

**THE EVOLUTION OF  
THE CORPORATE RULES**

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CRNCAR006**

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## Declaration

I, Carel Jacobus Cornelissen, hereby declare that this thesis is my own original work and that all sources have been accurately reported and acknowledged. Moreover, this document has not previously in whole or in part been submitted at any university in order to obtain an academic qualification.

Signed by candidate

Signed:

Date: 22/05/2009

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## Synopsis

The aim and objective of the intended research under the abovementioned title is as follows:

- Discuss the ambit of the corporate rules and the purpose for their enactment.
- Provide an overview of the history of the corporate rules, in general, and some of the major year on year amendments, in particular, since their inception.
- Highlight the significance of some of the major amendments, express a view on shortcomings, if any, and suggest further amendments, where necessary.
- Discuss the relevant sections in the new Companies Bill and the affect it may have on the application of the corporate rules.
- Discuss the extent of group taxation in short and consider, on a very high level, the advantages and disadvantages of introducing a group taxation regime in South Africa.

## Index

<b>Contents</b>	
<b>Declaration</b>	<b>2</b>
<b>Acknowledgements</b>	<b>3</b>
<b>Synopsis</b>	<b>4</b>
<b>Preface</b>	<b>9</b>
<b>Chapter 1: Introduction</b>	<b>11</b>
1.1 Background	11
1.2 Interpretation	14
1.3 Enter the corporate rules	17
<b>Chapter 2: The corporate rules</b>	<b>21</b>
2.1 Introduction	21
2.2 Company formations	22
2.2.1 Ambit	22
2.2.2 Extent of roll-over relief	23
2.2.3 Anti-avoidance	24
2.2.4 Exclusions	27
2.3 Share-for-share transactions	27
2.3.1 Ambit	27
2.3.2 Extent of roll-over relief	28
2.3.3 Anti-avoidance	29
2.3.4 Exclusions	30
2.4 Amalgamations	30
2.4.1 Ambit	31
2.4.2 Extent of roll-over relief	31

2.4.3	Anti-avoidance	31
2.4.4	Exclusions	32
2.5	Intra-group transactions	32
2.5.1	Ambit	32
2.5.2	Extent of roll-over relief	32
2.5.3	Anti-avoidance	33
2.5.4	Exclusions	34
2.6	Unbundling transactions	34
2.6.1	Ambit	34
2.6.2	Extent of roll-over relief	35
2.6.3	Anti-avoidance	36
2.6.4	Exclusions	36
2.7	Transactions relating to liquidation, winding-up and deregistration	37
2.7.1	Ambit	37
2.7.2	Extent of roll-over relief	37
2.7.3	Anti-avoidance	38
2.7.4	Exclusions	38
2.8	Commentary	39
<b>Chapter 3: Significant amendments in the history of the corporate rules</b>		<b>40</b>
3.1	Background	40
3.2	Elective versus mandatory relief	42
3.3	The meaning of “equity share”	45
3.4	The meaning of “qualifying interest”	46
3.5	Financial Instrument Holding Companies	49
3.6	Loss roll-overs	54

3.7	Consideration other than shares	55
3.8	De-grouping	57
3.9	Conclusion	63
	<b>Chapter 4: Company law and group relief measures</b>	<b>65</b>
4.1	Introduction	65
4.2	Background	65
4.3	The Companies Bill	68
	4.3.1 Categories of companies	68
	4.3.2 Close Corporations	71
	4.3.3 Capitalisation	72
	4.3.3.1 Subscription of shares	73
	4.3.3.2 Consideration for shares	74
	4.3.3.3 Financial assistance	75
	4.3.4 Subsidiary relationships and control	75
	4.3.5 Solvency and liquidity vis-à-vis business rescue	80
	4.3.5.1 Debt forgiveness	81
4.4	Conclusion	83
	<b>Chapter 5: Group taxation</b>	<b>84</b>
5.1	Introduction	84
5.2	Background	84
5.3	Corporate groups and company law	87
5.4	Corporate groups and taxation	88
	5.4.1 Defining a "group of companies"	89
	5.4.2 Advantages, disadvantages and feasibility of a group taxation regime	91

5.5	Conclusion	95
	<b>Chapter 6: Conclusion</b>	<b>96</b>
	<b>Bibliography</b>	<b>100</b>
	<b>Appendix 1: History of the corporate rules</b>	<b>105</b>
1.	Section 41	105
2.	Section 42	110
3.	Section 43	114
4.	Section 44	115
5.	Section 45	116
6.	Section 46	117
7.	Section 47	119
	<b>Appendix 2: Part III of Chapter II of the Income Tax Act</b>	<b>122</b>

## Preface

This research report forms the final part in fulfillment of the requirements of the Master of Commerce (Taxation) degree at the University of Cape Town. This study endeavours to cover the history and evolution of some of the provisions contained in Part III of Chapter II of the Income Tax Act No. 58 of 1962 ("the ITA"), as amended.

Part III of Chapter II (comprising sections 41 to 47) provides for roll-over relief, to some extent, in respect of transactions between group companies or between founding shareholders and their companies. These provisions are colloquially referred to as "the corporate rules".

The promulgation of the corporate rules followed soon after the introduction of the Eighth Schedule to the ITA.

This report commences with a background to the general thought behind the corporate rules in Chapter 1, followed by an introduction to the ambit and structure of the various transactions comprising the corporate rules in Chapter 2. Chapter 3 highlights some significant amendments during the tenure of the corporate rules. Chapter 4 analyses the effect the provisions of the Companies Bill may have on future application of the corporate rules, whereas Chapter 5 gives a brief introduction to group taxation and explores, on a very high level, the need for a group taxation regime in South Africa. Finally, Chapter 6 concludes the study by commenting on the balance to be struck between the politics of National Treasury's obligation towards the *fiscus* and the general populace vis-à-vis the contributing taxpayer's need for appreciation, in which instance the corporate rules plays a significant role.

This report further incorporates two appendices to complete the study and serve as reference guides. Appendix 1 summarises the history (in terms of the major year on year amendments) of the corporate rules since their enactment. Appendix 2 comprises Part III of Chapter II of the ITA, updated to include all legislative amendments up and until 30 January 2009.

## Chapter 1

### Introduction

*“After equity, simplicity is perhaps the next most universally sought after of qualities in individual taxes and tax systems as a whole: like fairness it is a word that, in this context, points to a complex of ideas.”<sup>1</sup>*

#### 1.1 Background

Many academic expositions of tax law may lead you to believe that taxation is grounded in the exact science (or at least in economics) and, therefore, that it progresses over time ie as scientific knowledge improves, tax law gets better.

However, the actual evolution of tax law has been nothing like the linear progression suggested by this view. In fact, the development of tax law tends to go in cycles, with different ideas being born, dying and then re-born.<sup>2</sup> It is said that, at its heart, taxation is all about politics, the relationship between citizens and the state and the proper size of the public sector.<sup>3</sup> When it comes to taxes on capital gains or wealth, the reality is even more glaring. As a result of the painful disparities of income levels and wealth in South Africa the issue of taxes on capital is emotive and highly politicised.<sup>4</sup>

The public profile of tax, especially tax risk management, has once again been put in the spotlight by regulatory developments within the sphere of corporate governance such as the Sarbanes-Oxley Act<sup>5</sup> in the United States of America, the King II Report<sup>6</sup>

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<sup>1</sup> Asprey, Mr Justice K.W. 1975. Full Report of the Taxation Review Committee. *The Asprey Report*. Australian Government Publishing Service. 3.19. Quoted by Williams, R.C. 1995. *Income Tax in South Africa: Cases & Materials*. Durban: Butterworths. 2.

<sup>2</sup> Avi-Yonah, R.S. 2003. Tax stories and tax histories: Is there a role for history in shaping tax law? *Michigan Law Review*. 101:2234.

<sup>3</sup> *Ibid* at 2235.

<sup>4</sup> Taxes on capital: a case of fiscal envy. *Financial Mail*. 10 April 1992. Quoted by Williams, R.C. 1995. *Income Tax in South Africa: Cases & Materials*. Durban: Butterworths. 10.

<sup>5</sup> Sarbanes-Oxley Act of 2002.

<sup>6</sup> King, M.E. (Gen Ed). *The King Report on Corporate Governance for South Africa 2002*.

in South Africa and similar legislation in other countries.<sup>7</sup> At the same time the Organisation for Economic Co-operation and Development (“OECD”) is on a drive to encourage transparency and the effective exchange of information (for tax purposes) between governments.

Despite the call for companies to become “good corporate citizens”<sup>8</sup>, and contrary to popular belief, in South Africa between 60 per cent and 70 per cent of revenue is collected from large businesses annually.<sup>9</sup> A recent study conducted by PricewaterhouseCoopers showed that during the 2007 tax year South Africa’s 50 largest companies paid R49,22 billion in taxes<sup>10</sup> and collected R52,890 billion on behalf of both national and local governments.<sup>11</sup> In fact, so dependant is the government on large businesses that Edward Kieswetter, the chief operations officer at the South African Revenue Service (“SARS”), refers to them as “agents of government, role models for compliance, and providers of revenue”.<sup>12</sup>

Companies are both taxpayers and tax collectors. As a result, tax plays a significant role in a company’s operations and affects its major stakeholders, including

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<sup>7</sup> Cliffe Dekker Attorneys, Spring 2007. Tax risk assessment. In *Matters for clients*.

<sup>8</sup> Rabkin, F. 2008. Directors’ duties and human rights. *Business Day*. 10 November 2008. During a conference on business and fundamental rights, organised by the South African Institute for Advanced Constitutional, Public, Human Rights and International Law, reference was made to a debate preceding the new Companies Bill’s finalisation which saw the discussion of three different models of a director’s duty to act in the best interest of the company – firstly, the classic position, which holds that the best interests of the company are essentially the interests of its shareholders; secondly, the “enlightened shareholder” model, which defines the best interests of the company to be that of its shareholders, but in so pursuing it is relevant to consider the interests of other stakeholders such as employees, suppliers, creditors, the environment and the community; and, thirdly, the “pluralist” approach, which saw the interests of stakeholders as “ends in themselves”, requiring directors to view the company’s best interests as balancing the interests of all its stakeholders.

<sup>9</sup> Temkin, S. 2008. SA companies pay fair share of tax. *Business Day*. 13 October 2008.

<sup>10</sup> The taxes paid by companies included, *inter alia*, corporate tax, secondary tax on companies, customs and excise duties and fuel levies. Of these, corporate tax represented 66,1 per cent of the total taxes borne by the companies surveyed (SA companies pay fair share of tax. *Business Day*. 13 October 2008).

<sup>11</sup> Temkin, S. 2008. SA companies pay fair share of tax. *Business Day*. 13 October 2008.

<sup>12</sup> Temkin, S. 2008. Big business the mainstay of taxation. *Business Day*. 30 September 2008.

shareholders and employees.<sup>13</sup> It is therefore important that a balance is struck between government's fiscal obligation to the nation and the need for taxpayers to be recognised as contributors to the *fiscus*. This is achieved by having a tax system that serves, as far as possible, all stakeholders equally. Nevertheless, it is "a difficult question to ask [*say*] what makes a 'good tax system'".<sup>14</sup>

A tax system can be judged by posing, inter alia, the following questions: Is the system fair? A recent study in Uganda showed that businesses headed by women are more harassed by tax officials than those headed by men.<sup>15</sup> Does it contribute to the growth and stability of the economy? Good returns on foreign direct investment notwithstanding, transnational corporations are also looking for competitive tax rates. Are the rights of individuals protected?<sup>16</sup> And, more importantly, probably, is the question as to whether it has achieved what the legislature and the powers that be had intended?

The evaluation of an existing tax system is complicated because we seek to realize all of these conflicting objectives simultaneously.<sup>17</sup> However, and notwithstanding populist perception, when evaluating a tax system one is more than often confined to fiscal legislation and its interpretation, as amplified by explanatory memoranda and case law.

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<sup>13</sup> Cliffe Dekker Attorneys. Spring 2007. Tax risk assessment. In *Matters for clients*.

<sup>14</sup> Caroline Otonglo, a member of the Doing Business Team at the International Finance Corporation. As quoted by Temkin, S. 2008. Paying tax in SA is getting easier – World Bank. *Business Day*. 2 December 2008. [*Own emphasis added.*]

<sup>15</sup> Temkin, S. 2008. Paying tax in SA is getting easier – World Bank. *Business Day*. 2 December 2008.

<sup>16</sup> *Canadian Royal Commission on Taxation Report*. 1966. Volume 1. 3. Quoted by Williams, R.C. 1995. *Income Tax in South Africa: Cases & Materials*. Durban: Butterworths. 1.

<sup>17</sup> *Ibid.*

## 1.2 Interpretation

The interpretation of statutes is said to be a non-subject; it is really about life and human nature and too broad, deep and variegated to be encapsulated in any theory.<sup>18</sup> However, in South Africa fiscal legislation is amended each (at least twice) and every year, which annually produces a fresh statute. As a consequence, the law of taxation requires constant interpretation and re-interpretation.<sup>19</sup> This, it is submitted, unfortunately makes the continuous interpretation of fiscal legislation the story of a tax consultant's life.

The ultimate goal in the interpretation of any statute should be to determine the "manifest purpose of the legislation".<sup>20</sup> In our law it is encapsulated in the primary rule of interpretation, which is to establish the intention of the legislature as expressed in the language of the Act. The cardinal or golden rule of interpreting such statute then, including fiscal legislation, is to apply the literal meaning of the words in that statute. To do so, one merely has to look at what is clearly said, without leaving room for any intendment.<sup>21</sup> This requires a grammatical<sup>22</sup> and logical construction of the words used in the statute. They must be read in the light of their popular<sup>23</sup> or ordinary and natural<sup>24</sup> sense, carelessness in drafting notwithstanding, and the context must not be ignored.<sup>25</sup> For example, the very first words of the Income Tax Act<sup>26</sup> ("the ITA") are:

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<sup>18</sup> Lord Wilberforce. 1972. A juridical viewpoint. In *Symposium on statutory interpretation*. 6. Quoted by Devenish, G.E. 1992. *Interpretation of statutes*. 1<sup>st</sup> ed. Cape Town: Juta & Co. 2.

<sup>19</sup> Meyerowitz, D., Emslie, T.S. & Davis, D.M. 2008. The so-called method of purposive construction of legislation. *The Taxpayer*. Cape Town: The Taxpayer. 57(12): 224.

<sup>20</sup> Botha, C.J. 1991. *Wetsuitleg: 'n Inleiding vir studente*. 1<sup>st</sup> ed. Cape Town: Juta & Co. 18.

<sup>21</sup> *Cape Brandy Syndicate v IRC* (1921) 1 KB 64 at 71. Quoted with approval in *CIR v Frankel* 1949 (3) SA 733 (A) at 738.

<sup>22</sup> *Union Government (Minister of Finance) v Mack* 1917 AD 731 at 750.

<sup>23</sup> *Custodian Parent v COT* 1950 (4) SA 286 (SR), 17 SATC 37.

<sup>24</sup> *New Union Goldfield Ltd v CIR* 1950 (3) SA 392 (A) at 404.

<sup>25</sup> Meyerowitz, D. 2007. *Meyerowitz on Income Tax 2006/2007*. Cape Town: The Taxpayer. 3-5.

“In this Act, unless the context otherwise indicates .....

It is only when such ordinary grammatical meaning will lead to absurdities or anomalies which could not have been intended by the legislature (the so-called “literal theory”) that one may rely on the other canons of interpretation to determine the legislature’s intention.<sup>27</sup>

There are several acknowledged theories of interpretation of which some are conflicting, others are complementary and all overlap to some extent. The most important theories of interpretation acknowledged in the South African context are: (i) the literal theory; (ii) the subjective theory; (iii) the purposive theory; (iv) the teleological or value-coherent theory; (v) the judicial or free theory; (vi) the objective or delegation theory; and (vii) normative transposition. Although each has some degree of merit, an examination and comparison of these theories expose the complex nature of interpretation and its underlying jurisprudential foundations.<sup>28</sup>

The theory of the so-called method of “purposive construction” of legislation recently surfaced in the Supreme Court of Appeal judgment of *CSARS v Airworld and Another*.<sup>29</sup> Hurt AJA, who delivered the judgment, had the following to say about the interpretation of statutes:<sup>30</sup>

“[T]he question is whether the word, properly considered in its context, is nevertheless ambiguous. Most of the rules of interpretation have been devised for the purpose of resolving apparent ambiguity and arriving at an interpretation which accords as well as possible both with the language which the Legislature has used and with the apparent intention with which the

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<sup>26</sup> Act No. 58 of 1962, as amended.

<sup>27</sup> *ITC 1396*, 47 SATC 141.

<sup>28</sup> Devenish, G.E. 1992. *Interpretation of statutes*. 1<sup>st</sup> ed. Cape Town: Juta & Co. 25.

<sup>29</sup> 2008 (3) SA 335 (SCA).

<sup>30</sup> At 345.

Legislature has used it. In recent years Courts have placed emphasis on the purpose with which the Legislature has enacted the relevant provision. The interpreter must endeavour to arrive at an interpretation which gives effect to such purpose. The purpose (which is usually clear or easily discernible) is used, in conjunction with the appropriate meaning of the language of the provision, as a guide in order to ascertain the legislator's intention."

Where the language used by the Legislature is therefore clear and intended, it cannot be departed from. However, the question to be asked is: how does one establish the purpose of the legislation if not with reference to the language of the statute, as a whole, and to the language of the specific provision being interpreted?<sup>31</sup> Moreover, more than often we are confronted with what may appear to be an anomaly or ambiguity that creates a *casus omissus* which cannot be supplied by the courts whose sole duty is to construe the Act as it stands. It is at this juncture, it is submitted that one has to have regard to both internal and external aids to statutory interpretation.<sup>32</sup>

One such external aid, often used by advisors, is the explanatory memoranda published with tax legislation. And, having regard to their applicability, Cote (1984: 350), a Canadian scholar, is of the view that:

"[T]he courts should accept reference to explanatory notes accompanying a bill in the same way and for the same reason that they take into consideration the views of the legislature. An explanatory note is a valid opinion about a statute being interpreted. The judge retains discretion to accord the weight justified by the circumstances. If the text is plain, the notes will have little weight. But if it is ambiguous, the notes may either suggest a possible interpretation or confirm the conclusions that the judge has inferred from other sources."<sup>33</sup>

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<sup>31</sup> Meyerowitz, D., Emslie, T.S. & Davis, D.M. 2008. The so-called method of purposive construction of legislation. *The Taxpayer*. Cape Town: The Taxpayer. 57(12): 225.

<sup>32</sup> The internal aids referred to are the preamble, the long title, the short title, the headings of paragraphs and sections of the Act, etc. The external aids refers to the source of particular sections, the surrounding circumstances or historical background or discussions preceding the passing of the Act such as Hansard, explanatory notes, reports of commissions of enquiry and international agreements, amongst others.

<sup>33</sup> Cote, Pierre-Andre. 1984. *Interpretation of legislation in Canada*. Montreal: Blais. 350. Quoted by Devenish, G.E. 1992. *Interpretation of statutes*. 1<sup>st</sup> ed. Cape Town: Juta & Co. 127.

Our courts have already recognised the importance of ‘background material’, such as explanatory memoranda, when interpreting legislation. In considering whether background material is admissible for purposes of interpreting the Constitution, the Court, in *S v Makwanyane and Another*<sup>34</sup>, concluded that:

“[W]here the background material is clear, is not in dispute, and is relevant to showing why particular provisions were or were not included in the Constitution, it can be taken into account by a Court in interpreting the Constitution.”

In general, all bills issued by SARS are accompanied by explanatory memoranda from its drafters. Although the use and admissibility of explanatory memoranda for purposes of the interpretation of statutes have yet to be confirmed by the South African courts, it seems though the remarks of Chaskalson CJ in *Makwanyane’s* case may serve as a precedent. This should be kept in mind when reference is made to explanatory memoranda throughout the course of this work.

### **1.3 Enter the corporate rules**

During 2001 the system of taxation in South Africa changed from being source based to that of being residency based.<sup>35</sup> At the same time we saw the introduction of the Eighth Schedule<sup>36</sup> to the ITA, which provides for the manner whereby taxable capital gains are included in a taxpayer’s taxable income and taxed.<sup>37</sup> At the time, and in the absence of any exemptive provisions, company group reorganisations suddenly

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<sup>34</sup> 1995 (3) SA 391 (CC). Quoted with approval, more recently, in *Minister of Health v New Clicks SA (Pty) Ltd & Others* 2006 (2) SA 311 (CC).

<sup>35</sup> South African tax residents have since then been taxed on their worldwide income.

<sup>36</sup> Inserted by section 38 of the Taxation Laws Amendment Act No. 5 of 2001 and made effective from October 1, 2001 and hereinafter referred to as “the Eighth Schedule”.

<sup>37</sup> The taxable capital gains of a person are included in that person’s taxable income for purposes of normal tax by virtue of section 26A of the ITA.

became an expensive affair as every disposal<sup>38</sup> of an asset<sup>39</sup> triggered a capital gains tax ("CGT") liability. This was not in line with international CGT regimes which provided for varying degrees of relief in respect of transactions between group companies or between founding shareholders and their company. The said relief applies to transactions between group companies, and between founding shareholders and their company, and is based on the view that where the group or the shareholders have retained a substantial interest in the assets, after having transferred them, it is appropriate to permit the tax-free transfer of those assets to the entity where they can be most efficiently used for business purposes.<sup>40</sup> This ultimately led to the amendment of Part III (comprising of sections 41 to 46) of Chapter II in the ITA.<sup>41</sup>

Part III of Chapter II of the ITA, colloquially referred to as "the corporate rules", is primarily designed to remove the tax and duty barriers and facilitate transactions between group companies on a tax neutral basis. However, it also plays a vital role in anti-tax avoidance.

Notwithstanding the income tax aspects, the following exemptions also apply:

- There is an exemption from securities transfer tax ("STT")<sup>42</sup> in respect of the disposal and transfer of securities<sup>43</sup> in terms of any of the transactions referred to

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<sup>38</sup> Paragraph 11(1) of the Eighth Schedule defines a "disposal" as "any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset" and includes, *inter alia*, the transfer of ownership and distribution of an asset by a company to a shareholder.

<sup>39</sup> An "asset" is defined in paragraph 1 of the Eighth Schedule as property of whatever nature, whether movable or immovable, corporeal or incorporeal, including a right or interest of whatever nature to or in such property. The definition further excludes any currency, but includes any coin made mainly from gold or platinum.

<sup>40</sup> SARS. 2001. *Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001*. 6.

<sup>41</sup> Part III was re-introduced by Act No. 60 of 2001, deemed to have come into operation on 1 October 2001 and applicable in respect of transactions entered into on or after that date. Part III of Chapter II previously housed the provisions dealing with non-shareholder's tax.

<sup>42</sup> As of 1 July 2008, and in terms of the Securities Transfer Tax Act No. 25 of 2007 ("the STT Act"), STT is payable on the transfer of any security and levied at a rate of 0,25 per cent on its taxable value, as defined.

in Part III. Prior to 1 July 2008 marketable securities tax was levied on the transfer of uncertificated securities in terms of the Uncertificated Securities Tax Act No. 31 of 1998 (“the UST Act”) and stamp duty was levied on the transfer of certificated securities in terms of the Stamp Duty Act No. 77 of 1968 (“the SDA”).<sup>44</sup> The said exemption also applied, in the case of the disposal and transfer of securities in terms of the corporate rules, to marketable securities tax and stamp duty before the introduction of STT.

- There is an exemption from value-added tax (“VAT”) where goods and services are supplied by one vendor to another vendor in terms of sections 42, 44, 45 or 47 of the ITA.<sup>45</sup>
- There is an exemption from transfer duty in respect of immovable property involved in an amalgamation or intra-group transaction or liquidation distribution.<sup>46</sup> To the extent that both the transferor and transferee are vendors for purposes of the VAT Act, the transfer of immovable property in terms of an asset-for-share transaction will be exempt from transfer duty.<sup>47</sup>
- There is further an exemption from donations tax, in terms of section 56(1)(r) of the ITA, to the extent that the donee is a resident and a member of the same group of companies as the donor.<sup>48</sup>

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<sup>43</sup> Section 1 of the STT Act defines a “security” as including a member’s interest, a share or any right to distribution in respect of any security.

<sup>44</sup> The STT Act repealed the UST Act and certain sections in the SDA. It should be noted that section 103(1) of the Revenue Laws Amendment Act No. 60 of 2008 (“the 2008 RLAA”) repeals the SDA in its entirety, save for the provisions contained in paragraph (i) of the proviso to item 14(1) of Schedule 1 of the SDA. Section 103(1) of the 2008 RLAA comes into operation on 1 April 2009.

<sup>45</sup> Section 8(25) of the Value-Added Tax Act No. 89 of 1991 (“the VAT Act”).

<sup>46</sup> Section 9(1)(l) of the Transfer Duty Act No. 40 of 1949 (“the Transfer Duty Act”).

<sup>47</sup> Section 9(15A) of the Transfer Duty Act.

<sup>48</sup> Subsection (r) was added to section 56(1) of the ITA by section 35(b) of the Revenue Laws Amendment Act No. 74 of 2002.

The introduction of the corporate rules was indeed a welcoming relief following the changes to the South African tax system. Having said that, at the time of their enactment, the structure, extent and effectiveness of the corporate rules were not thought through well enough. This, it is submitted, is evident from the amount of amendments promulgated since 2001.<sup>49</sup>

A comprehensive discussion on the history of the corporate rules would not only be extensive, but also fall beyond the scope of this study. Nevertheless, some of the amendments are significant and worth analysing. Chapter 3 focuses on those amendments.

Chapter 2 comprises an analysis of the different sections of the corporate rules in the format they were promulgated in 2001.<sup>50</sup> For the sake of completeness amalgamated transactions are included. The sections are presented against the background of four levels of analysis.

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<sup>49</sup> Appendix 1 sets out a history of the major year on year amendments.

<sup>50</sup> The corporate rules were introduced into the ITA by section 44(1) of Act No. 60 of 2001.

## Chapter 2

### The corporate rules

#### 2.1 Introduction

The group relief measures introduced by the Second Revenue Laws Amendment Act No. 60 of 2001 and contained in sections 41 to 46 comprised a general provision (section 41) wherein most of the relevant definitions were housed and the remainder of the sections were allocated as follows:

- company formations (section 42);
- share-for-share transactions (section 43);
- intra-group transactions (section 44);
- unbundling transactions (section 45); and
- transactions relating to liquidation, winding-up and deregistration (section 46).

These measures did not cater for transactions relating to mergers. The need was immediately identified and in 2002, the very next year, the legislator obliged and introduced similar relief for amalgamation transactions (as defined). These changes were brought in by the Revenue Laws Amendment Act No. 74 of 2002, which resulted in the sections being rearranged and allocated as follows:

- company formations (section 42)
- share-for-share transactions (section 43)
- amalgamation transactions (section 44)
- intra-group transactions (section 45)
- unbundling transactions (section 46); and
- transactions relating to liquidation, winding-up and deregistration (section 47).

The provisions contained in each section, save for the general provisions in section 41, may be analysed on four levels, namely, their *ambit*, the *extent of the roll-over relief* granted, *anti-avoidance* provisions and certain *exclusions*. It is against this background that the corporate rules will be presented and analysed.<sup>51</sup>

In this chapter the corporate rules are presented in their *original* albeit rearranged format ie incorporating amalgamation transactions<sup>52</sup>. However, where the reader is referred to specific provisions in the ITA, such reference will be to the rearranged, ie post 2002, numbering of the different sections.

It should further be noted that, in this chapter, the present tense will be used when analysing the corporate rules as if the legislation is being enacted now.

## **2.2 Company formations**

### **2.2.1 Ambit**

A “company formation transaction” means any transaction in terms of which a person (other than a trust which is not a special trust) transfers an asset to a resident company in exchange for equity shares<sup>53</sup> in that company, after which transaction that person holds a qualifying interest in that company (*section 42(1)*).<sup>54</sup>

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<sup>51</sup> The different sections in this chapter are structured as proposed in the Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001. Any reference to any specific section in this chapter is a reference to a provision in the Second Revenue Laws Amendment Act No. 60 of 2001 and deemed to have come into operation on 1 October 2001, unless otherwise indicated.

<sup>52</sup> As introduced by section 44(1) of the Second Revenue Laws Amendment Act No. 60 of 2001.

<sup>53</sup> At the time of the introduction of section 42, an “equity share”, in relation to a company, was defined (in section 41(1) of the ITA) as a share in the equity share capital of that company. This definition has subsequently been repealed and, although it may still be argued that it (an equity share) constitutes a share in the company’s equity share capital, for purposes of section 42 it now merely includes a participatory interest in a portfolio of a collective investment scheme as referred to in paragraph (e)(i) of the definition of “company” in section 1 of the ITA.

<sup>54</sup> SARS. 2001. *Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001*. 7.

