

GROUP TAXATION OF TIGHTLY-HELD QUALIFYING GROUPS IN SOUTH AFRICA

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EXECUTIVE SUMMARY/ABSTRACT

Currently, companies are taxed on an individual basis in South Africa and there is no provision for the offsetting of profits and losses of different companies within a tax group. Admittedly, businesses have the option to operate under a single divisionalised entity whereby they are able to enjoy offsetting profit and losses of trades of different divisions within such an entity. There are however, strong business reasons as to why businesses split themselves into separate legal entities. The most noteworthy benefit being the ability to manage business risk through limited liability provisions contained in corporate legislation.

Arguments have been put forward to the effect that groups, although legally separated through different corporate entities, operate in much the same way as a divisionalised single entity business does. The current tax treatment, which taxes entities of a group on their individual taxable incomes, is therefore argued to not provide a true assessment of the group's tax position. Arguments in the Margo Commission of Inquiry report have even gone as far as saying that it seems unfair to tax profitable entities in a group while the overall taxable income of the group may be negative.

With the above in mind, the question of whether a group tax system would be suitable for implementation in South Africa is brought to the table. As will be seen in this dissertation, there are strong opinions on either side of determining whether a group tax system would be appropriate for South Africa. Opinions in favour of a group tax system view the system as a potential tool to encourage business through more favourable tax conditions thereby encouraging growth and development of the economy. Drawbacks of the system include the perceived loss to the fiscus as tax relief is provided while concerns have also been raised relating to the current ability of the South African Revenue Service (SARS) to cope with the implementation of such a change to legislation.

The author of this dissertation acknowledges the need for South Africa to maximise its revenue collection to meet its budgetary obligations. However, at the same time, the author is of the view that government should look to creating environments in which smaller businesses may develop and grow, potentially increasing revenue collection in the long run in any event. For these reasons, the author has taken a conservative approach to explore the idea of providing for a group tax system for tightly-held tax groups with a limited turnover. This could potentially have the effect of developing small businesses while limiting the exposure of the fiscus to a revenue collection reduction. Loosely defined, tightly-held groups of companies refer to groups where there is a close relation between shareholders of the group.

Further to this, the author highlights the challenges that small businesses face in moving towards a group structure to derive the benefits that have been identified in this dissertation. With that in mind, the author has looked to encouraging group formation in small businesses by attempting to relieve some of the challenges that small businesses encounter in trying to establish a group structure.

Through this dissertation, the author proposes a group tax system whereby only tightly-held qualifying groups will be allowed to participate. The proposal contained within the dissertation has been drafted after assessing the findings of the preceding chapters as well as adapting some of the implementation provisions provided by the United Kingdom (UK) and the United States of America (USA) tax legislation.

This ability to produce a suitable proposal for implementation in South Africa will be a step towards concluding on whether South African tax legislators should be looking to implement a group tax system whereby tightly-held groups of companies will be the initial qualifying audience.

The conclusion drawn through the research conducted is that steps should be taken towards the implementation of group tax for tightly-held groups of companies. A stumbling block, however, as identified in the interim Nugent Commission report, is the current state that SARS finds itself in. It would seem reckless to recommend the instatement of a provision of this stature while SARS is in its current state. It is thus concluded, that movement towards a group tax system for tightly-held groups of companies should be delayed until such time that SARS has re-established itself as a proficient organ of the state.

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CHAPTER 1

1. INTRODUCTION

1.1. BACKGROUND

In terms of South Africa's current tax legislation, South Africa does not have a formal group tax system in place¹. Each company is required to submit and file its own tax returns and is liable for its own tax affairs².

There have been calls for a group tax system to be instated in South Africa³. Commissions of Inquiry have been set up to provide guidance on tax reform which included analysis on this matter, the findings of which will be discussed in chapter 5 of this dissertation.

Internationally, many of the developed countries such as the United States of America (USA), the United Kingdom (UK), Australia and much of Europe have adopted a system of group tax. South Africa has not yet adopted a formal group tax system for a number of reasons which will be discussed. It does appear though, by the fact that many developed countries have already adopted a group tax system and with regard to the many calls for it, that group tax is a tax reform mechanism that South African tax legislators may be considering.

With this background in mind, an investigation will be conducted to investigate whether South Africa should implement a group taxation system that will initially be applicable only to a few tightly-held qualifying corporate groups of companies (groups). Tightly-held⁴ qualifying groups can loosely be defined as South African resident groups of companies where there are close relationships between its shareholders⁵.

1.2. OVERVIEW

Businesses are generally discouraged from entering into corporate group formation by the burdensome compliance requirements and associated costs that accompany it. Currently, each entity within a tax group is required to fulfil its own individual tax compliance requirements. This includes submitting their own income tax returns and being liable for the resultant tax liability. These burdensome requirements play a part in depriving smaller businesses of the potential benefits associated with corporate groups as they may see the associated costs of forming and maintaining a group as beyond their reach. The burdensome compliance requirements are highlighted further when considering the need to conform to VAT requirements as well.

¹ Davis Tax Committee: Review of South Africa's Corporate Income Tax System: March 2018. (DTC Report) Page 74.

² Section 210 of The Tax Administration Act 28 of 2011.

³ DTC Report: Pages 76 to 77

⁴ This is a term that will be formally defined in chapter 2 of this paper.

⁵ In this context, shareholders are South African resident individuals who are required to have a direct family relationship with each other.

What has prevailed is that the larger corporations, which have the necessary resources and can afford to, form and maintain group structures, which allow them to derive advantages over their smaller, less established counterparts. The benefits associated with a group structure will be discussed in more detail in chapter 2.

Further to this and perhaps more importantly, businesses choose not to expand into group structures due to the lack of tax loss-sharing provisions in the current legislation. In a divisionalised entity, profits and losses of various trades conducted within a single entity may be set-off against each other. This, however, is not the case where different trades are conducted through separate corporate entities, even though the entities may form part of the same group of companies⁶.

This means that, barring the limited relief provided by the corporate rules⁷, South African companies are taxed individually on the income they earn, regardless of whether they form part of a group or not.

As noted in the Davis Tax Committee (DTC) report, which will be discussed in the coming chapters, tax legislation should not be implemented with only increasing revenue collection in mind. Tax legislation should also be implemented to encourage and stimulate growth⁸.

1.3. RESEARCH QUESTION AND OBJECTIVES

With the above background and overview in mind, the author aims to answer the following principle research question:

“Would it be beneficial for South Africa to incorporate a group tax system into its legislation that will, initially, only be aimed at tightly-held qualifying groups?”

As a secondary research investigation, the author will, through the research conducted, propose a suitable group tax provision for implementation in South Africa. As suggested in the primary research question, the proposal will be aimed at tightly-held qualifying groups of companies.

Aside from the core objectives, associated with group tax which will be discussed in chapter 3, the proposal will aim to achieve the following subsidiary objectives:

- Encourage group formation through reduced compliance requirements and more favourable taxing conditions;
- Encourage business activity by providing more favourable conditions in which to conduct business;
- Encourage and promote the longevity of businesses;
- Provide South Africa with an entry into group taxation without over-exposing the fiscus to reduction in revenue collection.

A proposal will be provided in chapter 8 and will be assessed in terms of the core objectives of group tax as well as the subsidiary objectives provided above.

⁶ Defined in Section 1 of the Income Tax Act 58 of 1962 (the Tax Act).

⁷ Sections 41 to 47 of the Tax Act (The corporate rules is discussed in further detail in chapter 4 of this dissertation

⁸ DTC Report: Page 77

Consequent upon the outcomes which arise from performing the research to answer the above research question and provide a potential proposed group tax option, included in the conclusion of the dissertation will be a recommendation on whether or not to implement the group tax proposal into South African tax legislation.

1.4. RESEARCH METHODOLOGY

The author will follow a doctrinal method of investigative research in completion of this dissertation. The research will delve into the opinions and recommendations of the relevant Commissions of Inquiry, professional opinions and current tax legislation to conclude on the research question posed.

Further to this, an investigation into the mechanics of group tax provisions implemented in other countries will be conducted to assist in drafting this dissertation's group tax proposal.

1.5. LIMITATIONS OF SCOPE

The dissertation will be limited to income tax consequences, however, references to other taxes in terms of South African tax legislation may be made without being a key focus. Attention will be placed on the main objectives of group tax, which include profit and loss offsetting and the tax neutral transfer of assets between group entities⁹. Intra-group loans and the resulting interest fall outside the scope of this dissertation.

As alluded to in the earlier parts of this chapter, the focus of this dissertation will be on South African resident corporate groups. As a result, non-resident companies will not be looked at, albeit that references may be made to them throughout this dissertation. Further to this, as indicated in the research question, only tightly held qualifying groups will be addressed and not groups in general.

The findings relating to the Nugent Commission will be limited to what is contained within the interim report, as at the time of research, the final report had not been published.

1.6. STRUCTURE OF THE DISSERTATION

This dissertation will follow a comprehensive structural process that delves into various areas that provide relevant insight to assist in drafting a suitable group tax proposal and, thereafter, a conclusion to the research question posed above. A brief summary of each chapter is provided, below, outlining its core purpose in the dissertation leading up to the conclusion in the final chapter.

Chapter 2

Chapter 2 aims to identify the benefits of groups that smaller businesses may be missing out on as a result of them possibly not being able to afford the associated costs of operating as groups. The concept of "Groups" will be introduced in terms of the different definitions provided by the various legislation applicable in South Africa. Groups, in terms of the different legislation, have different

⁹ DTC Report: Page 67

implications. For this reason, it has been deemed necessary to include the various definitions in this dissertation. Further to this, the proposed definition of a tightly-held group of companies will be formally introduced in this chapter which will be the audience of the group tax proposal in chapter 8.

Chapter 3

Chapter 3 formally introduces the concept of group tax to the dissertation. It investigates the perceived benefits and drawbacks of group tax in order to assess the necessity of implementing a group tax system in South Africa. The chapter will follow on to identify and explain some of the different models available by which group tax may be implemented.

Chapter 4

Chapter 4 analyses the existing set of corporate rules¹⁰ and provides a summary of the corporate tax relief currently provided by legislation. The chapter will go on further to assess whether there are group tax elements that exist within the corporate rules. What follows is an assessment as to whether the current provisions are sufficient to meet the objectives as set out in the research question which would render the objectives of group tax redundant.

Chapter 5

Chapter 5 will summarise and examine the findings of the reports provided by previous Commissions of Inquiry with regard to their views and recommendations on group taxation. The Margo Commission, the Katz Commission and the Davis Tax committee all included a study into group tax in their reports.

The chapter will draw out the findings which will be of benefit in drafting a suitable proposal for group tax in South Africa and thereafter assist in reaching a conclusion on the research question.

Chapter 6

Chapter 6 investigates the less formal opinions in the form of publicly available articles either written by professionals and key members of the industry, or articles in which they have been quoted. The insight attained from these articles will be extracted in pursuit of adding to the evidence required to provide a conclusion to the research question.

Chapter 7

Chapter 7 investigates the provisions that are present within the UK and the USA group tax systems in order to provide a guideline for drafting the proposal in this dissertation. The rationale for these countries' selection will be expanded upon in the chapter.

Chapter 8

Chapter 8 provides a group tax proposal for South Africa that will attempt to meet the core objectives associated with group tax, as well as the subsidiary objectives as set out in section 1.3 above.

Chapter 9

Chapter 9 looks into the current state of affairs at the South Africa Revenue Services (SARS) as provided by the Nugent Interim Report¹¹. The findings of the report will provide a formalised assessment into the current condition and capabilities of SARS. While this will not directly contribute

¹⁰ Sections 41 to 47 of the Tax Act

¹¹Interim Report: Commission of Inquiry into the Tax Administration and Governance by the South African Revenue Service: September 2018. Judge R Nugent (Nugent Commission Report)

to the conclusion of the research question, it may affect the timing of implementation should it be concluded that a group tax system be recommended for South Africa.

Chapter 10

Chapter 10 concludes the dissertation by providing an answer to the research question as posed in this chapter. It will include a recommendation as to whether the proposal drafted in chapter 8 should be implemented in South Africa.

CHAPTER 2

2. GROUPS

2.1. INTRODUCTION

Although formally introduced in the next section, group structures can loosely be defined to be a set of corporate entities with a common owner entity that together form a “group”. Groups are an important tool used by businesses to separate trades under the same ownership. As will be seen below, there are benefits and drawbacks of group structures. This chapter will highlight the importance of groups and hence the rationale for wanting to encourage their formation.

The definition of tightly-held groups, a concept introduced by this dissertation, will be formally presented in this chapter as well.

2.2. GROUP DEFINITIONS

In South Africa, there are at least three different definitions of “groups” provided by different statutory bodies applicable for different purposes. These definitions appear in:

- The South African Companies Act¹²;
- The International Financial Reporting Standards (IFRS);
- The South African Income Tax Act (hereinafter referred to as the Tax Act).¹³

A simplified¹⁴ conceptual summary of each definition is provided below.

2.2.1. THE COMPANIES ACT

In terms of the Companies Act, a group of companies is defined as two or more companies that share a holding company¹⁵ or subsidiary¹⁶ relationship. In order for this relationship to exist, the holding company must be able to exercise control over its subsidiary. Control is generally attained through an equity shareholding of at least 51%¹⁷.

¹² Companies Act, No. 71 of 2008 (the Companies Act)

¹³ The Tax Act

¹⁴ The definitions of groups in terms of the Companies Act and IFRS provided have been simplified for the purposes of this dissertation.

¹⁵ Defined in Section 1 of the Companies Act

¹⁶ Defined in Section 3(1)(a) of the Companies Act

¹⁷ Section 2(2)(a)(ii)(aa) of the Companies Act

2.2.2. IFRS

In terms of IFRS 10, a group is defined as a parent company and its subsidiaries. A parent is defined as a company that is able to exert control over another company (subsidiary). In order for a parent to exert control over a subsidiary it is, broadly, required to hold at least 51% of its voting rights, which generally translates to an equity shareholding of at least 51%¹⁸.

2.2.3. THE TAX ACT

In terms of section 1 of the Tax Act, a group of companies is defined as two or more companies in which one company (hereinafter referred to as the “controlling group company”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “controlled group company”), to the extent that—

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

This, however, is the general definition provided by the Tax Act. What may perhaps be of more significance to this dissertation is the definition provided under section 41 of the Act. Section 41 of the Act provides the rules and definitions for sections 42-47 which contain, what are generally referred to as, the “corporate rules”. The corporate rules provide relief to companies in certain circumstances and are currently the closest that South African tax legislation has to a group taxation system. The corporate rules will, however, be analysed in chapter 4 of this dissertation. For now, details pertaining to the definition of a group as provided in section 41 will be extracted.

