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GROUP TAXATION IN SOUTH AFRICA – A CONTEXTUAL ANALYSIS

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SUBMITTED TO THE UNIVERSITY OF CAPE TOWN

In partial fulfilment of the requirements for the degree MCom (Taxation)

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Date of submission: 15 August 2009

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DECLARATION

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Table of Contents

Chapter	Page
1. Introduction	1
2. What is Group Taxation?	3
2.1 What is the significance of group taxation in a South African context?	3
2.2 What is a Group Taxation regime?	6
2.2.1 The Organschaft Regime	6
2.2.2 The Group Contribution Regime	7
2.2.3 The Group Relief Regime	7
2.2.4 The Consolidation Regime	8
3. Group Taxation in an international context: Australia and the UK	9
3.1 Group Taxation in Australia	9
3.1.1 General	9
3.1.2 Implications of consolidation	11
3.1.3 Implications of exiting the consolidated group	13
3.1.4 The Fiscal Unity consolidation model	14
3.2 Group Taxation in the UK	16
3.2.1 Group Relief	17
3.2.2 Consortium Relief	19
3.2.3 Intra-group transfers of assets	21
3.2.4 Consolidation and group relief regimes contrasted	21

Table of Contents (cont.)

Chapter	Page
4. The Margo and Katz Commissions of Inquiry	23
4.1 The Margo Commission	23
4.1.1 Arguments in favour of the introduction of the consolidation group tax regime	26
4.1.2 Arguments against the adoption of the consolidation group tax regime	27
4.2 The Katz Commission	28
4.2.1 Advantages	30
4.2.2 Disadvantages	31
4.2.3 The Commission's view on whether or not group tax should be adopted in South Africa	32
5. Developments subsequent to the Katz Commission	36
5.1 The 2001 Amendment Act	37
5.2 The 2002 Amendment Act	39
5.3 Subsequent Amendments	40
6. The Corporate Rules and Group Taxation	41
6.1 Section 41	42
6.1.1 A 'group of companies'	42
6.1.2 Other Important Provisions	43
6.2 Asset-for-share transactions	43
6.2.1 General Requirements	44
6.2.2 Roll-over relief	45
6.2.3 Anti-Avoidance provisions	46
6.2.4 The existence of any group taxation provisions in section 42	47

Table of Contents (cont.)

Chapter	Page
6.3 Amalgamation transactions	48
6.3.1 General Requirements	48
6.3.2 Transfer of assets by the amalgamated company in exchange for shares in the resultant company in terms of an amalgamation transaction	49
6.3.2.1 Roll-over relief	49
6.3.2.2 Anti-Avoidance provisions	51
6.3.3 Disposal of shares in the amalgamated company and the transfer of shares in the resultant company from the amalgamated company to its holding company	51
6.3.3.1 Roll-over relief	51
6.3.3.2 Anti-Avoidance provision	52
6.3.4 The existence of any group taxation provisions in section 44	53
6.4 Intra-group transactions	54
6.4.1 General Requirements	54
6.4.2 Roll-Over relief	54
6.4.3 Anti-Avoidance provisions	55
6.4.4 The existence of any group taxation provisions in section 45	56
6.5 Unbundling transactions	57
6.5.1 General Requirements	57
6.5.2 Roll-Over relief	58
6.5.3 The existence of any group taxation provisions in section 46	59
6.6 Transactions relating to liquidation, winding-up and deregistration	59
6.6.1 General Requirements	59

Table of Contents (cont.)

Chapter	Page
6.6.2 Roll-Over relief	60
6.6.3 Anti-Avoidance provisions	61
6.6.4 The existence of any group taxation provisions in section 47	61
7. Other Group Taxation reliefs in the tax legislation	63
7.1 Provisions in the Income Tax Act which could be construed as containing group taxation type provisions (other than the corporate rules)	63
7.1.1 Connected Persons Definition	63
7.1.2 Controlled Foreign Companies	64
7.1.3 Section 24I(10) of the Income Tax Act	65
7.1.4 Donations Tax	67
7.1.5 Dividends and STC	68
7.1.6 Deemed Dividends	70
7.1.7 The 8 th Schedule to the Income Tax Act	71
7.1.7.1 Paragraph 12	71
7.1.7.2 Paragraph 39	72
7.1.7.3 Paragraph 64B	72
7.2 Elements of group taxation existing in other South African tax legislation	73
7.2.1 The VAT Act	73
7.2.2 The Transfer Duty Act	74
7.2.3 Securities Transfer Tax	76

Table of Contents (cont.)

Chapter		Page
8.	Is South Africa disadvantaged by not having Group Taxation (incorporating the informal views of a senior official of National Treasury)?	78
8.1	Why have the recommendations of the Katz Commission not been implemented?	78
8.2	Was the introduction of the corporate rules only in response to the advent of CGT (as indicated in the explanatory memorandum to the 2001 amendment act), or was its introduction to some extent motivated by group taxation considerations?	79
8.3	What is National Treasury's view on group taxation?	79
8.4	What should be done	80
8.5	The way forward	81
8.6	Does South Africa need group taxation?	82
9.	Conclusion	86
10.	Area for further research	88
11.	Bibliography	89

Abstract (Executive Summary)

A group taxation regime can be defined as:

"a set of rules that enables corporate taxpayers to compute the tax liability of related corporations on a consolidated or combined basis(,) (and)...encompasses not only full consolidation, but also transfer of particular tax attributes between the members of a corporate group"¹.

This definition is very broad and group taxation could be better understood when considering the more common forms of group taxation such as the group relief regime and the consolidation regime. The consolidation regime generally involves each company within a group of companies computing its own income after which the income is consolidated at the holding company-level for tax purposes. The holding company would thereafter become liable for the group's tax², whereas a group relief regime involves the ability of losses incurred by one company in a group of companies to be transferred to another member group company³.

Does group taxation exist in South Africa? Based on the above, it would appear not. The more pertinent question that has to be answered is whether or not elements of group taxation currently exist in South African tax legislation.

The debate in terms of the introduction of group taxation in South Africa was raised for the first time by the Margo Commission of Inquiry, which ultimately decided against recommending the introduction of group taxation. The Katz Commission of Inquiry however recommended the introduction of group taxation. National Treasury has however failed to act on the Katz Commission's recommendations.

¹ Cahiers De Droit Fiscal International (2004), p.25

² Ibid. pp. 30 - 31

³ Id. p.30

It did however introduce the corporate rules in 2001. These rules were introduced to prevent adverse CGT consequences arising in a group of companies' context and provide roll-over relief on the transfer of assets. In most instances, the roll-over relief is dependant on the existence of a group of companies, for example, in terms of the intra-group provisions, the unbundling of unlisted companies, and liquidation transactions. In addition, the Income Tax Act⁴ contains many other provisions which have elements of group taxation such as, *inter alia*, section 9D (controlled foreign companies), section 64B(5)(f) (Secondary Companies Tax (STC) relief), section 64C(4)(k) (exemption from deemed dividend provisions), and paragraph 12(5) of the 8th Schedule to the Income Tax Act. Moreover, the Value Added Tax Act⁵, the Securities Transfer Tax Act⁶ and the Transfer Duty Act⁷ also make provision for tax relief in terms transactions covered by the corporate rules.

The presence of the aforementioned provisions is indicative that elements of group taxation currently exist in South Africa, and it is submitted that South Africa is not prejudiced in not having a group taxation regime in place. Whilst it appears that National Treasury has been considering the viability of the introduction of group taxation, it does not appear to be a priority.

As the South African tax base and the South African economy grows, it is inevitable that a group taxation regime would be introduced at some stage in the future. It is however submitted that South Africa does not need group taxation at this stage.

⁴ No.58 of 1962

⁵ No.89 of 1991

⁶ No.25 of 2007

⁷ No.40 of 1949

Chapter 1: Introduction

The introduction of a group taxation regime in South Africa has previously been the subject of debate in South Africa. The reports of the Margo and Katz Commissions of Inquiry (“commissions”) are cases in point. To this end, both commissions made certain recommendations in terms of group taxation and its application with reference to South Africa.

Presently, there are certain aspects of South African tax legislation, for example, the corporate rules encapsulated in sections 41 to 47 of the Income Tax Act No.58 of 1962 (“the Income Tax Act”) which bear some of the hallmarks of a fully fledged group-taxation regime, for example, the section 45 intra-group relief provisions. This fact notwithstanding, the reality is that a group-tax regime currently does not exist in terms of the South African tax legislative framework.

The aim of this research paper is, *inter alia*, to illustrate what the notion of group taxation entails. In doing so, the rationale behind its existence, as well the various forms thereof, are to be considered. This research paper will also highlight how two of the more common forms of group taxation regimes operate. In this regard, a broad overview of the regimes currently in place in Australia and the United Kingdom will be given.

The findings and recommendations of the commissions will also be revisited. The reason for this being that an assessment will be made to determine to what extent, if at all, the recommendations of these commissions have been implemented by National Treasury. In performing this assessment, the relevant provisions of the Income Tax Act, as well as other tax legislation which could be said to contain elements of group taxation, will be highlighted and discussed at a high-level. This research paper will also consider the explanatory memoranda issued by National Treasury when these provisions were first introduced, as well as the commentary of the International Fiscal Association (“the IFA”). In addition, the comments in the explanatory memoranda in terms of any subsequent legislative amendments will be highlighted. A discussion on how the current

group tax regime in the Income Tax Act and other tax legislation differs to that of a 'normal' group tax regime will also be documented.

In order to ascertain why the recommendations of the Katz Commission in particular were not fully implemented and whether or not it is envisaged that a group tax regime is to be introduced in South Africa in the foreseeable future, the informal views (based on an interview conducted) of a senior official of the Department of National Treasury will be documented and commented upon.

This research paper will conclude by evaluating whether the non-introduction of a group taxation regime has benefitted or prejudiced South African taxpayers and whether or not there are any potential benefits for taxpayers should a group taxation regime be introduced in South Africa.

University of Cape Town

Chapter 2: What is Group Taxation?

2. What is group taxation and what is its relevance in the context of South Africa?

Group taxation from a South African perspective was first considered as far back as in the latter part of the 1980's when its viability as a corporate taxation regime was deliberated upon by the Margo Commission. Its suitability in a South African context was revisited in 1995 by the Katz Commission which recommended its viability as a taxation regime for South Africa. A more detailed discussion of the findings of both the Margo and Katz Commissions is addressed in Chapter 3 below.

2.1 What is the significance of group taxation in a South African context?

This question is relevant as neither the Income Tax Act, nor any of the other South African tax legislation for that matter, make provision for group taxation in the manner in which it is generally understood. The Income Tax Act instead imposes tax, *inter alia*, on a South Africa resident corporate entity (to the extent that it is in a tax-paying position) irrespective of whether or not that company is part of a group of companies¹. This is in stark contrast to a group taxation regime where a group of companies is, for example, either consolidated into one single entity for tax purposes or where, for example, a company forming part of a group of companies, which is in a loss-making position, is permitted to transfer its losses to a profit-making company in the same group.

Notwithstanding that the South African tax legislative framework does not cater for a group taxation regime *per se*, a discussion on it is relevant as South Africa is increasingly becoming an important role-player in the international community.