A “qualifying interest” is defined by section 42 as equity shares held in a company, which (a) is a listed company or will become a listed company within 6 months after the transaction (or such further period as approved by the Commissioner); or (b) in any other case 25 per cent of the total equity share capital of the company.<sup>55</sup>

### 2.2.2 *Extent of roll-over relief*

Where a person disposes of a *capital asset* to a company in terms of a company formation transaction and the market value of that asset exceeds its base cost (in other words a capital gain is realised) on the date of disposal –

- that person must be treated as –
  - having disposed of that capital asset for an amount equal to the base cost of that capital asset<sup>56</sup> on the date of that disposal (*section 42(2)(a)(i)*); and
  - having acquired those equity shares on the date that such person acquired that capital asset and for a cost equal to that base cost (*section 42(2)(a)(ii)*); and
- that company must be treated as having acquired that capital asset on the date that such person acquired that capital asset and at a cost equal to its base cost (*section 42(2)*).<sup>57</sup>

Where a person disposes of any asset (other than any financial instrument as defined in paragraph 1 of the Eighth Schedule) to a company in terms of a company formation transaction and that asset constitutes *trading stock* in the hands of that person which is

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<sup>55</sup> The definition is as introduced by the Second Revenue Laws Amendment Act No. 60 of 2001 at the time. This definition has subsequently been amended (see paragraph 3.4 in chapter 3).

<sup>56</sup> No capital gain will therefore be realised on that asset.

<sup>57</sup> In other words, that person is deemed to have acquired the shares at a value equal to its base cost to the company, and that company is deemed to have acquired the asset at a value equal to its base cost to that person. In both instances, the cost will be treated as expenditure actually incurred and paid for purposes of paragraph 20(1)(a) of the Eighth Schedule.

attributable to the business undertaking of that person which is transferred as a going concern, and will be treated as trading stock in the hands of the company concerned –

- that person must be treated as –
  - having disposed of that asset for an amount equal to the cost contemplated in sections 22(1) or 22(3), as the case may be (*section 42(4)(a)(i)*); and
  - having acquired the equity shares in terms of that company formation transaction at a cost equal to that cost (as contemplated in sections 22(1) or 22(3)) (*section 42(4)(a)(ii)*); and
- that company must be treated as having acquired that asset at a cost equal to the amount of the cost to that person (*section 42(4)(b)*).<sup>58</sup>

### 2.2.3 Anti-avoidance

Where a person disposes of a capital asset (“the formation asset”) to a company in terms of a company formation transaction and that person had, within a period of 18 months before that disposal, disposed of any other capital asset, in respect of which a capital loss was determined, to that company –

- that person will be treated as having disposed of the formation asset for an amount equal to the market value, although only so much of the gain realised as doesn’t exceed that prior loss will be taken into account in the determination of the taxable capital gain of that person.
- That person will then be treated as having acquired those shares in the company at a cost equal to the sum of the base cost of the asset and the amount of the capital gain so taken into account. This will prevent any capital gain from being taxed twice.

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<sup>58</sup> SARS. 2001. *Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001*. 7.

- The company will be treated as having acquired the asset at a cost equal to the cost of the shares to that person as mentioned above.<sup>59</sup>

Where a person disposes of an asset to a company in terms of a company formation transaction and, in addition to any equity shares in that company, becomes entitled to any consideration from that company, the transfer of that asset will, to the extent that consideration is receivable, be treated as a part disposal of that asset.<sup>60</sup>

Where a person disposes of a depreciable asset or any other asset in respect of which an allowance is allowable, the company's allowances claimable in respect of that asset will be limited to the amount of any allowance which that person would have been entitled to deduct in respect of that asset, had that asset not been disposed of by that person. Moreover, the company will be treated as having recovered or recouped any allowances which were claimed as a deduction by that person before disposal of that asset to the company.<sup>61</sup>

Where more than 50 per cent of the assets transferred by that person to the company consist of depreciable assets or trading stock and that person disposes of the shares within 18 months (other than by way of an involuntary disposal or as a result of the death of that person) the shares in that company will be treated as trading stock in the hands of the person.<sup>62</sup>

Where that person ceases to hold a qualifying interest in that company within a period of 18 months after entering into the corporate formation transaction -

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<sup>59</sup> *Ibid* at 7.

<sup>60</sup> *Ibid* at 7.

<sup>61</sup> *Ibid* at 7.

<sup>62</sup> *Ibid* at 8.

- other than by way of a disposal of the shares ie in terms of a value-shifting arrangement, that person will be treated as having disposed of the shares for proceeds equal to the market value on the date of acquiring the shares and to have reacquired those shares for a cost equal to that market value; or
- by way of disposal of some or all of the shares (other than in terms of an intra-group transaction, an unbundling transaction or a liquidation distribution), that person will be treated as having disposed of
  - the shares actually disposed of for the higher of either the proceeds or the market value on the date of the disposal; and
  - any shares not actually disposed of, for proceeds equal to the market value on the date of acquisition of those shares and to have reacquired those shares for a cost equal to that market value.<sup>63</sup>

This will, however, not apply where the person ceases to hold a qualifying interest as the result of the death of that person and where that qualifying interest accrues to the surviving spouse of that person.<sup>64</sup>

Capital losses will be ring-fenced where a person disposes of an asset to the company at a loss. The company will be treated as having acquired the asset for a cost equal to the market value thereof. The capital loss may, however, be deducted from any capital gains realised in respect of other capital assets disposed of by that person to that company.<sup>65</sup>

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<sup>63</sup> This will have the effect of including any capital gain realised on the shares actually disposed of in the taxable capital gain, whereas in the case of shares not disposed of only the gain, which would have been realised on the disposal of the asset to the company, will be taxable.

<sup>64</sup> *Ibid* at 8.

<sup>65</sup> *Ibid* at 8.

Where a person disposes of an asset to a company, which is encumbered by any debt incurred more than 18 months before that disposal and that company assumes that debt or an equivalent amount of debt that is secured by that asset or where that person transfers any business undertaking to a company as a going concern which includes any amount of any debt, that person must be treated as having acquired the shares in the company at a cost equal to the base cost of that asset or business undertaking, reduced by the amount of that debt.<sup>66</sup>

#### **2.2.4 Exclusions**

The relief provisions contained in section 42, will, however, not apply in respect of the disposal of an asset –

- by a company which is exempt from tax;
- which constitutes a financial instrument, unless it is a debt due to that person in respect of any goods sold or services rendered in terms of the business which is transferred as a going concern or the market value of the financial instruments transferred do not exceed 5 per cent of the market value of all the assets transferred; or

which was acquired in terms of any company formation transaction, within 18 months before that disposal.<sup>67</sup>

### **2.3 Share-for-share transactions**

#### **2.3.1 *Ambit***

A “share-for-share transaction” means a transaction in terms of which a person disposes of a share in a resident company (“target company”) to another resident

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<sup>66</sup> *Ibid* at 8.

<sup>67</sup> *Ibid* at 9.

company (“acquiring company”) in exchange for shares in that acquiring company and –

- after that transaction, the acquiring company –
  - holds at least 35 per cent of the direct shareholding in the target company (or more than 25 per cent in the case where no other shareholder holds an equal or greater shareholding than that acquiring company) where the target company is a listed company; or
  - where the target company is not a listed company, holds at least 75 per cent of direct shareholding in that target company; and
- that person holds shares in that acquiring company –
  - which is a listed company; or
  - in any other case, which constitutes a direct shareholding of more than 25 per cent.<sup>68</sup>

### ***2.3.2 Extent of roll-over relief***

Where that person disposes of shares (“the target shares”) (other than target shares held by that person as trading stock) in exchange for shares in the acquiring company, that person must be treated as having disposed of the target shares for proceeds equal to the base cost and to have acquired the shares in the acquiring company at a cost equal to its base cost. Where the target company is a listed company and the shares were acquired from any shareholder who does not hold a direct 25 per cent shareholding in the acquiring company after the share-for-share transaction, the acquiring company must be treated as having acquired those shares at a cost equal to the market value of those shares. In any other case, the acquiring company must be

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<sup>68</sup> *Ibid* at 9.

treated as having acquired those shares at a cost equal to the base cost of the person from whom the shares were acquired.<sup>69</sup>

Where shares are held as trading stock and disposed of in terms of a share-for-share transaction, the person must be treated as having disposed of those shares for proceeds equal to the cost of those shares contemplated in section 22(1) or (3) of the ITA, as the case may be, and to have acquired the shares in terms of the share-for-share transaction at a cost equal to the said amount. The company will be treated as having acquired those shares at a cost equal to the amount of the cost referred to as aforesaid. Moreover, the shares so acquired will constitute trading stock in the hands of that person.

### ***2.3.3 Anti-avoidance***

Similar anti-avoidance provisions to those in respect of company formation transactions apply in respect of a share-for-share transaction, where

- a person becomes entitled to any consideration other than the shares acquired;
- a person ceases to hold a qualifying interest in the acquiring company within 18 months after the share-for-share transaction;
- a loss share (ie base cost exceeds the market value) is disposed of within a period of 18 months before the share-for-share transaction; or
- where the acquiring company disposes of a share acquired in terms of a share-for-share transaction within 18 months after that transaction, other than in terms

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<sup>69</sup> *Ibid* at 10.

of an intra-group transaction, unbundling transaction or a liquidation transaction.<sup>70</sup>

#### **2.3.4 Exclusions**

The treatment provided for under section 43 does, however, not apply in respect of the disposal of any share by a company –

- to a company which is exempt from tax;
- within 18 months after acquiring that share in terms of a company formation transaction; or
- where more than 50 per cent of either the market value or actual cost of all the assets of the target company and any other company which is a controlled company in relation to the target company consists of financial instruments other than any share in a controlled company.

#### **2.4 Amalgamations**

When the corporate rules were introduced no relief was specifically provided for the merger or amalgamation of companies. However, provisions allowing group relief for amalgamation transactions were subsequently introduced by the Explanatory Memorandum on the Revenues Laws Amendment Bill, 2002 and enacted as section 44 of the ITA.<sup>71</sup>

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<sup>70</sup> *Ibid* at 10.

<sup>71</sup> Amalgamation transactions (section 44) were introduced into the ITA by the Revenue Laws Amendment Act No. 74 of 2002.

### **2.4.1 *Ambit***

An “amalgamation transaction” is defined as any transaction in terms of which a company (“the amalgamated company”) disposes of all its assets to another company (“the resultant company”) which is a resident, by means of an amalgamation, conversion or merger; and as a result of which that amalgamated company’s existence will be terminated.<sup>72</sup>

### **2.4.2 *Extent of roll-over relief***

Where the shareholder of the amalgamated company disposes of equity shares, that shareholder will qualify for roll-over relief if the market value of the shares exceeds the base cost or the amount for trading stock purposes, as the case may be. The shareholder can acquire the shares in the resultant company as either capital assets or as trading stock. This principle is similar to that applied in respect of share-for-share transactions.

### **2.4.3 *Anti-avoidance***

The person who disposed of the shares in the amalgamated company and acquired shares in the resultant company in terms of an amalgamation transaction is required to hold a qualifying interest in the resultant company for a period of 18 months. If the interest is not so held, the roll-over gain is triggered.

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<sup>72</sup> Section 44(1) of the ITA.

#### **2.4.4 Exclusions**

The roll-over relief will only be available if the amalgamated company has within a period of six months after the date of the amalgamation transaction taken the steps, as contemplated in section 41(4), to terminate its existence.

### **2.5 Intra-group transactions**

#### **2.5.1 *Ambit***

An “intra-group transaction” means a transaction in terms of which an asset is disposed of by one resident company to another resident company in the same group of companies.

#### **2.5.2 *Extent of roll-over relief***

Where a company disposes of an asset to another company in terms of an intra-group transaction, these companies may jointly elect

- in the case of a capital asset, that the transferor company must be treated as having disposed of that asset for proceeds equal to the base cost and the transferee company must be treated as having acquired that capital asset at a cost equal to that base cost;
- in the case of an asset which constitutes trading stock, the transferor company will be treated as having disposed of the asset for proceeds equal to the amount of the cost of the asset as determined in section 22(1) or (3), as the case may be, and the transferee company will be treated as having acquired that asset at a cost equal to that cost.<sup>73</sup>

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<sup>73</sup> *Ibid* at 11.

Where a depreciable asset is transferred, the allowable allowance of the transferee company will be limited to the amount which the transferor company could have deducted if that asset had not been disposed of by that transferor company. The transferee company will also be treated as having been allowed all allowances of that transferee company for purposes of the recoupment provisions.<sup>74</sup>

Similarly, when it comes to the transfer of contracts incorporating future expenditure the allowable allowance will be limited to the allowance in respect of future expenditure which the transferor company could have deducted in terms of section 24C of the ITA.

### **2.5.3 Anti-avoidance**

Where at any time after an intra-group transaction the two companies cease to form part of the same group of companies the transferee company will be treated as having disposed of that asset for proceeds equal to the market value on the date that the companies cease to form part of the same group of companies and to have immediately re-acquired that asset for a cost equal to that market value. This will have the effect that the transferee company realises the gain that was rolled over from the transferor company.<sup>75</sup>

Similar provisions apply in the case of an intra-group transaction in respect of the disposal within 18 months of that asset by the transferee company, as is the case in a corporate formation transaction.

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<sup>74</sup> *Ibid* at 11.

<sup>75</sup> *Ibid* at 11.

#### **2.5.4 Exclusions**

The intra-group transaction benefits will not apply where –

- the asset disposed of is a financial instrument, unless it constitutes a debt due to the transferor company in respect of goods sold or services rendered by the transferor company or where the market value of those financial instruments do not exceed 5 per cent of the total market value of all the assets transferred;
- the transferee company is exempt from tax; or
- more than 50 per cent of the market value or the actual costs of all the assets of the company and any other company which is a controlled company in relation to that company consists of financial instruments other than shares in a controlled company.<sup>76</sup>

As indicated in 1.3 above, an acquisition or disposal of any asset in terms of an intra-group transaction will be exempt from marketable securities tax<sup>77</sup>, stamp duties<sup>78</sup>, donations tax and transfer duty. The transfer will also not constitute a dividend for purposes of the secondary tax on companies (STC).<sup>79</sup>

## **2.6 Unbundling transactions**

### **2.6.1 Ambit**

Where an unbundling company disposes of distributable shares to its shareholders in terms of an unbundling transaction, that unbundling company must be treated as having disposed of those shares for proceeds equal to the base cost of those shares.

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<sup>76</sup> *Ibid* at 11.

<sup>77</sup> The UST Act has subsequently been repealed by the STT Act. As of 1 July 2008 STT is levied on the transfer of uncertificated securities in terms of an intra-group transaction.

<sup>78</sup> As of 1 July 2008 STT instead of stamp duty is payable on the transfer of certificated shares.

<sup>79</sup> Section 64B(5)(f) of the ITA.

The unbundling company will, therefore, not realise any capital gain from that disposal.

### ***2.6.2 Extent of roll-over relief***

The shareholder or that holding company must be treated as having acquired the shares held in the unbundling company and the distributable shares at a cost equal to

- where the shares held in the unbundling company were held as trading stock, the cost for the purposes of section 22(1) or (3), as the case may be, to that person of those shares in the unbundling company, or where such person is not a company, the lesser of such cost or the diminished value of the shares held in the unbundling company; or
- in any other case, the base cost of those shares held in the unbundling company.

A portion of the cost or base cost will be apportioned to the distributable shares, in the same proportion as the market value of the distributable shares bears to the market value of the shares held in the unbundling company.

The shares in the unbundling company and the distributable shares will be treated as being the same shares for purposes of section 9B. A 'distributable share' means a share in a resident company held directly by a resident unbundling company, if the unbundling company -

- in the case where the unbundled company is a listed company, holds at least 35 per cent of the shareholding (or where no other shareholder holds an equal or greater interest than the unbundling company, more than 25 per cent); or

- where that unbundled company is an unlisted company, holds more than 50 per cent of shareholding of that unlisted company; and
- in the case where the unbundling company is a listed company, those shares are to be listed on a stock exchange within six months after the distribution *in specie*.

### **2.6.3 Anti-avoidance**

Any share in a company acquired by the unbundling company during the period of 18 months before the date of the unbundling transaction, shall not be taken into account in determining the interest of the unbundling company in that other company and does not constitute a distributable share, unless that share was acquired in terms of a previous transaction contemplated in Part III of Chapter II, an unbundling transaction in terms of section 60 of the Income Tax Act No. 113 of 1993, or a rationalisation scheme contemplated in section 39 of the Taxation Laws Amendment Act No. 20 of 1994.

Moreover, the distribution *in specie* by an unbundling company in terms of an unbundling transaction is treated as having been distributed first from the share premium account of the unbundling company and thereafter from undistributed profits.

### **2.6.4 Exclusions**

The treatment awarded in terms of an unbundling does not apply –

- where more than 50 per cent of either the market value or actual costs of all the assets of the unbundled company and any controlled company in relation to that

unbundled company consist of financial instruments, other than shares in any controlled company; or

- in respect of any distribution of shares in terms of an unbundling transaction to a non-resident shareholder who acquires more than 5 per cent of the distributable shares in terms of that unbundling transaction.

## **2.7 Transactions relating to liquidation, winding-up and deregistration**

### **2.7.1 *Ambit***

Where a liquidating company disposes of a capital asset in terms of a liquidation distribution to its holding company the liquidating company must be treated as having disposed of that asset for proceeds equal to the base cost. The liquidating company does not, therefore, realise any capital gain as a result of the disposal of that asset.

### **2.7.2 *Extent of roll-over relief***

Where the asset constitutes trading stock the liquidating company must be treated as having disposed of that asset for an amount equal to the base cost of that asset, as contemplated in section 22(1) or (3), as the case may be, and that (base) cost will be carried over to the holding company.

Where the asset is a depreciable asset any claimable allowance of the holding company will be limited to the amount of any allowance that the liquidating company could deduct in respect of that asset, if that asset had not been disposed of by that liquidating company. The holding company will be treated as having been allowed any allowance which was allowed as a deduction in the determination of the taxable

income of that liquidating company for the purposes of the recoupment of any allowance.

Provision is further made for the transfer of an appropriate portion of any allowance for future expenditure as envisaged in section 24C.<sup>80</sup>

As indicated hereinabove, any acquisition or disposal of immovable property and marketable securities will be exempt from the applicable transfer duty, marketable securities tax, stamp duties and uncertificated securities tax.

### **2.7.3 Anti-avoidance**

Provisions similar to that in respect of corporate formation transactions apply in the case of a liquidation transaction where the holding company disposes of an asset within 18 months after so acquiring that asset.<sup>81</sup>

### **2.7.4 Exclusions**

The benefits provided in terms of liquidation transactions do not apply where –

- the holding company is exempt from tax;
- more than 50 per cent of either the market value or actual cost of all the assets of the liquidating company and any controlled company in relation to the liquidating company, consists of financial instruments other than shares in a controlled company;
- the liquidating company has not, within a period of six months after the date of the liquidation distribution, taken such steps as prescribed by the Minister of

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<sup>80</sup> Section 46(4)(b), as it then was.

<sup>81</sup> Section 47(4) of the ITA.

Finance by regulation to liquidate, wind up or deregister that company. Any tax which becomes payable as a result of the application of this paragraph shall be recoverable from the holding company.<sup>82</sup>

## 2.8 Commentary

Although the introduction of the corporate rules was welcomed, to some extent, it is submitted, the legislation was ill-contrived from the beginning. Not only is this evident from the endless amount of amendments that have been, and continue to be promulgated each and every year, but also the difficulty taxpayer's have found complying with certain provisions of the corporate rules, such as the de-grouping charge in section 45(4), for example.

The extent of the changes, both structural and textual, which the corporate rules have undergone since its enactment in 2001 is beyond the scope of this study.<sup>83</sup> Having said that, Chapter 3 nonetheless highlights some of, what are submitted to be, the more significant amendments in the history of the corporate rules.

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<sup>82</sup> Section 46(6), as it then was.

<sup>83</sup> Appendix 1 contains a history of the major year on year amendments of the corporate rules.

## Chapter 3

### Significant amendments in the history of the corporate rules

#### 3.1 Background

The purpose of this study, as the title indicates, is to analyse the evolution of the corporate rules. However, evolution by its nature is a very slow process and from the looks of the existing legislation, it is submitted, the corporate rules are far from being perfect. Considering the time, effort and resources spent by National Treasury to fine-tune the application and effectiveness of the corporate rules, to analyse all the amendments promulgated since 2001 will be an enormous task and beyond the scope of this study.

Our fiscal legislation undergoes amendments each and every year. The ITA, for one, is currently amended twice a year (amendment bills are usually released during March and August of each year).

Amendments, in general, serve the purpose of implementing changes to fiscal legislation, amongst others, as announced during the annual budget speech<sup>84</sup>, such as changes to tax rates, rebates, etc. In other instances amendments are used simply to amend existing provisions in a statute.

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<sup>84</sup> During February of each year the Minister of Finance presents his annual budget to the South African Parliament.

The introduction of any new piece of legislation more often than not requires some fine tuning afterwards. The corporate rules are no exception. In fact, it is the one part of the ITA that has been amended each and every year since its introduction.<sup>85</sup>

Any bystander would comment that this piece of legislation ought to be fairly straight forward, especially if one considers its objectives. Nonetheless, since the enactment of the sections in 2001, the revenue authorities have been tweaking, cutting and adding to them, to such an extent that the average taxpayer struggles to keep abreast of the latest amendments.

The revenue authorities' aptitude for legislative drafting notwithstanding, it is submitted that, these highlighted provisions in this chapter could be identified as having had a significant impact on the application and effectiveness of the corporate rules. Of the amendments to the provisions highlighted, some have made the corporate rules easier to apply and others have caused difficulty.

The following amendments will be analysed in this chapter:

- Elective versus mandatory relief;
- The meaning of "equity share";
- The meaning of "qualifying interest";
- Financial instrument holding company;
- Loss roll-overs;
- Consideration other than shares;
- De-grouping.

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<sup>85</sup> See Appendix 1 for a history on the major amendments of the corporate rules.

### 3.2 Elective versus mandatory relief

The question as to whether the roll-over relief envisaged in the corporate rules should be voluntary or elective and not mandatory has been a bone of contention since enactment of the sections. It appears the legislature has had difficulty in deciding which is the most appropriate, as reflected by the changes.

Initially, some of the sections were 'elective in' and others applied automatically, but with an option 'to elect out'.<sup>86</sup> Parties would enter into transactions without even being aware that the provisions of the corporate rules applied or, in other instances, the parties were required not to elect in, or to elect out of the group relief measures. There was no consistency nor one set of rules.

When the corporate rules were introduced in 2001 roll-over relief was mandatory and parties could not themselves decide whether they wanted the provisions to apply to a specific transaction.

In 2002, after some lobbying that the roll-over relief in respect of the corporate rules ought to be voluntary and elective rather than mandatory, sections 42(1) (company formations, as it then was), 45(1) (intra-group transactions) and 47(1) (liquidation transactions) were amended to allow a transferor and a transferee to jointly elect on a transaction-by-transaction basis, whether to apply the provisions to their transaction or not.<sup>87</sup>

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<sup>86</sup> The term "to elect out" means that where the provisions of a specific section is mandatory the parties may be allowed, in terms of the provisions of that section, to choose not to apply the roll-over relief, as envisaged in that section, to their transaction.

<sup>87</sup> The changes were introduced into the ITA by section 34(1) of the Revenues Laws Amendment Act No. 74 of 2002.

In the context of company formation transactions, as it then was, and intra-group transactions the election had to be made jointly, simply because the roll-over treatment could be disadvantageous to one of the parties. For example, in the case of a company formation transaction, where the market value of the asset transferred exceeded its base cost, the transferee would inherit the transferor's base cost (which would be lower than the market value of the asset on the date of transfer). Similarly, in the case of an intra-group transaction, the roll-over treatment could be disadvantageous to the transferor where, for example, the transferor has losses that it wished to utilise against the transferred gain. Moreover, as is the case in section 42, the transferee inherited the transferor's base cost.<sup>88</sup>

When it came to the company formation transactions provision, as it then was, and intra-group transactions, the transferee and transferor could elect the specific assets to which the roll-over relief would apply. However, in the case of a liquidation distribution the election could only be made in respect of all assets or none.

Roll-over relief remained mandatory in the case of share-for-share transactions, amalgamations (only introduced in that year) and unbundling transactions. In the case of amalgamations and unbundling transactions of listed companies, for example, there may be a large number of impacted shareholders (many of which might not be easily contactable) and obtaining evidence of an election from all the shareholders may present practical difficulties. For this reason, it is said, roll-over treatment remained automatic with an election only in circumstances, ie in group situations.<sup>89</sup>

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<sup>88</sup> SARS. 2008. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*. 35.

<sup>89</sup> *Ibid.*

Notwithstanding this, at no point was it clear when the election had to be made, ie on the date of the transaction or before the tax return was submitted.

In 2003 the elective regime was extended to share-for-share transactions<sup>90</sup>, amalgamations<sup>91</sup> and unbundling transactions<sup>92</sup> to the extent that the relief would apply only in the event that the parties so elect.<sup>93</sup> The election was however not universal as it only applied in some instances ie where the parties formed part of the same group of companies.<sup>94</sup>

In 2008, in complete contrast to the prior situation, sections 42 (asset-for-share transactions) and 45 (intra-group transactions) were amended to make the provisions of those sections also mandatory. Subsection (8A) was added to section 42<sup>95</sup> and paragraph (g) was added to section 45(6).<sup>96</sup> Thus, this meant that the provisions of sections 42 and 45 applied by default to all asset-for-share transactions and intra-group transactions unless the parties to such transactions jointly elect that the provisions of those sections will not apply.<sup>97</sup> However, because roll-over treatment could be disadvantageous in certain circumstances, parties entering into asset-for-share transactions and intra-group transactions will still be able to make an election for the roll-over treatment not to apply. This may be the case where, for example, a group company may have capital losses which it wishes to offset against a capital gain

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<sup>90</sup> Section 43(1)(d) of the ITA.

<sup>91</sup> Section 44(1) of the ITA.

<sup>92</sup> Section 46(8) of the ITA.

<sup>93</sup> The amendments were effected by the Revenues Laws Amendment Act No. 45 of 2003.

<sup>94</sup> Proviso to sections 43(1) and 44(1) of the ITA.

<sup>95</sup> Subsection (8A) was added by section 49(1)(i) of the Revenues Laws Amendment Act No. 60 of 2008 and applicable in respect of any asset-for-share transaction entered into after 1 January 2009.

<sup>96</sup> Paragraph (g) was added by section 56(1)(k) of the Revenue Laws Amendment Act No. 60 of 2008 and applicable in respect of any intra-group transaction entered into after 1 January 2009.

<sup>97</sup> Section 42(8A)(a) of the ITA. Subsection (8A) was added by section 49(1)(i) of the Revenues Laws Amendment Act No. 60 of 2008.

arising from the intra-group transfer and/or where it would be beneficial for a transferee company to have a bumped up base cost. Such election will need to be made jointly and on a “per asset” basis.<sup>98</sup>

Therefore, save for certain provisos<sup>99</sup>, as it currently is, all sections of the corporate rules are mandatory, ie they apply as the automatic default.<sup>100</sup> This, it is said, eliminates the uncertainties associated with the whole election process and eases the administrative burden as, in practice, parties invariably elect for roll-over relief to apply.<sup>101</sup>

From a compliance point of view, the parties will have to prove that they elected for the provisions of a particular section not to apply.<sup>102</sup> In this regard, it would be advisable to incorporate a clause to such an extent into the agreement.

### **3.3 The meaning of “equity share”**

When the corporate rules were first introduced, section 41 of the ITA defined an “equity share”, in relation to a company, as a share in the equity share capital of that company. The definition bore the same meaning for all the transactions to which the concept applied. By the same token, section 1 of the ITA defined “equity share capital”, in relation to a company, as –

“its issued share capital excluding any part thereof which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution, and the expression ‘equity shares’ shall be construed accordingly;”<sup>103</sup>

<sup>98</sup> SARS. 2008. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*. 35.

<sup>99</sup> In sections 44(1) and 46(8).

<sup>100</sup> See sections 42(8A)(a), 44(1), 45(6)(g), 46(8) and 47(6)(b) of the ITA.

<sup>101</sup> SARS. 2008. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*. 45.

<sup>102</sup> In terms of section 82.

<sup>103</sup> The wording before the substitution of the definition by section 3(1)(d) of Act No. 8 of 2007.

The term “equity share capital” in the context of the ITA carries the same meaning it has for company law purpose, which in most instances refers to the *ordinary* share capital of a company.<sup>104</sup>

When the corporate rules were introduced in 2001 “equity shares” only referred to a share in the equity share capital of a company. It was only in 2007 that the definition was amended to include a member’s interest in a close corporation.<sup>105</sup> However, since the definition of “company” in section 1 of the ITA includes a close corporation, it was a natural progression that “equity share” and “equity share capital” should be considered to include a member’s interest.

### **3.4 The meaning of “qualifying interest”**

The concept of a “qualifying interest” plays an important role in the application and extent of the corporate rules, albeit that its meaning differs from transaction to transaction. Not only does its meaning limit the use of roll-over relief in certain transactions, but it also plays a significant part in the anti-avoidance provisions contained in the corporate rules.

When the corporate rules were introduced the requirement with respect to a “qualifying interest” only applied to company formation transactions, as it then was. As a consequence, the definition of a “qualifying interest” was confined to section 42(1), which defined it as meaning, in respect of any person, equity shares held by that person in a company, which –

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<sup>104</sup> Compare the definition of “equity share capital” in section 1 of the ITA with that in section 1 of the Companies Act No. 61 of 1973. To the extent that the participation rights of preference shares are not limited, as envisaged in the definition, they will be included in the definition of “equity share capital”.