The definition of a group in section 41 maintains the definition provided in section 1, however, it limits a corporate group of companies to only include South African tax resident companies as well as certain other restrictions which will not be discussed in this dissertation. The limitation on resident companies means that, where companies are required to be part of the same group of companies to be able to benefit from relief provisions, foreign companies may only participate in certain specified circumstances¹⁹.

As noted above, the tax definition, with particular reference to section 41 of the Tax Act, is significantly narrower than the definition provided by the Companies Act and the accounting standards. The result of this would generally imply that if a group meets the requirements of a group in terms of section 41 of the Tax Act, it would likely also meet the requirements of the other statutory bodies. For that reason, it will be assumed that where the tax definition applies, the relevant entities will also qualify as being part of a group in terms of the Companies Act and for purposes of the accounting standards.

¹⁸ IFRS 10, page A537 - 538

¹⁹ These circumstances fall out of the scope of this dissertation.

2.3. TIGHTLY-HELD GROUP

As pointed out in the research question, the author will investigate the possibility of instating a group tax provision that would limit participation to tightly-held groups.

“Tightly-held group” is a term that has not been defined in terms of any of the relevant statutory bodies but is formally defined for the specific purposes of this dissertation, below.

2.3.1. TIGHTLY HELD GROUP – DEFINITION

For the specific purposes of this dissertation a “tightly-held group of companies” is defined as per the group definition provided in section 41 of the Act together with the following additional shareholding requirements:

All shareholders and beneficiaries, where applicable, are required to be:

- South African citizens, either through birth or naturalization; and
- tax resident in South Africa.

The parent company is required to be the ultimate parent company of the group with the following permissible forms of shareholding:

a) Individual ownership

This is where a single individual owns 100% of the equity shares of the parent company.

b) Ownership of members of a family

Direct members of a family may combine to hold 100% of the equity shares of the parent company. Where direct family members are defined within this dissertation is to include:

- Parents
- Children
- Spouses²⁰
- Siblings

The relationship may be to any of the shareholders. For example, where an individual is initially the sole owner and their spouse subsequently becomes a shareholder, the spouses direct family members may from thereon be permissible owners.

c) Trust²¹

The parent company may be owned by a trust where all the beneficiaries of the trust are direct family members as defined above. Ownership may also comprise a combination of trust and individuals,

²⁰If there is a divorce, each shareholder and their allowable family members would remain eligible current and future shareholders.

²¹ Section 1 of the Tax Act

provided the family member requirement is met. The trust itself will not be included in the group, but rather the group of companies that it owns.

The rationale for the author's specific focus on tightly-held groups will be expanded on in chapter 8, where a group tax proposal will be drafted for South Africa.

2.4. TAX GROUP STRUCTURES

As indicated in chapter 1, corporate group structures provide a number of business benefits that businesses utilize to gain a competitive advantage in the market. These benefits are often not realised by smaller, tightly-held businesses as they may find it difficult to endure the burdensome administration and compliance requirements associated with group structures. Part of these requirements include the requirement to individually see to the tax compliance affairs of each of the member entities within the group. Smaller, tightly-held businesses may view the compliance requirements of additional corporate entities as beyond the reach of their resources. As a result, these businesses are more likely to combine multiple trades under a single entity thereby restricting its ability to derive similar benefits to that of larger businesses who have the resources to meet the requirements of a group structure.

This section will set out some of the perceived benefits that a group structure may provide in an attempt to highlight the advantages that businesses with group structures may have over corporations where multiple trades are conducted through a single entity.

It is noted that the Margo Commission acknowledged the rationale for group formation in its report. Included in the Margo Commission report were concessions that separate entities could be required to satisfy trade regulations as well as to provide risk protection through the limited liability of companies²².

2.4.1. BENEFITS OF GROUP STRUCTURES

2.4.1.1. RISK MANAGEMENT

- A benefit of key importance that may be derived from group structures is the ability to limit and manage risk. Trades can be separated into their own corporate entities which carry limited liability status²³. This means, generally speaking, if a group entity conducting a trade finds itself in financial difficulty, creditors are only able to stake claims against that particular entity and its asset base. The assets and trades of the other group entities may remain unaffected, subject to legal expertise which goes beyond the scope of this dissertation²⁴.

²²Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa: 1987 (Margo Commission Report) Pages 199 to 200

²³ Mistarz, E, (2016) What are the advantages of a Holding Company – Legal Vision. Page 2

²⁴ There may be instances where gross negligence or fraudulent activity can be proven which have assets held by shareholders included in litigation. This could possibly include their shareholding in other group entities.

- Following on from the above, the separation of risk may increase the shareholders' appetites for taking on new and riskier ventures with the peace of mind of knowing that the risk associated with the new venture is limited to the entity in which the trade is conducted²⁵. This may result in increased return to shareholders which, if occurring on a large scale, has the possibility of contributing to the upturn of an economy²⁶. Of course, it may also result in decreased returns where new ventures lead to losses.
- The ability to manage risk within a business allows for its longevity as it allows the other trades to continue if a specific separate trade finds itself in financial difficulty.

2.4.1.2. STRATEGIC

- In practice, businesses often lure experts in the relevant industries into employment or incentivise existing employees by way of equity share offerings. Where multiple trades are carried out under one entity, shareholders may be reluctant to part with their shareholding thereby possibly foregoing the benefits of the relevant skills that may be available if such skilled people can be lured into employment. Under a group scenario, shareholders may be more willing to part with a minority shareholding in specific subsidiary companies while still being able to maintain control²⁷.
- Following on from the above, a similar principle may be applied where investment is required to further a certain trade. Shareholders are able to offer shares in the specific company that contains the trade requiring funding without having to forego ownership of their interests in the other trades.
- Where trades are contained in separate entities, it provides flexibility where the parent may wish to dispose of a trade for whatever reason. Under a group structure, subsidiaries are easily disposed of without affecting the operations of the other group entities and trades²⁸.

2.4.2. DRAWBACKS OF GROUP STRUCTURE

Some of the drawbacks of group structures are provided below:

- Group structures bring with them the formal separation of trades into different entities. In terms of accounting and tax practices, intra-group transactions then need to be recorded and relevant taxes may get triggered.
- Further to this, the requirement to satisfy group accounting and tax practices brings with it added complexity to the administration of the business which include extra tax submissions²⁹.

²⁵ Mistarz, E, (2016) What are the advantages of a Holding Company – Legal Vision. Page 2

²⁶ While research into the effects on the economy is out of the scope of this dissertation, it follows logical process that increased returns achieved within businesses would contribute to an improvement in the economy.

²⁷ Rogan, H, (2018) - Group structures – Weightmans. Page 7

²⁸ Ibid. Page 8

²⁹ Bragg, S, (2018) Corporation advantages and disadvantages – Accounting Tools – Page 1

- Current tax legislation does not allow for the loss sharing between group entities. This contrasts to the tax treatment of divisionalised entities where losses are shared amongst trades.

2.5. CONCLUSION

It is evident from the above findings that there are definite business advantages to the formation of group structures. As pointed out, smaller tightly-held businesses, that cannot afford the associated compliance and administration costs are limited in their ability to set up a group structure, may be at a disadvantage to their larger counterparts. Further to this, the current tax treatment of groups has the effect of causing shareholders to favour a divisionalised single-entity business.

For the above reasons, businesses may be deprived of the business advantages that a group structure may offer them. Single-entity businesses expose themselves to greater risk thereby potentially jeopardising the longevity of the business.

Based on the advantages and disadvantages of groups discussed in this chapter, there may be a case for the view to provide a more favourable tax environment to groups than is currently the case. This is to encourage more businesses to enter into group structures so that they may draw from its benefits.

For this reason, the group tax proposal in chapter 8 will aim to encourage group formation through the relief provided.

CHAPTER 3

3. GROUP TAX

3.1. WHAT IS GROUP TAX

Group tax refers to a system whereby companies within a group are taxed on a more unified basis such that *inter alia* profits of one company in the group are allowed to be offset with losses of other companies within a group. This is different to the current method of taxing each entity on an independent basis where no facility is available to share losses between group members other than through creative tax planning³⁰. There are various models in practice by which this may be achieved with varying independence levels of group members. The core objectives of group taxation are³¹:

1. Tax-neutral transfer of assets between companies within a group. This may be between parent and subsidiary as well as between subsidiaries.
2. Setting-off of profits against losses within a group to provide relief where entities within a group incur tax losses

There are group tax models in practice that do not allow for both of the above objectives to be achieved, however, all classical forms of group tax allow for some sort of loss sharing between group entities. In the sections to follow, some of the more common group tax models which exist in practice will be identified and explained³².

3.2. CALLS FOR GROUP TAX

In the DTC report, the committee acknowledged calls for group tax to be implemented in South Africa³³ based on the perceived benefits it may provide to the economy. These calls provide a rationale for why a full group tax system should be implemented in South Africa. Some of these arguments, as contained in the DTC report, are provided below:

- Corporations often split their business activities into smaller companies for business reasons such as the management of risk through limited liability. The concern is that, while the business may have split itself into smaller entities, in reality, it still operates as a single entity and perhaps should be taxed as such³⁴.

The Margo Commission have taken this a step further to state that it may even be viewed as unfair for entities in a group to be taxed while the overall position of the group may be in a loss position³⁵. This is because of the view that a group, with all its entities, operates in much the same way a divisionalised single-entity business.

³⁰ Margo Commission Report: Page 202

³¹ DTC Report: Page 67

³² Ibid. Page 67

³³ Ibid. Page 76

³⁴ Ibid. Page 76

³⁵ Ibid. Page 202

- A country's attractiveness as an investment destination is contributed to by the attractiveness of its tax legislation³⁶. Countries from which South Africa are looking to attract investment are generally from the more developed regions. These regions, in most cases, already have group tax systems in place. From an investor's perspective, it could appear risky for them to get involved with tax systems that they aren't familiar with or have less favourable terms than those which they are accustomed to. From this point one can deduce that a group tax system may improve the attractiveness for foreign investment.
- In terms of administration, there would be initial issues with the implementation of a group tax system, however, in the long-run there may be administration relief for SARS. Instead of collecting tax from every entity, they may only need to assess the liability of the unit as one entity, depending on the model of group tax implemented³⁷.
- As pointed out by the Margo report, similar results to that of profit and loss shifting within a group can be derived through *creative* tax planning³⁸. While this may be prohibited and lessened by anti-avoidance rules, there are likely many corporations that are able to structure their affairs in a tax neutral manner. This sort of planning is expensive and would likely only be done by the larger corporations thereby granting them an advantage over their smaller competitors. Group tax would diminish the necessity for this sort of tax planning and allow for increased business focus.
- Prior to the formal findings of the Nugent Commission, which will be discussed in further detail in chapter 9 of this dissertation, there was an acknowledgement of the strides taken by SARS in the last decade to become one of the more efficient organs of government. Concerns set out in the Margo report relating to the ability of SARS to cope with group taxation were argued to no longer have been prevalent³⁹. The Davis committee however, is of the view that although SARS has improved over the last decade, due to more recent problems (see chapter 8) it still has some way to go before it will be able to handle a transition over to group taxation⁴⁰.
- A point alluded to in chapter 1, included in the rationale for why a group tax system should be implemented is the opinion that tax policy should not only be determined with the aim of maximising revenue collection for the fiscus. It should be designed to support economic growth⁴¹.
- Groups may be prejudiced over divisionalised single-entity businesses in that profit-making entities may be liable for tax while the overall position of the group could be in a tax loss position. The additional cash outflow may jeopardize the long-term future of the group which

³⁶ Ibid. Page 76

³⁷ Ibid. Page 76

³⁸ Margo Commission Report: Page 202

³⁹ DTC Report: Page 78

⁴⁰ Ibid. Page 78

⁴¹ Ibid. Page 77

may result in a reduction of the fiscus' tax base in the future⁴². A group tax system would allow for the offsetting of profits with losses between trades while being able to maintain a group structure and the benefits thereof.

3.3. BENEFITS OF GROUP TAX

It may be viewed as unfair for entities in a group to be taxed while the overall position of the group may be in a loss position⁴³. This is because of the view that a group, with all its entities, operates in much the same way as a divisionalised single-entity business.

Below is a summary of some of the more pertinent benefits that a group tax regime may provide that have not already been covered in 3.2 above:

- Businesses are able to organise themselves in a manner that provides the most efficiency in terms of their business operations⁴⁴. This may result in the streamlining of group structures as entities previously established to simulate group tax advantages would no longer be required⁴⁵.
- The system may provide flexibility in terms of asset transfer between entities within a group. Group tax generally, depending on the selected model of implementation, allows for the tax neutral transfer of assets between group members⁴⁶. All members are seen as one and the same person with regard to the asset. As a consequence, any such gains on asset transfer will only be recognised when the asset is transferred to third parties outside of the group.
- Overall efficiency of the country's tax system may be improved as larger units are being taxed instead of its components being taxed individually. This may provide efficiency for the taxpaying entities as well as the revenue collection mechanism⁴⁷. Admittedly, SARS will need to ensure that all entities are correctly disclosed, however a reduction in compliance related requirements may be applicable depending on the model of implementation.
- From an investment perspective, businesses would be more open to investing in and expanding a business through additional subsidiaries if they have a safety net of being able to set off other profits with losses of new entities should they arise⁴⁸. This safety net can be achieved while maintaining the non-tax benefits associated with a group structure. While close monitoring of continuously loss-making entities should be applied, it generally is the case that start-ups usually find themselves in loss positions before they start turning profits.

⁴² Ibid. Page 77

⁴³ Ibid. Page 202

⁴⁴ Ibid. Page 66

⁴⁵ Third Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa, 1995 (Katz Commission Report (3)). Page 97

⁴⁶ DTC Report: Page 66

⁴⁷ Ibid. Page 66

⁴⁸ Margo Commission Report: Page 201

- A movement towards a group tax system would signify a movement in conformance with international practices⁴⁹.

3.4. DRAWBACKS OF GROUP TAX

Below is a summary of some of the drawbacks associated with group tax:

- Group taxation provides tax relief to corporate groups of companies. The potential relief on offer comes at the expense of the fiscus⁵⁰. There is a concern, that with South Africa's need to maximise revenue collection to meet its budgetary requirements, the country will not be able to sustain itself given the perceived likelihood of a drop in revenue collection that a group tax system would bring with it.
- A group tax system in South Africa may result in added complexity to an already complex tax system⁵¹. Questions have been raised as to whether a group tax system and its complexities can be capably managed by SARS and taxpayers. In this regard, there would be a need for skill levels to be aligned with the complexities of implementing a group tax system⁵².
- Group tax may be administratively burdensome for taxpayers⁵³ due to its unfamiliarity and would require skills training before a level of efficiency may be achieved.
- Group tax may create uncertainty for revenue collection and planning as it is generally not known upfront how entities within a group will act. This occurs in cases where entities within a group are able to elect whether they would be participating in a group tax system and where there are different permutations on loss transfer options available⁵⁴. This depends on the model of implementation.
- The provision for profit and loss offsetting may encourage the trafficking of loss incurring companies to abuse the system. This, together with the other relief mechanisms offered by group tax, means that added anti-avoidance provisions will be required to ensure that relief provisions are only used for the purposes for which they are intended by legislators⁵⁵.

