



Should tax claims be granted some priority in a business rescue: an analysis through the framework of the values and policy underpinning corporate re-organisation

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CHAPTER 1- INTRODUCTION

I. THE RATIONALE BEHIND THE CREATION OF THE BUSINESS RESCUE MECHANISM

It is a commercial reality that businesses fail; it is the logical consequence of unsuccessful risk-taking. When this failure occurs, the company will likely not have the assets sufficient to satisfy its outstanding obligations.¹ In such an instance, these failed companies can then be liquidated. However, this sequence of events is problematic if it represents the only available outcome. First, liquidation does not result in the debts to creditors being fully satisfied and as the company's assets are realised and distributed to satisfy these debts partially; there is no future possibility that the company will ever be able to satisfy these debts in full.² Secondly, this sole version of events negatively represents risk-taking by companies. This needs to be addressed because it is essential for companies to take feasible risks in order to contribute to the economy.³ Additionally, in the light of the finality of liquidation with regard to a company's future as well as to the partial repayment of debts, the perception of immediate liquidation as the only option for companies facing financial trouble discourages investment in companies that are taking these feasible risks in carrying out their business, or even in starting the company initially.⁴

Business rescue represents a beneficial, additional version of events that is available to companies that are experiencing financial difficulties. Although business rescue, like liquidation, does not inevitably ensure that a creditor's debt will be fully repaid, it differs in that the business rescue mechanism does not necessarily pull apart and terminate the company in order to satisfy these debts partially. This difference is crucial because it provides for the possibility that the company may continue in existence. This has positive implications for risk-taking; an alternative for a company besides termination through liquidation means that companies have an option that allows them to weather short term issues that arise from risk-taking. The implication of this is that there is a greater chance that the company will exist to

¹ Elizabeth Warren 'Bankruptcy policymaking in an imperfect world' (1993) 92 *Michigan Law Review* 336 at 343.

² Richard S Bradstreet 'Socio-economic considerations in corporate insolvency law: a South African case study' (2016) 31 *Australian Journal of Corporate Law* 162 at 179.

³ *Ibid* at 172.

⁴ Warren *op cit* (n1) 357-8.

see the longer term benefits of that risk-taking. Secondly, the availability of a mechanism that allows a company to survive initial dislocations due to risk-taking so that it can experience the long-term benefits, means that risks with long-term reward become more feasible and attractive.⁵ Thus, the availability of the business rescue mechanism helps to calm investor trepidation in the face of risk-taking by companies because it is mechanism that may allow a company to survive short-term difficulties and subsequently be able to deliver a return on investments.

Furthermore, the company's continued existence allows for the possibility of significant future benefits that are more likely to occur than the complete satisfaction of a present debt.⁶ The reality is that a failing company will usually lack the resources to meet all its obligations⁷ and therefore, complete payment of the debt to one creditor lessens the likelihood that another similarly situated creditor will be able to be paid in full.⁸ Moreover, insistence on full payment of the debt may render a failing company incapable of continuing to do business. The consequences of this will be widespread for many stakeholders in the company: employees will lose their source of income, suppliers lose a customer which may have knock-on effects on their businesses and stakeholders, customers must locate a new company to satisfy their needs, taxing authorities lose a source of tax etc⁹ and current creditors stand to lose commercial relationships whose contractual obligations are underpinned and strengthened by good will and good reputation.¹⁰ Compromise of debt and rehabilitative business rescue may allow a company to continue these relationships and remain in its integral position as a consumer and producer.¹¹ The business rescue mechanism seeks to address normative issues beyond the repayment of current debts to existing creditors; it takes cognisance of longer term, broader, social and economic concerns.¹²

⁵Ibid.

⁶ Bradstreet op cit (n2) at 171; S. Conradie and C. Lamprecht 'Business rescue: how can its success be valued at company level?' (2015) 19 (3) *Southern African Business Review* 1 at 17.

⁷ Warren op cit (n1) 343.

⁸ Andrew Keay 'Insolvency law: a matter of public interest' (2000) 51 *N. Ir. Legal Q.* 509 at 511; Warren ibid at 345.

⁹ Karen Gross 'Taking community interests into account in bankruptcy: an essay' (1994) 72 *Wash. U. L. Q.* 1031 at 517-18; Warren op cit (n1) 345.

¹⁰ Warren ibid at 356.

¹¹ Anneli Loubser 'Judicial management as a business rescue procedure in South African corporate law' (2004) 16 *South African Mercantile Law Journal* 137 at 137; Warren ibid at 341.

¹² Warren ibid at 345, 346.

II. THE RELEVANCE OF THE VALUES THAT UNDERPIN BUSINESS RESCUE

The rationale for and the benefits of a business rescue mechanism have been discussed above. It is worthwhile to discuss the principles that underlie the design of a business rescue mechanism so that it can be assessed whether the aims of the mechanism are being achieved and to identify the deficiencies in the specific business rescue mechanism under investigation.¹³

It has been suggested that mechanisms designed to address failing businesses are conceptualised on the basis of commercial practicality and pragmatism, and that they are devoid of the influence of theories, philosophies or politics.¹⁴ This premise is flawed. The idea of ‘commercial practicality and pragmatism’ is founded on particular norms and values such as allocative efficiency and reverence of the timing and type of the relationship entered into between a creditor and the debtor company.

Identification of the foundational values of a system assists in the assessment of the effectiveness of a business rescue procedure. This enables a more accurate judgment of the effectiveness of a business rescue system as the success of the system from the perspective of one value, may be judged inadequate from the perspective of another value.¹⁵

III. RESEARCH QUESTION

This dissertation will assess, through the framework of corporate reorganisation’s values and policy, whether tax claims should be granted some priority in South Africa’s business rescue claims hierarchy.

IV. WHY THE RANKING OF TAX CLAIMS UNDER BUSINESS RESCUE IS A MATTER OF INTEREST

The ladder of claims is a critical aspect of business rescue and is deserving of consideration. Secondly, the ranking of tax claims under business rescue is a matter of interest, both generally and in the context of the aims and values of the business rescue mechanism.

¹³ Conradie and Lamprecht op cit (n6) 1.

¹⁴ Bradstreet op cit (n2) 172-3.

¹⁵ Tracey Evans Chan ‘The public interest in judicial management’ (2013) *Singapore Journal of Legal Studies* 278 at 287.

(a) The significance of the hierarchy of claims within a business rescue

It is frequently stated that a fundamental principle of corporate reorganisation is the equal treatment of creditors.¹⁶ However, this principle is not absolute and justified deviations are permitted.¹⁷ These justifications rely on the normative and practical economic and social goals that business rescue attempts to balance and achieve.¹⁸

A clear example of a deviation from the principle of equality of treatment of creditors can be found in the ladder of priorities in which the creditors of the struggling corporation are ranked.¹⁹ The underlying premise of a corporate reorganisation is that the struggling corporation has insufficient assets to satisfy the claims of its creditors.²⁰ Therefore, the arrangement of the creditors' claims into a hierarchy of priorities necessarily results in the reduction of the assets available to satisfy claims of those creditors with lower priority.²¹ In essence, this clearly contradicts the principle of equal treatment of creditors.

Despite the ladder of priorities being a departure from the fundamental principle of the equality of treatment of creditors, it is a core structure of business rescue regimes.²² This is because the practical reality is that the debtor lacks the assets necessary to pay the claims of all its creditors, and the law must determine which claims will be satisfied, to what extent, and in what order.²³ The mechanism by which the law implements these determinations is the ladder of priorities. The ladder of priorities is ordered according to policy decisions that justify the inequality that the ladder embodies, and the priorities of the legal culture for which the business rescue mechanism is crafted.²⁴

The basis of these policy decisions is that the claims to the assets of debtors under in business rescue by some creditors are considered more deserving of satisfaction than the claims

¹⁶ Philip R Wood 'The bankruptcy ladder of priorities' (2013) 14 *Business Law International* 209 at 209, 243; Michael Reed Arner 'The worthier creditors (and a cheer for the King)-revisited' (1979) 53 *American Bankruptcy Law Journal* 389 at 391, 392.

¹⁷ Arner *ibid* at 391; Warren *op cit* (n1) 353; Morris G. Shanker 'The worthier creditors (and a cheer for the king)' (1976) 1 *Canadian Business Law Journal* 340 at 340.

¹⁸ Thomas H. Jackson 'Bankruptcy, non-bankruptcy entitlements, and the creditors' bargain' (1982) 91 *Yale Law Journal* 857 at 907; Wood *op cit* (n16) 210.

¹⁹ Wood *ibid*.

²⁰ Arner *op cit* (n16) 392.

²¹ Arner *ibid* at 392; Wood *op cit* (n16) 210.

²² Wood *ibid* at 210.

²³ Jackson *op cit* (n18) 857; Wood *op cit* (n16) 210, 211.

²⁴ Wood *ibid* at 201,211; Arner *op cit* (n16) 391.

of others.²⁵ However, it is critical that these policy decisions are persuasive and thoroughly considered because they result in the prioritising of certain creditors at the expense of others; this has consequences for the environment in which the corporation functions and in which the corporate reorganisation will take place.²⁶ First, the ladder of priorities alters contractual and property rights which are thought to be central to economic development.²⁷ Secondly, linked to this alteration of property rights, the ladder of priorities specifies the risk that different types of creditors take when they interact with a debtor corporation.²⁸ This influences the pricing of these transactions which must necessarily incorporate the additional cost of the risk indicated by the ladder of priorities.²⁹ Thirdly, the negotiations of the claimants in the business rescue occur in the shadow of the ladder of priorities which will position the claimants should the business rescue transition into a form of liquidation of the debtor. The shadow of the ladder of priorities affects the stake of claimants in the success of the rehabilitative business rescue of the corporate debtor.³⁰

In summary, the hierarchy of claims within a business rescue should reflect the policy priorities of the legal culture in which the business rescue occurs. The hierarchy of claims will support these policy priorities if it has been structured so that its outcome appropriately balances the costs and benefits to parties within the ladder of priorities, such that the impact of the ladder of priorities is consistent with the policy goals of the legal culture in which the business rescue is taking place.³¹ If this is not the case, it will be difficult to justify such a deviation from business rescue's foundational principle of the equal treatment creditors.³²

(b) The importance and implications of the ranking of tax claims in a business rescue

The hierarchy of claims structure is an interesting aspect of a corporate reorganisation mechanism; it represents a departure from the foundational equality principle and is justified by and meant to embody the priorities of the legal culture in which it occurs. The existence of the ladder of priorities as a whole perhaps should be scrutinised but that is not the direction which this dissertation intends to proceed. Instead, the focus of this analysis will centre on the

²⁵ Wood *ibid* at 211; Shanker *op cit* (n17) 341.

²⁶ Wood *ibid* at 210.

²⁷ *Ibid* at 211.

²⁸ Wood *ibid* at 211.

²⁹ Stephanie Ben-Ishai 'Technically the King can do wrong in reorganizing insolvent corporations: evidence from Canada' (2004) 13 *International Insolvency Review* 115 at 131; Wood *ibid* at 211.

³⁰ Wood *ibid* at 211.

³¹ *Ibid*; Shanker *op cit* (n17) 341.

³² Arner *op cit* (n16) 391, 392.

ranking of tax claims in the ladder of priorities of a business rescue. The ranking of tax claims in a business rescue is of interest for the following reasons.

First, the priority of tax claims originates from the historical context of absolutist monarchies.³³ It is based on a royal prerogative and the principle that the ‘King could do no wrong’.³⁴ Thus, it is important to question whether tax claims should retain their priority in the light of the advent of democracy and the fading away of monarchies. The historical justification for the priority of tax claims is no longer relevant but this does not mean that modern justifications do not exist which support the retention of tax priority. Alternatively, the modern context may lean in favour of the abolition of tax priority. Regardless of the outcome, it is worthwhile to consider whether the ranking of tax claims in a business rescue should stick to its historical stance but based on different reasoning, or whether there should be a break from tradition that is justified by the contemporary context.³⁵

Secondly, the imposition and collection of taxes is essential so that governments can perform their functions.³⁶ It would be undesirable if the business rescue mechanism were to be structured such that its use would be incentivised because it could be used to avoid the payment of taxes which would consequently undermine the integrity of the tax system.³⁷ Thus, careful thought should be given as to the ranking of tax claims in the business rescue so that the social and economic impact of the business rescue and its effect on the tax system are commensurate.

Thirdly, the shift in the contemporary context from a liquidation emphasis towards a business rescue preference alters the lens through which the normative justifications for and against tax priority should be viewed.³⁸ Furthermore, an investigation, in this context, into the policy reasons behind the ranking of tax claims in a business rescue allows for a judgment to be made as to the appropriate place for tax claims in a whole system that encompasses a variety of contrasting and converging interests.³⁹

³³ Leonard M Salter ‘Priority accorded the sovereign in bankruptcy: the American and British views’ (1958) 63 *Commercial Law Journal* 354 at 356.

³⁴ Ben-Ishai op cit (n29) 115-6.

³⁵ Barbara K Morgan ‘Should the sovereign be paid first - a comparative international analysis of the priority for tax claims in bankruptcy’ (2000) 74 *American Bankruptcy Law Journal* 461 at 461-2.

³⁶ Arner op cit (n16) 393; Shanker op cit (n17) 345.

³⁷ Arner ibid at 393; Ben-Ishai op cit (n29) 127.

³⁸ Ben-Ishai ibid at 117; 133.

³⁹ Ibid at 124.

Lastly, tax claims represent a variety of social and economic interests beyond simply being a debt by citizens to the state in return for its functions.⁴⁰ Taxes are in effect a debt to the community at large and thus it may be preferable to prioritise the payment of tax claims in a business rather than subordinating them to the claims of a smaller number of corporate stakeholders who will benefit from the company's business rescue.⁴¹ Tax claims encompass social concerns that will be harmed if tax debts are not satisfied, as well as the economic consideration of the impact on government function if taxes remain unpaid. However, these need to be weighed up against the social and economic impact if tax priority affects the probability of success of a business rescue, in addition to the economic consequences if other creditors are subordinated to tax claims, in a business rescue.⁴²

V. THE MANNER IN WHICH THIS DISSERTATION WILL ADDRESS THE RESEARCH QUESTION

This dissertation will approach the research question about the ranking of tax claims in a South African business rescue, as follows. First, it will create the evaluation framework by investigating the policy changes that surround corporate reorganisation, as well as the values that underlie corporate reorganisation and that are present in South African business rescue. This is important because policy should be the foundation of the structures that are fashioned. If something is appropriate from a policy perspective, there are always practical solutions that can be formulated to give effect to policy.⁴³

Secondly, it will elaborate on the policy arguments that have been made for and against some priority for tax claims in a corporate reorganisation. These arguments will then be assessed through the policy and values framework. This is important because there will always be arguments that support either stance⁴⁴ but in order to determine the weight which should be attributed to these arguments, it needs to be ascertained to what extent they are consistent with the policies and values of corporate reorganisation and business rescue. This is crucial so that the proposed raising or not of tax claims in business rescue's hierarchy of claims aligns with the policy and value foundations of corporate reorganisation rather than being based on suggested practical limitations.

⁴⁰ Arner op cit (n16) 393.

⁴¹ Salter op cit (n33) 354; Ben-Ishai op cit (n29) 127.

⁴² Morgan op cit (n35) 465, 466; Ben-Ishai op cit (n29) at 127, 131, 133.

⁴³ Keay op cit (n8) 527.

⁴⁴ Wood op cit (n16) 217.

Lastly, the conclusion will assess the strength of the arguments for and against some tax priority, that were consistent with business rescue's values and policy. Thereafter, an answer to the research question will be suggested as well as recommendations as to further areas of study that could be carried out and that would contribute to the findings of this dissertation. It should be highlighted that the research question is limited to an investigation as to whether tax claims in a business rescue should be elevated from being a concurrent claim to a preferred claim that is satisfied before the other concurrent claims in a business rescue.

CHAPTER 2 – THE VALUES AND POLICIES UNDERLYING BUSINESS RESCUE

This Chapter will discuss the context within which the policy considerations that influence the ranking of tax claims in a business rescue, are situated. First, it will explain what changes have occurred that make the ranking of creditors within a business rescue an issue worthy of reconsideration. Secondly, the current ranking of tax claims in a business rescue in South Africa will be stated as well as their ranking under liquidation. Thirdly, this section will briefly set out how the different policy aims of the liquidation mechanism and business rescue mechanisms suggest that it would be inappropriate to impose the ranking of tax claims in liquidation, on to business rescue, merely on the basis that tax claims are ranked a certain way under liquidation. In addition, this Chapter will discuss the values that underlie business rescue generally. It will then illustrate whether these values appear relevant to South Africa's Chapter 6 business rescue procedure.

I. A NEW PERSPECTIVE IN THE APPROACH TO AILING CORPORATIONS

Internationally, there has been a shift from a liquidation-centric response in the face of corporate insolvency.⁴⁵ Liquidation remains a possibility but emphasis is being placed increasingly often on business rescue as the preferable option, when it is feasible.⁴⁶ This shift is attributable largely to a changing perception as to the role played by a corporation and the interests affected when a corporation goes bankrupt. However, the advent of the 'fresh start' approach as well as a recognition of potential economic growth that will be encouraged through business rescue, are also contributing factors that helped to stimulate the movement towards a business rescue culture and away from one of liquidation.