<sup>105</sup> Inserted by section 3(1)(d) of the Taxation Laws Amendment Act No. 8 of 2007.

- “(a) is a listed company or will become a listed company within six months after that transaction (or as may be approved by the Commissioner, where the Commissioner is satisfied that those equity shares cannot be listed within than initial six months period due to circumstances beyond the control of the company, such further period not exceeding six months); or
- (b) in any other case, constitute an interest of more than 25 per cent of the total equity share capital of that company: Provided that in determining the total equity share capital of that company, regard must be had to any agreement in terms of which any person is, on the date of determining the qualifying interest, entitled to acquire an interest in the equity share capital in that company on that date at no or nominal cost.”

As it became clear that, invariably, a company will not succeed in completing the listing process within a period of six months, in 2002, the period, referred to in (a) above, was extended to 12 months. Moreover, the introduction of provisions dealing with amalgamation transactions in 2002 necessitated the move of the definition of “qualifying interest” to section 41 of the ITA, as a general definition to apply to both company formation transactions, as it then was, and amalgamations.<sup>106</sup> However, for purposes of amalgamation transactions the definition included an equity share held by that person in a resultant company which is a collective investment scheme referred to in paragraph (e)(i) of the definition of “company” in section 1.

Following the 2002 amendment section 41(1), presenting a simplified version of the term, defined a “qualifying interest”, in relation to any person, as equity shares held by that person in a company, which –

- “(a) is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds those shares; or
- (b) in any other case, constitute more than 25 per cent of the equity shares of that company.”

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<sup>106</sup> The amendments were introduced by section 34(1) of the Revenues Laws Amendment Act No. 74 of 2002.

A further consequence of the simplified definition was the clarification of the determination of a person's qualifying interest in a company following multiple company formation transactions on the same date. Whether a person obtained a qualifying interest in the equity shares of a company depended on the extent of his interest in the equity shares of that company at the end of the day, in question, and not on the extent of such interest after each transaction.

In 2005 the qualifying interest in the equity shares was reduced from 25 per cent to 20 per cent. This was *inter alia* consequential upon the introduction of a definition of "associated group of companies".

Section 41(1) defines an "associated group of companies" as –

"two or more companies in which one company (hereinafter referred to as the 'influencing company') directly or indirectly holds shares in at least one other company (hereinafter referred to as the 'influenced company'), to the extent that –

- (a) at least 20 per cent of the equity shares and voting rights of each influenced company are directly held by the influencing company, one or more influenced companies or any combination thereof as assets of a capital nature; and
- (b) the influencing company directly holds at least 20 per cent of the equity shares and voting rights in at least one influenced company as assets of a capital nature."<sup>107</sup>

The definitions of "associated group of companies", "influencing company" and "influenced company" were introduced for purposes of applying the rules relating to the concepts of domestic financial instrument holding company and foreign financial instrument holding company. The lower threshold of 20 per cent of the equity shares and voting rights were applied to effectively take the underlying assets of influenced

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<sup>107</sup> The definition of "associated group of companies" was inserted into section 41 by section 37(1)(a) of the Revenue Laws Amendment Act No. 31 of 2005.

companies into account to determine the domestic financial instrument holding company and foreign financial instrument holding company status of a group of companies. It was submitted that the wider concept of a group was based on the percentage used for international financial reporting where significant influence was presumed.<sup>108</sup>

The definition of “associated group of companies” came into operation on 8 November 2005 and bears reference to application of section 9D (“controlled foreign companies”).

### **3.5 Financial instrument holding companies**

The meaning of the terms “domestic financial instrument holding company” and “foreign financial instrument holding company” are to be found in sections 41(1) and 9D(1), respectively.

A “domestic financial instrument holding company” (“DFIHC”) basically means any resident company, where more than the prescribed proportion (50 per cent) of all the assets of that company, together with the assets of all influenced companies in relation to that company, consist of financial instruments.<sup>109</sup>

In determining the prescribed proportion, the following are excluded:

- a financial instrument that constitutes a debt in respect of goods sold or services rendered by that company where the amount of that debt was included in the

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<sup>108</sup> SARS. 2005. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005*. 29.

<sup>109</sup> Huxham, K. & Haupt, P. 2008. *Notes on South African income tax*. Cape Town: H & H Publications. 289.

income of that company and that debt is an integral part of a business conducted by that company as a going concern;

- a financial instrument of, or financial instruments transferred to certain regulated financial institutions, ie banks, insurance companies and collective investment schemes;
- any share of a controlled group company in relation to that company; and
- any financial instrument which constitutes a loan, advance or debt if both the debtor and creditor companies are members within the same group of companies.<sup>110</sup>

Save for the fact that it applies to non-resident companies, a “foreign financial instrument holding company” (“FFIHC”) bears a similar definition to that of a DFIHC.<sup>111</sup>

None of the domestic or foreign reorganisation and/or participation exemption rules applied to the sale of passive portfolio investments, because the purpose of *inter alia* the corporate rules was to promote the efficient restructuring of active businesses. As a consequence, financial instrument holding company rules were introduced to provide a backstop and qualification to the corporate rules so as to prevent, as a general rule, the transfer of financial instruments in a tax neutral manner.<sup>112</sup> This had the effect of acting as an anti-avoidance measure, as it limited the movement of financial instruments. This was done, as the reshuffling of financial instruments was often seen as a prelude for tax avoidance transactions. Consequently, the definitions

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<sup>110</sup> Section 41(1).

<sup>111</sup> Section 41(1) read with section 9D(1) of the ITA.

<sup>112</sup> Definitions added by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002.

of DFIHC and FFIHC and the criteria built into these definitions were introduced into the ITA in 2002.<sup>113</sup>

Generally, where more than half of the market value or actual cost of all the assets of a company together with any controlled company in relation to that company was attributable to financial instruments, the transfer of the shares of that company in terms of the roll-over rules was unacceptable. However, an exception was made for debts in respect of goods sold or services rendered by that company or transferor where the amount of the transaction was included in the income of that entity or a controlled group company in relation to that entity and the debt was an integral part of a business conducted by the company involved as a going concern. Shares held in controlled group companies as well as loans, advances or debts between companies which formed part of that group of companies were also disregarded when determining the portion of all assets of a group of companies in relation to a company consisting of financial instruments.<sup>114</sup>

The introduction of the financial instrument holding company rules, therefore, relaxed the limitation on the transfer of financial instruments.

In 2003, there were even a further “relaxation” of the limitations. The first was with regard to the rule in terms of which a company’s holding of financial instruments could not exceed half of its assets, as measured in terms of *historic cost* and *market value*.<sup>115</sup> Despite concessions that the historic cost test was unfair in view of the

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<sup>113</sup> SARS. 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 13.

<sup>114</sup> SARS. 2002. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002*. 34.

<sup>115</sup> The amendment was introduced by section 49(1) of the Revenue Laws Amendment Act No. 45 of 2003 and made retrospective to 6 November 2002 and applied in respect of any company formation

exclusion of self-generated goodwill, it was argued that, the market value test would not be sufficient on its own, especially, in view of the volatility of fair market value and its possible manipulation. As a result, the permissible limit for financial instruments, as measured against the historic cost of the company's assets, was relaxed by increasing it from one-half to two-thirds of such assets. Thus, both resident companies, as well as foreign companies qualified as financial instrument holding companies once their financial instruments exceeded two-thirds of all their assets when measured at their historic cost, or half of all their assets when measured at their market value.<sup>116</sup>

The second amendment related to the list of financial instruments to be disregarded when determining whether the financial instruments held by a company and by all its controlled group companies exceeded the permissible ratio. At the time, the definition of a DFIHC excluded financial instruments held by a controlled group company in relation to a resident company where that controlled group company was a regulated financial institution such as a bank, insurance company or a collective investment scheme. Similarly, and subject to certain requirements, the definition of a FFIHC also had an exclusion in respect of financial instruments held by a controlled group company in relation to a foreign company if that controlled group company was an institution that was similar to a local bank, insurer, dealer or broker. However, these exclusions only applied where the company *and* its controlled group companies were either all resident or non-resident.<sup>117</sup> The amendment removed the anomaly by extending the list of excluded financial instruments to instruments held by controlled

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transaction (as it then was), share-for-share transaction, amalgamation transaction, intra-group transaction, unbundling transaction or liquidation distribution which takes effect on or after that date.

<sup>116</sup> SARS. 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 14

<sup>117</sup> *Ibid* at 14.

group companies that met the requirements of either of the relevant exclusions, which applied in respect of regulated financial institutions and their foreign equivalents.<sup>118</sup>

The third amendment was aimed at extending roll-over relief to some transfers of cash and cash equivalents. The treatment of cash and cash equivalents as financial instruments for purposes of financial instrument company status made little sense in the case of intra-group transactions and liquidation distributions. In both instances, the purpose of the relief was to allow for the tax-free transfer of cash under the theory that companies within a group are economically the same as divisions of a single company. As a result, therefore, it was proposed that any financial instrument of which the market value was equal to its base cost, would be disregarded, in the case of disposals in terms of intra-group transactions or liquidation distributions, when calculating whether the financial instruments of the company, effecting that disposal, exceeded the permissible limit. As a result, the holding of cash and cash equivalents were not to be taken into account when determining whether that company qualified as a DFIHC or FFIHC.<sup>119</sup>

Notwithstanding further amendments to these definitions in 2005 and 2006, the limitations to financial instruments were finally removed in 2007.

SARS acknowledged that while the movement of financial instruments were often seen to be a predicate for tax avoidance, other practical mechanisms existed to achieve such movement without reliance on the reorganisation rules. The

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<sup>118</sup> The amendments were introduced by section 49(1) of the Revenue Laws Amendment Act No. 45 of 2003.

<sup>119</sup> As proposed in the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003 and introduced into the ITA by section 49(1) of the Revenue Laws Amendment Act No. 45 of 2003.

cumbersome nature of these rules, it was admitted, rather added unnecessary compliance costs for legitimate reorganisations with little protection against avoidance.<sup>120</sup> As a consequence, the limitations relating to financial instruments were removed and all reorganisations contemplated in Part III of Chapter II of the ITA can now be conducted without regard to any of the previous limitations.<sup>121</sup>

### **3.6 Loss roll-overs**

The transfer of assessed losses between companies, in general, and group companies, in particular, are prohibited in terms of section 103(2) of the ITA.

The corporate rules do not allow the transfer of capital losses. Capital losses are ring-fenced where a person disposes of an asset to a company at a loss. In other words, assets may not be transferred at a loss. When it comes to amalgamations, intra-group transactions and unbundling transactions this does not present a problem, as assets are treated as having been transferred at their base cost.

On the other hand, when it comes to asset-for share transactions, section 42 contains a specific anti-avoidance measure in that the roll-over relief is only available for transactions where the market value of the asset being disposed of equals or exceeds its base cost.<sup>122</sup>

This was, however, not always the case. When the corporate rules were introduced in 2001 no such limitation existed in respect of company formation transactions and share-for-share transactions. As a result, at the time, parties to transactions in terms

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<sup>120</sup> SARS. 2007. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007*. 21.

<sup>121</sup> The amendments were introduced by the Revenue Laws Amendment Act No. 35 of 2007.

<sup>122</sup> Section 42(1)(a) of the ITA.

of sections 42 and 43 could transfer built-in loss assets, ie assets of which the market value was lower than their base cost, to a transferee company. Notwithstanding the fact that, as a result of the provisions in section 103(2) of the ITA, theoretically, it would have been impossible for a taxpayer to shift built-in loss assets into a transferee company, the monitoring of such transactions were, apart from being complex, an administrative burden.<sup>123</sup> Moreover, it made the provisions relating to the disregarding of capital losses, where capital assets were disposed of within a period of 18 months from the date of entering into a company formation transaction, share-for-share transaction, intra-group transaction or liquidation distribution, to some extent superfluous. To this end, in 2002 the provisions of sections 42 and 43 were amended to avoid capital losses being transferred in this way.<sup>124</sup>

### **3.7 Consideration other than shares**

When the corporate rules was introduced in 2001, the provisions of section 42 did not provide for a situation where a person received consideration other than equity shares in a company following the transfer of an asset to that company in terms of a company formation transaction, as it then was. This certainly created problems with the apportionment of base cost in the case of capital assets, allowances allowed in the case of allowance assets or the amount in the case of trading stock, to be taken into account in the transferor's hands as the part of the asset disposed of which did not qualify for roll-over relief.<sup>125</sup>

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<sup>123</sup> SARS. 2002. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002*. 22.

<sup>124</sup> The amendments were introduced by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002.

<sup>125</sup> SARS. 2002. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002*. 36.

In 2002 section 42(4) was amended to provide for scenarios where an asset was disposed of to a company for a consideration consisting partly of something other than equity shares issued by that company. Following the amendment, such a disposal to a company was treated partly as a sale of that asset and partly as a company formation transaction, as it then was, eligible for roll-over relief.<sup>126</sup>

When roll-over relief with respect to amalgamation transactions was introduced in that same year, provision was similarly made for situations where a person disposed of an equity share in an amalgamated company, as defined, and, in addition to any equity shares in the resultant company, as defined, became entitled to other consideration.<sup>127</sup> Moreover, the amount of any other consideration to which a person became entitled to, in terms of the said amalgamation transaction, would for purposes of section 64B be deemed to have been a dividend declared and distributed, to that person, out of profits of that amalgamated company.<sup>128</sup>

In 2003 the issue was further clarified by limiting the deemed dividend to the amalgamated company's profits and reserves available for distribution. Save for the aforesaid, it made the provision consistent with section 64C(4)(c) and clarified the date of accrual of such deemed dividend.<sup>129</sup>

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<sup>126</sup> The amendments were introduced into the ITA by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002.

<sup>127</sup> Section 44(7) of the ITA. Roll-over relief for amalgamation transactions were introduced into the ITA by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002.

<sup>128</sup> Section 44(10) of the ITA.

<sup>129</sup> SARS. 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 68.

### 3.8 De-grouping

The so-called “de-grouping” provision contained in section 45(4) of the ITA, is nothing more than an anti-avoidance measure for purposes of intra-group transactions. Notwithstanding this, it is probably the one provision in the corporate rules that causes the most difficulty.

The object of roll-over relief with respect to intra-group transactions is to place a single group of companies on par with a single company containing multiple branch operations. The transfer of assets between two branches of a single company should be a non-event for tax purposes. Hence, the relief when assets are transferred between two companies within the same group. However, should the group companies engaged in the transfer subsequently become severed from one another, ie they are no longer part of the same group of companies, then the de-grouping charge triggers a deemed disposal. The de-grouping charge, it is said, stems from the branch analogy, which would trigger a gain if the branches were no longer part of the same company.<sup>130</sup>

When the corporate rules were promulgated in 2001, the de-grouping provision, contained in section 44(6) at the time, provided that –

“Where an asset is disposed of by a transferor company to a transferee company in terms of an intra-group transaction in respect of which the provisions of subsection (3) or (5) apply and the transferor company and the transferee company at any time thereafter cease to form part of the same group of companies before the disposal by the transferee company of that asset, that transferee company must be deemed to have disposed of that asset for an amount equal to the market value of that asset *on the date that such companies cease to form part of the same group of companies* and as having immediately reacquired that asset for a cost equal to that market value: Provided that where the transferor company or transferee company is liquidated or deregistered as

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<sup>130</sup> SARS. 2007. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007*. 22.

contemplated in section 46 [*as it then was*], the holding company and the liquidating company, as contemplated in that section, must be deemed to be one and the same company for purposes of this subsection.” [*Own emphasis added.*]

The fact that the transferee company was deemed to have disposed of the asset for an amount equal to its market value on the date it ceased to form part of that group of companies was not in accordance with the methodology followed in sections 42 and 43, ie where a gain is triggered when a qualifying interest is no longer held.

Consequently, the subsection was amended in 2002 to provide for the determination of market value of the asset on the date on which it was acquired in terms of the intra-group transaction.<sup>131</sup> In other words, the base cost of that asset in the hands of the transferee company would be the market value of that asset at the time of its acquisition.

Notwithstanding this, the provision still caused problems as it was silent on the effect the de-grouping may have had on any capital allowances and deductions in respect of an asset to which a transferee company may have been entitled to in terms of sections 11(e), 12B, 12C or 12E. However, in 2003 this was rectified by amending subsection (4) so as to provide that the deemed disposal and re-acquisition, as envisioned in section 45(4), of the affected asset was ignored when determining whether that transferee company qualified for such allowance or deduction, as well as when determining the amount thereof.<sup>132</sup>

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<sup>131</sup> The changes were introduced by the Revenue Laws Amendment Act No. 74 of 2002 and deemed to have come into operation 6 November 2002 and applicable in respect of any disposal on or after that date. The introduction of amalgamation transactions led to intra-group transactions being moved to section 45 and the de-grouping provision to subsection (4) where it has since been.

<sup>132</sup> SARS. 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 69.

To avoid triggering the de-grouping charge, companies within the same group embarked on so-called multi-tier roll-overs. A group of companies could dispose of an asset from one member to another in terms of an intra-group transaction, without triggering any gain or loss in respect of that disposal. Where a group consisted of more than two members the rolled over gain or loss could subsequently be rolled over again and that gain or loss so rolled over, from the transferor company to the transferee company, in terms of the later disposal would include gains or losses rolled over as a result of the first intra-group transaction.

In terms of the wording of section 45(4), as it then was, any gain or loss rolled over to a transferee company still holding the asset would only be triggered where that transferee company and its transferor company ceased to be members of the same group of companies in relation to each other. In other words, the rolled over gain or loss would not be triggered where a transferee company, that had not yet disposed of the asset, and the transferor company, from which it acquired that asset, left the larger group of companies of which they formed part, while remaining members of the same group of companies in relation to each other.<sup>133</sup>

As indicated herein above, the underlying rationale for the de-grouping provision was to act as an anti-avoidance measure. In the circumstances, it was said, a gain or loss from an intra-group disposal of an asset by a transferor company to a transferee company should only be deferred while that asset was held by that transferee company or by another company forming part of any group of companies in relation to the transferor company that effected the initial intra-group disposal. As a result, in

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<sup>133</sup> SARS. 2004. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, 69.

2004 section 45(4) was amended to ensure it applied where a transferee company held an asset, which it acquired –

- as a result of a disposal by a transferor company by means of an intra-group transaction; or
- as a result of that intra-group transaction as well as one or more disposals subsequent to that intra-group transaction, all of which resulted in a deferred gain or loss as a result of the application of Part III, ceased to form part of any group of companies in relation to the transferor company that effected the initial intra-group transaction.

This meant that the transferee company was deemed to have disposed of that asset to and to have immediately reacquired it from a connected person on the day immediately before the date on which that transferee company ceased to form part of that group of companies.<sup>134</sup>

Notwithstanding the intention to prevent the abuse through multiple roll-overs, one of the problems was that the de-grouping charge arose no matter how many years after the initial intra-group transfer the de-grouping occurs.<sup>135</sup> In 2007, however, a time limit was added.<sup>136</sup>

The 2007 amendment, which was delayed until 1 January 2009<sup>137</sup>, provided that the de-grouping charge applied only if the transferor and transferee companies involved

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<sup>134</sup> *Ibid* at 70. The amendments to section 45(4) were introduced by section 35(1)(a) of the Revenue Laws Amendment Act No. 32 of 2004 and effective from 26 October 2004.

<sup>135</sup> Another problem was the uncertainty with the determination of values in respect of allowance assets.

<sup>136</sup> By section 56(1)(a) of the Revenue Laws Amendment Act No. 35 of 2007.

<sup>137</sup> The amendment of section 45(4) was delayed until 1 January 2009 when the narrowed definition of “group of companies” in section 41 came into operation, to avoid an unnecessary triggering of the de-grouping charge for certain persons.

in the intra-group transfer became severed from one another (ie no longer formed part of the same group of companies) within a period of six years after the intra-group transfer. Group separations after the six-year period were therefore to be ignored.<sup>138</sup>

Although there may have been good intentions with the introduction of the six year rule in 2007, it caused confusion as to how the rule would apply. In other words, when a series of intra-group transactions are entered into, within the same group of companies, will the six year rule apply from the first transfer or from the last transfer?

Fortunately, the confusion was short lived. In 2008 the wording of section 45(4)(b) was replaced with the following:

- “(b) Where a transferee company which has acquired an asset as contemplated in paragraph (a) ceases within a period of six years after the acquisition to form part of any group of companies in relation to the transferor company contemplated in paragraph (a)(i) or a controlling group company in relation to the transferor company, and the transferee company has not disposed of that asset –
- (i) an amount equal to the lesser of –
    - (aa) the greatest capital gain that would have been determined in respect of any disposal of the asset in terms of an intra-group transaction within the period of six years preceding the date on which the transferee company ceased to form part of the group of companies, had subsection (2) not applied in respect of that disposal; or
    - (bb) the capital gain that would be determined if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date, is deemed to be a capital gain of the transferee company for the current year of assessment and the base cost of the asset must be increased by that amount and, where the asset is an allowance asset, the cost or value of the asset must be increased by 50 per cent of that amount;
  - (ii) an amount equal to the greater of –
    - (aa) the amount contemplated in paragraph (j) or (n) of the definition of ‘gross income’ that would have been included in income as a result of any disposal of the asset in terms of

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<sup>138</sup> SARS. 2007. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007*. 23.

- an intra-group transaction within the period of six years preceding the date on which the transferee company ceases to form part of the group of companies, had subsection (3) not applied in respect of that disposal; or
- (bb) the amount contemplated in paragraph (j) or (n) of the definition of 'gross income' that would be included in income if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date,
- must be included in the gross income of the transferee company for the current year of assessment and the cost or value of the asset for purposes of any deductions allowable in respect of that asset (other than deductions allowable in terms of section 12G or 12I) must be increased by that amount: Provided that where an amount contemplated in paragraph (j) of the definition of 'gross income' is so included, the cost or value is deemed to be so increased immediately before any subsequent disposal of the asset; and
- (iii) an amount equal to the lesser of –
- (aa) the greatest amount of taxable income (other than any taxable capital gain and any taxable income derived as a result of an amount being included in gross income in terms of paragraph (j) or (n) of the definition of 'gross income') that would have been determined in respect of any disposal of the asset in terms of an intra-group transaction within the period of six years preceding the date on which the transferee company ceases to form part of the group of companies, had subsection (2) not applied in respect of that disposal; or
- (bb) the taxable income (other than any taxable capital gain and any taxable income derived as a result of an amount being included in gross income in terms of paragraph (j) or (n) of the definition of 'gross income'), that would be determined if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date,
- must be included in the taxable income of the transferee company for the current year of assessment and the cost of the asset must be increased by that amount.”<sup>139</sup>

As it currently is, the provisions of section 45(4)(b) now effectively mean that if an asset was transferred through a series of intra-group transactions, each section 45 transfer is to be tested separately for purposes of the 6 year rule. Thus, the question as

<sup>139</sup> The amendment to subsection (b) of section 45(4) was introduced by the Revenue Laws Amendment Act No. 60 of 2008 and deemed to have come into operation on 21 October 2008 and applicable in respect of cessations on or after that date.

to whether or not the de-grouping charge was triggered will be tested by looking at the de-grouping date and going back six years.

Applying this test, means that there may be multiple de-groupings in the six year period and each one will be treated as a separate de-grouping.

### **3.9 Conclusion**

Apart from the fact that the corporate rules was consequential on the introduction of the Eighth Schedule to the ITA, the purpose of its enactment, it was said, was to permit the tax-free transfer of assets to entities where they can be most efficiently used for business purposes, especially where the group or the shareholders have retained a substantial interest in the assets so transferred.<sup>140</sup>

However, it is submitted that, the corporate rules was, and still is, nothing more than complicated anti-avoidance measures. The fact that the rules were mandatory when they were initially introduced posed more of a concern than a welcoming relief. As pointed out earlier, the parties to an intra-group transaction, for example, does not always want the roll-over relief to apply to the transfer of an asset. And, with the elimination of the loss roll-over provisions in 2002, it became even more pertinent that taxpayers should be allowed to decide whether to make use of the roll-over treatment or not.

That score being settled, the corporate rules, it is submitted, is far from being the effective tool it was intended to be. The de-grouping charge in section 45(4), for one,

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<sup>140</sup> SARS. 2001. *Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001*. 6.

still creates a lot of difficulty with multiple roll-overs within the same group of companies. Notwithstanding the fact that each amendment to section 45(4) has made the application of this provision more complicated, the administration thereof, it is submitted, has also become more burdensome and onerous for all parties involved.

South Africa does not recognise any group taxation regime, however, to some extent though the provisions contained in the corporate rules are nothing but a form of group relief. However, having regard to the simplicity a group taxation regime may offer, it is submitted that, it might be worthwhile investigating the advantages and disadvantages of a group taxation regime for South Africa. Chapter 5 explores, albeit on a very high level, such advantages and disadvantages. Nevertheless, the next chapter focuses on some proposed amendments to domestic company law and the possible impact they may have on the application and effectiveness of the corporate rules.

## Chapter 4

### Company law and group relief measures

*"In wealth, power and organization today's great companies are states within the State. Their policies can make or mar the fortunes of cities, provinces and whole nations. The relationship between the State and its large companies is a complex one. The State depends on its companies for revenue, supplies and employment, but objects if one of its key companies proposes to pursue a policy which is considered to be incompatible with the national interest. The leading companies resent government interference but look to the government for contracts, licences and supportive legislation. If threatened with financial catastrophe, they expect the government to bail them out. In a power contest between State and company, the State invariably wins. In the last resort, though, the State and its companies are linked in a symbiotic relationship. They prosper or suffer together."<sup>141</sup>*

#### 4.1 Introduction

The corporate rules were designed to provide roll-over relief with regard to asset and share transactions between group companies. Their application within the realms of taxation notwithstanding, it is submitted that we have to take cognisance of the structure and development of modern company law, for the corporate rules cannot function in isolation.

#### 4.2 Background

Companies play a very important part in the world economy; for one, the limited liability company has been a major instrument in making possible the industrial and commercial developments over the world.<sup>142</sup> When the limited liability concept was introduced in the nineteenth century its use was envisaged to serve entrepreneurs that needed to raise capital for large scale enterprises. However, it was soon recognised

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<sup>141</sup> Pretorius, J.T. (Gen Ed.), Delpont, P.A., Havenga, M. & Vermaas, M. 1999. *Hahlo's South African Company Law (through the cases)*, 6<sup>th</sup> ed. Cape Town: Juta & Co, Ltd. 4.

<sup>142</sup> Davies, Paul L. 1997. *Gower's Principles of Modern Company Law*. 6<sup>th</sup> ed. London: Sweet & Maxwell. 61.

that it could also be advantageously adopted by partnerships and sole traders, and today it is commonly used throughout industry and commerce.<sup>143</sup>

Since their recognition as separate legal personae<sup>144</sup> companies have endured tremendous development as a form of business enterprise, and the view that the company is no longer regarded as an “instrument of profit maximisation managed for the sole benefit of its shareholders”<sup>145</sup> notwithstanding, the development of the company as juristic personality reveals a somewhat different picture.

The development of modern company law is characterised by the following eight major economic themes: (i) the growth of larger business units; (ii) the development of increasingly elaborate structures; (iii) a shift from ownership to control; (iv) the increasing ownership of ordinary shares by institutional investors ie pension funds, insurance companies, unit trusts and investment trusts who manage other people’s savings; (v) the increasing amount of government intervention in corporate affairs; (vi) the changes in the world economy from being international to transnational; (vii) the growth of transnational corporations that rival the state in capital and power; and (viii) the legal impact of integration into the global economy.<sup>146</sup>

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<sup>143</sup> *Ibid* at 62.

<sup>144</sup> *Salomon v Salomon and Co. Ltd* [1897] AC 22 (HL).

<sup>145</sup> Schmitthoff, C.M. 1981. *Commercial law in a changing economic climate*. 2<sup>nd</sup> ed. 37. Schmitthoff is of the view that, because the company as an economic unit consists of a combination of several interests ie the shareholders as providers of capital, the employees as providers of labour, the creditors and the public, the concept of a company as an instrument of economic capitalism has developed into an enterprise founded on the theory of social responsibility. Quoted by Pretorius, J.T. (Gen Ed.), Delpont, P.A., Havenga, M. & Vermaas, M. 1999. *Hahlo’s South African Company Law (through the cases)*. 6<sup>th</sup> ed. Cape Town: Juta & Co, Ltd. 7.

<sup>146</sup> Farrar, J.H. & Hannigan, B.M. 1998. *Farrar’s Company Law*. 4<sup>th</sup> ed. 8-13. Quoted by Pretorius, J.T. (Gen Ed.), Delpont, P.A., Havenga, M. & Vermaas, M. 1999. *Hahlo’s South African Company Law (through the cases)*. 6<sup>th</sup> ed. Cape Town: Juta & Co, Ltd. 4-6.