Fifteen years since the advent of democracy sees South Africa as one of the most important countries on the African continent from a political and economic perspective.

¹ Paragraph (i) of the definition of 'gross income' as defined in section 1 of the Act read together with paragraph (b) of the definition of a 'resident' as defined in section 1 of the Act

South Africa is also a respected member of the international community and has, since its reintegration into the international community, become a target for foreign investors who are keen to do business in South Africa. This keenness may have been tempered to a large extent by the global economic meltdown, but the interest and willingness to invest in South Africa appears to remain.

Whilst the high cost of labour in South Africa does pose some challenges, the relatively high rate of corporate taxation (in comparison to other developing economies such as Brazil, China and some of the East-European bloc countries) acts as a disincentive to foreign companies wanting to invest in South Africa². Other disincentives include the high cost of labour in comparison to other developing economies (in this regard China and India are at the forefront in terms of their cheap cost of labour). The existence of a group taxation regime, which should reduce the effective tax rate of a group, could however act as an incentive to foreign conglomerates to invest in South Africa and to set-up business in South Africa.

In this regard, these foreign conglomerates, being fully aware that their investment would lead to an inflow of valuable foreign exchange, would undoubtedly seek to extract the highest possible return on their investment in South Africa, and one of the areas which could assist in this regard is group taxation.

South African companies, in particular, groups of companies, also stand to benefit were a group taxation regime to be implemented. Evidence of this can be seen in terms of how much the corporate sector contributes towards the national revenue, as corporate income tax is one of the most significant contributors to the total revenue collected by the South African Revenue Service (“SARS”). Total revenue collected by SARS for the 2008/2009 tax year totalled R625,57 billion rand, of which the main contributors were personal income tax (R197,07 billion), corporate income tax (R165,23 billion), and Value-Added

² Based on the corporate taxation rates highlighted in “The 2009 Worldwide Corporate Tax Guide”, Ernst & Young, EYGM Limited, 2009

Tax (“VAT”) (R153,81 billion)³. The presence of a favourable group tax regime could also inspire global companies to increase their investment spend in South Africa which in turn could lead to the generation of increased revenue, and more importantly, could potentially lead to the creation of employment opportunities, thereby contributing towards reducing the rate of unemployment in South Africa.

On the international stage, the current global economic meltdown has seen the closure of well-known financial institutions such as Lehman Brothers and also the buckling of two traditional American carmakers. Recently, the biggest carmaker in the world, General Motors, an American automobile manufacturer, filed for bankruptcy protection.

To assist with preventing similar events from occurring in South Africa, the call has been made by commentators for government to consider introducing a group taxation regime in South Africa^{4 5}. This could potentially ensure the survival of many groups as companies forming part of a group could potentially, (depending on which form of group tax regime would be implemented), be permitted to transfer their losses to companies which are in a profit-making position. The further upshot of this could, (other things remaining equal), be that the unemployment rate would not be subject to exponential increases as the continued existence of companies currently teetering on the brink could be secured.

Whilst much has been said about how a group tax regime could potentially be of benefit to South Africa^{6 7}, the following question needs to be addressed:

³ Media Statement – Minister of Finance, 1 April 2009, pp. 1 to 3

⁴ Tickle, D, (2009), p.1 “Full group tax system imperative in current economic meltdown” – SAICA Communique News Service – 18 June 2009

⁵ With reference to the possible introduction of group taxation, the South African Institute of Chartered Accountants (“SAICA”) has, in terms of its agenda for the 2009 SAICA Tax Conference listed as one of the main topics, the question of whether or not South Africa is ready for group tax and what the real advantages and disadvantages thereof are (www.saica.co.za/brochures/).

⁶ Ibid. pp.1 to 2

⁷ The Third Interim Report of the Katz Commission of Inquiry

What is a group taxation regime?

2.2 *What is a Group Taxation regime?*

A group taxation regime can be defined as:

“a set of rules that enables corporate taxpayers to compute the tax liability of related corporations on a consolidated or combined basis. Th(is) term...encompasses not only full consolidation, but also transfer of particular tax attributes between the members of a corporate group”⁸.

This definition is very broad and does not provide any clarity other than that the tax position of a group of companies will be considered on a consolidated or combined basis with a view towards ascertaining what the net result would be after the consolidation or combination of all the accounts of the respective companies forming part of the group. Adding to the difficulty of trying to give more definition to what constitutes a group taxation regime is that group taxation has been applied in different forms across the globe.

A study conducted by the IFA, a Netherlands based non-governmental and international non-profit organisation which focuses on the study of international tax law⁹ highlighted the following as the more common forms of group taxation regimes:

2.2.1 *The Organschaft Regime*¹⁰

In terms of this regime, subsidiaries having one common holding company are considered to be ‘organs’ of the holding company and are treated as one composite body.

⁸ Cahiers De Droit Fiscal International (2004), p.25

⁹ Cahiers De Droit Fiscal International (2004)

¹⁰ Id. p.29

The main feature of the Organschaft regime is that profits and losses of the subsidiaries are attributed to the holding company. This regime however does not cater for the deferral of gains or losses arising from the intra-group transfer of assets. Organschaft regimes are found in Germany and Austria¹¹.

2.2.2 *The Group Contribution Regime*¹²

This type of regime permits subsidiaries in a group to engage in a practice referred to as income shifting, in terms of which a profit-making company in the group is permitted to make a contribution to a loss-making company in the group coupled with the fact that the company making the contribution would be entitled to deduct the amount contributed from its tax base. By the same token, the company receiving the income contribution would include the amount received in its taxable income. This has the effect that profits and losses of companies in the group are off-set. The IFA's study has furthermore revealed that an important feature of this regime is that the tax relief is based on the transfer of wealth. This regime appears to have found favour in the Nordic region and is currently applied in Sweden, Norway and Finland¹³.

2.2.3 *The Group Relief Regime*¹⁴

This regime is also commonly referred to as the loss relief model. In terms of this regime losses incurred by one company in a group are permitted to be transferred to another group company¹⁵. This could result in a company which would previously have been in a taxpaying position subsequently finding itself in a position in which it would pay less tax than it would have before the transfer of the losses from its fellow group company. It

¹¹ Id. p.29

¹² Id. p.29

¹³ Ibid. pp.29 - 30

¹⁴ Id. p.30

¹⁵ Id. p.30

could even result in the company ending up in a tax neutral position¹⁶. What distinguishes this regime from the group contribution regime is that tax losses are transferred as opposed to the shifting of profits within a group. Group relief regimes are applied in the United Kingdom, New Zealand and Singapore¹⁷.

2.2.4 *The Consolidation Regime*¹⁸

This regime typically involves each company computing its own income after which the income is consolidated at the holding company-level. The holding company would thereafter become liable for the group's tax¹⁹. The IFA's investigations have revealed that this regime itself has been applied in different forms.

The consolidation regime is, amongst others, currently applied in Australia, Denmark, France, Italy, Japan and the United States of America²⁰.

At this juncture, it makes sense to comment on two of the more common forms of group taxation regimes, i.e. the consolidation and the group relief regimes and how they have been applied in practice.

In Chapter 3 the salient features of the group taxation regimes applicable in Australia and the United Kingdom ("UK") will be highlighted. Australia applies the consolidation regime and the UK, the group relief regime.

¹⁶ Tickle, D, (2009), p.1 "Full group tax system imperative in current economic meltdown" – SAICA Communique News Service – 18 June 2009

¹⁷ Cahiers De Droit Fiscal International (2004), page 30

¹⁸ Id. p.30

¹⁹ Ibid. pp. 30 - 31

²⁰ Ibid. p.30

Chapter 3: Group Taxation in an international context: Australia and the UK

Chapter 2 included a discussion on what a group taxation regime entails and highlighted four typical models of group taxation.

This chapter deals, in summary, with how a consolidation group taxation regime and a group relief taxation regime operate in practice. In this regard, reference will be made to the Australian and United Kingdom taxation regimes.

3.1 Group Taxation in Australia²¹

3.1.1 General

Group taxation came into operation in Australia with inception from 1 July 2002. The form of group taxation introduced was the 'consolidation' group taxation regime. The information as set-out below presents an overview of this regime as it applies in Australia and is not designed to exhaustively illustrate the mechanics thereof.

In providing this overview, the most significant aspects of this regime with reference to its application in Australia, will be highlighted. Certain areas have however been discussed slightly more in depth than others.

Groups (i.e. groups of companies) in Australia have a choice on whether or not they wish to consolidate for tax purposes. This choice must be made in the year the consolidated group is formed and before the due date for the submission of the tax return for that year.

²¹ Information on the Australian consolidation regime highlighted herein was obtained from Greenwoods and Freehills (2004), as well as the explanatory memoranda in terms of subsequent amendments up to and including the Taxation Amendment (2006 Measures No.4) Act 2006 published on the Australian Taxation Office website (www.ato.gov.au/consolidation). Greenwoods and Freehills are Australian tax experts and appear to be one of the foremost commentators on Australian tax law and its implications.

Once the election to consolidate has been made, all subsidiaries forming part of the group must form part of the consolidated group (i.e. there is no choice on whether or not to include or exclude a subsidiary from the consolidated group). This is commonly referred to as the 'one in, all in' principle. In order for a group to be in a position to consolidate, there must be a head company and at least one subsidiary member. In order to qualify as a head company, a company has to be an Australian resident with at least some of its income being subject to tax at the general corporate tax rate and must not be a wholly-owned subsidiary of an Australian resident company. Corporate unit trusts or public trading trusts also qualify as head companies and are capable of electing to consolidate²².

Subsidiaries of a group however, have to be 100% beneficially owned, directly or indirectly, by the head company or any other subsidiary in the group. Companies, trusts and partnerships are entities capable of being subsidiaries of a head company and are required to meet certain Australian residency requirements. Charities are precluded from being part of a consolidated group.

The consolidation regime also caters for "Multiple Entry Consolidated" ("MEC") groups. This is a departure from the standard rule by virtue of the fact that consolidation would be available to Australian resident subsidiaries having a foreign holding company, even though there may not be an Australian resident head company in the group structure. An MEC is treated on the same footing as a classic consolidated group.

It is important to note that the 100% holding requirement in terms of a normal group is equally applicable to a MEC group i.e. the foreign holding company must hold, directly or indirectly, 100% of the Australian resident subsidiary companies. Of great significance however is the fact that the 'one in, all in' principle (applicable to the classic consolidated model) does not apply in terms of a MEC group. There are various options

²² These trusts are used for infrastructure developments in Australia. They are taxed as companies but are also subject to certain rules applicable to trusts. These trusts, once having elected to consolidate, are taxed as companies in terms of Australian tax laws

available to subsidiaries of the non-resident holding company in that they can choose which of their fellow subsidiaries they wish to have in their consolidated group.

3.1.2 Implications of consolidation

As indicated in Chapter 2 above, the implication of consolidation is that the group is treated as a single entity. Consequently, a single tax return is submitted on behalf of the group and all intra-group transfers, shareholdings and loans are ignored for tax purposes. Furthermore, all assets, liabilities and tax losses (i.e. including those of all the subsidiaries) are attributed to the head company on consolidation.

