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Nyoka, Rejoice Nombulelo

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

A CRITICAL ANALYSIS OF SECTION 45 OF THE INCOME TAX ACT 58 OF 1962.

ABSTRACT

The introduction of CGT in SA resulted in the birth of the corporate restructuring rollover tax relief to avoid tax on the transfer of assets within the same economic unit. Section 45 of the Act specifically provides a deferral tax rollover relief for the transfer of assets within the same group of companies.

The built-in anti-avoidance rules in section 45 of the Act did not prevent taxpayers from abusing this tax rollover relief, instead it gave birth to innovative tax-free exit from investments and debt-push down schemes. Lawmakers mitigated the tax relief abuse by implementing burdensome rule-based anti-avoidance rules.

This study aims to critically analyse the intended purpose of section 45 of the Act and how the rule-based anti-avoidance rules in section 45 of the Act unduly hamper the efficacy of this tax relief.

Key Words: corporate rollover relief, intra-group transactions, capital gains tax (CGT), corporate income tax, de-grouping, early disposal, specific anti-avoidance, general anti-avoidance rules (GAAR), tax resident, group of companies, corporate restructuring.

DECLARATION

I, Rejoice Nombulelo Nyoka declare that this research report is my own independent work. Where I have used the ideas of others, I have acknowledged it appropriately. This research report is submitted in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation) at the University of Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other institution.

ACKNOWLEDGEMENTS

To God, thank you for being the source of my existence. To my ancestors, thank you for paving the way for me. To my late grandmother, MaMbatha, thank you for teaching me to get an education, I know you are screaming ‘Rejoice’ and dancing.

To my supervisor Roy Blumenthal, thank you for the guidance and sharing your knowledge.

Last but not least to my family, friends and my team at work for believing in me.

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1. LIST OF ABBREVIATIONS

Capital gains tax	CGT
Income Tax Act 58 of 1962	the Act
Binding Private Ruling	BPR
Republic of South Africa	SA
Securities Transfer Tax Act 25 of 2007	STT
South African Revenue Service	SARS
Tax Administration Act 28 of 2001	TAA Act
Transfer Duty Act 40 of 1949	Transfer Duty Act
Value-Added Tax Act 89 of 1991	VAT Act

2. INTRODUCTION

The introduction of CGT in SA in 2001 meant companies seeking to embark on group restructurings would be implicated on the basis that corporate restructurings at times include reallocation of assets. The policymakers mitigated this by introducing the corporate reorganisation rollover relief provisions which enable companies to transfer assets within the same economic unit to transfer assets in a tax-neutral manner. An economic unit refers to an instance where more than one company has the same equity shareholders and/or exchange business insights for the benefit of those shareholders. The corporate reorganisation rollover relief provisions are found in Part III of Chapter Two of the Act and refer to sections 41 to 47 of the Act. The rationale behind corporate reorganisation rollover relief provisions is that the tax is deferred to a later date when assets are disposed of by the group or if the companies no longer form part of the same economic unit.

This report will focus on one of the corporate reorganisation rollover relief provisions found in section 45 of the Act, intra-group transactions. The tax relief in section 45 of the Act sees a group of companies as different divisions under the controlling company, *'is to place a single group of companies on par with a single company containing multiple branch operations.'* (SARS, 2007:22). More specifically, this report will discuss the implications of the anti-avoidance provisions in the efficacy of this rollover tax relief.

Section 45 of the Act allows companies within the same group of companies to transfer any asset in a tax-neutral manner. The logic behind section 45 of the Act relief is that the transferee company steps into the shoes of the transferor company. Accordingly, the immediate tax consequences resulting from the transfer of assets are deferred to a later date on the basis that when the asset is ultimately disposed of outside the group of companies or a de-grouping event occurs. It is therefore important to understand that intra-group transactions relief does not permanently eliminate the tax consequences of transferring assets but postpones it. Currently, section 45 of the Act is an automatic election and companies wishing to opt out need to state in writing.

When section 45 of the Act was introduced, it already had built-in anti-avoidance provisions to curb potential tax abuse policymakers had detected internationally, i.e. from countries that already had a similar tax relief. These built-in anti-avoidance provisions gave birth to innovative tax planning structures that enabled corporates to exit tax-free from investments. In addition, section 45 of the Act became an essential tool in the acquisition of companies' transactions and this resulted in the creation of excessive assessed losses. National Treasury has found itself in the cat and mouse game and constantly improving the anti-avoidance provisions to curb the abuse of the intra-group transactions tax relief. The anti-avoidance provisions together with its improvements put in by National Treasury over the years are rule-based and this is not in line with the fundamental concept of principle-based tax rules. Therefore, unintended consequences are created resulting in genuine commercial structures being negatively affected.

The statement of the problem

Almost every group of companies in SA has undergone or will at some stage undergo a corporate restructuring which includes a transfer of assets from one company to another within a group. Therefore, the tax rollover relief in section 45 of the Act is crucial in the tax system of SA as it encourages companies to undergo restructurings without triggering immediate tax implications. This crucial tax relief has surprisingly undergone numerous amendments since its introduction which create uncertainty for the companies electing it. In addition to the numerous amendments, the 2018 Davis Tax Committee's report on the Efficiency of South Africa's Corporate Income Tax System (the Report), found that '*rules-based nature of the provisions makes them very mechanical and thus not user friendly or necessarily achieving their objectives'* (Davis Tax Committee, 2018:6). Tax legislation is based on principle, which means it is built on doctrines that specify the intention of legislation, rather than set rules detailing requirements. Therefore, incorporating rule-based provisions within a principle-based legislation is bound to create unintended consequences with implementation. The report further highlighted that the anti-avoidance rules in section 45 of the Act as the most burdensome in the corporate rollover relief provisions.

> The most burdensome of the anti-avoidance rules are in section 45 of the Act which deals with intra-group transactions where an asset is disposed of by a company to another company in the same group of companies. (Davis Tax Committee, 2018:57)

From the above findings of the Report, it has become evident over the years that the complex rule-based anti-avoidance provisions in section 45 of the Act are the most burdensome in the Act as a result hampering the relief efficacy. '*The roll over rules are riddled with complex anti-tax avoidance provisions which hampers their efficacy*' (Davis Tax Committee, 2018:6).

The research report will critically analyse section 45 of the Act. One of its objectives is to enable a tax-neutral transfer of assets within the same group of companies. It will discuss the impact of burdensome anti-avoidance provisions in corporate restructurings through the transfer of assets within a group of companies.

This research report will therefore give an opinion on the research question: How are the anti-avoidance provisions in section 45 of the Act unduly hampering the efficacy of the intra-group transaction tax relief?

Research sub-questions

The first sub-question is:

What was the mischief that gave rise to section 45 of the Act?

The first sub-question will be answered by providing background on the introduction of CGT in SA as the corporate reorganisation rollover relief provisions, including section 45 of the Act, was as a result of CGT introduction. A typical restructure within a group of companies by way of a disposal of an asset where section 45 of the Act does not apply will be demonstrated. The objectives of the corporate reorganisation rollover relief provisions will be discussed and ultimately start the focus on section 45 of the Act. The key concept of section 45 of the Act which includes the fundamental definitions, i.e. equity, group of companies, etc. will be discussed. This will ultimately list the factors that need to be present for a transaction to qualify as intra-group transactions.

The second sub-question is:

What led to the introduction of burdensome tax anti-avoidance provisions in section 45 of the Act?

The second sub-question will be answered by illustrating examples of an intra-group transaction and discussing its tax implication. It will further illustrate intra-group transactions structured prior to 2008. It will demonstrate the tax benefit as a result of utilising the tax relief. It will also demonstrate the tax-free exit structures as a result of abusing the intra-group transaction relief. Common transaction structures and funding methods of intra-group transactions will be demonstrated. It will then discuss the objective of anti-avoidance provisions. It will also discuss the purposes of GAAR and specific anti-avoidance in section 45 of the Act. This sub-question will ultimately illustrate the difference between GAAR and specific anti-avoidance provisions in section 45 of the Act.

The third sub-question is:

Are the tax anti-avoidance provisions in section 45 of the Act achieving their intended purpose?

The third sub-question will discuss the 18-month deemed sale rule and illustrate the structures that National Treasury was targeting. It will demonstrate other commercial structures that have been impacted by this anti-avoidance provision. Demonstrate how the 18-month deemed sale rule unduly hampers the efficacy of the tax relief. It will discuss the two types of de-grouping charge rule and illustrate the structures targeted by National Treasury. It will demonstrate other commercial structures that have been impacted by this anti-avoidance provision. It will discuss the statute interpretation challenges with the de-grouping charge rule. Finally, the discussion on how the de-grouping charge rule unduly hampers the efficacy of the tax relief.

The last sub-question is:

What do improvements up to the year 2021 in the anti-avoidance provisions in section 45 of the Act indicate?

The last sub-question will discuss the improvements on the anti-avoidance rules up to 2021 on both the taxpayers and tax authorities. It will also discuss the implications of the improvements on newly entered intragroup transactions and ultimately give a view on what the improvements indicates.

Summary of sub-questions

The last sub-question will provide the summary of the sub-questions mentioned above and provide a view on how the anti-avoidance in section 45 of the Act unduly hamper the efficacy of the tax relief. It will also highlight what needs to be considered by companies electing for section 45 of the Act.

Scope and limitations

This research report will be limited to the SA income tax implications, and will not include the exchange control regulations.

The implications of section 45 of the Act on the following sections will not be discussed due to their speciality:

- Section 25BB;

The examples provided are for illustrative purposes only.

Research methodology

This research will use a qualitative method as it will allow for the interpretation of the various acts and will consider other research on the topic. The research will be collated from the following sources:

- Statutes;
- Textbooks;
- Davis Tax Committee;
- Court Cases;
- Electronic databases – Google Scholar, LexisNexis, ResearchGate, Lexology;
- Electronic resources – Internet; and
- Journals

Research data was collected by reading and analysing the relevant sections in the Act and government publications, mainly the National Treasury and SARS website. Research data was also collected from the internet by typing the relevant keywords on the topic.

3. HISTORY OF CORPORATE REORGANISATION ROLLOVER RULES

Income as a result of a gain on the disposal of capital assets has the same economic value as income from wages and other income therefore taxpayers should bear a similar tax burden (National Treasury, 2001). Before 1 October 2001, taxpayers in South Africa got the benefit of getting their gains on the disposal of capital assets tax-free because South African did not have capital gains tax (CGT). The absence of CGT in South Africa opened opportunities for tax avoidance where taxpayers plan their tax affairs in a manner that would result in a gain on capital assets. It follows, '*one in five cases litigated by SARS involves the capital versus ordinary distinction.*' (National Treasury, 2001:12)

On 1 October 2001, South Africa introduced CGT with the purpose of broadening the tax base, limiting tax avoidance activities, improving economic efficiency and aligning with international tax standards.

CGT applies to the gain on the disposal and/or deemed disposal of assets on and after 1 October 2001. Most of the provisions of CGT which produce either taxable capital gains or assessed losses are found in the 8th Schedule of the Act. Taxable capital gains, which occur when the proceeds of an asset disposed of exceeds the base cost, are included in taxable income in terms of section 26A of the Act. An assessed capital loss on the other hand, which occurs when the base cost of an asset disposed of exceeds the proceeds, the loss cannot be set off against taxable income, instead, it is carried forward to subsequent years and can only be used to set off future capital gains.

CGT applies to tax residents on the disposal of assets all over the world and non-residents on immovable assets situated in South Africa on or after 1 October 2001.