Worldwide, corporate governance issues and increasing regulatory requirements are forcing businesses to develop a more rigorous approach to risk management.<sup>147</sup> Large businesses are also constantly reminded that they have a responsibility as corporate citizens.<sup>148</sup> South Africa is no different and as a developing country it needs to stay abreast of worldwide trends to continuously attract foreign direct investment from transnational corporations. When it comes to the development of domestic company law the approach is no different. The government has embarked on an overhaul of the existing corporate legislation by introducing the Companies Bill No. 61 of 2008 ("the Companies Bill").<sup>149</sup>

The important role companies, especially those who are large businesses, play in our macro economic environment, it is submitted, is recognised by the effort of the government to level the playing field between large businesses and small and medium enterprises, albeit by means of statutory intervention. Nevertheless, the corporate rules, as contained in Part III of Chapter II of the ITA, are complex and situations inevitably arise where the rules are not easily applicable or their consequences are unintended and unwelcome.<sup>150</sup>

It is against this background that the proposed amendments to the Companies Act will be discussed to determine whether those changes may impact the effectiveness of the corporate rules.

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<sup>147</sup> Cliffe Dekker Attorneys. Spring 2007. Tax risk assessment. In *Matters for clients*.

<sup>148</sup> See *vt* 8.

<sup>149</sup> The Companies Bill is said to repeal the Companies Act No. 61 of 1973 ("the Companies Act"), except for the provisions dealing with winding-up and liquidations, and amend certain sections of the Close Corporations Act No. 69 of 1984 ("the Close Corporations Act") once promulgated. The Companies Bill was passed by Parliament during 2008 and it is expected that it will come into effect some time during 2010.

<sup>150</sup> Surtees, P. 2003. Deductions, recoupments, losses through scrapping, secondary trades, and corporate restructuring. *Juta's Business Law*. 12(2): 62.

A detailed discussion of the proposed changes to the Companies Act is beyond the scope of this study. However, some of the issues that are tax related are addressed, for example, the categorisation of companies as public interest companies and its effect on the appointment of independent non-executive directors to its audit committees; the question of control vis-à-vis the definition of a “group of companies” in the ITA, etc.

### **4.3 The Companies Bill**

The objectives of the Companies Bill are said to be simplification, flexibility, corporate efficiency, transparency and predictable regulations. And, although the Companies Bill may achieve its objectives from a company law perspective, an assessment of the impact that the proposed amendment may or *may not* have on the application and effectiveness of the tax group relief measures is appropriate.

#### **4.3.1 Categories of companies**

The first draft of the bill, the Companies Bill, 2007 (“the 2007 Bill”) distinguished between three types of companies, namely a widely held company (“WHC”)<sup>151</sup>, a closely held company (“CHC”) and a not for profit company (“NPC”). The 2007 Bill further introduced a cross-cutting characterisation of companies as so-called “public interest companies” in instances where the company may have a greater responsibility to the wider public.

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<sup>151</sup> In terms of clause 8(2) of the 2007 Bill a for profit company would be deemed a WHC if, (a) the company’s Memorandum of Incorporation (i) permits it to offer its shares to the public, within the meaning of section 60 and 61; (ii) limits, negates or restricts the pre-emptive right of every shareholder set out in section 36(1); or (iii) provides for the unrestricted transferability of any of its shares; or (b) a majority of its shares are held by another WHC, or collectively by two or more related or inter-related persons, any one of which is a WHC. All the remaining for profit companies, save for the aforesaid, would be known as CHC’s.

In terms of clause 9(1) of the 2007 Bill a company would be treated as a public interest company if it is either a WHC or a CHC (or a NPC) that –

- is predominantly engaged in public interest activities<sup>152</sup>; or
- at the time a determination is made, satisfies any two of the following three criteria:
  - its average asset value, combined with the average asset value of any related or inter-related juristic person, over the preceding three years exceeds R25 000 000 in the case of a for profit company or R10 000 000 in the case of a NPC;
  - its average annual turnover, combined with the average annual turnover of any related or inter-related juristic person, over the preceding three years exceeds R50 000 000 in the case of a for profit company and R20 000 000 in the case of a NPC; and
  - its average number of employees, combined with the average number of employees of any related or inter-related juristic person, over the preceding three years exceeds 200 in the case of a for profit company and 50 in the case of a NPC.

It is submitted that the categorisation of companies in accordance with the 2007 Bill, especially the provision for public interest companies, would certainly have had an effect on the way corporate restructuring is conducted. For one, parties would have had to be wary of the fact that by entering into an asset-for-share transaction, amalgamation or intra-group transaction a company's aggregate asset value or

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<sup>152</sup>The following economic activities are said to be public interest activities, namely, taking deposits from the public or exercising a public trust, activities that have a substantial or significant impact on the environment, activities that contribute to public health or the supply or maintenance of essential goods, services or infrastructure.

aggregate turnover may be altered, thereby altering the category into which it falls. Where, for example, the resultant company's asset value immediately after the transaction exceeds the prescribed threshold, and one of the other criteria are satisfied, the company would be classified as a public interest company. This, of course, would change the company's profile and status when it comes to *inter alia* financial accountability and compliance. The company's financial reporting requirements would have become more onerous (*clause 96(7)*) and the company would be obliged to appoint independent non-executive directors (*clause 100(2)*). Imagine the effect this may have on private companies where the shareholders are also the directors or family owned businesses. For example, the moment the company becomes a public interest company the directors of that company must establish an audit committee which is to be headed by an independent non-executive director. The audit committee will, amongst others, appoint auditors and determine their fees, determine the nature and extent of non-audit services and approve the consultancy fees of consultants or specialists engaged by the audit committee to assist in the performance of their duties.

Nevertheless, at first glance the categorisation of companies as public interest companies seems to have been abolished as the Companies Bill now only differentiates between NPC's<sup>153</sup> and profit companies. Profit companies are divided into private companies, personal liability companies<sup>154</sup>, public companies and state owned companies. Only public companies and state owned companies will be required to comply with certain financial reporting standards<sup>155</sup> and appoint audit committees.<sup>156</sup>

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<sup>153</sup> The NPC will be the successor to the current section 21 company.

<sup>154</sup> The personal liability company will be the successor to the current section 53 company.

<sup>155</sup> Clause 34 of the Companies Bill.

<sup>156</sup> Clause 94(2) of the Companies Bill.

However, clause 30(2)(b)(i) read with clause 30(7) of the Companies Bill provides that the Minister may make regulations, which may include different requirements for different categories of companies, prescribing the categories of private companies that are required to have their annual financial statements audited. These regulations will be made whilst taking into account the public interest and having regard to the social and economic significance of the company, as indicated by its annual turnover, size of workforce or the nature and extent of its activities.

We should be mindful of the Ministerial powers granted and cognisance should be taken of these regulations once published in the Government Gazette. It is submitted that the categorisation of companies as public interest companies will continue to play a role in the Companies Bill albeit not expressly so stated.

The requirement to appoint non-executive directors, it is submitted, may lead to an increase in the number of unbundling transactions. South Africa does not recognise a consolidation regime, or any other group taxation regime for that matter, and groups of private companies may be tempted to use the roll-over relief provided for in section 46 of the ITA to escape the imposition of regulations governing the financial reporting requirements of so-called public interest companies.

#### **4.3.2 Close Corporations**

The definition of a "company" in the Companies Bill excludes close corporations in so far as they have not converted to companies in terms of Schedule 2.<sup>157</sup>

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<sup>157</sup> A "company" is defined as meaning a juristic person incorporated in terms of the Companies Bill, or a juristic person that, immediately before the effective date, (a) was registered in terms of the Companies Act, other than as an external company as defined in that Act; or the Close Corporations Act, if it has subsequently been converted in terms of Schedule 2; (b) was in existence and recognised

Notwithstanding the exclusion in the Companies Bill, close corporations are included in the definition of a “company” in the ITA.<sup>158</sup> The reference to an “equity share” in Part III of Chapter II of the ITA includes the members’ interest in a close corporation.<sup>159</sup> Although the definition of “equity share capital” in section 1 of the ITA was only amended in 2007, to include members’ interest in close corporations<sup>160</sup>, it has always been understood that the application of the corporate rules relates to close corporations as well.

Close corporations would continue to make use of the corporate rules for as long as the Close Corporations Act remains in force. However, it is anticipated that close corporations will be allowed to continue trading as such (under the auspices of the Close Corporations Act), for a period of ten years whereafter they will have to convert to companies.

It should be noted that any conversion, as aforesaid, will not have any adverse tax consequences, as such close corporation and such company will for purposes of the ITA be deemed to be and to have been one and the same company.<sup>161</sup>

### **4.3.3 Capitalisation**

The Companies Bill will bring about a number of changes with regard to the capitalisation of companies. Probably the most important of these is the absence of the capital maintenance rule by abolishing par value shares. Different classes of

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as an “existing company” in terms of the Companies Act; or (c) was deregistered in terms of the Companies Act and has subsequently been re-registered in terms of this Act.

<sup>158</sup> Paragraph (f) of the definition of “company” in section 1 of the ITA.

<sup>159</sup> The definition of “equity share capital” in section 1 of the ITA.

<sup>160</sup> Inserted by section 3(1)(d) of the Taxation Laws Amendment Act No. 8 of 2007.

<sup>161</sup> Section 40A(1) of the ITA.

shares will still be permitted and in most instances should be classified and specified. However, provision is also made for unclassified shares, unspecified shares and voteless shares.<sup>162</sup>

The proposed capitalisation regime has to be considered when making use of the corporate rules. Some of these are discussed below.

#### *4.3.3.1 Subscription of shares*

Clause 39(2) of the Companies Bill provides that the existing shareholders of a private company have a 'right of first refusal' in respect of shares proposed to be issued by that company.<sup>163</sup> This means that shareholders of a company have a statutory pre-emptive right to subscribe for a percentage of the shares to be issued equal to the voting power of that shareholder's general voting rights immediately before the offer was made to a third party.

Moreover, the minority protection incorporated in the Companies Bill could lead to difficulty when it comes to the implementation of company reorganisations.

Clause 115(2) of the Companies Bill provides that no amalgamation or merger, or scheme of arrangement or disposal of all or the greater part of its assets or undertaking may be implemented by a company unless that company has acquired the necessary approval from its shareholders. The required approval for the transactions includes *inter alia* a special resolution from its shareholders and, where that company is a subsidiary, the shareholders of the company's holding company. Shareholders

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<sup>162</sup> Clause 37 of the Companies Bill.

<sup>163</sup> Capitalisation shares (as contemplated in clause 47) and shares issued in terms of options or conversion rights or as contemplated in clauses 40(5) to (7) are excluded (*clause 39(1)(b)*).

that disapprove of a merger may lodge a formal objection and approach a court of law to stop the process.

Although the minority protection envisioned in clause 115(2) may have the greatest of intentions, it is submitted that it could lead to practical difficulty in implementing amalgamation transactions.<sup>164</sup> That being said, having regard to the meaning of what constitutes a disposal<sup>165</sup>, it is submitted that there would not have been a transfer of ownership of any assets in the event of a merger being reversed as a result of an objection by any shareholder. It follows that the anti-avoidance provisions in section 44(5) of the ITA will not be triggered.

#### *4.3.3.2 Consideration for shares*

Section 92(1) of the Companies Act does not allow the issue or allotment of shares unless the full issue price or other consideration for such shares has been paid to and received by the company. It seems that this will no longer be a requirement for the issue or allotting of shares when one considers the provisions of the Companies Bill.

Clause 40(1) of the Companies Bill provides that the board of a company may *inter alia* issue authorised shares against adequate consideration for the company. The term “adequate” is not defined, but it is submitted that its ordinary meaning will apply. The term “consideration” is however defined and is said to mean “anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including (a) any money, property, negotiable instrument, securities, investment credit facility, token or ticket; (b) any labour, barter

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<sup>164</sup> KPMG. 2008. *KPMG Comments on the Companies Bill, 2008*. 12.

<sup>165</sup> Paragraph 11(1) of the Eighth Schedule.

or similar exchange of one thing for another; or (c) any other thing, undertaking, promise, agreement or assurance, irrespective of its appearance or intrinsic value, or whether it is transferred directly or indirectly”.<sup>166</sup> Albeit the consideration must be adequate, it is notable that the consideration may be in the form of an instrument which is not necessarily negotiable at the time of issuing the shares *or* it could be in the form of an agreement for future services (so-called “sweat equity”), future benefits or future payment by the subscribing party.<sup>167</sup>

The fact that shares may be issued in exchange for future services does not have any bearing on the application of the corporate rules. In terms of an asset-for-share transaction a natural person is currently allowed to dispose of “sweat equity” to a company in exchange for an equity share or shares, provided that that person will be engaged on a full-time basis in the business of the company.

#### *4.3.3.3 Financial assistance*

Financial assistance by a company for subscription of its securities is prohibited in certain circumstances<sup>168</sup>, but the solvency and liquidity test introduced into the Companies Act by the Corporate Laws Amendment Act No. 24 of 2006 remains one of the criteria when financial assistance is approved.<sup>169</sup>

#### *4.3.4 Subsidiary relationships and control*

Save for the reference in Schedule 4, the Companies Act does not contain a definition of the term “group of companies” and the group concept and control in our company

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<sup>166</sup> Clause 1.

<sup>167</sup> Clause 40(5) of the Companies Bill.

<sup>168</sup> Clause 44 of the Companies Bill.

<sup>169</sup> Clause 44(3)(b).

law is founded on the relationship between the company and its subsidiaries or connected persons.

In terms of section 1(3)(a) of the Companies Act a company is deemed to be a subsidiary of another company if that other company is either a member of it and holds or controls a majority of the voting rights in it (whether pursuant with an agreement with other members or otherwise) or has the right to appoint or remove directors holding a majority of the voting rights at the meeting of the board, or if it is a subsidiary of any company which is a subsidiary of that other company, or if subsidiaries of that other company, or if that other company and one or more of its subsidiaries together hold or control a majority of the voting rights, or can appoint or remove a director by exercising a majority of the voting rights at board meetings.

The subsidiary relationship will however see a slight change in emphasis in the Companies Bill. In terms of clause 3(1) of the Companies Bill a company is –

- (a) a subsidiary of another juristic person if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in combination, is or are directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholder agreement or otherwise; or has or have the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board; or
- (b) a wholly-owned subsidiary of another juristic person if all of the general voting rights associated with issued securities of the company are held or

controlled, alone or in any combination, by one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries.

The term "juristic person" is defined as including a foreign company and a trust, irrespective of whether the trust is resident or not.<sup>170</sup> Moreover, a juristic person is related (connected) to another juristic person if either of them directly or indirectly controls the other or the business of the other *or* either is a subsidiary of the other *or* a person<sup>171</sup> directly or indirectly controls each of them or their businesses.<sup>172</sup>

These developments are important as they draw trusts into the sphere of the group concept for corporate law purposes. For company law purposes this means that a company may be a subsidiary of a trust where the trust directly or indirectly controls the business of the company, the voting rights or the right to appoint directors to the board of the company, for example. In a sense recognition is given to a trust as a separate legal entity. This is in contradiction with the common law which does not recognise a trust as a separate legal persona.

Trusts may be treated as persons for tax purposes<sup>173</sup>, but it is trite that they are merely funds, consisting of cash or assets, created by a founder or donor and administered by trustees on behalf of beneficiaries or a certain class of beneficiaries. Whilst the legal dominium of property is vested in the trustees, they have no beneficial interest in it

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<sup>170</sup> Clause 1 of the Companies Bill.

<sup>171</sup> A person includes a juristic person.

<sup>172</sup> Clause 2(1)(c) of the Companies Bill.

<sup>173</sup> The definition of "person" in section 1 of the ITA.

and are bound to hold and apply it for the benefit of the beneficiaries.<sup>174</sup> Once an asset has been vested in a beneficiary, actions by the trustee are actions on behalf of the beneficiary<sup>175</sup>, but under a discretionary trust a beneficiary only has a contingent right (ie an expectation that may never be realised). As it is currently, there is no certainty as to whether trusts can exploit the benefits of the group relief measures. For example, where the trust beneficiaries have vested interests in the assets that are being disposed of (ie the trustees are merely acting on behalf of the beneficiaries) in terms of an asset-for-share transaction, it is submitted that, the requirements of section 42 will apply to each beneficiary individually.

However, the position is uncertain when it comes to discretionary trusts. Some commentators are of the view that, although not a real right, beneficiaries in a discretionary trust have personal rights that have value for purposes of the Eighth Schedule.<sup>176</sup> If this is so, one has to consider what the effect will be on beneficiaries of discretionary trusts where trustees embark on transactions and wish to make use of the roll-over relief provided for by the corporate rules? When it comes to compliance with the provisions of asset-for-share transactions, is it enough if the trust holds a qualifying interest or does each beneficiary have to comply with the requirement to utilise the relief?

The emphasis on the control aspect could prove problematic. In general, a person controls a juristic person, or its business, if that person is directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with the

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<sup>174</sup> *Estate Kemp and others v McDonald's Trustee* 1915 AD 491 at 507.

<sup>175</sup> McAllister, D.S. 2007. *Comprehensive guide to capital gains tax*. SARS. 384.

<sup>176</sup> *Ibid* at 385.

securities of that company.<sup>177</sup> However, a person is also said to control a juristic person where that person has the ability to materially influence the policy of the juristic person in a manner where the person would be able to exercise an element of control over the voting rights attached to the securities of that company.<sup>178</sup>

The terms "equity share" and "qualifying interest" play a vital role as requirements for utilising roll-over relief in asset-for-share transactions and amalgamation transactions. The ITA defines a "qualifying interest", for purposes of unlisted companies, as meaning at least 20 per cent of the equity shares and voting rights of that company.<sup>179</sup> However, considering the reach of the control (as envisaged in clause 2(2)(d) of the Companies Bill) of a person over the voting rights of a juristic person, the reference to voting rights in the definition of "qualifying interest" seems superfluous. For example, a person may obtain a qualifying interest after having entered into an asset-for-share transaction, but not have any 'voting rights' because the company is 'controlled' by another person.

Having said that, and considering that these matters may not have an impact on the application of the corporate rules in general, when embarking on a corporate reorganisation, it is submitted, one will have to familiarise oneself with the relationships and control within a client's business structure. Meticulous planning will be the order of the day.

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<sup>177</sup> Clause 2(2) of the Companies Bill.

<sup>178</sup> Clause 2(2)(d) of the Companies Bill.

<sup>179</sup> Section 41(1).

#### ***4.3.5 Solvency and liquidity vis-à-vis business rescue***

In keeping with international corporate best practice the Companies Bill moves away from the existing capital maintenance regime based on par value shares, to one based on solvency and liquidity. The solvency and liquidity test is defined in clause 4 and has two criteria, namely the monetary asset value and the ability to pay debts. A company satisfies the solvency and liquidity test if –

- the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued; and
- it appears that the company will be able to pay its debts as and when they become due in the ordinary course of business for a period of 12 months following –
  - the date on which the test was considered; or
  - a distribution of a dividend, a share buy-back or payment in lieu of capitalisation shares.<sup>180</sup>

It appears that the solvency and liquidity test applies at company level unless the company is a member of a group of companies, in which case, it appears the consolidated assets and consolidated liabilities of the company have to be considered. This creates some confusion as the term “consolidated” is usually synonymous to group assets and not assets of the company. Moreover, the phrase “consolidated assets of the company” can also be interpreted to mean only the consolidated assets of the sub-group where the company contemplating the transaction is the holding

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<sup>180</sup> Clause 4(1) of the Companies Bill.

company and not the consolidated assets of the holding company of the group ie the ultimate holding company at the top of the group. This implies that there may be many sub-groups within one group of companies, which may render the test impractical.<sup>181</sup>

The qualification of the solvency and liquidity test notwithstanding, reference is also made to various derivatives of the term “solvency”. This creates confusion as the Companies Bill does not define “solvency” and it is uncertain whether the solvency and liquidity test should actually apply in those circumstances.<sup>182</sup> In the absence of any explanation, it is submitted that the ordinary meaning of the word must apply ie the opposite of “insolvent”.

Having said that, the terminology used, in relation to the solvency and liquidity test and business rescue procedure, in the Companies Bill is akin to a consolidation regime. South Africa does not have a group taxation system and the ‘consolidation regime’, therefore, will only apply for company law purposes and will have no bearing on the application of the corporate rules.

#### *4.3.5.1 Debt forgiveness*

Chapter 6 of the Companies Bill contains provisions dealing with business rescue and compromises with creditors that are aimed at companies that are financially distressed.<sup>183</sup> A company is said to be “financially distressed” if it is unable to pay its

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<sup>181</sup> KPMG. 2008. *KPMG Comments on the Companies Bill, 2008*. 5-6.

<sup>182</sup> Clauses 79, 80 and 81 that deals with the procedure in winding-up solvent companies.

<sup>183</sup> Clause 128(1) of the Companies Bill.

debts as and when they fall due or where it seems reasonably likely that the company will become insolvent within the immediately ensuing six months.<sup>184</sup>

The section seems to cover both factual insolvency and commercial insolvency, but again there is no indication as to whether the consolidated assets and liabilities of the company, or where the company is part of a group of companies the consolidated assets and liabilities of the group, should be considered to determine insolvency.

Moreover, clause 150 of the Companies Bill sets out the procedure, requirements and extent of the business rescue plan. Amongst others, the business rescue plan should make reference to those debts from which the company has been released or is to be converted to equity in the company, or another company.<sup>185</sup> It should be noted though, where the company is released from any debt without consideration, or where the consideration is less than the face value of that debt, such release or discharge will trigger a CGT liability unless that company and the creditor are members of the same group of companies.<sup>186</sup>

There does not seem to be any incentive for creditors to release a company from a debt, on the one hand, but it will certainly burden that company with a CGT liability. It therefore remains to be seen what the reasoning behind the debt forgiveness provision was.

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<sup>184</sup> Clause 128(1)(f).

<sup>185</sup> Clause 150(2)(b)(ii) read with clause 154(1) of the Companies Bill.

<sup>186</sup> Paragraph 12(5) of the Eighth Schedule.

#### 4.4 Conclusion

The Companies Act and the ITA are interdependent, especially in circumstances where the corporate rules lack clarity on corporate law aspects. Although certain terms may have different meanings for company law and taxation purposes, it is submitted, the one cannot exist without the other.

Save for politics, contemporary company law plays an important role in the development and otherwise amendment of tax legislation. In the ever changing world economy where transnational corporations influence more and more domestic economies, it is submitted that, revenue authorities are increasingly under pressure to align tax legislation in accordance with international principles. Apart from fiscal legislation, this more than often entails staying abreast of international developments in other areas, such as corporate law.

Having said that, one of the areas where there has not been any consensus is the question of group taxation. From a company law point of view groups of companies are presented as single economic units. However, save for the group relief provided for by the corporate rules, South Africa does not recognise any of the group taxation regimes and each company within a group of companies, as defined, is taxed as a separate taxpayer.<sup>187</sup>

Albeit on a very high level, Chapter 5 provides a brief introduction to group taxation and explores the need for a group taxation regime in South Africa.

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<sup>187</sup> Section 5(1)(d) of the ITA.

## Chapter 5

### Group taxation

#### 5.1 Introduction

Despite the many submissions made to National Treasury and the appointment of two commissions of inquiry (ie the Margo Commission and the Katz Commission), to investigate group taxation regimes, South Africa does not have a group taxation regime.

This chapter provides a brief introduction to group taxation and explores, on a very high level, the advantages and disadvantages of group taxation and the need for such a regime in South Africa.

#### 5.2 Background

Group taxation is designed to reduce the effect that the separate existence of related companies has on the aggregate tax liability of that particular group of companies.<sup>188</sup>

Thus, corporate groups are presented as an economic unit with the argument that it should be treated as if it were a single corporation.<sup>189</sup> This can be attractive to taxpayers because it gives them flexibility to organize their business affairs and engage in internal restructurings without concerns of any adverse tax consequences.

The rules of group taxation, generally, (i) eliminate income and loss recognition on intra-group transactions by providing for deferral until after the group is terminated or

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<sup>188</sup> Jones Day. 2008. Group Taxation. Available: <http://www.jonesday.com>. [2008, May 22]. 1.

<sup>189</sup> Masui, Y. 2004. Group taxation: general report. *Cahiers de droit fiscal international*. IFA. 89b:23.

the group member involved or underlying asset leaves the group and (ii) permit the offset of losses of one group member against the profits of a related group member.<sup>190</sup>

A number of countries around the world recognise the concept of group taxation and the following regimes currently exist: (a) the *Organschaft*; (b) the system of “group contribution”; (c) the concept of “group relief”; and (d) the “consolidation” model.

(a) *Organschaft*

The idea of *Organschaft* is common in German-speaking regions, like Austria and Germany. In terms of this regime, corporate members controlled by a common parent are deemed to be inner “organs” of the parent. These companies are treated as the hands and feet of one living creature, consequently, the profits and losses of the members are attributed to the parent. However, there is no deferral of gains or losses arising from intra-group transfer of assets.<sup>191</sup>

(b) *Group contribution*

The system of “group contribution” is popular in Scandinavian countries like Sweden, Norway and Finland. The regime mainly allows income shifting between members of a corporate group. For example, where a profit-making member makes a contribution to a loss-making member, the profit-making member can deduct the amount from its tax base, and the loss-making member can include the same amount in its income. The result, therefore, is the offset of profits and losses between members of a corporate group.<sup>192</sup>

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<sup>190</sup> Jones Day *supra*.

<sup>191</sup> Masui, Y. 2004. Group taxation: general report. *Cahiers de droit fiscal international*. IFA. 89b:29.

<sup>192</sup> *Ibid* at 29.

(c) *Group relief*

The concept of “group relief” is recognised, mainly, in common law jurisdictions such as the United Kingdom, New Zealand and Singapore. The regime enables the transfer of losses from one member of a corporate group to another and what distinguishes it from the Scandinavian “group contribution” system is that tax losses themselves are transferred. It is therefore not necessary to shift profits within a group.<sup>193</sup>

(d) *The “consolidation” model*

A variety of “consolidation” models have been adopted in various jurisdictions, but most typically, corporate income is computed separately at the level of each member and thereafter, after some adjustments, combined at the group level. The parent company is then liable for tax on behalf of the entire group.<sup>194</sup>

When it comes to taxation of companies, in general, corporate groups wish to achieve two objectives: the offset of profits and losses between members of that group and the deferral of gains arising from the transfer of assets between members within that group. These two issues are central to the taxation of corporate groups.<sup>195</sup>

The early recognition and development of group taxation regimes notwithstanding<sup>196</sup> many countries still do not treat a corporate group as a single economic unit. And although some elements of the group concept are recognized for both company law and taxation purposes, South Africa does not have a system of group taxation.<sup>197</sup>

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<sup>193</sup> *Ibid* at 30.

<sup>194</sup> *Ibid* at 30.

<sup>195</sup> *Ibid* at 31.

<sup>196</sup> *Ibid* at 26.

<sup>197</sup> Save for the limited relief contained in sections 41 to 47 of the ITA.

The concept of a corporate group may be somewhat of a contradiction in our domestic law. This causes us to distinguish between the meanings assigned to the concept for company law and taxation purposes.

### 5.3 Corporate groups and company law

In the context of company law, the 'group' concept was first acknowledged by the South African courts in *R v Milne and Erleigh (7)*<sup>198</sup>. Centlivres CJ, who delivered the judgment of the Appellate Division, as it was then known, had the following to say:

"The word 'group' has been used with many shades of meaning. The basic idea seems to be: An association of companies, created not by resolutions to associate but by the acts of individuals, and depending on the facts that they have a single secretary, generally itself a company, and are controlled as to the appointment of their directors, and therefore as to the administration of their affairs, by one or a few people. The persons who wield the controlling power are the only legal personae apart from the companies themselves. There is no persona which is the group, and there are no interests involved except the interests of the companies and the interests of the controllers. This is not mere legal technicality. No doubt it may be convenient to talk of the interests of the group, but no one could seriously think of the group as having interests distinct from those of the companies and controllers. The fact that in a group bargaining between companies may often be non-existent, because the controllers decide, does not support the idea of a single persona with single interests."<sup>199</sup>

The basic characteristic of a group is that the management of the various independent holding and subsidiary companies comprising the group is coordinated in such a way that management takes place on a central and unified basis in the interest of the group

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<sup>198</sup> 1951 (1) SA 791 (A).

<sup>199</sup> At 827F.

as a whole.<sup>200</sup> This control makes it possible for the group to be managed as a single economic unit.<sup>201</sup>

Therefore, from a company law's perspective, the group concept is designed more to regulate the possible abuse of control and to ensure proper disclosure of the company group's financial position than anything else.<sup>202</sup> And, although certain elements of the group concept are recognised, the Companies Act does not formally define a "group of companies".<sup>203</sup> The only definition of the term is to be found in Schedule 4 of the Companies Act (which deals with the requirements for the annual financial reporting) where a "group of companies or group" is said to mean a holding company, which is itself not a wholly owned subsidiary, together with all its subsidiary companies.<sup>204</sup>

#### 5.4 Corporate groups and taxation

When it comes to corporate groups and taxation, the position is somewhat different. Save for the extent of the group relief provided for by the corporate rules, South Africa does not recognise any of the group taxation regimes.

The corporate rules provide some relief with regard to asset and share transactions for group companies, and although it may be the first step in the direction of a group tax system<sup>205</sup>, each legal entity within a group is taxed as a separate taxpayer.<sup>206</sup>

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<sup>200</sup> Cilliers, H.S., Benade, M.L., Henning, J.J., Du Plessis, J.J., Delpont, P.A. (Man Ed.), De Koker, L. & Pretorius, J.T. 2000. *Corporate Law*. 3<sup>rd</sup> ed. Durban: Butterworths. 432.