(a) A different understanding of the corporation and those impacted by bankruptcy

A corporation is not a faceless profit-making entity whose continued existence impacts only on the interests of and results from the contribution of creditors and shareholders. The corporation does not operate in this limited vacuum.⁴⁷ Instead, the corporation is integrated into the community in which it functions so the consequences of a corporation's bankruptcy are experienced by creditors, and shareholders, as well as by employees, suppliers, distributors,

⁴⁵ Ben-Ishai op cit (n29) 115, 116, 123-4.

⁴⁶ Ibid at 116; 131; Morgan op cit (n35) at 504-5; Gross op cit (n9) at 1033.

⁴⁷ Loubser op cit (n11) 137.

customers, and involuntary creditors (among others) and thus the wider community.⁴⁸ The bankruptcy of a corporation results in economic and social losses that extend to stakeholders beyond shareholders and creditors.⁴⁹

Secondly, the value of a corporation relies on the contributions of stakeholders beyond shareholders and creditors. The corporation's value is based on more than simply assets and the extension of credit. Frequently, a large part of this value is derived from human capital and the goodwill generated by the corporation.⁵⁰ This aspect of a corporation's value is difficult to retain if the corporation is liquidated.⁵¹

A business rescue mechanism should be structured in accordance with the above insights. It should protect and maximise the value of the corporation for the benefit of all interested parties.⁵² In the light of the extension in the understanding of who these interested parties are, this broadens the meaning of the 'maximisation of value' to include the bettering of the public interest through the retention of jobs, and the maintenance of stability and community which crucially contribute to a firm's value.⁵³ It is not appropriate that a business rescue mechanism should focus solely on returning value to creditors and shareholders in the case of the bankruptcy of a corporation. However, the interests of creditors and shareholders should not be ignored in favour of the public interest.⁵⁴ The goal is that a business rescue mechanism should allocate the risk of bankruptcy equitably amongst the participants in the economy.⁵⁵ Business rescue needs to achieve a balance among social, economic and political interests.⁵⁶

(b) The 'fresh start' and the economic benefits of business rescue

Secondly, the arrival of the 'fresh start' attitude to business rescue, and the perception of the potential economic value of business rescue have encouraged the move from a liquidation focus to one that encourages business rescue where possible.

⁴⁸ Loubser *ibid* at 137; Ben-Ishai *op cit* (n29) 117; Juanitta Calitz 'Some thoughts on state regulation of South African insolvency law' (2011) 44 *De Jure* 290 at 294.

⁴⁹ Ben-Ishai *ibid* at 117.

⁵⁰ *Ibid* at 116.

⁵¹ *Ibid*.

⁵² Morgan *op cit* (n35) 504.

⁵³ Calitz *op cit* (n48) 294; Ben-Ishai *op cit* (n29) 127.

⁵⁴ Gross *op cit* (n9) 1032-1033.

⁵⁵ Morgan *op cit* (n35) 504.

⁵⁶ Ben-Ishai *op cit* (n29) 135.

The ‘fresh start’ approach to business rescue can be summarised as follows: the failing of a corporation is a risk of capitalism rather than a crime. Accordingly, bankruptcy should not be punished but rather the corporation should be assisted so that it can recover and participate in and contribute to the capitalist system.⁵⁷ The corporation should be given a fresh start rather than be penalised for being unable to avoid a risk that is a normal element of capitalist, commercial enterprise activity.⁵⁸

Moreover, insolvency systems are fundamental to the functioning of commercial activity. They are essential for the development of credit markets and entrepreneurship,⁵⁹ and raise the efficiency level of economies.⁶⁰ Business rescue is a vital component of insolvency systems because it aims to ensure the equitable treatment of interested parties such that social, economic and political interests are recognised and optimised as appropriate.⁶¹ For example, where a corporation’s value stems more from its human capital and goodwill than from its assets, an optimal response in the case of bankruptcy would be business rescue rather than liquidation. This is because liquidation does not capture the value of the corporation inherent in its goodwill and human capital, and thus does not maximise the outcome economically for creditors nor socially for interested parties, to the same extent as can potentially be achieved through business rescue.⁶²

Recognition of the ‘fresh start approach’, and of the economic and social value of business rescue, has encouraged the move towards business rescue instead of liquidation because they support the perception that, as a first resort, business rescue is principally and economically more consistent with the reality of commercial activity, than liquidation is. This is limited to situations where business rescue is feasible.⁶³ There is no intention to suggest that a culture of ‘business rescue at any cost’ has been created. Rather, it is a culture that, in a situation where liquidation and business rescue are both practical, business rescue will be preferred as the first resort.⁶⁴

⁵⁷ Loubser op cit (n11) 137; Arner op cit (n16) 391; *Kruger v The Master, ex parte Kruger* 1982 (1) 754 (W) at 758; Keay op cit (n8) 518.

⁵⁸ *Kruger* ibid; Lynn M LoPucki ‘The unsecured creditor’s bargain’ (1994) 80 *Virginia Law Review* 1887 at 1937; Keay op cit (n8) 518.

⁵⁹ Calitz op cit (n48) 295.

⁶⁰ Ben-Ishai op cit (n29) 135.

⁶¹ Wood op cit (n16) 210; Ben-Ishai ibid at 135.

⁶² Ben-Ishai ibid at 116.

⁶³ Morgan op cit (n35) 504-5.

⁶⁴ Ben-Ishai op cit (n29) 131.

(c) Why the shift away from liquidation responses to bankruptcy and towards a business rescue approach will have implications for the assessment of the ranking of tax claims

The trend away from liquidation and towards business rescue will have implications for the treatment of creditors. There is a difference in the norms, and the weight attributed to these norms, under liquidation and business rescue. Thus, it is appropriate that this normative context be taken into consideration when evaluating the policy claims made in favour of and against affording some form of priority to tax claims. Secondly, the different understanding of the corporation and those impacted by bankruptcy, and the recognition of the ‘fresh start’ approach and the economic value of business rescue, that have instigated the trend away from liquidation and towards business rescue, will influence the perspective from which the ranking of tax claims should be considered. This is because these concepts are foundational to the new conception of a business rescue mechanism.

II. THE DIFFERENT RANKINGS UNDER AND ROLES OF LIQUIDATION AND BUSINESS RESCUE

In the light of the context of a shift from a culture that emphasised liquidation to one that promotes business rescue where it is feasible,⁶⁵ this section will set out the ranking of tax claims under liquidation and business rescue in South Africa, and will briefly state the contrasting policy goals of business rescue and liquidation. It will then discuss how the differences between liquidation and business rescue suggest that it would not be appropriate to present the ranking of tax claims under liquidation as justification for altering the ranking of tax claims under business rescue, although they are both insolvency mechanisms.⁶⁶

(a) The ranking of tax claims under liquidation and under business rescue in South Africa

In liquidation, tax claims are ranked ahead of those of the concurrent creditors;⁶⁷ the South African Revenue Service (hereafter ‘SARS’) is a preferred creditor in liquidation proceedings.⁶⁸ In contrast to liquidation, where the ranking of tax claims in the hierarchy of

⁶⁵ Ben-Ishai *ibid* at 116, 131; Morgan *op cit* (n35) 504-5; Gross *op cit* (n9) 1033.

⁶⁶ *Commissioner for the South African Revenue v Beginsel NO and others* 2016 JOL 35788 (WCC) para 19, 24.

⁶⁷ *Ibid* para 9; Alastair Morphet ‘Business rescue: SARS’ place in the queue?’ (2102) *Moneyweb’s Tax Breaks* 2 at 2, 3.

⁶⁸ *Beginsel supra* (n66) para 19; Morphet *ibid* at 3.

claims is specifically stated, Chapter 6 of the Companies Act 71 of 2008 does not expressly set out the ranking of tax claims under a business rescue.⁶⁹

The question as to SARS's place in the hierarchy of claims in a business rescue was settled in *SARS v Beginsel*.⁷⁰ In *Beginsel*, it was held that SARS is not a preferent creditor for the purposes of business rescue proceedings.⁷¹ First, the business rescue provisions of the Companies Act⁷² do not create statutory preferences unlike those contained in s96-s102 of the Insolvency Act.⁷³ Had the legislature intended to confer a preference on SARS in business rescue proceedings, it would have done so clearly and yet the Companies Act⁷⁴ provides no evidence of such an intention by the legislature.⁷⁵ Secondly, the interpretation contended for by SARS would contradict the goal set out in s7(k) Companies Act⁷⁶ that the rights and interests of all relevant stakeholders must be balanced under business rescue proceedings.⁷⁷

(b) The policy goals of liquidation and business rescue

Liquidation and business rescue represent two different responses to the same issue of corporate insolvency.

Liquidation aims to maximise the distribution of assets to creditors, according to their preference, through a collective proceeding that aims to treat these creditors equitably.⁷⁸ Liquidation is a manner in which creditors are provided that to which they are entitled: the repayment of debts owed to them.⁷⁹ Liquidation is a mechanism that is designed for the benefit of creditors.⁸⁰ Additionally, liquidation provides the ultimate exit for insolvent debtor⁸¹ and thus disrupts the relationship between the insolvent debtor and its stakeholders.⁸²

⁶⁹ *Beginsel* ibid para 13, 23-4; *Morphet* ibid at 2.

⁷⁰ *Beginsel* ibid para 21.

⁷¹ *Ibid* para 24.

⁷² Companies Act 71 of 2008, Chapter 6.

⁷³ Insolvency Act 24 of 1936.

⁷⁴ 71 of 2008.

⁷⁵ *Beginsel* supra (n66) para 24, 34; *Morphet* op cit (n67) 3.

⁷⁶ 71 of 2008.

⁷⁷ *Beginsel* supra (n66) para 22, 28-9, 32.

⁷⁸ *Morgan* op cit (n35) at 470; *Walker v Syfret NO* 1911 AD 141 at 166; Companies Act 61 of 1973, s391.

⁷⁹ *Kotze v Tulryk Bpk* 1977 (3) SA 118 (T) at 120 cited in *Loubser* op cit (n11) 147.

⁸⁰ Cases cited in André Boraine et al 'The pro-creditor approach in South African insolvency law and the possible impact of the Constitution' (2015) 3 *Nottingham Insolvency and Business Law e-Journal* 59 at 61.

⁸¹ *Morgan* op cit (n35) 470.

⁸² *Jackson* op cit (n18) 896.

Corporate reorganisation's goals extend beyond the 'repayment of debts owed to creditors' economic objective of liquidation, and are based upon both social and economic objectives.⁸³ Corporate reorganisation attempts to balance the interests of all stakeholders. This is achieved through a collective proceeding that emphasises the maximisation of the value of the company for the economic benefit of creditors and the social benefit of stakeholders, and that enforces an equitable and orderly distribution in response to the diversity of claims against the debtor.⁸⁴ Corporate reorganisation aims to rehabilitate the corporation and thus continue its web of interactions with a range of stakeholders.⁸⁵ Alternatively, a corporate reorganisation will aim to deliver a better return for the company's creditors than if the company had immediately been placed into liquidation.⁸⁶

(c) Business rescue structures should not be viewed through the lens of liquidation

From the section above, it should be clear that although liquidation and business rescue are solutions to the same issue of corporate insolvency, their objectives and guiding values diverge. Liquidation has a heavy creditor emphasis and results in the dismembering of the corporation, regardless of the effect on other stakeholders.⁸⁷ Business rescue attempts to rehabilitate and retain the corporation, for the sake of the economic and social benefits that such rehabilitation would impart on all stakeholders.⁸⁸ Although the treatment of creditors is still an important consideration – for example, business rescue proceedings may include a liquidation process if it would result in a better return for creditors than an immediate liquidation – they are not the sole consideration, unlike in liquidation.⁸⁹

The different purposes of business rescue and liquidation mean that it is not justifiable to suggest that business rescue mechanisms be criticised or suggested to conform to the manner in which matters are handled under liquidation, simply by virtue of the fact that liquidation approaches a matter in a particular fashion.⁹⁰ Business rescue and liquidation are not

⁸³ Calitz op cit (n48) 294. The objectives and underlying policy objectives of business rescue will be discussed extensively later in this Chapter but though they will be briefly stated here. However, later portions of this chapter will expand expansion on the meaning of the policy objectives and values of business rescue, and provide authority for the points stated.

⁸⁴ Ben-Ishai op cit (n29) 116.

⁸⁵ Jackson op cit (n18) 896; Ben-Ishai op cit (n29) 132; 133.

⁸⁶ Conradie and Lamprecht op cit (n6) 7, 13-14.

⁸⁷ Ben-Ishai op cit (n29) 132; 133.

⁸⁸ Ben-Ishai ibid at 133; Eric Levenstein *An Appraisal of the new South African business rescue procedure* (unpublished LLD thesis, University of Pretoria, 2015) at 37.

⁸⁹ Ben-Ishai ibid at 132; 133. Levenstein ibid.

⁹⁰ *Beginsel* supra (n66) para 24.

interchangeable despite their commonality of an orderly and equitable distribution of assets through a collective proceeding, in response to the failure of a business. Thus, although the liquidation mechanism may be viewed as the core around which business rescue was constructed,⁹¹ this does not necessarily render the liquidation mechanism a suitable or persuasive source in the assessment of the aptness of business rescue's structures.

III. THE VALUES THAT ARE PROPOSED TO UNDERLIE BUSINESS RESCUE GENERALLY

Since the values of liquidation cannot be relied on in order to judge business rescue's adequacy, and the appropriateness of business rescue's ranking of tax claims in its claims hierarchy, it is necessary to explore more fully what values underpin business rescue. This section does not intend to encapsulate all the possible values that all possible business rescue systems may promote. Instead, the aim of this section is to bring attention to certain common values that underpin corporate reorganisation regimes for the purpose of creating a framework within which to analyse South Africa's ranking of its tax collector, in the hierarchy of claimants under business rescue.

It is worthwhile first to identify the basic foundation from which these principles of corporate reorganisation proceed. Essentially, business rescue is of a communitarian nature and seeks to achieve a balancing of interests in order to promote the collective good.⁹² Business rescue requires a compromise of the interests of some parties that is consistent with values and policy objectives that will be discussed below. What constitutes the 'collective good' is determined by the balance of values that a business rescue regime strikes and whether the use of the business rescue mechanism has an equitable impact on stakeholders.⁹³ Business rescue should not be reduced to a value maximisation enterprise for creditors with the strongest claims because this ignores the multitude of claimants and other stakeholders affected when a business fails.⁹⁴ To do so would also undermine the contributions made by other stakeholders in the running of a business.⁹⁵ Business rescue is both an economic and social enterprise.⁹⁶ Thus the

⁹¹ Morgan op cit (n35) 470.

⁹² Warren op cit (n1) 360, 361; Gross op cit (n9) 1040-1043.

⁹³ Ibid at 287.

⁹⁴ Warren op cit (n1) 345, 346.

⁹⁵ Ibid at 356.

⁹⁶ Chan op cit (n15) 285.

furtherance of the collective good requires that business rescue appropriately reconciles social and economic interests.⁹⁷

(a) Maximisation of the value of a company

This discussion of underlying principles will begin with the theme of value maximisation of the company. Value maximisation of a struggling business implicates both social and economic considerations.⁹⁸

Value maximisation of the business is important from a social perspective because if the business rescue mechanism increases the value of an ailing business, this decreases the negative consequences of a failing debtor, that otherwise would need to be absorbed by those interacting with or relying on the debtor company.⁹⁹ For example, suppliers to the company will not forego payment on as much of the debt owed to them by the company, employees may continue to be employed for a longer period than would have otherwise been the case, the company's contribution to a country's economy is maximised as much as possible, and consumers may continue their relationship with the company for a longer period.¹⁰⁰

Economically, value maximisation of a failing company is essential because it allows creditors to recover as much of the debt owed to them as is feasible. Normatively, this is appropriate because a debtor and creditor enter into a consensual, reciprocal, good faith relationship and it undermines this relationship if one party is enabled to evade performance of its reciprocal obligation.¹⁰¹ Commercially, it is crucial because if creditors cannot be assured of a maximum return (in the circumstances) on their extension of credit, creditors will be less willing to extend credit, on as accessible terms, which would be detrimental to commercial development.¹⁰²

(b) The treatment of creditors

Creditor participation and co-operation underpin commercial activity. The manner in which business rescue approaches the rights and claims of creditors is critical because a business cannot run without the co-operation of creditors, and rescue of the business cannot be achieved without the future co-operation of creditors or their willingness to compromise existing debts.

⁹⁷ Ibid at 285.

⁹⁸ Ibid at 283.

⁹⁹ Warren op cit (n1) 344.

¹⁰⁰ Conradie and Lamprecht op cit (n6) 12.

¹⁰¹ Chan op cit (n15) 281.

¹⁰² Chan ibid at 283; Keay op cit (n8) 525.