The tax cost of assets attributed to the head company is the cost of the head company's investment (i.e. shareholding) in the subsidiary owning the assets. The allocation of these tax costs are subject to a prescribed cost-setting process.

Important to note in terms of this process, is that the level of attribution of the tax losses of a subsidiary to the head company is dependent on whether or not the subsidiary was part of the group at the time of consolidation. Ring-fencing rules do not appear to apply in terms of this process. There are also implications in terms of the pre-consolidation capital gains tax ("CGT") roll-overs arising from intra-group transfers and the setting of the costs could give rise to a capital gain in the head company's hands. There is no setting of costs as described above with reference to the assets of each first onshore company in a MEC group, as each company is effectively a head company of its own 'group' and as the tax costs of assets for a head company in a consolidated group are not set, it is deemed inappropriate to allow foreign-owned companies in an identical position to access the tax cost setting provisions simply due to them being part of a MEC group.

The cost-setting exercise gives rise to the notion of an allocable cost amount which has to be allocated to the subsidiary's assets. A set procedure (as alluded to above and not relevant for the purposes of this discussion) is employed in allocating the allocable cost.

A subsidiary which becomes part of the consolidated group is, subject to certain limitations and/ or conditions, permitted to bring its pre-consolidated losses into the group. No ring-fencing rules appear to have application. There are tests laid down for determining the extent of the transferrable loss. In this regard, tests are conducted to see whether or not the same level of ownership exists after consolidation, and also, whether or not the head company is engaged in the same business as the subsidiary. There are also certain limitations placed on the head company in terms of the utilisation of those losses.

Where the losses are transferred from the subsidiary to the head company, the head company is deemed to have incurred the loss in the year in which that loss was transferred to it. All losses transferred by a joining subsidiary retain their respective natures, for example, a capital loss transferred remains a capital loss and a revenue loss transferred remains a revenue loss. Furthermore, losses transferred from a joining subsidiary can only be utilised after the losses which have been generated within the consolidated group have been used.

The tax credits of a subsidiary (if any) are also transferred to the head company. Tax credits are determined with reference to a 'franking account'. This account records tax paid by the capture of corporate tax paid and attaching it to dividends paid to shareholders. Tax credits of a company are referred to as 'franking credits'. The franking credits of subsidiaries within a consolidated group are transferred to the head company, who keeps a 'franking account' on behalf of the consolidated group. Debit balances on a franking account are however not transferred to a head company. The subsidiary would generally settle this deficit. This payment can however be utilised by the head company as set-off against future income tax liabilities.

Australian companies who hold an interest of greater than ten percent in a foreign company are able to receive tax-free dividends from these foreign companies. These dividends are recorded in a foreign dividend account. One foreign dividend account is kept in the context of a consolidated group which effectively pools the balances

transferred by subsidiaries to the head company (upon joining the group). The existence of a surplus on a group foreign dividend account could result in dividends paid to non-residents being free from dividend withholding tax.

Income of a controlled foreign company (“CFC”) in terms of an Australian company, which has been taxed in Australia, can be repatriated into Australia as tax-free dividends. Accounts are kept to keep track of these balances. Only one such account is kept by the head of a consolidated group.

Furthermore, whilst the head of a group is the taxpayer and is responsible for the payment of taxes on behalf of the group, the failure by it to meet its obligations to the *fiscus* in this regard is tempered by the fact that all the companies forming part of the group are jointly and severally liable for the taxes liable to be paid to the *fiscus*. Should such circumstances eventuate, the liability of the companies can be minimised where a valid tax sharing agreement has been entered into between the members of a consolidated group.

3.1.3 Implications of exiting the consolidated group

Notwithstanding the ‘one-in, all-in’ principle, subsidiaries are permitted to exit a consolidated group, if ceasing to form part of the consolidated group.

An exit of a subsidiary from a group can give rise to a capital gain or loss in the hands of the head company. This can arise due to the fact that the tax cost of the head company’s interest in the subsidiary having to be revalued. The revaluation effectively reverses the exercise in terms of which the allocable cost amount was arrived at. Furthermore, where a subsidiary exits a group and leaves with the same liabilities that it brought into the group, the value of those liabilities would be the same as the value thereof at the time of joining the group.

A subsidiary is also precluded from taking any franking credits and any foreign dividend account balance with it upon exiting a group. Where a subsidiary holds an interest in a CFC, a portion of the credits based on its shareholding in a CFC is returned to it.

The aforementioned represents an overview of how a consolidation group taxation regime operates in practice.

As indicated in Chapter 1, companies which form part of a group are all taxpayers in their own right, and are required to submit their own tax returns. Whilst the Income Tax Act does provide for roll-over relief in terms of intra-group transactions, as well as other forms of tax relief²³, these relief rules are significantly less complex than those in terms of the Australian consolidation regime. The Australian consolidation regime does however appear to provide corporate groups with tax relief that is significantly higher than that provided for by the Income Tax Act²⁴.

3.1.4 The Fiscal Unity consolidation model

A more relaxed consolidation model applies in the Netherlands. Whilst the details of this regime will not be discussed herein, the essence of this group taxation regime is that the Netherlands applies the 'fiscal unity' regime²⁵. The following are the significant features of the fiscal unity regime:

- The parent company must own at least a 95% interest in the subsidiary;
- Dutch resident and non-resident companies could be included in a fiscal unity provided the place of effective management in terms of these companies is

²³ To be the subject of discussion in Chapter 6 and 7

²⁴ As stated above, the tax relief available to South African groups will be discussed in more detail in Chapter 6 and 7

²⁵ Ernst & Young - The 2009 Worldwide Corporate Tax Guide, Ernst & Young, EYGM Limited, 2009, p.696

located in the Netherlands. A fiscal unity could also include the permanent establishment of a company that is effectively managed in a non-Dutch jurisdiction; and

- A subsidiary could, from the date of its acquisition, be included in a fiscal unity²⁶.

The advantages of being part of a fiscal unity are the following:

- The losses of a subsidiary may be offset against profits of other member group companies;
- There are no direct tax consequences in terms of reorganisations and the movements of assets with hidden reserves from one company to another; and
- Inter-company profits are capable of being fully deferred²⁷.

These high-level remarks about the fiscal unity regime are relevant, as it appears, (based on the remarks of a senior official of National Treasury), that the relaxed approach in terms thereof could possibly be of application (to a very limited extent) in South Africa²⁸.

Another preferred group taxation regime (internationally) is the Group Relief regime. For an overview of how a Group Relief taxation regime operates in practice, regard will be had to how the mechanics of this regime operates in the context of the United Kingdom's ("UK's") tax legislation.

As in the case of the discussion of the Australian group taxation regime, the discussion below is intended to provide an overview of how the Group Relief ("Group relief")

²⁶ Ibid. pp.696 to 697

²⁷ Id. p.697

²⁸ The content of the informal views expressed by the senior official of National Treasury are addressed in Chapter 7 below

taxation regime is applied in the UK and is not intended to provide an exhaustive illustration of the mechanics of this regime.

3.2 Group Taxation in the UK²⁹

The UK recognises a group of companies as a single economic unit and various reliefs are afforded to corporate groups in the UK³⁰. The IFA is of the view that these reliefs are key features of the UK tax system and are also widely used³¹. Group relief in the UK context is aimed at enabling a company within a group of companies to surrender trading losses, excess interest expenses on borrowings, excess capital allowances, excess management expenses, charges on income and certain losses relating to intangibles³². This generally takes place in the following instances:

- The surrender by a subsidiary of its losses to its holding company;
- The surrender by the holding company of its losses to its subsidiary or subsidiaries; and
- The surrender of its losses by one subsidiary to another subsidiary within the same group of companies.

It is important to note that where a company surrenders its losses to a fellow group company, in circumstances where its losses are greater than the profits of the fellow group company, the company would only be permitted to surrender its losses to the extent that the profit of the fellow group company would be reduced to zero.

²⁹ Information on the UK group taxation regime has been obtained from Cahiers Du Droit Fiscal International (2004) and Tolley Tax Training – LexisNexis (2008) and the information thereon is in terms of the group tax legislation as it was up to 2008

³⁰ Cahiers De Droit Fiscal International (2004), page 687

³¹ Id. p687

³² Ibid. p.688; Tolley Tax Training – LexisNexis (2008), page 17.3

Group relief in the UK has application at two different levels:

- Group relief (in the first instance); and
- Consortium relief (if applicable, after the application of group relief).

3.2.1 *Group relief*

Group relief is available to companies forming part of a group of companies. Unlike Australia which has a 100% holding requirement, a group of companies (in the UK group relief scenario) involves one company holding an interest in another company, directly or indirectly, of at least 75%³³. The 75% interest held by the holding company (referred to as the equitable ownership in the subsidiary) includes the presence of the following:

- Ownership of the ordinary share capital of a subsidiary must at least be at the 75% level;
- The interest in the subsidiary must entitle the holding company to at least 75% of the subsidiary's available distributable profits; and
- The interest in the subsidiary must entitle the holding company to at least 75% of the subsidiary's assets on the winding-up of the subsidiary³⁴.

It follows therefore, that a company joins a group when 75% of its equitable ownership vests in the group holding company. In line with this, only losses that are incurred after joining the group would qualify for the group relief³⁵. A company is regarded as having left the group when arrangements for the sale of the holding company's interest in it have

³³ Cahiers De Droit Fiscal International (2004), page 688; Tolley Tax Training – LexisNexis (2008), page 17.2

³⁴ Tolley Tax Training – LexisNexis (2008), page 17.2

³⁵ Ibid. p.18.3

come into force³⁶, as opposed to the actual divestment by the holding company of its equitable ownership in the subsidiary. Arrangements could be said to come into force where, for example, the disposal of the interest in a subsidiary has been approved by the shareholders³⁷, or where a contract for the disposal of the interest in the subsidiary has been agreed to between the parties to the agreement³⁸.

Noteworthy however is the fact that an international group of companies would be recognised for the purposes of the group relief provisions, provided that the 75% equitable ownership requirement as outlined above has been satisfied. Based on this, losses between UK subsidiaries (or UK branches) of a non-UK resident holding company³⁹ are capable of being transferred. Losses of non-resident subsidiaries are also capable of utilisation in terms of the group relief provisions provided the non-resident subsidiaries are residents in countries falling within the European Economic Area. Furthermore, losses of offshore branches of UK-resident companies could also qualify for the group relief⁴⁰.

There are however various conditions that have to be satisfied before the losses of non-resident subsidiaries and the losses of off-shore branches of UK resident companies can be utilised in terms of the group relief system. A discussion of these conditions is not required for purposes of this research paper and is therefore not addressed herein.

The application of the group relief system could give rise to companies within the group being taxed at lower marginal rates (various marginal rates of taxation apply depending on the level of a company's notional profit⁴¹). Provision is also made for the time-

³⁶ *Ibid.* p.18.3

³⁷ *Ibid.* p.18.4

³⁸ *Ibid.* p.18.5

³⁹ *Ibid.* p.18.7

⁴⁰ *Ibid.* p.18.8

⁴¹ *Ibid.* p.17.5

apportionment of losses and profits in circumstances where companies within a group have different accounting periods⁴².