Disposal is defined in paragraph 11 of the 8th Schedule of the Act but subjected to subparagraph 2 of the paragraph, and is as follows:

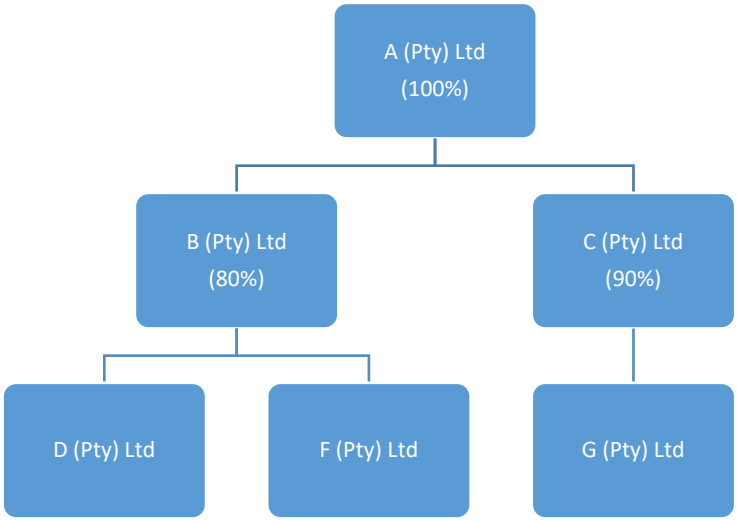
> any event, act, forbearance or operation of law which results in the creation, variation, **transfer** or extinction **of an asset**, and includes—
>
> a) the sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or **transfer of ownership of an asset**;

b) the forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset;
c) the scrapping, loss, or destruction of an asset;
d) the vesting of an interest in an asset of a trust in a beneficiary;
e) the distribution of an asset by a company to a holder of shares;
f) the granting, renewal, extension or exercise of an option; or
g) the decrease in value of a person's interest in a company, trust or partnership as a result of a value shifting arrangement. (my Emphasis) (the Act)

Companies operate in a macro-environment with factors that demand constant change, as a result corporates are constantly restructuring to stay relevant '*To cope with ever-changing market conditions, companies often have to reorganize.*' (Girod and Karim, 2017:1). Group restructuring normally includes transfer of assets within the group of companies.

> Restructuring embraces the reallocation of assets, businesses, or functions within a group of companies; the reorganisation of ownership of companies within a group; and/or the reorganisation of debt and/or financial restructuring within a group. (The Davis Tax Committee, 2018:54)

Since corporate restructurings in most instances trigger a disposal event resulting in CGT finding application even though a substantial interest of an asset is still retained in the same economic unit. Consider an example of a group structure below. This structure and the example thereto are purely for illustrative purposes only and do not represent a real structure.



The management of G (Pty) Ltd has realised that Product C in G (Pty) Ltd is not performing due to the company not having enough expertise and capacity to improve its performance. The management has noticed though that D (Pty) Ltd is the market

leader in Product C, it follows as part of its strategic objective to focus on Product B where it has the potential to be market leader. A decision was made to cease the production of Product C in G (Pty) Ltd and all the assets in relation to Product C would be transferred to D (Pty) Ltd for a consideration equal to the market value of the assets.

This transfer of assets transaction would typically trigger immediate tax implications for G (Pty) Ltd as the transferor of the assets. The applicable tax would be CGT in a case where the asset is held on capital and normal income tax where the asset is not held on capital.

Considering that both G (Pty) Ltd and D (Pty) Ltd are both ultimately held by A (Pty) Ltd, therefore arguable that there is no real transfer of ownership of an asset where G (Pty) Ltd transfers assets to D (Pty) Ltd. Therefore, at the introduction of CGT, South Africa also announced the introduction of corporate reorganisation rollover relief provisions to defer the tax that would be triggered as a result of restructurings similar to the example above. These rollover relief provisions only came into effect on 2 November 2002 due to the complexity that had been noted around it.

The objectives of the corporate reorganisation

Corporate reorganisation rollover relief provisions are found in Part III of Chapter Two of the Act. The strategic objective of the corporate reorganisation rollover relief provisions was to enable competitiveness with the rest of the world in order to promote the domestic restructuring of SA group companies in order to promote growth and ultimately achieving a tax neutral restructuring within the same economic unit.

As of 2021, Part III of Chapter Two of the Act has six corporate reorganisation rollover relief measures and they are asset-for-share (section 42 of the Act), substitutive share-for-share (section 43 of the Act), amalgamation (section 44 of the Act), intra-group (section 45 of the Act), unbundling (section 46 of the Act) and liquidation, winding-up, and deregistration (section 47 of the Act). However, when one considers the sections listed above of the Act, section 41 of the Act contains specific definitions for the purposes of corporate reorganisation rollover relief rules.

It allows companies within the same group to transfer assets and defers the tax to a future date on the basis that the transferee steps into the shoes of the transferor and tax is triggered when the asset is disposed of by the group.

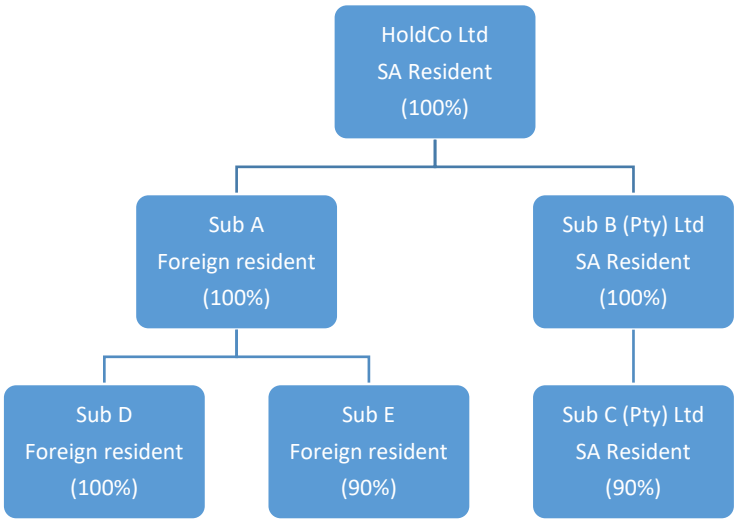
The key concept of section 45

Section 45 of the Act provides a tax relief where by an asset is transferred within a group of companies and is referred to as an intra-group transaction. It provides a tax relief for Income Tax, Donations Tax, Dividends Tax, Value-Added Tax, Securities Transfer Tax and Transfer Duty.

Intra-group transactions can be classified into two. The first one is between resident companies, mainly to facilitate reorganisation of domestic incorporated assets and can be referred to as domestic-to-domestic transfer. In this regard an asset is disposed of by the transferor company to a transferee company and both companies form part of the same group of companies at the end of the transaction. It is to be noted that the transferee company must retain the same nature that the transferor company held the asset as, i.e. if the asset was held by the transferor as capital asset, the transferee must also hold it as capital asset and if it was held as trading stock the transferee must also hold it as trading stock. An example of this type of this intra-group transaction is the one discussed earlier in the chapter.

The second type of an intra-group transaction is between a resident and a controlled foreign company (CFC) in relation to one or more resident companies that form part of the same group of companies. This is mainly to facilitate inbound (foreign incorporated assets can be transferred into SA) and foreign-to-foreign (foreign incorporated assets are transferred to CFC within the same group of companies) reorganisations. In this regard an asset constituting equity share held as a capital asset by the transferor company in the foreign company is disposed of to the transferee company in exchange for the issue of debt or shares other than equity shares by the transferee company. This type of an intra-group transaction can be illustrated as follows:

As part of the overall HoldCo Group strategy, Sub A disposed of Sub D to Sub B (Pty) Ltd on loan account and Sub B (Pty) Ltd will continue to hold Sub D as a capital asset.



In both types of intra-group transactions discussed above, it is evident that a group of companies and an asset are fundamental requirements for an intra-group transaction.

<u>The key concept of section 45: Group of companies</u>

The generic definition of group of companies is found in section 1 of the Act and

> means 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 percent 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 Act)

For the purposes of corporate reorganisation rollover relief, section 41 of the Act also provides the definition of group companies which narrows the generic definition in section 1 of the Act. Section 41 of the Act's definition of group of companies includes a proviso that excludes companies that are exempt from income tax, foreign resident companies and where shares are not equity shares but trading stock.

> A group that does not have a "controlling group company" after applying the proviso cannot comprise a "group of companies" for the purposes of the definition of that term in section 41(1). (SARS, 2020:3)

Equity share is defined in section 1 of the Act as

> any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution (the Act)

For income tax purposes, *"All "equity shares" are "shares", but not all "shares" are "equity shares""* (Wilson and McCarthy, n.d:1). This is further supported by the SARS BPR No. 143 issued on 2 May 2013, where a preference share with no restrictions was treated as an equity share for income tax purposes. Therefore, any share that does not carry any right regarding restrictions in relation to voting, dividends and return of capital would be considered equity shares when determining the 70 percent equity for a group of companies' requirements.

It is evident that section 41 of the Act narrows the generic definition of a group of companies, i.e. excludes companies mentioned in the previous paragraphs and shares that are not equity shares as defined. Therefore, companies wishing to enter into an intra-group transaction need to determine if a group of companies still exist after taking into account the proviso.

<u>The key concept of section 45: Asset</u>

An asset is defined in paragraph 1 of the 8th Schedule of the Act

> (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 (the Act)

However, for purposes of intra-group transactions, where an asset is transferred it could be capital or trading stock and needs to retain its nature in the hands of the transferee.

A capital asset is defined in section 41 of the Act and makes reference to the generic asset definition in terms of paragraph 1 of the 8th Sch. of the Act, which has been discussed earlier in the chapter. Section 41 of the Act's definition excludes trading stock as this is also separately defined in section 41 of the Act and will further be discussed below.

The generic definition of trading stock is provided in section 1 of the Act and

> (a) includes –

(i) anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by the taxpayer or on behalf of the taxpayer;
(ii) anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income, otherwise than—
(aa) in terms of paragraph (j) or (m) of the definition of "gross income";
(bb) in terms of paragraph 14(1) of the First Schedule; or
(cc) as a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (n) of the definition of "gross income"; or
(iii) any consumable stores and spare parts acquired by the taxpayer to be used or consumed in the course of the taxpayer's trade; but

b) does not include—
(i) a foreign currency option contract; or
(ii) a forward exchange contract,

as defined in section 24I(1); (the Act)

However, section 41 of the Act provides a specific definition of trading stock for the purposes of corporate rollover tax reliefs. The definition in section 41 of the Act specifically includes livestock or produce for the purposes of pastoral, agricultural or other farming operations and any reference to an amount that is subjected to a tax deduction from income of the taxpayer. Therefore, trading stock is an asset used in the course of the taxpayer's trade and sale of that asset is included in the taxpayer's gross income. The expenditure relating to trading stock is deducted from the taxpayer's income for the purposes of determining taxable income. Unlike the capital asset where the taxpayer can claim a wear and tear and/or special allowance over a period of time.

Even though section 45(1) of the Act makes reference to two types of assets, i.e. capital and trading stock. For the purposes of intra-group transactions, it is important for a company considering to utilise this tax relief to also understand an allowance asset as it may have different tax implications to a generic capital and trading stock asset. An allowance asset is defined in section 41 of the Act as a capital asset in which a taxpayer is allowed to claim a deduction or any allowance from normal tax other than in terms of the 8th Sch. of the Act, i.e. sections 11(*e*), 12C, etc. An allowance asset also includes a debt in relation bad debts allowances and bad debts written off in terms of section 11(*i*) and (*j*) of the Act.

It is therefore vital for companies entering into an intra-group transaction to clearly classify assets as normal capital asset, trading stock and allowance asset.