Therefore, business rescue must embody a principle, at minimum, of creditor recognition and perhaps even creditor-emphasis.¹⁰³

The reason for this emphasis on creditors in a business rescue mechanism is twofold. First, creditors provide credit which facilitates economic activity. There is a substantial risk that if creditors do not find that their interests and the return on their credit are adequately protected by a business rescue mechanism, they will not make credit available or will only do so in a less accessible fashion.¹⁰⁴ This would negatively impact on economic activity as well as the social benefits that flow from economic activity.¹⁰⁵ Secondly, the creditor-debtor relationship is premised on commercial expectations that are based on established economic patterns.¹⁰⁶ This commercial expectation is that debts will be incurred and discharged in good faith by debtors.¹⁰⁷ It is preferable that a business rescue procedure does not disrupt these expectations as the creation of uncertainty around the terms of the debtor-creditor relationship discourages creditor willingness to participate on terms as amenable to debtors.¹⁰⁸ Deviations from these commercial patterns would need to be carefully considered and justified so as not to undermine commercial morality to the extent that commercial activity is jeopardised.¹⁰⁹

Commercial development relies heavily on creditors. Therefore, it makes economic sense that a business rescue procedure should protect creditors and that this protection should be a foundational value of a business rescue mechanism.

(c) The influence of social benefit considerations

While the interests of creditors is a significant principle that underlies a business rescue mechanism, it is not the sole, determining value behind business rescue.¹¹⁰ The failing of a business implicates more than the debtor company or its creditors; the triad of interests affected is completed by the public interest.¹¹¹ The company structure unites diverse interests including those of investors, employees, creditors, consumers and the public. The company's success benefits its shareholders in addition to its employees, the business community and the public.¹¹²

¹⁰³ Bradstreet op cit (n2) 185.

¹⁰⁴ Bradstreet ibid at 185; Chan op cit (n15) 283; Warren op cit (n1) 359; Keay op cit (n8) 525.

¹⁰⁵ Bradstreet ibid at 175; Chan ibid at 283.

¹⁰⁶ Warren op cit (n1) 359.

¹⁰⁷ Chan ibid at 281; Keay op cit (n8) 528-9.

¹⁰⁸ Warren op cit (n1) 359.

¹⁰⁹ Chan ibid at 281; Warren ibid at 359.

¹¹⁰ Bradstreet op cit (n2) 176-7.

¹¹¹ Chan op cit (n15) 281.

¹¹² Chan ibid at 283-4.

Therefore the public interest is a value that influences the conception of a business rescue mechanism.

It would be a mischaracterisation to reduce business rescue merely to a mechanism of collectivised debt collection.¹¹³ To do so would ignore the clear interest of other stakeholders beyond creditors, in the success of a business rescue.¹¹⁴ While economically, it is crucial that a business rescue mechanism provides an adequate return to creditors,¹¹⁵ this economic perspective is an aspect of business rescue mechanism rather than the full picture. The failure of a company has a broader effect than impacting on creditor rights and shareholder returns. A company's failure does not occur in a vacuum and the repercussions thereof directly or indirectly prejudice the public interest by affecting communities and society's values and structures that are involved in economic activity, such as the commercial morality that underpins the debtor-creditor relationship.¹¹⁶ The occurrence of a company failing when it had become integrated into a community means that business rescue cannot be an exclusively private matter between the debtor company and its creditors; the public interest and the community are necessarily involved.¹¹⁷

However, recognition of the principles of public interest and social benefit in a business rescue does not mean that the interests of creditors are to be disregarded.¹¹⁸ Instead, it is merely necessary that business rescue is not blinkered so as only to consider creditor interests. The fact that the principle of public interest underlies a business rescue mechanism means that the effect of creditor interest consideration on the public interest should be weighed up against the gains of creditor-centric actions.¹¹⁹ Ideally, business rescue is a procedure premised on the economic rationale of creditor-protection but additionally acknowledges and, where possible, protects the public interest.¹²⁰ Careful consideration must be given as to if and to what extent, the economic perspective of creditor and shareholder interests is departed from, in favour of the social issue of the public interest.¹²¹

¹¹³ Bradstreet op cit (n2) 177, 185; Chan ibid at 279; Gross op cit (n9) 527-528.

¹¹⁴ Chan ibid at 279, 284.

¹¹⁵ Conradie and Lamprecht op cit note 6 at 11.

¹¹⁶ Bradstreet op cit (n2) 176-7.

¹¹⁷ Chan op cit (n15) 279.

¹¹⁸ Bradstreet op cit (n2) 185; Gross op cit (n9) 1032-1033; Keay op cit (n8) 528.

¹¹⁹ Conradie and Lamprecht op cit note 6 at 11.

¹²⁰ Ibid at 18-20.

¹²¹ Bradstreet op cit (n2) 178-9.

(d) Equitable and orderly distribution

The discussions around maximisation of the value of the failing company and the inclusion of public interest in addition to the interest of creditors in a business rescue hint at the communitarian undertones of the business rescue mechanism.¹²² This communitarian theme is extended through the inclusion of the values of equality, orderly distribution of claims and collectivism that underlie the business rescue mechanism.¹²³

First, the business rescue process does not allow creditors to enforce their claims in a unilateral, piecemeal fashion whereby they compete to collect varying levels of satisfaction of their claims.¹²⁴ Such a creditor collection competition decreases the assets available for distribution, and reduces the value of the enterprise by undermining its collective value; the effect is a sub-optimal outcome of economic efficiency and of the ability to manage the failing business in a manner consistent with public policy objectives.¹²⁵ Therefore, the collectivisation principle steers business rescue towards achieving an equitable, optimal outcome.¹²⁶

Moreover, business rescue does not only promote collective action but also enforces a pre-determined priority of repayment.¹²⁷ The combination of collective action and a pre-determined hierarchy of claims results in business rescue taking an equality approach to claimants: claimants cannot rush on the assets of the failing company to the detriment of a claimant with a similar type of claim who is not as prompt in their enforcement or requires a longer period to organise and present their claim.¹²⁸ The pre-determined priority of repayment promotes equality by allowing principled policy rather than self-seeking individuals to dictate distribution.¹²⁹ The submission of individuals to communitarian policy control is permitted in return for the benefits of being part of a community.¹³⁰

However, while the pre-determined priority of repayment is based on a foundation of equality, the hierarchy itself provides for exceptions to the collectivism and equality principles. This is evident when specific claimants are ranked in front of or behind other claimants with similar types of claims, or the satisfaction of the specific claim will be prejudicial to the

¹²² Warren op cit (n1) 360.

¹²³ Gross op cit (n9) 1040-3.

¹²⁴ Keay op cit (n8) 511; Chan op cit (n15) 282.

¹²⁵ Chan ibid at 282-3.

¹²⁶ Ibid at 282.

¹²⁷ Warren op cit (n1) 352.

¹²⁸ Ibid 353.

¹²⁹ Keay op cit (n8) 354; Warren ibid at 354.

¹³⁰ Warren ibid at 360, 361.

collective of the company or the collective of its stakeholders. Yet these deviations themselves are founded on communitarian logic. The deviation will be permitted for economic reasons that may indirectly impact the public, or will be justified for reasons of redistribution.¹³¹ Corporate reorganisation is firmly underpinned by social principles and attempts to balance these with economic values.

(e) The meaning of a successful business rescue

It has previously been stated that a business rescue is both a social and economic enterprise. Yet the meaning ascribed to the success of a business rescue influences how the social and economic considerations are managed and prioritised by the business rescue mechanism.

First, a business rescue may be judged a success if – in a literal interpretation of the title of the process – the business is rescued from its failing financial circumstances and is rehabilitated so that it continues to operate as a solvent entity. A preliminary point is that success under this meaning requires that it is not necessary for the business rescue mechanism to be applied again to the company,¹³² and that the company is not liquidated under the guise of a business rescue.¹³³ Yet even this seemingly literal interpretation of business rescue must be clarified to establish how a company that exits business rescue must continue to exist in order for it to have been a successful business rescue. It is uncertain whether the company entity must persist even if it consists of different assets, or if it is adequate if only the key operations of the company continue.¹³⁴ The latter would encourage a business rescue mechanism that is formulated to include social considerations such as suppliers, consumers and the interest of the community that the company's operations continue.¹³⁵

Alternatively, and perhaps counter-intuitively, a business rescue can be labelled a success if use of the process leads to liquidation as part of the business rescue,¹³⁶ or if the process cannot return the company to solvency, that the liquidation under the business rescue will lead to a better return for creditors than an immediate liquidation.¹³⁷ This conception of business rescue success emphasises the interests of creditors and the economic considerations

¹³¹ Ibid at 353.

¹³² Conradie and Lamprecht op cit (n6) 8.

¹³³ Ibid at 7-8; 15.

¹³⁴ Ibid at 10, 15-16.

¹³⁵ Ibid at 10.

¹³⁶ Ibid at 7.

¹³⁷ Ibid at 13-14.

associated with creditors. Therefore, this idea of a successful business rescue lends itself to the crafting of a mechanism with a strong economic emphasis.

The meaning of a successful business rescue influences the values that should be prioritised in the formulation of a business rescue mechanism. It may even be said that the meaning of success is a value which underpins the business rescue mechanism and may favour either economic or social considerations.

IV. THE VALUES PRESENT IN SOUTH AFRICA'S BUSINESS RESCUE REGIME

This section intends to assess whether the values discussed above manifest themselves in the South African business rescue regime. The examples used are intended to illustrate an example of the values rather than to represent a complete analysis of the values present in the South African business rescue regime.

(a) Maximisation of the value of a company

It is important for the effectiveness of a business rescue regime that it maximises the value of a firm's assets,¹³⁸ regardless of whether this maximisation of value is for social or economic reasons, or both.

The existence of this value in the South African business rescue regime is indicated, for example, in the moratorium on statutory proceedings¹³⁹ which prevents a rush of claims against a failing company that would dissipate its assets and collective value. Additionally, the power of the business rescue practitioner¹⁴⁰ to suspend or apply to court for the cancellation of contracts or contractual provisions enables the company to avoid the enforcement of wasteful obligations that harm rather than increase its value.

(b) The treatment of creditors

Section 7 of the Companies Act¹⁴¹ provides the first hint as to the place of creditors in South Africa's business rescue mechanism; Section 7 requires that the rescue mechanism promote the development of the South African economy by encouraging entrepreneurship and enterprise efficiency and that the rescue must balance the rights and interests of all relevant

¹³⁸ Bradstreet op cit (n2) 180.

¹³⁹ Companies Act 71 of 2008, s128(1)(b), s133.

¹⁴⁰ Ibid, s136.

¹⁴¹ Ibid.

stakeholders.¹⁴² Furthermore, the definition of ‘affected persons’¹⁴³ who may apply to court for an order that a company begin business rescue proceedings,¹⁴⁴ apply to a court to set aside a business rescue resolution or appointment of a business rescue practitioner,¹⁴⁵ or take the steps to extend business rescue proceedings if a business rescue plan was proposed and rejected,¹⁴⁶ has been extended to encompass a greater range of stakeholders.¹⁴⁷

However, the South African business rescue mechanism still displays clear acknowledgement of the importance of creditors and the economic considerations with which they are intertwined. Section 7 of the Companies Act also reiterates the goal of promoting investment in the South African economy, the creation of optimum conditions for the investment of capital in enterprises, and the provision of a predictable and effective environment for the efficient regulation of companies.¹⁴⁸ If creditor rights were disregarded or diluted too greatly in a business rescue, the availability of credit would be compromised and these aims of the Companies Act¹⁴⁹ would be undermined.¹⁵⁰ Thus, it is appropriate that creditors retain significant control over the business rescue process. This is implemented, for example, through the fact that the adoption of the business rescue plan which dictates how the rescue will proceed, can only occur if it is approved by the creditors in accordance with s152(2).¹⁵¹ Consequently, the business rescue practitioner must formulate a rescue plan that accommodates the demands of creditors,¹⁵² and is entitled to consult the creditors’ committee in order to ascertain the creditors’ priorities¹⁵³ though the business rescue practitioner cannot be instructed as to how to devise the business rescue plan.¹⁵⁴ It is clear that creditor interests remain a key value in South Africa’s business rescue regime.

¹⁴² Ibid, s7(b) and (k).

¹⁴³ Ibid, s128(1)(a).

¹⁴⁴ Ibid, s131.

¹⁴⁵ Ibid, s130.

¹⁴⁶ Ibid, s153(1).

¹⁴⁷ Richard Bradstreet and Marius Pretorius and Philip Mindlin ‘The wolf in sheep’s clothing – when debtor-friendly is creditor friendly: South Africa’s business rescue and alternatives learned from the United States’ Chapter 11’ (2015) 2 *Journal of Corporate and Commercial Law and Practice* 1 at 10.

¹⁴⁸ Companies Act, s7(c), (g) and (l).

¹⁴⁹ Companies Act.

¹⁵⁰ Bradstreet op cit (n2) 175, 185.

¹⁵¹ Companies Act.

¹⁵² Bradstreet, Pretorius and Mindlin op cit (n147) at 25.

¹⁵³ Companies Act, s145(3).

¹⁵⁴ Ibid, s149(1)(a).

(c) The influence of social benefit considerations

While creditor interests remain crucial, South Africa's business rescue regime also seeks to afford prominence to social benefit considerations.

First, the special treatment of employees under South Africa's business rescue regime embodies its recognition of the company as a means of achieving both economic and social benefits.¹⁵⁵ An example would be that, unlike other creditor contracts, the business rescue practitioner cannot suspend, alter or cancel employment contracts, and employees must continue to be employed on the same terms, despite the business rescue process.¹⁵⁶ This nuanced approach to the employee-company relationship as something beyond the conventional debtor-creditor relationship illustrates the consciousness of social benefit considerations, in the South African business rescue regime. It seeks to protect those who are less likely to be able to spread the risk of the company's failure, and those upon whom the failure has significant social consequences.¹⁵⁷

Moreover, the extension of the meaning of 'affected persons'¹⁵⁸ who have powers to direct the business rescue process is, to some extent,¹⁵⁹ recognition of interests in a company besides those of conventional creditors. The inclusion of employees acknowledges their interest in the company as creditors but also the social benefit of their employment.

Thirdly, s7(k) of the Companies Act¹⁶⁰ states that the business rescue mechanism ought to be designed in a manner that balances the rights and interests of all relevant stakeholders. The meaning of 'stakeholders' extends beyond the 'affected persons' in s128(1)(a)¹⁶¹ to include the community in which the company operates, as well as its employees, suppliers and consumers.¹⁶²

South Africa's business rescue regime does not ignore the social implications of a company's failure. It purposefully seeks to address them in conjunction with its awareness of the economic issues that must be managed in a business rescue.

¹⁵⁵ Bradstreet op cit (n2) 163.

¹⁵⁶ Companies Act, s136.

¹⁵⁷ Bradstreet op cit (n2) 163; Warren op cit (n1) 357.

¹⁵⁸ Companies Act, s128(1)(a).

¹⁵⁹ Ibid, s131, s130, S153(1).

¹⁶⁰ Companies Act.

¹⁶¹ Ibid.

¹⁶² Bradstreet op cit (n2) 169.

Moreover, the South African Constitution¹⁶³ applies to private as well as public power and thus the private sphere of commercial activity is subject to the Constitution's goal of the promotion of social justice.¹⁶⁴ The Constitution seeks to redress damage and inequality perpetrated by the Apartheid regime,¹⁶⁵ and due to the supremacy of the Constitution,¹⁶⁶ business rescue cannot ignore these social considerations and must address them.¹⁶⁷

(d) Equitable and orderly distribution

In order to realise economic and social interests through business, the principle of an equitable and orderly distribution is present in the South African business rescue regime. The statutory moratorium on the rights of claimants against the failing company¹⁶⁸ as well as the ranking of claims set out in s135¹⁶⁹ combine to allow policy and procedure to manage the business rescue and distribute value rather than the unilateral actions of individual claimants.

(e) The meaning of a successful business rescue

South Africa's business rescue mechanism specifically states what it means to rescue a company: the process will restructure the company's affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.¹⁷⁰

It has been suggested that it is not a business rescue if there cannot be a return of the company to solvency, and there is only a prospect of a liquidation that will provide a better return to the company's creditors than an immediate liquidation.¹⁷¹ However, it has since been decided that in South Africa, a business rescue can consist of a return of the company to solvency, or if the process will provide a better return to the company's creditors than an

¹⁶³ Of the Republic of South Africa, 1996.

¹⁶⁴ Bradstreet op cit (n2) 163, 164, 165, 167.

¹⁶⁵ Ibid at 165.

¹⁶⁶ Constitution, s2.

¹⁶⁷ Bradstreet op cit (n2) 167.

¹⁶⁸ Companies Act, s128(1)(b), s133.

¹⁶⁹ Companies Act.

¹⁷⁰ Ibid, s128(1)(b).

¹⁷¹ *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening)* 2012 (5) SA 515 (GSJ) para 17.

immediate liquidation, even if there was no prospect at all of returning the company to solvency.¹⁷²

V. CONCLUSION

Recently, there has been a movement away from a liquidation-centric legal culture to one in which business rescue is preferred. This shift in the legal culture has been motivated by a recent expansion in the understanding of who is affected when a corporation fails; there are a broader number of interests affected than merely those of the creditors and shareholders of the corporation. Moreover, the corporation derives its value from a greater number of stakeholders than merely its creditors and shareholders. Secondly, this shift is justifiable in light of the potential economic benefits that business rescue can promote. Any evaluations of the business rescue mechanism must be underscored by the values and policy goals that motivated this shift towards a business rescue culture.

Business rescue is a crucial mechanism in the commercial sphere and it must be carefully devised to achieve optimum outcomes. However, an optimum outcome is not a neutral, uniform consequence. The success of a business rescue and identification of its flaws can only be assessed if the values prominent in system and the goals of the particular business rescue mechanism are established.