<sup>201</sup> Wilcocks, J.S. & Middelman, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 8(3):41.

<sup>202</sup> Pretorius, J.T. (Gen Ed.), Delpont, P.A., Havenga, M. & Vermaas, M. 1999. *Hahlo's South African Company Law (through the cases)*. 6<sup>th</sup> ed. Cape Town: Juta & Co, Ltd. 421.

<sup>203</sup> The Companies Bill does however define the term. A "group of companies" is defined as two or more companies that share a holding company or subsidiary relationship.

<sup>204</sup> Paragraph 4(q).

<sup>205</sup> Wilcocks, J.S. & Middelman, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 38.

### 5.4.1 Defining a “group of companies”

The ITA defines a “group of companies” as two or more companies in which one company (“the controlling group company”) directly or indirectly holds shares in at least one other company (“the controlled group company”), to the extent that –

- at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
- the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company.<sup>207</sup>

It appears, therefore, that control seems to be the emphasis when complying with the criteria of the definition, as contemplated in section 1 of the ITA. However, when it comes to the corporate rules, section 41(1) of the ITA prescribes a somewhat different definition of a “group of companies”.

In terms of section 41(1) a “group of companies” means a group of companies as defined in section 1: Provided that for the purposes of section 41 –

- “(i) any company that would, but for the provisions of this definition, form part of a group of companies shall not form part of that group of companies if -
  - (aa) that company is a company contemplated in paragraph (c), (d) or (e) of the definition of “company”;
  - (bb) that company is a company contemplated in section 21 of the Companies Act;
  - (cc) any amount constituting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received by or to accrue to that company;
  - (dd) that company is a public benefit organisation or recreational club that has been approved by the Commissioner in terms of section 30 or 30A; or

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<sup>206</sup> In terms of section 5(1)(d) of the ITA.

<sup>207</sup> Section 1.

- (ee) that company is a company contemplated in paragraph (b) of the definition of “company”, unless that company has its place of effective management in the Republic; and
- (ii) any share that would, but for the provisions of this definition, be an equity share shall be deemed not to be an equity share if –
  - (aa) that share is held as trading stock; or
  - (bb) any person is under a contractual obligation to sell or purchase that share, or has an option to sell or purchase that share unless that obligation or option provides for the sale or purchase of that share at its market value at the time of that sale or purchase.”

A company is therefore a member of a group in terms of the Companies Act if the holding company holds the majority (more than 50 per cent) of the voting rights.<sup>208</sup>

However, for tax purposes (in terms of the ITA) a company is a member of a group if 70 per cent of the equity share capital of that company is held by a controlling group company. Thus, it is submitted, the Companies Act recognises control in terms of voting rights whereas the ITA focuses on control in terms of shareholding.<sup>209</sup>

Moreover, and for purposes of the corporate rules, provision is also made for the term “associated group of companies”. An “associated group of companies” is defined as two or more companies in which one company (“the influencing company”) directly or indirectly holds shares in at least one other company (“the influenced company”), to the extent that –

- at least 20 per cent of the equity shares and voting rights of each influenced company are directly held by the influencing company, one or more influenced companies or any combination thereof as assets of a capital nature; and

<sup>208</sup> Section 1(3)(a) of the Companies Act.

<sup>209</sup> Wilcocks, J.S. & Middelmann, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 41.

- the influencing company directly holds at least 20 per cent of the equity shares and voting rights in at least one influenced company as assets of a capital nature.<sup>210</sup>

Therefore, it is submitted, although no formal group taxation regime exists within the realms of the South African income tax dispensation certain characteristics of the group concept has been adopted to allow for the proper implementation of the corporate rules.

#### ***5.4.2 Advantages, disadvantages and feasibility of a group taxation regime***

The need for a group taxation regime in South Africa was first considered in 1986 by the Margo Commission<sup>211</sup> who recommended that a system of group taxation should not be implemented in South Africa.<sup>212</sup> In 1995 the question surfaced again when, this time, the Katz Commission<sup>213</sup> considered the viability of a group taxation regime and concluded that:

“[Although] mindful of the view amongst some that the issue of group taxation is not a priority. It disagrees with this view, and regards the current position as a structural defect in the system that cannot be passed over in any serious tax reform process.”<sup>214</sup>

This was supported by the South African Chamber of Business (“SACOB”) who thought the adoption of a group taxation system would achieve greater fiscal control, minimise some of the economic distortions existent at a corporate level, facilitate the

<sup>210</sup> Section 41 of the ITA.

<sup>211</sup> South Africa. 1986. Report of the commission of inquiry into the tax structure of the Republic of South Africa (Chairman: CS Margo). Pretoria: Government Printer.

<sup>212</sup> Wilcocks, J.S. & Middelmann, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 39.

<sup>213</sup> South Africa. 1995. Third interim report of the commission of inquiry into certain aspects of the tax structure of South Africa (Chairman: MM Katz). Pretoria: Government Printer.

<sup>214</sup> *Ibid* at 96. Quoted by Wilcocks & Middelmann *supra* at 39.

corporate unbundling process and bring South Africa in line with the tax treatment of companies in industrialised countries.<sup>215</sup>

Considering the feasibility of a group taxation regime, the Katz Commission (South Africa 1995: 96-97)<sup>216</sup> listed the following advantages:

- A closely held group of companies can constitute a single economic unit for purposes of strategic and financial planning.
- The divisionalisation of companies into a single legal entity purely for tax reasons creates distortions which results in a loss of protection when it comes to the limited liability concept.<sup>217</sup> It also influences operational, management, compensation and competition policies.
- Companies often invest large resources in establishing techniques that bear no commercial substance, mainly aimed at avoiding tax through the use of certain intra-group transactions, such as unsubstantiated management fees and transfer pricing. A system of group taxation could eliminate this.
- Despite complicated anti-avoidance rules, the manipulation of intra-group transactions is difficult to police. Moreover, because tax laws do not recognise the reality of a group's economic interest, tax avoidance and evasion do not end with merely trying to match profit or losses within a group. As a result of common ownership or control, intra-group transactions have a tax effect although no real economic or commercial effect may be present. Consequently,

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<sup>215</sup> South African Chamber of Commerce. 1996. Comments on the third interim report of the commission of inquiry into certain aspects of the tax structure in South Africa. Johannesburg: SACOB. 4. Quoted by Wilcocks & Middelmann *supra* at 39.

<sup>216</sup> Quoted by Wilcocks, J.S. & Middelmann, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 48.

<sup>217</sup> A divisional structure refers to a structure where separate businesses are housed in separate divisions within one company, which from a legal point of view comprises a single legal entity.

further abuse is possible by manipulating the cost bases to engineer timing, capital or revenue mismatches, or simply to 'lose' one end of the transaction.

- When companies are assessed a full audit trail of all intra-group transactions, as well as the correct tax effects of transactions with outside parties will be accessible. This will certainly increase the power of the revenue authorities to police the system.
- The assumption that group taxation encourages the formation of conglomerates is incorrect. In fact, group taxation facilitates the unbundling of large organisations into more efficient multi-company structures. In the current tax system this is discouraged, as it results in higher tax liabilities through higher profitability in each of the sub-units and it eliminates the benefit of assessed losses.
- It will align our current system with international practices and make foreign direct investment in South Africa more attractive for the international trade and investment community.

Although overshadowed by the advantages, the Katz Commission (South Africa 1995: 98)<sup>218</sup> did identify some disadvantages:

- A system of group taxation is complex.
- The cost (to the *fiscus*) of implementing and managing such a system is perceived to be high.
- There is a need for anti-avoidance measures.<sup>219</sup>

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<sup>218</sup> Quoted by Wilcocks, J.S. & Middelmann, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 48.

<sup>219</sup> Section 103(1), which housed the anti-avoidance rules at the time, has since been replaced by the general anti-avoidance rules ("GAAR"). GAAR (comprising sections 80A to 80L) was introduced into the ITA by section 34(1) of Act No. 20 of 2006 and deemed to have come into operation on 2 November 2006.

Whether or not a regime is complex or not, it is submitted, depends on the system implemented. Save for the fact that the transfer of losses from one member in a group to another are not allowed, the existing corporate rules is nothing more than a group relief regime.

Nevertheless, having regard to the advantages, disadvantages and other considerations, the Katz Commission recommended the introduction of a system of group taxation in the form of a consolidation system, albeit with the following alterations (South Africa 1995: 100)<sup>220</sup>:

- In order to reduce cost and complexity only wholly owned groups should qualify for consolidation.
- Any losses that arise prior to consolidation should be excluded.
- A full consolidation method does not need to be implemented initially.

It further found that claims that National Treasury would incur substantial losses were unfounded and exaggerated, as not all tax losses are available to group companies.

Moreover, not all group companies have profits that can be set off against such losses.

Nonetheless, it was recommended the potential cost (to the *fiscus*) of setting off these losses could be countered by excluding losses prior to the first consolidation (as stated above).<sup>221</sup>

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<sup>220</sup> Quoted by Wilcocks, J.S. & Middelmann, S.N. 2004. Evaluation of the need to introduce a system of group taxation in South Africa. *South African Business Review*. 49.

<sup>221</sup> *Ibid.*

## 5.5 Conclusion

Although the recommendations by the Katz Commission was accepted in principle it was decided to keep the introduction of a group taxation system in abeyance until such time that SARS is fully operational.<sup>222</sup>

In the thirteen years since the Katz Commission's recommendations SARS has made enormous strides in becoming not only fully operational, but also the most efficient government department. That being said and earlier undertakings notwithstanding, it is fair to say that we are in no way close to adopting a system of group taxation.

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<sup>222</sup> Wilcocks & Middelman *supra* at 39.

## Chapter 6

### Conclusion

The basic philosophy that taxpayers are perfectly entitled to arrange their affairs so as to pay the least amount of tax has repeatedly been confirmed by the courts. In one such instance, Lord President Clyde, in *Ayreshire Pullman Motor Services and DM Ritchie v Commissioner for Inland Revenue* (1929) 14 TC 754, said:

“No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly – to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, as far as he honestly can, the depletion of his means by the Revenue.”

This dictum, it is submitted, applies to both individual as well as institutional taxpayers and, although effective tax planning is made out to be immoral<sup>223</sup> when it comes to, especially, large businesses the location of their investments is influenced by international taxation considerations.<sup>224</sup> Apart from the potential influence international tax rules and the tax laws of other countries may have on the behaviour of transnational corporations, when it comes to the location and scope of international business activity, domestic operations that are connected to foreign operations may also be influenced.<sup>225</sup>

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<sup>223</sup> During an address in the National Assembly on 25 May 2007, Finance Minister Trevor Manuel said South Africa’s low tax morality cost the country an estimated R20 billion in lost revenue annually.

<sup>224</sup> Glaister, Keith W. & Frecknall Hughes, J. 2008. Corporate strategy formulation and taxation: Evidence from UK firms. *British Journal of Management*. 19:34.

<sup>225</sup> Hines, J.R. 1999. Lessons from behavioural responses to international taxation. *National Tax Journal*. 52(2):305-322. Quoted by Glaister, Keith W. & Frecknall Hughes, J. 2008. Corporate strategy formulation and taxation: Evidence from UK firms. *British Journal of Management*. 19:33.

Notwithstanding this, when the corporate rules was introduced in 2001 it was noted that a balance needed to be struck between the breadth of the concessions introduced, by the measures, and the potential for tax avoidance.<sup>226</sup> Hence, the corporate rules was confined to South African group companies. Save for asset-for-share transactions, the corporate rules are not available to non-residents. Non-resident companies are also excluded from the group definition.

As indicated herein above, the main purpose of the corporate rules was to provide the tax-free transfer of assets when embarking on reorganisations of, preferably active, businesses. Hence, the introduction of the limitation on financial instruments that, it was said, are invariably passive in nature. However, that, it is submitted, should not be the criteria, as many groups of companies have passive members, for example, a passive holding company. This being said, since the removal of the limitation on financial instruments the DFIHC and FFIHC definitions have become largely redundant.

Considering, therefore, that the mandatory versus elective issue has been resolved to some extent, the question remains: has the corporate rules achieved their purpose? The provisions contained in the corporate rules certainly did not turn out the friendly tool it was meant to be. Because the rules are interspersed with anti-avoidance measures, it is submitted that they are not always used by parties to a transaction.

Moreover, it is submitted that, the prohibition against the transfer of losses and assets with built-in losses limits the application and effectiveness of the corporate rules. The

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<sup>226</sup> SARS. 2001. *Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001*. 6.

commercial reality is that group companies, in general, want to be able to offset profits and losses between members of that group and defer gains arising from the transfer of assets between members within that group.<sup>227</sup>

Save for focusing on refining the relief it set out to provide, the corporate rules, it is submitted, has unfortunately developed into yet another set of complicated anti-avoidance provisions. As long as taxpayers find ways of circumventing provisions like the de-grouping charge, for example, the more amendments will be promulgated to counter those strategies.

In the circumstances, it may perhaps be sensible to reconsider the proposals with regard to a group tax regime, which would, it is submitted, eliminate the resources and effort invested in corporate reorganisations. There would certainly not be any need to appoint any more commissions of enquiries. The recommendations made by the Katz Commission are a good starting point.

Although the group relief measures contained in the corporate rules caters for many of the suggestions made by the Katz Commission, their recommendation for a group taxation regime in the form of a consolidation model would be a welcoming replacement of the existing regime. In this regard it is suggested that:

- to the extent that group companies constitute a group of companies, as defined in section 1 of the ITA, they should be given a choice as to whether they wish the consolidation regime to apply to the group, in other words it should be elective; and

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<sup>227</sup> Masui, Y. 2004. Group taxation: general report. *Cahiers de droit fiscal international*. IFA. 89b:31.

- once elected, group companies should be allowed to transfer assets and losses between members within the same group of companies without triggering any adverse tax consequences. Having said that, assessed losses incurred by a company prior to it forming part of a group of companies, as defined, should be ring-fenced to comply with section 103(2) of the ITA.

The Katz Commission further recommended that there would be a need for the necessary anti-avoidance measures. However, it is submitted, the existing general anti-avoidance rules contained in sections 80A to 80L of the ITA are comprehensive enough to cover any transaction or arrangement which may fall outside the scope of such group taxation regime.

In conclusion, therefore, it is submitted that the corporate rules has not evolved to such an extent that it has become the helpful set of group relief measures it was intended to be. On the contrary, it is submitted that, the corporate rules are onerous and an administrative burden for both taxpayers and SARS.

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## Appendix 1

### History of the corporate rules

The corporate rules were introduced into the ITA by section 44(1) of the Second Revenue Laws Amendment Act No. 60 of 2001 and deemed to have come into operation on 1 October 2001 and applicable in respect of any transaction entered into on or after that date. Chapter 2 sets out the ambit and structure of the corporate rules in the format introduced in 2001.

In 2002 the corporate rules underwent major amendments, which included *inter alia* the introduction of rules pertaining to amalgamation transactions. These amendments were introduced by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002 and deemed to have come into operation on 6 November 2002 and applicable in respect of any disposal on or after that date.

Since the corporate rules were introduced there has been an enormous amount of amendments and a complete history of those amendments is beyond the scope of this study. Notwithstanding this, a summary of the major year on year amendments since 2002 (ie the first major amendment) is set out in this appendix. The purpose of this appendix is merely to serve as a reference guide.

The year on year amendments are presented as proposed in the explanatory memoranda released with the annual amendment bills.

#### 1. Section 41

Section 41 of the ITA is a general section, containing mostly definitions of the terms applicable to the transactions in sections 42 to 47.

##### 1.1 The 2002 amendments

The Explanatory Memorandum to the Revenue Laws Amendment Bill, 2002<sup>228</sup> (“the 2002 EM”) proposed the following amendments to section 41:

- The term “allowance asset” was replaced by the term “depreciable asset”.

Reason: According to the 2002 EM the purpose of the corporate rules was to extend roll-over relief to any asset of a person if that asset qualified for a deduction or allowance under the ITA that must be included in the income of that person in the year following that, in which it was allowed or that was subject to recoupment in the hands of that person. The inclusion or potential recoupment associated with an asset transferred in terms of a company formation transaction shifts to the transferee company. All the remaining allowances or deductions associated with that asset also shift to the transferee company as if that company held those assets all along. The amendment replaced the concept of a “depreciable asset” with the wider concept of an “allowance asset” and deleted a superfluous qualification of that concept that had the

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<sup>228</sup> [W.P. 2 – ‘02].

unintended effect of excluding farming assets falling under the First Schedule from this relief.<sup>229</sup>

The reformulation of the provisions dealing with the treatment of assets in respect of which deductions or allowances are claimable was aimed at clarifying and simplifying the rule that the transferee steps into the shoes of the transferor. The two parties are deemed to be one and the same for purposes of determining any allowance to which the transferee may be entitled or in respect of amounts recovered or recouped. This was the case where certain assets or obligations were transferred in terms of a company formation transaction, amalgamation transaction, intra-group transaction or liquidation distribution.

The provisions were only applicable where the asset constituted an allowance asset in the hands of both the transferor and the transferee. In essence, it gives effect to the principle in terms of which roll-over treatment was extended to any allowances that may have been recouped by the transferor or that may have been included in the transferor's income upon the disposal of a capital asset or of a liability under a company formation transaction.

The potential recoupment of allowances enjoyed by the transferor or their inclusion in the transferor's income was, therefore, shifted into the transferee company. All remaining unutilised capital allowances associated with the transferred assets or liabilities also shift to that company in whose hands they would continue to be deducted as if that company had held those assets all along.<sup>230</sup>

- The term "domestic financial instrument holding company" was introduced.

Reason: The definition replaced and significantly relaxed the limitation on the transfer of financial instruments, which existed at the time. As a general rule the transfer of financial instruments or of a company, where more than 50 per cent of the market value or actual cost of all the assets of that company together with any controlled company in relation to that company was attributable to financial instruments, was unacceptable. However, an exception was made for debts in respect of goods sold or services rendered by that company or transferor where the amount of the transaction was included in the income of that entity and the debt was an integral part of a business conducted by that entity as a going concern. An important further exception was made for financial instruments of, or financial instruments transferred to certain regulated financial institutions, ie banks, insurance companies and collective investment schemes.<sup>231</sup>

- The definition of "equity share" was amended to include a member's interest in a close corporation. Moreover, in order to clarify what would qualify as "equity shares held" in the context of the corporate rules the concepts "held" and "shareholder" were defined.

Reason: The registered shareholder of an equity share is the holder of an equity share unless another person would be entitled to all or part of the benefit of the rights of participation in the profits or income attaching to that equity share. In that case the other person will be deemed to be the shareholder. The amendment ensured that the

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<sup>229</sup> *Ibid* at 34.

<sup>230</sup> *Ibid* at 19.

<sup>231</sup> *Ibid* at 34.

beneficial owner of an equity share would qualify as the holder of the share and not an entity in whose name the equity share was registered in its capacity as nominee on behalf of the beneficial owner.<sup>232</sup>

- The definition of “qualifying interest” was amended to include equity shares held by a person in a company which –
  - is a listed company;
  - will become a listed company within 12 months; or
  - constituted more than 25 per cent of the equity shares in any other company.

Reason: The concept was used to determine a qualifying interest for company formations and amalgamation transactions. The rule in respect of a company which would become listed within 12 months replaced the existing provision requiring the company to be listed within a period of six months or such further period, not exceeding six months, which was subject to the discretion of the Commissioner.<sup>233</sup>

## 1.2 The 2003 Amendments

The following amendments to section 41 were proposed by the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003.<sup>234</sup>

- The criteria contained in the definitions of “domestic financial instrument holding company” and “foreign financial instrument holding company” was relaxed.

Reason: See the comments on the amendment at 3.5 in Chapter 3.

- The definition of “allowance asset” was clarified.

Reason: The corporate rules extended rollover treatment to any asset of a person if that asset qualified for a deduction or allowance under the ITA, which should be included in the income of that person in the year following that in which it was allowed or that was subject to recoupment in the hands of that person. The inclusion or potential recoupment associated with an asset transferred in terms of a company formation transaction, as it then was, shifted to the transferee company. All the remaining allowances or deductions associated with that asset also shifted to the transferee company as if that company has held those assets all along. The suggested amendment clarified that the deductions or allowances concerned were limited to those taken into account when determining the portion of a person’s taxable income not consisting of any taxable capital gain.<sup>235</sup>

- Subsection (2) was amended to exclude the application of the provisions of section 31(A) into the ITA.
- Subsection (4) was amended so as to exclude assets required to satisfy anticipated liabilities to any sphere of government of any country.<sup>236</sup>

<sup>232</sup> *Ibid* at 34.

<sup>233</sup> *Ibid* at 35.

<sup>234</sup> [W.P. 2 – ‘03].

<sup>235</sup> *Ibid* at 64.

<sup>236</sup> *Ibid* at 65.

### 1.3 The 2004 Amendments

The following major amendments were proposed by the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004.<sup>237</sup>

- To allow for a trade debt of a foreign controlled group company to be taken into account for purposes of determining whether a company was a domestic financial instrument holding company.
- To allow for a trade debt of a foreign company or controlled group company to be taken into account for purposes of determining whether a company is a foreign financial instrument holding company.<sup>238</sup>

### 1.4 The 2005 Amendments

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005<sup>239</sup> proposed the following amendments to section 41:

- Definitions of “associated group of companies”, “influencing company” and “influenced company” were introduced for purposes of applying the rules relating to domestic financial instrument holding company and foreign financial instrument holding companies.

Reason: The corporate rules contained anti-avoidance provisions that prevented the shifting of built-in gain or loss assets into a company transferee. Without these anti-avoidance rules, taxpayers could, for example, use the roll-over mechanism to shift built-in gain assets into a transferee company with excess losses. The introduced rules provided, broadly, for the ring-fencing of gains or losses in the hands of the transferee where that transferee disposed of assets within 18 months after their acquisition. Transferee companies were thus prevented from setting off any resulting gain or loss against their own losses or revenue or capital gains, respectively.<sup>240</sup>

- A definition of “prescribed proportion” was introduced in order to allow a simplified determination of the proportionate share of all assets of a company consisting of financial instruments where shares in that company were to be disposed of between members of the same group of companies.

Reason: The simplified determination entails the use of the book value (as determined for purposes of a company’s most recent audited financial statements) of the assets instead of the requirement to perform a burdensome market valuation of assets on the date of the relevant transaction. The definition also provides that only the portion, equal to the effective shareholding in the company, of the value or cost of the assets of that company be taken into account.<sup>241</sup>

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<sup>237</sup> [W.P. 3 – ‘04].

<sup>238</sup> *Ibid* at 68.

<sup>239</sup> [W.P. – ‘05].

<sup>240</sup> *Ibid* at 29.

<sup>241</sup> *Ibid* at 30.

## 1.5 The 2006 Amendments

In 2006 the following amendments were proposed by the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006<sup>242</sup>:

- The financial instrument holding company definitions (for both domestic and foreign companies) were modified in various respects.

Reason: Financial instruments were, at the time, not taken into account for purposes of the financial instrument holding company definitions if the base cost of those instruments equaled their market value (ie had no built-in gain or loss). Instruments lacking built-in gain or loss could not give rise to tax avoidance in terms of the reorganisation rules (ie the reorganisation roll-over rules could not be used to artificially shift built-in gain or loss because none exist). The amendment further disregarded financial instruments with terms of less than 12 months.<sup>243</sup>

Moreover, active financial services operations, such as banks, were generally excluded from the financial instrument holding company definition (ie they were not passive companies likely to be the subject of tax avoidance). As a consequence, certain changes were implemented. (See the discussion at 3.5 in Chapter 3 on these changes.)

- The definition of a “foreign financial instrument” in relation to a DFIHC was amended to include any financial instrument with a market value equal to the base cost and any instrument as defined in section 24J of the ITA with a term less than 12 months.
- The “mainly test” was replaced by the “plurality test”.

Reason: The exemption would apply if the CFC conducts more business in the country of incorporation than any other single country. In determining whether the CFC conducted more business in the country of residence, the Commissioner may disregard business conducted in another country if attributable to a branch within that other country and subject to tax by that other country as income from tax branch, after taking into account applicable tax treaties.<sup>244</sup>

## 1.6 The 2007 Amendments

The Explanatory Memorandum to the Revenue Laws Amendment Bill, 2007 proposed the following amendments to section 41:

- The limitations relating to financial instruments were removed.

Reason: See the comments on the amendment at 3.5 in Chapter 3.

- The word “proceeds” in the definition of “base cost” was replaced with the words “an amount received or accrued”.

<sup>242</sup> [W.P. 2 – ‘06].

<sup>243</sup> *Ibid* at 77.

<sup>244</sup> *Ibid* at 76.

Reason: For purposes of the corporate rules the term “base cost” was defined as having the same meaning as it bore in the Eighth Schedule. However, for the purposes of sections 42, 43 and 44 the base cost had to be determined as if the asset was disposed of on the date of the transaction for “proceeds” equal to the market value of the asset as at that date. The latter deeming provision was required in order to enable the base cost of pre-valuation date assets to be determined where the time-apportionment base cost or 20 per cent of proceeds methods were adopted.

The existing wording had proved problematic in at least two instances. Firstly, in the case of the disposal of a share, it was unclear whether any capital distribution received or accrued on or after the valuation date, but prior to the transaction had to be added to the deemed proceeds in terms of paragraph 76(1)(b) of the Eighth Schedule. Secondly, in the case of an allowance asset, it seemed that no account had to be taken of any recoupment that could arise on the date of the transaction in determining the proceeds. The deeming provision simply provided the “end result” proceeds without applying paragraph 35(3)(a) of the Eighth Schedule.<sup>245</sup>

- The definition of “equity share” was deleted.

Reason: The definition was moved to section 1 of the ITA.

## **2. Section 42**

Section 42 was introduced into the ITA to provide roll-over relief for so-called company formation transactions. Subsequent to the repeal of section 43 (share-for-share transactions) the title of section 42 was renamed to “asset-for-share transactions.”<sup>246</sup>

### **2.1 The 2002 amendments**

The following amendments to section 42 were proposed in the 2002 EM:

- The definition of “company formation transaction”, as it was then called, was amended.

Reason: The change was aimed at clarifying the position where a person acquired a qualifying interest as a result of a number of transactions effected on the same date. The question whether such a transaction could qualify as a company formation transaction, therefore, depended on the extent of that person’s interest in the equity share of that company at the end of that day, and not on the extent of such interest after each of those transactions. Prior to the amendment roll-over relief did not apply to capital assets, the base cost of which exceeded their market value at the time of transfer to the company, ie assets, the disposal of which gave rise to a capital loss. A similar qualification was inserted in respect of trading stock qualifying for roll-over relief.<sup>247</sup>

<sup>245</sup> SARS. 2007. *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2007*. 30-31.

<sup>246</sup> Section 43 was repealed by the Revenue Laws Amendment Act No. 35 of 2007. The heading to section 42 was amended by section 26(1)(a) of the Taxations Laws Amendment Act No. 3 of 2008.

<sup>247</sup> [W.P. 2 – ‘02] at 35.

- Section 42(2) was amended to make provision for the transferee company to acquire an asset, held by the transferor as a capital asset, as either a capital asset or as trading stock. The result was that the transferor may hold the equity shares received in terms of the formation transaction as either capital assets or trading stock irrespective of the nature of the formation asset. However, where an asset was held as trading stock it would only be allowed to be acquired by the transferee as trading stock and not as a capital asset.<sup>248</sup>

Reason: The limitation was introduced to avoid gains on disposal of the asset being subject to a lesser tax burden.

- Section 42(4) was amended to provide for scenarios where an asset was disposed of to a company for a consideration consisting partly of something other than equity shares issued by that company. The result was that the disposal to that company would be treated partly as a sale of that asset and partly as a company formation transaction eligible for roll-over relief.

Reason: The amendment clarified the rules regarding the determination of the portion of the base cost in the case of a capital asset, allowances allowed in the case of an allowance asset or amount in the case of trading stock, which was to be taken into account in the transferor's hands as the part of the asset disposed of that did not qualify for roll-over relief.<sup>249</sup>

- Section 42(5) saw the introduction of a 50 per cent test which was to be applied each time a person disposed of a share acquired under a corporate formation transaction.

Reason: According to the 2002 EM taxpayers could transfer allowance assets and/or trading stock for company transferee shares pursuant to a section 42 roll-over, followed by a capital gain sale of the company transferee shares initially received. The amendment was designed to prevent transactions that exploited this.<sup>250</sup>

In terms of the said anti-avoidance rules company transferee shares received in exchange for section 42 roll-over assets, would be treated as having been disposed of as trading stock if:

- more than 50 per cent of the assets (in terms of fair market value) transferred by the transferor to the company transferee under a company formation transaction consisted of allowance assets and/or trading stock; and
  - the transferor subsequently disposed of those shares within 18 months after their acquisition under a company formation transaction (unless the disposal stems from death of the transferor, an involuntary disposal, intra-group transaction, unbundling transaction or liquidation distribution).<sup>251</sup>
- Section 42(6) provided that transferors involved in a company formation transaction with an unlisted company must hold a qualifying interest in that company for at least 18 months after that transaction. Any failure to maintain a

<sup>248</sup> *Ibid* at 35.

<sup>249</sup> *Ibid* at 36.

