would constitute "trading stock" as defined.

Although the literal interpretation of the above phrase may not present significant difficulties in the ordinary course of business, it should be noted that if these words relate to the definition of a "capital asset", as defined in section 41(1), such interpretation may have anomalous implications in the context of the corporate rules.

As discussed above, the 'roll-over' tax relief afforded by the corporate rules will generally not apply to the transfer of an asset to the extent that it constitutes "trading stock" in the hands of the transferor if that asset is acquired by the acquiring company as a "capital asset". The apparent purpose of this rule seems to be to ensure that the parties do not use the 'roll-over' tax relief provisions to transfer assets which are held on revenue account (which would be subject to normal tax if disposed of) to a company which will hold the asset on capital account and hence only be subject to CGT upon disposal.

It therefore follows, from a conceptual point of view, that the distinction between "trading stock" and a "capital asset" in terms of section 41(1) is intended as a distinction between assets which are respectively held on revenue and capital account. However, to the extent that the words of the "trading stock" definition contained in section 1(1) are given their literal meaning, instances would arise where, irrespective of the fact that an asset retains its capital nature in the hands of both parties, the disposal becomes taxable.

A literal interpretation of the "trading stock" definition is particularly problematic in transactions involving the corporate rules where assets are transferred between companies within the same economic unit on a back-to-back basis. In these instances, assets held on capital account would typically retain their nature in the hands of the different transacting entities, however, the transfer of capital assets would fall outside the ambit of 'roll-over' relief by virtue of the fact that such assets would constitute "trading stock" as defined in section 1(1) of the Act due to the short period for which the assets were held before the assets are transferred again.

However, it is important to note that the definitions contained in section 1 and section 41(1) are prefaced with the wording "unless the context otherwise indicates". Consequently, one may depart from an apparent literal interpretation of the definitions contained in section 1(1) or section 41(1) under certain circumstances.

In *CIR v Simpson* [1949] 4 All SA 460 (A), Watermeyer CJ found that term "income", in the context of section 7(2) of the Act, should be given its ordinary meaning, that is 'profits' or 'gains', and not the meaning ascribed to it by the definition contained in the Act. In arriving at his decision Watermeyer CJ applied the rule laid down by Halsbury, *Laws of England*, in para. 591 of Vol. 31 (Hailsham ed.) which is:

> *"*A definition section does not necessarily apply in all the possible contexts in which a word may be found in the statute. If a defined expression is used in a context which the definition will not fit, it may be interpreted according to its ordinary meaning.*"*

This approach was confirmed in *De Beers Holdings (Pty) Ltd v CIR* 1986 (1) SA 8 (A), where the court referred to trading stock in the following manner:

> *"*The normal way in which a dealer in shares operates is to buy shares and resell them at a profit. They constitute his stock-in-trade, as do groceries in a grocer's business… the dealer acquires the shares with the intention of ultimately disposing of them as part of a scheme of profit-making. This distinguishes his trade from that of an investor in shares who buys shares to hold them as a capital asset and reap a return in the form of dividends…*"*

The court then continued to note that the definition of "trading stock" (as it then read) "would seem to comprehend what is ordinarily understood by the term trading stock".

The court in the *Endumeni* case confirmed its support of the so-called 'purposive approach' to statutory interpretation. The court noted that such approach was objective as opposed to being subjective; regard is to be had to the context of the provision in the light of the document as a whole and a sensible meaning is to be preferred to one which is insensible or has unbusinesslike results or undermines the apparent purpose of the legislation.

In light of the above, the term "trading stock" should be given its ordinary meaning (that is, acquired with a profit motive) for purposes of applying the definition of "capital asset" as defined in section 41(1) and that the mere acquisition of an asset with the intention of disposing of it is insufficient in itself to render an asset as trading stock.

It therefore follows that the assets which are transferred should only fall within definition of "trading stock" in the event that the capital/revenue analysis below concludes that the proceeds on disposal of the assets will be of a revenue nature.

This is in line with the various BPRs which had been issued by SARS which are discussed below. The intention of the group must at all times be considered. Should there be a change of intention, then it could be possible for the 'roll-over' tax relief to not apply to the subsequent transaction.

4.3 The capital or revenue nature of the sale proceeds

It is generally accepted that the dominant intention with which a taxpayer acquires an asset determines whether it is acquired on capital or revenue account. In the case of *CIR v Stott* (1928 AD), the court considered whether the sale of land gave rise to a receipt of a capital nature or of a revenue nature, and the court held:

> *"*It is unnecessary to go so far as to say that the intention with which an article or land is bought is conclusive as to whether the proceeds derived from a sale are taxable or not. It is sufficient to say that the intention is an important factor and unless some other factor intervenes to show that when the article was sold it was sold in pursuance of a scheme of profit-making, it is conclusive in determining whether it is capital or gross income.*"*

The rule applies to both the intention of the taxpayer at the date of acquisition as well as upon any change of intention that may occur prior to disposal of the asset.

Given the short period in which the assets will be acquired and subsequently disposed of by the transferors, in relation to, for example, the successive asset-for-share transactions, one could assume that there will be no 'change of intention' during the period that the assets will be held for. Therefore, the intention of the transferors at the time of the acquisition of the assets is relevant and this intention could be either capital or revenue in nature.

In this regard, the Appellate Division held, in the case of *CIR v Pick 'n Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A), that "…receipts were revenue if they derived from 'an operation of business in carrying out a scheme for profit-making', and non-revenue if they did not…*"*

Applying the legal principle formulated in the *CIR v Pick 'n Pay Employee Share Purchase Trust* case to the circumstances of the successive corporate transactions, the transferors should hold the assets that are transferred on capital account provided that, it was not the intention of the transferors to acquire and dispose of the assets in a "scheme of profit making".

The respective transferors will dispose of the assets in exchange for shares or assumption of liabilities in/by the respective transferee company, the value of which will be equal to the acquisition value of the assets being transferred. In other words, the transfer of assets in successive corporate transactions should not result in the transferors realising a profit which was inherent in the assets being transferred.

On the basis that the transferors should realise the assets that are transferred at the same value at which they were acquired, it is unlikely that the transferors can be seen to be embarking on a "scheme of profit making". Accordingly, the transferors should hold the assets that are transferred on capital account.