The key concept of section 45: Deemed disposal date and consideration

As mentioned earlier in the chapter, intra-group transaction relief allows companies to transfer assets within the same group of companies in a tax neutral manner. This is achieved by section 45(2) of the Act which deems the transferor to have disposed of an asset for an amount equal to the base cost of an asset at the date of transfer. Even though section 45(2) of the Act deems an asset to be transferred for an amount equal to base cost the actual consideration need not. It further deems the transferor and the transferee to be one and the same person with respect to acquisition date and expenditure incurred for the asset thereby resulting in the transferee stepping into the shoes of the transferor. Section 45(2) of the Act further constitutes an important provision, which states that, in order for companies to enter into an intra-group transaction, the market value of an asset transferred must exceed its base cost. The base cost of an asset for the purposes of capital gains tax can be simplified as an expenditure actually incurred for the acquisition or creation of an asset reduced by any allowances claimed as a deduction for determining taxable income.

The important thing companies need to take into account is that the intra-group transaction is an automatic election, if all the key concepts are present it will be triggered. Companies wishing to elect out need to agree in writing at the date of the disposal of an asset that the intra-group transaction relief does not apply. Intra-group transactions tax relief does not apply in respect of transfer of an asset if the all the income of the transferee company is exempt in terms of section 10 of the Act, i.e. Public Benefit Organisation approved by SARS as being exempt from income tax. Other instances where this relief does not apply are provided in section 45(6) of the Act.

The components that need to be present for an intra-group transaction tax relief are therefore group of companies, asset with a market value more than its base cost and disposal. The key concept can be illustrated by the statement, a disposal of asset with a base cost that does not exceed the market value within the group of companies. It is design is a way that the transferee steps into the shoes of the transferor and the tax

implications are deferred to a later date when the asset is disposed and/or deemed to be disposed of outside the group of companies.

The key concept of section 45 having been discussed above, it is vital to discuss the tax implication thereof to enable companies choosing to elect out of it to understand the pros and cons and ultimately make an informed decision. These tax implications will be discussed in the following chapters.

4. THE TAX IMPACTS OF CORPORATE RESTRUCTURING THROUGH INTRA-GROUP TRANSACTIONS

Having established the basic concept on intra-group transactions, this chapter will discuss the tax implications of common intra-group transactions. These examples will discuss the tax implications when the relief is elected versus when not elected. These examples will ignore the anti-avoidance provisions as these will be discussed in the following chapters.

As illustrated in the previous chapter, there are two types of intra-group transactions as defined in section 45(1) of the Act. The first one can be classified as tax resident and tax resident transfer of an asset where the transferor and the transferee will belong to the same group of companies at the end of the day of the intra-group transaction. In this regard, different types of assets are provided for, i.e. capital or trading stock. The second type of intra-group transaction can be classified as a transfer of an equity asset held as a capital asset is transferred between a tax resident and a foreign tax resident in exchange for the issue of shares for debt. It is to be noted that the first type of intra-group transactions is not only limited to assets held as capital like the second type of intra-group company but is also extended to assets held as trading stock.

The general rule is that the transfer of an asset will constitute a sale and depending on how the asset is held, i.e. on capital or revenue, the proceeds may be seen as proceeds for CGT purposes or gross income as defined in section 1 of the Act. This will ultimately trigger tax in the hands of the seller, being the transferor in this regard. However, when the transfer qualifies as an intra-group transaction as defined in section 45(1) of the Act, the tax on income or capital that would normally be triggered is deferred in terms of section 45(2) of the Act which deems the transferor and the transferee to be the same person. As a result, an intra-group transaction yields a tax relief on the transfer of an asset and puts the group of companies in a similar position with a single company with multiple division operations.

As mentioned earlier the assets transferred between a tax resident companies, i.e. the first type of intra-group transaction can be an asset held as capital or non-capital,

hence the need for the proper classification of an asset. In addition to the requirement for an asset to be classified as capital or trading stock, there is an additional need to further indicate if the assets are an allowance one as defined in section 41 of the Act because of the tax implications that need to be considered.

The tax implications of an intra-group transaction.

In addition to income tax (normal tax and CGT), the transfer of an asset may also trigger other types of taxes, i.e. VAT, Donations Tax, Dividends Tax, Transfer Duty and STT will be briefly discussed.

The imposition of VAT is provided for in section 7 of the VAT Act and is basically imposed on the supply of goods or services by any vendor in the course or furtherance of any carried enterprise. The VAT rate in SA is currently 15 per cent. The term supply is defined in section 1 of the VAT Act to include

> … performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of "supply" shall be construed accordingly; (VAT Act)

Section 12 of the VAT Act provides for goods and services that will be exempt from VAT which includes the exemption of VAT from the supply of any financial services. Financial services activities are provided for in section 2 of the VAT Act and include *'the issue, allotment or transfer of ownership of an equity security'* (VAT Act). It is important for companies considering utilising the intra-group transaction to keep in mind the VAT Act will also apply. The VAT Act also provided for tax relief where goods or services are transferred between VAT vendors in terms of an intra-group transaction as defined in the VAT Act. However, for this tax relief to apply, the transfer of an enterprise needs to be on a going concern basis and the supply can be zero-rated.

Donations Tax which is incorporated in the Act, even though Donations Tax is incorporated in the Act it is not a tax on income but a tax on the disposal of capital. Section 54 of the Act states that Donations Tax shall be levied on the value of any property disposed of by means of a donation by a tax resident. A flat tax rate at 20 per

cent applies on the cumulative donated property value of not exceeding R30m and 25% for cumulative donated property value exceeding R30m. However, Donations Tax does not apply to natural persons donating the sum of not more than R100 000 during a year of assessment. Donations are defined in section 55 of the Act as *'any gratuitous disposal of property including any gratuitous waiver or renunciation of a right'* (the Act). There are some cases where Donations Tax will be exempt, for example in terms of section 56(1)(*r*) of the Act for donations within the same group of companies. On the basis that a group of companies, i.e. one company holds at least 70 per cent of the equity shares in two or more companies, is one of the key concepts or requirements for an intra-group transaction. One can therefore conclude that an intra-group transaction should be exempt from Donations Tax on this basis. Consequently, where the consideration of an intra-group transaction is less than the market value of an asset transferred, Donations Tax will not be triggered.

Dividends Tax like Donations Tax, is also provided for in the Act. Dividends Tax is not a tax on income instead a tax on dividends paid any amount transferred by a company for the benefit of a shareholder in respect of a share held. Dividends Tax is levied at 20 per cent of the dividend declared. However, section 64F(*a*) of the Act exempts Dividends Tax in a dividend declared to a tax resident company. On the basis that intra-group transactions can only be done by companies, i.e. not natural persons or trusts, it should therefore qualify for an exemption from Dividends Tax.

Transfer Duty is regulated by the Transfer Duty Act and applies in respect of the acquisition of property. The definition of property in terms of the Transfer Duty Act is specific and property that is land and any fixtures thereon, real right to land, any right to minerals, etc. Transfer Duty is levied is the obligation on an acquirer of the property. On the basis that an intra-group transaction is the transfer of an asset, it may happen at times that the type of an asset transferred is property as defined in the Transfer Duty Act that may trigger Transfer Duty. Section 9(1)(*l*) of the Transfer Duty Act states that Transfer Duty shall not be payable when an acquisition of an asset is done in terms of an intra-group transaction in terms of section 45 of the Act. However, this exemption is not automatic, the public officer of the transferee company needs to make

a sworn affidavit or solemn declaration that the transfer of property is indeed done in terms of section 45 of the Act.

STT is regulated by the STT Act and is levied on the transfer of any security as defined in the STT Act. The definition of security in the STT Act includes shares, therefore where the asset transferred in the intra-group transaction is a share, STT will be triggered. STT is levied at 0.25 per cent and is an obligation of the purchaser of the security. Section 8(1)(*a*)(iii) of the STT Act provides for an exemption from STT of disposal of security that is disposed of in terms of an intra-group transaction. Similar to Transfer Duty, this exemption is not automatic, the public officer of the transferee company needs to make a sworn affidavit or solemn declaration that the transfer of a security is done in terms of section 45 of the Act.

Examples of intra-group transactions and the tax implications thereon.

Example 1 – Transfer of shares held as capital at market value and the consideration is paid in cash

Background facts

Company P holds 51 per cent equity shares in Company C and 100 per cent equity shares in Companies A and B. Companies A and B operate in the insurance industry where Company A is a non-life insurer and Company B is a life insurer. Company C provides insurance underwriting services mostly to Company A.

- Company P is the ultimate holding company
- All the companies are privately owned, i.e. not listed in the JSE and tax residents of SA
- All the companies have a June year-end
- All the companies are VAT vendors
- As part of Company P's strategic objective which is to reduce costs, it was resolved that Company P would buy 49 per cent equity shares of Company C for capital appreciation and transfer all of it to Company A
- Company P paid R50m cash for the purchase of the remaining 49 per cent of equity shares of Company C on 1 July 2020 which represents the market value

of the shares at the date of the transaction. This acquisition results in all Company C equity shares being held by Company P, i.e. Step 1 of the transaction

- Immediately after the acquisition of Company C equity shares, Company P transfers the 100 per cent equity shares held in Company C to Company A on 1 July 2020 for R120m which represents the market value and the consideration paid for in cash, i.e. Step 2 of the transaction

Tax implications

If the parties do not agree in writing that the intra-group transaction tax relief as defined in section 45 of the Act does not apply the tax implications of this transaction are discussed.

Step 1 of the transaction:

The purchase of the 49 per cent equity shares by Company P represents an expenditure actually incurred for the acquisition of the shares. On the basis that Company P purchased the shares for capital appreciation and will get dividends, i.e. shares being the tree and dividends being the fruits. It follows the R50m paid by Company P represents the base cost of the shares as defined in Para 20 of the 8th Sch. of the Act for determining capital gains when the asset is disposed of in the future and the acquisition date of the asset is 1 July 2020. The onus is on Company P to argue that the shares are held as a capital asset. The R50m represents capital contributed capital in Company C as it is the consideration for the issue of shares. Company P will also incur STT at the rate of 0.25 per cent which is R125 000. Since the shares in question are not listed in the JSE, the STT return together with the payment is due to SARS within two months from the end of the month in which the transfer of the shares took place. Donations Tax, Transfer Duty, Dividends Tax and VAT will not apply.

Step 2 of the transaction:

The transfer of all the equity shares held by Company P in Company C to Company A represents disposal of an asset by Company P. As mentioned in the background, Company P had acquired the shares for capital appreciation and treated it as capital

in nature. The R120m received by Company P for the disposal of shares represents proceeds as defined in para 35 of the 8th Sch. of the Act. The R50m for the 49 percent plus any expenditure actually incurred for the acquisition of the initial 51 per cent is the base cost as defined and should be excluded from proceeds to determine capital gains or loss. Assuming the actual result is a capital gain, Company P must include 80 per cent of the capital gain in its taxable income in terms of section 26A of the Act. This will result in Company P effectively paying tax at 22.4 per cent for the year pf assessment in question as the corporate income tax rate is 28 per cent. Company P will not be subjected to STT as it is the seller of the shares. VAT, Donations Tax, Transfer Duty and Dividends Tax will also not apply. Company A on the other hand, the same tax implications that applied to Company P in Step 1 of the transaction will apply.

Tax implications

If the intra-group transaction tax relief as defined in section 45 of the Act automatically applies, i.e. section 45(6) of the Act does not apply. The tax implications of this transaction are discussed.

Companies A, B and P are a group of companies for the purposes of section 41 of the Act, with Company P being the controlling company. Company C on the other hand pre-acquisition of the 49% shares by Company P did not belong to the same group of companies controlled by Company P for the purposes of section 41 of the Act. However, at the end of the acquisition of shares transaction, Company C does belong to the group of companies held by Company P.