3.5. GROUP TAX MODELS

As discussed above, there are core group tax objectives, as provided by the DTC report. Countries make use of various group tax models to achieve a set of goals specific to their fiscal policies. The most prevalent of these Models are identified and their basic features described below as provided by the DTC report.

⁴⁹ Ibid. Page 201

⁵⁰ Katz Commission Report(3): Page 98

⁵¹ Ibid. Page 98

⁵² DTC Report Page 78

⁵³ Ibid. Page 83

⁵⁴ Margo Commission Report: Page 200

⁵⁵ Ibid. Page 201

3.5.1. ORGANSCHAFT MODEL

This model may be found in Austria and Germany. It has the effect of allowing profits and losses of the subsidiaries to be consolidated at the parent level. As the name suggests, the subsidiaries are treated as organs of the parent that, together, form a single body.

Profit earning entities within the group are required to transfer their profits up to the parent which, in turn, will redistribute them to its subsidiaries in the most tax efficient manner or how it sees fit. Profits are thereby reduced in profit-making entities as this profit would get transferred to loss making entities which, in turn, reduces their losses.

In practice there is generally a provision which disallows an entity that was a profit earning entity to show a loss after the profits have been redistributed. Thus, the transfer of profit would be limited to the neutrality of member entities.

The relief, however, does not make provision for the deferral of gains and losses incurred on the transfer of assets between entities within the group.

Each entity would then still be required to submit its own tax returns⁵⁶.

3.5.2. GROUP CONTRIBUTION MODEL

This model is practiced mainly in the Nordic region where countries such as Norway, Finland and Sweden have introduced it. It is based on the shifting of profits from one entity to another within the same group. This may be between the parent and its members as well as amongst member entities themselves.

The entity transferring its profits will be granted a deduction for the amount transferred while the entities receiving the profits will recognise a taxable income. Again, in practice, the transfer of profits is only allowed such that the transferor does not enter itself into a loss-making position.

Each entity will be required to submit its own tax return and would be responsible for its own tax affairs after taking into account the profit shifting relief discussed above⁵⁷.

The contribution model differs from the Organschaft model in that it allows the direct transfer of profit between all qualifying and participating group members whereas in an Organschaft, all incomes are first transferred to the parent and thereafter distributed to its entities.

3.5.3. GROUP RELIEF MODEL

As will be seen through the later chapters in this dissertation, this mechanism has been favoured by the various research findings that have been conducted regarding group tax in South Africa. It is currently practiced in the UK and Netherlands.

⁵⁶ DTC Report: Page 67

⁵⁷ Ibid. Page 68

In this model, losses, as opposed to profits per the models discussed above, are transferred between entities in a group. This may be done between the parent and its subsidiaries or between the subsidiaries themselves. There is a limitation that limits losses being received to achieve neutrality.

Group members would be responsible to see to their own tax affairs after taking the loss transfers into account⁵⁸.

3.5.4. CONSOLIDATION MODEL

In this model, all entities within the group lose their individual identities for tax purposes and jointly take the identity of the parent. This model is implemented in developed countries such as Australia and the USA as well as in developing countries such as Taiwan and South Korea⁵⁹. It is the most commonly used model globally.

All members within the group calculate their incomes at member level which thereafter gets consolidated at parent level after making necessary adjustments. Intra-group transactions are disregarded for tax purposes.

The result of the consolidation model is that the parent is required to see to the tax affairs of the group in that it is required to submit a tax return on behalf of itself and its participating members. This would provide for the desired effect of reducing the compliance requirements for groups thereby allowing smaller businesses form groups and derive its benefits.

3.5.5. SUMMARY OF AVAILABLE GROUP TAX MODELS

As noted above there are various models by which group tax may be implemented. It cannot be said, in general, that one model is superior to another. The model of implementation needs to be assessed in line with the objectives of the relevant legislative bodies as well as its cohesion with existing tax laws.

3.6. CONCLUSION

It is evident, based on the perceived benefits and the rationale for calls to group tax that a group tax system would provide for a more favourable environment in which to conduct business. Notable evidence for this is the ability to offset profits and losses between group entities while being able to maintain group structures and their benefits. As a result, businesses will be able to focus more on their core business activities instead of utilizing their resources to simulate the effects of profit and loss offsetting.

Further to this, the ability to offset profits with losses within group structures provides for more shareholder confidence when deciding to enter into a new business venture. The comfort of being able to maintain the limited liability of the new venture will increase the likelihood of the business

⁵⁸ Ibid. Page 68

⁵⁹ DLA Piper (2018), Guide to going Global Tax. Pages 154 and 175

taking it on. As noted, group tax could result in the reduction of compliance requirements for groups where the consolidation model is implemented. These key benefits of group tax, as provided by this chapter, may lead to the growth and development of businesses that participate in it.

CHAPTER 4

4. CORPORATE RULES

4.1. INTRODUCTION

Subsequent to the release of the Margo and Katz Commission reports, legislators introduced the corporate rules as a form of relief offered to companies. Currently, the corporate rules are the closest legislation that South Africa has that could be ascribed to a group tax system.

As stated in chapter 3, the core objectives of group tax are to allow entities within a group to tax neutrally transfer assets amongst members as well as allowing them to share their assessed losses.

This chapter aims to provide a brief analysis of the current corporate relief mechanisms available in South Africa and to assess whether there are elements of group tax that exist within them.

4.2. THE CORPORATE RULES

The set of corporate rules that are found in Sections 41 – 47 of the Tax Act provide tax relief to companies which are primarily aimed at providing tax relief on transfer of assets between corporate entities in certain pre-defined circumstances.

For the relevant reliefs to apply, the parties involved are required to meet certain criteria which are to be discussed as the chapter progresses. Special focus will, however, be placed on the income tax aspects.

The below sub-sections of this chapter will provide a brief summary of the nature of the transactions to which the reliefs apply and the specific reliefs provided by each of the sections contained in the corporate rules. Further detail may be found in the Tax Act under the relevant sections.

4.2.1. SECTION 41

Section 41 is a general provision that provides the definitions and clarity of terms used in sections 42 to 47. The terms defined in these sections are limited to use within the corporate rules provisions and override the definitions found elsewhere in the Act where applicable.

In general, the tax treatment as per the corporate rules supersedes the treatments as stipulated elsewhere in the Act⁶⁰. Included in the exceptions to this include the general anti-avoidance rules in

⁶⁰ Section 41(2) of the Tax Act

respect of assessed losses⁶¹, the anti-avoidance provisions⁶² and instances where shares are issued in return for assets with different value to the shares⁶³.

4.2.2. SECTION 42 – ASSET FOR SHARE TRANSACTION

4.2.2.1. APPLICATION

Section 42 deals with asset for share transactions. As the title suggests, the section provides roll-over relief for companies that wish to acquire assets from anyone in exchange for equity shares in its company⁶⁴. Companies are not required to be part of the same group of companies in order to participate in this provision⁶⁵.

In general, if the requirements of section 42⁶⁶ are met, the provision allows rollover relief to be applied where assets are acquired by a company in exchange for its equity shares.

The result of the above transaction is that the acquiring company effectively steps into the shoes of the transferor with regard to the asset, thereby rolling over the tax consequences until such time that the asset is disposed of to an outside third party. The acquiring company will be one in the same as the transferor with regard to:

- The cost,
- the time of acquisition; and
- valuation done by the transferor in terms of the eighth schedule⁶⁷ (where applicable).

4.2.2.2. ANTI-AVOIDANCE PROVISIONS

Legislation has provided for anti-avoidance rules to limit the abuse of the relief within an 18-month period from the date of the transaction.

In terms of the transferor company, anti-avoidance rules⁶⁸ are triggered if the company ceases to hold a qualifying interest⁶⁹ in the transferee company within 18 months of the asset for share transaction.

In general, the transferor company is deemed to have sold, at market value, all its shares it acquired in terms of the asset for share transaction. This may give rise to capital gains tax that had been deferred in terms of the asset for share transaction⁷⁰.

⁶¹ Section 103(2) of the Tax Act

⁶² Sections 80A to 80L of the Tax Act

⁶³ Section 24BA of the Tax Act

⁶⁴ Section 42(1) of the Tax Act

⁶⁵ Section 42(2)(a) of the Tax Act

⁶⁶ Section 42(2)(a) of the Tax Act

⁶⁷ Section 42(2)(b)(aa) of the Tax Act

⁶⁸ Section 42(6)(a) of the Tax Act

⁶⁹ Section 42 (a) of the Tax Act

⁷⁰ Section 42(6)(a) of the Tax Act

In terms of the transferee company, anti-avoidance rules are triggered if the company disposes of the asset acquired in terms of the asset for share transaction within an 18-month period of the transaction. The result is that, generally, a “portion” of the resulting profit on disposal may not be offset against any accumulated losses available to the company⁷¹.

The “portion” referred to above is calculated as the market value of the asset on date of Asset for share transfer, less the deemed cost of the transfer⁷².

4.2.2.3. *GROUP TAX ELEMENTS*

Section 42 allows for tax roll-over relief where assets are transferred from any person (including companies) to a resident company^{73 74}. The relief is much the same as would be afforded to companies within a group participating in a consolidation system of group tax.

Whilst, the tax neutral transfer of assets between group members is an element of group tax relief, it is noted that there is no group requirement in order for relief to be derived under section 42. The author, however, acknowledges that while it may not be a requirement, groups may participate in the provision and benefit from the relief in much the same way since, in meeting the group requirements, entities would also meet the qualifying interest requirement of Section 42.

Although the provision does allow for the tax neutral transfer of assets between corporate entities, it does so in instances that are not generally covered by group tax. Traditional group tax systems do not necessarily include relief in instances where assets are transferred in exchange for shares.

Thus, while the section contains relief mechanisms that provide for tax neutrality when assets are transferred, it does not contain the elements that are contained within a traditional group tax system.

4.2.3. SECTION 44 – AMALGAMATION TRANSACTIONS

4.2.3.1. *APPLICATION*

Section 44 deals with Amalgamation transactions. An amalgamation transaction is defined as a transaction whereby a resident company (amalgamated company) transfers all of its assets to another resident company (resultant company) in exchange for equity shares in that resultant company. The result of which needs to lead to the termination of the amalgamated company within 36 months of the transaction⁷⁵.

Companies are not required to be part of the same group of companies in order to participate in this provision.

⁷¹ Section 42(7) of the Tax Act

⁷² Haupt, P (2015) Notes on South Africa Income Tax – Page 555

⁷³ Section 42(a)(i) of the Tax Act

⁷⁴ Section 42(b) allows for the provisions of the section to apply to foreign companies; however, this is beyond the scope of this dissertation, thus details of which has been omitted.

⁷⁵ Section 44(1) of the Tax Act

If the requirements for the section are met, the consequences for the amalgamated and resultant companies will be the same as that of the rollover relief provided under section 42 above⁷⁶.

Shareholders are deemed to have disposed of shares in the amalgamated company at base cost and acquired the shares in resultant at that same cost⁷⁷. The shares in the resultant company, held by the amalgamated company, are transferred to the shareholders of the amalgamated company's shareholders without triggering dividends tax⁷⁸.

The above results in the tax neutral transfer of assets between the two companies where an amalgamation transaction has taken place. The effects are that the tax consequences of the asset transfer will be rolled over until such time that the assets are disposed of to an outside third party.

4.2.3.2. ANTI-AVOIDANCE PROVISIONS

The resultant company will trigger anti-avoidance provisions if it disposes of an asset transferred in terms of the amalgamation transaction within 18 months of the transaction⁷⁹. As was the case with section 42, the result, generally, is that a portion of the capital on the disposal of capital assets may not be set off against any other capital loss available to the company. In the case where trading stock is disposed of, a portion of the profits on sale may be deemed to be from a separate trade and cannot be set off against other assessed losses⁸⁰.

As was the case with the asset for share transaction, the portion referred to above is equal to the market value of the asset on the date of transfer, less the deemed cost at which it had been transferred in terms of the amalgamation transaction.

4.2.3.3. GROUP TAX ELEMENTS

There are elements of group tax present in the section 44 amalgamation provision. Assets are allowed to be transferred tax neutrally between two companies subject to the anti-avoidance provisions.

While the author acknowledges that there are no group requirements for this transaction to be applied, it is submitted that these benefits may nevertheless still be derived by a group of companies where an amalgamation transaction is to take place.

⁷⁶ Sections 44(2)(a), 44(2)(b) and 44(3)(a) of the Tax Act

⁷⁷ Section 44(8) of the Tax Act

⁷⁸ Section 44(6) of the Tax Act

⁷⁹ Section 44(5) of the Tax Act

⁸⁰ Section 44(5) of the Tax Act

4.2.4. SECTION 45 – INTRA-GROUP TRANSACTIONS

4.2.4.1. APPLICATION

An intra-group transaction is defined as the disposal of an asset by one company to another resident⁸¹ company within the same group of companies⁸². The term group is defined in terms of Section 41 of the Act⁸³.

If the requirements⁸⁴ of the section are met, the transferor is deemed to have disposed of assets tax neutrally to the transferee company thereby not triggering any tax consequences for both parties⁸⁵.

The result of the above is that, with regard to the asset being transferred, the transferee steps into the shoes of the transferor as if it had held the asset from initial purchase into the group. This results in the tax neutral transfer of assets between entities within the same group of companies⁸⁶. The relief provided by section 45 is automatic unless elected out by the transferor and transferee companies⁸⁷.

4.2.4.2. ANTI-AVOIDANCE PROVISIONS

There are two instances of relevance to this dissertation⁸⁸ where anti-avoidance provisions may get triggered in terms of an intra-company transaction. These two instances are de-grouping and the disposal of the asset transferred in terms of the intra-company transaction.

De-grouping

De-grouping occurs when the entities in question cease to meet the requirements of a group in terms of Section 41 of the Act. The Act states that if either of the entities de-group within a 6-year period of the transaction, the transferee company is deemed to have disposed of the section 45 assets which are still on hand⁸⁹. The result is that the transferee company will trigger tax consequences similar to that in the previous sections⁹⁰.

18-month rule

If an asset is disposed of by the transferee company within 18 months, then the effects will be similar to that of those described in section 42 asset for share transactions⁹¹.

⁸¹ Section 45(1)(b) contains instances where section 45 may apply to foreign companies. This, however, is beyond the scope of this dissertation, thus, discussion of which has been omitted.