It therefore follows that sub-paragraph (a)(i) of the definition of "trading stock" in section 1(1) should be applied in the context of section 41(1), that the assets that are transferred should not meet the definition of "trading stock" and consequently, should be "capital assets" in the hands of the transferors.

4.4 SARS' view on successive corporate transactions

SARS has issued various Binding Private Rulings (BPR) on these issues. Although not binding on persons other than the applicant for the rulings, it does provide an indication of how SARS

is likely to consider these issues. It is important that each case be considered based on its own specific facts and circumstances. Some of these BPRs are discussed below.

4.4.1 BPR 159 – Asset-for-share and amalgamation transactions

On 16 January 2014, SARS issued BPR 159, dealing with asset-for-share and amalgamation transactions. The relevant background facts of BPR159 can be summarised as follows:

- The Co-Applicant disposed of its business to a NewCo in return for equity shares in that NewCo in terms of a section 42 asset-for-share transaction;
- the Co-Applicant then disposed of the newly issued shares in NewCo to the Applicant (another related party) in exchange for the issue of shares in the Applicant; and
- the Co-Applicant then distributed its newly acquired shares in the Applicant to its shareholders in anticipation of winding up as contemplated in section 44 of the Act.

Based on the above-mentioned facts, SARS ruled that:

> *"*The NewCo shares will be regarded as having been acquired and held by the Co-Applicant on capital account even though the equity shares in NewCo will be disposed of to the Applicant shortly after acquisition. The facts and circumstances of the matter take into account the proposed steps before and after the acquisition of the NewCo shares by the Co-Applicant, are very specific and, in the corporate rules contained in Part II of Chapter II of the Income Tax Act, indicate that the Co-Applicant and the group as a whole will not deal with the asset as trading stock.*"*

4.4.2 BPR 328 – Consecutive asset-for-share transactions

On 20 September 2019, SARS issued BPR 328, dealing with consecutive asset-for-share transactions. The relevant background facts of BPR159 can be summarised as follows:

- Several shareholders transferred 18.69% of their shares in company A to the Applicant, in turn for the issue of shares in the Applicant, in terms of a section 42 asset-for-share transaction.
- The Applicant then disposed of this 18.69% to InvestCo in return for the issue of shares by InvestCo to the Applicant, in terms of a section 42 asset-for-share transaction.

Based on the above-mentioned facts, SARS ruled that:

"a) The shares in company A will be regarded as having been acquired and held by the applicant on capital account even though these shares will be disposed of to InvestCo shortly after acquisition. The facts and circumstances of this matter, taking into account the proposed steps before and after the acquisition of the shares in company A by InvestCo, are very specific and, in the context of the corporate rules, indicate that the applicant and the group as a whole will not deal with the shares in Company A as trading stock.

b) Section 42(7) will apply to the proposed transaction but will have no tax implications.

c) The base cost of the shares in company A, on the date of their disposal to the Applicant and InvestCo, will remain the same as the base costs of those shares for the original shareholders."

4.4.3 Other BPRs issued by SARS

In BPR 230, issued by SARS on 4 May 2016, SARS ruled that the corporate rules will apply, and no adverse tax implications will arise where an asset is disposed of in exchange for shares in terms of section 42 within a period of 18-months of the acquisition of the asset in terms of section 45 (Cliffe Dekker Hofmeyr, 2016).

In BPR 288, issued by SARS on 17 January 2018, SARS ruled that where a taxpayer transfers capital assets to a company in exchange for shares and section 42 applies, and the company shortly thereafter disposes of those capital assets to another company in exchange for shares and section 42 applies to this transaction as well, then both transactions will qualify for the section 42 'roll-over' tax relief (Cliffe Dekker Hofmeyr, 2018).

4.5 Conclusion

In this chapter, the conclusion is reached that successive transactions utilising the corporate rules could be implemented without any adverse tax implications arising. This conclusion is reached on the basis of there not being a change of intention on the part of the taxpayer despite the short period in which the assets are held before same will be transferred in terms of the subsequent transaction. However, each case should be considered based on its specific facts and circumstances. In the next chapter, the implications of the GAAR on transactions which are implemented in terms of the corporate rules, are discussed.

CHAPTER 5: WHAT IMPLICATIONS WILL THE GAAR HAVE ON TRANSACTIONS WHICH ARE IMPLEMENTED IN TERMS OF THE CORPORATE RULES?

5.1 Overview of the issue

The current GAAR, which, applies to 'impermissible avoidance arrangements' entered into on or after 2 November 2006, introduced a number of new concepts, while retaining some elements of s 103(1) of the Act, which contained the old GAAR (De Koker & Williams, 2021, para 19.33). The GAAR aims to prevent transactions that are implemented solely or mainly for the purpose of avoiding taxes.

Section 41(2) provides that the corporate rules will apply notwithstanding any provision contained in the Act, other than certain specific mentioned provisions. One of the specifically mentioned provisions is the GAAR. Even though the corporate rules have been promulgated in order to provide taxpayers with 'roll-over' tax relief, these sections are still open for abuse and potentially the GAAR contained in Part IIA of the Act, that is, section 80A to section 80L of the Act, may apply (Blew, 2015, p. 52).

It must therefore be considered under what instances will the GAAR apply to transactions implemented in terms of the corporate rules, taking into consideration that the corporate rules are specifically designed to result in a "tax benefit" for the taxpayer, which is one of the requirements of the GAAR.

5.2 The GAAR requirements

The GAAR provisions apply to "impermissible avoidance arrangements" or to "steps in or parts of an arrangement".

An "avoidance arrangement" is considered an "impermissible avoidance arrangement" under section 80A of the Act if its sole or main purpose was to obtain a tax benefit. In addition to the tax benefit requirement, the arrangement must be entered into or carried out in a way that would not ordinarily be employed for bona fide business reasons other than to obtain a tax benefit, or it must lack commercial substance in whole or in part, taking into account the provisions of section 80C of the Act.

For a transaction to qualify as an "impermissible avoidance arrangement", the following requirements must be met:

- There must be an "arrangement" as defined in section 80L of the Act (the "arrangement" requirement);
- the arrangement must result in a "tax benefit" (the "tax benefit" requirement);
- the taxpayer must have entered into the arrangement with the sole or main purpose to obtain a tax benefit (the "sole or main purpose" requirement); and
- the arrangement must either be abnormal, lack commercial substance, have created non-arm's length rights and obligations, or resulted directly or indirectly in the misuse or abuse of the Act (the "abnormality" requirement).