The acquisition of the 49 per cent equity shares by Company P represents the acquisition of an asset. Company P and the previous shareholders of Company C are not a group of companies as defined in section 41 of the Act. Consequently, the similar tax implications discussed in Step 1 above if parties elect out still apply. The transfer of equity shares held in Company C by Company P to Company A is an intra-group transaction as defined in section 45(1)(*a*) of the Act. Section 45(2)(*a*) of the Act then applies and deems Company P to have transferred the capital asset for an amount equal to the base cost on the date of transfer. It also deems Company A to step into

the shoes of Company P in respect of the acquisition date of an asset and the amount of expenditure for that asset. Through this process, the intra-group transaction achieves the nil CGT implications for Company P and any CGT when the asset is disposed of outside the group or within the group without the election of this relief will be suffered by Company A. In order to qualify for the STT exemption, the public officer of Company A needs to make a sworn affidavit or solemn declaration that the transfer of a security is done in terms of section 45 of the Act.

This is a good example of illustration of the financial relief the intra-group transaction has in corporate restructurings.

Example 2 – Transfer of trading stock at cost value and the consideration is paid in cash

Background facts

Company P holds 100 per cent equity shares in Companies A and B. Companies A and B operate in the retail industry

- Company P is the ultimate holding company.
- All the companies are privately owned, i.e. not listed in the JSE and tax residents of SA.
- All the companies have a December year-end.
- All the companies are VAT vendors.
- As part of the broader group strategy, it was decided that Company A will focus on high-end products and Company B will focus on low-end products.
- Product Y was therefore transferred by Company A to Company B at cost price and paid R10m cash.

Tax implications

Similar to Example 1 above, tax implications in a case where parties do not agree in writing that the intra-group transaction tax relief as defined in section 45 of the Act does not apply are discussed.

The transfer of Product Y by Company A to company B is the disposal of a trading stock asset that is not capital in nature. Accordingly, any amounts received or accrued for the disposal will fall under gross income as defined in section 1 of the Act. Since Product Y is not disposed of in the ordinary course of trade and not at market value, i.e. disposed of to a connected person at cost price, section 22(8)(ii) of the Act will apply and deem the disposal to be a market value. If the market value is higher than the cost of Product Y, Company A will have a net effect of income included in its taxable income and pay tax at 28 per cent. The cost to Company B for the acquisition of Product Y will still be the actual amount of expenditure incurred and will be entitled to a tax deduction.

The disposal of Product Y will also have VAT implications where Donations Tax, Transfer Duty, Dividends Tax and VAT will not apply.

Tax implications

Similar to example 1 above, the tax implications when intra-group transaction tax relief as defined in section 45 of the Act automatically apply, i.e. section 45(6) of the Act does not apply will be discussed.

The transfer of trading stock by Company A to Company B is an intra-group transaction as defined in section 45(1)(*a*) of the Act. Section 45(2)(*b*) of the Act then applies and deems Company A to have transferred trading stock for an amount equal to its cost in terms of section 11(*a*) of the Act or tax value in terms of 22(1) or (2). Furthermore, Company B to step into the shoes of Company A in respect of the acquisition date and the cost or tax value of the trading stock. The tax burden is then moved to Company B when it disposes of trading stock to a third party as part of its normal trading.

The VAT implications of this transaction will also be nil on the basis that it is an intra-group transaction.

STT, Donations Tax and Transfer Duty will not apply.

The two examples discussed two types of assets, i.e. capital and trading stock, there are other types of assets that may also be transferred and where an allowance other than the one in sections 11(*e*) and section 12C of the Act were claimed. An example of this is illustrated in section 45(3)(*b*) of the Act, where a tax relief applies in a transfer of contract on a going concern and an allowance in terms of sections 24, 24C or 24P was allowable. There are contracts that may be transferred on a going concern and an allowance was claimed in terms of section 28(3) of the Act which applies to short-term insurers. Section 28(3) of the Act grants a taxpayer who is an insurer a tax deduction for the insurance liabilities in the Annual Financial Statements on the basis that it will be added back in the following tax year. Section 45 of the Act is not clear if insurers can also automatically utilise section 45(3)(*b*) of the Act or such transfers would fall under section 45(3)(*a*) of the Act. Nevertheless, insurers who utilise section 28(3) of the Act and intend to transfer insurance contracts on a going concern need to consider options to structure the transaction in a tax-efficient manner.

The birth of the abuse of the intra-group tax relief

The earlier examples in this chapter illustrated the financial relief as a result of utilising the intra-group transactions tax rollover relied on. Companies started using the intra-group transactions rollover tax relief for the unintended creation of excessive assessed tax losses and exiting from investments tax-free. Each of these unintended transactions will be discussed.

Excessive assessed loss can be linked to debt push-down structures, in this regard a company acquiring equity shares in another entity into an additional transaction step, i.e. a target company transfers its assets to one of its new affiliates for a consideration sourced from an external banker equal to an acquisition cost by the acquiring company. The report detailed that an intra-group transaction achieves the tax neutral position by deeming the transfer of an asset to be at an amount equal to the cost incurred or tax value. The deemed disposal value is a tax term and not a consideration as such, this means that an intra-group transaction can be done for consideration on loan or consideration at a market value similar to the first example above. It is expected that the intra-group transfer of assets will be done on loan, this is supported by the fact

that section 45(3A) of the Act and the newly introduced section 45(3B) of the Act provides for the tax treatment in cases where an intra-group transaction consideration is on loan or for an in the issue of a share other than an equity share. The transferee company qualified for a tax deduction on the interest on the loan for the intra-group transaction. Generally, a transferee is already entitled to a tax deduction of operating expenses, the interest on the loan for the intra-group transactions, therefore, increases the operating costs of the transferee company, in a case where the acquired assets do not yield the anticipated growth in profit in the transferee company. The transferee will most likely be in an assessed tax loss position which would otherwise have not been available if the intra-group transaction was not utilised. These transactions can be illustrated with an example below.

Company P holds 100 per cent of the equity shares in Company A and Company B. All companies are tax residents of SA, VAT vendors and not listed on the JSE. As part of the group's expansion strategic objective, Company P wishes to acquire equity shares in NewCo from an independent person. The market value of the equity shares in NewCo is R100m. In order to achieve this Company P utilises the intra-group transactions tax relief and enters in the following transaction steps:

- Step 1: Company P secures a bridging loan from an independent bank for the acquisition of equity shares in NewCo
- Step 2: NewCo dispose of all of its assets to its affiliate, Company A for R100m
- Step 3: Company A secures a long-term loan from an independent bank to pay NewCo as consideration for the transferred assets
- Step 4: NewCo uses the intra-group transaction consideration to declare and pay a dividend to Company P
- Step 5: Company P repays the bridging loan for the acquisition of equity shares in NewCO

The acquisition of NewCo equity shares by Company P result in NewCo belonging to the same group of companies as Companies A and B as defined in section 41 of the Act. Therefore, the transfer of assets by NewCo to Company A in Step 2 is an intra-group transaction as defined in section 45(1)(*a*) of the Act. In this regard, NewCo is able to get tax relief on the transfer of assets. The intra-group transaction in this regard

enables companies to structure transactions in a manner that entitles them to a tax deduction that would otherwise be not be achieved in a normal acquisition of equity shares and these give rise to exempt dividends.

These specific structures led to the National Treasury announcing the haphazard 18-month suspension of the tax relief in 2011. Even though the intra-group transaction was not suspended instead interest limitation provisions were introduced in the Act. The first limitation of deduction of interest relating to corporate restructurings was section 23K which became effective on 3 June 2011. Section 23K of the Act provided that interest deduction in relation to the debt used to fund an intra-group transaction will no longer be automated, instead, an approval process would need to be followed. The approval process required the transferee company to disclose to the Commissioner for SARS the debt to equity ratio, estimated interest expense that would be allowable for the deduction, comparison of the economic impacts of the terms of the debt versus the ones that would be had the debt been treated as equity, the relationship between the issuer of the debt and the holder, and any other information the Commissions may deem relevant. It is clear that this extensive approval process was not sustainable. In this regard a new section in the Act, section 23N was introduced in 2014 to replace section 23K.

Section 23N of the Act applies to transactions entered on and after 1 April 2014. It achieves the limitation of interest deduction for an acquiring company in an intra-group transaction reorganisation for the year in which the transaction was entered and the five years immediately following the transaction. The limitation ensures a nil impact within a group of companies in a case where section 45 of the Act has been utilised debt push-down structures by providing that the interest eligible for a deduction may not exceed interest received by the acquiring company. In addition to the interest income and expense matching, section 23N also provides a limit to interest deduction in a form of a formula that is linked to the adjusted taxable income of an acquiring company. The formula for determining an amount of interest to be deductible is

A = B x C/D whereby

A = percentage to be determined

B = the number 40

C = the average repo rate plus 400 basis points

D = the number 10

Therefore if the repo rate is 6% then the percentage is 32%.

Another abuse of the intra-group transaction tax relief was around the tax-free exit from investments, *'A tax-free cash-out is a transaction whereby a company wishes to dispose of an asset to an independent third party purchaser, without the seller being subjected to tax'* (National Treasury, 2008:14). A tax-free exit from investments can be illustrated in the example below:

Company P holds 100 per cent of the equity shares in Company A, Company B and Company C. All companies are tax residents of SA, VAT vendors and not listed in the JSE. Company P wishes to dispose of assets in Company C with a market value of R50m and a base cost of R20m to an independent third party tax-free. In order to achieve this Company P utilises the intra-group transactions tax relief and enters in the following transaction steps:

- Step 1: Company P incorporates Company D for a nominal value
- Step 2: Company C transfers all of its assets to the newly formed Company D for a consideration of R50m
- Step 3: Company D secures an independent third party backed R50m loan from BankA, an independent bank. The loan is used to pay Company C for the assets transferred
- Step 4: Company C uses the R50m consideration from Company D to pay declared dividend
- Step 5: Company P transfers 100 per cent equity shares in Company C to Company D for a nil consideration
- Step 6: Independent third party acquires all the equity shares of Company D from Company P with a nominal value due to the attached debt

Companies A, B, C and D are wholly owned by Company P, therefore a group of companies as defined in section 41 of the Act. It follows, the transfer of assets by Company C to Company D is an intra-group transaction as defined in section 45(1)(*a*) of the Act. In this regard, section 45(2) of the Act applies and Company D steps into

the shoes of Company C which results in Company C being entitled to tax relief for the transfer of the assets. The disposal of Company C by Company P to Company D is also an intra-group transaction as defined in section 45(1)(*a*) of the Act.

This example illustrates how what was introduced to enable group companies to transfer assets within the group without incurring immediate tax implications was used to dispose of assets outside the group tax-free. These structures were popular before the amendment of section 45(4)(*b*) de-grouping in 2008 which will be discussed later in this research report.

This research report has illustrated the tax relief as a result of removal of the tax barrier in the transfer of assets within the group of companies. It further illustrated how section 45 of the Act has instead become a key acquisition tool resulting in avoidance of tax, i.e. creating debt-push down structures that enable excess interest deductions and tax-free exits from investments. Therefore, discussion on tax avoidance must be heard.

The rationale of General Anti-Avoidance Rule

The 1936 *Duke of Westminster* ruling gave birth to one of the well-known dictum in a tax case, not just among tax professionals, even entrepreneurs mention Lord Tomlin's famous lines to this day *'every man is entitled to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be'* (*IRC v Duke of Westminster*, 1936). (the author's emphasis). Taxpayers have over the years taken means to plan their affairs using tax provisions with the law to pay less tax than what it would have been without the utilisation of the provisions. Lord Tomlin, in the Westminster ruling, uses "less than it would be" which is very broad, does not have clear boundaries if less is reducing the tax liability by 50 per cent or by 100 per cent is sufficient. History together with some of the examples in the previous chapter has proved that some taxpayers are happy to push against boundaries as a result the tax authorities don't even get the crumbs.

SA largely relies on taxes to deliver basic service, i.e. infrastructure, clean water, electricity, etc. to the citizens. SA is one of the countries leading with inequalities resulting in a large amount of poor people relying on government grants to survive. COVID-19 pandemic made this as SA was contemplating increasing taxes to help fund the basic income grant.