3.2.2 Consortium Relief

Consortium relief is considered to be a variation of group relief and applies in circumstances where losses of a 'consortium' company are capable of being transferred to consortium members, and conversely, where losses of consortium members are capable of being transferred to a 'consortium' company⁴³. As will be seen further below, consortium relief ranks after group relief, and is applied after the group relief has been applied, or in instances where group relief is not applicable.

A consortium company is a company in which consortium members hold an equitable ownership (as defined in terms of the group relief provisions) of at least 75% in a consortium company, and the consortium members are companies which individually have an equitable ownership of at least 5% in the consortium company⁴⁴. Foreign companies are also capable of qualifying as consortium members, but the concessions granted to non-resident subsidiaries and offshore branches of UK resident companies under the group relief system do not have application in terms of consortium relief⁴⁵.

A consortium member's 'entitlement' to the losses of a consortium company is dependant on the level of its equitable ownership in the consortium company, as well as the consortium member's available profit⁴⁶. In instances where the consortium members make losses, the consortium relief would be the lower of the consortium member's actual loss, or the portion of the consortium company's profits attributable to the consortium

⁴² Ibid. p.18.1

⁴³ Ibid. p.19.1

⁴⁴ Ibid. pp.19.1 and 19.2

⁴⁵ Ibid. p.19.2

⁴⁶ Id. p.19.2

member (i.e. this amount is dependant on the extent of the consortium member's interest in the consortium company⁴⁷).

Of significant importance (as highlighted above) is the fact that group relief enjoys preference over consortium relief⁴⁸. This can best be illustrated in terms of the following example:

Company A owns 80% of company B, which in turn is a consortium company in terms of its relationship with company C (company C being a consortium member which owns a 10% interest in company B). If company B has incurred losses, these losses must first be transferred to company A. 10% of the remaining losses would then be capable of being transferred to C.

The consortium relief provisions also make provision for a 'group consortium company'. A group consortium company is simply a consortium company which is a holding company of a group as contemplated in terms of the group relief system⁴⁹. The normal ranking rules still apply in the sense that group relief must first be applied, after which the consortium relief rules (to the extent that the group consortium company still has a loss) will be applied⁵⁰. Provision is also made for further variations of corporate structures in as far as consortium relief is concerned. These are not deemed to be relevant for the purposes of this research paper and have therefore not been addressed herein.

⁴⁷ Ibid. p.19.3

⁴⁸ Ibid. p.19.6

⁴⁹ Ibid. p.20.1

⁵⁰ Ibid. p.20.2

3.2.3 *Intra-group transfers of assets*

Apart from the group relief and consortium relief rules, provision is made in the UK tax legislation for roll-over relief in terms of intra-group transfer of assets⁵¹. This form of relief does not form part of the group relief provisions, but nevertheless affords relief in terms of intra-group transactions. This regime, *prima facie*, is similar to the current provisions in the Income Tax Act which governs intra-group transactions.

Transfers of assets between companies who are members of a chargeable gains group are subject to roll-over relief in that the tax consequences are deferred until its disposal outside of the chargeable gains group⁵². A chargeable gains group would typically consist of a principal company and its so-called '75% subsidiaries'⁵³. A 75% subsidiary of a 75% subsidiary would form part of a chargeable gains group, provided that it at least qualifies as an 'effective 51% subsidiary' of the principal company⁵⁴. The interest held by the principal company in its subsidiaries is required to be an equitable ownership (as contemplated in the group and consortium relief rules)⁵⁵.

The aforementioned represent a summary of the provisions relating to group taxation in the UK.

3.2.4 *Consolidation and group relief regimes contrasted*

A quick comparison of a group relief regime and a consolidation regime highlights a significant difference in that each company within a group relief regime (as contemplated in the UK) retains its own respective status as a taxpayer and would still be required to

⁵¹ Cahiers De Droit Fiscal International (2004), page 694

⁵² Id. p.694

⁵³ Ibid. p.695

⁵⁴ Id. p.695

⁵⁵ Id. p.695

file its own tax return as opposed to the consolidation regime, in which the consolidated group is viewed as one entity requiring the filing of one tax return for the entire group.

The group relief regime as applied in the UK appears to be a very sensible regime and appears less complex and easier to apply in practice. It would, at first blush, appear to be a regime that should be capable of being introduced into the South African tax legislative framework, and should be capable of being adopted by SARS without the need for any significant infrastructural and logistical adjustments.

South African income tax legislation does not permit the transfer of losses in a group of companies' scenario. This would however, be possible if a group relief regime was introduced in South Africa.

University of Cape Town

Chapter 4: The Margo and Katz Commissions of Inquiry

Having provided an overview of group taxation in its two most common guises and having illustrated how it is applied in the case of Australia and the UK, this chapter will focus on the findings of the Margo Commission (in which the debate on group taxation and its applicability to South Africa commenced) and the Katz Commission (which recommended the introduction of group taxation in South Africa).

4.1 The Margo Commission

The main objective of the Margo commission (“commission”) was to investigate and to propose appropriate measures aimed at reforming the tax regime in South Africa. It appears from the introduction to the commission’s report that the reasons giving rise to the need for tax reform in South Africa were by and large on all fours with those giving rise to the need for tax reform in other countries⁵⁶. These included the following factors:

- high inflationary environments;
- the need to simplify and reform the income tax structure due to it interfering with economic choices and retarding saving, investment and growth;
- the elimination of erosion and leakages of revenue;
- the redistribution of the overall tax burden to make it fairer, easier and more acceptable; and to foster confidence and respect for the *fiscus*⁵⁷.

Moreover, it is very important to note that the commission was conducted during one of the darkest periods of South Africa’s socio-political history, i.e. during the era of Apartheid. During this period South Africa, as a result of its apartheid policies was faced

⁵⁶ Margo Commission, page 3

⁵⁷ Ibid. pp.2 - 3

with increasing isolation from the international community and had rightly been on the receiving end of severe economic and political sanctions imposed by the international community. This resulted in large-scale disinvestment from South Africa, which together with the imposition of economic sanctions and international trade boycotts, had dire consequences for the South African economy. Internally, there was a large-scale political uprising against the Nationalist apartheid regime, which included both violent and peaceful forms of political protests and activism, as well as industrial action from the labour movements in South Africa. These factors were recognised by the commission and appear to have been taken into consideration by it⁵⁸.

The reforms recommended by the commission should therefore be considered against this backdrop.

Of relevance for the purposes of this thesis however, is that the commission considered in detail whether or not a group taxation regime would be appropriate in South Africa, and in the final analysis, that it opposed, by a majority vote, the introduction of group taxation in South Africa. In arriving at this conclusion, the commission compared the consolidation group regime with the Group relief regime (discussed in Chapter 2 and 3 below), and also considered the arguments for and against the implementation of a consolidation group regime⁵⁹. What follows below is a summary of the aforementioned factors as dealt with by the commission⁶⁰.

As a point of departure, the commission accepted that the South African practice of taxing each company separately was not necessarily a prevailing general practice in terms of other tax jurisdictions and that the representations in favour of group taxation were motivated by the belief that group taxation represents a form of tax relief.

⁵⁸ Margo Commission, page 2

⁵⁹ Ibid. pp. 199 to 202

⁶⁰ i.e. as dealt with in the Margo Commission report on pages 199 to 202

The Commission was also in favour of retaining single operating companies in a group as opposed to consolidating or merging a group into one unit.

In determining what would qualify as an appropriate group taxation regime in terms of South Africa (had the adoption of group taxation been recommended), the commission considered the consolidation and group relief regimes.

The commission found that the Group relief regime appeared to be favoured over the consolidation regime in terms of representations made to it. It was also of the view that the perception that the group relief regime was a simpler system than the consolidation system only held true at a conceptual level, and felt that the group relief regime caused more uncertainty and delays in comparison with the consolidation regime. This was based on the view that loss transfers have implications for both transferor and transferee companies, and given the time span for making an election (ostensibly on whether or not to claim the group relief), various permutations and combinations are brought into the equation. Accordingly, the forecasting of future income and profits and in making the appropriate choice would require great skill.

In as far as the consolidation regime is concerned, certain members of the commission were of the view that whilst this regime, *prima facie*, appeared to be more complex, it in fact represented a simpler and a more sound approach to group taxation. The commission found that a consolidation exercise could be concluded in a relatively short time and without any further uncertainty. The commission appears to have been of the view that the consolidation model, coupled with anti-avoidance legislation in terms of trafficking in assessed losses, as well as the ring-fencing of a company's assessed losses which existed prior to the company forming part of a consolidated group, would be more suited to the South African *fiscus*.

In deciding whether or not a consolidation group tax regime would be appropriate in a South African context, the commission considered arguments for and against its

implementation. The following are the more salient factors highlighted in these arguments:

4.1.1 Arguments in favour of the introduction of the consolidation group tax regime:

- The lack of a consolidation group tax regime would give rise to large divisionalised companies;
- The lack of such a regime would act as a disincentive towards investing in South Africa;
- Risk-taking would be encouraged as other companies within a group stood to gain from losses incurred by the risk-taking company;
- That it was inherently unfair when one company in a group would be required to pay taxes on its profits, in circumstances where the group viewed as one economic entity could be in a break-even or loss-making position, with the presence of the latter giving rise to capital formation being impaired;
- That group relief is any event achieved by means of tax planning in terms of which income from profitable companies are siphoned off to loss making companies in a group;
- That the adoption of the consolidation group tax regime would be in line with trends in other tax jurisdictions; and
- That the system of a single trading entity would also result in the achievement of neutrality.

4.1.2 Arguments against the adoption of the consolidation group tax regime:

- The adoption of this regime would give rise to a significant loss of revenue to the *fiscus*;
- The consolidation group tax regime would enable ‘tax engineering’ by virtue of attempting to use ring-fenced assessed losses which arose outside of the group;
- It would foster the trafficking in assessed losses which would require the introduction of complex anti-avoidance legislation;
- The ability to transfer the profits of a profit-making company could prejudice the creditors of that company; and
- The principle that separate legal entities are to be taxed in their own respective rights would be undermined.

As indicated above, the commission ultimately, by a majority vote, opposed the adoption of a group taxation regime for South Africa. The minority grouping in the commission, who were in favour of the adoption of group taxation, recommended that the adoption thereof should be subject to the following:

- That the group taxation regime should apply in the situation where subsidiaries in a group are wholly-owned by the holding company;
- That only losses arising whilst a company was a subsidiary within a group be allowed, with losses existing prior to entry into a group being disallowed; and
- That there should be strict enforcement of the anti-avoidance legislation to discourage the trafficking in assessed losses.

Needless to say, the commission's impact (or lack thereof) on group taxation in South Africa was that no such taxation regime was adopted or mooted to be adopted in the foreseeable future. Notwithstanding this, and more importantly however, was the fact that the commission did not dismiss the notion of group taxation out of hand. Instead, it chose to consider arguments for and against its suitability for adoption in South Africa. In my opinion, the commission at least succeeded in opening the debate on the application of group taxation in a South African context and no doubt paved the way for debate on this topic to be revisited at a later stage.

Whilst proponents favouring group taxation may have debated the merits or demerits of the Margo Commission's ultimate stance on this topic, no further official debate or comment appears to have been made on this topic. That was the case at least until the commissioning of the Katz Commission of Inquiry.