⁸² Section 45(1)(a) of the Tax Act

⁸³ Section 45(1)(a) of the Tax Act

⁸⁴ Haupt, P (2015) Notes on South African Income Tax, Page 568

⁸⁵ Section 45(2) and (3) of the Tax Act

⁸⁶ Section 41 of the Tax Act

⁸⁷ Section 45(6) of the Tax Act

⁸⁸ Section 45(3A) of the Tax Act contains anti-avoidance provisions where the asset is funded by debt. A discussion of this is beyond the scope of this dissertation and has thus been omitted.

⁸⁹ Section 45(4) of the Tax Act

⁹⁰ Sections 45(4)(b)(i), 45(4)(b)(ii) and 45(4)(b)(iii) of the Tax Act

⁹¹ Section 45(5) of the Tax Act

In general, where the transferee company has disposed of an asset acquired in terms of a section 45 transaction, a portion of the gains, profit or recoupment may not be set off against other capital losses or accumulated losses of the company. The disallowed portion is the market value on date of section 45 transaction, less the base cost at which it was transferred⁹².

4.2.4.3. GROUP TAX ELEMENTS

Section 45, which deals with intra-company transactions, contains the closest link to group tax that is currently present in tax legislation in that the presence of a group is required. The section allows for the tax neutral transfer of assets between companies within a group where rollover provisions defer the triggering of tax until such time that the assets are disposed of out of the group.

With section 45, there is a group requirement which ties it more closely to a group taxation system than the previous corporate rules discussed. The tax neutrality achieved in section 45 is similar to the rollover relief provided through a consolidation model of group taxation where intra-group transactions are disregarded for tax purposes.

4.2.5. SECTION 46 – UNBUNDLING TRANSACTIONS

4.2.5.1. APPLICATION

An unbundling transaction is defined as any transaction in terms of which a company (unbundling company) transfers its full equity shareholding in an unbundled company to its shareholders⁹³.

The aim of this is to enable the shareholders of the unbundling company to directly hold the shares of the unbundled company.

In terms of the scope of this dissertation, the focus will be concentrated on resident companies while also disregarding the unbundling transactions that are necessary in terms of an order from the competition tribunal.

In this regard, there are 2 types of companies to which this provision may apply.

1. Resident listed companies
2. Resident unlisted companies

Unlisted companies are required to be part of the same group of companies to participate in the provision.

If the requirements⁹⁴ of section 46 are met, then the shares transferred to the shareholders of the unbundling company will be deemed to have been transferred at the same date and cost at which the unbundling company acquired them⁹⁵.

⁹² Haupt, P (2015) Notes on South African Income Tax, Page 572

⁹³ Section 46(1) of the Tax Act

⁹⁴ Haupt, P (2015) Notes on South African Income Tax, Page 575

⁹⁵ Section 46(2) of the Tax Act

The result of this is that no capital gains are realised as a result of the transaction if the market value on the date of transfers exceeds the cost on acquisition. Further to this, the dividend in specie which is used to transfer shares from the unbundling company to its shareholders is disregarded for the purposes of dividends tax⁹⁶.

4.2.5.2. ANTI-AVOIDANCE PROVISIONS

There are no anti-avoidance provisions for an unbundling transaction in terms of section 46, the requirements are however limiting.

4.2.5.3. GROUP TAX ELEMENTS

Section 46 unbundling transactions allow for the tax neutral transfer of shares in the unbundled company, held by the unbundling company to its shareholders.

For unlisted companies, the shareholding company of the unbundling company and the unbundling company are required to be part of the same group of companies. Therefore, under section 46, shares are allowed to be transferred tax neutrally between members of a group.

The group requirement is relaxed for listed companies where a 35% or 25%⁹⁷ equity shareholding is required. The author, however, submits that groups may equally derive the benefit thereof.

There are therefore group tax elements present in section 46 as assets (shares) are able to be transferred tax neutrally between companies where the applicable shareholding criteria is met.

4.2.6. SECTION 47 – LIQUIDATION DISTRIBUTION

4.2.6.1. APPLICATION

A liquidation distribution transaction is defined as any transaction in terms of which a resident liquidating company distributes all of its assets to its shareholders in anticipation of or in the course of the liquidation, winding-up or deregistration of the liquidating company. The liquidating company may however, retain assets required to settle any debts that it had incurred in its normal course of trade⁹⁸.

Unlisted companies are required to be part of the same group of companies to participate in the provision.

⁹⁶ Section 46(5) of the Tax Act

⁹⁷ 25% would be sufficient only if there are no other shareholders that own more shares in the unbundled company.

⁹⁸ Section 47(1) of the Tax Act

If the requirements⁹⁹ of the section are met, similarly to the previous provisions, the shareholding company is deemed to be one and the same person as the liquidating company with regard to the assets transferred and is said to have stepped into the shoes of the liquidating company and thus rollover relief will be applicable to the shareholding company with regard to the assets transferred¹⁰⁰.

4.2.6.2. ANTI-AVOIDANCE PROVISIONS

Anti-avoidance provisions may get triggered in terms of a liquidation transaction where an asset acquired in terms of a liquidation distribution is disposed of within 18 months of the transaction¹⁰¹. Tax is triggered in much the same way as that of the Section 45 intracompany transactions 18-month anti-avoidance rules. A portion of the gains, profit or recoupment may not be set off against other capital losses or accumulated losses of the company. Where the disallowed portion is the market value on date of section 45 transaction, less the base cost at which it was transferred

4.2.6.3. GROUP TAX ELEMENTS

Section 47 liquidation distribution allows for the tax neutral transfer of assets from the liquidating company to its shareholding company in cases where they form part of the same group of companies. Similar to section 45, the intra-group transaction provision, the roll-over relief derived from the transfer of assets between companies within a group represents elements of group taxation.

4.3. CONCLUSION

From the above analysis of the corporate rules, it is evident that there are some elements of group tax that exist within the corporate rules. This is found predominantly with regard to the tax neutral transfer of assets from one corporate entity to another. This is consistent with the results that could be obtained where a group participates in a group tax system with a notable exception being an organschaft group tax system.

For sections 45, 46 and 47 there are requirements for companies to be part of the same group in order for the reliefs of the provisions to be applicable. For sections 42 and 44, these requirements are relaxed.

As stated in chapter 3, one of the main objectives of a group taxation system is to allow for the tax neutral transfer of assets between entities within a group¹⁰².

From this chapter's investigation, it would seem that the current South African corporate tax legislation does indeed allow for roll-over relief when assets are transferred between entities in a group and therefore contain one of the objectives of group taxation.

⁹⁹ Haupt, P (2015) Notes on South African Income Tax, Page 579 to 580

¹⁰⁰ Sections 47(2)(a)(i), 47(2)(a)(ii), 47(2)(b)(ii) and 47(3)(b)(ii) of the Tax Act

¹⁰¹ Section 47(4)(a) of the Tax Act

¹⁰² DTC Report: Page 67

There is, however, currently no provision in the corporate rules, nor in the rest of the Act which allow for profits and losses to offset each other in determining group taxable income. The anti-avoidance rules contained within the corporate rules, together with the anti-avoidance rules that prohibit the use of assessed losses in certain instances actively prohibit the sharing of losses between entities through intra-company transactions.

It is further noted that the anti-avoidance provisions contained in these rules greatly limit the flexibility to manoeuvre assets between group entities which would not have been the case under a traditional group tax system.

On this basis, the author submits that while there are elements of group taxation in the corporate rules provision, there does not exist a group tax system in the complete sense. It is thus submitted that the current provisions contained within the corporate rules are insufficient to meet the objectives of a group tax system.

CHAPTER 5

5. COMMISSIONS OF INQUIRY

5.1. INTRODUCTION

Over the years there have been various Commissions of Inquiry set up in order that they may provide an analysis of the tax system of its time. The Commissions are generally set up by the Finance minister at the time to provide guidance and recommendations as to policy changes and additions that may enhance the efficiency of the tax system and the country as a whole.

Of particular relevance for the purpose of this dissertation, are the:

- Margo Commission of Inquiry (Published 1987),
- Katz Commission of Inquiry (Published 1995) and
- Davis Tax Committee¹⁰³(Published 2018).

These Commissions all contained an analysis of group taxation as part of their recommendation reports. Bear in mind that all three were released at different times and therefore had differing economic, political and social contexts.

While there are some commonalities contained within the reports, there are differing views, possibly as a result of the different environment within which they were produced. A further breakdown and analysis of these reports are provided below.

Parts of these reports have already been discussed earlier in this dissertation, with particular reference to the benefits and drawbacks of group tax identified in chapter 3. The findings and recommendations of the above reports, based on their respective arguments contained in chapter 3, will be provided below.

The recommendations contained in the reports will be used to draft a group tax proposal for South Africa in chapter 9 and ultimately assist in concluding on the research question posed in chapter 1.

5.2. MARGO COMMISSION OF INQUIRY

5.2.1. BACKGROUND

The Margo Commission of Inquiry (the Commission¹⁰⁴) was formed on 20 November 1984 on the proclamation of Former President P.W Botha and on the order of then Finance Minister BJ Du Plessis¹⁰⁵. The Commission was set up with the objective of reforming the tax system in South Africa.

¹⁰³ The DTC differed from the other bodies in that it was a committee and not a commission. The DTC mandate was similar to that of its predecessors, however, being a committee, it did not have the right of subpoena which limited its work.

¹⁰⁴ This short-hand is limited for use in subchapter 5.2 when referring to the Margo Commission.

¹⁰⁵ Margo Commission Report: Page 8

Included in the recommendations provided by the report was the Commission's view on group tax in South Africa.

The Commission's report was publicly released in 1987, titled Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa. By a majority vote of its members, the Commission believed that a group taxation system in South Africa would not be appropriate¹⁰⁶.

The Commission had taken a comprehensive approach in deciding whether or not group taxation should be implemented. This chapter will analyse the group tax part of the report and look into the reasons as to why the Commission had been opposed to South Africa instating a group taxation system when so many of the world's developed countries were already long enjoying its fruits.

In arriving at its final recommendation, the Commission provided a discussion on which group tax model would be best suited to South Africa. Thereafter, the Commission formulated arguments for and against group tax which ultimately led to their final vote and conclusive recommendation.

5.2.2. ELECTION OF GROUP TAX MODEL

The majority of the submissions received by the Commission in its investigation into group tax favoured the group relief model. The group relief model was perceived to be simpler, however this was noted as a questionable belief by the Commission. In fact, the Commission expressed concern over the complexity of the model and the uncertainty it may bring. It was asserted that, due to the long timespan provided to entities to decide on the many possibilities to transfer losses within the group, it may result in difficulty for the planning and forecasting for both the entities, as well as the Revenue service¹⁰⁷.

Members of the Commission had expressed favour of the consolidation model due to their perceived view that it would be a simpler model to implement. The exercise of consolidation occurs in a relatively short period and the method of consolidation provides certainty as to how the profits and losses will be combined at a group level¹⁰⁸. This reduces the uncertainty associated with the group relief model discussed above. Members were also of the view the consolidation approach is a sounder method of group tax.

The Commission seemed to be of the view that a consolidated system with a strong set of anti-avoidance rules would be the best option for South Africa should a group tax system be implemented¹⁰⁹.

5.2.3. RECOMMENDATIONS OF THE REPORT

As stated upfront, the members of the Commission voted against the implementation of group taxation¹¹⁰ as they were of the view that the perceived drawbacks of the system were not endurable

¹⁰⁶ Ibid. Page 202

¹⁰⁷ Margo Commission report: Page 200

¹⁰⁸ Ibid. Page 201

¹⁰⁹ Omar, S, (2009), Group Taxation in South Africa – A contextual analysis: Page 25

¹¹⁰ Ibid. Page 202

for the country at the time – given the climate in which this report was released as well as the level of development prevalent in South Africa.

There were, however, some important points of value noted by the minority group who were in favour of recommending a group tax system in South Africa. They suggested that a group tax system should be introduced subject to the following accompanying provisions:

- Anti-avoidance measures should be put in place to limit the trafficking of assessed losses;
- Group tax relief should not apply to losses incurred prior to a subsidiary joining the group;
- There should be requirements that only allow for wholly owned subsidiaries to participate in the group tax system¹¹¹.

5.2.4. KEY TAKEAWAYS

The Margo Commission had voted against recommending the instatement of a group tax system in South Africa for concerns mainly relating to the prevailing state of the economy and capabilities of SARS at the time to deal with the perceived complexities of group tax. The members seemed to be of the view that, should a group tax system be implemented it should be via the consolidation model for reasons including the perceived complexity of a group relief system and the uncertainty it provided to the fiscus. Further to this, the discerning portion of the Commission provided valuable rules to accompany a group tax system to limit its perceived drawbacks.

5.3. THE KATZ COMMISSION OF INQUIRY

5.3.1. BACKGROUND

The Katz Commission report was issued in 1995 at the request of then Finance Minister, Trevor Manuel. The differing periods in which the work was performed meant contrasting economic, political and social climates in South Africa as compared to the Margo Commission report. South Africa had just been liberated from the oppressive Apartheid regime and had been energized by the new-found democracy.

The Katz Commission had of course recognised the change in climate and as a result had concluded on a positive recommendation to instate group taxation in South Africa¹¹². It was of the view that South Africa had been lagging behind in terms of corporate tax treatment of groups and could not afford to fall behind any further¹¹³.

5.3.2. ELECTION OF GROUP TAX MODEL

¹¹¹ Ibid. Page 202

¹¹² First Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa (Katz Commission Report (1)): Pages 7 to 8

¹¹³ Katz Commission Report (3), Page 96

The Katz Commission (the Commission¹¹⁴) eventually also favoured the consolidation model for group tax as opposed to the group relief model¹¹⁵. The reasons it provided for this are summarised below:

- The Group relief model does not recognise that, although a group may consist of different entities, they operate very much as a unit¹¹⁶.
- Group relief provides an environment which encourages manipulation of intra-group transactions looking to derive undue tax advantages for the group¹¹⁷.
- The consolidation model has the advantage of allowing the group to submit a single submission to SARS that contains financial information of the entire participating group. This allows for an easier audit trail¹¹⁸.
- Group relief was perceived to be a more complex system to maintain when considering the uncertainties of timing and optional loss transfers¹¹⁹.

As a result of the above, the Katz Commission thus felt that should a group tax system be implemented in South Africa, it should be implemented via the consolidation method.

5.3.3. RECOMMENDATIONS OF THE REPORT

As stated earlier, the Commission was of the view that South Africa had already lagged behind other countries in terms of corporate taxation¹²⁰. As a result of this view, it recommended that group tax be implemented amid concerns of its drawbacks.

The Commission had recommended that the consolidation model be utilized to implement group tax in South Africa citing the various reasons as stated above.

Bearing the drawbacks in mind as well as the perceived fragility of the political, economic and social climates, the Commission recommended a gradual approach of implementation. The effects of a gradual approach translated into the following rules being recommended as part of a group tax introduction¹²¹.