> Data published by the World Bank in September shows that a third of South Africans are beneficiaries of a social grant directly, which rises to close to two-thirds when those who benefit indirectly are included. (BusinessTech, 2021:pp 9)

It is evident that the collection of taxes plays a crucial role in SA. Ignoring constant reported corruption in the country, which is not part of this report, one can argue that the tax loss resulting from impermissible arrangements have direct implications in contributing to the inequalities in the country. The Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act published by the SARS in 2005, demonstrated that impermissible arrangements have huge cost to the economy.

In order for the company to properly function it needs to maintain its economy and an effective tax system plays a crucial role in a sustainable economy. From the previous chapter examples, it is evident that the intra-group transaction tax relief has also been used for its intended purpose, i.e. transferring assets within the same economic unit. The relief has also been used to significantly decrease the tax liability that would usually be incurred had the relief been not available. Tax avoidance structures are mostly legal as they take advantage of the existing law however these structures usually overshoot the intention of the law. The lawmakers have found themselves in a position of establishing boundaries between acceptable and aggressive tax planning, as a result of an introduction of anti-avoidance rules. '*Parliament and SARS are not obliged to stand still while the techniques of tax avoidance progress and are technically improved*.' (SARS, 2005:47). SA, therefore, has anti-avoidance rules to curb the abuse of excessive tax planning, the anti-avoidance is the General Anti-Avoidance Rule (GAAR) and specific anti-avoidance rules.

GAAR is a generic anti-avoidance found in Chapter III Part IIA of the Act (sections 80A to 80L of the Act), it applies to all transactions and enables tax authorities to establish the boundary between legitimate tax planning and impermissible tax avoidance. It was

introduced in SA on 2 November 2006 to replace the anti-avoidance in section 103(1) that proved to be fruitless.

> A GAAR, by its nature, operates in tension with this notion. It imposes limits upon the extent to which an "ordering of affairs" is to be respected for tax purposes. It thus helps to establish the boundary between legitimate tax planning and impermissible tax avoidance. (SARS, 2005:5)

The basic fundamental of GAAR stems from the fact that taxpayer has entered in an avoidance arrangement with the sole or the main purpose was to obtain a tax benefit, therefore, resulting in it being an impermissible avoidance arrangement'.

As mentioned in the earlier chapters, companies in general, need to undergo restructuring to be sustainable. In SA, a country that went through inequality which has now resulted in the government putting laws in place to enable the inclusivity of Black People as defined in the Broad-based Black Economic Empowerment Act 53 of 2003 (B-BBEE). Companies operating in SA, therefore need to comply with B-BBEE at time restructure specifically to achieve the required B-BBEE rating and use the corporate reorganisation rollover reliefs to achieve this in the most tax-efficient manner. Earlier in this chapter, it was mentioned that some taxpayers will push the limit and end up abusing the tax provisions by entering into impermissible tax avoidance arrangements. An example of this is Huda Industries Limited that entered into a transaction with an objective of introducing the empowerment shareholders. However, this transaction ended up making headlines over secret profits in a B-BBEE deal that were not subjected to tax. In this regard, SARS, after the extensive investigation was able to rule that the B-BBEE transaction Huda Industries Limited had entered into was indeed an impermissible tax avoidance arrangement in terms of the GAAR provisions.

GAAR investigations require a lot of resources such as time and money but most of all curiosity from tax authorities. This is because impermissible tax avoidance arrangements are usually achieved through the use of complex group structures that have a presence in other countries and a team of tax experts.

It is challenging for tax authorities to pinpoint an impermissible tax avoidance at face value as they are not involved in the daily running of the business. In an article

published by Edward Nathan Sonnenbergs Inc. in 2007, a question was posed as to the extent one can make use of the GAAR provisions, bearing in mind that they have been specifically reserved in the context of corporate restructuring rules. In the article, the following example is provided

> A holding company wishes to declare dividends to its shareholders, it is possible for Holdco (Holdco) to create cash by entering into a transaction making use of the provisions of section 45 of the Act dealing with intra-group transactions. Essentially Holdco will transfer its entire business to Subco on the basis that there will be no negative tax consequences associated with such transfer. Value added tax will also not be payable as Holdco and Subco will be deemed to be one and the same person. Subco, however, can fund the acquisition of the assets at market value by obtaining funding from a financial institution. The interest payable on such debt would be deductible in view of the fact that the debt has been used to acquire assets. The proceeds from the sale of the business can be used by Holdco to declare a dividend. (ENS, 2007: pp4)

From the provided example, obviously SARS would not know the real commercial substance, which is to declare a dividend and structure a transaction in a way that yields a tax benefit through using the intra-group transaction rollover tax relief.

GAAR is specifically designed to assist tax authorities to determine an impermissible tax avoidance arrangement. The common characteristics being lack of commercial substance (in whole or in part), structuring a transaction in an abnormal manner solely to get a tax benefit, round trip financing, use of tax-indifferences, unnecessary steps that result in the complexity of the arrangement, inconsistent treatment for tax and financial accounting purposes, high transaction costs and fee discrepancy clause.

In addition, section 41(2) of the Act provides that the corporate roll-over relief rules are subjected to GAAR

> The provisions of this Part must, subject to subsection (3), apply in respect of an asset-for-share transaction, a substitutive share-for-share transaction, an amalgamation transaction, an intra-group transaction, an unbundling transaction and a liquidation distribution as contemplated in sections 42, 43, 44, 45, 46 and 47, respectively, notwithstanding any provision to the contrary contained in the Act, other than sections 24BA, 24I, 25BB (5) and 103, **Part IIA of Chapter III** and paragraph 11(1)(g) of the Eighth Schedule and any adjusted gain on transfer or redemption of an instrument, as defined in section 24J(1) and any adjusted loss on transfer or redemption of an instrument as defined in section 24J(1). (the Act) (author's emphasis).

GAAR because of its broadness therefore has a role in curbing the abuse of the intra-group transaction tax relief.

The second type of anti-avoidance is a specific one that is built within the specific section of the Act, they take preference to GAAR and is designed to curb the abuse of that specific provision. The specific anti-avoidance rules tend to be rule-based due to their nature of being specific to a certain provision of the Act.

Earlier in the research report, the introduction of CGT was discussed and how it would trigger tax on the restructuring of companies within the same economic unit. The lawmakers responded to this by adopting international trends and introducing rollover tax relief provisions. This would allow companies to restructure their group without incurring the immediate tax consequences. The research report further discussed section 45 of the Act which allows companies within the same group of companies to transfer assets and defer the tax to a later date when the asset is disposed of outside the group.

The specific anti-avoidance rules found in section 45 of the Act are early disposal of an asset and de-grouping charge. These anti-avoidance provisions '*prevent the shifting of built-in gain assets into a company transferee through the mechanism of a company formation transaction*' (SARS, 2003:12) and will be discussed in detail in the following chapter.

Intra-group transaction tax relief is used by companies that operate in a complex environment which many factors like technology, globalisation and access to world-class tax experts. As a result, the GAAR is an effective way of curbing the abuse of the tax provision.

> To prevent the proliferation of targeted anti-avoidance practices more reliance should be placed on general principles, as well as the GAAR; and the "targeted" anti-avoidance provisions considered as an absolute last resort, after a comprehensive assessment of any existing applicable law (including both legislation and case law) has been performed. (DTC, 2018:90)

Therefore, GAAR can yield more benefit in helping tax authorities to curb abuse of the tax law and mostly to protect the country's economy.

The major difference between GAAR and specific anti-avoidance is that GAAR is wide enough to cover complex, all types of tax avoidance schemes that are not captured by the other specific anti-avoidance provisions.

5. THE EVOLUTION OF SPECIFIC ANTI-AVOIDANCE RULES IN SECTION 45 OF THE ACT

Earlier in this research report, it was highlighted that some taxpayers misuse the law and end up avoiding tax hence the need for anti-avoidance provisions in an effective tax system. This chapter will discuss the specific anti-avoidance in section 45 of the Act and will ultimately provide a view on whether it achieves it intended purpose.

The 18-month anti-avoidance rule

The 18-month anti-avoidance rule also referred to as an early disposal anti-avoidance rule in section 45(5) of the Act prevents companies from using the intra-group transaction tax relief to transfer assets with gains to companies with excess loss. The early disposal anti-avoidance rule was introduced in 2001 with the introduction of the intra-group transaction relief, it applies when a transferee company disposes of an asset within a period of 18-months after the intra-group transaction. It however does not apply to involuntary disposal in terms of paragraph 65 of the 8th Sch. of the Act. Initially, it was designed to apply to assets held on the capital account however a year later this anti-avoidance extended to also apply to assets held as trading stock and allowance assets.

The early disposal anti-avoidance rule in the case of an asset held on a capital account is found in section 45(5)(*a*) of the Act. The rationale behind it is that it reverses the tax benefit that was received as a result of an intra-group transaction. The proceeds on the disposal of an asset the transferee company asset is acquired as a result of an intra-group transaction within 18 months cannot be less than the market value of the asset at the date of the intra-group transaction. It further states that the determining capital gain, i.e. deemed to be not less than the gain that would have been determined at the beginning of the 18 months, cannot be taken into account when determining taxable gain in terms of paragraph 10 of the 8th Sch. of the Act, i.e. capital gain cannot be offset with a capital loss. However, an increase in the value of the capital asset after the intra-group transaction may be set off against any loss.

Section 45(5)(*b*)(i) of the Act provides for the early disposal of anti-avoidance rules in a case of an asset held as trading stock. It states that where trading stock that was acquired as a result of an intra-group transaction, is disposed of within 18 months and the amount received or accrued is less than the market value at the date of the intra-group transaction, i.e. market value is the beginning of the 18 months. The loss resulting from the disposal of that trading stock must be ring-fenced as it is deemed to be attributable to a separate trade. In a case where the transferee has an assessed loss and/or loss from other trades and the disposal of the trading stock that was acquired in terms of the intra-group transaction gives rise to the gain. The gain on the disposal will not be offset with the assessed and/or assessed loss by the transferee company, i.e. as part of its trade. This provision does not however apply to trading stock that is frequently and continuously disposed of early disposal. This is because trading stock frequently and continuously is bound to be disposed of in a very short space of time, i.e. less than 18 months and the selling price is related to economic factors.

Section 45(5)(*b*)(ii) of the Act provides for the early disposal anti-avoidance rules in a case of an asset held as an allowance asset. In a case where a transferee company, within 18 months of an intra-group transaction, disposes of an allowance asset that was acquired in terms of the intra-group transaction. And the recoupment in relation to that asset included in the transferee's taxable income is less than what would have been determined at the beginning of the 18 months of the intra-group transaction. The recoupment is deemed to be attributable to a separate trade and taxable income and cannot be offset with the assessed loss from other trade. Similar to a capital asset, the portion of the recoupment relating to an increase in the value of an allowance asset after the intra-group transaction may be offset with the assessed loss of the transferee company. In a case where an allowance asset disposed of within 18 months of the intra-group transaction result in an assessed loss, it may not be offset with any taxable income of the transferee. Therefore, the anti-avoidance rules for an allowance asset are the same as the ones for trading stock.

In summary, the early disposal anti-avoidance rules reverse the intra-group transaction tax relief '*by ring-fencing the gain or loss arising from the early disposal of*

an asset to ensure that the gain or loss is not offset against other gains and losses.' (National Treasury, 2021:146). It achieves by reversing the tax relief and ensures that in the 18 months of the intra-group transaction, companies do not avoid tax that they would have been subjected to had they not utilised the intra-group transaction relief. It also prevents the creation and utilisation of losses within 18 months as a result of utilising the intra-group transaction relief.