4.2 *The Katz Commission*

The Katz Commission ("the commission"), as in the case of the Margo Commission, was tasked with recommending means and ways of transforming the tax regime in South Africa. Of great importance however, is the fact that the prevailing atmosphere in South Africa at the time of the commissioning of the commission stood in stark contrast to the conditions prevailing at the time of the Margo commission. South Africa had become a non-racial, multi-party democracy with the fall of the Apartheid regime and was granted re-entry into the fold of the international community. Moreover, armed with the charismatic and inspirational leadership of the Honourable (former) President Nelson Mandela, who mesmerised international political and business leaders with his sheer presence and charisma, South Africa became an enticing prospect, especially for the international business community who were eager to explore trading opportunities and business operations in South Africa, and also due to having been persuaded by the Honourable President Mandela to do so. South Africa became the so-called 'flavour of the month'. In this regard the commission was cognisant that factors such as the newly

established democracy in South Africa, the acceptance of the legitimacy of its government (and consequently its right to collect taxes), the knowledge that the fruits of economic growth should be shared across the South African spectrum, the need for the alleviation of abject poverty (a state in which the majority of South Africans found themselves), and the new logistical demands and global competition (as a direct result of South Africa's re-entry into the international arena), had to be taken into account in formulating its recommendations in terms of the South African tax structure⁶¹.

However, whilst South Africa had made significant political strides and whilst the South African economy had commenced its journey on a path of growth (albeit fairly slow), its tax legislation lacked the necessary level of sophistication to keep up with these developments.

It is these developments which contributed towards the constitution of the commission. From November 1994, the commission released a series of reports in terms of which its recommendations on various areas of taxation were aired. Of relevance for the purposes of this research paper is the Third Interim Report of the Katz Commission. In this report⁶², the commission clearly expresses the view that South Africa, from a group taxation perspective had fallen behind in its tax treatment of groups of companies in comparison with its international counterparts and that South Africa could ill-afford to lag-behind in terms of the manner in which it taxed corporate groups. In arriving at its recommendation, the commission considered the advantages and disadvantages of group taxation, debated which regime (i.e. the consolidation regime or the group relief regime) was more suitable from a South African perspective, how group taxation should be introduced, and what the mechanics of this preferred group taxation regime should be⁶³.

⁶¹ Katz Commission (1), Pages 7 to 8

⁶² Katz Commission (3), pages 96 to 111

⁶³ Id. pp. 96 to 111

The following are the advantages and disadvantages of group taxation from the commission's perspective⁶⁴:

4.2.1 Advantages:

- A closely held group of companies would be viewed as a single economic unit under a group taxation regime. A tax system that fails to take cognisance of this reality would in all likelihood create economic and business distortions, for example, the divisionalisation of companies into one legal entity purely for tax reasons (which has the effect of denying the companies protection of limited liability in terms of company law). Where companies are unable to divisionalise as a result of legal or strategic reasons, it could give rise to complex intra-group transactions (aimed purely at avoiding or reducing the company's tax liability) which could also be lacking in commercial substance, such as transfer pricing or excessive management fees. The existence of an appropriate group taxation regime would avoid the need for these artificial types of transactions. Moreover, should such transactions be entered into, a full audit trail would be available to the revenue authorities were a suitable group taxation regime to be in operation;
- Group taxation facilitates the unbundling of large corporate groups into more efficient group company structures. The commission was of the view that these types of unbundling exercises could result in the unbundled companies incurring higher tax liabilities as a result of increased profits; and
- Foreign investors would have expectations in terms of the existence of some form of group taxation in South Africa.

⁶⁴ Ibid pp. 96 to 98

4.2.2 Disadvantages:

- Depending on its nature, a group taxation regime could potentially be very complex;
- Again, depending on its nature, it is perceived to be costly from the perspective of the *fiscus*; and
- The existence of a group taxation regime could give rise to the need for additional anti-avoidance legislation.

The commission felt that the disadvantages highlighted by the Margo Commission had doubtful validity in the first place or had since fallen away, and therefore did not feel the need to highlight them.

By stating that it would be appropriate to introduce a compromised form of group taxation that would not be complex nor costly and would be capable of evolving into a fully fledged group taxation regime, the commission implied that the disadvantages highlighted were not sufficiently serious to militate against the adoption of an appropriate group taxation regime.

The commission also expressed its preference for the consolidation group taxation regime as opposed to the group relief regime. In this regard, the commission advanced the following reasons:

- The group relief regime does very little in terms of the recognition of the economic unit of a corporate group;
- The group relief regime potentially creates an environment for the manipulation of intra-group transactions, engineering timing differences, manipulating cost bases and the exploitation of capital/revenue mismatches. The commission felt

that such manipulations would not have any impact in terms of the consolidation regime;

- The consolidation regime represented what a group taxation regime should be, whereas the group relief was precisely that, a ‘group relief’ regime and not a group taxation regime; and
- The group relief regime is potentially far more complex than the consolidation regime, due to the latter being a more flexible regime and due to the difficulties created as a result of the time span involved in making an election in terms of the group relief regime.

4.2.3 The Commission’s view on whether or not group tax should be adopted in South Africa

In order to minimise the impact of factors such as cost and complexity, the commission recommended that a gradual approach be adopted in terms of introducing a consolidation-type group taxation regime in South Africa. The commission found that claims to the effect that the *fiscus* would incur substantial losses during the transition to a group taxation regime, were either exaggerated or unsubstantiated and that any potential cost to the *fiscus* could be substantially mitigated by excluding losses of a company prior to it becoming part of a consolidated group, and that the *fiscus* actually stood to lose more in terms of the tax regime as it then was (as groups with both profit and loss—making companies were able to avoid paying tax, as it could manipulate its tax exposure in the form of artificial intra-group transactions), as opposed to what it could lose in terms of a group taxation regime.

The commission also forwarded a proposal in terms of the mechanics of the recommended consolidation group taxation regime and how it should be phased in. In line with the proposal that the group taxation regime should be introduced gradually, the regime proposed by the commission also included several aspects of the group relief

regime. A detailed discussion of the proposed regime is not required for the purposes of this research paper. Instead, a summary of the highlights of the regime proposed by the commission are provided below.

In this regard, David Clegg⁶⁵ accurately provided a summary of the commission's recommendations in terms of the introduction of a consolidation group taxation regime as involving the following mechanism:

- A group of companies is to be determined on the basis of wholly-owned subsidiaries. Excluded from this holding were shares held by employees which did not exceed 10% of a company's equity capital;
- That group taxation would apply on an elective basis in terms of the entire group. Companies acquired into or disposed of from a group would enter or exit at the commencement or end of their first or last wholly-owned period;
- The ring-fencing of existing assessed losses brought forward as at the commencement date of group taxation in the instance of a particular group;
- Each company's own 'sub-return' (i.e. each company within the group) was to be based on the normal tax principles but would then be adjusted by the calculation of the capital allowances based on the original cost to the group, the reversal of section 24 or 24C allowances (in terms of the Income Tax Act) and bad debt allowances on intra-group transactions, and the reversal of group unrealised profits and losses on trading stock transfers between companies within the group;
- The current taxable income in terms of the 'sub-returns' (before taking into account assessed losses brought forward) would then be 'contributed' to the

⁶⁵ A well-respected South African tax practitioner, author and commentator and recently-retired partner of the firm, Ernst & Young Advisory Services Limited in the publication, "In Touch with Ernst & Young", February 1996.

consolidated return for set-off against the current year losses of the other group companies (on a pro-rata or election basis); and

- The taxable income of a company which has not been contributed (i.e. absorbed by a current year loss) from a sub-return to a consolidated return could then be used for set-off against a prior year's assessed loss in terms of that company. Any balance of assessed loss in that company (after set-off) would however remain ring-fenced for the following year and therefore not available for set-off in terms of the consolidation. A company's current year losses that has not been set-off by the consolidated taxable income of the group, is also ring-fenced and carried forward in that company, as opposed to being carried forward as a consolidated loss⁶⁶.

The decision by the Katz Commission to recommend the adoption of group taxation was not surprising. The Margo Commission had commenced the debate on the viability of group taxation in South Africa, but decided against recommending its adoption as it ultimately was of the view that it was not suitable in the prevailing environment (from a socio-political and economic perspective) in South Africa at the time. Due to the changed socio-economic and political environment at the time of the Katz Commission, as well as the developments internationally from an economic perspective, and having had the debate on group taxation previously opened by the Margo Commission, the Katz Commission was able to take a more favourable view on group taxation, which resulted in it recommending the adoption of group taxation in South Africa, albeit in terms of a gradual approach.

The Katz Commission's approach, in my opinion, had merit as it would have enabled the National Treasury and the South African Revenue Service ("SARS"), (given the administrative and logistical constraints within which they operated in), to gradually put into operation the necessary processes and procedures required to successfully implement group taxation. From thereon, in line with the Katz Commission's recommendations, the

⁶⁶ In Touch with Ernst & Young, pp. 4 to 5

group taxation regime could gradually have been adapted and modified until it eventually operated as a fully-functional and effective consolidation group taxation regime.

Notwithstanding the recommendations of the Katz Commission in this regard, it would appear that the recommendations in terms of the adoption of group taxation have been largely ignored, as to date, no such regime has been adopted or implemented in South Africa.

The developments in terms of the taxation of companies and groups of companies in South Africa subsequent to the recommendations of the Katz Commission will now be considered to ascertain whether or not any of the recommendations of the Katz Commission have been included in the Income Tax Act, or whether or not any elements of group taxation had been introduced subsequent to the Katz Commission.

University of Cape Town

Chapter 5: Developments subsequent to the Katz Commission

This chapter will examine to what extent any of the Katz Commission's recommendations in terms of the taxation of corporate groups or groups of companies have found their way into the Income Tax Act. Furthermore, given that the Third Interim report of the Katz Commission was published in December 1995, only developments subsequent to this will be considered.

An examination of the legislative changes from 1996 onwards confirms that no group taxation regime was introduced by National Treasury. The most significant development (other than the introduction of capital gains tax ("CGT") with effect from 1 October 2001) was the introduction of the corporate rules to the Income Tax Act in terms of the Second Revenue Laws Amendment Act of 2001⁶⁷ ("the 2001 Amendment Act"), and its amendment in terms of the Revenue Laws Amendment Act of 2002⁶⁸ ("the 2002 Amendment Act"). The aim of the corporate rules is to allow the transfer of assets with limited taxation consequences, and to be of application in transactions between group companies and between founding shareholders and their companies⁶⁹.

It appears that the introduction of the corporate rules in terms of the 2001 Amendment Act was in response to the introduction of CGT and not as a result of the recommendations of the Katz Commission on group taxation. This is apparent from the IFA's commentary, as its studies found that the South African tax legislation (subsequent to the advent of CGT) were inadequate in the context of corporate restructures as it was not able to adequately cater for the adverse CGT consequences triggered in a reorganisation of companies within a group of companies⁷⁰. More specifically, the potential cascading effect of CGT in respect of multi-tier groups of companies was not

⁶⁷ No.60 of 2001

⁶⁸ No.74 of 2002

⁶⁹ Huxham and Haupt, page 304

⁷⁰ Cahiers De Droit Fiscal International (2004), page 596

catered for⁷¹. The tax legislation, prior to the introduction of the corporate rules, had the effect that the transfer of assets between companies would represent a separate CGT event, and accordingly, a reorganisation, in the context of a multi-tier group of companies would lead to a multiplicity of CGT events, each event attracting CGT in respect of one disposal⁷².