Each of these requirements are successive and, therefore, the failure of a transaction to meet a prior requirement will render the GAAR provisions inapplicable. If, on the other hand, all of the requirements set out above are met, SARS is extended wide powers under section 80C of the Act to re-characterise the transaction in the manner which SARS deems appropriate.

5.2.1 The "arrangement" requirement

Given the wide definition of "arrangement" in section 80L, that is, "any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof", most transactions or agreements would satisfy the definition of an "arrangement".

5.2.2 The 'tax benefit' requirement

The term "tax benefit" is defined in section 1(1) of the Act to include "any avoidance, postponement or reduction of any liability for tax".

Therefore, any transaction which is structured in a manner which results in the avoidance, postponement, or reduction of an amount of tax which, ordinarily, should have been payable may result in a "tax benefit" for the purposes of GAAR.

As transactions in terms of the corporate rules are implemented to postpone tax in a group context which would ordinarily have been payable had the corporate rules not been used, it is arguable that a tax benefit will arise. There are also arguments which can be made that support the position that the use of the corporate rules does not necessarily result in a "tax benefit".

It is the accepted practice of SARS that the manner in which a "tax benefit" can be determined is by making a comparison of the taxpayer's status before and after the implementation of the transaction. This 'comparative approach' has been extended to state that a 'but for' test must be applied to the "arrangement" in order to ascertain if the same benefit is achieved by the taxpayer in question in the absence of the arrangement. SARS must be sufficiently clear in its mind that, had the alternative position taken place (that is, in the absence of the "arrangement" in its specific format), the "tax benefit" would not have arisen in order for SARS to both substantiate and quantify the "tax benefit". This approach has been confirmed in *CIR v Louw* 1983 3 SA 551 (A), 45 SATC 113 and *ITC* 1625 (1996) 59 SATC 383, where it was stated that "in order to determine whether a scheme had the effect of the avoidance of tax, it had to be asked whether the taxpayer would "suffer a tax" were it not for the scheme" (Spence Attorneys, Notaries & Conveyancers, 2020).

In the recent case of *Sasol Oil (Pty) Ltd v CSARS* (923/2017) [2018] ZASCA 153, the Court found that "the Commissioner has not shown that the impugned transactions had the effect of avoiding liability for tax". Therefore, in order for a transaction to fall foul of the anti-avoidance rules, there must be an anticipated liability to pay tax that is prevented or stepped out of the way of.

5.2.3 The "sole or main purpose" requirement

In order to establish whether the "sole or main purpose" of a transaction is to obtain a tax benefit, regard is given to the taxpayer's purpose and intention upon entering into the transaction. In determining the purpose of, or motive behind, entering into a particular transaction the subjective intention of the taxpayer, as supported by objective facts relating to that specific transaction, is therefore of paramount importance.

The term "solely" means "the only purpose of the taxpayer" and the term "main" was canvassed in the case of *SBI v Lourens Erasmus (Edms) Bpk* 1966 (4) SA 434 (A), 28 SATC 233. The term "main" and was held to mean "a quantitative measure of more than 50%".

In *CIR v Bobat and Others* [2005] 67 SATC 47 (N) at 60, the court held that "a main purpose is obviously one which is dominant over any other". Therefore, where the taxpayer had two purposes of equal significance, one of which is the avoidance of tax, the requirement of main purpose of tax avoidance is not satisfied. In *CIR v King* 14 SATC 184, the court ruled that in similar instances the taxpayer's "dominant purpose" needs to be established.

In *IRC v Brebner* (1967) 1 All ER 779 at 784, the House of Lords stated: "*...when a genuine commercial transaction is considered and there are two ways of carrying it out, one that involves paying more tax than the other, it is quite wrong to draw inference, as a necessary consequence, that in adopting the course which involves paying less tax, one of the main objectives is to avoid tax".*

Where a "tax benefit" is obtained as a result of a transaction, section 80G of the Act imputes a presumption on the taxpayer that the sole or main purpose of entering into the transaction was to obtain the "tax benefit", until the taxpayer can prove otherwise. Therefore, as the onus rests on the taxpayer, the taxpayer bears the evidentiary burden to prove, on a balance of probabilities, that obtaining the "tax benefit" was not the sole or main purpose of entering into the transaction.

Where the taxpayer is able to discharge the onus of proving that the sole or main purpose of the transaction as a whole, as well as all constituent parts thereof, is not the obtaining of a "tax benefit", any challenge under GAAR must fail.

5.2.4 The "abnormality" requirement

Where an arrangement was entered into with the sole or main purpose of obtaining a tax benefit, section 80A provides the transaction needs to also meet one of the following requirements before the transaction will qualify as an "impermissible avoidance arrangement":

"(a) in the context of business—

(i) it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or

(ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

(b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or

(c) in any context—

(i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or

(ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act…"

What is required to not fall within the ambit of these elements, is that a reasonable person viewing the arrangement must reasonably conclude that the arrangement is arm's length and something that is normally done for bona fide business purposes such that the transaction and the manner in which it is carried out, is more likely to be regarded as normal than abnormal. This is confirmed in *Estate G v Commissioner of Taxes* 1964 (2) SA 701 (SR), 26 SATC 168 and *Hicklin v SIR* 1980 1 SA 481 (A).

5.3 Practical example

In an article by Edward Nathan Sonnenbergs Inc., the following practical example is given:

> "Should one for instance take a scenario of a holding company wishing to declare dividends to its shareholders, it is possible for Holdco (Holdco) to create cash by entering into a transaction making use of the provisions of section 45 of the Act dealing with intra-group transactions".