Concerns around the 18-month anti-avoidance rule

Taxpayers in general usually have concerns with anti-avoidance provisions, even though there is proof that some abuse the tax provisions. Some taxpayers feel specific schemes should be attacked instead of applying the blanket approach. The same with the early disposal anti-avoidance where taxpayers have expressed concern around the harsh and not contributing to fiscal neutrality.

> Taxpayers perceive the 18-month anti-avoidance rule as unnecessarily strict, unfair, and harsh and regard it as not contributing to fiscal neutrality. In situations where this anti-avoidance provision is triggered, taxable income is raised in the transferee company. The taxable income cannot be offset against any possible assessed loss or assessed capital loss of the transferee or transferor companies. On the other hand, the period of 18 months has been criticised as being too long and unrealistic in a modern world where business opportunities emerge at an accelerated pace. (DTC, 2018:58)

It is therefore vital to discuss the concerns raised by taxpayers and understand if these concerns unduly hamper the efficacy of the intra-group transaction.

In the case of an early anti-avoidance being unfair on the basis that it does not contribute to fiscal neutrality. Fiscal neutrality in this context basically means tax policies should create balance in the economy. Neutrality is one of the key fundamentals of the country's tax policy *'One of the key principles of tax policy design is neutrality – taxpayer decisions should be based on economic fundamentals and not distorted by tax considerations'* (SARS, 2020:10). Fiscal neutrality is not achieved in instances where an early disposal anti-avoidance is triggered and it results in a taxable gain and the transferee has a loss that cannot be used to offset the gain. Also, on the basis that a holistic tax implication of the transferor at the beginning of the intra-group transaction is not taken into account. There are instances where a transferor may also have assessed loss from disposal of other assets that would have been utilised in a

case if the intra-group transaction was not elected. One may argue that companies need to look at the group tax impact and consider the full tax implications including anti-avoidance rules when electing in such transactions. However, the fact that transactions, where an early anti-avoidance is triggered and result in a taxable gain that cannot be offset with a loss, does not create neutrality and therefore contradict the fundamental of the tax policy.

Earlier in the research paper, the objectives of corporate reorganisation rollover reliefs were discussed. The objectives include promoting domestic companies restructuring, promotion of growth, and achieving a tax neutral restructuring within the same economic unit. It is therefore clear that the corporate rollover reliefs, including intra-group transactions were designed to create efficacy for companies. However, an early anti-avoidance provision proves to fail to create tax neutrality.

Example 1

Background facts

HoldCo holds 100% equity shares in Company A and B. Both A and B are in the manufacturing industry. As part of the overall group strategy, it was decided that Product A which is manufactured by Company A will be discontinued due to it not being profitable.

- All companies are tax residents of SA.
- All the companies are VAT vendors.
- All companies have a December year-end.
- The machinery was first acquired (new and unused) by Company A on 1 July 2010 for R200m and was brought into use on the same day.
- Company A sells the manufacturing asset to Company B on 1 January 2012;
- The machinery used for Product A had a market value of R150m on 1 January 2012;
- Company B sells the machinery to a third party on 31 December 2012 for R80m.
- Company A claimed section 12C of the Act allowance.
- Company B has an assessed capital loss of R90m and assessed loss of R50m

HoldCo holds at least 70 per cent of equity shares in both Company A and B, therefore HoldCo and Company A and B are a group of companies for the purposes of section 41 of the Act. The sale by Company A to Company B for the machinery used for Product A qualifies for an intra-group transaction relief in terms of section 45(1)(*a*) of the Act. As a result, the tax implications, being CGT and recoupment are deferred to a later date. Company B is deemed to be one and the same person as Company A in relation to the acquisition date and base cost of an asset. When Company B later disposes of the assets to a third party for R110m, it would normally be able to offset the capital gain with the assessed capital loss of R90m and any recoupment would be offset with assessed losses. However, with the early disposal anti-avoidance in place, section 45(5)(*a*) of the Act applies and the tax is determined as follows for Company B:

Recoupment	
Proceeds	*R150m*
Less: Tax Value	*(80m)*
Recoupment	*R70m*
Capital gains	
Proceeds (R150m – R70m)	*R80m*
Less: Base Cost (R200m – R120m)	*(R80m)*
Capital Gain	*NIL*

Example 2, extracted from the SARS BPR No. 30 dated 4 May 2016.

Background facts

HoldCo holds qualifying equity shares in Company A, B and C. Company A used to hold equity shares in its now-fellow sister company, Company C. Company A transferred its capital asset being the investment in Company C to its parent HoldCo at market value. One can say, as part of the group's strategy to rationalise the corporate and operational structure in South Africa, HoldCo will later transfer its shareholding in Company C to Company B by way of an asset-for-share transaction as contemplated by section 42 of the Act. SARS ruled that early disposal anti-

avoidance in terms of section 45(5)(*a*)(i) of the Act triggers a capital gain if an asset is disposed of within 18 months after the intra-group transaction.

If one looks at section 45(5)(*a*)(i) at face value, it is arguable that the transfer of the equity in Company C does trigger capital gains. An early disposal anti-avoidance is not explicit on whether the reversal of the tax relief applies or is excluded in the group of companies couple the intra-group transactions with successive corporate reorganisation rollover reliefs in the Act. However, in this case, if one considers the objective of corporate reorganisation rollover rules, which is to defer tax on the disposal of assets within the same economic unit. This BPR concluding that no capital gains would be triggered is proving to be in line with the objective of the corporate reorganisation rollover reliefs. The nature of BPR is that it is only binding between SARS and the applicant, as a result, taxpayers cannot just freely rely on it. The challenge with BPR is that not all the facts are stated obviously to also protect the objectives of the application which may be in line with its strategy to remain relevant in the business environment. This not only hinders taxpayers who cannot afford the cost relating to the process of applying for a BPR but it also doesn't address the principle. This is that corporate reorganisation rollover reliefs were not intended to trigger tax for the asset that remains within the same economic unit, provided that it is not a distribution. The principle was that the asset in question would enable the group to continue with its operations and hopefully generate more profits which would result in an increase in normal tax.

What is evident from the two examples is that taxpayers intending to abuse the provision do not usually run their transactions through SARS. Even though one can say the law is clear as to when tax gets triggered however the objective of the Act should always be taken into account. The second example indicates that if taxpayers share similar values to SARS, i.e. transparency being one of SARS values, SARS is able to understand the factors creating complexity around the law and find a solution.

The second example illustrates that tax neutrality is achieved if the taxpayer has embarked on other corporate rollover reliefs and liaised with SARS to get a BPR. This

is not normally the case for most taxpayers, this means in the absence of the BPR taxpayers trigger tax and this doesn't achieve tax neutrality.

This chapter has illustrated that some taxpayers will do everything to avoid tax hence the need for anti-avoidance. However, some taxpayers are transparent and should not suffer because of the few culprits. The chapter has also illustrated that not all taxpayers can afford the cost that comes with being transparent, i.e. through the BPR process, as a result, there is an element of hampering the efficacy of the relief.

The de-grouping anti-avoidance rule

The de-grouping anti-avoidance rule commonly referred to as the de-grouping charge was first introduced with the introduction of the intra-group tax relief. This is because lawmakers predicted that taxpayers would not use the tax relief for its intended purpose, i.e. use it to dispose of assets outside the group, and as a result avoid the tax thereto. Its objective at the time was to prevent the transferor and the transferee from disposing of assets therefore the transferor and transferee needed to be part of the same group of companies for a period of six years. If the asset transferred in an intra-group transaction has not been disposed of and the transferor and the transferee cease to remain in the same group of companies within the six-year period. The de-grouping charge would be triggered and it resulted in a deemed disposal of an asset at market value which would also result in tax being triggered.

> the transferee company is deemed to have disposed of the asset acquired in terms of an intra-group asset at market value on the date the transferee and transferor companies cease to form part of the same group of companies. (SARS, 2002:41)

This built-in de-grouping charge did not stop the abuse of the intra-group tax relief, instead, it gave birth to new tax planning structures. These structures would allow for the assets would be disposed of by the group without the transferor and transferee ceasing to be in the same group of companies. One of the noted tax planning structures extracted from the Explanatory Memorandum on the Taxation Law Amendments Bill, 2008

> Parent owns all of Operating Sub. Operating Sub has assets with a value of R1 million and a base cost of R200 000. Parent plans to sell Operating Sub to Independent Purchaser without tax. In order to achieve these goals, the parties enter into the following transactions:
> Step 1: Parent forms Newco Sub for nominal consideration.

> Step 2: Operating Sub transfers all of its assets to Newco Sub in exchange for R1 million of cash provided by Newco Sub. Newco Sub obtained the cash by borrowing the cash from an unrelated bank backed by a guarantee from Independent Purchaser.
> Step 3: Operating Sub distributes the R1 million cash to Parent as a tax-free dividend, leaving Operating Sub as an empty shell.
> Step 4: Parent transfers all the shares of Operating Sub to Newco Sub in exchange for the issue of additional Newco Sub shares.
> Step 5: Independent Purchaser pays nominal consideration for all the shares of Newco Sub (which now have nominal value due to the newly attached debt). (National Treasury, 2008:14)

Structures similar to the one above would not trigger the de-grouping charge as it was initially introduced because the transferor and the transferee company remained part of the same group of companies. '*It has come to Government's attention that certain taxpayers are seeking to misuse intra-group relief so as to arguably achieve disguised tax-free cash-outs*.' (National Treasury, 2008:14). However, the asset had exited the group tax-free and this is not what was intended by the intra-group relief.

In 2008 the de-grouping charge was refined to put to a stop to disguised sales by expanding and including additional triggers which resulted in two types of de-grouping charges.

<u>The six-year de-grouping charge</u>

The first de-grouping charge is the six-year de-grouping charge which is found in section 45(4) of the Act and is an expansion of the initial six-year de-grouping but widen so that it is triggered even when the transferee company ceases to form part of any controlling company.

> the de-grouping charge will now apply if the transferee company becomes separated not just from the transferor company but also from any controlling parent (i.e. any shareholder having direct or indirect control) of the transferee or transferor company (National Treasury, 2008:15)

The six-year de-grouping charge provision post the 2008 and 2013 Tax Amendments reads as follows

> (b) Where a transferee company contemplated in paragraph (a) of the definition of "intragroup transaction" which has acquired an asset as contemplated in paragraph (a) ceases within a period of six years after the acquisition to form part of any group of companies in relation to the transferor company contemplated in paragraph (a)(i) or a controlling group company in relation to the transferor company, and the transferee company has not disposed of that asset….
> (bA) Where a transferee company contemplated in paragraph (b) of the definition of "intragroup transaction" which has acquired an asset that constitutes an equity share as contemplated in paragraph (a)—
> (i) ceases within a period of six years after the acquisition—

(aa) to form part of any group of companies (as defined in section 1) in relation to
(A) the transferor company contemplated in paragraph (a) (i); or
(B) any controlling group company of a group of companies (as defined in section 1) in relation to that transferor company; or
(bb) to be a controlled foreign company in relation to any resident that is part of any group of companies contemplated in item (aa); and

(ii) has not disposed of that equity share at the time of so ceasing, (the Act)

It is to be noted that the de-grouping charge does not apply to an asset constituting of trading stock that is frequently disposed of. As per the extract from the Act above, an asset constituting of equity share is dealt with in section 45(4)(*bA*) while other assets are dealt with in section 45(4)(*b*).

Section 45(4)(*b*) applies to any asset. The six-year de-grouping charge does not apply if any of the parties of the intra-group transaction is liquidated or wound up or deregistered and the controlling company still holds at least 70% of equity shares. This is in line with the objective of the broader corporate restructuring roll-over relief, tax would be incurred if the asset left the economic unit. For the basis of section 45 of the Act, the tax would be incurred in the asset left the group of companies as defined in section 41 of the Act.