5.1 The 2001 Amendment Act

The 2001 Amendment Act introduced CGT roll-over relief provisions, which also included income tax roll-over relief (with reference to recoupment of certain allowances in terms of the disposal of assets) and in particular introduced relief in terms of the transactions highlighted below. Please note that the explanations of these transactions are high-level explanations and unless otherwise stated, provide a high-level description of these transactions as provided for in the 2001 Amendment Act. A more detailed and current description of the implications of these transactions in terms of the corporate rules (i.e. as they currently appear in the Income Tax Act) will be addressed in Chapter 6 below. The transactions envisaged in terms of the corporate rules were the following:

- Company formations – These related to transactions in terms which one person, (referred to as the transferor) disposed of an asset to a company that was a resident, (referred to as the transferee), in exchange for equity shares in that transferee company, and in terms of which the transferor would have acquired a qualifying share (i.e. a minimum shareholding) in that transferee company;
- Share-for-share transactions – These related to transactions in which a person (the transferor) disposed of an equity share in a company to a resident company (the transferee), in exchange for equity shares in the transferee company, subject to the transferor holding a qualifying share in the transferee company;

⁷¹ Id. p.596; Explanatory Memorandum to the 2001 Act

⁷² Id. p.596

- Transfers between group companies (intra-group transactions) – These related to transactions in which a company (the transferor) disposed of an asset to another company (the transferee), and in circumstances where both companies were part of the same group of companies;
- Unbundling transactions – These related to transactions in terms of which an unbundling company disposed of its interest in a resident company (‘the unbundled company’) to its shareholder(s) (which could include the unbundling company’s holding company); and
- Transactions relating to liquidation, winding-up and deregistration – These transactions involved the disposal by a liquidating company of its asset(s) to its holding company.

All of these transactions provided various forms of roll-over relief mainly from a CGT perspective, but also included in certain instances, exemptions and/or roll-over relief from Income Tax, Marketable Securities Tax, Uncertificated Securities Tax, Stamp Duties (the latter three as they then were), Donations’ Tax and Secondary Company’s tax. Furthermore, in an attempt to combat the exploitation of loop-holes in these provisions, the 2001 Amendment Act also proposed various anti-avoidance measures which were to apply to the corporate rules. The effect of the roll-over relief was that it deferred any potential CGT liability, with such potential CGT liability arising in the transferee’s hands.

The effect and impact of the 2001 Amendment Act had hardly been digested when the corporate rules were refined and amended in terms of the 2002 Amendment Act. The significant features of the 2002 Amendment Act in terms of the corporate rules were that a new section dealing with amalgamation transactions was introduced and that company formation transactions, intra-group transactions and liquidations, winding-ups and de-registrations would apply on an elective basis. (Note however, that the 2001 Amendment

Act had already made provision for the transferor and transferee companies to jointly elect that the roll-over relief was to apply to an intra-group transaction.)

5.2 *The 2002 Amendment Act*

The provisions relating to amalgamation transactions introduced in terms of the 2002 Amendment Act applied in terms of transactions where a company (the amalgamated company) disposed of all its assets to a resident company, in terms of a merger, an amalgamation or a conversion, which would result in the amalgamated company's existence being terminated. In as far as the elections in terms of the company-formation transactions, intra-group transactions and liquidation transactions were concerned, the following should be noted:

- Company-formation and Intra-group transactions – The 2002 Amendment Act made provision for the transferor and transferee to make a joint election on a transaction-by-transaction basis, for the company-formation provisions and the intra-group provisions to apply thereto;
- The election in terms of liquidations, winding-ups and de-registrations was required to be made jointly by all the parties to the transaction and had to apply to all the assets transferred in terms of the transaction; and
- By not inserting any election provisions in terms of share-for-share transactions, amalgamation transactions and unbundling transactions, the implication thereof was that the roll-over relief in terms of these transactions applied automatically, and were, as the IFA puts it, mandatory provisions⁷³.

⁷³ Ibid. p.599

5.3 *Subsequent Amendments*

The corporate rules were subsequently subjected to various amendments and refinements, with the most notable being:

- (i) The combining of the sections dealing with company-formation transactions and share-for-share transactions into one section entitled ‘asset-for-share transactions’⁷⁴; and
- (ii) The narrowing of the definition of a ‘group of companies’ to apply only to South African resident groups of companies, who were able to qualify for the roll-over relief in terms of the corporate rules. The implications of the corporate rules will be discussed in more depth in Chapter 6.

Whilst legislative amendments since 1996 were only looked at for the purposes of this discussion, it stands to be mentioned that the Taxation Laws Amendment Act of 1988⁷⁵ introduced provisions which exempted from transfer duty and stamp duty the transfer of property or shares between companies who were members of the same group of companies, in circumstances where such transfer took place in terms of the rationalisation of companies and which had occurred within the period commencing on 17 June 1988 and ending on 30 June 2001.

This legislation appears to have been the first provision introduced that had elements of group tax therein.

⁷⁴ In terms of amendments introduced by the Revenue Laws Amendment Act No.35 of 2007, the Revenue Laws Amendment Act No.60 of 2008 and the Taxation Laws Amendment Act No.3 of 2008

⁷⁵ Section 48

Chapter 6: The Corporate Rules and Group Taxation

Having established that a group taxation regime in the classical sense (as highlighted in chapter 2) has not been introduced in South Africa, the objective of this chapter, as well as the following chapter, is to highlight to what extent the South African tax legislation makes provision for relief that could possibly be ascribed to group taxation principles or which could possibly be construed as having certain elements or characteristics of a group taxation regime. In this regard, reference will be made to the Income Tax Act, the Value Added Tax Act⁷⁶, the Securities Transfer Tax Act⁷⁷ and the Transfer Duty Act⁷⁸. This chapter will address the implications of the corporate rules and highlight any aspects thereof which display any group taxation characteristics. The remaining provisions of the Income Tax Act which could be seen to display certain characteristics of group taxation, as well as similar provisions in the Value-Added Tax Act, the Securities Transfer Tax Act and the Transfer Duty Act, will be addressed in Chapter 7.

The Income Tax Act contains a number of provisions which provide relief to group companies and in certain instances provides relief for the founding shareholders of a company and the company itself, the most significant of which are set-out in sections 41 to 47 of Part III of the Income Tax Act.

Section 41 is a general provision and provides the definitions of entities and terms referred to in sections 42 to 47. Sections 42 to 47 contain the provisions relating to asset-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and transactions relating to liquidations, windings-up and deregistrations, respectively.

It is submitted that as the corporate rules, viewed as a taxation regime, are the closest to what could be considered as a group taxation regime, a more in depth discussion thereof

⁷⁶ No.89 of 1991

⁷⁷ No.25 of 2007

⁷⁸ No.40 of 1949

is warranted. The following addresses the tax implications of the corporate rules, but does not however, represent an exhaustive discussion thereof. Only the aspects deemed necessary for the purposes of this research paper have been addressed.

6.1 Section 41

In the context of section 41, terms which have been defined in section 1 of the Income Tax Act are in certain instances subject to further definition in the sense that the section 41 definition would be more restrictive.

An example of this is the definition of a 'group of companies'. The section 1 definition includes foreign groups whereas the section 41 definition only applies to South African resident groups. A glance at the section 1 and section 41 definitions of a 'group of companies' as they currently appear in the Income Tax Act demonstrates such restriction.

6.1.1 A 'group of companies'

A 'group of companies' is defined in section 1 as follows:

"A "group of companies" means two or more companies in which one company (hereinafter referred to as the "controlling group company") directly or indirectly holds shares in at least one other company (hereinafter referred to as the "controlled group company"), to the extent that -

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

Included in the section 1 definition of a 'company' are resident and non-resident companies and it therefore includes both South African resident groups and international groups, provided the 70% shareholding requirement is met.

The section 41 'group of companies' definition however excludes non-resident companies⁷⁹. The relevance of this is that any relief relating to a group of companies in terms of the corporate rules would only have application to South African groups of companies. This restricted approach is as a result of a recent amendment to the Income Tax Act and has only been of application since 21 February 2008.

6.1.2 Other important provisions

Another important provision in terms of section 41 is that the corporate rules (i.e. sections 41 to 47) override the normal tax rules as provided for in the Income Tax Act other than the provisions of section 24B(2) and 24B(3) (transactions where assets are acquired in exchange for shares issued), the general anti-avoidance provisions in terms of sections 80A to 80 L, and the provisions of section 103 (the anti-avoidance provision in terms of assessed losses)⁸⁰ with these provisions enjoying precedence over the corporate rules⁸¹.

Whilst section 41 contains many other definitions, a discussion thereof is not required for the purposes hereof. The implications of sections 42, 44, 45, 46 and 47 of the Income Tax Act which require closer scrutiny will now be addressed⁸².

6.2 Asset-for-share transactions

Asset-for-share transactions are governed in terms of the provisions of section 42 of the Income Tax Act. Share-for-share transactions which were previously governed by the provisions of section 43 are with effect from 1 January 2007, also governed in terms of

⁷⁹ Subparagraph (ee) of the section 41 definition of a 'group of companies'

⁸⁰ A discussion on these provisions is not relevant for the purposes hereof

⁸¹ Section 41(2) of the Income Tax Act; Huxham and Haupt, 2009, page 309

⁸² The implications of section 46A, which provides for the limitation of costs applicable to unbundling transactions are not addressed herein as it not deemed to be relevant for the purposes of this discussion

the provisions of section 42 ('the asset-for-share provisions'). The aspects deemed to be the most significant aspects of this section have been expanded upon below.

6.2.1 General Requirements

An asset-for-share transaction envisages the disposal of an asset by a person (a natural person or a company (the transferor)) to a South African resident company (the transferee) in exchange for equity shares in the transferee. In addition, the asset-for-share provisions require that a transferor company must hold a qualifying interest in the transferee company at the end of the day on which the asset is disposed of.

A 'qualifying interest' in the context of an unlisted company involves the transferor holding at least 20% of the equity shares and the voting rights of a transferee company or holding an equity share in a company forming part of the same group of companies as the transferee company⁸³. A 'qualifying interest' in a listed company involves the transferor holding an equity share in that transferee company⁸⁴.

The asset-for-share provisions require that a capital asset acquired by the transferee must be treated as a capital asset⁸⁵, and an acquisition of trading stock must be treated as trading stock⁸⁶. An exception to this rule applies where the transferor and transferee are not part of the same group of companies, with the transferee being permitted to treat a capital asset acquired as trading stock⁸⁷.

⁸³ Subparagraphs (c) and (d) of the definition of a 'qualifying interest' as provided for in section 42(1)

⁸⁴ Subparagraph (a) of the definition of a 'qualifying interest' as provided for in section 42(1)

⁸⁵ Section 42(1)(b)(ii)

⁸⁶ Section 42(1)(b)(i)

⁸⁷ Section 42(1)(b)(iii)

The provisions of section 42 apply automatically on an asset-by-asset basis unless the transferor and transferee jointly elect that it should not apply⁸⁸.