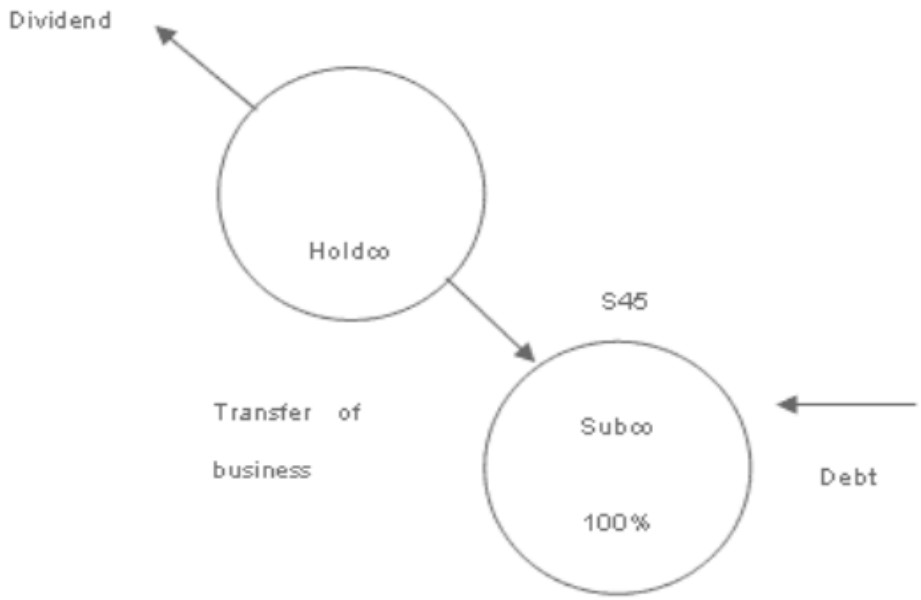


Figure 6: Example from Edward Nathan Sonnenbergs Inc.

> "Essentially Holdco will transfer its entire business to Subco on the basis that there will be no negative tax consequences associated with such transfer. Value added tax will also not be payable as Holdco and Subco will be deemed to be one and the same person.

Subco, however, can fund the acquisition of the assets at market value by obtaining funding from a financial institution. The interest payable on such debt would be deductible in view of the fact that the debt has been used to acquire assets. The proceeds from the sale of the business can be used by Holdco to declare a dividend".

(Edward Nathan Sonnenbergs Inc., 2007).

In the article, it was considered whether this type of transaction would be susceptible to attack by SARS given the clear purpose in these circumstances merely to create cash with which to pay dividends. In the article, it is further stated that:

"Ultimately the question may be whether one can justify the transfer of the business from Holdco to Subco commercially, but one will have to ask:

- what the sole or main purpose of Holdco and/or Subco may have been in entering into the transaction;
- whether there would be a tax benefit should one apply the so-called "but for test" in the context of Subco. In other words, but for the transaction Subco would not have received any business income and would therefore not have claimed any deduction. If anybody is to be attacked, it will be Holdco that received cash pursuant to the transfer of the business.

In the context of Subco, however, one will also have to take care of the following issues:

- whether the interest rate may be seen to be excessive;
- the extent to which Subco would be able to service the debt from cashflow projections;
- the extent to which Subco has been capitalised as opposed to it funding the acquisition through means of 100% debt."

(Edward Nathan Sonnenbergs Inc., 2007).

5.4 Conclusion

Based on the above, it is possible for adverse tax implications to arise as a result of the GAAR applying to a transaction which had been implemented utilising the 'roll-over' tax relief provided by the corporate rules.

When entering into restructuring transactions, regard must be had to the "whole picture" of the transaction as well as the reasons for choosing to implement one structure over another (Spence Attorneys, Notaries & Conveyancers, 2020).

As long as the “sole or main purpose” of the transaction or restructure was not to obtain a “tax benefit” and evidence is available to show that the “sole or main purpose” of the transaction or restructure was implemented for commercial reasons, no adverse implications as a result of the application of the GAAR should arise. If the tax benefits flowing from the corporate rules is simply the most tax-efficient manner of achieving the main commercial objective, it cannot be said that the sole or main purpose of the transaction or restructure is to obtain a tax benefit. If there is credible oral and documentary evidence to support the taxpayer’s case, it is unlikely that the GAAR could be successfully invoked (Seligson, 2019:2).

Therefore, it is imperative for taxpayers to consider the possible implications which could arise as a result of the GAAR for each and every transaction that is entered into.

In the next chapter, the corporate rules are critically analysed taking into consideration the aspects which have been discussed above.

CHAPTER 6: CRITICAL ANALYSIS OF THE CORPORATE RULES

6.1 Introduction

In this chapter, the corporate rules are critically analysed, taking into account the shortcomings of the rules that were highlighted by the DTC in the DTC Report, as well as the recommendations that were made by the DTC. Furthermore, in this chapter, it is considered whether subsequent tax law amendments addressed any of the DTC's recommendations.

6.2 The DTC Report

The DTC was established on 17 July 2013 following the Minister's declaration in the 2013 Budget that a tax review committee would be established to inquire into the role of SA's tax system in "promoting inclusive economic growth, employment creation, economic development, and fiscal sustainability" (Davis Tax Committee, 2018, p. 1).

It is expected that the DTC will consider the long-term objectives set out by the National Development Plan, as well as recent international and domestic developments (Davis Tax Committee, 2018, p. 1).

The DTC is advisory in nature, and it makes recommendations to the Minister. As part of the routine budget and legislative processes, the Minister will consider the DTC Report and its recommendations and make any necessary announcements (Davis Tax Committee, 2018, p. 1).

The DTC's mandate included, among other things, a study of SA's corporate tax system, with a focus on the following:

- "the efficiency of the corporate income tax structure;
- tax avoidance (e.g., base erosion, income splitting and profit shifting, including the tax bias in favour of debt financing);
- tax incentives to promote developmental objectives, and;
- average (marginal) and effective corporate income tax rates in the various sectors of the economy",

(Davis Tax Committee, 2018, p. 1).

On 31 October 2016, the DTC established a Corporate Income Tax Sub-committee to assess the effectiveness of SA's corporate income tax structure, which produced the report "The Efficiency of South Africa's Corporate Income Tax System", which outlines the DTC's viewpoint (Davis Tax Committee, 2018, p. 1).

As part of the DTC Report, the DTC reviewed the SA corporate rules contained in the Act.

Following a review of the corporate rules by the DTC, the following inadequacies were identified:

- Because the provisions are rules based, they are quite mechanical and thus not user friendly. As a result, these provisions do not always achieve the goals for which they were created:
- the asset-for-share transaction relief effectively imposes double tax and hence does not achieve its aims;
- the roll-over rules are riddled with complex anti-avoidance provisions, reducing their effectiveness;
- the anti-avoidance rules are fragmented, resulting in unnecessary complexities;
- the use of section 46 of the Act is confined for unlisted companies, limiting its ability to achieve the corporate rules' objectives; and
- the cross-border application of group restructuring rules should be considered,

(Davis Tax Committee, 2018, p. 6).