South Africa's business rescue system appears to attempt to present a balanced approach between the interests of creditors and the interests of other stakeholders and the public benefit. The mechanism aims to further economic goals and respect commercial norms while promoting social benefits and equitable redistribution, consistent with the constitutional mandate that underlies every law or action in South Africa. Thus, in the assessment of the adequacy of South Africa's business rescue procedure, the aim of achieving this balance between social and economic interests as well as the meaning of a business rescue, must constitute the framework from which this assessment must take place.

¹⁷² *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) para 24-8.

CHAPTER 3 - THE POLICY ARGUMENTS IN FAVOUR OF TAX PRIORITY IN A BUSINESS RESCUE

The ranking of claims in a business rescue departs from the equitable treatments of creditors and results in some creditor claims being satisfied and other creditors being paid very little or nothing. The choice as to which creditors are prioritised needs to be justified by convincing policy reasons that are consistent with the principles of business rescue. This chapter will present and discuss a few key policy arguments that have been made in favour of a priority ranking for tax collection, in the hierarchy of claims in a business rescue. It will then evaluate whether business rescue values and policy, that were discussed in the previously, reinforce these policy arguments or decrease the weight which should be attributed to them.

I. PRIORITISATION OF TAX CLAIMS IS IN THE PUBLIC INTEREST

Historically, tax claims were granted priority in recognition of the monarch's right to be paid first on the basis that the monarch has absolute power over their citizens, and had a divine right to protect their revenue.¹⁷³ This rationale no longer applies in modern societies which are usually run by governments without the divine rights or absolute power of monarchs.

The state has evolved from representing the individualistic crown and into a government that represents the interests of the population. The state rules with the consent of the governed and according to a social contract whereby power is exchanged for the protection of the public good.¹⁷⁴ An aspect of upholding the public good is that the government renders services to the debtor company and other citizens in return for payment in the form of taxes.¹⁷⁵ Thus, the prioritising of the repayment of tax claims protects the funding necessary for the provision of important government services that benefit the public.¹⁷⁶

Secondly, as the government represents the collective will of its citizens, and the governmental services funded by taxes are performed for the community of citizens, tax debts in effect are debts owed to the community.¹⁷⁷ The community encapsulates many different interests; it seems persuasive to prefer a tax claim which affects the public generally rather than

¹⁷³ Shanker op cit (n17) 342-3, 344; Salter op cit (n33) 356.

¹⁷⁴ Shanker ibid at 344; Stanford Encyclopaedia of Philosophy 'Locke's political philosophy' available at <https://plato.stanford.edu/entries/locke-political/>, accessed 28 October 2018.

¹⁷⁵ Shanker ibid at 345.

¹⁷⁶ Morgan op cit (n35) 463.

¹⁷⁷ Ben-Ishai op cit (n29) 127; Morgan ibid.

the claims of individual creditors which have a more limited impact than tax claims.¹⁷⁸ The public interest should be preferred over the private interest.

Furthermore, non-prioritised tax claims in a business rescue may diminish the funding available for essential government services but they also shift the burden of the unpaid taxes which must then be borne by the community.¹⁷⁹ It seems inequitable that a company undergoing business rescue should be able to shift its tax burden onto the community in which it functioned, particularly when this community was an important contributor towards its existence by providing employees, customers, suppliers and the supportive structures in the form of governmental services.¹⁸⁰ Moreover, the use of these amounts to pay other creditors or to support the business rescue, instead of satisfying the outstanding tax claims, means that these funds that do not belong to the debtor company, are used to provide a windfall for other creditors. This would occur despite the enormity of the impact on the community of the non-repayment of tax debts and despite the creditors having no fair claim to these funds.¹⁸¹

Tax claims are associated with community interests and community benefits because they are a debt owed to the government which represents the public, and because the payment of tax funds essential government services that benefit the citizenry. The broad effect of non-payment of tax claims by a debtor under a business rescue thus impacts on a wide range of stakeholders as a result of the above. This impact refers to direct taxes which are taxes that are payable by and collectible from the debtor company itself.¹⁸²

Yet community interests are also noticeably linked to the payment of taxes when the taxes in issue are indirect taxes whereby the debtor company acts as a tax collector on behalf of the government, rather than the taxpayer.¹⁸³ Indirect taxes include employee-related taxes such as income taxes, unemployment insurance taxes, and pension/social security taxes.¹⁸⁴ Employees structure their affairs on the assumption that their employer-companies perform their tax collection role and organise the payment of these taxes that are in fact owed by the employees.¹⁸⁵ If employer-companies do not co-ordinate the payment of these taxes and go

¹⁷⁸ Ibid.

¹⁷⁹ Morgan *ibid*.

¹⁸⁰ Ibid.

¹⁸¹ Ben-Ishai *op cit* (n29) 127, 128; Morgan *op cit* (n35) 464.

¹⁸² Morgan *ibid* at 472.

¹⁸³ Ibid.

¹⁸⁴ Ibid. Other types of indirect taxes exist but they will not be discussed because they are not pertinent to the point that is being made in this section.

¹⁸⁵ Ibid at 483.

into a business rescue in which tax claims are not afforded priority, there is a strong chance that these taxes will not be paid.

Consequently, employees will be negatively impacted as their contributions to unemployment insurance will diminish and thus the amounts available in these funds will decrease. This is a social welfare issue because the unemployment insurance fund system is a crucial pillar of social security – it assists by providing subsistence income in times of income loss due to unemployment¹⁸⁶ – and it relies on employee and employer contributions; the government does not fund the unemployment insurance fund system.¹⁸⁷ In countries, such as South Africa, in which there is a high level of unemployment,¹⁸⁸ an underfunded unemployment insurance fund is concerning because it increases the risk that the pay-outs to unemployed workers will not be what is due and therefore will not alleviate the harm of the loss of employment, despite this being the system's purpose.¹⁸⁹

Diminished contributions to the unemployment insurance fund system present an economic as well as a social problem.¹⁹⁰ Unemployment insurance aims to limit the severity of the impact of a loss in income on an individual and their dependents' living standards. Yet, this maintenance of consumption is justified economically as well as socially.¹⁹¹ If consumption patterns remain relatively stable (assisted by unemployment insurance contributions) this helps to mitigate the consequences of economic downturns, such as increased unemployment and investor trepidation, that may be an effect of overcautiousness in spending.¹⁹²

Secondly, companies act in a quasi-trust capacity when they collect a portion of their employees' salaries to pay the indirect taxes of income taxes, unemployment insurance taxes, and pension/social security taxes.¹⁹³ It seems problematic if these taxes are not afforded some priority because otherwise, the employer-company, who is acting as the government's tax

¹⁸⁶ Haroon Borhat, Sumayya Goga and David Tseng 'Unemployment insurance in South Africa a descriptive overview of claimants and claims' (2013) Development Policy Research Unit Working Paper 13/160. Development Policy Research Unit, University of Cape Town at 1.

¹⁸⁷ Ibid at 4, 8.

¹⁸⁸ Ibid at 1; Makhado Ramudzuli Ramabulana 'Pension law for employers' available at http://www.sabpp.co.za/wp-content/uploads/2017/03/Fact_sheet_march_2017.pdf accessed 28 October 2018 at 10, 25.

¹⁸⁹ Borhat et al op cit (n186) at 3, 34; JA Swanepoel and NJ Schoeman 'The fiscal impact of unemployment insurance programmes as automatic stabilisers: the South African experience' (2003) 38 (4) *Journal of Public Administration* 397 at 417, 408.

¹⁹⁰ Swanepoel ibid at 398-9.

¹⁹¹ Ibid

¹⁹² Ibid at 398-9, 401, 409.

¹⁹³ Ben-Ishai op cit (n29) 121; Morgan op cit (n35) 472.

collector, in effect will distribute the portions of employee salaries allocated to the aforementioned taxes instead to its own estate; this will then be to the benefit of other creditors who have no entitlement to these funds. This is inequitable.¹⁹⁴

(a) Applicable business rescue values

Business rescue culture is alert to the fact that a corporation's existence and bankruptcy implicates a greater variety of stakeholders than simply the corporation's creditors.¹⁹⁵ Accordingly, it is important that these stakeholders are granted some protection should the corporation enter bankruptcy territory.¹⁹⁶ Therefore, business rescue mechanisms need to be structured so as to balance the interest of creditors and these additional stakeholders in order to achieve an optimal outcome.¹⁹⁷ Thus, the interest of the public must be taken into account as a key value when assessing a business rescue mechanism.¹⁹⁸ Tax claims are representative of debts owed to the community. Moreover, the public is negatively affected by a corporation's failure to satisfy these tax debts as the public must bear the burden and consequences of the shortfall. This undermines the communitarian notion that each actor in a society is responsible for the public's well-being because these actors are connected to and rely upon one another.¹⁹⁹ Therefore, it would appear inconsistent with the public interest value underlying business culture if a business rescue mechanism does not approach tax claims in a manner that protects those broad interests involved in tax debts.

Secondly, default by corporations on taxes owed on behalf of their employees risks wider social and economic implications as well as the inappropriate allocation of these funds instead to other claimants. Evidently, these social and economic consequences are not in the public interest and are contrary to the attempt in business rescue to treat social, economic and political interests equitably and optimally.²⁰⁰ Moreover, the misallocation of the tax funds goes against the equitable and orderly distribution that corporate reorganisation prioritises.²⁰¹

¹⁹⁴ Morgan *ibid* at 464; Ramabulana *op cit* (n188) 19.

¹⁹⁵ Conradie and Lamprecht *op cit* (n6) 18-20; Chan *op cit* (n15) 279.

¹⁹⁶ Keye *op cit* (n8) 510.

¹⁹⁷ Warren *op cit* (n1) 360, 361; Wood *op cit* (n16) 210; Ben-Ishai *op cit* (n29) 135.

¹⁹⁸ Keye *op cit* (n8) 510.

¹⁹⁹ Gross *op cit* (n9) 1036-7, 1040-1, 1042-3.

²⁰⁰ Wood *op cit* (n16) 210; Ben-Ishai *op cit* (n29) 135. These social consequences would also perpetuate disadvantage and inequality and this would be inconsistent with South Africa's constitutional emphasis on the promotion of social justice. See '(c) The influence of social benefit considerations' in Chapter 2.

²⁰¹ Keye *op cit* (n8) 515, 516; Jackson *op cit* (n18) 867; Ben-Ishai *op cit* (n29) 116.

This particular policy argument in favour of some tax priority is a pertinent and worthy critique because it aligns with business rescue culture's foundational values rather than criticising the business rescue's ranking of tax claims based on a premise that is not relevant to business rescue's normative basis and objectives.

II. THE STATE CANNOT AFFORD TO ABSORB TAX DEFAULTS BY BUSINESSES UNDERGOING BUSINESS RESCUE NOR SHOULD THE STATE BE EXPECTED TO ABSORB SUCH LOSSES

Even if one views the state as a creditor in its own right rather than as a representative of the community and the collective interests of various stakeholders, there are still persuasive policy reasons why the tax debts owed to the state should be granted some priority under a business rescue. First, it has been suggested that the government can absorb the losses of income if its tax claims against a debtor-company undergoing business rescue are not satisfied. This is because the government can distribute this loss of tax income among its many other taxpayers. Arguably, the implication of the diversity of the government's tax-paying debtors is that default by one debtor is sufficiently mitigated by the payment of tax debts by other debtors.²⁰² However, the current state of affairs exposes the weakness of this argument. Many governments operate at alarming deficits; the loss of tax revenue from business rescue debtors aggravates a severe situation in which the funding of government services and operations is already extremely compromised.²⁰³ Budget deficits mean that there are less funds available to be spent by the government but also that governments have to borrow money in order to maintain some level of function. Borrowing money comes at a price and the servicing cost of debt further reduces the funds available for the provision of essential services like healthcare and education, and social assistance such as the provision of housing.²⁰⁴ The suggestion that it is unnecessary for tax claims to have some form of priority under business rescue because the government can diversify their interests among many taxpayers – and thus easily absorb the

²⁰² Shanker op cit (n17) 342-3; Arner op cit (n16) 390; Warren op cit (n1) 357.

²⁰³ Shanker ibid at 343; Olivia Kumwenda-Mtambo 'South African budget deficit expected to reach eight-year high' available at <https://www.reuters.com/article/safrica-budget/update-3-south-african-budget-deficit-expected-to-reach-eight-year-high-idUSL8N1N05D8> accessed on 28 October 2018 ; South African Market insights 'South Africa's fiscal policy over time' available <https://www.southafricanmi.com/south-africas-fiscal-policy.html> accessed 28 October 2018 ; Justin Brown 'R195bn: That is our budget deficit' available at <https://www.fin24.com/Budget/Budget-and-Economy/r195bn-that-is-our-budget-deficit-20180204> accessed on 28 October 2018; South African Market insights 'Is SA's government spending money faster than they can collect taxes?' available at <https://www.southafricanmi.com/blog-16jul2017.html> , accessed on 28 October 2018.

²⁰⁴ *Spending money* ibid.

loss – ignores the reality that many governments operate at a loss. In the light of this context, the non-payment of tax claims by companies under business rescue should not be readily disregarded.

Secondly, even if the government could afford for companies under business rescue to default on their tax debts,²⁰⁵ it does not follow that the government should be expected to write-off these tax debts.²⁰⁶ This justification against a tax priority reasons, in essence, that a creditor who can afford for their debt not to be paid should therefore allow a debtor company not to repay such a debt if that company enters into business rescue.²⁰⁷ Such reasoning is problematic on at least two fronts. First, practically and politically, it is difficult to decide who these deep-pocketed, benevolent creditors will be.²⁰⁸ For if the basis for disallowing tax priority is that the government can afford the loss, this rationale will extend and apply to other creditors with substantial means.²⁰⁹ It may be an insurmountable task to devise a satisfactory and succinct method to calculate a creditor's ability to afford the loss of debt due to a debtor's business rescue. A miscalculation as to the identification of these sufficiently wealthy and resilient creditors in every matter risks a ripple effect whereby the forced forfeiture of debts owed by a debtor under business rescue, gravely impairs the sustainability of the debtor's creditors. Secondly, such an approach to debts owed by a debtor undergoing business rescue contradicts established commercial practices that do not release debtors from their obligations on the basis that the creditor can survive even if the debtor does not perform.²¹⁰

(a) Applicable business rescue values

One of the foundational values of business rescue culture is communitarianism: the corporation and multiple stakeholders in addition to the corporation's creditors are intertwined and their interrelatedness means that their conduct needs to reconcile and balance a variety of interests.²¹¹ Accordingly, business rescue needs to address both social and economic implications.²¹² The justification against some form of priority for tax claims – that the

²⁰⁵ Warren op cit (n1) 357; Shanker ibid at 342-3.

²⁰⁶ Shanker ibid at 343.

²⁰⁷ Ibid.

²⁰⁸ Ibid.

²⁰⁹ Ibid.

²¹⁰ Warren op cit (n1) 359; Chan op cit (n15) 281. This commercial expectation is that debts will be incurred and discharged in good faith by debtors.

²¹¹ Warren ibid at 360, 361; Gross op cit (n9) 1040, 1041, 1041-2, 1042-3; Bradstreet op cit (n2) 183; Chan ibid at 285.

²¹² Chan ibid.

government can absorb the cost of default on tax debts – appears to contradict these foundational elements of business rescue culture. This is because the reality is that governments are not in practice able to afford such defaults. The consequences of these defaults are economic strain on the government as a creditor which has knock-on social and economic effects on the society which the government intends to serve. This inconsistency with a core premise of business rescue culture – that an appropriate business rescue mechanism should attempt to ameliorate both social and economic costs²¹³ – is a persuasive reason to attribute little weight to this suggested rationale against some form of tax priority in a business rescue.

Regardless of whether the government can afford such defaults in practice, in principle the financial strength of the debtor should not be a ground upon which a creditor's claim should be subordinated. First, such reasoning threatens the assumptions upon which commercial reality relies such as that the debtor-creditor relationship is one of good faith where credit is extended and this debt will be repaid.²¹⁴ This commercial norm is not altered by reason of the financial strength or identity of either party. A key aim of business rescue is to support and bolster the functioning of commercial activity;²¹⁵ it would be contrary to this aim if business rescue mechanisms undermine the commercial morality according to which commercial activity functions.²¹⁶

Secondly, the business rescue mechanism needs to approach and affect the multitude of interests related to a failing enterprise equitably.²¹⁷ An embodiment of this equitable ideal is the structure of business rescue as a collective mechanism²¹⁸ The collective structure of business rescue is an attempt to ensure that creditors receive what is rightfully owed to them rather than allowing factors such as the strength or diligence of a creditor to determine what it recovers from a struggling debtor. Furthermore, this focus on equitable treatment is also apparent in the conception of a successful business rescue outcome that includes a liquidation that will result in a better return for creditors than an immediate liquidation²¹⁹ and where a business rescue is required to balance the rights and interests of all relevant stakeholders.²²⁰ A

²¹³ Keay op cit (n8) 512.

²¹⁴ Chan op cit (n15) 281; Keay *ibid* at 528-9.

²¹⁵ Calitz op cit (n48) 295; Ben-Ishai op cit (n29) 135; Companies Act, s7(c), (g) and (l).