6.2.2 Roll-over relief

It is important to note that a capital asset will be deemed to be transferred at its base cost, thereby not giving rise to any capital gains tax implications for the transferor⁸⁹. At the same time, the transferor's base cost in the equity shares acquired in the transferee company would be equal to the base cost of the asset disposed of to the transferee⁹⁰. Furthermore, the transferee's base cost of a capital asset acquired from the transferor would be that of the transferor's⁹¹, and the transferee's tax cost of trading stock acquired from the transferor would also be that of the transferor's⁹². The transferee company effectively steps into the shoes of the transferor company in terms of the asset transferred. This also applies to allowances claimable under section 24C in respect of contracts where a business is transferred as a going concern⁹³. In the case of capital assets in terms of which allowances have been claimed, no recoupments would be recognised in the transferor's hands and the transferee would be entitled to claim any future allowances thereon, if still applicable⁹⁴.

The section 42 relief only applies to the extent that assets are transferred in exchange for shares. Apportionment rules apply if additional consideration, other than in the form of shares, is forwarded to a transferor⁹⁵.

⁸⁸ Section 42(8A)(a)

⁸⁹ Section 42(2)(a)(i) read together with section 42(1)(a)(i)

⁹⁰ Section 42(2)(a)(ii)(bb)

⁹¹ Section 42(2)(b)(ii)(aa)

⁹² Section 42(2)(b)(ii)(bb)

⁹³ Section 42(3)(c)

⁹⁴ Section 42(3)(a) and (b)

⁹⁵ Section 42(4)

6.2.3 *Anti-Avoidance provisions*

Section 42 contains anti-avoidance provisions designed to combat abuse thereof and are triggered in the following instances:

- Where a transferor ceases to hold a qualifying interest in a transferee company within 18 months after the conclusion of an asset-for-share transaction (other than in terms of an intra-group transaction, an unbundling transaction, a liquidation, winding-up or deregistration (“transactions in terms of the corporate rules”) or in terms of an involuntary disposal), a deemed disposal and re-acquisition of the transferor’s remaining interest in the transferee company is triggered, thereby giving rise to a CGT liability to the transferor⁹⁶;
- Where the transferor disposes of an equity share in the transferee within 18 months after the conclusion of an asset-for-share transaction (other than transactions in terms of the corporate rules), the equity share disposed of could (in certain instances) be treated as the disposal of trading stock⁹⁷;
- Where the transferee company disposes of a capital asset within 18-months from the conclusion of an asset-for-share transaction, ring-fencing rules would apply to a portion of any resultant capital gain or loss⁹⁸;
- The ring-fencing rules would also apply to a portion of any recoupment of allowances arising on the disposal of a capital asset within the aforementioned 18-month period⁹⁹ and to any profit realised on the disposal of trading stock within

⁹⁶ Section 42(6)

⁹⁷ Section 42(5)

⁹⁸ Section 42(7)(a)

⁹⁹ Section 42(7)(b)(ii)

the 18-month period, unless the trading stock is of the same kind or equivalent quality as the trading stock it regularly and continuously sells¹⁰⁰.

6.2.4 The existence of any group taxation provisions in section 42

Whilst section 42 provides roll-over relief in terms of the disposal of an asset in exchange for shares, the relief is not of a permanent nature and has the effect of deferring or delaying the triggering of a taxable event. Furthermore, whilst this relief is similar to that afforded to group companies in a consolidation model (such as the Australian consolidation model which ignores the transfer of assets between group companies) it is not a classical form of group taxation relief, as the existence of a group of companies is not a prerequisite for the application of section 42. In addition, the provisions apply automatically on an asset-by-asset basis, but the transferor and the transferee company can jointly elect for the asset-for-share provision not to apply to the transfer of an asset. An election on this basis does not appear to be consistent with the principle of group taxation, again for example, such as in the case of Australia, where the group taxation rules apply automatically (after the group has elected for the consolidation group taxation to apply to it) and are not capable of being elected out of. It is an all-or-nothing approach. Section 42 does however accord a transferor forming part of the same group of companies an advantage in that it would meet the requirement of holding a qualifying interest in circumstances where it holds an equity share in a company forming part of the same group of companies as the transferee company. On the other hand, a transferee not being a member of the same group of companies as the transferor would have the option of treating a capital asset acquired as a capital asset or as trading stock.

A further group taxation-type relief is that the disposal of an asset or of an equity share in circumstances which would normally trigger the section 42 anti-avoidance provisions, are relaxed where the disposal is in terms of an intra-group transaction, an unbundling transaction or a liquidation transaction. Intra-group transactions, unbundling transactions

¹⁰⁰ Section 42(7)(b)(i) read together with paragraph (b) of the section 41 definition of 'trading stock'; Huxham and Haupt, 2009, page312

and liquidation transactions accord roll-over relief in a ‘group of companies’ scenario (although an unbundling transaction is permitted to take place where the shareholder is a listed company or in unlisted unbundlings to group companies).

Section 42 does therefore contain certain group tax-related provisions, albeit that it is not intended to provide relief in a ‘group of companies only scenario’.

6.3 Amalgamation transactions

6.3.1 General Requirements

Amalgamation transactions are governed by the provisions of section 44 of the Income Tax Act. It involves an amalgamation, conversion or merger of a company (the amalgamated company) in terms of which the amalgamated company disposes of all its assets (except those required to settle its trade debts) to a South African resident company (the resultant company) in exchange for equity shares in the resultant company or by the assumption of debt by the resultant company and in terms of which the amalgamated company’s existence is terminated¹⁰¹. The termination of the amalgamated company’s existence involves the liquidation, deregistration or wind up of the amalgamated company coupled with the distribution *in specie* of the shares in the resultant company to the shareholder of the amalgamated company. As in the case of the discussion of section 42, the aspects deemed to be the most significant aspects of this section have been expanded upon below.

The shareholder of an amalgamated company is required to hold a qualifying interest in the resultant company where equity shares in the resultant company have been distributed by an amalgamated company to its shareholder in terms of the liquidation, deregistration or wind up transaction of the amalgamated company¹⁰².

¹⁰¹ Section 44(1)(a) reads together with section 44(4)

¹⁰² Section 44(6)

The definition of a 'qualifying interest' in terms of an amalgamation transaction is similar to the section 42 definition with the only difference being that an equity share in a company forming part of the same group of companies is not included in the section 44 definition¹⁰³.

Section 44 applies automatically in the context of the disposal of an asset by the amalgamated company to the resultant company unless the holding company of the amalgamated company and the resultant company form part of the same group of companies and these three companies jointly elect for it not to apply¹⁰⁴.

There are two events which require consideration in terms of an amalgamation transaction, namely:

- The transfer by the amalgamated company of all its assets in exchange for equity shares in the resultant company; and
- The disposal of the shares in the amalgamated company and the transfer of the shares in the resultant company from the amalgamated company to its holding company.

6.3.2 Transfer of assets by the amalgamated company in exchange for shares in the resultant company in terms of an amalgamation transaction

6.3.2.1 Roll-over relief

Where the amalgamated company transfers its assets to the resultant company in exchange for shares in the resultant company, the following roll-over relief implications apply:

¹⁰³ As defined in Section 44(1). The section 42 definition of a 'qualifying interest' is set-out in paragraph 6.2.1 above

¹⁰⁴ Section 44(1)(b)

- An asset transferred as a capital asset and treated by the resultant company as a capital asset, is transferred at its base cost¹⁰⁵;
- Trading stock acquired by the resultant company as trading stock is transferred at its tax value¹⁰⁶; and
- In the case of capital assets in terms of which allowances have been claimed and would be claimable, no recouplements would be recognised in the transferor's hands and the resultant company would be entitled to claim any future allowances, if still applicable^{107 108}.

The roll-over relief also applies to allowances claimed (and claimable) under section 24C in respect of contracts where a business is transferred as a going concern¹⁰⁹. The aforementioned reliefs are all based on the fact that the resultant company effectively steps into the shoes of the transferor company.

The tax implications are virtually identical to the transfer of assets in the context of an 'asset-for-share' transaction with the only difference being that section 42 enables the transferee in a group of companies scenario to elect whether to treat a capital asset transferred to it as a capital asset or as trading stock.

¹⁰⁵ Section 44(2)(a)

¹⁰⁶ Section 44(2)(b)

¹⁰⁷ Section 44(3)(a)(i)

¹⁰⁸ Section 44(3)(a)(ii)

¹⁰⁹ Section 44(3)(b)

6.3.2.2 Anti-Avoidance provisions

Section 44 also has certain anti-avoidance provisions which could be triggered upon the disposal of the assets acquired by a resultant company from an amalgamated company within 18 months of the conclusion of the amalgamation transaction. In this regard, the following would be applicable:

- Ring-fencing rules would apply to a portion of any capital gain or loss arising as a result of the disposal of a capital asset by a resultant company^{110 111};
- The disposal by the resultant company of trading stock would result in any profits or losses in terms of such disposal being ring-fenced¹¹²; and
- Similarly, ring-fencing rules also apply to a portion of any recoupment arising on the disposal by the resultant company of a capital asset (in respect of which capital allowances could be claimed)¹¹³.

6.3.3 Disposal of shares in the amalgamated company and the transfer of shares in the resultant company from the amalgamated company to its holding company

6.3.3.1 Roll-over relief

The section 44 roll-over relief will only apply provided the amalgamated company has taken steps within 18 months after the date of the amalgamation transaction, to liquidate,

¹¹⁰ Section 44(5)(a)

¹¹¹ Section 44(5)(a)(ii), also Huxham and Haupt, 2009, page 318

¹¹² Section 44(5)(b)(i)

¹¹³ Section 44(5)(b)(ii)

wind up or deregister or has not done anything which prevents its liquidation, winding-up or deregistration from taking place¹¹⁴.

Roll-over relief also applies where the amalgamated company's holding company disposes of its interest in the amalgamated company (as part of its liquidation, wind up or deregistration), and in turn acquires equity shares in the resultant company either as capital assets or trading stock, and holds a qualifying interest in the resultant company¹¹⁵.

The holding company is deemed to have disposed of its equity shares in the amalgamated company at the base cost (or at the tax cost) thereof and to have acquired the equity shares in the resultant company at that same base cost (or tax cost), depending on whether the shares in the amalgamated company were disposed of and the shares in the resultant company were acquired as capital assets or as trading stock, as the case may be¹¹⁶.

Accordingly, no CGT or income tax consequences would arise. The shares in the amalgamated company are effectively replaced with shares in the resultant company.

Furthermore, acquisition by the holding company of the shares in the resultant company in terms of a distribution *in specie* from the amalgamated company, is deemed not to be a dividend¹¹⁷.

6.3.3.2 *Anti-Avoidance provision*

Where the holding company ceases to hold a qualifying interest in the resultant company within 18 months after the conclusion of an amalgamation transaction (other than transactions in terms of the corporate rules or in terms of an involuntary disposal), a

¹¹⁴ Section 44(13)

¹¹⁵ Section 44(6); the definition of a 'qualifying interest' is set-out in paragraph 6.2.1 above

¹¹⁶ Section 44(6)(b)(i),(ii) and (iii) and section 44(6)(c)

¹¹⁷ Section 44(8) and section 44(9) read together

deemed disposal and re-acquisition of the holding company's remaining interest in the resultant company is triggered¹¹⁸.