<u>The two-year de-grouping charge</u>

The second de-grouping charge is called the two-year de-grouping charge and is found in section 45(4B) of the Act. The two-year de-grouping charge applies when within two years of the intra-group transaction, the consideration or 10% of an amount derived in relation to it leaves the group in terms of the scheme. The two-year de-grouping charge deems the transferor and the transferee to have ceased to form part of the same group of companies. The two-year de-grouping charge provision post the 2008 and 2013 Tax Amendments reads as follows

(4B) A transferee company and a transferor company contemplated in subsection (4) (b) must for purposes of subsection (4) be deemed to have ceased to form part of any group of companies in relation to each other if a disposal contemplated in subsection (4) forms part of any transaction, operation or scheme in terms of which—

(a) any consideration received or accrued in respect of that disposal; or
(b) more than 10 per cent of any amount derived directly or indirectly from such consideration,

has, within two years of that disposal, been disposed of—

(i) by that transferor company; or
(ii) by any other company forming part of the same group of companies as the transferor company,

> to any person that does not form part of the same group of companies as the transferor company—
>
> (aa) for no consideration;
>
> (bb) for a consideration which does not reflect an arm's length price; or
>
> (cc) by means of a distribution. (the Act)

Both the two-year and six-year de-grouping charges affect the transferee company, i.e. the transferee company incurs the tax. The de-grouping charge is based on the greatest capital gain the asset had been disposed of during the de-grouping period or the capital gain that would have been determined if the assets were disposed of at the de-grouping date at market value.

Concerns around the de-grouping charge anti-avoidance rules

Noting that the lawmakers have a responsibility of preventing tax avoidance structure for numerous reasons which include the fair shift of the tax burden. On the basis that specific anti-avoidance provisions apply to a specific transaction and are usually rule-based in nature, it is bound to have unintended consequences. This results in the tax efficacy of the tax relief being questioned. Some of the concerns noted with the de-grouping charges are as follows:

- the relevancy of the two and six years de-grouping charge in the current business world; and
- interpretation of the statute, specifically section 45(4)(*b*) of the Act finding application to genuine structures.

The first element from the above-listed concerns to discuss with the de-grouping charge is the relevancy of the de-grouping charge period in the current business environment. In 2020 the Harvard Business School published the Five Tips For Managing Change article and this included research from Gartner which revealed that an average business has gone through five major changes in the past years. The article further stated

> Organizational change is typically pursued because it's believed the transition will enable a business to operate at a higher level—becoming more efficient, productive, innovative, and profitable. (HBS, 2020:2)

Based on the above it is evident that in order for a business to survive it needs to undergo change. The tax policies operate within an economy and more specifically within a business environment, therefore having a direct impact on businesses.

> Tax policy must strike a balance between securing the revenues needed by governments to finance their social and economic programmes and the need for a tax system that promotes innovation, productivity and inclusive and sustainable economic growth. (OECD, 2021:45)

Noting the need for businesses to constantly change to grow and the requirement for a tax system to promote productivity and sustainable economic growth. Lawmakers cannot ignore the business environment when introducing and implementing tax laws. Based on that, the two-year de-grouping charge is justifiable when one considered the average number of changes a business goes through. The six-year de-grouping charge seems to be irrelevant in the current business environment that is forced to constantly change.

The second element of the de-grouping charge concerns is the charge finding application in genuine business structures. This concern can be illustrated by an example below:

ForeignCo operates in the insurance industry in different countries except for Africa due to complex regulatory requirements. ForeignCo approaches ParentCo who is the sole shareholder in HoldCo. HoldCo is a SA tax resident holding company that indirectly holds 100% in the insurance operating companies through SPVCo. HoldCo also holds other companies that do have an insurance liability. The ParentCo agrees to sell 40% equity shares for R500m on 1 July 2020. The ParentCo Group is not listed on the Johannesburg Stock Exchange.

Pre this transaction, the Group had entered into the following intra-group transactions of which the assets are still held by the transferee:

- On 1 July 2017 Admin1 sold the Personal Lines Business to STCo for R30m which was also the market value of the business at the date of the transaction. This transaction was part of the Customer Centricity group strategy;
- On 1 July 2018 SPVB sold shares of Admin3 to STCo for no considerations as part of its broader group strategy of diversifying STCo's balance sheet. At the date of the transaction, the market value of the shares was R50m; and

- On 1 July 2020 LTCo sold computer software to Admin2 for R20m. The computer software was initially purchased by LTCo on 1 July 2019 for R30m. LTCo had previously claimed wear and tear of R10m.

On the basis that HoldCo did not issue new shares to ForeignCo instead pre-existing shareholders, ParentCo sold shares previously issued to them. ForeignCo pays STT for the transfer of these shares. The STT return is submitted and paid over to SARS by HoldCo within two months from the end of the month the transfer of shares took place. ParentCo pays CGT at 22.4% which is R112m as part of their corporate income tax liability. Even if the company had issued new shares, Paragraph 43A of the 8th Schedule of the Act would apply. Paragraph 43A of the 8th Schedule of the Act applies where a company declares an exempt extraordinary dividend prior to the issuance of new shares with the intention of avoiding CGT as the extraordinary dividend declared decreases the value of shares in the company. Paragraph 43A of the 8th Schedule of the Act deems the extraordinary dividends declared to be proceeds and subjects it to CGT. Therefore, the fiscus would not be out of pocket for the introduction of the new shareholder in this example.

In addition to the CGT paid by ParentCo as a result of ForeignCo acquiring 40% shares in HoldCo. The six-year de-grouping charge in terms of sections 45(4)(*b*) and 45(4)(*bA*) of the Act may find its application as the introduction of the new shareholder which leads to HoldCo no longer being a controlling group company and the assets are still held by the transferee. Earlier in the chapter, an extract of section 45(4)(*b*) and 45(4)(*bA*) was provided and discussed which clarified that a de-grouping applies if a transferee company within six years of an intra-group transaction ceases to form part of the group of companies with any controlling group company. Specifically, section 45(4)(*bA*) could be open to interpretation that may have unintended consequences *'interpretation of statute is not as simple as it may appear at first glance. Many cases have ended up in court as a result of legislation that was construed in different ways.'* (Visagie, 2015:28). This was further confirmed by the Report of The Efficiency of South Africa's Corporate Income Tax System

> A literal interpretation of the de-grouping charge could result in de-grouping charges being triggered in scenarios that were never intended to be captured by the legislation. (DTC, 2018:61)

It is therefore critical to also apply the principles of statute interpretation when interpreting statute in general, including tax. Wallis JA in the *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) judgement provided the general rule for interpreting statute is to give the words their ordinary grammatical meaning unless they lead to absurdity. Absurd is defined in the Oxford dictionary as *'completely ridiculous; not logical and sensible'*. As per above, the Report on The Efficiency of South Africa's Corporate Income Tax System states that giving the words in section 45(4)(*bA*) its grammatical meaning could result in the de-grouping charge applying to scenarios it was never intended for. Wallis JA further stated how the law should be interpreted

> A court must interpret the words in issue according to their ordinary meaning in the context of the Regulations as a whole, as well as background material, which reveals the purpose of the Regulation, in order to arrive at the true intention of the draftsman of the Rules. (Endumeni Court case, 2012:14)

When tax law is introduced or amended, the process guided by the Constitution of South Africa for making law is followed, the process may

> …start with a discussion document called a Green Paper that is drafted in the Ministry or department dealing with a particular issue. This discussion document gives an idea of the general thinking that informs a particular policy. It is then published for comment, suggestions or ideas. This leads to the development of a more refined discussion document, a White Paper, which is a broad statement of government policy. It is drafted by the relevant department or task team and the relevant parliamentary committees may propose amendments or other proposals. After this, it is sent back to the Ministry for further discussion, input and final decisions. (Parliament, nd:pp5)

In this regard, National Treasury manages the process of introducing and/or amending tax law through publishing the Explanatory Memorandum on the Taxations Law Amendment Bill for public response and/or comments. Public comments are taken into account and where necessary published in the Response Document to the Taxation Law Amendment Bill. The Explanatory Memorandum on the Taxation Law Amendment Bill provides a brief background of the intention of the law. Therefore, how the intention of the tax law is known regardless of the grammatical absurdity that may be caused by the drafting of the law.

Earlier in the chapter, the intention of including the controlling group company when considering if the de-grouping charge is triggered was discussed and it is clear that this was to prevent tax-free exit from investments. However, in the example provided

above, the shareholder does not exit the investment tax-free, i.e. paid CGT through normal disposal and/or through the application of paragraph 43A of the 8th. Sch. of the Act. In contrast with the objective of corporate restructuring rules, where tax relief is provided because of the asset being still retained in the same economic unit. The literal interpretation of section 45(4)(*bA*) therefore triggers a de-grouping charge even though the asset is still within the economic unit. In the example, the tax is paid by HoldCo who is the shareholder of the controlling group company, and also paid by the transferee company which strains the group of the company financially.

An example of the restructuring benefits that can be unlocked if the interpretation of statute is applied is illustrated in the SARS BPR No. 360. In this regard, a group of companies went through an internal restructuring that was followed by the introduction of a BBBEE shareholder. The BBBEE requirement is an important element in conducting a business in SA therefore this restructuring would enable this group to realise its strategy to protect and enhance its commercial position. The internal restructuring was done to group together the target investments that the BBBEE shareholder would invest in. One of the transaction steps of this restructuring was an intra-group transaction as defined in section 45(1)(*a*) of the Act. The consideration of this transaction was on loan, as a result, section 45(3A) of the Act would find its application and deem the expenditure in relation to the acquisition of a debt to be nil for the purposes of paragraph 20 of the 8th Sch. of the Act. In this specific transaction, a set-off agreement was also concluded where an existing loan, not in relation to this intra-group transaction, between the parties would set-off the existing loan with the loan for the intra-group transaction relating to this internal restructuring and introduction of the BBBEE shareholder. Section 45(3A)(*b*)(i) of the Act provides that the tax implication of any capital for any repayment in relation to the intra-group transaction loan must be disregarded provided the group of companies is still intact when the repayment is made. This puts the group in a tax-neutral position, i.e. the repayment of a loan with a nil base cost would result in proceeds being greater than base cost ultimately achieving a capital gain. Section 45(3A)(*b*)(i) basically disregards this gain. Section 45(3A) of the Act states ‘an asset is acquired by a transferee company from a transferor company in terms of an intra-group transaction’ (the Act, 2021), this is not explicit about instances where there was an existing loan between the group of companies that were not in respect of the intra-group transaction is used

to later off-set the intra-group. However, the taxpayer in this instant was able to utilise section 45(3A)(*b*)(i) of the Act to achieve a tax-neutralised position for this restructuring.

Based on the discussion in this chapter, it is evident that companies enter into restructuring for different reasons, i.e. genuine commercial reasons and to avoid tax. On the basis that the anti-avoidance uses a rule-based method, companies entering in genuine commercial transactions find themselves triggering these tax anti-avoidance rules which trigger the tax. The intra-group transaction rollover tax relief ends up not being conducive for transferring assets within the group of companies.

The anti-avoidance one can conclude that in the de-grouping charges found in section 45 of the Act, being the two and six-year have different outcomes.

For the two-year de-grouping charge, there is no evidence that supports that it unduly hamper the efficacy of the intra-group transaction tax relief. The Report of The Efficiency of South Africa's Corporate Income Tax System also cannot support the period be reduced to be less than 18 months which justify that the two-year is reasonable. The two-year de-grouping charge also caters to the ever-changing business environment if one considers the change management implementation process. The two-year de-grouping is also in line with the objective of the corporate rollover relief, which is to not tax assets within the same economic unit, therefore it is only fair for the tax to be triggered when the consideration received by the transferor as a result of an intra-group transaction leaves the group as a part of a series of arrangement to transfer asset tax-free.