- Only wholly owned subsidiaries should qualify to be included in a group taxation system, with an exception for employees to own up 10% of the subsidiaries' equity¹²².
- Election should take place for the entire group. This means that all qualifying subsidiaries would be forced to follow the election of the parent. New group companies would qualify from the first full year that they are part of the group¹²³.
- Any accumulated losses accrued prior to the commencement or election of group taxation for the group should be ring-fenced as not being allowed to set off against current or future

¹¹⁴ This short-hand limited for use in subchapter 5.3 when referring to the Katz Commission

¹¹⁵ Katz Commission Report: Page 98

¹¹⁶ Ibid. Page 98

¹¹⁷ Ibid. Page 98

¹¹⁸ Ibid. Page 99

¹¹⁹ Ibid. Page 99

¹²⁰ Omar, S (2009) – Group Taxation in South Africa – A contextual analysis: Page 29

¹²¹ Katz Commission Report (3): Page 107

¹²² Ibid. Page 107

¹²³ Ibid. Page 107

profits of the group. These losses may only be offset against that specific company's future profits¹²⁴.

- Each company's individual returns to be based on normal tax rules and adjustments made thereafter for intra-company transactions (the Katz report had preceded but contributed to the decision to incorporate the corporate rules into legislation). Thereafter profits and losses should get contributed up to the parent in preparation of a consolidated return¹²⁵.

5.3.4. KEY TAKEAWAYS

The Katz Commission was resolute in its examination of South Africa's corporate tax treatment in comparison with the international community. As a result of this, it believed that South Africa should be looking to implement a group tax system. It acknowledged the drawbacks in the wake of prevailing climates within the country at the time, leading to a gradual implementation recommendation.

5.4. THE DAVIS TAX COMMITTEE

5.4.1. BACKGROUND

In July 2013, then Minister of Finance, Pravin Gordhan, appointed the members of the Tax Review Committee. This name later changed to the Davis Tax Committee. Included in its mandate was to assess South Africa's tax policy framework and its role in supporting objectives of inclusive growth, employment, development and fiscal sustainability¹²⁶.

In terms of the above mandated appointment, the DTC released a report in March 2018 titled, "Review of South Africa's Corporate System". The report provides an analysis of the current corporate tax structure prevalent in South Africa and recommendations thereon. Of particular interest to this dissertation is chapter 9 which focuses on group taxation.

As an introduction to the investigation, the DTC posed the question of whether the introduction of group company taxation would enhance the efficiency of South Africa's tax structure¹²⁷. The format in which the report goes about answering this question is to firstly highlight and acknowledge the benefits that group taxation could offer and to determine a suitable mechanism whereby to achieve this in South Africa. Thereafter, as its recommendation, it discusses whether or not group tax should be implemented in South Africa at this time.

Included on the findings of the DTC, the report contained fundamental items¹²⁸, which it believed need to be established in order to propose a comprehensive group tax system. Further discussion of this has been provided in chapter 9, the group tax proposal chapter.

¹²⁴ Ibid. Page 108

¹²⁵ Ibid. Page 107

¹²⁶ PWC Tax Alert (April 2018): Davis Committee: Final reports and conclusion of work

¹²⁷ DTC Report: page 7

¹²⁸ Davis Tax Committee: Review of South Africa's Corporate Income Tax System: March 2018. Page 78 to 83

5.4.2. ELECTION OF A GROUP TAX MODEL

The DTC was of the view that if a full group tax system is introduced in South Africa, it should be implemented through the group relief model¹²⁹. The DTC had an advantage over its predecessors in that the set of corporate rules had already been established. It was of the view that a provision to transfer losses between group entities would be a relatively simple addition to the existing corporate rules¹³⁰.

5.4.3. RECOMMENDATION OF THE REPORT

The DTC has taken a conservative approach in its recommendation. While it has not denied the benefits group tax may have, it had expressed concerns on whether the economy, in its current state, will be able to handle the massive adjustment.

It was concerned that group tax may have little effect in encouraging businesses and bringing about confidence due to other discouraging policies¹³¹. The DTC expressed concern of the country suffering a double knock as tax collection will be set to reduce while the country maintains its lack of business appetite due to other prevailing conditions and general lack of business confidence.

The DTC had advised, however, that until such time that the economy is strong enough to cope with the drawbacks associated with group taxation, the tax system should, for now, rely on the corporate rules to provide corporate tax relief¹³².

It needs to be noted that during the period in which DTC had produced their report, SARS' revenue collection had been showing large deficits with its targets. The state of affairs of SARS, as will be discussed in chapter 9, has compromised tax collection¹³³ this was seen during the 2017/2018 period treasury where had registered a R48.2bn shortfall in taxes¹³⁴. These shortfalls which have been experienced in recent times were generally not the case during the periods in which the previous reports were published, as SARS was previously recognised to be an efficient organ of the state¹³⁵.

5.4.4. KEY TAKEAWAYS

The DTC has recognised the benefits that group taxation could bring to the economy of South Africa, however, was fearful that the possible drawbacks could be fatal to an unstable economy. The DTC report, thus, recommended that group tax should not be implemented until such time that the economy is able to withstand the associated drawbacks without exposing the country to critical adverse effects.

¹²⁹ Ibid. Page 84

¹³⁰ Ibid. Page 85

¹³¹ Ibid. Page 84

¹³² Ibid. Page 85

¹³³ Nugent Commission Report: Page 15

¹³⁴ Tehillah Niselow (August 2018): SA Revenue Service Shortfall to blame for VAT hike – Treasury – Fin 24

¹³⁵ Nugent Commission Report: Pages 13 to 14

5.5. CONCLUSION

Having completed the investigation into the findings of the three relevant Commissions of Inquiry who included in their reports attention to the topic of group tax in South Africa, it can be safely said that all of the reports have displayed positivity towards a group tax system in principle. There has been concern regarding its implementation based predominantly on the development stage South Africa finds itself in.

For the Margo Commission and Davis Committee reports, the concerns of adverse effects to the country proved to be too great for them to recommend the immediate instatement of group tax. Conversely, the Katz Commission had believed that South Africa could not afford to lag behind other countries anymore and recommended in their report that group tax be implemented. Albeit with a gradual approach due to the concerns it shared with the Margo Commission and DTC. The DTC has, however, been more optimistic about the implementation of group tax in South Africa than the Margo Commission as it believes that group tax should be initiated when the economy is strong enough to absorb such change.

It is interesting to note that the DTC report had been issued three decades after the Margo Commission report. While definite steps towards a group tax system had been taken through the implementation of the corporate rules, in these three decades the country has not managed to be deemed ready to instate a loss transfer mechanism.

CHAPTER 6

6. PROFESSIONAL OPINION

6.1. INTRODUCTION

Following on from the previous chapter where formalised reports containing studies into group taxation were looked at, this chapter will explore the less formalised opinions of professionals derived from publicly available articles where the question of group tax in South Africa is delved into.

The chapter aims to identify arguments of professionals in their personal capacities where they are not constrained by the views of other members. While it is acknowledged that these articles have been provided in different times and therefore differing contexts to that of the formalised reports in the previous chapter, they have nevertheless been deemed to provide valuable insight to the outcome of this dissertation.

In the sections that follow, the author will provide a summary of the articles and extract information deemed to be valuable to the conclusion.

6.2. THE SOUTH AFRICAN TAX SYSTEM: A NATION IN MICROCOSM

6.2.1. BACKGROUND

The first article to be discussed does not delve deeply into the question of group taxation. However, it has relevance to the dissertation in that it discusses the need for tax reform to play a role in assisting the development of the South African economy.

The article was written by two of nine foreigners that were invited by the newly elected democratic government to South Africa in 1995. They were invited to a workshop that was aimed at advancing tax reform systems that South African legislation could explore that could benefit the South African economy¹³⁶.

Admittedly, this article is almost 24 years old, however, it remains relevant since many of the issues prevalent at the time of issue are still prevalent today. The article had provided a tax strategy for economic improvement that, had it been implemented at the time, may have resulted in a different present scenario. The strategy provided, even though 24 years old, may still be useful for implementation today.

¹³⁶ Aaron, H and Slemrod, J (1999) – The South African Tax System: A Nation in Microcosm – Brookings – Accessed 11 October 2018: Page 1

6.2.2. FINDINGS

The article indicates that participants of the workshop had identified a few key strategies that it believed, at the time, may have led to resolving some of the economic issues prevalent in South Africa.

As submitted by the article, SARS had identified the complexity of tax legislation as a major threat to its ability to collect revenue¹³⁷. As a result of this, the workshop agreed that in the short-run, legislators should look to maintaining simple rules¹³⁸ that would allow a greater portion of the population to understand and participate in it. Attention should be directed at improving literacy and general education levels as the workshop believed it would bring with it economic development.

In the medium to long term, efforts should be directed at improving the administrative capabilities of SARS and its staff¹³⁹.

With the pressure of international tax competition in mind, legislators should find balance between revenue collection and maintaining competitiveness with other jurisdictions. In this regard, the workshop believed that South Africa should look to moving towards a consolidated group tax system as a defence mechanism to avoid the shifting of incomes out of the South African tax net to more tax favourable destinations¹⁴⁰.

The article went on further to acknowledge the importance of tax policy reform in sustaining the multi-racial democracy in South Africa. The workshop was of the opinion that, given the low average income per capita levels at the time, real improvements to the development of the economy would need to be derived from broad-based economic growth and should not be dependent only on redistribution as a means of reform¹⁴¹. Further to this, the article acknowledged the tough task that all developing countries have in promoting economic growth using the very limited resources at their disposal¹⁴².

6.2.3. KEY TAKEAWAYS

As noted above, the authors' views are that the development of the economy should stem from broad-based economic growth. This translates into an opinion that instead of relying on redistribution to combat low income per capita levels, participation in economic activity should be more inclusive.

This aligns to one of the objectives intended to be achieved by this dissertation's group tax proposal, which is aimed at growing and developing smaller businesses through tax provisions.

The article acknowledged that developing countries need to maximise their revenue collection in order to see to the needs of the country. With that being said, the article nevertheless recommended that a group tax system be implemented in the long-run.

¹³⁷ Ibid. Page 5

¹³⁸ Ibid. Page 11

¹³⁹ Ibid. Page 11

¹⁴⁰ Ibid. Page 13

¹⁴¹ Ibid. Page 14

¹⁴² Ibid. Page 1

6.3. SAICA NEWS: FULL GROUP TAX SYSTEM IMPERATIVE IN CURRENT ECONOMIC MELTDOWN

6.3.1. OVERVIEW

This article¹⁴³, in which Deborah Tickle¹⁴⁴ is quoted, was published around 10 years ago in May 2009 around the time of the infamous recession. Negative effects of the recession, where economic instability had become prevalent, had been felt globally.

As a result of the tough economic times, many companies found themselves in loss suffering positions. As noted in the article, this provided for some sort of relief in that "A tax loss can, in a small way, bring some relief to a firm's cash flow in that it would no longer have to pay income tax three times a year, since the taxable income it generates is offset by its tax loss. The big caveat to this statement is that many companies do not operate in isolation but are part of a group of companies"¹⁴⁵.

Current legislation dictates that only the company that has sustained the loss may utilize the loss in offsetting its future profits for tax purposes. In a group scenario, there may be companies making a profit and some who are showing losses. In order to sustain the operations of the group, "loss-making companies in a group are often funded by their profitable peers, with, however, the latter receiving no resultant tax benefit"¹⁴⁶.

In order for profit making trades to benefit from losses incurred from other trades, these trades would need to all trade under a single divisionalised company. Companies separate themselves into smaller companies as part of a group to derive commercial benefits and to manage risk through limited liability. The article states that, "although the ownership in groups is almost the same as if the group were one company, tax laws prohibit the cross-utilization of tax losses"¹⁴⁷.

6.3.2. GROUP TAX VIEW

This scenario is not unique to South Africa. Other countries, however, have implemented a system of group tax that allows loss transfer between entities in a group structure. South Africa has not introduced a profit and loss offsetting provision into its legislation with a possible reason being that of the potential cost to the fiscus it may cause¹⁴⁸.

Tickle stated that, "drastic measures are sometimes required in drastic times. The cost to the fiscus of losing some of the taxpayer groups altogether - because tax is being extracted from the better businesses, whilst others in the group are dragging it down - may be higher in the long run."

¹⁴³ Tickle, D, (2009) – Full group tax system imperative in current economic meltdown. Page 1 – SAICA Communique News Service – Accessed 11 October 2018

¹⁴⁴ Deborah Tickle is a respected Tax Practitioner and a member of SAICA and the DTC

¹⁴⁵ Tickle, D, (2009) – Full group tax system imperative in current economic meltdown. Page 1 – SAICA Communique News Service – Accessed 11 October 2018

¹⁴⁶ Ibid. Page 1

¹⁴⁷ Ibid. Page 1

¹⁴⁸ Ibid. Page 2

The article concludes implying favour to the instatement of a group tax system declaring that "Ultimately, the severity of the economic downturn strongly suggests that the time is right for Treasury to reconsider South Africa's current group rationalization provisions and move them up to the next level of full group taxation."¹⁴⁹.

6.3.3. KEY TAKEAWAYS

While the author has not attempted to draw similarities between the current economic climate and the climate in which the article was published, it is clear to note that the view of the article is that group tax could be instated in times of economic distress. In fact, the article has gone as far as stating that, "the ability to cross-utilize the losses could be critical to the group's survival." This emphasizes the need for group tax during tough economic conditions.

The article supports the view that operating multiple trades under a single divisionalised entity may sometimes not be the best way to conduct business and has therefore acknowledged that group structures may be necessary.

6.4. GROUP TAX: JUST A SMALL STEP AWAY

6.4.1. OVERVIEW

This is an article¹⁵⁰ in which David Lerner¹⁵¹, a respected tax professional, was quoted. The article, that was published post 2010, deals with the question of group tax in South Africa from Lerner's point of view.

Lerner had expressed his admiration towards South African tax legislators together with the revenue services for what they had managed to do, "what South Africa managed to do in a few years took others several decades." This was with reference to the provisions provided by the corporate rules.

With the above corporate rules in place, Lerner still believed that there are two areas still in need of attention, namely:

1. Group tax in South Africa; and
2. the potential group tax holds for interest relief on the acquisition of shares¹⁵².

He believed that, "The absence of these provisions has put South African business at a competitive disadvantage compared to their international rivals". In his opinion, many tenders had already been

¹⁴⁹ Ibid. Page 3

¹⁵⁰ Lerner, D, Group Tax: Just a small step away – SAICA: Page 1 – SAICA Communique News Service – Accessed 11 October 2018

¹⁵¹ David Lerner is a respected tax practitioner and current partner at PWC

¹⁵² Lerner, D, Group Tax: Just a small step away – SAICA: Page 1 – SAICA Communique News Service – Accessed 11 October 2018

lost due to the less favourable tax treatment provided in South Africa in comparison to its counterparts¹⁵³.