<sup>250</sup> *Ibid* at 36.

<sup>251</sup> *Ibid* at 36.

qualifying interest for the required period would be treated as a disposal event in respect of all the shares acquired by the transferor under the formation transaction. Where the transferor's interest was reduced due to an actual disposal of some of the shares, the transferor would be deemed to have disposed of any shares still retained at a price equal to their market value at the time they were originally acquired under the company formation transaction. The gain in the transferor's hands initially deferred under the company formation transaction was therefore crystallised, while the base cost of the retained shares was also adjusted to their market value at the time of their acquisition under the formation transaction. Shares actually disposed of were deemed to have been disposed of at the higher of actual proceeds or their market value at the time of that disposal.<sup>252</sup>

**Reason:** The rule was inconsistent with some of the other rules applying to actual disposals and was considered to be superfluous in view of the anti-avoidance provisions of the Eighth Schedule regarding non-arm's length transactions.<sup>253</sup> Disposals in terms of an intra-group transaction, an unbundling, a liquidation distribution or as a result of an involuntary disposal or death of the transferor were excluded from the rule in order to bring it into line with similar rules which applied in respect of other corporate transactions.<sup>254</sup>

- In terms of section 42(8) taxpayers were allowed to transfer property subject to a previously existing debt, thereby creating debt relief for the transferor. In the case of a company formation transaction, any such debt relief for the transferor was economically akin to the receipt of consideration other than equity shares of the transferee company. As a general rule, this form of debt relief would trigger part-disposal treatment under section 42(4). However, pure part-disposal treatment for this form of debt relief was problematic in practical terms because company formations regularly involved non-tax motivated transfers of property secured by debt. Business assets such as land, plant and equipment were customarily debt financed.<sup>255</sup>

**Reason:** In order to eliminate the practical concern, the transfer of certain categories of debt secured capital assets was exempted from part-sale treatment under subsection (4). These categories of exempted debt assumptions involved situations that typically arose in company formation transactions. These categories did not cover situations where a transferor borrowed against property immediately before a company formation in order to achieve a disguised tax-free partial cash-out. These exempt categories of debt secured asset transfers included the transfer of any capital asset secured by debt if that debt was incurred more than 18 months before the company formation. The transfer of any asset secured by refinanced debt incurred within 18 months before the company formation was excluded, if that refinanced debt was incurred at the same time as that asset was acquired.<sup>256</sup>

Transfers of debt secured property subject to exemption received full roll-over treatment. The transferor had no gain on the transfer, and the transferee company

<sup>252</sup> *Ibid* at 36.

<sup>253</sup> Paragraph 38 of the Eighth Schedule.

<sup>254</sup> [W.P. 2 - '02] at 36.

<sup>255</sup> *Ibid* at 37.

<sup>256</sup> *Ibid* at 37.

received a base cost in the transferred asset equal to the base cost of that asset in the hands of the transferor. However, tax-free treatment in these circumstances came with a price. The transferor received a base cost in the equity shares of the transferee company equal to the base cost of the asset or business undertaking transferred, but had to treat the face value of the debt as a capital distribution in respect of that share for purposes of paragraph 76 or as an amount to be included in the transferor's income when that transferor disposed of the equity shares of the transferee company.<sup>257</sup>

## 2.2 The 2003 amendments

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003<sup>258</sup> proposed the following major amendments to section 42:

- Subsection (1) was amended so as to relax the requirement that only potential gain assets qualified for the roll-over.

Reason: It was proposed that the requirement be relaxed to allow the disposal of assets the market value of which was equal to or exceeded their base cost or the amount taken into account in respect of that asset in terms of section 11(a) or 22. This, it was said, would allow for the disposal of debt claims that may otherwise have been disqualified.<sup>259</sup>

- Subsection (4) was amended to cater for situation where a party to a company formation transaction received consideration other than shares.

Reason: See comments at 3.7 in Chapter 3.

## 2.3 The 2005 amendments

The following major amendments were proposed by the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005<sup>260</sup>:

- The rollover relief in respect of company formation transactions was extended to trusts and the incorporation of professional partnerships, however, restraints of trade and personal goodwill remained excluded from the assets eligible for relief.<sup>261</sup>
- Professional partnerships were enabled to utilise the company formation transaction roll-over provisions. The relief in respect of company formations are however only available to natural persons who will be engaged on a full-time basis in the business of that company of rendering any service.<sup>262</sup>

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<sup>257</sup> *Ibid* at 37.

<sup>258</sup> [W.P. 2 – '03].

<sup>259</sup> *Ibid* at 65.

<sup>260</sup> [W.P. – '05].

<sup>261</sup> *Ibid* at 32.

<sup>262</sup> *Ibid*.

### 3. Section 43

Section 43 of the ITA was repealed by section 54(1) of the Revenue Laws Amendment Act No. 35 of 2007. The amendment was deemed to have come into operation on 1 January 2007 and applies in respect of any transaction entered into on or after that date.

The amendment further provided that any transaction entered into during the period 1 January 2007 to 7 January 2008, that would have been a share-for-share transaction had section 43 not been repealed, would be deemed to be an asset-for-share transaction as defined in section 42 of the ITA.

The application of the provisions of sections 42 and 43 essentially achieved the same result. Hence, a duplicate set of provisions. However, when the limitations relating to the transfer of financial instruments were removed, little reason existed for two sets of rules.<sup>263</sup>

Notwithstanding this, it is important to take cognisance of the amendments to certain provisions in section 43 while it was still in force.

#### 3.1 The 2002 amendments

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002<sup>264</sup> proposed the following amendments to section 43:

- The definition of “share-for-share transaction” was amended to limit its application to shares where the market value exceeded the base cost of the shares held as capital assets or the amounts that were taken into account in terms of section 11(a), 22(1) or 22(2) in the case of assets held as trading stock.

Section 43 provided that any share-for-share transaction entered into in terms of an offer made on the same terms as the transaction and which was accepted within a period of 45 days before or after that transaction was taken into account to determine whether the acquiring company held the required direct interest in the target company.

It was proposed that the period be changed to take into account any other share-for-share transaction entered into within a period of 90 days after the first transaction. As it was, it was not clear when the transferor of the target shares should have held the required interest in the equity share capital of the acquiring company. The reworded provision provided that the qualifying interest should be held at the close of day during which the share-for-share transaction was effected.<sup>265</sup>

- Section 43(2) was amended to allow the person who disposed of the shares in the target company in terms of a share-for-share transaction, to acquire the shares in the acquiring company as either capital assets or as trading stock where the shares in the target company were held as capital assets, and as trading stock where the

<sup>263</sup> SARS. *Explanatory Memorandum to the Revenue Laws Amendment Bill, 2007*. 20.

<sup>264</sup> [W.P. 2 – '02].

<sup>265</sup> *Ibid* at 38.

shares in the target company were held as trading stock, at the same tax values as the shares disposed of.

Provision was made for an acquiring company to acquire target company shares as either capital assets or as trading stock at the tax value to the person who disposed of the shares irrespective of whether the shares were held as capital assets or trading stock in the hands of that person. However, where the target company was a listed company the acquiring company was, in certain instances, deemed to have acquired the shares at market value.<sup>266</sup>

- Section 43(3) was amended to introduce the part-disposal rule, similar to that in section 42(4).
- The requirement in section 43(4), that a qualifying interest of more than 25 per cent should be held for a period of 18 months in the acquiring company by the person who disposed of the target shares, was similar to the rule contained in section 42(6).

Where the qualifying interest was not so held, the roll-over gain at the time of the share-for-share transaction was triggered.<sup>267</sup>

- An anti-avoidance measure was introduced in subsection (5) to ensure that where an acquiring company ceased to hold the required interest in the target company within a period of 18 months from the date of the share-for-share transaction, the roll-over gain at the time of the share-for-share transaction was triggered. Provision was further made for exceptions to these rules for subsequent involuntary disposals, intra-group, unbundling and liquidation transactions.<sup>268</sup>

### 3.2 The 2005 amendments

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005 proposed that the roll-over relief in respect of share-for-share transactions would be extended to trusts. It was also proposed that the provision preventing consecutive share-for share transactions within an 18 month period be deleted, thereby allowing relief for consecutive corporate transactions.<sup>269</sup>

## 4. Section 44

When the corporate rules were initially enacted in 2001 no relief treatment existed for mergers and amalgamation transactions. In 2002, however, the Revenue Laws Amendment Act No. 74 of 2002 introduced roll-over provisions in respect of amalgamation transactions. After a reshuffle of the sections in Part III of Chapter II, these provisions were housed in section 44 of the ITA.

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<sup>266</sup> *Ibid.*

<sup>267</sup> *Ibid* at 39.

<sup>268</sup> *Ibid* at 39.

<sup>269</sup> [W.P. – '05].

#### 4.1 The 2003 amendments

The following amendments to the provisions relating to amalgamation transactions were proposed in 2003<sup>270</sup>:

- Subsection (10) was amended limit the deemed dividend to the amalgamated company's profits and reserves available for distribution in order to make it consistent with section 64C(4)(c) and clarify the date of accrual of such deemed dividend.<sup>271</sup>
- Subsection (13) was amended to exclude roll-over relief where an amalgamated company withdrew or invalidated steps taken to terminates its existence.<sup>272</sup>

#### 5. Section 45

Section 45 deals with the provisions relating to intra-group transactions. Before the introduction of the provisions relating to amalgamation transactions, the provisions were contained in section 44 of the Act.<sup>273</sup> Therefore, any reference to section 44 in 5.1 (below) should be deemed to be a reference to the intra-group provisions.

#### 5.1 The 2002 amendments

The following amendments to intra-group transactions were introduced by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002. The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002<sup>274</sup> proposed the amendments as follows:

- Subsection (1) was amended to remove the requirement that a transferor company needed to be a resident.<sup>275</sup>
- A further amendment to subsection (1) was the extension of the definition of intra-group transactions to provide that the transferee must have held an asset as a capital asset where the transferor held it as a capital asset and that the transferee must have held an asset as trading stock where the transferor held it as trading stock.<sup>276</sup>
- Subsection (4), the so-called de-grouping charge was amended to provide that where a transferor company ceased to form part of the same group of companies the intra-group asset would be deemed to have been disposed of for an amount equal to the market value of the asset on the date on which it was acquired in terms of the intra-group transaction, rather than the date on which the transferee and transferor ceased to form part of the same group of companies.<sup>277</sup>

<sup>270</sup> SARS, 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 68.

<sup>271</sup> *Ibid* at 68.

<sup>272</sup> *Ibid*.

<sup>273</sup> Provisions relating to amalgamation transactions were introduced into the ITA by section 34(1) of the Revenue Laws Amendment Act No. 74 of 2002.

<sup>274</sup> [W.P. 2 – '02].

<sup>275</sup> *Ibid* at 40.

<sup>276</sup> *Ibid*.

<sup>277</sup> *Ibid* at 41.

- Subsection (5) was amended to ensure that where a capital asset was disposed of within 18 months after it was acquired in terms of an intra-group transaction, so much of the capital loss as was rolled over to the transferee company, would be disregarded.

It was proposed that the capital loss would be deducted from the amount of any capital gain determined in respect of the disposal during that year or any subsequent year of assessment of any other asset acquired, by the transferee company from the transferor company, in terms of an intra-group transaction. This was done to soften the impact of the capital loss so disregarded.<sup>278</sup>

## 5.2 The 2003 amendments

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003<sup>279</sup> introduced the following major amendment:

- Subsection (4) was amended to ensure that capital allowances were not effected by a de-grouping.

Reason: See comments at 3.8 in Chapter 3.

## 5.3 The 2004 amendments

The following major amendment was proposed in 2004:

- Subsection (4) was amended to circumvent multi-tier roll-overs.<sup>280</sup>

Reason: See comments at 3.8 in Chapter 3.

## 5.4 The 2007 amendments

- The de-grouping provision in subsection (4) was again amended in 2007 by adding a time limit of 6 years.<sup>281</sup>

Reason: See comments at 3.8 in Chapter 3.

## 6. Section 46

Section 46 contains the provisions which relates to the roll-over treatment available in respect of unbundling transactions. In 2002 unbundling transactions were moved from section 45 to section 46.

### 6.1 The 2002 amendments

<sup>278</sup> *Ibid.*

<sup>279</sup> [W.P. 2 – '03].

<sup>280</sup> SARS. 2004. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*. 69.

<sup>281</sup> SARS. 2007. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007*. 23.

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002<sup>282</sup> proposed the following amendments to unbundling transactions:

- The existing provisions of subsection (1) provided that the qualifying interest of the unbundling company in the unbundled company could have been 25 per cent in the absence of any other shareholder with an equal or greater interest or 35 per cent, if the unbundled company became a listed company within the prescribed period.

Reason: It was not considered to be justifiable to allow that lower percentage, compared to the normal, more than 50 per cent interest in an unlisted company. As a consequence, it was proposed that the distinction be removed and a 50 per cent requirement be introduced in respect of all unlisted companies.<sup>283</sup>

- It was further proposed that the following shares would qualify for relief:
  - shares acquired by an unbundling company in terms of a substitution (as contemplated in paragraph 78(2) of the Eighth Schedule) of equity shares acquired not less than 18 months before the unbundling transaction; and
  - shares acquired in terms of a transaction contemplated in Part III of Chapter II of the ITA or a transaction which would have qualified as such had the parties made the required election or had that asset been a gain asset at the time of disposal.<sup>284</sup>
- It was further proposed that subsection (3) be amended to provide that the base cost or the cost to the shareholder of the equity shares, held in the unbundling company immediately prior to the unbundling transaction, be split between those previously held shares and the unbundled equity shares acquired on the basis of the market values of the shares at the close of day after the unbundling transaction. However, this attribution of the cost should only be done if the nature of the unbundling shares acquired, was the same as the previously held shares, ie if the previously held shares were capital assets and the unbundling shares are acquired as capital assets.<sup>285</sup>

Reason: The existing rule was that the market value of the shares should have been determined on the date on which the shareholders became entitled to acquire distributable shares. The utilisation of this market value, which might be determined prior to the distribution of the unbundling shares, could result in an anomalous split of the cost or base cost.<sup>286</sup>

## 6.2 The 2003 amendments

- A new definition of “unbundling transaction” was proposed.

Reason: In terms of the existing provisions, the qualifying interest of the unbundling company in the unbundled company had to consist of equity shares acquired at least

<sup>282</sup> [W.P. 2 - '02].

<sup>283</sup> *Ibid* at 41.

<sup>284</sup> *Ibid*.

<sup>285</sup> *Ibid* at 42.

<sup>286</sup> *Ibid*.

18 months prior to the transaction, shares acquired in terms of a substitution (as contemplated in paragraph 78(2) of the Eighth Schedule) of equity shares so acquired, or shares acquired in terms of a transaction contemplated in Part III or a transaction which would have qualified as such had the parties made the required election or had that asset been a gain asset at the time of disposal.

The proposed definition dispensed with the 18 month requirement and provided for partial unbundling, in the case of an unlisted unbundling company, to the extent to which the shares in the unbundled company were disposed of to a company that was a member of the same group of companies as that unbundling company. It further provided for a disposal of shares by means of an unbundling transaction effected to comply with an order made in terms of the Competition Act No. 89 of 1998 irrespective of whether or not the shares constituted the minimum shareholding normally required for an unbundling transaction.<sup>287</sup>

## **7. Transactions relating to liquidation, winding-up and deregistration**

The provisions relating to liquidations, winding-up and deregistration are contained in section 47 of the ITA.

### **7.1 The 2002 amendments**

During 2002 the roll-over treatment for transactions relating to the liquidation, winding-up and deregistration of companies were moved from section 46 to section 47 of the ITA.<sup>288</sup> Simultaneously, the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2002<sup>289</sup> proposed the following amendments to the section:

- Provision was made for the liquidating company and its holding company to jointly elect that the section applied in respect of all the assets disposed of by the liquidating company to the holding company.<sup>290</sup>
- Subsection (2) was amended to clarify the effect on the transferee subsequent to the transfer of an asset. It provided that the transferee stepped into the shoes of the transferor regarding the date of acquisition of the asset, the amount and date of any expenditure incurred in respect of the acquisition of that asset by the transferor, and any valuation of a pre-valuation date asset affected by the transferor within the period contemplated in paragraph 29(4) of the Eighth Schedule.<sup>291</sup>

### **7.2 The 2003 amendments**

The following amendments to section 47 were introduced in 2003<sup>292</sup>:

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<sup>287</sup> SARS, 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*. 70. The amendment was introduced by section 54(1)(a) of the Revenue Laws Amendment Act No. 45 of 2003 and deemed to be effective from 6 November 2002.

<sup>288</sup> This was as a result of the introduction of provisions relating to amalgamation transactions.

<sup>289</sup> [W.P. 2 – '02].

<sup>290</sup> *Ibid* at 42.

<sup>291</sup> *Ibid* at 19.

<sup>292</sup> SARS, 2003. *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003*.

- Subsection 1 was amended to provide for the retention, by a liquidating company, of assets it elected to use to settle its trading debts. Provision was also made for partial relief to the extent to which its assets were disposed of to its holding company.<sup>293</sup>
- Subsection (5) was amended to simplify the rule where a holding company disposed of a share in a liquidating company as a result of a liquidation, winding-up or deregistration of that liquidating company. That holding company was treated as having disposed of those shares for proceeds equal to the base cost or amount otherwise taken into account in respect of those shares.<sup>294</sup>
- Subsection (6) was amended to provide for liquidation distributions to be excluded from roll-over relief where a liquidating company at any stage withdrew or invalidated any step so taken.<sup>295</sup>

### 7.3 The 2004 amendments

It was proposed that section 47 be amended in order to pre-empt any possible argument that the requirement that the recipient of certain liquidation distributions was a resident was discriminatory.<sup>296</sup>

### 7.4 The 2005 amendments

- The Explanatory Memorandum on the Revenue Laws Bill, 2005 proposed the introduction of a new subsection (3A).<sup>297</sup>

Reason: The amendment limited roll-over relief in respect of liquidation distributions to situations where assets of a liquidating company were disposed of in exchange for the cancellation, by the holding company, of shares held by it in that liquidating company or in return for the assumption, by that holding company, of eligible debts of that liquidating company.<sup>298</sup>

The proposed rules are similar to those proposed in respect of the assumption, as part of an amalgamation transaction, of debts of an amalgamated company.

### 7.5 The 2007 amendments

The following major amendments were introduced in 2007:

- It was proposed that the reference to cancellation be changed to refer to the disposal of the shares as a result of the liquidation, winding up or deregistration of the liquidating company. This brings the wording in section 47(3A)(a) in line with similar wording used in section 47(5).

<sup>293</sup> *Ibid* at 70.

<sup>294</sup> *Ibid* at 70.

<sup>295</sup> *Ibid* at 71.

<sup>296</sup> SARS. 2004. *Explanatory Memorandum on the Revenue Amendment Bill, 2004*. 72.

<sup>297</sup> SARS. 2005. *Explanatory Memorandum on the Revenue Amendment Bill, 2005*. 34.

<sup>298</sup> *Ibid*.

Reason: In terms of section 47(3A)(a) one of the requirements for affording roll-over treatment to a liquidating company was that the equity shares in that company must have been cancelled. This, however, was confusing, as under South African company law shares were not technically cancelled upon liquidation or deregistration of a company.<sup>299</sup>

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<sup>299</sup> SARS. 2007. *Explanatory Memorandum on the Taxations Laws Amendment Bill, 2007*. 34.

## Appendix 2

### Part III of Chapter II of the Act<sup>300</sup>

*Special rules relating to asset-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distributions*

#### Section 41: General

- (1) For the purposes of this Part, unless the context otherwise indicates, any word or expression that has been defined in section 1, shall bear the same meaning so defined, and -

**“allowance asset”** means a capital asset in respect of which a deduction or allowance is allowable in term so this Act for purposes other than the determination of any capital gain or capital loss;

**“asset”** means an asset as defined in paragraph 1 of the Eighth Schedule;

**“associated group of companies”** means two or more companies in which one company (hereinafter referred to as the ‘influencing company’) directly or indirectly holds shares in at least one other company (hereinafter referred to as the ‘influenced company’), to the extent that -

- (a) at least 20% of the equity shares and voting rights of each influenced company are directly held by the influencing company, one or more influenced companies or any combination thereof as assets of a capital nature; and
- (b) the influencing company directly holds at least 20% of the equity shares and voting rights in at least one influenced company as assets of a capital nature;

**“base cost”** means the base cost as defined in paragraph 1 of the Eighth Schedule: Provided that where the base cost of an asset as at a specific date is to be determined as contemplated in paragraph 26 or 27 of the Eighth Schedule, the amount thereof must, for purposes of section 42 or 44, be determined as if that asset had been disposed of on that date for an amount received or accrued equal to the market value of that asset as at that date;

**“capital asset”** means an asset as defined in paragraph 1 of the Eighth Schedule, which does not constitute trading stock;

**“date of acquisition”** means the date of acquisition as determined in accordance with paragraph 13 of the Eighth Schedule or, where a person acquires an asset in terms of a transaction subject to the provisions of this Part, the deemed date of acquisition of that asset by that person as contemplated in this Part;

**“domestic financial instrument holding company”** means any company which is a resident, where more than the prescribed proportion of all the assets of that company together with the assets of all influenced companies in relation to that company consists of financial instruments, other than -

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<sup>300</sup> Updated to include the Revenue Laws Amendment Act No. 60 of 2008.

- (a) a financial instrument that constitutes a debt due to that company or to any influenced company in relation to that company in respect of goods sold or services rendered by that company or influenced company, as the case may be, where –
  - (i) the amount of that debt is or was included in the income of that company or influenced company, as the case may be, (or in the case of a foreign influenced company, would have been so included were that foreign company a resident); and
  - (ii) that debt is an integral part of a business conducted as a going concern by that company or influenced company, as the case may be; or
- (b) any financial instrument held by that company or by any influenced company in relation to that company, where that company or influenced company, as the case may be, is –
  - (i) a bank regulated in terms of the Banks Act No. 94 of 1990;
  - (ii) an authorised user regulated in terms of the Securities Services Act, 2004;
  - (iii) an insurer regulated in terms of the Long Term Insurance Act No. 52 of 1998;
  - (iv) an insurer regulated in terms of the Short Term Insurance Act No. 53 of 1998; or
  - (v) .....
  - (vi) a collective investment scheme regulated in terms of the Collective Investment Schemes Control Act No. 45 of 2002; or
- (c) any financial instrument held by any influenced company in relation to that company if that influenced company is a foreign company as contemplated in paragraph (b) of the definition of “foreign financial instrument holding company”:

Provided that in determining whether more than the prescribed proportion of the assets of the company and influenced companies consist of financial instruments, the following assets must be wholly disregarded –

- (i) any share of an influenced company in relation to that company;
- (ii) any financial instrument which constitutes a loan, advance or debt entered into between –
  - (aa) that company and any influenced company in relation to that company; or
  - (bb) influenced companies in relation to that company;
- (iii) any financial instrument with market value equal to its base cost other than a financial instrument contemplated in paragraphs (a), (b) and (c) of this definition; and
- (iv) any instrument defined in section 24J with a term of less than 12 months other than a financial instrument contemplated in paragraphs (a), (b) and (c) of this definition;

“**disposal**” means a disposal as defined in paragraph 1 of the Eighth Schedule and any deemed disposal in terms of this Part;

“**foreign financial instrument holding company**” means any foreign company as defined in section 9D, where more than the prescribed proportion of all the assets of that company, together with the assets of all influenced companies in relation to that foreign company, consist of financial instruments, other than –

- (a) any financial instrument that constitutes a debt due to that foreign company, or to any influenced company in relation to that foreign company, in respect of goods sold or services rendered by that foreign company or influenced company, as the case may be, where –
  - (i) the amount of that debt is or was included in the income of that foreign company or influenced company, as the case may be (or would have been so included were that foreign company or controlled group company a resident); and
  - (ii) that debt is an integral part of a business conducted as a going concern by that foreign company or controlled group company, as the case may be;
- (b) any financial instrument arising from the principal trading activities of that foreign company or of any influenced company in relation to that foreign company which is a bank or financier, insurer or broker that conducts more business in the country of residence of that foreign company, or in the country of residence of that influenced company, as the case may be, than in any other single country and that company –
  - (i) regularly accepts deposits or premiums or makes loans, issues letters of credit, provides guarantees or effects similar transactions for the account of clients, or receives commissions from clients, who are not connected persons in relation to that company; and
  - (ii) derives more than 50% of its income or gains from principal trading activities with respect to those clients;
- (c) any financial instrument held by any influenced company in relation to that foreign company if that influenced company is an influenced company as contemplated in paragraph (b) of the definition of “domestic financial instrument holding company”:

Provided that in determining whether more than the prescribed proportion of the assets of the company and all influenced companies consist of financial instruments –

- (i) the following assets must be wholly disregarded –
  - (aa) any share in any other influenced company in the same associated group of companies;
  - (bb) any financial instrument which constitutes a loan, advance or debt entered into between –
    - (A) that company and any influenced company in relation to that company; or
    - (B) influenced companies in relation to that company;
  - (cc) any financial instrument with a market value equal to base cost other than a financial instrument contemplated in paragraphs (a), (b) and (c) of this definition; and
  - (dd) any instrument defined in section 24J with a term of less than 12 months other than a financial instrument contemplated in paragraphs (a), (b) and (c) of this definition;
- (ii) paragraph (b) will not apply to a foreign company that is potentially eligible for preferential tax treatment in its country of residence if –
  - (aa) the tax treatment is dependent upon the company conducting business with clients who are not residents of that country; or
  - (bb) a prerequisite of that tax treatment is that more than 50% of the ownership of that company must be held by persons who are not residents of that country;

**“group of companies”** means a group of companies as defined in section 1: Provided that for the purposes of this definition –

- (i) any company that would, but for the provisions of this definition, form part of a group of companies shall not form part of that group of companies if –
  - (aa) that company is a company contemplated in paragraph (c), (d) or (e) of the definition of “company”;
  - (bb) that company is a company contemplated in section 21 of the Companies Act No. 61 of 1973;
  - (cc) any amount constituting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received by or to accrue to that company;
  - (dd) that company is a public benefit organisation or recreational club that has been approved by the Commissioner in terms of section 30 or 30A; or
  - (ee) that company is a company contemplated in paragraph (b) of the definition of “company”, unless that company has its place of effective management in the Republic; and
- (ii) any share that would, but for the provisions of this definition, be an equity share shall be deemed not to be an equity share if –
  - (aa) that share is held as trading stock; or
  - (bb) any person is under a contractual obligation to sell or purchase that share, or has an option to sell or purchase that share unless that obligation or option provides for the sale or purchase of that share at its market value at the time of that sale or purchase;

**“hold”** in relation to an equity share means the holding, by a person, of an equity share in such manner that that person qualifies as a “shareholder” as defined in this subsection, and the word **“held”** must be construed accordingly;

**“listed company”** means a company as contemplated in paragraph (a) of the definition of ‘listed company’ in section 1;

**“market value”** in relation to an asset means the price which could be obtained upon a sale of that asset between a willing buyer and a willing seller dealing at arm’s length in an open market; and

**“prescribed proportion”** in relation to the assets of a company and influenced companies (if any), means –

- (a) half of the market value or two-thirds of the actual cost of all assets: Provided that in relation to the assets of a foreign company as defined in section 9D(1) and influenced companies (if any) the expression “or two-thirds of the actual cost” shall be disregarded if any asset disposed of by that foreign company is deemed not to be attributable to a permanent establishment of that company in terms of paragraph (d) of the proviso to section 9D(6); or
- (b) where shares in the equity share capital of that company are to be disposed of between members of the same group of companies, either –
  - (i) the proportion determined in the manner contemplated in paragraph (a); or
  - (ii) half of the book value (as determined for purposes of that company’s most recent audited financial statements) of all assets or two-thirds of the actual cost of all assets;

Provided that in determining the value or cost of all the assets of an influenced company in relation to a company, only such percentage of the value or cost of all those assets, as is equivalent to the percentage of the effective shareholding of that company in that influenced company, must be taken into account;

**“shareholder”** in relation to an equity share, means the registered shareholder of that equity share, unless a person other than that registered shareholder is entitled to all or part of the benefit of the rights of participation in the profits, income or capital attaching to that equity share, in which case that person must, to the extent of that entitlement to that benefit, be deemed to be the shareholder; and

**“trading stock”** –

- (a) for purposes of sections 42, 44, 45 and 47, includes any livestock or produce contemplated in the First Schedule and any reference in section 11(a) or 22(1) or (2) to an amount taken into account in respect of an asset shall, in the case of such livestock or produce, be construed as a reference to the amount taken into account in respect thereof in terms of paragraph 5(1) or 9 of the First Schedule, as the case may be; and
- (b) for purposes of sections 42(7)(b)(i), 44(5)(b)(i), 45(5)(b)(i) and 47(4)(b)(i), means trading stock that is neither of the same kind nor of the same or equivalent quality as trading stock regularly and continuously disposed of by that person;