On the other hand, the report paper illustrations that the six-year de-grouping charge does unduly hamper the efficacy of the intra-group transaction tax relief due to the six-year period a group of companies is required to be intact and the interpretation of legislation. The six years that the group of company is required to stay intact in order for the de-grouping charge to be not triggered is long and not realistic in the current business environment where businesses are constantly required to change to stay relevant. The literal interpretation of the provision results in a de-grouping charge

being triggered when the de-grouping occurs high up in the structure and there is proof that there is no tax-free exit from investments.

6. THE IMPROVEMENTS OF THE ANTI-AVOIDANCE RULES UP TO 2021

It has been just over two decades since the intra-group transactions rollover tax relief was first introduced in the Act. However, to this day the taxpayers look forward to the national budget speech because of the uncertainty around the relief which results in constant amendments.

The intra-group transactions tax rollover relief has faced major amendments over the two decades with the early amendments noted in their infancy stage. The notable trends with the amendments in the infancy stage were mostly to cultivate and simplify the application of the tax relief which is common with an introduction of any complex policy. Some of the remarkable progressive amendments were the extension of the intra-group transaction to include a company that is not a tax resident of SA, as long as the group of companies' requirement was met. Such amendments indicate that lawmakers were indeed factoring in the economic factors in the environment that companies operate in.

As discussed in the previous chapters, this relief became of the most abused provisions in the Act by taxpayers eligible for it. The remarkable abuse which is supported by the discussion in previous chapters was through debt push-down structures. This resulted in excessive interest deduction leaving the tax authorities with no income to tax and/or creating excessive assessed losses. In cases of abuse of the law, lawmakers are left with no choice but to react by curbing the abuse and in some instances, the reaction is rather too harsh and not fully considered. A good example of these proposed amendments was in June 2011 resulting from the concern around excessive debt. In this regard, National Treasury proposed the suspension of the intra-group tax relief for a period of 18 months effective from 3 June 2011. This proposed announcement was not even in line with the common practice of the taxation law amendments, where the Minister of Finance would first announce the proposal in the national budget speech. However, to the defence of the National Treasury, the 18 months suspension would allow for the reassessing alternatives to deal with the excessive debt. Failure to follow the normal process by National Treasury was not well received by the stakeholders as tax policies play a huge impact in the company's

strategic planning. Notwithstanding the noted debt pushes down and tax-free exits from investments, it needs to be considered that not all taxpayers are culprits in this manner.

None the less, as illustrated in the previous chapters, the reactive measures to curb the abuse end up applying to genuine commercial structures resulting in the hampering with the efficacy of the tax relief. Section 45 of the Act ended up not being suspended; instead, a special interest deduction limitation was introduced in the Act to curb the excessive interest deduction. In this regard, it is evident that lawmakers do take into account the concerns of taxpayers and try to find a balance between protecting the law and creating a conducive economic environment.

Earlier in this chapter, it was illustrated that in the initial stages of the intra-group transaction tax relief, the lawmakers had the intention to meet taxpayers halfway. However, few culprits entered into planned tax avoidance structures which meant the lawmakers were left with no choice but to take strict measures to protect the fiscus. As a result the noted introduction of amendments of the intra-group transactions tax relief and introduction of other sections in the Act designed to curb tax abuse.

In the past three years, being 2019 to 2021, the theme in the national budget speech around the intra-group transactions tax relief has been the terms “refinement” and “clarifying”. The refinement which will be discussed is around the zero-base cost rule in relation to the de-grouping charge and early disposal anti-avoidance rules. This refinement indicates the complexity around this section of the Act which is now over two decades now but still requires refinement and clarity.

> In Annexure C of the 2019 Budget Review, Government proposed that it would make legislative changes in the Income Tax Act to clarify how the multiple anti-avoidance rules applicable to intra-group transactions should interact with each other in order to ensure that they do not give rise to double taxation in the event that more than one of them apply in respect of one intra-group transaction. (National Treasury, 2019:27)

In the previous chapters, it was illustrated that the consideration for an intra-group transaction can be through an exchange for debt or non-equity shares. In transactions with such consideration, the zero-base cost rule found in section 45(3A) of the Act applies. The zero-base cost rule deems the debt or non-equity shares issued in

exchange for an asset to have been acquired by the holder, i.e. transferor, for nil expenditure. In addition, any repayment of the debt or redemption of the non-equity shares will not result in any taxable income or aggregate capital must be disregarded provided the group of companies is still intact when the repayments are made. This ensures that no tax capital gains tax is created, i.e. a settlement of debt with a nil base cost result in the proceeds “settlement amount” being fully taxable as there is no base cost to be offset with proceeds.

But in a case of a de-grouping being triggered, i.e. the transferor and the transferee ceases to form a group of companies with each other or any controlling group company, a deemed disposal with tax implications is triggered. This means the tax that was deferred as a result of the relied application is reversed. The de-grouping at times gets triggered before the full repayment and/or redemption of the debt or non-equity shares which were used as consideration for an intra-group transaction. In this regard, double taxation applies, i.e. as a result of de-grouping charge and another as a result of the repayment of consideration of debt with a nil base cost. This anomaly was rectified by the insertion of subsection 3B in section 45 of the Act which came into effect on 1 January 2021.

The insertion of subsection 3B in section 45 of the Act basically results in the reinstatement of the tax attributes of the debt or non-equity shares to reflect the ones that would have to be present on the date of that de-grouping, had tax deferral not applied. This provision basically means in a case where the zero-base cost rule is applied, the expenditure incurred for the debt is deemed to be an amount equal to the face value of that debt immediately after the acquisition of an asset reduced by any repayment. In the case of non-equity, the expenditure incurred is deemed to be the market value of the share less any amount attributable to the redemption of the share.

In the 2021 national budget speech, additional clarification in relation to the zero-base cost rule in relation to an early disposal anti-avoidance was announced. This resulted in the newly introduced section 45(3B) of the Act going through an amendment in a space of a year after its introduction. This amendment was through the substitution that came into effect on 1 January 2022 after the realisation that the double tax also

applies in the case of early disposal of an asset that was acquired in terms of an intra-group transaction. As discussed earlier in the research report, where an asset that was acquired in terms of an intra-group transaction is disposed of outside the group of companies within 18 months of the intra-group transaction, the early anti-avoidance tax rules apply and reverse the deferred tax relief. In a case where the consideration of the intra-group transaction was the issue of debt or non-equity share, double tax occurs due to the zero-base cost rule applying. The refinement is similar to the one that applies to the de-grouping discussed above, i.e. increase the base cost to the debt face value or market value of the share less any settlements.

The amendments in relation to the zero-base cost rule were also extended to apply on the sixth anniversary of an intra-group transaction. The de-grouping rule was designed to curb the tax-free exit from investments by putting in place the six years that the group of companies is required to stay intact. However, in a case where the group stays intact for the prescribed period and the consideration in relation to an intra-group transaction was through the issue of a debt or non-equity share that remains outstanding or not redeemed. The zero-base cost still deemed the expenditure incurred in relation to the intra-group transaction to be still nil. However, this amendment rectifies this anomaly by bumping up the base cost in the same manner as discussed above, i.e. when a de-grouping charge or early disposal is triggered.

The amendments in relation to the zero-base cost rule only became effective in 2021 for de-grouping and in 2022 for early disposal, which is eight years after the introduction of the zero-base cost rules deeming rules. This means taxpayers who utilised the tax relief and debt was used as consideration have been subjected to double taxation. On the basis that the introduction and subsequent amendment of section 45(3B) of the Act is not retrospective, companies that were impacted by the zero-base cost rules suffered this double tax. There are clearly some of the reasons the intra-group transaction relief has been seen as one of the most burdensome in the Act. Nevertheless, the extension of section 45(3B) applying in the six-year anniversary of the intra-group transaction is a progressive move in creating conducive tax policies in the economic environment.

The improvements to section 45 of the Act were initially to ensure that the objective of the section, being deferring tax in the transfer of assets within the group. The abuse of the section resulted in the lawmakers reacting in a harsh manner through the introduction of numerous anti-avoidance rules. These anti-avoidance defeated the objective of the intra-group transactions relief as resulted in double taxation in some cases and also applied to genuine commercial structures. Through the process of applying for the BPR, taxpayers with resources were able to still get the tax deferral relief when restructuring because SARS got the opportunity to see the full transaction and the strategic objective. This is illustrated by the BPR No. 360 illustrated in the previous chapters.

The latest improvements indicate that lawmakers are listening to the concerns of taxpayers and are willing to right wrongs however this can only be achieved with the collaboration between taxpayers and lawmakers.

7. CONCLUSION

An intra-group transaction is a transaction whereby one company transfers an asset to another within the same group of companies and is common in corporate restructurings. Under normal circumstances, an intra-group transaction will have immediate tax implications that are more likely to result in a cash tax outflow for the transferor of the asset. This is so even though that cash tax outflow would not have occurred if the group of companies had operated as a single legal entity. Section 45 of the Act provides tax relief in an intra-group transaction if certain requirements as listed in the section are met. The rationale behind section 45 of the Act is that the transferring company steps into the shoes of the transferor and defers the tax implications to a later date when the asset is disposed of the group of companies or the group of companies cease to exist. In this regard, the transferee company becomes liable for future tax concerning the asset transferred.

Section 45 of the Act classifies intra-group transactions into two parts, the first one between tax residents and the second one between a tax resident and a non-resident. It further deems the transferee to have acquired the asset on the original acquisition date of the transferor and have the same base cost as the transferor. Even though the transferee is deemed to have the same acquisition cost and acquisition date as the transferee, the consideration of the asset may not necessarily be the base cost amount. Section 45 of the Act acknowledges that the consideration for an intra-group transaction may be on loan or for the issue of a share other than equity share and deems the base cost in relation to the debt or share to be nil.

Since its introduction, section 45 of the Act had built-in anti-avoidance rules. In the beginning, it was to prevent abuse of the tax relief. The built-in anti-avoidance rules opened a door for creative tax planning that resulted in companies exiting from investments tax-free. Section 45 was not just used for normal intra-group transactions but played a huge role in company acquisition transactions for pushing down debts resulting in excessive assessed losses.

The abuse of section 45 of the Act by some companies has led to harsh introduction and refinement of the anti-avoidance that companies wishing to utilise this relied need to understand. These anti-avoidance are not only perceived as harsh but are rule-based which is not in line with the fundamental tax principles, require complex calculations, and may result in unintended consequences when interpreted grammatically. In addition, constant amendments in the anti-avoidance rules have also resulted in uncertainty for companies that have or choose to elect it. In an event where a rule-based anti-avoidance is triggered, the transferee company has a tax obligation even though the intention was not to avoid tax but was part of a genuine commercial transaction. GAAR is available for complex transactions and can be used in some instances instead of the blanket approach anti-avoidance in section 45 of the Act. This unduly hampers the efficacy of the intra-group transaction tax relief.

The research shows that companies who have taken the BPR route on an intra-group transaction where they are not certain on the anti-avoidance have been fruitful as SARS get to see parts of the transactions that would not normally be seen in normal instances. The BPR is however not sustainable as not all companies have the resources for this route, again unduly hampering the efficacy of the intra-group transaction tax relief.

When these anti-avoidance were triggered in the past it resulted in double taxation, even though the recent amendments has rectify and continue to take feedback from stakeholders in rectifying it. This does not change the fact that for some a certain period a provision that was intended to provide a tax relief has resulted in double taxation.

Companies wishing to utilise section 45 of the Act need to understand the anti-avoidance rules in the section, plan accordingly, and where uncertain explore the BPR route.

In conclusion, section 45 of the Act does provide immediate tax relief, however, in a fast-changing business environment, its anti-avoidance rules make it unattractive. SARS needs to also consider the GAAR in order to make this tax relief fruitful. Despite

the constant amendments in the section, very little research has been done on the topic. As a result, this report recommends that more research be done on the topic.

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