6.4.2. GROUP TAX VIEW

Similar to the previous article with reference to group tax, Lermer states that “current economic volatility suggested it was surely time to revisit these key tax reliefs”. He believed that current tax treatment of groups has caused a “mismatch between economic and fiscal realities”. Companies in a group are taxed in their individual capacities whereas in reality the group operates as a single interdependent operating entity¹⁵⁴.

While Lermer was of the view that group taxation and its associated reliefs should be revisited in tough economic times, he too noted, however, that there are potential drawbacks of the system. His concerns, as provided below, are in line with those already discussed in this dissertation:

- The complexity that a group tax system may bring to South African tax legislation and practice thereof
- The cost that it may have to the fiscus in terms of revenue collection
- The need for additional anti-avoidance measures to combat potential abuse of relief provisions¹⁵⁵

In line with the more recently published DTC report¹⁵⁶, Lermer expressed favour towards a group relief model of group tax. He stated that, “Looking at the road South Africa has already travelled over the past decade, the UK group relief approach seems the most appropriate way forward”¹⁵⁷.

Further to the provisions of the corporate rules, Lermer states that, “The only major further step necessary to convert to a UK style group relief system is the transfer of losses between group entities¹⁵⁸”.

6.4.3. KEY TAKEAWAYS

Similar to the previous article, this article has expressed favour to revisiting the idea of group tax in South Africa during volatile economic times. Again, the author has not attempted to draw similarities between current economic volatility and the volatility experienced at the time the article was published. The article has been cited to draw further emphasis of the view that group tax could be implemented during economic volatility.

¹⁵³ Ibid. Page 1

¹⁵⁴ Ibid. Page 1

¹⁵⁵ Ibid. Page 1

¹⁵⁶ DTC Report: Page 7

¹⁵⁷ Lermer, D, Group Tax: Just a small step away – SAICA – SAICA Communique News Service – Accessed 11 October 2018. Page 2

¹⁵⁸ Ibid. Page 2

With regard to the model of implementation, there is agreement between this article and the DTC report in the belief that the group relief model would be the most appropriate, given the path already taken by tax legislation.

Further to the above, the article echoes concerns previously noted in this dissertation regarding the complexity a group tax system and the loss to fiscus it may bring.

6.5. CONCLUSION

The first article, although not providing an in-depth analysis on group taxation, has provided some important thoughts that may be of benefit to this dissertation. It provides for an outside (foreign) view of the tax system in South Africa. What stands out, as submitted by the author, is the article's opinion on the importance of tax policy in sustaining the multi-racial democracy in South Africa. The author shares the view of the article in that it believes that economic reform cannot only be derived through redistribution of wealth, but through broad-based economic growth that encourages participation of those in need of reform. Further to this, the article recommended that South Africa should move towards a consolidation group tax system.

Concerns relating to the complexity that a group tax system may bring to the tax system as well as the likely reduction in revenue collection has been expressed in this chapter as well.

Of significance in this chapter, however, is the seemingly contrasting views of two of the articles with the recently published DTC report. The above articles have expressed favour to the view that under tough economic conditions, the implementation of a group tax system could provide much needed relief to businesses struggling in tough economic conditions. The DTC, as provided in their recommendations, were of the view that loss sharing should only be implemented at a point where the economy is stable enough to handle the change.

However, as pointed out in chapter 5 under the DTC section, there had been large shortfalls in SARS' revenue collection, relating to the state of affairs at SARS, during the period in which the DTC were compiling their findings which had been generally unprecedented during the periods that the articles discussed in this chapter had been written. This may provide for the rationale in difference of opinion between the articles in this chapter and the recommendations provided by the DTC report.

CHAPTER 7

7. GROUP TAX PROVISIONS – AN INTERNATIONAL ANALYSIS

7.1. INTRODUCTION

Group tax has been implemented in many countries across the world. These countries are predominantly the more developed countries. In this chapter, the author will delve into the implementation mechanics of how some of these countries implement group tax into their tax systems.

These mechanics will be used to assist in drafting the mechanics of the proposal in this chapter. The following countries have been selected as part of the research investigation whose findings will be provided in the proposal later in this chapter.

- The UK
- The USA

7.2. THE UK

At this stage, it seems as though the group relief model would be most appropriate for South Africa given the tax legislative path already taken¹⁵⁹. Chapters 5 and 6 have displayed strong evidence to suggest that with the instatement of the corporate rules into legislation, the group relief model of group tax would be the most appropriate given that a loss transfer provision could easily be added to it.

The UK group tax system is an example of a mature group model. Further to this, there have been inferences drawn in the Lerner article regarding the appropriateness of the UK group tax system for implementation in South Africa as well as the similarities that exist between the UK tax legislation with South Africa's¹⁶⁰. For these reasons, the UK has been selected as part of this investigation to provide guidelines for the proposal.

7.2.1. QUALIFYING GROUP REQUIREMENTS

Parent Company

The parent of the group can be any corporation, UK resident or not¹⁶¹.

¹⁵⁹ DTC Report, page 7

¹⁶⁰ DTC Report, page 74

¹⁶¹ Jones Day, Group Taxation, Page 10

Subsidiary Company

For subsidiary companies to qualify for group tax they are required to have their income included in the tax net of the UK. This may include resident companies or foreign companies.

The ownership requirements of the parent to its subsidiaries differ for the different provisions of group tax.

In order for capital neutral transfer of capital assets to be achieved, the parent must directly or indirectly own 50% of the subsidiaries profit and assets on liquidation. Further to this, the parent must directly or indirectly own 75% of the ordinary share capital of the subsidiary¹⁶².

Revenue losses can be transferred between group entities if the parent directly or indirectly owns 75% of the ordinary shares as well as the profits and assets of the relevant subsidiaries on liquidation¹⁶³.

It follows that in order for a group to qualify for full group tax in the UK, it would need to comprise a parent company (incorporated anywhere) with an ownership in at least one subsidiary, whose income must be included in the UK tax net, with a minimum shareholding of 75%.

7.2.2. MECHANICS OF THE SYSTEM

As alluded to by the qualifying group requirements above, the UK group tax system allows for the tax neutral transfer of assets between group companies as well as the ability to share losses. This may be between parent and subsidiaries or amongst subsidiaries themselves. Where a loss is transferred, the loss-making entity surrenders its loss to a profit-making company. The surrendered amount is claimed as a deduction in the return of the transferor company while an income is recognised in the transferee company.

The UK group tax system allows for resident and, in some cases, non-resident losses to be transferred to other group entities¹⁶⁴. Transfer of non-resident losses are subject to qualifying criteria which are beyond the scope of this dissertation.

Losses are only allowed to be transferred to the extent that the transferee company's profit would be reduced to zero¹⁶⁵.

Pre-group losses may not be used to offset profits of the group.

Gains and losses incurred on the transfer of capital assets between entities in the same group are deferred until such time that the assets are transferred out of the group. To attain this rollover relief, the transferred assets are required to remain within the UK tax net.

Where a company is dual listed, it may only claim relief that has not already been claimed in the other country¹⁶⁶.

¹⁶² Omar, S (2009) – Group Taxation in South Africa – A contextual analysis: Page 17

¹⁶³ Ibid. Page 17

¹⁶⁴ Ibid. Page 18

¹⁶⁵ Ibid. Page 16

¹⁶⁶ Jones Day, Group Taxation: Pages 10 to 12

7.2.3. ELECTION

For losses to be transferred, the loss-making company needs to provide written consent to the revenue authority.

Tax neutral transfer of assets between all qualifying entities in the group are automatic and compulsory¹⁶⁷.

7.2.4. TERM

There is no minimum term for group relief in the UK¹⁶⁸.

7.2.5. TERMINATION OF THE GROUP

A group effectively terminates when it no longer meets the qualifying group requirements. The effects of group termination are that any capital gains that were deferred as a result of being part of the group get triggered.

Any unutilized losses remain with the company to which it belongs to be utilized in the future¹⁶⁹.

7.2.6. LEAVING THE GROUP

If an entity leaves a group¹⁷⁰, the entity will no longer be able to participate in the group tax reliefs associated with that group. Similar to the group termination, previously deferred capital gains are triggered upon exit. Any unutilized losses that have been accumulated by the leaving entity remain with the entity and may be utilized by it in the future¹⁷¹.

7.2.7. TAX RETURN SUBMISSION

Each entity within the group is required to submit its own tax returns on which tax will be calculated and must be paid. Inland Revenue may agree for companies within the group to pay taxes on behalf of another^{172 173}.

¹⁶⁷ Ibid. Pages 10 to 12

¹⁶⁸ Ibid. Pages 10 to 12

¹⁶⁹ Ibid. Pages 10 to 12

¹⁷⁰ An entity leaves the group when it no longer meets the requirements to be in that group.

¹⁷¹ Jones Day, Group Taxation: Pages 10 to 12

¹⁷² Ibid. Pages 10 to 12

¹⁷³ This becomes applicable when a profit-making company transfers its profits to a struggling entity. The struggling entity perhaps would not be able to pay the taxes.

7.2.8. TAX LIABILITY

Generally, each entity will be liable for their own tax affairs and cannot be held liable for the liability of other group entities should they default¹⁷⁴. There are however circumstances where tax of a defaulting group member may be collected from other group members.

7.2.9. FOREIGN ENTITY PARTICIPATION

International group of companies can also be recognised for group relief if the 75% ownership requirement is satisfied. Group tax reliefs may apply to foreign entities subject to additional qualifying criteria which is not part of the scope of this dissertation and therefore not covered herein¹⁷⁵.

7.3. USA

As noted in chapter 1 of this dissertation, reference was made to the desire to reduce the compliance requirements associated with groups through the implementation of group tax in South Africa. With the consolidation model, there is the opportunity to allow a single tax return submission by the parent company on behalf of the group to be submitted. The USA group tax system is an example of a working consolidation model.

Further to this, the provisions provided in the USA group tax system seem to be well structured to limit the loss to its fiscus and allow for more certainty for revenue collection. For these reasons, the USA group tax system has been investigated.

7.3.1. QUALIFYING GROUP REQUIREMENTS

Parent Company

In order for consolidation to apply, the parent must be a domestic corporation that is the ultimate parent company. This means that the share capital of the parent may not be 80% owned, directly or indirectly by another company that would be an eligible parent.

Subsidiary Company

Subsidiaries are required to be domestic corporations where at least 80% of the shareholding and voting rights are owned by the parent company.

All group members are required to have the same tax years¹⁷⁶.

¹⁷⁴ Jones Day, Group Taxation: Pages 10 to 12

¹⁷⁵ Ibid. Pages 10 to 12

¹⁷⁶ Ibid. Pages 12 to 14

It follows that for a group to participate in the USA group consolidation tax, there needs to a domestic corporation with at least 80% ownership in at least one subsidiary.

7.3.2. MECHANICS OF THE SYSTEM

The consequences of a consolidation model of group tax is that the entire group of participating companies are seen as one unit for tax purposes¹⁷⁷. This results in intra-company transactions and more specifically, the internal transfer of assets, being disregarded for tax purposes until such time that those assets are transferred to outside parties.

Profits and losses are consolidated at parent level which has the effect of offsetting group profits with group losses¹⁷⁸. Losses that have been accrued to members prior to their participation in the group are disallowed to be offset against group profits. These losses may only be offset against the entities' own future profits¹⁷⁹.

Similar to that of the UK legislation, where a corporation is resident in the US but also subject to tax in another jurisdiction, then, any losses incurred by that company are disallowed in so far as those losses may be allowed as a deduction in the other jurisdiction¹⁸⁰.

7.3.3. ELECTION

Election must be made by the due date of the group parents tax return for the tax year in which consolidation is to be adopted, which is generally 9 months after the end of the fiscal year. For the first consolidated year, all group members to which it is to apply must sign a consent form formalising their agreement to consolidate.

All qualifying subsidiaries are forced to form part of the group consolidation. This means an "all in" or "all out" approach¹⁸¹.

7.3.4. TERM

There is no minimum term for which a group may elect to participate in group taxation. Groups may voluntarily terminate their full participation in group taxation, however, they will need to complete consolidated returns until such time that their termination request is approved¹⁸².

¹⁷⁷ DTC Report: Page 68

¹⁷⁸ Ibid. Page 68

¹⁷⁹ Jones Day, Group Taxation: Page 13

¹⁸⁰ Ibid. Pages 12 to 14

¹⁸¹ Ibid. Pages 12 to 14

¹⁸² Ibid. Pages 12 to 14

7.3.5. TERMINATION OF THE GROUP

Where the group ceases to meet the qualifying requirements of a group, mandatory termination of consolidation group tax will come into effect.

Where a group terminates its participation in group taxation the following repercussions will take effect:

- Gains or losses on intercompany transactions that were previously disregarded get recognised;
- Entities will be required to submit individual tax returns; and
- The utilization of unused net operating losses and capital loss carry overs become subject to limitations

7.3.6. LEAVING THE GROUP

A group member may only leave the group if the requirements of the group cease to be met. The groups may remain intact for purposes of group tax unless the leaving group is the parent of the group. Upon leaving the group, previously deferred capital gains may be triggered¹⁸³.

If a group member ceases to be a member then the corporation may not be included in any consolidated return filed by the group or by any other tax group having the same common parent before the 61st month (5 year) after the first year in which the company ceased to be a member¹⁸⁴.

7.3.7. TAX RETURN SUBMISSION

The group is required to submit a single tax return by the parent on behalf of the consolidated group¹⁸⁵.

7.3.8. TAX LIABILITY

Tax liability of the group becomes payable by the parent company; however, the members may be held jointly and severally liable for the entire consolidated tax liability should the parent default¹⁸⁶.

Funds may be transferred to the parent company through normal consolidation rules to fund the tax liability of the group.

¹⁸³ Ibid. Pages 12 to 14

¹⁸⁴ Ibid. Pages 12 to 14

¹⁸⁵ Ibid. Pages 12 to 14

¹⁸⁶ Ibid. Pages 12 to 14

7.3.9. FOREIGN ENTITY PARTICIPATION

There is no provision for foreign entity involvement in the US group tax system¹⁸⁷.

7.4. KEY TAKE-AWAYS

From the above analysis of the two countries and their respective group tax systems, there are some key features that stand out.

- Both of the countries investigated have provisions within their group tax systems which allow for loss sharing and tax neutral transfer of assets between group members.
- 100% ownership in subsidiaries are not required, however, substantial control is.
- There is a consensus to disallow the use of pre-group accumulated losses.
- There are consequences of leaving the group or ceasing to participate in group tax. The result of which is that it may trigger tax consequences of previously deferred taxes.
- No minimum participation period has been prescribed
- The UK group tax system allows for foreign participation, while the USA system limits participation to domestic entities.
- It is noted that neither of the countries investigated have placed ownership or turnover limitations on participating groups.