²¹⁶ Amanda Visser 'Business rescue in SA fails to deliver' available <https://citizen.co.za/business/business-analysis-and-profiles/825336/business-rescue-in-sa-fails-to-deliver/> accessed 28 October 2018.

²¹⁷ Chan op cit (n15) 287.

²¹⁸ Keay op cit (n8) 515.

²¹⁹ Conradie and Lamprecht op cit (n6) 13-14.

²²⁰ Companies Act, s7(k).

second embodiment of this equitable ideal is the emphasis on the pari passu principle which requires equal distribution of the debtor's assets among its creditors, as a basic premise.²²¹

The starting point of business rescue is to treat similar creditors similarly and according to the nature of their agreement with the debtor. The suggestion that the satisfaction of creditor claims could hinge on the creditor's ability to absorb such default, even if a method to identify such creditors could be formulated, is contrary to the value of equitable treatment upon which business rescue is based. Such reasoning endorses variable treatment of creditors on the basis of their financial strength. This does not conform to the acceptable deviations from the pari passu principle that are justified on the basis of social and economic objectives that business rescue seeks to achieve.²²² A creditor's pricing of credit or the attractiveness of an environment for the creditor's operation²²³ is not assessed based on the creditor's own financial strength but rather on the behaviour of debtors, and the certainty and benefits offered by the operating environment. Therefore, this suggested deviation would not support the economic aims of a business rescue; business rescue must not prejudice creditors to the extent that the availability of credit is compromised. The economic environment must remain consistent with established commercial practices so that it is attractive to investors and creditors.²²⁴

Moreover, distinctions among creditors on the basis of the creditor's financial strength is not strongly linked to the protection of the debtor's stakeholders and the pursuit of public benefit which business rescue aims to balance with the rights of creditors. The objectives of business rescue do not support the contention that the claims of more financially robust creditors are less deserving of satisfaction in a business rescue than the claims of creditors of less financial strength.²²⁵

III. CREDITOR APATHY AND DISCOURAGING TAX COLLECTOR CO-OPERATION

The reasoning above criticises discrimination against the government's rights as a creditor, with regard to its tax claims, on the basis of the government's identity and nature because the

²²¹ Keay op cit (n8) 515, 516.

²²² Wood op cit (n16) 209, 243; Arner op cit (n16) 391, 392; Warren op cit (n1) 353; Shanker op cit (n17) 340; Jackson op cit (n18) 907.

²²³ For an environment to be appealing to a creditor, the operating environment must be stable so that a creditor can rely on the commercial norms and transact accordingly.

²²⁴ See Chapter 2 '(b)The treatment of creditors'; Visser op cit (n216).

²²⁵ Wood op cit (n16) 211; Shanker op cit (n17) 341.

distinction is based on a premise that is and would have consequences that are contrary to business rescue policy and values. However, this does not mean that a stakeholder's particular circumstances should not influence the ranking of their claims under business rescue. These circumstances and their implications, if consistent with the values and policy of business rescue, may serve as appropriate justification for why claims of such stakeholders are more deserving of satisfaction than others.²²⁶

For example, the government's tax relationship with a corporation is a special debtor-creditor relationship because the debt owed is triggered by certain events rather than negotiated.²²⁷ Tax collection can also involve mechanisms not necessarily available to other creditors, which can extinguish a corporation before business rescue can be attempted.²²⁸ Arguably, the government tax collector is more likely to attempt these routes and not to support business rescue attempts if its interests are not appropriately acknowledged in business rescue proceedings.²²⁹ It is not guaranteed that tax claims will constitute the majority of claims against the debtor corporation (which may allow for influence over the process) so affording tax claims a measure of priority in the hierarchy of ranking of claims would consistently communicate that tax claims will not be ignored under business rescue.

However, some concern has been expressed that affording tax claims some priority results in creditor apathy because accordingly, other creditors will receive decreased dividends which disincentivises their participation in business rescue proceedings and therefore decreases the quality of the business rescue process.²³⁰ It is not appealing for these creditors to volunteer their time and efforts in order to fight for the satisfaction of tax claims.²³¹

This argument rests on the assumption that prioritised tax claims consume the majority of a debtor corporation's available assets.²³² This is usually an incorrect assumption, but it will depend on the facts of each case.²³³ Even if one proceeds on the basis of this assumption, it

²²⁶ Wood *ibid*.

²²⁷ BDO 'Tax could jettison attempts at business rescue' available <https://sataxguide.wordpress.com/2013/03/13/tax-could-jettison-attempts-at-business-rescue/> accessed 28 October 2018.

²²⁸ Morgan *op cit* (n35) 465; Ben-Ishai *op cit* (n29) 123; Visser *op cit* (n216); SARS 'what if I don't agree' available <http://www.sars.gov.za/ClientSegments/Individuals/What-If-Not-Agree/Pages/default.aspx> accessed 28 October 2018.

²²⁹ Morgan *ibid*; Visser *op cit* (n216); Ben-Ishai *ibid* at 133.

²³⁰ Shanker *op cit* (n17) 342-3, 346; Ben-Ishai *ibid* at 127.

²³¹ Shanker *ibid* at 346.

²³² Shanker *ibid*; Salter *op cit* (n33) 354.

²³³ Shanker *ibid* at 346-7.

remains doubtful that this is the source of creditor apathy. If the elimination of a priority for tax claims would significantly decrease the total losses incurred by creditors, there is little economic motivation for these creditors to involve themselves in the business rescue process. This is because it would be certain that the business rescue process would ensure the best return for these creditors, regardless of the extent of their participation. It is a more profitable use of the creditors' resources to concentrate on active enterprises.²³⁴ On the other hand, it may be the case that the creditor's bad debt loss is a relatively small proportion of the creditor's total gross income, and it is thus more commercially prudent to expend time and effort on continuing commercial activities.²³⁵ In either instance, the quantity and priority of tax claims is not the source of creditor apathy in the process. Moreover, creditor participation is limited in the business rescue process so it is unclear how creditor apathy detracts from the quality of a business rescue process.²³⁶ Thus, this cannot be a reason to oppose some affording of priority to tax claims in a business rescue.

(a) Applicable business rescue values

Business rescue culture emphasises the 'fresh start' approach whereby it is acknowledged that the failing of a corporation is a standard risk of corporate commercial activity.²³⁷ Moreover, it is recognised that if certain creditors insist on independently recovering their debts from an ailing corporate debtor, this may constitute the turning point which renders the debtor unable to continue its business which will have a widespread, negative impact on a variety of stakeholders.²³⁸ However, business rescue could ameliorate these negative effects on the broad number of stakeholders.²³⁹

It is therefore important that the tax collector does not view business rescue unfavourably to the extent that it implements collection mechanisms in order to recover as much of its tax claims as possible even if business rescue is a feasible option.²⁴⁰ This would be to the detriment of a struggling debtor corporation and, subsequently, of its variety of stakeholders. Business rescue mechanisms should not be structured so as to alienate the tax collector. However, business rescue should not be expected to cater narrowly for tax claims

²³⁴ Ibid 347-8.

²³⁵ Ibid at 347.

²³⁶ Shanker *ibid* at 348.

²³⁷ Loubser *op cit* (n11) 137; Arner *op cit* (n16) 391; *Kruger supra* (n57) 758; Keay *op cit* (n8) 518.

²³⁸ Warren *op cit* (n1) at 345.

²³⁹ Ibid at 341; Ben-Ishai *op cit* (n29) 117.

²⁴⁰ Ben-Ishai *ibid* at 116, 131; Morgan *op cit* (n35) 504-5; Gross *op cit* (n9) 1033.

because business rescue is of a communitarian nature²⁴¹ and is not intended to be a tax collection mechanism. Instead, the hierarchy of claims needs to balance the economic and social aims of business rescue and thus the interests of a corporation's stakeholders.²⁴² Additionally, it is for the tax collector to take into account, when it decides whether to participate in a business rescue or to exercise its particular collection strategies against an ailing debtor, that it is a special creditor who does not seek satisfaction of its debts for its own sake; tax debts are debts to the community.²⁴³ Therefore, the tax collector has a responsibility to weigh up in each case whether a business rescue²⁴⁴ or its tax collection mechanisms will result in optimal social benefit.

The particular circumstances surrounding tax claims and the powers of the government as a tax collector suggest that some priority for tax claims may potentially encourage critical government support for business rescue. However, it is more persuasive that the nature of tax claims implies that it is the responsibility of the government as a tax collector to take into account its representative and community-minded position in choosing whether to exercise its particular collection strategies against an ailing debtor, or to allow business rescue to take place. The onus falls on the tax collector to act with appropriate circumspection rather than on business rescue to attempt to entice the support of the tax collector. Against this backdrop, the tax collector's ability to collect delinquent tax debts from an ailing debtor corporation through means other than a business rescue is not significantly supportive of the stance that tax claims should be afforded some priority in a business rescue. This line of reasoning instead emphasises the tax collector's contemplative responsibilities rather than a business rescue values-based motivation in favour of some priority for tax claims.

IV. THE GOVERNMENT IS AN INVOLUNTARY CREDITOR WITH RESPECT TO ITS TAX CLAIMS

It has been suggested that the circumstances in which tax claims arise are circumstances that weigh strongly in favour of tax claims being granted some form of priority in a business rescue.²⁴⁵ The situation under consideration is that the government is an involuntary creditor

²⁴¹ Warren op cit (n1) 360, 361; Gross ibid at 1042-3.

²⁴² Wood op cit (n16) 211; Ben-Ishai op cit (n29) 135.

²⁴³ Ben-Ishai ibid at 127; Morgan op cit (n35) 463.

²⁴⁴ There are also tax benefits if other stakeholders benefit from a business rescue or the corporation is rehabilitated; tax can continue to be collected from them. See Ben-Ishai ibid at 124, 132; Morgan ibid at 466.

²⁴⁵ Shanker op cit (n17) 344.

in relation to its tax claims against a debtor company; the government has no choice but to enter into a debtor-creditor relationship with a company that operates within its territory.²⁴⁶ The debtor company pays taxes in reciprocation of the governmental services and programmes that the state is responsible for providing to its citizenry, including the debtor company.²⁴⁷ The government's involuntary creditor status with regard to its tax claims has multiple implications which appear persuasive that tax claims should receive some priority under a business rescue.

First, unlike voluntary creditors, the government cannot choose whether or not to extend credit to a debtor company.²⁴⁸ This is evident from labelling the government an 'involuntary creditor' but it is worth emphasising because this lack of choice weakens the government's position in the debtor-creditor relationship. The government cannot refuse to enter into a debtor-creditor relationship²⁴⁹ regardless of the credit risk represented by a particular debtor.²⁵⁰ Moreover, the government's exposure to the risk of the debtor's insolvency is not outweighed by some profit or business advantage;²⁵¹ this is unlike voluntary creditors who undertake the risk of a debtor's insolvency usually because the transaction is potentially, sufficiently advantageous to the creditor such that the possible risk is acceptable.²⁵² The government involuntarily extends credit to its tax-paying debtors and is required to do so without the benefit of this risk being balanced sufficiently by some proportional advantage to the government.

Secondly, the government is constrained in the ways in which it can adjust the terms of the debtor-creditor relationship to compensate for the risk presented by a particular debtor.²⁵³ The governmental services are provided to the debtor-company before it pays its taxes so unlike other creditors, the government cannot refuse to extend credit and instead demand cash payment of the tax claims, in advance of its performance.²⁵⁴ Furthermore, the amount of tax claims cannot be determined in advance of the government's reciprocal performance which renders it difficult to calculate an appropriate amount of security that could be given to secure

²⁴⁶ Ben-Ishai op cit (n29) 124; Shanker ibid at 345; LoPucki op cit (n58) 1893, 1897.

²⁴⁷ Shanker ibid.

²⁴⁸ Ibid; Arner op cit (n16) 391; Morgan op cit (n35) 464.

²⁴⁹ This refers to the debtor-creditor relationship in which taxes are paid and in return, the government provides particular services which are to the benefit of all its citizens.

²⁵⁰ Ben-Ishai op cit (n29) 124; Shanker op cit (n17) 344-5; LoPucki op cit (n58) 1892; Morgan op cit (n35) 464.

²⁵¹ LoPucki ibid at 1897.

²⁵² Shanker op cit (n17) 344-5.

²⁵³ Ben-Ishai op cit (n29) 125.

²⁵⁴ Shanker op cit (n17) 344-5; Arner op cit (n16) 391; Morgan op cit (n35) 464.

the debtor-company's corresponding performance.²⁵⁵ In addition, tax claims and interest for outstanding taxes are not based on an assessment of the risk of the likelihood of the debtor defaulting but are instead determined according to the type of debtor such as an individual, a trust, a corporation etc.²⁵⁶ A further limitation in the calculation of amounts related to taxes is that this calculation must embody a compromise between economic need and political feasibility.²⁵⁷ Thus, the amount of tax claims does not compensate for the unsecured risk of non-payment of tax by certain debtors.

(a) Applicable business rescue values

The government's status as an involuntary creditor with regard to its tax claims and the implications thereof elicit a certain degree of sympathy because it seems that the conventional benefits and risk-mitigation options accessible to creditors are not available to the government in this particular instance.²⁵⁸ Nevertheless, the weight attributed to the involuntary creditor argument should not depend on the amount of sympathy this argument elicits but must depend on the extent to which it embodies the values and culture of business rescue.

The sympathy elicited may stem from a feeling that the pairing of involuntary creditor disadvantages and limitations, with no priority in the ranking of claims in a business rescue, is inconsistent with the theme of equitable treatment of stakeholders that is prominent in business rescue culture.²⁵⁹ It may sit uneasily not to grant some priority in a business rescue to a creditor with such an inability to prepare for or avoid the risk of a debtor not satisfying its debts. However, 'equitable treatment' under business rescue means that stakeholders must be treated in a fashion that is consistent with the economic and social objectives that business rescue aims to achieve,²⁶⁰ rather than according to some vague notion of what is fair.

A major economic consideration of business rescue is that the business rescue mechanism must be structured so as not to discourage the ready availability of credit.²⁶¹ This

²⁵⁵ Shanker *ibid* at 345; Morgan *ibid*.

²⁵⁶ Arner *op cit* (n16) 391; LoPucki *op cit* (n58) 1897; SARS 'Income Tax rates' available <http://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/default.aspx> accessed 28 October 2018; Deloitte 'Taxation and investment in South Africa 2016' available <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-southafricaguide-2016.pdf> accessed 28 October 2018.

²⁵⁷ Richard J. Kovach 'Personal and political bias in the debate over federal income taxation rates and progressivity' (2006) 21 *Akron Tax J.* 1 at 31.

²⁵⁸ These implications are discussed above.

²⁵⁹ Chan *op cit* (n15) 282, 287.

²⁶⁰ Jackson *op cit* (n18) 907; Wood *op cit* (n16) 210.

²⁶¹ Keay *op cit* (n8) 525; Chan *op cit* (n15) 283; Bradstreet *op cit* (n2) 185; Warren *op cit* (n1) 359.

is important for economic activity. Yet the availability of credit will not be compromised should tax claims not be granted some form of priority in the business rescue rankings. First, the government involuntarily extends credit in the form of tax debts so the ranking of these tax claims in a business rescue will not affect the availability of the services provided in return for the payment of tax. Secondly, the government is limited in the terms on which it extends credit in the form of tax claims,²⁶² and therefore there is a low probability that the ranking of tax claims will render this extension of credit available only at largely inflated and perhaps inaccessible terms.

Moreover, the consideration of the ranking of tax claims in a business rescue needs to take into account the difference between a liquidation culture and a business rescue culture. Liquidation prioritises the delivery of the return on debts to which creditors are entitled.²⁶³ In contrast, business rescue recognises the significance of stakeholders beyond creditors but also attempts to balance the needs of creditors to the extent that their contributions are a necessary element of prolific commercial activity²⁶⁴ that is both economically and socially beneficial for a country;²⁶⁵ the emphasis is that business rescue must be structured so that it is a success and thus achieves economic and social aims beyond solely the repayment of creditors of that to which they are entitled.²⁶⁶ The granting of priority to post-commencement financing, the fees of the business rescue practitioner, and the salaries of employees²⁶⁷ is contributory to the achievement of this different emphasis of a successful business rescue rather than prioritising the repayment of creditors, because these stakeholders are necessary components of a successful business rescue.²⁶⁸ Furthermore, the repayment of secured creditors should be prioritised to an extent because it is consistent with commercial morality to do so²⁶⁹ and

²⁶² This is discussed under the previous heading.

²⁶³ *Kotze* supra (n79) at 120 cited in Loubser op cit (n11) 147.

²⁶⁴ Bradstreet op cit (n2) 185.

²⁶⁵ Chan op cit (n15) 283; Bradstreet ibid at 175.

²⁶⁶ Warren op cit (n1) 345, 346; Keay op cit (n8) 529.

²⁶⁷ This is not necessarily the order of the rankings but a list of stakeholders that have traditionally been prioritised in the corporate reorganisation hierarchy of claims.

²⁶⁸ H Stoop & A Hutchison 'Post-commencement finance – domiciled resident or uneasy foreign transplant?' (2017) 20 *PER* 1 at 17, 21, 29; Wood op cit (n16) 222-3.