**“unlisted company”** means any company which is not a listed company as defined in this subsection.

- (2) The provisions of this Part must, subject to subsection (3), apply in respect of an asset-for-share transaction, an amalgamation transaction, an intra-group transaction, an unbundling transaction and a liquidation distribution as contemplated in sections 42, 44, 45, 46 and 47, respectively, notwithstanding any provision to the contrary contained in the Act, other than sections 24B(2) and (3) and 103 and Part IIA of Chapter III.
- (3) The provisions of this Part shall not apply in respect of any transaction in terms of which any asset is disposed of to an insurer as defined in section 29A if the asset is to be held in the insurer's untaxed policyholder fund as contemplated in subsection (4)(a) of that section.
- (4) A company must for the purposes of this Part, be deemed to have taken steps to liquidate, wind up or deregister, where –
  - (a) in the case of a liquidation or winding-up –
    - (i) that company has lodged a resolution authorising the voluntary liquidation or winding-up of that company, for registration in terms of –
      - (aa) section 200 of the Companies Act No. 61 of 1973, in the case of a company registered in terms of that Act;
      - (bb) section 67(2) of the Close Corporations Act No. 69 of 1984, in the case of a close corporation; or
      - (cc) a similar provision contained in any foreign law relating to the liquidation of companies, in the case where that company is

- incorporated in a country other than the Republic, if such foreign law so requires; and
- (ii) that company has disposed of all assets and has settled all liabilities (other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up); and
- (b) in the case of a deregistration of a company, that company has submitted a written statement signed by each of its directors confirming that the company has ceased to carry on business and has no assets or liabilities –
- (i) to the Registrar of Companies in terms of section 73(5) of the Companies Act, 1973, in the case of a company registered in terms of that Act;
  - (ii) to the Registrar of Close Corporations in terms of section 26(2) of the Close Corporations Act, 1984, in the case of a close corporation; or
  - (iii) in the case where that company is incorporated in a country other than the Republic, to a person who, in terms of any similar provision contained in any foreign law, exercises the powers and performs the duties assigned to a Registrar contemplated in subparagraph (i) or (ii), if such foreign law so requires;
- (c) that company has submitted a copy of the resolution contemplated in paragraph (a)(i) or the written statement contemplated in paragraph (b) to the Commissioner; and
- (d) all the returns or information required to be submitted or furnished to the Commissioner in terms of any Act administered by the Commissioner by the end of the relevant period within which the steps contemplated in this subsection must be taken, have been submitted or furnished or arrangements have been made with the Commissioner for the submission of any outstanding returns or furnishing of information.
- (5) .....
- (6) .....
- (7) An amount contemplated in paragraph (j) of the definition of “gross income” in section 1 must for purposes of this Part be deemed to be an amount that must be recovered or recouped.
- (8) (a) This subsection applies where a capital distribution in respect of any share as contemplated in paragraph 76(1)(b) of the Eighth Schedule has been received by or has accrued to any person, and that person has disposed of that share, after that receipt or accrual, in terms of a disposal or distribution in respect of which the provisions of section 42, 44, 45 or 47 apply.
- (b) Where paragraph (a) applies, that capital distribution must for purposes of paragraph 76(1)(b) of the Eighth Schedule be deemed to have been received by or to have accrued to –
- (i) the person to whom that share is so disposed of or distributed in respect of that share; and

- (ii) the person so disposing of that share, in respect of any share acquired in consequence of that disposal (other than a transferor company contemplated in section 45(1)(a)).
- (9) Where a person has made an election in respect of an asset under paragraph 65 or 66 of the Eighth Schedule and disposes of or distributes any replacement asset in relation to that asset in terms of section 42, 44, 45 or 47 –
- (a) the person so disposing of or distributing that replacement asset must disregard any capital gain or amount recovered or recouped which was apportioned to that asset under paragraph 65 or 66 of the Eighth Schedule or section 8(4)(e) and (eA), as the case may be, and which otherwise would have had to be brought to account at the time of that disposal or distribution; and
  - (b) the company acquiring that replacement asset and the person referred to in paragraph (a) must be treated as one and the same person for the purposes of section 8(4)(eB), (eC) or (eD) and paragraphs 65 and 66 of the Eighth Schedule.<sup>301</sup>

#### **Section 42: Asset-for-share transactions**

- (1) For the purposes of this section –

**“asset-for-share transaction”** means any transaction –

- (a) in terms of which a person disposes of an asset, other than an asset which constitutes a restraint of trade or personal goodwill, the market value of which is equal to or exceeds –
  - (i) in the case of an asset held as a capital asset, the base cost of that asset on the date of that disposal; or
  - (ii) in the case of an asset held as trading stock, the amount taken into account in respect of that asset in terms of section 11(a) or 22(1) or (2), to a company which is a resident, in exchange for an equity share or shares of that company and that person –
    - (aa) at the close of the day on which that asset is disposed of, holds a qualifying interest in that company or
    - (bb) is a natural person who will be engaged on a full-time basis in the business of that company, or a controlled group company in relation to that company, of rendering a service; and
- (b) as a result of which that company acquires that asset from that person –
  - (i) as trading stock, where that person holds it as trading stock;
  - (ii) as a capital asset, where that person holds it as a capital asset; or
  - (iii) as trading stock, where that person holds it as a capital asset and that company and that person do not form part of the same group of companies;<sup>302</sup>

**“equity share”** means an equity share as contemplated in section 44; and

<sup>301</sup> Subsection (9) is deemed to have come into operation on 1 January 2008 and applies in respect of an asset disposed of on or after that date.

<sup>302</sup> Subsection (1)(b) is deemed to have come into operation on 1 January 2009 and applies in respect of any asset-for-share transaction entered into on or after that date.

**“qualifying interest”** of a person means –

- (a) an equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that share;
- (b) an equity share held by that person in a company which is a company contemplated in paragraph (e)(i) of the definition of “company” in section 1 or will become such a company within 12 months after the transaction as a result of which that person holds that share;
- (c) equity shares held by that person in a company that constitute at least 20% of the equity shares and voting rights of a company; or
- (d) an equity share held by that person in a company which forms part of the same group of companies as that person.

(2) Subject to subsections (4) and (8), where a person disposes of an asset to a company in terms of an asset-for-share transaction –

- (a) that person must be deemed to have –
  - (i) disposed of that asset for an amount equal to the amount contemplated in subparagraphs (i) or (ii) of paragraph (a) of the definition of “asset-for-share transaction”, as the case may be; and
  - (ii) acquired the equity shares in that company on the date that such person acquired that asset (other than for purposes of determining whether that share is a “qualifying share” as defined in section 9C where that asset is not an equity share) and for a cost equal to –
    - (aa) where that asset is so disposed of as a capital asset, any expenditure in respect of that asset incurred by that person that is allowable in terms of paragraph 20 of the Eighth Schedule and to have incurred such cost at the date of incurral by that person of such expenditure; or
    - (bb) where that asset is so disposed of as trading stock, the amount taken into account in respect of that asset in terms of section 11(a) or 22(1) or (2),  
which cost must, where those equity shares are acquired as –
      - (A) capital assets, be treated as an expenditure actually incurred and paid by that person in respect of those equity shares for the purposes of paragraph 20 of the Eighth Schedule; and
      - (B) trading stock, be treated as the amount to be taken into account by that person in respect of those equity shares for the purposes of section 11(a) or 22(1) or (2);
- (b) subject to paragraph (bA), that person and that company must, for purposes of determining –
  - (i) any taxable income derived by that company from a trade carried on by it; or
  - (ii) any capital gain or capital loss in respect of a disposal of that asset by that company,  
be deemed to be one and the same person with respect to –
    - (aa) where that asset is acquired by that company as a capital asset from that person who disposes of it as a capital asset –
      - (A) the date of acquisition of that asset by that person and the amount and date of incurral by that person of any expenditure in respect of

- that asset allowable in terms of paragraph 20 of the Eighth Schedule; and
- (B) any valuation of that asset effected by that person within the period contemplated in paragraph 29(4) of the Eighth Schedule;
- (bb) where that asset is acquired by that company as trading stock from that person who disposes of it as trading stock, the date of acquisition of that asset by that person and the amount and date of incurral by that person of any cost or expenditure incurred in respect of that asset as contemplated in section 11(a) or 22(1) or (2); or
- (cc) where that asset is acquired by that company as trading stock from that person who disposes of it as a capital asset –
- (A) the date of acquisition of that asset by that person and the amount and date of incurral by that person of any expenditure allowable in terms of paragraph 20 of the Eighth Schedule; or
- (B) where that person has valued that asset as contemplated in paragraph 29(4) of the Eighth Schedule, the amount of the market value so determined,
- which amount must, notwithstanding paragraph 25 of the Eighth Schedule, be treated as the amount to be taken into account by that company in respect of that asset for purposes of section 11(a) or 22(1) or (2);
- (bA) that company must, where that company is a listed company or a company contemplated in paragraph (e)(i) of the definition of “company” and the asset was acquired by that company from any person who does not hold more than 20% of the equity share capital of that company after the asset-for-share transaction, be deemed to have acquired the asset at a cost equal to the market value of the asset; and
- (c) any valuation of that asset effected by that person within the period contemplated in paragraph 29(4) of the Eighth Schedule must be deemed to have been effected in respect of the equity shares in that company acquired in terms of that asset-for-share transaction.
- (3) Subject to subsection (4) or (8), where a person disposes of –
- (a) an asset that constitutes an allowance asset in that person’s hands to a company as part of an asset-for-share transaction and that company acquires that asset as an allowance asset –
- (i) no allowance allowed to that person in respect of that asset must be recovered or recouped by that person or included in that person’s income for the year of that transfer; and
- (ii) that person and that company must be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction –
- (aa) to which that company may be entitled in respect of that asset; or
- (bb) that is to be recovered or recouped by or included in the income of that company in respect of that asset;
- (b) an asset that constitutes an allowance asset in that person’s hands to a company as part of an asset-for-share transaction and that company acquires that asset as trading stock, no allowance allowed to that person in respect of that asset must be recovered or recouped by that person or included in that person’s income for the year of that transfer; or

- (c) a contract to a company as part of a disposal of a business as a going concern in terms of an asset-for-share transaction and that contract imposes an obligation on that person in respect of which an allowance in terms of section 24C was allowable to that person for the year preceding that in which that contract is transferred or would have been allowable to that person for the year of that transfer had that contract not been so transferred –
- (i) no allowance allowed to that person in respect of that obligation must be included in that person's income for the year of that transfer; and
  - (ii) that person and that company must be deemed to be one and the same person for purposes of determining the amount of any allowance –
    - (aa) to which that company may be entitled in respect of that obligation; or
    - (bb) that is to be included in the income of that company in respect of that obligation.

- (3A) For purposes of the definition of “contributed tax capital”, if an asset is disposed of by a person to a company in terms of an asset-for-share transaction and that person at the close of the day on which that asset is disposed of holds a qualifying interest in that company as contemplated in paragraph (c) of the definition of “qualifying interest”, or is a natural person who will be engaged on a full-time basis in the business of that company or a controlled group company in relation to that company of rendering a service, the amount received by or accrued to the company for the issue of the shares is deemed to be equal to –
- (a) if the asset is trading stock, the amount taken into account by that person in respect of the asset in terms of section 11(a) or 22(1) or (2); or
  - (b) if the asset is an asset other than trading stock, the base cost of that asset determined at the time of that disposal in relation to the person disposing of that asset.<sup>303</sup>

- (4) Where –
- (a) a person disposes of an asset to a company in terms of an asset-for-share transaction; and
  - (b) that person becomes entitled, in exchange for that asset, to any consideration in addition to any equity shares issued by the company to that person, other than any debt assumed by that company as contemplated in subsection (8),
- the disposal of that asset to that company contemplated in paragraph (a) must, to the extent that any equity shares are issued by the company to that person, be deemed to be a disposal in terms of an asset-for-share transaction for purposes of this section, and to the extent that such person becomes entitled to any other consideration, as contemplated in paragraph (b), be deemed to be a disposal of part of that asset other than in terms of an asset-for-share transaction, in which case the amount to be determined in respect of –
- (i) in the case of a disposal of a capital asset, the base cost of that asset at the time of that disposal;
  - (ii) in the case of a disposal of an allowance asset, the amount of the allowances allowed to that person in respect of that asset; or

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<sup>303</sup> Subsection (3A) comes into operation on the date on which Part VIII (“Dividends Tax”) of Chapter II of the ITA comes into operation.

- (iii) in the case of the disposal of an asset that constitutes trading stock, the amount taken into account in respect of that asset in terms of section 11(a) or 22(1) or (2),

that must be attributed to the part of the asset deemed to have been disposed of other than in terms of an asset-for-share transaction, must bear the same ratio to the respective amounts referred to in subparagraphs (i) to (iii) as the market value of the consideration not consisting of equity shares issued by that company bears to the market value of the total consideration in respect of that asset.

(5) Where a person –

- (a) acquired any equity share in a company in terms of an asset-for-share transaction; and
- (b) disposes of any such equity share (other than by way of an intra-group transaction contemplated in section 45, an unbundling transaction contemplated in section 46 or a liquidation distribution contemplated in section 47, an involuntary disposal as contemplated in paragraph 65 of the Eighth Schedule or the death of that person) within a period of 18 months after the date of acquisition contemplated in paragraph (a) and immediately prior to that disposal more than 50% of the market value of all the assets disposed of by that person to that company in terms of any transaction in respect of which the provisions of this Part apply, is attributable to allowance assets or trading stock or both,

that person must be deemed to have disposed of that share as trading stock to the extent that any amount received by or accrued to that person in respect of the disposal of that share is less than or equal to the market value of that share at the beginning of such period of 18 months.

(6) Where a person disposed of any asset in terms of an asset-for-share transaction and that person ceases to hold a qualifying interest in that company, as contemplated in paragraphs (c) and (d) of the definition of “qualifying interest”, within a period of 18 months after the date of the disposal of that asset (whether or not by way of the disposal of shares in that company) or ceases within that period to be engaged on a full-time basis in the business of the company, or controlled group company in relation to that company, of rendering the service contemplated in subsection (1)(a)(ii)(bb), that person is for purposes of subsection (5), section 22 or the Eighth Schedule deemed to have –

- (a) disposed of all the equity shares acquired in terms of that asset-for-share transaction that are still held immediately after that person ceased to hold such a qualifying interest, for an amount equal to the market value of those equity shares as at the beginning of that period of 18 months; and
- (b) immediately reacquired all the equity shares contemplated in paragraph (a) at a cost equal to the amount contemplated in that paragraph:

Provided that the provisions of this subsection do not apply where that person ceases to hold a qualifying interest in that company in terms of an intra-group transaction contemplated in section 45, an unbundling transaction contemplated in section 46 or a liquidation distribution contemplated in section 47, an involuntary disposal as contemplated in paragraph 65 of the Eighth Schedule or a disposal that would have constituted an involuntary disposal as contemplated in that paragraph had that asset not been a financial instrument, or as the result of the death of that person.

- (7) Where a company disposes of an asset within a period of 18 months after acquiring that asset in terms of an asset-for-share transaction, and –
- (a) that asset constitutes a capital asset, so much of any capital gain determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, may not be taken into account in determining any net capital gain or assessed capital loss of that company but is subject to paragraph 10 of the Eighth Schedule for purpose of determining an amount of taxable capital gain derived from that gain, which taxable capital gain may not be set off against any assessed loss or balance of assessed loss of that company; or
- (b) that asset constitutes –
- (i) trading stock in the hands of that company, so much of the amount received or accrued in respect of the disposal of that trading stock as does not exceed the market value of that trading stock as at the beginning of that period of 18 months and so much of the amount taken into account in respect of that trading stock in terms of section 11(a) or 22(1) or (2) as is equal to the amount so taken into account in terms of subsection (2)(b); or
- (ii) an allowance asset in the hands of that company, so much of any allowance in respect of that asset that is recovered or recouped by or included in the income of that company as a result of that disposal as does not exceed the amount that would have been recovered had that asset been disposed of at the beginning of that period of 18 months for an amount equal to the market value of that asset as at that date, must be deemed to be attributable to a separate trade carried on by that company, the taxable income from which trade may not be set off against any assessed loss or balance of assessed loss of that company.
- (8) Where a person disposes of –
- (a) any asset which secures any debt to a company in terms of an asset-for-share transaction and that debt was incurred by that person –
- (i) more than 18 months before that disposal; or
- (ii) within a period of 18 months before that disposal –
- (aa) and that debt was incurred at the same time as that asset was acquired by that person; or
- (bb) to the extent that debt constitutes the refinancing of any debt in respect of that asset incurred as contemplated in subparagraph (i) or item (aa) of subparagraph (ii), and that company assumes that debt or an equivalent amount of debt that is secured by that asset; or
- (b) any business undertaking as a going concern to a company in terms of an asset-for-share transaction and that disposal includes any amount of any debt that is attributable to, and arose in the normal course of that business undertaking,

that person must, upon the disposal of any equity share acquired in terms of that asset-for-share transaction and notwithstanding the fact that that person may be liable as surety for the payment of the debt referred to in subparagraphs (a) or (b), treat so much of the face value of that debt as relates to that equity share, as a capital distribution of cash in respect of that equity share, for the purposes of paragraph 76 of

the Eighth Schedule, where that equity share is held as a capital asset or where that equity share is held as trading stock, as income to be included in that person's income.

- (8A) This section does not apply to the disposal of an asset by a person to a company if –
- (a) the person and the company jointly elect that this section does not apply; or
  - (b) the disposal would not be taken into account for purposes of determining any taxable income or assessed loss of that person.<sup>304</sup>

#### **Section 44: Amalgamation Transactions**

(1) For the purposes of this section –

**“amalgamation transaction”** means any transaction –

- (a) in terms of which any company (hereinafter referred to as the “amalgamated company”) disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to another company (hereinafter referred to as the “resultant company”) which is resident, by means of an amalgamation, conversion or merger; and
- (b) as a result of which that amalgamated company's existence will be terminated: Provided that the provisions of this section will not apply to a disposal of an asset by an amalgamated company to a resultant company where that resultant company and the person contemplated in subsection (6) form part of the same group of companies immediately before and after that disposal, if that amalgamated company, resultant company and person jointly so elect;

**“equity share”** includes a participatory interest in a portfolio of a collective investment scheme referred to in paragraph (e)(i) of the definition of “company” in section 1;

**“qualifying interest”** of a person means –

- (a) an equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that share;
  - (b) an equity share held by that person in a company which is a company contemplated in paragraph (e)(i) of the definition of “company” in section 1 or will become such a company within 12 months after the transaction as a result of which that person holds that share; or
  - (c) equity shares held by that person in a company that constitute at least 20% of the equity shares and voting rights of a company.
- (2) Where an amalgamated company disposes of –
- (a) a capital asset in terms of an amalgamation transaction to a resultant company which acquires it as a capital asset –

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<sup>304</sup> Subsection (8A) came into operation on 1 January 2009 and applies in respect of any asset-for-share transaction entered into on or after that date.

- (i) the amalgamated company must be deemed to have disposed of that asset for an amount equal to the base cost of that asset on the date of that disposal; and
  - (ii) that resultant company and that amalgamated company must, for purposes of determining any capital gain or capital loss in respect of a disposal of that asset by that resultant company, be deemed to be one and the same person with respect to –
    - (aa) the date of acquisition of that asset by that amalgamated company and the amount and date of incurral by that amalgamated company of any expenditure in respect of that asset allowable in terms of paragraph 20 of the Eighth Schedule; and
    - (bb) any valuation of that asset effected by that amalgamated company as contemplated in paragraph 29(4) of the Eighth Schedule;
- (b) an asset held by it as trading stock in terms of an amalgamation transaction to a resultant company which acquires it as trading stock –
- (i) that amalgamated company must be deemed to have disposed of that asset for an amount equal to the amount taken into account by that amalgamated company in respect of that asset in terms of section 11(a) or 22(1) or (2); and
  - (ii) that amalgamated company and that resultant company must, for purposes of determining any taxable income derived by that resultant company from a trade carried on by it, be deemed to be one and the same person with respect to the date of acquisition of that asset by that amalgamated company and the amount and date of incurral by that amalgamated company of any cost or expenditure incurred in respect of that asset as contemplated in section 11(a) or 22(1) or (2).
- (3) Where an amalgamated company disposes of –
- (a) an asset that constitutes an allowance asset in that amalgamated company's hands to a resultant company as part of an amalgamation transaction and that resultant company acquires that asset as an allowance asset –
    - (i) no allowance allowed to that amalgamated company in respect of that asset must be recovered or recouped by that amalgamated company or included in that amalgamated company's income for the year of that transfer; and
    - (ii) that amalgamated company and that resultant company must be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction –
      - (aa) to which that resultant company may be entitled in respect of that asset; or
      - (bb) that is to be recovered or recouped by or included in the income of that resultant company in respect of that asset;
  - (b) a contract to a resultant company as part of a disposal of a business as a going concern in terms of an amalgamation transaction and that contract imposes an obligation on that amalgamated company in respect of which an allowance in terms of section 24C was allowable to that amalgamated company for the year preceding that in which that contract is transferred or would have been allowable to that amalgamated company for the year of that transfer had that contract not been so transferred –

- (i) no allowance allowed to that amalgamated company in respect of that obligation must be included in that amalgamated company's income for the year of that transfer; and
  - (ii) that amalgamated company and that resultant company must be deemed to be one and the same person for purposes of determining the amount of any allowance –
    - (aa) to which that resultant company may be entitled in respect of that obligation; or
    - (bb) that is to be included in the income of that resultant company in respect of that obligation.
- (4) The provisions of subsections (2) and (3) will apply to a disposal of an asset by an amalgamated company to a resultant company as part of an amalgamation transaction only to the extent that such asset is so disposed of in exchange for –
- (a) an equity share or shares in that resultant company; or
  - (b) the assumption by that resultant company of a debt of that amalgamated company that was incurred by that amalgamated company –
    - (i) more than 18 months before that disposal; or
    - (ii) within a period of 18 months before that disposal, to the extent that the debt –
      - (aa) constitutes the refinancing of any debt incurred as contemplated in subparagraph (i); or
      - (bb) is attributable to and arose in the normal course of a business undertaking disposed of, as a going concern, to that resultant company as part of that amalgamation transaction.
- (4A) For purposes of the definition of “contributed tax capital”, if the resultant company issues shares in exchange for the disposal of an asset in terms of an amalgamation transaction, the amount received by or accrued to the resultant company as consideration for the issue of shares is deemed to be equal to an amount which bears to the contributed tax capital of the amalgamated company at the time of termination contemplated in subsection (1)(b) the same ratio as the value of the shares held in the amalgamated company at that time by shareholders other than the resultant company bears to the value of all shares held in the amalgamated company at that time.<sup>305</sup>
- (5) Where the resultant company acquires any asset from the amalgamated company in terms of an amalgamation transaction that was subject to subsection (2) or (3) and that resultant company disposes of that asset within a period of 18 months after so acquiring that asset and –
- (a) that asset constitutes a capital asset in the hands of that resultant company –
    - (i) so much of any capital gain determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, may not be taken into account in determining any net capital gain or assessed capital loss of that resultant company but is subject to

<sup>305</sup> Subsection (4A) comes into operation on the date on which Part VIII (“Dividends Tax”) of Chapter II of the ITA comes into operation.

paragraph 10 of the Eighth Schedule for purpose of determining an amount of taxable capital gain derived from that gain, which taxable capital gain may not be set off against any assessed loss or balance of assessed loss of that resultant company; or

- (ii) so much of any capital loss determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, must be disregarded in determining the aggregate capital gain or aggregate capital loss of that resultant company for purposes of the Eighth Schedule: Provided that the amount of any capital loss so disregarded may be deducted from the amount of any capital gain determined in respect of the disposal during that year or any subsequent year of assessment of any other asset acquired by that resultant company from that amalgamated company in terms of that amalgamation transaction; or
- (b) that asset constitutes –
- (i) trading stock in the hands of that resultant company, so much of the amount received or accrued in respect of the disposal of that trading stock as does not exceed the market value of that trading stock as at the beginning of that period of 18 months and so much of the amount taken into account in respect of that trading stock in terms of section 11(a) or 22(1) or (2) as is equal to the amount so taken into account in terms of subsection (2)(b); or
  - (ii) an allowance asset in the hands of that resultant company, so much of any allowance in respect of that asset that is recovered or recouped by or included in the income of that resultant company as a result of that disposal as does not exceed the amount that would have been recovered had that asset been disposed of at the beginning of that period of 18 months for an amount equal to market value of that asset as at that date, must be deemed to be attributable to a separate trade carried on by that resultant company, the taxable income or assessed loss from which trade may not be set off against or added to any assessed loss or balance of assessed loss of that resultant company.
- (6) (a) Subject to subsection (7), this subsection applies where –
- (i) a person disposes of any equity shares in an amalgamated company as a result of the liquidation, winding up or deregistration of that amalgamated company and acquires equity shares in the resultant company as part of an amalgamation transaction in respect of which subsection (2) or (3) applied, which equity shares in the resultant company are acquired –
    - (aa) as either capital assets or trading stock, in the case where that share in the amalgamated company is disposed of as a capital asset; or
    - (bb) as trading stock in the case where that share in the amalgamated company is disposed of as trading stock; and
  - (ii) that person at the end of the day during which that disposal is effected, holds a qualifying interest in that resultant company,
- (b) The person contemplated in paragraph (a) is deemed to have –

- (i) disposed of the equity share in that amalgamated company for an amount equal to the expenditure incurred by that person in respect of that equity share which is or was allowable in terms of paragraph 20 of the Eighth Schedule or taken into account in terms of section 11(a) or 22(1) or (2), as the case may be;
  - (ii) acquired the equity shares in the resultant company on the date on which that person acquired the equity share in the amalgamated company for a cost equal to the expenditure incurred by that person as contemplated in subparagraph (i); and
  - (iii) to have incurred the cost contemplated in subparagraph (ii) on the date on which that person incurred the expenditure in respect of the equity share in the amalgamated company, which cost must be treated as -
    - (aa) an expenditure actually incurred and paid by that person in respect of those equity shares for the purposes of paragraph 20 of the Eighth Schedule, if those equity shares in the resultant company are acquired as capital assets; or
    - (bb) the amount to be taken into account by that person in respect of those equity shares for the purposes of section 11(a) or 22(1) or (2), if those equity shares in the resultant company are acquired as trading stock.
- (c) Any valuation of the equity share in the amalgamated company which was done by the person contemplated in paragraph (a) within the period contemplated in paragraph 29(4) of the Eighth Schedule is deemed to have been done by that person in respect of the equity shares in the resultant company.

(7) Where -

- (a) a person disposes of an equity share in an amalgamated company; and
- (b) that person becomes entitled, in exchange for that share, to any consideration in addition to any equity shares in the resultant company,

the disposal of that share in the amalgamated company contemplated in paragraph (a) must, to the extent that that person becomes entitled to any equity shares in that resultant company, be deemed to be a disposal in respect of which subsection (6) applies (hereinafter referred to as the qualifying transaction), and to the extent that such person becomes entitled to any other consideration, as contemplated in paragraph (b), be deemed to be a disposal of part of that share in respect of which subsection (6) does not apply (hereinafter referred to as the non-qualifying transaction), in which case the amount to be determined in respect of -

- (i) in the case of a disposal of a share as a capital asset, the base cost of that share at the time of that disposal; or
- (ii) in the case of the disposal of a share as trading stock, the amount taken into account in respect of that share in terms of section 11(a) or 22(1) or (2),

that must be attributed to the part of the share deemed to have been disposed of in terms of the non-qualifying transaction, must bear the same ratio to the respective amounts contemplated in subparagraphs (i) or (ii) as the market value of the total consideration not consisting of equity shares in that resultant company bears to the amount of the full consideration in respect of that share.

- (8) Where an amalgamated company disposes of any equity shares in a resultant company that were acquired by that amalgamated company in terms of an amalgamation transaction that was subject to subsection (2) or (3), to a shareholder of that amalgamated company as part of that amalgamation transaction, that amalgamated company must disregard that disposal for purposes of determining its taxable income or assessed loss.
- (9) Where an amalgamated company disposes of any equity shares in a resultant company that were acquired by that amalgamated company in terms of an amalgamation transaction that was subject to subsection (2) or (3), to a shareholder of that amalgamated company as part of an amalgamation transaction –
- (a) the disposal by that amalgamated company of those shares must be deemed not to be a dividend with respect to that amalgamated company for purposes of section 64B(3); and
- (b) any shares acquired by a company in terms of that disposal must be deemed not to be a dividend which accrued to that company for the purposes of section 64B(3).
- (9A) Where subsection (9) applies –
- (a) the resultant company's equity share capital (including any share premium) arising from the amalgamation transaction must be deemed to be a profit not of a capital nature available for distribution to its shareholders for the purposes of paragraph (i) of the first proviso to the definition of 'dividend' to the extent of any profits distributed by the amalgamated company in terms of subsection (9); and
- (b) those deemed profits must be deemed to have arisen immediately prior to the date on which the resultant company became part of any group of companies.
- (10) For purposes of section 64B, so much of the amount of any other consideration to which a person becomes entitled as contemplated in subsection (7)(b) as does not exceed the amalgamated company's profits which are available for distribution as contemplated in section 64C(4)(c) must be deemed to be a dividend declared and distributed out of profits of that amalgamated company to that person and to have accrued as a dividend to that person on the date on which that person became entitled thereto.
- (11) Where a person disposed of any equity share in an amalgamated company in terms of a qualifying transaction contemplated in subsection (6) and that person ceases to hold an interest in the resultant company, as contemplated in paragraph (c) of the definition of "qualifying interest" in subsection (1), within a period of 18 months after the disposal in terms of that qualifying transaction (whether or not by way of the disposal of any shares in the resultant company), that person must for purposes of section 22 or the Eighth Schedule be deemed to have –
- (a) disposed of all the equity shares in the resultant company acquired in terms of that qualifying transaction that are still held immediately after that person ceased to hold such an interest, for an amount equal to the market value of those equity shares as at the beginning of that period of 18 months; and

- (b) immediately reacquired all the equity shares contemplated in paragraph (a) at a cost equal to the amount contemplated in that paragraph:

Provided that the provisions of this subsection do not apply where that person ceases to hold an interest in that resultant company, as contemplated in the definition of "qualifying interest" in subsection (1), in terms of an intra-group transaction contemplated in section 45, an unbundling transaction contemplated in section 46, or an involuntary disposal as contemplated in paragraph 65 of the Eighth Schedule or a disposal that would have constituted an involuntary disposal as contemplated in that paragraph had that asset not been a financial instrument, or as the result of the death of that person.<sup>306</sup>

(12) .....