These take-aways will be used to assist in the author's drafting of a group tax proposal for South Africa in the next chapter.

¹⁸⁷ Ibid. Pages 12 to 14

CHAPTER 8

8. GROUP TAX PROPOSAL

8.1. INTRODUCTION

Group tax, as discussed in chapter 3, is a system whereby groups are taxed on a more unified approach as opposed to their members being treated and taxed independently. This results in various tax reliefs with the most prominent one being that of profit and loss off-setting for tax purposes.

This chapter will set out a proposed tax system, based on a set of pre-determined objectives, which it will aim to achieve as well as the research contained in the preceding chapters. The focus of this proposal will be to set out a group tax system for tightly-held groups of companies in South Africa. This, however, does not imply that the system will be more beneficial to tightly-held groups over any other groups. The rationale for focusing on tightly-held groups will be expanded on later in the chapter.

The conclusion will contain a summarised assessment of the proposal based on the objectives it set out to achieve.

8.2. OBJECTIVES OF THE PROPOSAL

The objectives of group tax, as identified in chapter 3, generally comprise of two key reliefs provided to participating corporate groups.

1. The allowance for profits to be offset by losses between group member entities
2. The tax neutral movement of assets between members of a group.

While the above objectives are fundamental to a group tax system, this proposal will attempt to go beyond that and attempt to be creative in instating a system that will also look to encourage development and growth in tightly-held businesses through tax policy.

These objectives have already been provided in chapter 1 under the research question, however, they are restated below for completeness and ease of reference:

- Encourage group formation through reduced compliance requirements and favourable taxing conditions;
- Encourage business activity by providing more favourable conditions in which to conduct business;
- Encourage and promote the longevity of businesses;
- Provide South Africa with an entry into group taxation without over-exposing the fiscus to a reduction in revenue collection

The objectives, as stated above, will be aimed to be achieved for tightly-held groups of companies participating in the proposed group tax system.

8.3. GROUP TAX PROPOSAL

8.3.1. WHAT SHOULD CONSTITUTE A GROUP

A group for the purposes of this proposal should be a tightly-held group as defined in chapter 2.

8.3.1.1. RATIONALE FOR TIGHTLY-HELD GROUPS

The author acknowledges the possible benefits that a group tax system may have to businesses and the economy of South Africa. However, it also understands the potential drawbacks that are associated with group tax.

The main drawbacks, as identified through the research include:

- The potential loss to fiscus due to the increased tax relief provided to taxpayers
- The difficulty of SARS and tax practitioners to implement a new tax system

With the above in mind, the author has selected tightly-held groups, together with their qualifying criteria stated below, to be the initial audience of a group tax system in South Africa. The limited audience has the effect of limiting the exposure of the fiscus to reductions in its revenue collection.

Further to this, as stated upfront, this proposal aims to encourage and develop small businesses and has thus elected to focus group tax and its associated benefits and reliefs on these businesses.

8.3.2. QUALIFYING CRITERIA

Where a group of companies meets the requirements of a tightly-held group as defined in this dissertation, they may be able to participate in group tax should the group meet the below qualifying criteria.

8.3.2.1. PARENT REQUIREMENTS

The parent company is required to be the ultimate parent of the group. In terms of section 41, to which the group definition of this proposal is based, all companies within the group are required to be South African registered and resident companies whose income falls within the tax net of South Africa.

The requirements of the USA provision are similarly limited to domestic corporations¹⁸⁸. This is opposed to the UK provision that allows any corporation to be the parent of the group – domestic or foreign¹⁸⁹. The approach taken by the USA provision has been favoured for use in this proposal as the author is not looking to propose foreign inclusion in group tax.

¹⁸⁸ John Day, Group Taxation: Page 12

¹⁸⁹ Ibid. Page 10

8.3.2.2. *SUBSIDIARY REQUIREMENTS*

In order for subsidiaries to qualify to form part of the group for purposes of this proposal, the parent is required to meet the following shareholding requirements in group members.

Shareholding in subsidiaries are required to meet the requirements as set out in section 41 of the Act as detailed in chapter 2. Careful consideration, of which the rationale is discussed below, has been given to requiring subsidiaries to be wholly owned by the parent, however, the author has decided against this. Instead, the following ownership criteria of subsidiary are required:

- a) 100% ownership by the parent company; OR
- b) At least 70% ownership by the parent company with the remaining equity shareholding to be held by a direct family member as defined.

The rationale for this is that, as noted in chapter 2, a benefit of a group structure is that it allows direct shareholding for minority shareholders in certain trades (where conducted in separate group member entities) without the parent shareholders having to part with shares in the entire business.

With this in mind, this proposal aims to provide for flexibility to shareholders who may wish to invite additional minority shareholders¹⁹⁰ in specific entities without having to part with shares in the parent company. Shareholders may wish to invite additional shareholders to subsidiaries to meet capital requirements and to attract, motivate and hold onto key employees. These additional shareholders would be subject to the family shareholder requirements.

The recommendation to include non-wholly owned subsidiaries goes against the recommendation of the Katz Commission who recommended that only wholly owned subsidiaries be allowed to participate. This was part of its recommendation of a gradual approach to a full group tax system.

The subsidiary requirements are, however, in line with the requirements of the UK and USA group tax provisions which both allow non-wholly owned subsidiaries to participate¹⁹¹. As is the case with this proposal, both these countries do however, require substantial control of the equity holding.

8.3.2.3. *GROUP TURNOVER*

The proposal will set a limitation of R20m on the annual combined turnover of the group to be allowed to participate in group tax. The turnover limit for individual participating entities is R5 million per entity.

The limitation of R20m was chosen using the guidelines provided in the requirements for Small Business Corporations as defined in the tax Act¹⁹².

It is noted that there is no turnover limitation placed on companies either the USA or the UK. However, the turnover limitation been proposed to limit the potential loss to fiscus as well as to focus relief on smaller businesses.

¹⁹⁰ Subject to them meeting the family ownership requirement

¹⁹¹ Jones Day, Group Taxation: Pages 10 and 12

¹⁹² Section 12E(4) of the Tax Act

8.3.3. GROUP TAX IMPLEMENTATION

Further to the above qualifying requirements, the DTC has provided the fundamental items¹⁹³ that need to be established in order to propose a comprehensive group tax system. These items are provided below.

8.3.3.1. GROUP TAX MODEL

In line with one of the objectives of this proposal to reduce the compliance burden on participating groups, the ideal model of group tax implementation would have been the consolidation model. As noted in chapter 3, the consolidation model allows the parent of the group to submit a single tax return on behalf the participating members of the group. However, based on the research conducted in the previous chapters, the author has decided against proposing the consolidation model of group tax.

As noted in chapter 5, where the Commissions of Inquiry were discussed, the Margo and Katz Commissions had eventually recommended that if group tax is to be implemented in South Africa it should be implemented via the consolidated model. The rationale for this conclusion was their view of the consolidation model being less complex than the group relief model. These reports were of course issued prior to the introduction of the corporate rules.

Upon investigation into the DTC report, it became apparent, that a group relief model would be better suited to the current tax system in South Africa. The DTC report's view was that the corporate rules seemed to have paved the way towards an eventual group relief group tax system whereby the transfer of losses between group entities would be a simple addition to the existing corporate rules. As noted in chapter 6, this view had been shared with a view in the professional opinion chapter where it had been stated that, "Looking at the road South Africa has already travelled over the past decade, the UK group relief approach seems the most appropriate way forward"¹⁹⁴.

The implementation of a group relief model of group tax poses a challenge to the proposal's ability to allow a single tax return submission and thereby reduce the compliance requirements of participating groups.

Further to this, a consolidation model of group tax would be counterproductive to what has already been achieved by tax legislation. The corporate rules have been noted to already allow for the tax neutral transfer of assets between group entities. A consolidated group tax system would add complexity and uncertainty regarding the application of the existing rules.

For these reasons, the view of the DTC report which recommends a group relief model of group tax has been accepted and supported by this dissertation. Albeit, at the expense of not being able to reduce the compliance requirements through single tax return submissions.

¹⁹³ DTC Report: Page 78 to 83

¹⁹⁴ Lerner, D, Group Tax: Just a small step away – SAICA: Page 2 – SAICA Communique News Service – Accessed 11 October 2018

8.3.3.2. TAX LOSSES

It is proposed that tax losses of group members would be allowed to be used to offset against group profits. The tax losses that may be used to offset profits would however, be limited to:

- losses incurred only from when the relevant member company had met the requirements of being part of the group in question
- losses may only be utilized by the group such that they were accumulated after the group commenced participating in group taxation.

Pre-group tax and pre-grouping losses may only be set off against the entities' own future income. This has been deemed to be a necessary complexity by the author, as it will limit the loss to the fiscus and discourage the trafficking of losses. Without this provision, groups may acquire companies that have an existing assessed loss in order to derive a tax benefit to the group in the future under a group tax system.

The provision to limit the use of pre-group and pre-group tax losses, in determining group taxable income under a group tax system is in line with the provisions of the USA group tax legislation¹⁹⁵.

8.3.3.3. ASSET TRANSFER

Similar to the provisions contained within the UK tax system¹⁹⁶, the tax neutral transfer of assets within the group will not form part of the group tax provisions. Companies participating in group tax will continue to have access to the provisions of the corporate rules which, as noted in chapter 4, allows for the tax neutral transfer of assets between companies within the same group.

It is proposed, however, that qualifying¹⁹⁷ groups of companies have the anti-avoidance provisions in section 45 relaxed to the extent that the 18-month rule should not apply where companies transfer the assets within group between participating entities. This is to allow qualifying groups flexibility to position its assets in the most efficient manner within the group without the effects of adverse tax effects as a limitation.

Concerns relating to the 18-month anti-avoidance rules have also been included in the DTC report¹⁹⁸. It was submitted that "Taxpayers perceive the 18-month anti-avoidance rule as unnecessarily strict, unfair, and harsh and regard it as not contributing to fiscal neutrality¹⁹⁹. The anti-avoidance provision has also been criticized as being "too long and unrealistic in a modern world where business opportunities emerge at an accelerated pace"²⁰⁰.

¹⁹⁵ Jones Day, Group Taxation: Page 13

¹⁹⁶ Omar, S (2009), Group taxation in South Africa – A contextual analysis. Page 21

¹⁹⁷ In terms of the qualifying criteria stated in this chapter to which groups may participate in group tax.

¹⁹⁸ The DTC Report: Page 58 and 59

¹⁹⁹ SN Middelmann A study of the applicability of a system of group taxation in South Africa. (2003). University of Pretoria.

²⁰⁰ The DTC Report: Page 59

The UK intracompany provision contains a 6-year de-grouping anti-avoidance provision, however, does not place limitations, through the triggering of tax consequences, on when the asset may be sold²⁰¹.

8.3.3.4. *ELECTION*

In terms of the USA group tax provision, the parent company is required to elect on behalf of the group if it will be participating in group taxation. All eligible companies within the group are required to follow the parent's election²⁰². The UK does not have an election provision, however, requires the consent of the surrendering company to be submitted in writing to the revenue authority to allow its losses to be utilized by the receiving company.

In order to maintain control of the participating companies, this proposal recommends that companies wishing to participate in the provisions of group tax are to submit their election to SARS together with supporting documentation confirming their conformance to the qualifying requirements.

Non-qualifying companies within the group would not disqualify the entire group from group taxation unless the group's turnover limitation has been exceeded. In all other cases, qualifying companies may participate while non-qualifying companies would be required to follow normal corporate tax legislation.

Election is to be made not less than 3 months prior to due date of the companies' annual tax return submission.

8.3.3.5. *TERM*

Once election is made by the parent on behalf of the group to apply group taxation, they will be required to resubmit their election forms together with its supporting documents to confirm conformance with the participating requirements.

The USA provision allows the automatic re-election of group tax for subsequent years. However, due to the stringent participation requirements of this proposal, the author is of the view that companies could easily fall out of the allowable participation requirements. To avoid having companies slip through and continue to unduly benefit from group tax provisions, the author recommends annual re-election.

As was the case with initial election, re-election should be required not less than 3 months prior to the due date of the companies' annual tax return submission.

²⁰¹ John Day, Group Taxation: Page 11

²⁰² Ibid. Page 12

8.3.3.6. *TERMINATION OF GROUP TAX*

Group tax would be terminated for the following reasons:

- Where a group no longer meets the requirements of the group tax provision
- Where a company is no longer part of the participating group

Where the group tax is terminated as a result of the reasons stated above, the member companies will be required to revert back to conventional tax laws.

Where termination occurs as a result of de-grouping, standard anti-avoidance provisions will be applicable in terms of the corporate rules. This includes the realization of capital gains that had been deferred as a result of it being an intra group transaction. This is the case with the UK and USA group tax provisions²⁰³.

Any unutilized accumulated losses available on termination will only be available for use by the relevant company to which it belongs.

8.3.3.7. *TAX RETURN SUBMISSION*

Ideally, the author would have liked to have proposed a single tax return submission on behalf of the group to reduce compliance requirements as is the case with the USA²⁰⁴. However, this would not have been appropriate given that the proposal has recommended a group relief model of group tax.

The proposal therefore follows the UK provision which requires each participating to submit its own tax returns after taking into account any loss transfer that had occurred within its books²⁰⁵. It has thus been conceded that the proposal would not be able to reduce compliance requirements in terms of a single tax return submission for the group.

8.3.3.8. *TAX LIABILITY*

Tax liability will be calculated and payable on each tax return submission by the relevant participating companies. Other group companies may be allowed to pay taxes on behalf of other group entities²⁰⁶.

The UK provision states that group members are not jointly and severally liable for aggregate group tax liabilities but are only liable for their own tax affairs²⁰⁷. This is different to the USA provision that holds each member entity jointly and severally liable for the entire liability of the group²⁰⁸.

²⁰³ John Day, Group Taxation: Pages 12 and 13

²⁰⁴ Ibid, Page 14

²⁰⁵ Ibid. Page 12

²⁰⁶ This is to allow for cases where profits have been transferred to struggling entities that would be unable to fund tax payments.

²⁰⁷ Ibid. Page 12

²⁰⁸ Ibid. Page 14

To protect the fiscus, it is proposed that upon failure by a participating company to settle its tax liability, SARS may hold the participating companies liable to the extent of the taxes that they would have had to pay had they not participated in the group tax provision.

8.4. CONCLUSION

The proposal set out above has attempted to meet a set of stated objectives aimed at developing and growing small businesses. The proposed group tax system is to follow the group relief model whereby group entities would be allowed to transfer their assessed losses between each other. This would be coupled with the existing set of corporate rules, which as seen in chapter 4, allows for the tax neutral transfer of assets between entities within the same group. These reliefs, together, satisfy the core objectives of a group tax system as identified in 8.2 above.

In addition to the core objectives noted above, the proposal aimed to achieve a set of secondary objectives focused on developing and growing small businesses.