²⁶⁹ The securing of credit is a major and conventional manner in which creditors attempt to ensure the repayment of debts, and the return on this extra effort and expense is that an asset will be used to satisfy outstanding debt of the secured creditor rather than being allocated to pay for unsecured debts, particularly when the debtor encounters financial difficulty. It would undermine this premise and thus a fundamental commercial norm upon which commercial activity is based if secured creditors' claims are ranked equally or behind those of unsecured creditors. See Rizwaan Jameel Mokal 'The search for someone to save: a defensive case for the priority of secured credit' (2002) 22 (4) *Oxford Journal of Legal Studies* 687 at 687-8.

business rescue does not seek to undermine commercial morality more than is necessary because it would have a detrimental effect on commercial activity.²⁷⁰

The main remaining stakeholders left to be ranked would be tax claims, the claims of other unsecured creditors, and damages claims. However, the fact that tax claims are a form of involuntary credit would not distinguish them from damages claims²⁷¹ or from many other unsecured creditors whose creditor status may also be involuntary in that they are effectively forced by market conditions and customs of trade to extend unsecured credit to debtors on terms that may not reflect and compensate for the risk of non-payment posed by a debtor.²⁷² However, taxes and the extension of unsecured credit contribute to the creation of a commercially attractive environment while those with damages claims do not further the economic and social aims of corporate reorganisation. This is a relevant distinguishing factor. Therefore, whether tax claims should be granted priority over other unsecured creditors' claims will need to be assessed on the basis of equitable treatment that is judged according to the values and objectives of business rescue.²⁷³ The fact that tax claims are involuntary debts should not be a decisive point in this assessment.

V. TAX PRIORITY IN THE RANKING OF BUSINESS RESCUE CLAIMS PREVENTS THE ABUSE OF BUSINESS RESCUE AS A MEANS OF TAX AVOIDANCE

The premise of business rescue is that the mechanism will achieve either of the two objectives of a business rescue while balancing the rights of all stakeholders²⁷⁴ and adhering to the equitable ranking of creditor repayments that is justified through communitarianism-themed reasoning.²⁷⁵ The failure to grant tax claims some priority in the ranking of creditor repayments could pose the risk of undermining these business rescue policy foundations. It has been suggested that this is because the absence of any tax priority in business rescue makes the business rescue mechanism vulnerable to misuse as a means of a tax escape.²⁷⁶

²⁷⁰ Chan op cit (n15) 281; Warren op cit (n1) 359.

²⁷¹ Damages claimants are evidently involuntary creditors of a debtor corporation.

²⁷² Morgan op cit (n35) 467; Ben-Ishai op cit (n29) 131-2.

²⁷³ A conclusion to this issue will be proposed in the concluding chapter.

²⁷⁴ Companies Act s7(k).

²⁷⁵ Warren op cit (n1) 353.

²⁷⁶ Morgan op cit (n35) 465; Arner op cit (n16) 390-1.

Debtors may be incentivised not to comply with their tax obligations if they are aware that their tax repayment can be circumvented by entering business rescue.²⁷⁷ For example, a struggling debtor may have an interest in or preference for paying specific creditors rather than meeting their tax obligations. Such creditors could be suppliers or employees or the lessors of the business premises.²⁷⁸ The struggling debtor may view these creditors as more directly and immediately useful to and thus valuable for the rehabilitation of the business than the infrastructure supported by tax payments. In such an instance, a struggling debtor could enter business rescue as a way in which to avoid paying its tax claims and rather use those funds to make payment to its strategic creditors (who are ranked more highly than tax claims if tax claims are granted no form of priority).

The avoidance of the payment of tax claims is concerning because it risks undermining the integrity of the tax system. As has been acknowledged prior, the payment of tax claims has broad implications; tax claims are effectively debts owed to more than just the tax service but rather extend to the community who are represented by the tax service and are impacted upon by the repayment or not of these debts.²⁷⁹ Moreover, the avoidance of the repayment of tax claims contradicts the fair duty of each taxpayer to contribute to the discharge of the collective tax burden.²⁸⁰ Furthermore, tax evasion also negatively affects the integrity of the tax system.²⁸¹ This is because modern taxation relies on some form of tax priority as part of its collection process.²⁸² If business rescue were to enable tax evasion by removing any priority of tax claims, it would provide a mechanism to avoid compliance with the tax collection system.²⁸³ This may detract from the tax collection system's effectiveness to such an extent that tax compliance would be severely compromised.²⁸⁴

In some jurisdictions, tax claims are excepted from the debtor's release from all of its debts, following the conclusion of the business rescue;²⁸⁵ this is intended to prevent debtors from exploiting business rescue proceedings in order to evade their tax obligations.²⁸⁶

²⁷⁷ Ben-Ishai op cit (n29) 126.

²⁷⁸ This is an example of creditors who, from the debtor's perspective, may be more indispensable to the debtor's business than the result of paying tax claims. This is not intended to be a comprehensive list.

²⁷⁹ Morgan op cit (n35) 463.

²⁸⁰ Ibid.

²⁸¹ Ben-Ishai op cit (n29) 126.

²⁸² Ibid.

²⁸³ Ibid.

²⁸⁴ Ibid.

²⁸⁵ Arner op cit (n16) 393; Morgan op cit (n35) 474.

²⁸⁶ Morgan ibid at 465.

However, it is necessary to grant these non-dischargeable tax debts some priority so that it becomes more probable that they will be paid in full during the bankruptcy process and thus the debtor will have fewer non-dischargeable debts that remain once the business rescue process has concluded.²⁸⁷

(a) Applicable business rescue values

It is crucial to restate that business rescue aims to balance the provision of fresh start for the debtor with the necessity of considering the rights and interests of creditors, as well as the importance of commercial certainty and social benefit considerations. In practice, this translates to creditors accepting a debt ‘haircut’ in return for the debtor company’s rehabilitation into the market place, or in exchange for the receipt of a greater return on the creditors’ debts than would have been achieved under liquidation²⁸⁸ (though it is likely to be less than the value of the debt because debtors in business rescue lack sufficient assets to satisfy all of their debts).²⁸⁹

However, the premise of this compromise rests on a genuine attempt to achieve either of the two objectives of a business rescue while balancing the rights of all stakeholders²⁹⁰ and adhering to the equitable ranking of creditor repayments that is justified through communitarianism-themed reasoning.²⁹¹ The avoidance of tax claims through business rescue offends the objective of business rescue as well as the social considerations encompassed by business rescue policy.²⁹² Thus, the concern that business rescue will be used as a method tax evasion if tax claims are not granted some priority is consistent with business rescue culture and values.

Secondly, the possible exception of tax claims against the debtor from discharge upon conclusion of the business rescue accords with business rescue policy. This is because the rationale for this exception to the debtor’s ‘fresh start’ premise of business rescue is that it prevents debtors from exploiting business rescue proceedings in order to evade their tax obligations.²⁹³ Yet while the non-dischargeability of tax debts detracts from the ‘fresh start’ of

²⁸⁷ Arner op cit (n16) 393; *ibid*.

²⁸⁸ Companies Act, s128(1)(b).

²⁸⁹ Arner op cit (n16) 392.

²⁹⁰ Companies Act s7(k).

²⁹¹ Warren op cit (n1) 353.

²⁹² This is because tax debts are in effect a debt owed to the community who will suffer the consequences if tax debts are not paid.

²⁹³ Morgan op cit (n35) 465.

the debtor, the prioritising of these non-dischargeable tax debts during the business rescue mitigates this detraction to some extent because it means that the debtor will have fewer debts remaining upon the conclusion of business rescue that will inhibit its ‘fresh start’.²⁹⁴ This combination encapsulates business rescue culture in that it attempts to balance the social benefit considerations that are encompassed by the payment of tax claims, and the emphasis on the debtor’s ‘fresh start’, with the equitable treatment of all creditors. However, if some priority were granted in favour of tax claims but without the non-dischargeability condition, it may not achieve the balancing of interests that business rescue promotes; it may not necessarily prevent the use of business rescue to avoid tax debts and would require further justification that relies on business rescue policy, in order to constitute a warranted departure from the value of the *pari passu* treatment of creditors.²⁹⁵

VI. CONCLUSION

There will always be arguments that can be made by stakeholders as to why they deserve some priority in the ranking of claims in a business rescue.²⁹⁶ The strength of these policy arguments should be evaluated through the lens of business rescue policy and values. This is critical so that decisions made on the basis of these policy arguments support the objectives of business rescue. This chapter demonstrates this approach in the context of arguments in favour of granting tax claims some priority in business rescue’s hierarchy of claims. This approach has exposed that some of the arguments in favour of some tax priority in a business are persuasive in isolation but not when assessed through business rescue policy and objectives, while the persuasiveness of other arguments are reinforced through such an assessment.

²⁹⁴ Arner op cit (n16) 393; Ibid.

²⁹⁵ Arner ibid at 394.

²⁹⁶ Wood op cit (n16) 217.

CHAPTER 4 - THE POLICY ARGUMENTS AGAINST TAX PRIORITY IN A BUSINESS RESCUE

This chapter will present and discuss a few key policy arguments that have been made against a priority ranking for tax collection, in the hierarchy of claims in a corporate reorganisation. The approach of the evaluation will be framed by the business rescue values espoused in Chapter 2 as well as the influence of the shift from a liquidation to a business rescue culture that is elaborated on in Chapter 2.

I. THE IMPACT ON THE AVAILABILITY OF CREDIT

The first argument that is commonly made against the granting of some priority for tax claims revolves around the matter of the availability of credit. Commercial activity relies on the ready extension of credit, on accessible terms, and therefore it is crucial that the structure of corporate reorganisation mechanisms support rather than hinder this.²⁹⁷ The ranking of tax claims in corporate reorganisation's hierarchy of preferences has two key implications with regard to the availability of credit.

First, as discussed in 'Chapter 4: V. The Government Is An Involuntary Creditor With Respect To Its Tax Claims', the government's decision to enter into a debtor-creditor relationship with a taxpayer is not affected by the risk posed by the particular taxpayer nor are the costs of the relationship adjusted according to the level of risk predicted in each relationship. Instead, as a sophisticated, repeat player in the market, the government's tax rates will balance an underestimation and an overestimation of the risk of loss of its tax claims from debtors under corporate reorganisation, in the aggregate. Furthermore, the tax rates i.e. the cost of credit in this debtor-creditor relationship, will be determined by a compromise between economic requirements and what is politically palatable²⁹⁸ rather than the strict risk attendant upon each transaction. Tax rates are not priced so as to generate a profit but rather to cover government costs.²⁹⁹ Thus, the amount of tax payable by a debtor company in return for the government's provision of public services and infrastructure³⁰⁰ will not increase regardless of the risk³⁰¹ that attaches to the particular debtor-creditor relationship. The government's

²⁹⁷ Chan op cit (n15) 283; Keay op cit (n8) 525.

²⁹⁸ Kovach op cit (n257) 31.

²⁹⁹ LoPucki op cit (n58) 1897.

³⁰⁰ This is a form of an extension of credit.

³⁰¹ Such risk would include the ranking of tax claims should the debtor corporation undergo business rescue.

extension of credit in this form contributes to the creation of an attractive commercial environment that facilitates commercial activity. However, the benefits and accessibility of this form of credit to each corporate debtor will not decrease if the priority of tax claims in a business rescue is lowered.

Secondly, if business rescue grants some priority to tax claims, this may jeopardise the ready availability of credit in two ways. First, regardless of what the reality is in each case, creditors of the debtor corporation will perceive such priority as an unknown³⁰² substantial deduction from their own returns in the case of the debtor corporation's business rescue.³⁰³ In response, creditors may attempt to secure their debts against the corporation but this may not be a feasible option for every creditor for the following reasons. The transaction costs to enter into a secured credit agreement are more expensive. Moreover, the benefits of security may not have been deemed to be needed and thus a justifiable expense at the time the transaction was entered into, or the creditor may have viewed itself as less exposed to loss than its competitors and therefore lacked the incentive to outbid its competitors for secured status.³⁰⁴ The result is that there will be unsecured creditors who will need to compensate for the risk of non-satisfaction of their debts, that has increased because some priority has been afforded to tax claims.

These unsecured creditors will have to increase the rates at which they extend credit in order to compensate for the increased risk, or they will refuse to transact with a corporate debtor who they perceive will possibly enter business rescue before their debt is fully satisfied.³⁰⁵ In either of these situations, the availability of credit has decreased because fewer debtors will be able to borrow at the increased rate, or because fewer debtors will be acceptable borrowers, to more cautious creditors.

On the other hand, these unsecured creditors may be unable to adjust their lending rates appropriately or may not practically have the choice to refuse to extend credit to debtors that they perceive as too risky. Creditors may be practically constrained as a result of trade customs in their particular field whereby the extension of credit facilities is the accepted manner in

³⁰² Tax is contingent on many factors and the information necessary to calculate the tax owed by a debtor corporation is unlikely to be available to its other creditors.

³⁰³ Shanker op cit (n17) 346; Salter op cit (n33) 354.

³⁰⁴ LoPucki op cit (n58) 1895.

³⁰⁵ Ibid at 1892.

which transactions proceed.³⁰⁶ Alternatively, a creditor may have to imitate the circumspection in choice of debtors exercised by, or the rate of the extension of credit offered by the creditor's competitors rather than proceeding according to its own assessment, in order to remain competitive.³⁰⁷ Market conditions rather than the creditor's judgment of its own best interests may thus dictate the supply of credit.³⁰⁸

Additionally, creditors may not have the ability to determine the efficient lending price that protects their interests. First, the assumption that uninformed creditors can copy and thus benefit from the conduct of informed unsecured creditors is incorrect for many unsecured credit markets.³⁰⁹ Secondly, markets do not necessarily 'learn'.³¹⁰ Each debtor represents its own micro-market in that it presents a unique risk and requires an individual assessment.³¹¹ It is therefore unlikely in such a situation that creditors who under-price their credit will suffer losses and then adjust. The alternative outcome – that these creditors will instead go bankrupt and then be replaced by creditors who supply credit at an appropriate, higher rate such that market equilibrium will be reached – is an equally unlikely scenario because it would need to occur before the factors unique to such a specific situation change and thus shift the point of market equilibrium.³¹² It is more probable in these circumstances that creditors will not have the knowledge necessary to determine this appropriate rate of credit and creditors will suffer losses for this lack of knowledge such that they are forced to exit the market, and no other creditor can adjust with sufficient speed to take their place.³¹³ The effect of this is that there will be fewer creditors in the market that are available to extend credit.

(a) Applicable business rescue values

The argument presented above proposes that tax claims should not be granted some priority in a business rescue claims hierarchy because to do so would undermine the availability of credit sourced from other creditors while subordination of tax claims would not substantially alter the availability of credit, in the form of tax debts. Business rescue is intended to achieve both social and economic objectives.³¹⁴ An element of this is that corporate reorganisation mechanisms

³⁰⁶ Morgan op cit (n35) 467.

³⁰⁷ Ibid.

³⁰⁸ Ben-Ishai op cit (n29) 131-2.

³⁰⁹ LoPucki op cit (n58) 1955.

³¹⁰ Ibid at 1956.

³¹¹ Ibid.

³¹² Ibid at 1955-6.

³¹³ Ibid.

³¹⁴ Chan op cit (n15) 285.

aim to help develop credit markets, encourage entrepreneurship and raise the efficiency level of economies; they should promote commercial activity.³¹⁵ Corporate reorganisation mechanisms must embody some deference towards the rights of creditors as the co-operation and participation of creditors is a crucial element of commercial activity; creditors are the source of credit.³¹⁶

However, one of the main reasons for the principle of creditor deference in a corporate reorganisation is because this deference aims to protect the availability of credit that is critical for commercial activity;³¹⁷ the protection and encouragement of commercial activity is one of the economic objectives of corporate reorganisation. The availability of tax debts as a form of credit will not significantly decrease regardless of the treatment of tax claims under a business rescue. Thus, the ‘ready availability of credit’ is not an economic objective of South African business rescue that can be used, in this instance, to justify the deviation from the foundational ‘equal treatment of creditors’ principle of corporate reorganisation, with regard to the treatment of tax claims.³¹⁸

In contrast, the ranking of the claims of other creditors behind tax claims, in a business rescue, will increase the risk to which these other creditors are exposed when they transact with the debtor corporation.³¹⁹ In most situations, these creditors will respond by raising the price of access to their credit and/or by becoming more hesitant to extend credit. Where these responses are not practically possible, these creditors will be rendered vulnerable to the consequences of this increased risk. In either scenario, the availability of credit is compromised which is undesirable in the light of the economic objective of promoting commercial activity that underlies corporate reorganisation policy generally.³²⁰

Furthermore, increased vulnerability to the risks posed by transacting with the debtor corporation may result in the forced exit of some creditors from the market. This could have repercussions for other stakeholders such as employees and other customers of the exiting creditor. In such an instance, the social objectives of corporate reorganisation would be undermined.³²¹ Thus, the subordination of the claims of other creditors to tax claims would be

³¹⁵ Calitz op cit (n48) 295; Ben-Ishai op cit (n29) 135.

³¹⁶ Bradstreet op cit (n2) 185.

³¹⁷ Ibid; Warren op cit (n1)359. Keay op cit (n8) 525.

³¹⁸ Wood op cit (n16) 209, 210, 243; Arner op cit (n16) 391, 392; Warren ibid at 353; Jackson op cit (n18) 907.