(13) The provisions of this section do not apply where the amalgamated company –

- (a) has not, within a period of 18 months after the date of the amalgamation transaction, or such further period as the Commissioner may allow, taken the steps contemplated in section 41(4) to liquidate, wind up or deregister; or
- (b) has at any stage withdrawn any step taken to liquidate, wind up or deregister that company, as contemplated in paragraph (a), or does anything to invalidate any step so taken, with the result that the company will not be liquidated, wound up or deregistered.

Provided that any tax which becomes payable as a result of the application of this subsection shall be recoverable from the resultant company.

(14) The provisions of this section do not apply in respect of any transaction if –

- (a) the resultant company holds at least 70% of the equity shares in the amalgamated company immediately before the amalgamation, conversion or merger;
- (b) the resultant company is a company contemplated in paragraph (c) or (d) of the definition of "company";
- (bA) the resultant company is a company contemplated in paragraph (e)(i) of the definition of "company" and the amalgamated company is not a company contemplated in that paragraph;
- (c) the resultant company is a company contemplated in section 21 of the Companies Act No. 61 of 1973;
- (d) the resultant company is a company contemplated in paragraph (b) or (e)(i) of the definition of "company" in section 1 and does not have its place of effective management in the Republic;
- (e) any amount constituting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received by or to accrue to the resultant company; or
- (f) the resultant company is a public benefit organisation or recreational club approved by the Commissioner in terms of section 30 or 30A.

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<sup>306</sup> This format of subsection (11) is deemed to have come into operation on 1 January 2007 and applies in respect of amalgamation transactions entered into on or after that date.

## Section 45: Intra-group transactions

(1) For the purposes of this section –

**“intra-group transaction”** means any transaction –

- (a) in terms of which any asset is disposed of by one company (hereinafter referred to as the “transferor company”) to another company which is a resident (hereinafter referred to as the “transferee company”) and both companies form part of the same group of companies as at the end of the day of that transaction; and
- (b) as a result of which that transferee company acquires that asset from that transferor company –
  - (i) as a capital asset, where that transferor company holds it as a capital asset; or
  - (ii) as trading stock, where that transferor company holds it as trading stock.

(2) Where a transferor company disposes of –

- (a) a capital asset in terms of an intra-group transaction to a transferee company which acquires it as a capital asset –
  - (i) the transferor company must be deemed to have disposed of that asset for an amount equal to the base cost of that asset on the date of that disposal; and
  - (ii) that transferor company and that transferee company must, for purposes of determining any capital gain or capital loss in respect of a disposal of that asset by that transferee company, be deemed to be one and the same person with respect to –
    - (aa) the date of acquisition of that asset by that transferor company and the amount and date of incurral by that transferor company of any expenditure in respect of that asset allowable in terms of paragraph 20 of the Eighth Schedule; and
    - (bb) any valuation of that asset effected by that transferor company as contemplated in paragraph 29(4) of the Eighth Schedule;
- (b) an asset held by it as trading stock in terms of an intra-group transaction to a transferee company which acquires it as trading stock –
  - (i) that transferor company must be deemed to have disposed of that asset for an amount equal to the amount taken into account by that transferor company in respect of that asset in terms of section 11(a) or 22(1) or (2); and
  - (ii) that transferor company and that transferee company must, for purposes of determining any taxable income derived by that transferee company from a trade carried on by it, be deemed to be one and the same person with respect to the date of acquisition of that asset by that transferor company and the amount and date of incurral by that transferor company of any cost or expenditure incurred in respect of that asset as contemplated in section 11(a) or 22(1) or (2).

(3) Where a transferor company transfers –

- (a) an asset that constitutes an allowance asset in that transferor company's hands to a transferee company in terms of an intra-group transaction and that transferee company acquires that asset as an allowance asset –

- (i) no allowance allowed to that transferor company in respect of that asset must be recovered or recouped by that transferor company or included in that transferor company's income for the year of that transfer; and
  - (ii) that transferor company and that transferee company must be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction –
    - (aa) to which that transferee company may be entitled in respect of that asset; or
    - (bb) that is to be recovered or recouped by or included in the income of that transferee company in respect of that asset;
- (b) a contract to a transferee company as part of a disposal of a business as a going concern in terms of an intra-group transaction and that contract imposes an obligation on that transferor company in respect of which an allowance in terms of section 24C was allowable to that transferor company for the year preceding that in which that contract is transferred or would have been allowable to that transferor company for the year of that transfer had that contract not been so transferred –
- (i) no allowance allowed to that transferor company in respect of that obligation must be included in that transferor company's income for the year of that transfer; and
  - (ii) that transferor company and that transferee company must be deemed to be one and the same person for purposes of determining the amount of any allowance –
    - (aa) to which that transferee company may be entitled in respect of that obligation; or
    - (bb) that is to be included in the income of that transferee company in respect of that obligation.
- (4) (a) This subsection applies in respect of a transferee company which has acquired an asset –
- (i) in terms of a disposal by a transferor company by means of an intra-group transaction; or
  - (ii) in terms of one or more disposals subsequent to the disposal contemplated in subparagraph (i) and no capital gain or capital loss was determined in respect of any of those disposals as a result of the application of this Part.
- (b) Where a transferee company which has acquired an asset as contemplated in paragraph (a) ceases within a period of six years after the acquisition to form part of any group of companies in relation to the transferor company contemplated in paragraph (a)(i) or a controlling group company in relation to the transferor company, and the transferee company has not disposed of that asset –
- (i) an amount equal to the lesser of –
    - (aa) the greatest capital gain that would have been determined in respect of any disposal of the asset in terms of an intra-group transaction within the period of six years preceding the date on which the transferee company ceased to form part of the group of companies, had subsection (2) not applied in respect of that disposal; or

- (bb) the capital gain that would be determined if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date,  
is deemed to be a capital gain of the transferee company for the current year of assessment and the base cost of the asset must be increased by that amount and, where the asset is an allowance asset, the cost or value of the asset must be increased by 50% of that amount;
- (ii) an amount equal to the greater of -
- (aa) the amount contemplated in paragraph (j) or (n) of the definition of "gross income" that would have been included in income as a result of any disposal of the asset in terms of an intra-group transaction within the period of six years preceding the date on which the transferee company ceases to form part of the group of companies, had subsection (3) not applied in respect of that disposal; or
- (bb) the amount contemplated in paragraph (j) or (n) of the definition of "gross income" that would be included in income if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date,  
must be included in the gross income of the transferee company for the current year of assessment and the cost or value of the asset for purposes of any deductions allowable in respect of that asset (other than deductions allowable in terms of section 12G or 12I) must be increased by that amount: Provided that where an amount contemplated in paragraph (j) of the definition of "gross income" is so included, the cost or value is deemed to be so increased immediately before any subsequent disposal of the asset; and
- (iii) an amount equal to the lesser of -
- (aa) the greatest amount of taxable income (other than any taxable capital gain and any taxable income derived as a result of an amount being included in gross income in terms of paragraph (j) or (n) of the definition of "gross income") that would have been determined in respect of any disposal of the asset in terms of an intra-group transaction within the period of six years preceding the date on which the transferee company ceases to form part of the group of companies, had subsection (2) not applied in respect of that disposal; or
- (bb) the taxable income (other than any taxable capital gain and any taxable income derived as a result of an amount being included in gross income in terms of paragraph (j) or (n) of the definition of "gross income"), that would be determined if the asset was disposed of on the date on which the transferee company ceases to form part of the group of companies for an amount equal to the market value of the asset on that date,

- must be included in the taxable income of the transferee company for the current year of assessment and the cost of the asset must be increased by that amount;<sup>307</sup>
- (c) Where the transferor company or transferee company contemplated in paragraph (b) is liquidated, wound up or deregistered at a time when a company which is a resident (hereinafter referred to as the “holding company”) holds at least 70% of the equity shares of that company which is liquidated, wound up or deregistered, the holding company and the company which is liquidated, wound up or deregistered must be deemed to be one and the same company for purposes of paragraph (b).
- (4A) Subsection (4)(b) does not apply in respect of any asset disposed of prior to 21 February 2008, where that transferee company and that transferor company contemplated in that subsection cease to form part of a group of companies by reason of the coming into operation of section 52(1)(c) of the Revenue Laws Amendment Act No. 35 of 2007.<sup>308</sup>
- (4B) A transferee company and a transferor company contemplated in subsection (4) must for purposes of that subsection be deemed to have ceased to form part of any group of companies in relation to each other if a disposal contemplated in that subsection forms part of any transaction, operation or scheme in terms of which –
- (a) any consideration received or accrued in respect of that disposal; or
- (b) more than 10% of any amount derived directly or indirectly from such consideration, has, within two years of that disposal, been disposed of –
- (i) by that transferor company; or
- (ii) by any other company forming part of the same group of companies as the transferor company,
- to any person that does not form part of the same group of companies as the transferor company –
- (aa) for no consideration;
- (bb) for a consideration which does not reflect an arm’s length price; or
- (cc) by means of a distribution.<sup>309</sup>
- (5) Where a transferee company disposes of an asset other than in terms of an involuntary disposal as contemplated in paragraph 65 of the Eighth Schedule or a disposal that would have constituted an involuntary disposal as contemplated in that paragraph had that asset not been a financial instrument, within a period of 18 months after acquiring that asset in terms of an intra-group transaction and
- (a) that asset constitutes a capital asset in the hands of that transferee company –
- (i) so much of any a capital gain determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset

<sup>307</sup> Subsection (4)(b) is deemed to have come into operation on 21 October 2008 and applies in respect of cessations on or after that date.

<sup>308</sup> Deemed to have come in operation on 21 February 2008.

<sup>309</sup> This format of subsection (4B)(b) is deemed to have come into operation on 21 February 2008 and applies in respect of an asset disposed of on or after that date.

as at that date, may not be taken into account in determining any net capital gain or assessed capital loss of that transferee company but is subject to paragraph 10 of the Eighth Schedule for purpose of determining an amount of taxable capital gain derived from that gain, which taxable capital gain may not be set off against any assessed loss or balance of assessed loss of that transferee company; or

- (ii) so much of any capital loss determined in respect of the disposal of that asset as does not exceed that amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, must be disregarded in determining the aggregate capital gain or aggregate capital loss of that transferee company for purposes of the Eighth Schedule: Provided that the amount of any capital loss so disregarded may be deducted from the amount of any capital gain determined in respect of the disposal during that year or any subsequent year of assessment of any other asset acquired by that transferee company from the transferor company in terms of an intra-group transaction; or

(b) that asset constitutes –

- (i) trading stock in the hands of that transferee company, so much of the amount received or accrued in respect of the disposal of that trading stock as does not exceed the market value of that trading stock as at the beginning of that period of 18 months and so much of the amount taken into account in respect of that trading stock in terms of section 11(a) or 22(1) or (2) as is equal to the amount so taken into account in terms of subsection (2)(b); or
- (ii) an allowance asset in the hands of that transferee company, so much of any allowance in respect of that asset that is recovered or recouped by or included in the income of that transferee company as a result of that disposal as does not exceed the amount that would have been recovered had that asset been disposed of at the beginning of that period of 18 months for an amount equal to the market value of that asset as at that date,

must be deemed to be attributable to a separate trade carried on by that transferee company, the taxable income or assessed loss from which trade may not be set off against any assessed loss or balance of assessed loss of that transferee company.

(6) This section does not apply in respect of the disposal of an asset if –

- (a) .....
- (b) all the receipts and the accruals of the transferee company are exempt from tax in terms of section 10(1)(cA), (cN), (cO), (cP), (d) or (t);
- (c) the asset was disposed of by the transferor company in exchange for shares issued by the transferee company;
- (d) the asset constitutes a share that is distributed by the transferor company to the transferee company; or
- (e) the asset was disposed of by the transferor company to the transferee company in terms of a liquidation distribution referred to in section 47 regardless of whether or not an election has been made for the provisions of that section to

- apply and regardless of whether or not that transferee company acquired that asset as a capital asset or as trading stock;
- (f) the asset constitutes a share in the transferee company; or
  - (g) the transferor company and the transferee company jointly elect that this section does not apply.<sup>310</sup>

#### Section 46: Unbundling Transactions

- (1) For purposes of this section, “**unbundling transaction**” means any transaction in terms of which all the equity shares of a company which is a resident or a controlled foreign company (hereinafter referred to as the “unbundled company”) that are held by a company (hereinafter referred to as the “unbundling company”) which, if listed, is a resident, are distributed by that unbundling company to the shareholder or shareholders of that unbundling company in accordance with the effective interest of that shareholder or those shareholders, as the case may be, in the shares of that unbundling company, but only to the extent to which those shares are so distributed –
- (a) where that unbundling company is a listed company and the shares of the unbundled company are listed or will be listed within 12 months after that distribution, to the shareholders of that unbundling company;
  - (b) where that unbundling company is an unlisted company, to any shareholder of that unbundling company that forms part of the same group of companies as that unbundling company; or
  - (c) pursuant to an order in terms of the Competition Act No. 89 of 1998 made by the Competition Tribunal or the Competition Appeal Court, to the shareholders of that unbundling company; or
  - (d) where that unbundled company is a controlled foreign company, to a person that holds at least 95% of the equity shares in that unbundling company:
- Provided that the shares contemplated in paragraph (a) or (b) constitute –
- (i) where that unbundled company is a listed company immediately before that distribution –
    - (aa) more than 25% of the equity shares of that unbundled company in the case where no other shareholder holds an equal or greater amount of equity shares in that unbundled company; or
    - (bb) in any other case, at least 35% of the equity shares of that unbundled company; or
  - (ii) where that unbundled company is an unlisted company immediately before that distribution, more than 50% of the equity shares of that unbundled company:
- Provided further that shares which are distributed as contemplated in paragraph (d) constitute at least 95% of the equity shares of that unbundled company.
- (2) Where an unbundling company distributes shares in terms of an unbundling transaction, that unbundling company must disregard that distribution for

<sup>310</sup> This format of subsection (6) is deemed to have into operation on 1 January 2009 and applies in respect of intra-group transactions entered into on or after that date.

purposes of determining its taxable income or assessed loss, or its net income as contemplated in section 9D.

- (3) (a) If a shareholder acquires equity shares (hereinafter referred to as “unbundled shares”) in terms of an unbundling transaction –
- (i) that shareholder must –
    - (aa) allocate a portion of the expenditure and any market value attributable to the equity shares held in the unbundling company (hereinafter referred to as the “unbundling shares”) to the unbundled shares in accordance with subparagraph (v); and
    - (bb) reduce the expenditure and market value attributable to the unbundling shares by the amount so allocated to the unbundled shares;
  - (ii) the unbundled shares must, other than for purposes of determining whether a share is a “qualifying share” as defined in section 9C, be deemed to have been acquired on the same date as the unbundling shares;
  - (iii) the unbundled shares must be deemed to have been acquired as -
    - (aa) trading stock, if the unbundling shares were held as trading stock;
    - (bb) capital assets, if the unbundling shares were held as capital assets;
  - (iv) any expenditure allocated to the unbundled shares must be deemed to have been incurred on the date on which the expenditure was incurred in respect of the unbundling shares; and
  - (v) the proportionate amount of the expenditure and market value to be allocated to the unbundled shares in terms of subparagraph (i)(aa) must be determined in accordance with the ratio that the market value of the unbundled shares, as at the end of the day after that distribution, bears to the sum of the market value, as at the end of that day, of the unbundling shares and of the unbundled shares.

(b) For the purposes of this subsection –

“**expenditure**” means in relation to unbundled shares acquired as –

- (i) trading stock, the amount taken into account prior to the unbundling transaction in respect of the unbundling shares for the purposes of section 11(a) or 22(1) or (2); and
- (ii) capital assets, the expenditure incurred prior to the unbundling transaction in respect of the unbundling shares that is allowable in terms of paragraph 20 of the Eighth Schedule;

“**market value**” in relation to unbundling shares acquired prior to the valuation date as defined in paragraph 1 of the Eighth Schedule, means any market value adopted or determined by the shareholder in respect of those shares within the period contemplated in paragraph 29(4) of the Eighth Schedule.

- (3A) If shares are distributed in terms of an unbundling transaction, the contributed tax capital of –
- (a) the unbundling company immediately after the distribution is deemed to be an amount which bears to the contributed tax capital of that company immediately before distribution the same ratio as the aggregate market value, immediately after the distribution, of the

- shares in that company bears to the aggregate market value of the shares immediately before distribution; and
- (b) the unbundled company immediately after the distribution is deemed to be an amount equal to the sum of –
- (i) an amount which bears to the contributed tax capital of the unbundling company immediately before the distribution the same ratio as the aggregate market value of the distributed shares before the distribution bears to the aggregate market value of the shares in the unbundling company immediately before the distribution; and
  - (ii) an amount which bears to the contributed tax capital of the unbundled company immediately before the distribution the same ratio as the shares held in that company immediately before the distribution by persons other than the unbundling company bear to all shares held in that company immediately before the distribution.<sup>311</sup>
- (4) Where those shares are distributed by an unbundling company to a shareholder in terms of an unbundling transaction and that shareholder held the unbundling shares as a result of the exercise, by that shareholder, of a right contemplated in section 8A, a portion of any gain made by that shareholder in the exercise of that right to acquire those unbundling shares must be included in the income of that shareholder –
- (a) in the year of assessment during which that shareholder becomes entitled to dispose of those shares, which portion shall be an amount which bears to such gain the same ratio as that contemplated in subsection (3)(a); and
  - (b) in the year of assessment during which that person becomes entitled to dispose of the unbundling shares, which portion shall be calculated by reducing such gain by the amount which has been determined or is to be determined in terms of paragraph (a).
- (5) Where shares are distributed by an unbundling company to a shareholder in terms of an unbundling transaction –
- (a) the distribution by that unbundling company of the shares must be deemed not to be a dividend with respect to that unbundling company for the purposes of section 64B(3); and
  - (b) any shares acquired by a company in terms of that distribution must be deemed not to be a dividend which accrued to that company for the purposes of section 64B(3).
- (6) Any shares distributed by an unbundling company in terms of an unbundling transaction, must be deemed to have been distributed first from the share premium account of that unbundling company.

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311 Subsection (3A) comes into operation on the date on which Part VIII ("Dividends Tax") of Chapter II of the ITA comes into operation.

- (7) (a) This section does not apply if, immediately after any distribution of shares in terms of an unbundling transaction, 20% or more of the shares in the unbundled company are held by a disqualified person either alone or together with any connected person (who is a disqualified person) in relation to that disqualified person.
- (b) For the purposes of paragraph (a) a “disqualified person” means –
- (i) a person that is not a resident;
  - (ii) the Government, a provincial administration or a municipality;
  - (iii) a public benefit organisation as defined in section 30 that has been approved by the Commissioner in terms of that section;
  - (iv) a recreational club as defined in section 30A that has been approved by the Commissioner in terms of that section;
  - (v) a company or trust contemplated in section 37A;
  - (vi) a fund contemplated in section 10(1)(d)(i) or (ii); or
  - (vii) a person contemplated in section 10(1)(cA) or (t).<sup>312</sup>
- (8) Where an unlisted unbundling company disposes of shares in an unlisted unbundled company in terms of an unbundling transaction to a shareholder and that unbundled company is a controlled group company in relation to that shareholder immediately before and after that disposal, the provisions of this section will not apply to that disposal if that shareholder and that unbundling company jointly so elect.

**Section 46A: Limitation of expenditure incurred in respect of shares held in an unbundling company**

- (1) Notwithstanding any other provision of this Act, if a taxpayer acquires a share in an unbundled company from an unbundling company in terms of an unbundling transaction defined in section 46 and a share in that unbundling company was within a period of two years preceding the acquisition held by a person who was a connected person in relation to the taxpayer at any time during that period, and any amount received by or accrued to that person in respect of the disposal of the share at any time during that period would not have been subject to normal tax or would not have been taken into account for purposes of determining the net income, as defined in section 9D, of that person, the expenditure incurred by the taxpayer in respect of any share held in that company shall not for purposes of this Act exceed an amount determined in accordance with subsection (2).
- (2) The amount to be determined for purposes of subsection (1) is the sum of –
- (a) the cost of the equity share to the connected person contemplated in subsection (1) that first held that share less the sum of all deductions that have been allowed in respect of the share to any connected person that held that share during that period;
  - (b) any amount contemplated in paragraph (n) of the definition of “gross income” in section 1 that is required to be included in the income of any connected

<sup>312</sup> Subsection (7) came into operation on 1 January 2009 and applies in respect of any distribution on or after that date.

- person that held that share during that period that arises as a result of the disposal of the share by any such person; and
- (c) any capital gain of any connected person that held that share during that period that arises as a result of the disposal of the share by any such person.

#### **Section 47: Transactions relating to liquidation, winding-up and deregistration**

- (1) For the purposes of this section “**liquidation distribution**” means any transaction –
- (a) in terms of which any company (hereinafter referred to as the “liquidating company”) distributes all its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders, in anticipation of or in the course of the liquidation, winding up or deregistration of that company, but only to the extent to which those assets are so disposed of to another company (hereinafter referred to as the “holding company”) which –
- (i) is not –
- (aa) a person that is not a resident;
  - (bb) a public benefit organisation as defined in section 30 that has been approved by the Commissioner in terms of that section;
  - (cc) a recreational club as defined in section 30A that has been approved by the Commissioner in terms of that section;
  - (dd) a person contemplated in section 10(1)(cA), (d) or (f); and
- (ii) on the date of that disposal forms part of the same group of companies as the liquidating company or holds 95% of the equity shares in that company.<sup>313</sup>
- (2) Where a liquidating company disposes of –
- (a) a capital asset in terms of a liquidation distribution to its holding company which acquires it as a capital asset –
- (i) that liquidating company must be deemed to have disposed of that asset for an amount equal to the base cost of that asset on the date of the disposal thereof; and
- (ii) that liquidating company and that holding company must, for purposes of determining any capital gain or capital loss in respect of a disposal of that asset by that holding company, be deemed to be one and the same person with respect to –
- (aa) the date of acquisition of that asset by that liquidating company and the amount and date of incurral by that liquidating company of any expenditure in respect of that asset allowable in terms of paragraph 20 of the Eighth Schedule; and
  - (bb) any valuation of that asset effected by that liquidating company as contemplated in paragraph 29(4) of the Eighth Schedule; or
- (b) an asset held by it as trading stock in terms of a liquidation distribution to its holding company which acquires it as trading stock –

<sup>313</sup> This format of subsection (1) applies in respect of any liquidation distribution made on or after 1 January 2009.

- (i) that liquidating company must be deemed to have disposed of that asset for an amount equal to the amount taken into account by that liquidating company in respect of that asset in terms of section 11(a) or 22(1) or (2); and
  - (ii) that liquidating company and that holding company must, for purposes of determining any taxable income derived by that holding company from a trade carried on by it, be deemed to be one and the same person with respect to the date of acquisition of that asset by that liquidating company and the amount and date of incurral by that liquidating company of any cost or expenditure incurred in respect of that asset as contemplated in section 11(a) or 22(1) or (2).
- (3) Where a liquidating company disposes of –
- (a) an asset that constitutes an allowance asset in that liquidating company's hands to its holding company in terms of a liquidation distribution and that holding company acquires that asset as an allowance asset –
    - (i) no allowance allowed to that liquidating company in respect of that asset must be recovered or recouped by that liquidating company or included in that liquidating company's income for the year of that transfer; and
    - (ii) that liquidating company and that holding company must be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction –
      - (aa) to which that holding company may be entitled in respect of that asset; or
      - (bb) that is to be recovered or recouped by or included in the income of that holding company in respect of that asset; or
  - (b) a contract to its holding company as part of a disposal of a business as a going concern in terms of a liquidation distribution and that contract imposes an obligation on that liquidating company in respect of which an allowance in terms of section 24C was allowable to that liquidating company for the year preceding that in which that contract is transferred or would have been allowable to that liquidating company for the year of that transfer had that contract not been so transferred –
    - (i) no allowance allowed to that liquidating company in respect of that obligation must be included in that liquidating company's income for the year of that transfer; and
    - (ii) that liquidating company and that holding company must be deemed to be one and the same person for purposes of determining the amount of any allowance –
      - (aa) to which that holding company may be entitled in respect of that obligation; or
      - (bb) that is to be included in the income of that holding company in respect of that obligation.
- (3A) The provisions of subsections (2) and (3) apply to a disposal of an asset by a liquidating company to its holding company in terms of a liquidation distribution only to the extent that –
- (a) equity shares held by that holding company in that liquidating company are disposed of as a result of the liquidation, winding up or deregistration of that liquidating company; and

- (b) that holding company has not assumed any debt of that liquidating company which was incurred by that liquidating company within a period of 18 months before that disposal, unless that debt –
  - (i) constitutes the refinancing of any debt incurred in more than 18 months before that disposal; or
  - (ii) is attributable to and arose in the normal course of a business undertaking disposed of, as a going concern, to that holding company as part of that liquidation distribution.
  
- (4) Where the holding company acquires any asset from the liquidating company in terms of a liquidation distribution and that holding company disposes of that asset within a period of 18 months after so acquiring that asset and –
  - (a) that asset constitutes a capital asset in the hands of that holding company –
    - (i) so much of any capital gain determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date, may not be taken into account in determining any net capital gain or assessed capital loss of that holding company but is subject to paragraph 10 of the Eighth Schedule for purpose of determining an amount of taxable capital gain derived from that gain, which taxable capital gain may not be set off against any assessed loss or balance of assessed loss of that holding company; or
    - (ii) so much of any capital loss determined in respect of the disposal of that asset as does not exceed the amount that would have been determined had that asset been disposed of at the beginning of that period of 18 months for proceeds equal to the market value of that asset as at that date must be disregarded in determining the aggregate capital gain or aggregate capital loss of that holding company for purposes of the Eighth Schedule: Provided that the amount of any capital loss so disregarded may be deducted from the amount of any capital gain determined in respect of the disposal during that year or any subsequent year of assessment of any other asset acquired by that holding company from the liquidating company in terms of that liquidation distribution; or
  - (b) that asset constitutes –
    - (i) trading stock in the hands of that holding company, so much of the amount received or accrued in respect of the disposal of that trading stock as does not exceed the market value of that trading stock as at the beginning of that period of 18 months and so much of the amount taken into account in respect of that trading stock in terms of section 11(a) or 22(1) or (2) as is equal to the amount so taken into account in terms of subsection (2)(b); or
    - (ii) an allowance asset in the hands of that holding company, so much of any allowance in respect of that asset that is recovered or recouped by or included in the income of that holding company as a result of that disposal as does not exceed the amount that would have been recovered had that asset been disposed of at the beginning of that period of 18 months for an amount equal to the market value of that asset as at that date,

must be deemed to be attributable to a separate trade carried on by that holding company, the taxable income or assessed loss from which trade may not be set off against or added to any assessed loss or balance of assessed loss of that holding company.

- (5) Where –
- (a) a holding company disposes of any equity share in a liquidating company as a result of the liquidation, winding up or deregistration of that liquidating company; or
  - (b) in anticipation of or in the course of the liquidation, winding up or deregistration of a liquidating company, a capital distribution of cash or an asset *in specie* by that company is received by or accrues to a holding company,

the holding company must disregard that disposal or distribution for purposes of determining its taxable income, assessed loss, aggregate capital gain or aggregate capital loss.

- (6) The provisions of this section do not apply where –
- (a) .....
  - (b) the holding company and the liquidating company jointly elect that this section does not apply;
  - (bA) the distribution would not be taken into account for purposes of determining any taxable income or assessed loss of the liquidating company; or
  - (c) the liquidating company –
    - (i) has not, within a period of 18 months after the date of the liquidation distribution, or such further period as the Commissioner may allow, taken the steps contemplated in section 41(4) to liquidate, wind up or deregister; or
    - (ii) has at any stage withdrawn any step taken to liquidate, wind up or deregister that company, as contemplated in paragraph (i), or does anything to invalidate any step so taken, with the result that the company will not be liquidated, wound up or deregistered:

Provided that any tax which becomes payable as a result of the application of this paragraph shall be recoverable from the holding company.<sup>314</sup>

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<sup>314</sup> Subsections (6)(b) and (bA) came into operation on 1 January 2009 and applies in respect of any liquidation distribution on or after that date.