Each of the aforementioned shortcomings are discussed below in more detail, as well as the general recommendations which were made by the DTC.

6.2.1 First shortcoming: Mechanical nature of the provisions

The corporate rules are designed in such a way that they are "rules-based" rather than "principle-based". This has the effect that if the exact requirements of a certain rule are not met, the taxpayer will be unable to benefit from the relief (Davis Tax Committee, 2018, p. 55).

Furthermore, when the corporate rules interact with sections falling outside of the corporate rules, unintended difficulties arise. Because the corporate rules are mechanical in design, they are also restrictive and incredibly complex, as they aim to account for every scenario that could emerge during a restructuring transaction (Davis Tax Committee, 2018, p. 55).

By way of example, the DTC stated that, the provisions only apply to assets and not liabilities in the context of corporate restructuring transactions. Furthermore, the provisions provide very specific relief in relation to those assets. The effect of the provisions not dealing with liabilities require that other provisions of the Act must deal with the liabilities, such as the debt concession or compromise rules contained in section 19 of the Act and paragraph 12A of the Eighth Schedule (Davis Tax Committee, 2018, p. 55).

The DTC is of the view that the fact that other provisions in the Act, and not the corporate rules, applies to liabilities, could lead to tax abuse. On this point, the DTC concluded that the fundamental principle underpinning the corporate rules, namely that the transferee should "step into the shoes" of the transferor in a corporate reorganisation, should apply. As a result, reformulating the rules to be principle-based rather than rule-based would make more sense. This means that instead of aiming to cover every possible situation, the rules should offer a framework within which the underlying principles can operate and evolve through interpretation and practice (Davis Tax Committee, 2018, p. 56).

There are benefits and drawbacks to both the "rules-based" and "principle-based"' nature of the corporate rules, such as the certainty which is provided by the "rules-based" nature of the corporate rules. This however may exclude certain transactions from the 'roll-over' tax relief which could, for example, have been intended to be covered by the rules. On the other hand, a "principle-based' nature of the corporate rules would cover a broader range of transactions but could be open to abuse by taxpayers.

If a "rules-based" regime will be retained, then taxpayers will most likely benefit from the expansion of the corporate rules to cover a broader range of local and international transactions.

6.2.2 Second shortcoming: Effective double taxation as a result of the "asset-for-share transaction" relief

The DTC determined that the transferor is deemed to receive the shares issued to it in exchange for its assets at the original base cost of the assets transferred to the transferee company in a section 42 "asset-for-share transaction". In addition, the transferee company acquires the assets from the transferor at the transferor's original base cost. Because the rollover base cost of the assets is allocated to the target company's shares, such a transaction results in the creation of two assets, whereas there was only one asset before to the reorganisation. Economic double

taxation will arise when the shares are sold (SAICA, as cited in Davis Tax Committee, 2018, p. 56).

Although this can be avoided, the DTC said that this was not the aim of the rules, which are intended to simply defer the tax on the asset's disposal until it is sold outside of the 'group' (Davis Tax Committee, 2018, p. 56).

6.2.3 Third shortcoming: The corporate rules are riddled with complex anti-avoidance provisions

The DTC found that, while corporate rules play a valuable role in enabling business transactions within a group environment, they are overly burdensome and cumbersome. The corporate rules have been amended numerous times over the years to curb abuse by taxpayers (Davis Tax Committee, 2018, p. 56).

One of the anti-avoidance rules that was specifically highlighted by the DTC is the anti-avoidance rules contained in section 45 of the Act. Over the years, section 45 has been used in a number of tax avoidance schemes, including debt push down schemes involving the claim of large interest deductions that resulted in significant tax losses. In the DTC Report, the following two 'main' types of anti-avoidance measures were highlighted:

- The 18-month deemed sale rule provided for in section 45(5) which effectively results in a deemed sale on the transaction date as the profit of the deemed sale is taxed and may not be set-off against any loss. Any further profits or gains arising after the transaction is dealt with in terms of the normal rules (Koekemoer, A.D., as cited in Davis Tax Committee, 2018, p. 58). This anti-avoidance provision is perceived by taxpayers as unnecessarily strict and unfair and is regarded as not contributing to fiscal neutrality (Middelmann, S.N., as cited in Davis Tax Committee, 2018, p. 58). Furthermore, in a modern world when economic prospects occur at a rapid pace, the 18-month timeframe has been criticised as being too long and unrealistic (Davis Tax Committee, 2018, p. 59).
- The 6-year de-grouping rule contained in section 45(4) and the 2-year de-grouping rule contained in section 45(4B). If one of the group companies that engaged in the "intra-group transaction" later leaves the group or no longer forms part of the same "group of companies", the de-grouping charge triggers a deemed disposal. The de-grouping charge shields the fiscus from third-party sales disguised as section 45 "intra-group transactions". Concerns about the de-grouping charges were raised in the following areas:

- The company becomes liable for tax which should only be incurred in the future if the rules was broken. This impacts negatively on the company's cash flow (Davis Tax Committee, 2018, p. 60).
- the 6-year period is regarded excessively long in that a group is effectively locked into a structure for a period of six years. The DTC stated that "the 6-year threshold has not kept pace with the increased dynamism in the world of corporate transactions. The spike in innovation and alliances, together with the harsher economic environment means that it is unreasonable to expect major groups to remain static for extended periods" (Davis Tax Committee, 2018, p. 60).
- The 6-year period is significantly longer than other periods contained in the corporate rules (Davis Tax Committee, 2018, p. 60).
- The administration and application of the 6-year de-grouping charge in section 45 provides difficulties for taxpayers as the long period makes it difficult to keep track of the date of the relevant transactions, as well as the details relating to the specific assets. In addition, as the assets must be traced and assigned to funds from a specific transaction, the 2-year de-grouping rule is problematic as proceeds lose their distinct identity over time (Visagie, J, as cited in Davis Tax Committee, 2018, p. 61).

It must be considered whether the unintended consequences and difficulties which may arise due to the complex nature of the anti-avoidance provisions within the corporate rules could be addressed using the GAAR. This could however result in abuse by taxpayers. This aspect is discussed in detail in the previous chapter.