³¹⁹ Ben-Ishai op cit (n29) 131; Wood ibid at 211.

³²⁰ Calitz op cit (n48) 295; Ben-Ishai ibid at 135.

³²¹ Warren op cit (n1) 345; Keay op cit (n8) 517.

inconsistent with the economic and social objectives of corporate reorganisation. As a result of these policy implications, tax claims should not be preferred over the claims of these creditors, in a business rescue.³²²

II. THE RELATIVE IMPACT ON OTHER STAKEHOLDERS

The second justification against some priority of tax claims in a corporate reorganisation is based on the impact such ranking would have on the robustness of other creditors. The consideration of the ranking of tax claims in the corporate reorganisation claims hierarchy cannot occur in isolation. It is not appropriate to base the judgement of the ranking solely on the attributes of the government as the tax collector, to the exclusion of the contemplation of the effects on and interests of other stakeholders. This is because the foundation of the hierarchy of claims is a decision that the claims of some stakeholders are considered more deserving of satisfaction than the claims of others.³²³ This necessitates that the effects on the government as the tax collector, of the ranking of claims and of the corporate reorganisation, must be viewed relative to the effects on other stakeholders.

The first consideration is the severity of the effect of decreased priority of tax claims when compared with the effect on other creditors, if tax claims rank more highly in the case of a corporate debtor's corporate reorganisation. In short, it is argued that the effect on other creditors of a lowered ranking in the corporate reorganisation claims hierarchy is more substantial relative to the impact experienced by the government should its priority for tax claims be diminished. This proposition is based on the following reasons. First, other creditors are generally individuals or smaller entities than the government.³²⁴ They are also likely to have fewer debtors. Thus, the debts owed by these debtors to 'other creditors' are larger in proportion to the finances of these other creditors than the tax debts of specific corporation creditors are in relation to the government's overall tax income.³²⁵ Moreover, the government has a greater relative ability to spread the risks of default because there are more taxpayers than these other creditors have debtors. Therefore, the effect of a default by specific taxpayers is distributed among the many other performing taxpayers and is less impactful than the default by a

³²² Wood op cit (n16) 211; Shanker op cit (n17) 341.

³²³ Ibid.

³²⁴ It is possible for a creditor to be a large entity with a creditor base as large or larger than the government's tax-paying creditors, but this is not the usual state of affairs.

³²⁵ Ben-Ishai op cit (n29) 128; Morgan op cit (n35) 466; *Fiscal policy* op cit (n203).

corporate debtor on the debts owed to its ‘other creditors’.³²⁶ In addition, the government’s tax collector is a sophisticated, repeat player in the market who should consequently be able to calculate a balanced risk of loss, due to debtor default, and adjust accordingly.³²⁷ This is not necessarily the case for a corporate debtor’s ‘other creditors’ who may be new to the market or unsophisticated, and accordingly unable to estimate appropriately the risk of a corporate debtor’s default.³²⁸ Alternatively or in conjunction with this, ‘other creditors’ may be forced to extend credit at a rate dictated by market forces rather than at a rate that compensates for potential debtor default.³²⁹ Thus, in comparison to the government, ‘other creditors’ of a corporate debtor cannot adequately diversify the risk of the debtor’s default nor can they adjust their rates of credit to compensate for such default.³³⁰ In summary, the effect of these circumstances is that the default of a corporate debtor, on its debts, is proportionally more severe on its other creditors than it is on the government whose tax debts are not wholly satisfied.³³¹

In addition, the government should not require prioritisation of its tax claims in a corporate reorganisation, at the expense of ‘other creditors’ and stakeholders.³³² Such prioritisation does not optimise the distribution of value of a business rescued corporation. This is because the loss experienced by the government, should it have inferior priority for its tax claims, is less than the value that will be created for other stakeholders, should the business rescue rehabilitate the debtor corporation, and less than the value that will flow to ‘other creditors’ as a result of not having their claims against a debtor in business rescue subordinated to another party who may have substantial claims.³³³ Furthermore, the default on such debts to ‘other creditors’ is likely to be proportionally severe as discussed above. The risk is that such default may substantially weaken these ‘other creditors’ of the ailing corporate debtor to the extent that these ‘other creditors’ may be pushed into financial failure themselves.³³⁴

The second consideration relevant to the influence of the relative effect on other stakeholders is whether and to what extent other stakeholders can still benefit should tax claims

³²⁶ Shanker op cit (n17) 342-3; Warren op cit (n1) 357; Ben-Ishai ibid 125-6.

³²⁷ LoPucki op cit (n58) 1956; Ben-Ishai ibid at 125.

³²⁸ LoPucki ibid at 1955-6.

³²⁹ Morgan op cit (n35) 467.

³³⁰ Ben-Ishai op cit (n29) 125.

³³¹ Ibid at 128; Arner op cit (n16) 392-3.

³³² Morgan op cit (n35) 505.

³³³ Ben-Ishai op cit (n29) 124; Shanker op cit (n17) 346.

³³⁴ Morgan op cit (n35) 466.

be granted priority over their claims in a business rescue, as well as the reverse position which asks what benefits would be available to the tax collector. ‘Chapter 4 - II. Prioritisation of Tax Claims is in the Public Interest’ extensively discusses the public interest value that will be attained for other stakeholders should tax claims be granted some priority in a business rescue. However, what remains to be discussed is how the ranking of tax claims as inferior to the claims of other stakeholders, in a business rescue, will not leave tax claims without any form of compensation should a taxpaying debtor corporation enter business rescue. First, what is being argued for is a lower priority for tax claims and not a removal of the ability of tax claims to share in the failing debtor’s estate. The ramification is that even if tax claims are ranked subordinate to other creditors and stakeholders, tax authorities will not be excluded entirely from sharing in the return of a corporate debtor’s estate because they would still be entitled to a portion of the general distribution.³³⁵

Secondly, it is worth highlighting that other creditors and stakeholders are likely to be taxpayers and therefore the tax collector will have tax claims against them as well as against the corporate debtor.³³⁶ An inferior tax priority in business rescue may directly decrease the amount of tax that is collected from a corporate debtor. However, the increased extent of satisfaction of claims by other creditors, that results from subordinating the priority of tax claims to the claims of these parties, may allow these creditors to continue to function and therefore to continue contributing to the discharge of the tax burden.³³⁷ The tax collector indirectly benefits if other creditors are granted greater priority in a business rescue.³³⁸ This specific attribute of tax collection – that tax claims arise against a diversity of creditors – means that even if the corporation in business rescue is not the direct source of the satisfaction of tax claims, the distribution of this debtor’s estate to other taxpaying creditors allows for tax to be indirectly recouped because the tax collector is a creditor of these creditors.³³⁹ Furthermore, decreased tax priority still allows for some satisfaction of tax claims but while not severely affecting other creditors by lowering the extent of the satisfaction of their claims against the ailing debtor.

³³⁵ Ibid at 466-467.

³³⁶ Ben-Ishai op cit (n29) 128.

³³⁷ Ibid; Morgan op cit (n35) 466.

³³⁸ Ben-Ishai ibid at 124, 132.

³³⁹ Ibid at 132.

(a) Applicable business rescue values

First, it should be noted that the reasoning above is distinguishable from the argument put forth and rejected in ‘Chapter 4: III. The State Cannot Afford To Absorb Tax Defaults By Businesses Undergoing Business Rescue Nor Should The State Be Expected To Absorb Such Losses’. Unlike this rejected argument, the reasoning does not suggest that other creditors’ claims should be preferred above tax claims because the tax collector is a more robust creditor whose circumstances could enable it to be less severely affected by debtor default and able to absorb such losses. Instead, it is reasoned that distribution to the other creditors ahead of distribution to the tax collector reflects greater maximisation and optimisation of the value of the debtor corporation. This is because these other creditors will experience a greater gain in value from the preference of their claims over the tax collector’s, than the tax collector will experience a loss in this situation. This is a result of the relative severity of the loss upon these different parties due to their differing positions of power, as well as the fact that the tax collector can still indirectly satisfy some of its tax needs, by taxing these other creditors.

The value optimisation argument is consistent with the shift from a liquidation culture to a business rescue culture. Liquidation culture emphasises the repayment of creditors, strictly according to what they are owed.³⁴⁰ In contrast, business rescue culture advances social and economic objectives, and the maximisation of the value of the company under business rescue must be in furtherance of these dual objectives.³⁴¹ The value optimisation argument embodies an economic goal of corporate reorganisation which is the promotion of economic efficiency.³⁴² Economic efficiency would encourage a distribution of the debtor company’s value in such a way that the receipt of the company’s value is most significant to those among whom it is divided. As explained above, this may involve distribution of the debtor company’s value to its other creditors, instead of to the tax collector, because of the difference in the proportional value to these parties. Furthermore, this order of preference would be more economically optimal because more parties would benefit; other creditors would have their debts owed by the debtor company partially satisfied and the tax collector would benefit from being able to tax these other creditors. In contrast, preference for tax claims would exclude these other

³⁴⁰ *Kotze* supra (n79) at 120 cited in *Loubser* op cit (n11) 147.

³⁴¹ *Calitz* op cit (n48) 294; *Ben-Ishai* op cit (n29) 116.

³⁴² *Chan* op cit (n15) 282-3.

creditors from possible amelioration of the debtor-company's failure that is intended to be offered by corporate reorganisation.

Moreover, some return on the debts by the debtor company is relatively more impactful on other creditors, besides the tax collector, because it may be decisive as to whether these creditors are able to continue in the market. The structure of corporate reorganisation needs to support their continuation for two reasons. First, it would be contrary to corporate reorganisation's economic goal of encouraging commercial activity³⁴³ if the mechanism is structured so as to prefer the tax collector's claims although this may force other creditors out of the market. This inconsistency with this corporate reorganisation objective of encouraging commercial activity is further compounded by the fact that preference of these other creditors would not precipitate the failure of the tax collector whose superior diversity of creditors would enable it to absorb the default.³⁴⁴

Secondly, there may be social harm caused if these other creditors fail as a result of business rescue not facilitating the partial satisfaction of their claims. This is because other stakeholders may be reliant on the functioning of these creditors and therefore their exit from the market will have knock-on effects on these other stakeholders who may, for example, lose their employer, credit provider, supplier or source of tax.³⁴⁵ Thus, in the light of business rescue's economic and social aims as well as the shift from a liquidation culture to a business rescue culture, it would not be appropriate to grant tax claims some priority, particularly over the claims of other creditors.

III. THE TAX COLLECTOR'S PARTICULAR ABILITIES

The third line of reasoning against tax claim priority in a business rescue relies on the tax collector's specialised monitoring and collection abilities. When financially ailing corporations enter into corporate reorganisation proceedings, this stays collection on debts by the corporation's debtors.³⁴⁶ Preceding this entry into corporate reorganisation, the debtor corporation's creditors are often unaware of the serious financial difficulties of the debtor

³⁴³ Calitz op cit (n48) 295; Ben-Ishai op cit (n29) 135.

³⁴⁴ Shanker op cit (n17) 342-3; Ben-Ishai ibid at 125-6.

³⁴⁵ Warren op cit (n1) 345; Keay op cit (n8) 517-18.

³⁴⁶ A moratorium on creditor claims is common to many corporate reorganisation systems. Warren ibid at 348; Chan op cit (n15) 286; Conradie and Lamprecht op cit (n6) 13; David Morrison and Colin Anderson 'Is corporate rescue a realistic ideal? Business as usual in Australia and the UK' (2015) *Festschrift for Ian Fletcher* 1 at 4; Ben-Ishai op cit (n29) 118-19; Wood op cit (n16) 201; LoPucki op cit (n58) 1946.

corporation³⁴⁷ or are hugely limited in the ways by which they could attempt to enforce repayment of the debts owed to them.

However, the tax collector is privy to information regarding the debtor corporation's financial state and is granted special collection methods for its tax debts, which are not available to other creditors, in order to enforce their debts against a debtor corporation.³⁴⁸ Arguably, the differentiation of the tax collector by these additional abilities is a reason to grant the tax collector a lower ranking in the business rescue claims; the tax collector is particularly able to detect when a debtor corporation is ailing and has multiple methods at its disposal to collect its tax debts before business rescue commences.³⁴⁹ In such circumstances, the allocation of some form of tax priority in business rescue would reward delinquent collection efforts.³⁵⁰

(a) Tax collector's monitoring capabilities

First, the tax collector receives regular tax reports from its debtor corporations.³⁵¹ These tax reports or their absence thereof are indicative of the debtor corporation's financial health.³⁵² Such information is not provided to the corporation's other creditors and tax information of other taxpayers is not publicly available.³⁵³ This causes a power imbalance between the tax collector and other creditors whose detriment will be further compounded if tax claims are also ranked ahead of theirs in the business rescue claims hierarchy.³⁵⁴ Unlike tax authorities, other creditors cannot conduct their affairs in accordance with the knowledge of a debtor corporation's struggling financial circumstances.³⁵⁵ Thus, such creditors must rely on a ranking of their claims in the business rescue hierarchy in order to obtain some return on the credit which they have extended.

³⁴⁷ Ben-Ishai *ibid* 126; Morgan *op cit* (n35) 468.

³⁴⁸ Prinsloo, N 'Do you owe SARS money?' available https://www.findanaccountant.co.za/content_owe-sars-money accessed 28 October 2018; Morgan *ibid*.

³⁴⁹ These methods of monitoring and collection will be explained below.

³⁵⁰ Ben-Ishai *op cit* (n29) 126; Morgan *op cit* (n35) 468.

³⁵¹ Morgan *ibid* at 468, 473; Ben-Ishai *ibid*; SARS 'Tax periods for VAT vendors' available <http://www.sars.gov.za/TaxTypes/VAT/Pages/Tax-periods-for-vat-vendors.aspx> accessed 28 October 2018; Nyasha Musviba 'South Africa: VAT essentials' available <http://www.sataxguide.co.za/south-africa-vat-essentials/> accessed 28 October 2018; Tax Administration Act 28 OF 2011, s25; s72 ; GC Palmer 'Tax administration – returns and records' in Ashleka Kanjan *The Law of South Africa* vol 22 Second Edition Replacement Volume (2018) Part 3 at 31.

³⁵² Morgan *ibid*; *returns and records* *ibid*; GC Palmer 'Tax administration – inspection, request for relevant material, audit and criminal investigation' in Ashleka Kanjan *The Law of South Africa* vol 22 Second Edition Replacement Volume (2018) Part 3 at 56.

³⁵³ Ben-Ishai *op cit* (n29) 126; Morgan *ibid*; Tax Administration Act s69(1).

³⁵⁴ Ben-Ishai *ibid*.

³⁵⁵ Morgan *op cit* (n35) 468.

Secondly, tax authorities have access to investigative mechanisms, in addition to tax reports, so that a taxpayer corporation's taxes can be assessed;³⁵⁶ this necessarily provides tax authorities with insight into the financial state of this taxpayer.³⁵⁷ Such additional investigative mechanisms include the conducting of an audit or criminal investigations,³⁵⁸ search without a warrant for relevant material that is reasonably foreseeable to be relevant to the administration of tax,³⁵⁹ and the ability to require taxpayers to submit material that, in the opinion of the tax authorities, is relevant to the administration of tax.³⁶⁰ It is clear that the tax authorities have a capability beyond those of other creditors, to assess and to be aware of a debtor corporation's financial standing. As will be discussed below, tax authorities also have special collection abilities that allow them to strengthen their position in recognition of a debtor corporation's financially precarious standing.

(b) Tax collector's collection capabilities

Tax collectors are provided with certain powers to enable them to fulfil their duty of collecting tax.³⁶¹ Furthermore, these special collection powers are also intended to compensate for the disadvantages that tax collectors experience as a result of their being involuntary creditors³⁶² against a corporate debtor.³⁶³ The mechanisms commonly made available to tax collectors in order to strengthen their position are: the imposition of penalties and higher-than-normal interest rates, third party liability and garnishing orders, and court judgment.³⁶⁴

First, the imposition of penalties and higher interest rates are not collection mechanisms as such in that they do not enable tax collectors to enforce upon outstanding tax debts. However, these mechanisms impose a not insubstantial financial burden on non-compliant taxpayers.³⁶⁵

³⁵⁶ *relevant material, audit and criminal investigation* op cit (n352); Morgan *ibid* at 473.

³⁵⁷ Morgan *ibid* at 468.

³⁵⁸ Tax Administration Act, Part B, Chapter 5.

³⁵⁹ *Ibid* s63, s1, s3(2).

³⁶⁰ *Ibid*, s46.

³⁶¹ Keulder, C 'Pay now, argue later rule – before and after the Tax Administration Act' (2013) 16 *Potchefstroom Elec. L.J.* 124 at 126.

³⁶² These disadvantages were discussed previously in Chapter 4: V. The Government Is An Involuntary Creditor.

³⁶³ Morgan op cit (n35) 467, 505; Ben-Ishai op cit (n29) 126.

³⁶⁴ Morgan *ibid* at 467, 473, 474; Ben-Ishai *ibid*.