It is the opinion of the author, that the implementation of a group tax system would encourage the formation of group structures. This would be achieved through the reliefs provided by the proposed system together with the benefits of groups discussed in chapter 2. Together, this would improve on the current conditions in which to conduct business. Participating businesses would be buoyed with the peace of mind knowing that risks of new ventures could be separated while any losses incurred could be used to offset profits of their other operations. The separation of risks also improves the longevity outlook of a business as the remaining operations are unaffected should a separated trade find itself in financial difficulty.

The proposal has set out strict qualifying criteria which limit the participation in it. As noted previously in this dissertation, a drawback of group tax is the potential reduction in revenue collection for the fiscus as relief is provided to taxpayers. This becomes especially important for developing countries that need to maximize their tax collection to see to the needs of the country.

Further to this, the limitations applied by the proposal which limits the qualifying audience, has the effect of focusing the potential reliefs and benefits of the proposal on smaller businesses.

Included in the objectives aimed to be achieved by the proposal was to propose a system that would result in a reduction in compliance requirements for businesses that participate in it. As noted in 8.3.3.1. above this objective has been hindered by strong evidence to suggest that a group relief model would be better suited. As a result of this, qualifying businesses would need to accept the benefits associated with groups together with the reliefs that would be provided under the proposed system as sufficient encouragement to form group structures.

CHAPTER 9

9. NUGENT COMMISSION OF INQUIRY

9.1. INTRODUCTION

Throughout the research conducted into group tax thus far, there has been a common concern relating to the complexities of a group tax system and the ability of SARS to be able to maintain it. As stated in the DTC report, one of the reasons that group tax not been implemented in South Africa is due to inadequate resources at SARS²⁰⁹. However, there have also been arguments that SARS has reorganised itself in the past 10 years and that it is capable of handling group tax.

Fortunately, for the purposes of this dissertation, there has been a Commission set up in order to assess the current position of SARS. What follows in this chapter is the findings of the interim report of this Commission which will provide clarity on the ability of SARS to adequately transition the current tax legislation towards a group tax system.

9.2. BACKGROUND

In his State of the Nation address, President Cyril Ramaphosa committed to taking steps to stabilise SARS, restore its credibility and strengthen its capacity to meet revenue targets. In this regard, on 23 May 2018, the President appointed a Commission of Inquiry into tax administration and governance in the South African Revenue Services (the Commission²¹⁰)²¹¹.

The Commission is chaired by retired Justice Robert Nugent. Professor Michael Katz, Advocate Mabongi and Mr Vuyo Kahla are assisting him. The Commission was mandated, in summary, to provide an analysis of the current state of SARS and to provide recommendations for improvement should it be required²¹². In this regard, the Commission released an interim report titled, Commission of Inquiry into the Tax Administration and Governance by the South African Revenue (the report) Service on 27 September 2018²¹³.

²⁰⁹ DTC report: Page 78

²¹⁰ This short-hand is limited to use chapter 9 when referring to the Nugent Commission

²¹¹ The Presidency (2018): President Ramaphosa establishes commission of inquiry into tax administration and governance of SARS

²¹² Ibid. Page 1

²¹³ Nugent Commission Report: Page 1

9.3. FINDINGS

The Commission was deeply concerned about the current state of affairs at SARS. The concerns as provided by the report are summarised below²¹⁴.

9.3.1. CURRENT STATE OF SARS

On the instatement of Mr Moyane as Commissioner of SARS there has been a halt in the development of information technology (IT) systems. This has led to the degeneration of SARS' IT infrastructure. A submission from an IT company contracted to provide an assessment of SARS' IT systems painted a dim view in declaring that SARS' IT systems were in disarray²¹⁵.

Further to this, there have been around 200 employees in managerial positions that have been removed from their posts and moved into positions of lesser importance and effect. This has led to the resignation and wastage of expertise of key personnel at SARS²¹⁶.

SARS has shown a lack of cohesion with other key state organs such as Treasury, the Auditor General, the Davis Tax Committee and the Financial Intelligence Centre. SARS' reputation is far from ideal due to media reports which are largely seen to be true²¹⁷.

The Commission has expressed concern about the senior management at SARS that have allowed the state of affairs at SARS under Mr Moyane to have deteriorated to such a degree. In 2014, Mr Moyane disbanded the Executive Committee (EXCO) of SARS on the grounds of unconfirmed allegations of the infamous rogue unit that was allegedly operating within SARS. In 2015, Mr Moyane acted to reinstate the EXCO by appointing new personnel to the committee. Only two of the new appointees were selected from within SARS. The rest were brought in from outside with little to no experience in tax collection. By 2017, the two employees brought in to the EXCO from within SARS were no longer in those positions. This resulted in the wealth of knowledge and experience of the pre-Moyane era to have been completely eradicated in the EXCO²¹⁸.

"The air at SARS reeks of intrigue, fear, distrust and suspicion"²¹⁹. This is quoted directly from the interim report issued by the Nugent Commission which points to an institution that has fallen to well beneath where it should be in terms of its integrity and capabilities.

9.3.2. FORMER STATE OF SARS

Prior to Mr Moyane taking office at SARS as the Commissioner, SARS was proving itself to be a competent organ of the state earning itself accolades domestically and internationally. The model adopted by SARS at the time was based on three legs:

²¹⁴ Ibid. Page 1

²¹⁵ Ibid. Page 15

²¹⁶ Ibid. Page 15

²¹⁷ Ibid. Page 15

²¹⁸ Ibid. Pages 16 to 17

²¹⁹ Ibid. Page 14

1. Education
2. Service
3. Enforcement²²⁰

The organisation was structured to meet the objectives of reversing non-compliance with tax laws. SARS had implemented the IT system that is currently still being utilized today to move away from manual paper systems which improved efficiency for SARS and taxpayers alike.

The online system made data capturing easier allowing analysis for trends to be observed which provided an improved basis on which revenue planning could be conducted. There were measures in place to combat illicit trades which had the potential to deny SARS their share of revenue collection.

Employees were generally behind the ethos of what SARS should represent which provided for a vibrant and dedicated environment that was efficient and continuously improving in what they were set out to do²²¹.

The state at SARS at the time had led the DTC and industry professionals to applaud the strides that SARS had taken to become one of the more efficient organs of the state.

Under the leadership of Mr Moyane, however, this has all since been eroded and the once competent organ of the state is now in dire need of revitalisation²²².

The degeneration of SARS has compromised the ability of SARS to correctly collect revenue to the benefit of delinquent taxpayers and illicit trades²²³.

9.4. RECOMMENDATIONS

The Commission identified SARS as an institution that is vital to the welfare of the country. It is an organisation that controls the flow of more than R1 trillion in revenue collection through the year and is thus vulnerable to corruption. For this reason, SARS requires leadership and staff of the highest quality and integrity to manage the organisation. Proper governance of SARS is required which requires an amendment of the legislation that governs it. In order for SARS to operate at optimum efficiency for its mandated purposes, it requires long-term certainty and stability which is currently not present²²⁴.

The effectiveness of tax administration is achievable through the use of up-to-date IT systems. As noted above, SARS' IT systems are in disarray and in need of attention²²⁵. This, together with the findings stated above have resulted in the poor position that SARS currently finds itself in.

The interim report identified two key recommendations that should be affected immediately, without which, the poor performance and levels of operations of SARS are set to continue.

²²⁰ Ibid. Page 13

²²¹ Ibid. Page 14

²²² Ibid. Page 13

²²³ Ibid. Page 15

²²⁴ Ibid. Page 9

²²⁵ Ibid. Page 23

The recommendations are:

1. The President needs to take steps without delay to remove the current Commissioner of SARS, Mr Tom Moyane, from office.
2. The President needs to take steps without delay to appoint a new Commissioner of SARS²²⁶.

The Commission has cautioned, worryingly, that the removal of Mr Moyane and the instatement of a new Commissioner at SARS is only but the first step on the road to recovery. The remaining steps to follow are to be outlined in the final report²²⁷.

9.5. CONCLUSION

What has transpired subsequent to the release of the interim report, is that the President has acted on the recommendation of the Nugent Commission interim report and removed Mr Moyane from his position as Commissioner of SARS²²⁸.

What can be seen from the findings of the interim report into the state of affairs of SARS is that SARS is currently in a state of disarray. The concerns of the Commissions of Inquiry discussed in the previous chapters regarding the complexity of a group tax system have been given extra significance based on the findings of the interim report contained in this chapter. The decision on whether or not to instate a group tax system needs to be viewed with this background in mind.

²²⁶ Ibid. Page 30

²²⁷ Ibid. Page 29

²²⁸ Barry Bateman (2018): President Ramaphosa fires Tom Moyane as SARS Commissioner - EWN

CHAPTER 10

10. CONCLUSION AND RECOMMENDATIONS

Through this dissertation, as provided in the research question, the author set out to determine whether or not it would be beneficial for South Africa to incorporate a group tax system into its legislation that will, initially, only be aimed at tightly-held qualifying groups. In answering this question, an investigative process had been followed that provided arguments for and against instating group tax in South Africa. These findings had been used to propose a group tax proposal for South Africa and thereafter conclude on the research question as provided below in this chapter.

Group tax is a system that provides tax relief to corporate entities that operate within a group of companies. Its core objectives are to allow flexibility of asset ownership through tax neutral transfers within the group as well as allowing the sharing of assessed losses between member entities.

Admittedly, these core objectives of group tax can be achieved through conducting a multi-trade business under a single divisionalised entity. This way, assets can be transferred from one division to another while losses of trades are offset with profits of the others. However, as noted in chapter 2 of this dissertation, there are strong business rationale that favour the necessity for group structures in conducting business. Further to this, there is widespread agreement that groups are necessary in conducting business as was seen in the Margo report, as well as the Tickle article reviewed in chapter 6.

Following on from the above, the view that group structures are necessary and sometimes required to promote business has been accepted. This is based on the key benefit of groups, as discussed in chapter 2, which provide limited liability that separates the risks of entities within a group. The limitation of risk protects the operations and asset base of other trades, should a trade find itself in financial difficulty. This provides for potential increased longevity of businesses while boosting investor confidence.

Group tax, as identified in chapter 3, takes the benefits associated with groups a step further. It allows groups to be treated similarly to divisionalised entities for tax purposes, while granting businesses access to the benefits of groups. Under a group tax scenario, shareholders can be more confident in expanding their businesses through the addition of trades knowing that, firstly the risks could be separated and secondly, any losses incurred could be offset against profits from the other group entities. This, together with the other benefits discussed through the dissertation, champion the argument for group tax to be implemented.

As set out in chapter 4, the current corporate rules cater for the tax neutral transfer of assets between group entities, however, there does not exist any provisions that allow losses to be shared between group member entities. It was thus concluded, that current legislation contains elements of group tax in that it allows for assets to be transferred tax neutrally between corporate group members, however, lacks any form of loss sharing provisions. In fact, legislation, through its anti-avoidance measures, actively prohibits the sharing of losses between corporate entities.

After investigating the Commissions of Inquiry that had included in their reports, recommendations regarding group tax, a common theme has been found. Concerns relating to the likely reduction in revenue collection to the fiscus and the complexity of the system had been key concerns that resulted

in two of the three reports (Margo Commission and DTC reports) investigated, having recommended against the implementation of group tax at the time of reporting. These concerns have been identified as possible reasons as to why group tax has not already been instated.

The most recent of the Commissions of Inquiry, and as a result probably the most relevant, was the DTC report. The DTC report suggested in its recommendations that group tax should not be entered into until such time that the economy is strong enough to withstand its potential drawbacks. This view seemed to contrast with the opinions of professionals expressed in publicly published articles in which it was indicated that group tax was seen as a necessity during tough economic times as a means to promote the survival of tax paying entities.

Rationale for this was however noted, as during the period in which the DTC conducted their work, SARS had been in a poor state of affairs which had compromised revenue collection. Nevertheless, it was drawn from the articles provided in chapter 6, that group tax could be instated during tough economic periods as a means to provide relief to businesses.

An investigation was conducted into the mechanics of the UK group relief system as well as the USA consolidation system. The findings provided useful guidelines in drafting a proposal with the UK system providing insight into the group relief model and the USA legislation providing mechanisms that limit losses and uncertainty to the fiscus. These findings were combined and adapted to the proposal drafted in this dissertation, as set out in chapter 8.

The proposal, in chapter 8, has set out to achieve a set of goals which included the core objectives of a group tax system. As alluded to in the research question, the proposal aims to provide for a group tax system for tightly-held groups as defined in chapter 2. The rationale for electing tightly-held groups of companies as the beneficiaries of group tax relief is two-fold: to encourage development and growth in the smaller businesses while simultaneously limiting the possible adverse effects associated with group tax, in particular the impact on revenue collection.

The proposal's limiting participation criteria have the effect of focusing these improved business conditions and tax reliefs on the smaller businesses with the hope that it may stimulate growth and development of these businesses. Further to this, the limited participation, and hence limited loss to fiscus suggested by the group tax proposal is in line with the understanding that developing countries need to maximise revenue collection in order to tend to the maintenance of the country.

The author of this dissertation opines that the proposal, as submitted in chapter 8, has achieved a middle ground between what is currently in place and a full-on group tax system. Although, implemented differently, the proposal is in line with the view of the Katz Commission to take a gradual approach to group tax as well as an opinion contained within the DTC report that tax legislation should not be implemented bearing only revenue collection in mind but should take a long-term view. "The tax cash outflow can, unnecessarily result in the demise of groups, essentially killing the goose that will lay the future golden egg for the fiscus"²²⁹.

The author thus recommends that steps towards the implementation of group tax for tightly-held groups of companies, as submitted in the proposal in chapter 8, should be taken.

With the above being submitted, the author also bears in mind the current position of SARS as identified in the interim Nugent Commission report. In light of the current leadership and resource crisis in which SARS finds itself, it would seem reckless to implement a new system of this magnitude.

²²⁹ DTC Report: Page 77

This is especially significant given the common agreement found through the research conducted that group tax would add great complexity to the current tax system. However, steps have been taken since the release of the interim Nugent report to resolve the issues identified. As has been acknowledged in the preceding chapters, SARS has previously shown itself to be an efficient organ of the state when under sound management.

Based on the current position of SARS, it is submitted that the recommendation to implement a group tax system for tightly-held groups of companies should be delayed until such time that SARS has re-established itself as an efficient organ of the state.

AREA FOR FURTHER RESEARCH

As identified in this dissertation, legislators in developing countries may be reluctant to implement a group tax system and offer loss sharing reliefs between group entities because of the resultant loss to fiscus that may occur.

Consequently, further research has been identified that could be delved into to investigate the exposure of the fiscus to the various groupings of taxpayers that could be allowed participation in group tax.

Having an idea of the possible exposure to an initial reduction in revenue collection for the fiscus may allow for adequate planning which could alleviate uncertainty and provide confidence to implement group tax.

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