6.2.4 Fourth shortcoming: Fragmented nature of the anti-avoidance rules

The fragmented nature of the anti-avoidance measures in the corporate rules, according to the DTC, must be addressed. Historically, Treasury have introduced new measures based on a perception of the consequences of specific transactions. Usually, a generic provision is used to target a specific practice, and then additional measures are added to refine the generic provision's applicability. The additional measures, such as section 24K and section 23N of the Act, may be "stand-alone" provisions rather than amendments to the original provisions. Because of this fragmentation, taxpayers are more likely to make mistakes when completing their tax returns (CFO Forum, as cited in Davis Tax Committee, 2018, p. 63).

The DTC proposed "that the rules should be more accommodating of business and commercial needs" (Davis Tax Committee, p. 63).

6.2.5 Fifth shortcoming: Limitations of unbundling transactions in relation to unlisted companies

The application of section 46 to unlisted companies is subjected to an unnecessary restriction. When an unlisted company is unbundled, the shares must be distributed to another unlisted company in the same "group of companies" for section 46 to apply. Furthermore, for section 46 to apply, more than 50% of the shares of the unlisted unbundled company must be distributed to its shareholders. In many circumstances, such percentage shareholdings are excessively high, resulting in taxpayers being unable to use section 46 (Davis Tax Committee, 2018, p. 63).

Because the tax will still be paid at a later date, it has been recommended that the unbundling requirements be made broader and more flexible in order to allow the corporate market to function properly and to facilitate commercial deals that rely on a company's unbundling of shares to its shareholders (Dachs, P, as cited in Davis Tax Committee, 2018, p. 63).

6.2.6 Sixth shortcoming: Cross-border application of the corporate rules

The current corporate rules only deal with specific aspects relating to cross-border transactions. SARS and Treasury should review aspects dealing with offshore funds, according to the DTC, keeping in mind that the corporate rules are designed to delay tax, not to eliminate it entirely (Davis Tax Committee, 2018, p. 64).

This recommendation makes sense and should be explored further. It should however be kept in mind that an extension of the corporate rules should not result in financial loss for the fiscus.

6.3 Further shortcomings of the corporate rules

In addition to the above shortcomings highlighted by the corporate rules, the following shortcomings, some of which were dealt with by the DTC in the DTC Report, should also be considered:

- The greatest shortcoming of the corporate rules is that they are not extensive enough to cover a broad range of cross-border transactions. They are for the most part limited to the transfer of equity shares between SA residents and CFCs as well as CFCs to CFCs.

- The concept of a "group of companies" as defined in section 41(1) is restrictive and it is considered that the corporate rules should apply to a "group of companies" that meet the definition in section 1(1).
- The corporate rules are complex and the 6-year de-grouping rule in section 45 makes the provision less attractive when compared to section 42 or section 44.
- The corporate rules also do not cover the roll-over of interest-bearing arrangements subject to section 24J of the Act (dealing with the incurral and accrual of interest) or the transfer of exchange items, especially those in terms of which the gains or losses have been deferred in terms of section 24I(10A) of the Act. The latter on its own could make the simplification of a group structure impossible due to potential cash tax being triggered on the 'realisation' of deferred exchange gains.
- The corporate rules need to be aligned to changes in the Companies Act, for example, in section 44 dealing with mergers and amalgamations.
- The recent amendments to section 46 unbundling transactions make it clear that these provisions do not apply to the extent that shares are distributed to 'disqualified persons' that is, persons that are non-resident or tax exempt and hold at least 5% of the shares in the unbundling company immediately before the transaction. The latter amendment is not a taxpayer friendly amendment.

6.4 Group company taxation to enhance efficiency of SA's tax structure

As an alternative to overhauling the corporate rules in their entirety, consideration should be given as to whether the implementation of group company taxation would actually improve the efficiency of SA's corporate tax structure, and if so, in what form? This aspect was also discussed by the DTC in the DTC Report and is briefly discussed below.

The DTC examined the objectives, benefits, and downsides of group company taxation in order to determine if it would improve the efficiency of SA's corporate tax structure.

Group tax systems have several advantages, including the ability to treat a group of companies as a single economic unit for financial and strategic planning, the ability to ensure a complete audit trail of all intra-group transactions, as well as the correct tax implications of transactions with parties outside the group. In addition, group taxation could lead to the unbundling large organisations into more efficient multi-company structures (Wilcocks & Middelmann, 2004).

Some downsides of group tax systems include the complexity of the system, the perceived expense to the fiscus, and the requirement for anti-avoidance measures. (Wilcocks & Middelmann, 2004).

Following its review, the DTC concluded that, while the introduction of group taxation using the "group relief or loss transfer" model could give SA a competitive advantage and support economic growth, the DTC does not support the introduction of a group tax system in SA's current economic circumstances due to the radical amendments that a group tax system would necessitate. A formal group tax regime, according to the DTC, should only be implemented when the SA economy is strong enough to sustain such a significant change, which may initially result in a loss of tax revenue (Davis Tax Committee, 2018, p. 84).

A gradual approach to implementing a group tax regime may be considered, beginning with the addition of the set-off of assessed losses to the corporate rules, which would mainly be a straightforward change to current legislation (DTC Report, 2018, p. 84).

Instead of adopting group taxation model at this time, the DTC recommends that the corporate rules be evaluated and expanded upon if scenarios arise in which the rules do not give appropriate relief. Once it is determined that the SA economy is robust enough to endure such a change, the corporate rules could be augmented with a loss transfer requirement at election for companies that are 100% owned (DTC Report, 2018, p. 85).

6.5 Conclusion

Based on these findings of the DTC, as dealt with above, the DTC made certain general recommendations regarding the corporate rules.

The DTC advised that the rules-based nature of the provisions be replaced with more principle-based provisions, and that adjustments be made to ensure that the "asset-for-share transaction" relief does not effectively result in double taxation. A review of anti-tax avoidance rules is also proposed in order to eliminate those that impede the effectiveness of corporate rules. The aim of this review of anti-avoidance measures would be to simplify them and to rely on the Act's general anti-avoidance provisions, that is, the GAAR. Those anti-avoidance rules that remain would help to simplify the components that are difficult to comprehend and apply. It should also be considered whether section 46 relief should be extended to more unlisted companies. Aspects of the corporate rules relating to offshore funds should be examined, keeping in mind

that the corporate rules are only intended to postpone taxation, not to eliminate it entirely. Finally, based on the DTC Report's conclusions on group taxation, loss transfers should be considered (Davis Tax Committee, 2018, p. 7).