³⁶⁵ Morgan *ibid*; Ben-Ishai *ibid*; GC Palmer 'Tax administration –percentage-based penalty' in Ashleka Kanjan *The Law of South Africa* vol 22 Second Edition Replacement Volume (2018) Part 3 at 236; BusinessTech 'SARS to impose penalties for outstanding corporate income tax returns' available <https://businesstech.co.za/news/finance/275257/sars-to-impose-penalties-for-outstanding-corporate-income-tax-returns/> accessed 28 October 2018; Tax Administration Act, s213(1); Income Tax Act 58 of 1962; Value-added Tax Act 89 of 1991 s39; Pierre Moolman 'Changes to VAT compliance rules' (2017) *The South African Insurance Industry Survey* 53 at 53.

An ailing debtor corporation may, as result of the possible imposition of penalties and high interest rates following its non-payment of its taxes, be encouraged to pay its taxes rather than incur further penalties which would contribute to the weakening of its financial position. Tax penalties and high interest potentially incentivise debtor corporations not to become heavily indebted to tax collectors. If these mechanisms accordingly decrease the amount of tax debts, it may be preferable to rank the claims of other creditors above those of the tax collector in a business rescue because these creditors cannot encourage or penalise the non-repayment of their debts, to the same extent as the tax collector, before business rescue is commenced.³⁶⁶ Consequently, the debtor corporation may be more heavily indebted to these other creditors and these creditors more severely out of pocket.

In a similar vein, the tax collector can approach a court for civil judgement for the recovery of tax deemed to be owing, even if the tax assessment is subject to an objection or appeal.³⁶⁷ While this may not equate to the tax collector actually retrieving the debt from the debtor corporation, it is a strong incentive for the debtor to settle its tax debt because there are serious legal repercussions of disobeying a court order. This differs from the recourse available to other creditors where the debtor corporation has not performed. In such a matter, a court would only enforce specific performance on the terms demanded by the creditor, once it has been determined that those were the terms of performance that were agreed upon by the debtor and creditor; the performance tendered must constitute a breach of the agreement before specific performance can be ordered.³⁶⁸ In a dispute that concerns the content of an obligation, a court would not order a debtor to perform an obligation and only after performance, judge whether the nature of the obligation due was that as contended by the debtor or the creditor. This recourse available to tax collectors, even when the tax assessment is disputed,³⁶⁹ is exceptional.

In addition, the tax collector may approach the courts for a preservation order in instances where preservation of certain assets is reasonably required to serve the collection of due and owing, or future due and owing tax debts.³⁷⁰ This too is exceptional because it is available even

³⁶⁶ Morgan *ibid* at 506.

³⁶⁷ Tax Administration Act, s172.

³⁶⁸ WA Joubert and JA Faris 'Contract – specific performance' in Ashleka Kanjan *The Law of South Africa* vol 9 Third Edition Volume (2014) at 420.

³⁶⁹ In these circumstances, the content of the performance owed is the amount of debt payable by the debtor corporation.

³⁷⁰ GC Palmer 'Tax administration – payment of tax' in Ashleka Kanjan *The Law of South Africa* vol 22 Second Edition Replacement Volume (2018) Part 3 at 183; Tax Administration Act, s163.

if the taxpayer disputes that such a tax debt exists.³⁷¹ A preservation order enables the tax collector to prevent tax evasion through the dissipation of assets the value of which is viewed as required for the collection of tax debts.³⁷² A preservation order, to some extent, enables the tax collector to prevent a debtor company from conducting itself in a way that endangers the repayment of tax debts; the tax collector can improve its chance of being able to collect its tax debts.

On the other hand, tax collectors can also ensure the actual collection and receipt of their tax debts despite some reluctance of the debtor corporation itself. Tax collectors can enforce the debts of debtor corporations by claiming the money from third parties who hold or owe funds³⁷³ to the debtor corporation.³⁷⁴ If third parties fail to provide the funds claimed to the tax collector, these third parties can also be held personally liable for the debtor corporation's tax debts and the amount may then be collected from them.³⁷⁵ This mechanism is powerful because it allows the tax collector to enforce satisfaction of the debtor corporation's tax debts, without the co-operation of the debtor.

In summary, the tax collector is particularly enabled to monitor and collect its tax debts, before it becomes necessary for a debtor corporation to enter business rescue. If the tax collector is reasonably diligent in the exercise of its monitoring and collection abilities, business rescue will not become a haven for tax evaders, regardless of the ranking of tax claims in the business rescue hierarchy of claims. Thus, it seems preferable to rank the claims of other creditors, who do not have access to the tax collector's special abilities, above tax claims. This would help to minimise the effect of a business rescue on these creditors, who are largely limited in the manner in which they can monitor and enforce the debts owed to them.

(c) Applicable business rescue values

The underlying theme of the argument above is that the tax collector is particularly able to monitor the financial status of debtor corporations and may make use of exceptional collection

³⁷¹ Ibid.

³⁷² Ibid.

³⁷³ For example, a bank that holds funds on a behalf of a corporation, owes these funds to the debtor corporation.

³⁷⁴ Morgan op cit (n35) 467; GC Palmer 'Tax administration – collection of debt from third parties' in Ashleka Kanjan *The Law of South Africa* vol 22 Second Edition Replacement Volume (2018) Part 3 at 200; Tax Administration Act s179.

³⁷⁵ Morgan ibid at 474; Ben-Ishai op cit (n29) 126; *Third party appointments* ibid; *collection of debt from third parties* ibid; Tax Administration Act s179; Stassen, C 'SARS: Extended powers to recover tax debt' available <http://www.thesait.org.za/news/138868/Opinion-SARS-Extended-Powers-To-Recover-Tax-Debt.htm> accessed 28 October 2018; Ramabulana op cit (n188) 21.

mechanisms to recoup tax debts. If it is noted by the tax collector, through its monitoring mechanism, that a debtor corporation's financial state is declining, the tax collector can use the collection mechanisms particularly available to it, to attempt to recoup its tax debts before a business rescue commences. In contrast, other creditors do not have access to such insight into their debtor's financial state nor access to such collection mechanisms. Thus, other creditors may be left in a worse position than the reasonably diligent tax collector, when the debtor corporation enters business rescue.³⁷⁶

Admittedly, it is important that tax collection occurs. The payment of taxes enables the government to provide critical services to the public.³⁷⁷ Furthermore, the payment of taxes collected by the debtor corporation, on behalf of the tax collector, contributes toward important employee support systems such as unemployment insurance and pensions.³⁷⁸ Therefore the granting of exceptional and powerful monitoring and collection mechanisms to the tax collector is apt. Yet in the context of the tax collector's specialised monitoring and collection mechanisms, it is inappropriate to grant tax claims some priority in the business rescue ranking of claims; this would condone and possibly encourage tax collectors not to make use of the mechanisms that are specifically provided to them and to which other creditors do not have access.³⁷⁹ These other creditors would then have to bear the burden of the tax collector's lack of diligence.³⁸⁰ Moreover, business rescue is not intended to function as one of the tax collection mechanisms that is made available to tax collectors. A successful business rescue enables a debtor company to continue in existence on a solvent basis, or results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.³⁸¹ Tax collectors are not singled out as the creditor for whom business rescue should result in a better return than from a liquidation.

Secondly, corporate reorganisation aims to achieve a balancing of social and economic interests.³⁸² While the payment of tax debts represents an important social interest, corporate reorganisation does not intend to disregard the interests of creditors simply on the basis that a competing social interest exists.³⁸³ Corporate reorganisation recognises the interests of

³⁷⁶ Ben-Ishai *ibid.*

³⁷⁷ Shanker *op cit* (n17) 345.

³⁷⁸ Morgan *op cit* (n35) 472.

³⁷⁹ *Ibid* at 483; Ben-Ishai *op cit* (n29) 126.

³⁸⁰ Ben-Ishai *ibid.*

³⁸¹ Companies Act, s128(1)(b).

³⁸² Chan *op cit* (n15) 285; Warren *op cit* (n1) 360, 361.

³⁸³ Bradstreet *op cit* (n2) 185; Gross *op cit* (n9) 1032-3.

creditors as a crucial economic factor because the availability of credit at accessible rates is dependent on the treatment of creditors.³⁸⁴ Furthermore, the availability of accessible credit stimulates economic activity which leads to social benefits.³⁸⁵ Thus, both tax claims and the claims of other creditors represent economic and social interests. However, the argument against some tax priority – that the tax collector has collection advantages over other creditors who would then be more severely disadvantaged in a business rescue should tax claims be granted some priority and therefore such priority should not be granted – is consistent with the premise of balancing stakeholder interests and equitable treatment of claims that are foundational to corporate reorganisation. Thus, it is a persuasive argument because it aligns with business rescue's values.

IV. CONCLUSION

Throughout this chapter, it has been emphasised that corporate reorganisation attempts to balance a variety of interests and to achieve both social and economic objectives. Policy arguments that propose that tax claims not be granted some priority in the business rescue hierarchy of claims need to accord with these underlying premises of corporate reorganisation. If this approach is not taken, it is difficult to judge the value of the policy arguments because any policy justification favours certain stakeholders and disadvantages others. This renders it difficult to decide what the 'right' course of option would be. It is crucial that the ideals of corporate reorganisation are used to evaluate the policy arguments so that changes to the corporate reorganisation mechanism that are effected as a result of the policy arguments, are consistent with what the mechanism is trying to achieve. Otherwise, the risk is run that the corporate reorganisation mechanism will be distorted by those with the better skills of persuasion rather than bettered by proposals that support corporate reorganisation's ultimate objectives.

The arguments presented in this chapter are thematically consistent with the objectives of corporate reorganisation. They support an equitable approach to the interests of stakeholders and the balance between social and economic interests. Furthermore, they seek to ensure that the integrity of the corporate reorganisation mechanism is maintained, rather than allowing it

³⁸⁴ Bradstreet *ibid*; Chan *op cit* (n15) 283; Keay *ibid* at 525.

³⁸⁵ Bradstreet *ibid* at 175; Chan *ibid*.

to be manipulated to serve the interests of the tax collector, at the expense of the values that underlie business rescue culture.

CHAPTER 5 – CONCLUSION

I. SHOULD TAX CLAIMS BE PREFERRED CLAIMS IN A BUSINESS RESCUE?

The decision as to how to rank tax claims in a business rescue is a difficult one. Tax claims encompass a myriad of social and economic considerations and these would need to be weighed up against and compared to the interests of other stakeholders who have claims against the debtor company undergoing business rescue. Such a broad and comprehensive comparison is beyond the scope of what this dissertation could discuss. Instead, the question was narrowed to ask whether tax claims should be granted some priority in the hierarchy of claims in a business rescue, which would mean ranking it as a preferred rather than concurrent creditor, or whether it should remain in the concurrent group.

In the investigation of this question, the interests and the role of other unsecured creditors frequently became a pertinent comparator. This is because other unsecured creditors share many characteristics with the tax collector: their claims are also concurrently ranked in business rescue, in practice their extension of credit is involuntary and the adjustment of the terms on which it is extended may be limited, and they too embody social and economic interests. The ranking of tax claims has implications for these unsecured creditors and the conclusion reached could place tax claims in front of or concurrent with the claims of other unsecured creditors.

(a) Critical assessment of the arguments in favour of some tax priority that are consistent with business rescue's policy and values

Chapter 3 concluded that three of the policy arguments discussed aligned with the values and policy of business rescue. First, that some prioritisation of tax claims is in the public interest. This reasoning implicates social and communitarian, as well as economic considerations. However, it should be noted that this argument appears to rely on the notion that an overwhelming number of business rescues occur. Thus, a failure to grant some tax priority in business rescue will lead to a massive shortfall in taxes. Yet this does not align with business rescue policy or practical reality. Business rescue is intended to be limited to cases where it is a feasible option. Often, ailing companies will have weakened to a point of no-return in which case business rescue will not be appropriate. It is less common that ailing companies will be suitable business rescue candidates. Thus, the floodgates of business rescue will remain only ajar and massive tax losses are unlikely to occur to the extent that unmanageable social impact will result.

Secondly, it was emphasised that the state cannot afford to absorb the losses of non-repayment of tax claims by businesses undergoing business rescue nor should the state be expected to absorb such losses. This reasoning highlights the social risks that are taken if apparently more financially robust creditors are expected to absorb debtor corporations' default as well as the fact that commercial morality would be compromised which is both socially and economically worrying. Yet legislation could limit the infringement of commercial morality only to the tax collector and justify this limitation in the light of the special nature and characteristics of the tax collector.

Thirdly, some tax claim priority in business rescue's claims hierarchy will prevent the abuse of business rescue as a means of tax avoidance. This argument emphasises the public interest in tax payments not being circumvented, and the social and economic implications there-of, and that the integrity of the tax system should not be compromised. Yet this argument should be viewed with caution. It relies on the premise that the only element of a business rescue that prevents tax evasion is the ranking of tax claims. Arguably, some investigation should be undertaken into the entry requirements for a business rescue because possibly, it is the role of the entry threshold and procedure to ensure that business rescue is genuinely and realistically being undertaken rather than being abused as means of tax evasion. Moreover, an in-depth evaluation of the tax system's monitoring and collection mechanisms would be appropriate because the effectiveness of these mechanisms as well as the circumstances in which the tax collector chooses to use them are likely to be more influential in preventing the abuse of business rescue to avoid tax payments and in upholding the integrity of the tax system.

(b) Critical assessment of the arguments against some tax priority that are consistent with business rescue's policy and values

In fact, it was argued in Chapter 4 that some tax priority in business rescue compromises rather than maintains the integrity of the tax system. This is because the tax collector has special abilities to monitor the financial status of its taxpayers, and has exceptional collection mechanisms that are available to it and to no other creditor. These mechanisms are designed so that the tax collector can enforce tax collection to a greater extent. If the tax collector does not use these specialised mechanisms and instead relies on a more prioritised ranking in business rescue in order to collect tax, this undermines the integrity of the tax system. This is because it allows for the neglect of the allocated tax collection mechanisms that are foundational to the tax system. Furthermore, it distorts the nature of the business rescue mechanism into a tax

collection mechanism rather than supporting its social and economic objectives. Some tax priority may incentivise delinquent tax collection while removing such priority may encourage the tax collector to use the mechanisms provided to it.

Moreover, other creditors such as the unsecured creditors who currently rank concurrently with the tax collector's claims in business rescue, would bear the burden of lazy tax collection if tax claims were prioritised over their claims. This seems inequitable in the light of the fact that these unsecured creditors could not monitor or collect their debts to the same extent that the tax collector can. It may be that the tax collector lacks sufficient human resources to utilise its monitoring and collection mechanisms adequately. Yet this is a practical issue that can be remedied by a practical solution. However, the integrity of the tax system and the power imbalance between unsecured creditors and the tax collector is a policy issue and is thus not altered by practical hitches that can be smoothed over. Policy is the foundation of practice and it is critical that values and normative objectives are not obscured by excuses of practical difficulties which can be resolved.

Furthermore, the burden of increased tax priority would be relatively more severe on unsecured creditors than the loss that the tax collector would experience if it were not granted some tax priority and even if unsecured creditors' claims were ranked ahead of the tax collector's claims. The impact experienced by unsecured creditors would lead to proportionally more substantial economic and social consequences.

Lastly, a pivotal argument against affording tax claims some priority in a business rescue is that it would significantly compromise the availability of credit. An important rationale behind the business rescue mechanism is that, for the sake of the economic and social influence that functioning companies exercise, it is critical that ailing companies be rehabilitated where possible so that the impact of their failure is mitigated. An effective business rescue mechanism is intended to contribute to commercial activity. However, some tax priority in business rescue forces unsecured creditors to make credit more expensive and more cautiously extended to compensate for this increased risk, or it will force some creditors out of the market. This detracts from commercial activity as readily available and accessible credit is a prominent element of commercial activity.

(c) A comparison of the arguments for and against some tax priority in a business rescue

Logical arguments both for and against some priority for tax claims in the business rescue claims hierarchy can be made so as to be consistent with business rescue's normative objectives and values. However, what becomes clear is that the arguments in favour of some tax priority rely heavily on the social and the corresponding economic impact that are linked to the default on tax claims by debtor corporations undergoing business rescue. On the other hand, the arguments against some tax priority emphasise the serious economic consequences that may arise from increasing the priority of tax claims as well as the fact that this will have significant social consequences. Moreover, the tax collector need not rely on business rescue to enforce its tax debts, and it is more equitable and appropriate that the tax collector should make use of the exceptional monitoring and collection powers that have been granted to it.

It has become apparent that the policy arguments in favour of some tax priority, while compelling in some instances, can lack nuance. However, the arguments against some priority for tax claims in a business rescue align with and support the normative objectives and values of business rescue. Furthermore, these arguments embody the attempts at balancing social and economic interests that are at the core of business rescue policy. Thus, it can be concluded that tax claims should not be granted some form of priority in business rescue's hierarchy of claims; they should remain concurrent claims.

II. RECOMMENDATIONS

This dissertation explored the question of whether tax claims should be granted some priority in a business rescue and concluded that tax claims should remain concurrent claims in the ranking of business rescue claims. Yet the exploration of the question surrounding tax claims shone some focus on the importance of and disadvantages faced by other unsecured creditors who are also concurrently ranked in business rescue's hierarchy. Further study should be conducted as to whether the claims of other unsecured creditors should remain concurrent or whether they should be granted some priority and thus be prioritised ahead of tax claims. Such study may add to this dissertation's investigation because it would examine another perspective of the research question which is whether the ranking of tax claims in a business rescue should be lowered beneath other claimants.

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