The general recommendation is that the corporate rules in their entirety must be overhauled and simplified to cater for a host of transactions (domestic and cross-border) especially since SA exchange control provisions have been somewhat relaxed and numerous provisions have been enacted into the Act to protect the SA tax base. This will ensure that the corporate rules comply with the policy objectives for which they were initially enacted into the Act, that is, to encourage SA companies to restructure their businesses domestically in order to promote growth and to alleviate unintended hardships caused by CGT.

CHAPTER 7: CONCLUSION

As a result of the hardships caused by Covid-19 and the accompanying lockdowns, it is likely that an increased number of SA groups of companies will need to restructure their affairs (Webber Wentzel, in alliance with Linklaters. 2021).

The corporate rules, contained in section 41 to section 47 of the Act provide group companies with an opportunity to restructure the group without the burden of having to pay income tax, CGT and other taxes which would ordinarily have been payable had the companies not formed part of the same "group of companies" (as defined in section 41(1)). The corporate rules provide relief for the following types of transactions:

- Section 42 "asset for share transaction".
- Section 43 "substitutive share-for-share transaction".
- Section 44 "amalgamation transaction".
- Section 45 "intra-group transaction".
- Section 46 "unbundling transaction" .
- Section 47 "liquidation distribution".

As is evident from the various BPRs issued by SARS, it is possible to restructure a group of companies using successive corporate rule transactions, without there being adverse tax implications. This is beneficial for groups of companies that are considering restructuring as numerous group restructure transactions involve multiple corporate rule transactions.

Most of the corporate rules contain complex and punitive anti-avoidance rules which, if triggered, will result in adverse tax implications for the relevant group company. In this regard, the DTC reviewed the corporate rules and made, inter alia, certain recommendations to allow for the corporate rules to achieve the objectives for which they were initially introduced into the Act, that is, to promote domestic restructuring of SA groups to promote growth and to alleviate unintended hardships caused by CGT. Following its review of the corporate rules, the DTC found that:

- Because the provisions are rules-based, they are quite mechanical and hence not user-friendly or necessarily fulfilling their goals.
- The "asset-for-share transaction" relief effectively imposes double taxation and hence does not achieve its aims.

- Complex tax anti-avoidance provisions exist in the corporate rules, limiting their effectiveness.
- The anti-avoidance rules are disjointed, which adds unnecessary complexities.
- "Unbundling transactions", provided for in section 46, are restricted for unlisted companies, limiting its ability to meet the corporate rules' objectives.
- The cross-border application of the corporate rules should be considered,

(Davis Tax Committee, 2018).

The DTC proposed that the current "rules-based" nature of the corporate rules be replaced with more "principle-based" provisions, and that adjustments be made to ensure that the "asset-for-share transaction" relief does not effectively result in double taxation (Davis Tax Committee, 2018).

A review of anti-tax avoidance regulations is also proposed in order to eliminate those that impede the effectiveness of corporate rules. The goal of this review of the anti-tax avoidance provisions would be to reduce complexity and rely on the Act's general anti-avoidance provisions, that is, the GAAR. Those anti-avoidance rules that remain would help to simplify the aspects that are difficult to comprehend and apply (Davis Tax Committee, 2018).

It should also be considered whether section 46 relief should be extended to more unlisted companies (Davis Tax Committee, 2018).

Aspects of the corporate laws relating to offshore funds should be examined, keeping in mind that the corporate rules are only intended to postpone taxation, not to eliminate it entirely (Davis Tax Committee, 2018).

Finally, based on the conclusion on group taxes contained in the DTC Report, loss transfers should be considered (Davis Tax Committee, 2018).

The DTC investigated whether the implementation of group company taxes would improve the efficiency of SA's tax structure as a result of the deficiencies of the corporate rules. It was concluded that based on the current economic climate, this is not currently a viable option (Davis Tax Committee, 2018).

Furthermore, the following shortcomings of the corporate rules (other than those mentioned by the DTC in the DTC Report) were also noted:

- The corporate rules also do not cover the roll-over of interest-bearing arrangements subject to section 24J of the Act (dealing with the incurral and accrual of interest) or the transfer of exchange items, especially those in terms of which the gains or losses have been deferred in terms of section 24I(10A) of the Act.
- The corporate rules need to be aligned to changes in the Companies Act, for example, in section 44 dealing with mergers and amalgamations.

Lastly, the GAAR must be considered for every transaction or transaction step in a group restructure as it may be considered as tax avoidance in terms of GAAR where the corporate rules are abused. This will normally be the case where a transaction or a specific step of a transaction lacks commercial substance and has been entered into with the sole or main purpose to gain a tax benefit (Seligson, 2019:2).

To conclude, SA's corporate rules currently achieve the purpose for which the rules were implemented, that is, with a policy objective of competitiveness, to promote domestic restructuring of SA groups to promote growth and to alleviate unintended hardships caused by the enactment of the CGT in 2001 (Parliamentary Monitoring Group, as cited in Davis Tax Committee, 2018). The shortcomings of the corporate rules, as discussed in detail above, should be considered further by Treasury to make sure that the purpose of the corporate rules is not defeated.

REFERENCES

BOOKS

Haupt, P. & Haupt, E., 2022, *Notes on South African Income Tax*, H & H Publications, Roggebaai

CASE LAW

CIR v Bobat and Others [2005] 67 SATC 47 (N)

CIR v King 14 SATC 184

CIR v Louw 1983 3 SA 551 (A)

CIR v Pick 'n Pay Employee Share Purchase Trust 1992 (4) SA 39 (A)

CIR v Simpson [1949] 4 All SA 460 (A)

CIR v Stott 1928 AD 252, SATC 253

CSARS v Labat (669/10) [2011] ZASCA 157

De Beers Holdings (Pty) Ltd v CIR 1986 (1) SA 8 (A)

Estate G v Commissioner of Taxes 1964 (2) SA 701 (SR), 26 SATC 168

Hicklin v SIR 1980 1 SA 481 (A)

IRC v Brebner (1967) 1 All ER 779

ITC 1625 (1996) 59 SATC 383

Leviton & Son v De Klerk's Trustee 1914 CPD 691

Natal Joint Municipal Pension Fund v Endumeni Municipality [2012] ZASCA 13

Sasol Oil (Pty) Ltd v CSARS (923/2017) [2018] ZASCA 153

DICTIONARIES

Cambridge Dictionary. [Electronic]. Available: CONTINGENT LIABILITY | meaning in the Cambridge English Dictionary [2022, June 7]

Oxford Learner's Dictionaries. [Electronic]. Available: debt noun - Definition, pictures, pronunciation and usage notes | Oxford Advanced Learner's Dictionary at OxfordLearnersDictionaries.com [2022, June 7]

ONLINE RESOURCES

Davis, D., Olivier, L. & Urquhart, G. 2020. *Tax: Juta's Practice Collection*. [Electronic]. updated: June. Jutastat e-publications. Available: Juta Law Online Publications (wits.ac.za) [2021, December 15]

De Koker, A.P. & Williams, R.C., 2021, *Silke on South African Income Tax*. [Electronic]. LexisNexis, Durban. Available: New My LexisNexis [2021, December 15]

ONLINE ARTICLES AND JOURNAL ARTICLES

AJM Tax. 2022. Automatic application of intra-group transactions. [Electronic]. Available: AUTOMATIC APPLICATION OF INTRA-GROUP TRANSACTIONS - AJM Tax [2022, May 25]

Cliffe Dekker Hofmeyr. 2016. Successive corporate reorganisation transactions. [Electronic]. Available: Cliffe Dekker Hofmeyr - Successive corporate reorganisation transactions [2022, May 24]

Cliffe Dekker Hofmeyr. 2018. Consecutive asset-for-share transactions. [Electronic]. Available: Cliffe Dekker Hofmeyr - Consecutive asset-for-share transactions [2022, May 25]

Edward Nathan Sonnenbergs Inc. 2007. Corporate restructuring rules. [Electronic]. Available: 1577. Corporate restructuring rules (saica.co.za) [2021, December 15]

Furman, J. 2008. The Concept of Neutrality in Tax Policy. [Electronic]. Available: Microsoft Word - furman tax neutrality.doc (brookings.edu) [2022, April 28]

Seligson, M. 2019. Restructuring Companies via the Corporate Rules: Tax Methodology and Analysis. *Business Tax & Company Law Quarterly*, 10(2), June:1-12

Shepstone & Wylie Attorneys. 2015. Additional Tax Amendments: Business (General). [Electronic]. Available: Shepstone & Wylie - Additional Tax Amendments: Business (General) [2022, May 18]

Spence Attorneys, Notaries & Conveyancers. 2020. Don't forget the GAAR when structuring commercial transactions! [Electronic]. Available: Don't forget the GAAR when structuring commercial transactions! (spencelaw.co.za) [2022, June 26]

Webber Wentzel, in alliance with Linklaters. 2021. South Africa: Restructuring in 2021. [Electronic]. Available: South Africa: Restructuring in 2021 | Debtwire Events [2021, December 18]

Wilcocks, J.S. & S.N. Middelmann. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. [Electronic]. Available: Evaluation of the need to introduce a system of group taxation in South Africa : research article (journals.co.za)

OTHER

Blew, C. 2015. *The corporate income tax effect of group restructurings in South Africa*. Unpublished master's thesis. Johannesburg: University of the Witwatersrand

PUBLICATION BY GOVERNMENT ORGANISATION

Davis Tax Committee. 2018. *Review of the Efficiency of South Africa's Corporate Income Tax System*. [Electronic]. Available: 20180411 Final DTC CIT Report - to Minister.pdf (taxcom.org.za) [2021, December 15]

Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007. 2007. [Electronic]. Available: Microsoft Word - Final EM _8.11.07_.doc (sars.gov.za) [2022, May 18]

Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011. 2011. [Electronic]. Available: TABLE OF CONTENTS (sars.gov.za) [2022, May 22]

Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012. 2012. [Electronic]. Available: TABLE OF CONTENTS (sars.gov.za) [2022, May 25]

Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017. 2017. [Electronic]. Available: TABLE OF CONTENTS (sars.gov.za) [2022, May 18]

Finance Standing Committee. 2001. *Second Revenue Laws Amendment Bill: briefing continued.* [Electronic]. PowerPoint presentation available: Second Revenue Laws Amendment Bill: briefing continued | PMG [2022, April 28]

McAllister, D.S. 2020. *Comprehensive Guide to Capital Gains Tax (Issue 9)*. [Electronic]. Available: Introduction of Capital Gains Tax (sars.gov.za) [2022, May 18]

South African Revenue Service, 2018. *Binding Private Ruling: BPR 159*. [Electronic]. Available: LAPD-IntR-R-BPR-2014-02-BPR159-Asset-for-share-and-amalgamation-transactions.pdf (sars.gov.za) [2022, May 25]

South African Revenue Service, 2018. *Binding Private Ruling: BPR 230*. [Electronic]. Available:LAPD-IntR-R-BPR-2016-15-BPR230-Disposal-of-an-asset-in-terms-of-an-asset-for-share-transaction-within-18-months.pdf (sars.gov.za) [2022, May 25]

South African Revenue Service, 2018. *Binding Private Ruling: BPR 288*. [Electronic]. Available: SOUTH AFRICAN REVENUE SERVICE (sars.gov.za) SOUTH AFRICAN REVENUE SERVICE (sars.gov.za) [2022, May 25]

South African Revenue Service, 2018. *Binding Private Ruling: BPR 328*. [Electronic]. Available: SOUTH AFRICAN REVENUE SERVICE (sars.gov.za) [2022, May 25]

South African Revenue Service, 2014. *Interpretation Note No. 43 (Issue 5)*. [Electronic]. Available: 1 (sars.gov.za) [2022, May 25]

South African Revenue Service, 2021. *Draft Interpretation Note*. [Electronic]. Available: LPrep-Draft-2021-82-Draft-IN-on-extraordinary-dividends-treated-as-income-or-proceeds-on-disposal-of-certain-shares.pdf (sars.gov.za) [2022, May 25]

STATUTES

Companies Act 71 of 2008, as amended

Competition Act 89 of 1998, as amended

Co-operatives Act 14 of 2005, as amended

Income Tax Act 58 of 1962, as amended

Revenue Laws Amendment Act 74 of 2002

Second Revenue Laws Amendment Act 60 of 2001

Securities Transfer Tax Act 25 of 2007, as amended

Tax Administration Act 28 of 2011, as amended

Taxation Laws Amendment Act 3 of 2008

Taxation Laws Amendment Act 17 of 2017

Transfer Duty Act 40 of 1949, as amended

Value-Added Tax Act 89 of 1991, as amended