6.3.4 *The existence of any group taxation provisions in section 44*

As in the instance of section 42, section 44 provides roll-over relief in terms of the transfer of assets and shares (similar to those granted in terms of international group taxation principles), but there appears little, if any, group taxation relief to parties to an amalgamation transaction.

The types of relief that would normally apply in the case of a group are present, but the availability of the section 44 relief is not dependent on the existence of a group of companies. In this regard, the distribution *in specie* by an amalgamated company of its interest in a resultant company to its holding company or shareholder, as the case may be is relevant. The relief accorded in this instance is that the distribution would not give rise to any STC in the amalgamated company's hands and would not be recognised as the accrual of a dividend in the holding company's or the shareholder's hands. This relief is also not dependant on the existence of a group of companies.

Where the resultant company and the shareholder or holding company of the amalgamated company are part of the same group of companies an election for the provisions of section 44 not to apply could be made. This, it is submitted cannot be construed as being a group taxation relief.

Save therefore for the presence of roll-over relief on the transfer of assets and shares, section 44, it is submitted, does not contain any provisions that can be ascribed to a group taxation regime.

¹¹⁸ Section 44(11)

6.4 *Intra-group transactions*

Intra-group transactions are governed in terms of the provisions of section 45 of the Income Tax Act. The following are deemed the most significant provisions of section 45.

6.4.1 *General Requirements*

An intra-group transaction involves the transfer of an asset by one company (the transferor company) to a South African resident company (the transferee company) where both companies at the end of the day on which the transaction is concluded, form part of the same group of companies¹¹⁹. The intra-group transaction provisions apply automatically unless the transferor and transferee companies jointly elect for the provisions of section 45 not to apply¹²⁰.

6.4.2 *Roll-Over relief*

The section 45 roll-over relief rules in terms of the following transfers are a mirror image of the roll-over relief provisions as discussed in terms of the rules applicable to amalgamation transactions¹²¹:

- The transfer of an asset held as a capital asset by the transferor company to the transferee company who acquires it as a capital asset¹²²;
- The transfer of an asset held as trading stock by the transferor company to the transferee company who acquires it as trading stock¹²³;

¹¹⁹ Section 45

¹²⁰ Section 45(6)(g)

¹²¹ As set-out on paragraph 6.3.2.1 above

¹²² Section 45(2)(a)

¹²³ Section 45(2)(b)

- The transfer of an asset held as a capital asset (in terms of which capital allowances could be claimed) by the transferor company to the transferee company who acquires the capital asset on the same basis¹²⁴; and
- The transfer of a business as a going concern where allowances have been claimed or are claimable under section 24C¹²⁵.

6.4.3 *Anti-Avoidance provisions*

Anti-avoidance provisions apply where a transferee company degroups from the group of companies in terms of which it and the transferor company belong to, as well as in instances where the asset acquired by a transferee company is disposed of within 18 months after the conclusion of the intra-group transaction.

Where a transferee company has acquired an asset in terms of an intra-group transaction and ceases to form part of the same group of companies as the transferor company within a period of 6 years after the intra-group transaction, the following section 45 degrouping provisions would be triggered:

- In the case of an asset held as a capital asset, the degrouping would result in the deemed disposal and re-acquisition by the transferee company of that asset¹²⁶;
- In the case of an asset held as a capital asset (in respect of which allowances could be claimed), degrouping would give rise to the recoupment of the allowances previously claimed in the transferee company's hands¹²⁷; and

¹²⁴ Section 45(3)(a)

¹²⁵ Section 45(3)(b)

¹²⁶ Section 45(4)(b)(i)

¹²⁷ Section 45(4)(b)(ii)

- In the case of an asset held as trading stock, the degrouping provisions would give rise to a deemed sale and re-acquisition of the trading stock¹²⁸.

No degrouping arises in the case of the liquidation, wind up or deregistration of a transferor or transferee company, where the holding company holds at least 70% of the equity shareholding of the company subject to the liquidation, wind up or deregistration¹²⁹.

In addition, where an asset acquired in terms of an intra-group transaction is disposed of within 18 months of the intra-group transaction, the anti-avoidance provisions as discussed in terms of the amalgamation transactions would apply, and the tax implications which arise in the hands of the resultant company would equally apply to the transferee company in the intra-group transaction scenario¹³⁰.

6.4.4 The existence of any group taxation provisions in section 45

Section 45 is the one section in the Income Tax Act which comes closest to a group taxation type provision. The reason for this being that the section 45 relief provisions can only apply where parties to an intra-group transaction are part of the same group of companies. In a consolidation regime (such as the Australian model), intra-group transactions are ignored for income tax purposes. The underlying principles in terms of the section 45 intra-group transfers and the Australian consolidation regime therefore appear to be the same i.e. they are permitted in the context of a group of companies.

It is submitted therefore, that section 45 represents the existence of an element of group taxation.

¹²⁸ Section 45(4)(b)(iii)

¹²⁹ Section 45(4)(c)

¹³⁰ Section 45(5); paragraph 6.3.2.2 above

6.5 *Unbundling transactions*

6.5.1 *General Requirements*

Unbundling transactions envisage the unbundling of a company (the unbundled company), which is either a South African resident or a controlled foreign company¹³¹, in terms of which the shareholders of any listed company or the group company shareholders of an unlisted company (the unbundling company) acquire by way of a distribution *in specie*, all the distributable shares held by the unbundling company and in terms of which the effective shareholding of the shareholders or group company shareholders in the underlying shares are not changed by the transaction¹³².

In addition to the requirements noted above, the following should also be taken cognisance of:

- A listed unbundling company must be a South African resident¹³³;
- The listed unbundling company must hold at least 35% of the equity shares in a listed unbundled company or hold more than 25% of the equity shares if no other person holds an equal or greater amount¹³⁴;
- The holding company of an unlisted unbundling company must form part of the same group of companies as the unlisted unbundling company¹³⁵ and the

¹³¹ Income Tax Act, Section 9D

¹³² Huxham and Haupt, 2009, page 326; section 46

¹³³ Section 46(1)

¹³⁴ Proviso (i) to Section 46(1)

¹³⁵ Section 46(1)(b)

unbundling company must hold more than 50% of the equity shares in an unlisted unbundled company¹³⁶; and

- Where the unbundled company is a controlled foreign company, the holding company of the unbundling company must own at least 95% of the equity shares in the unbundling company¹³⁷.

The equity shares acquired by the shareholder of the unbundling company (i.e. the unbundled shares) must be acquired as trading stock, if held by the unbundling company as trading stock, and as capital assets, if held by the unbundling company as capital assets¹³⁸.

6.5.2 *Roll-Over relief*

Section 46 lays down criteria for the allocation of the base cost and tax cost in terms of the unbundled shares. The base cost or tax cost (as the case may be) allocated to the unbundled shares is deemed to have been incurred on the same date as the date of the acquisition of the unbundling shares¹³⁹. The effect of these provisions is that the unbundling company does not make any capital gain or loss in terms of the acquisition of the unbundled shares¹⁴⁰.

Furthermore, the distribution of the unbundled shares to the shareholder of the unbundling company is not a dividend and therefore does not create any STC liability for the unbundling company¹⁴¹.

¹³⁶ Proviso (ii) to section 46(1)

¹³⁷ Section 46(1)(d)

¹³⁸ Section 46(3)(a)(iii)

¹³⁹ Section 46(3)(a)(iv)

¹⁴⁰ Huxham and Haupt, 2009, page 327

In the context of the distribution of shares in an unlisted unbundled company, section 46 permits an unlisted unbundling company and its group company shareholder to jointly elect for the provisions of section 46 not to apply to that unbundling transaction¹⁴².

6.5.3 The existence of any group taxation provisions in section 46

Generally, group taxation relief applies in the case of unbundling companies who are listed companies, as well as to a distribution by an unlisted unbundling company of its shareholding in an unlisted unbundled company to its shareholder, who together with it, forms part of the same group of companies. The effect of this distribution is that no STC or CGT arises in the unbundling company's hands.

The unbundling relief in the context of listed companies is however, not dependant on the existence of a group of companies.

Interestingly, there are no anti-avoidance provisions in section 46 as in the case of the other corporate rules.

6.6 Transactions relating to liquidation, winding-up and deregistration

These transactions are governed in terms of the provisions of section 47 of the Income Tax Act.

6.6.1 General Requirements

Section 47 applies in instances where a liquidating company distributes all its assets (other than assets retained to settle its trade debts) to its holding company in anticipation of, or in the course of the liquidation, winding-up or deregistration of the liquidating

¹⁴¹ Section 46(5)(a)

¹⁴² Section 46(8)

company, and the liquidating company and its holding company form part of the same group of companies, or the holding company holds at least 95% of the liquidating company's equity shares¹⁴³.

The section 47 relief does not apply, *inter alia*, where the parties to a liquidating transaction jointly elect for it not to apply or where the liquidating company has not within 18 months of the liquidation distribution taken steps to liquidate, wind up or deregister, or to withdraw from or take steps which results in the liquidation, wind up or deregistration not taking place¹⁴⁴.

6.6.2 Roll-Over relief

The section 47 roll-over relief rules in terms of the following are also a mirror image of the roll-over relief provisions as discussed in terms of the rules applicable to amalgamation transactions¹⁴⁵ (i.e. the position of the liquidating company being similar to that of the amalgamating company and its holding company being similar to that of the resultant company):

- The disposal of an asset held as a capital asset in terms of a distribution by the liquidating company to its holding company who acquires it as a capital asset¹⁴⁶;
- The disposal of an asset held as trading stock in terms of a distribution by the liquidating company to its holding company who acquires it as trading stock¹⁴⁷;

¹⁴³ Section 46(1)(a)

¹⁴⁴ Section 47(6)

¹⁴⁵ As set-out in paragraph 6.3.2.1 above

¹⁴⁶ Section 47(2)(a)

¹⁴⁷ Section 47(2)(b)

- The disposal of an asset held as a capital asset (in respect of which capital allowances could be claimed) in terms of a distribution by the liquidating company to its holding company who acquires the capital asset on the same basis¹⁴⁸; and
- The transfer of a business as a going concern where allowances have been claimed or are claimable under section 24C¹⁴⁹.

A further requirement for the aforementioned relief is that the holding company must dispose of its shares in the liquidating company subject to the liquidation, winding-up or deregistration of the liquidating company, and the holding company has not assumed any of the liquidating company's debt other than the refinancing of any debt incurred more than 18 months prior to the disposal or it involves the assumption of ordinary trade debt of a business transferred to the holding company as a going concern¹⁵⁰.

6.6.3 *Anti-Avoidance provisions*

Where an asset disposed of in terms of a liquidation transaction is disposed of within 18 months from the conclusion of the liquidating transaction, the anti-avoidance provisions as discussed in terms of the amalgamation transactions would apply and the tax implications which arise in the hands of the resultant company would equally apply to the holding company (of a liquidating company)¹⁵¹.

6.6.4 *The existence of any group taxation provisions in section 47*

The operation of the roll-over relief provisions, save in the case of a holding company which holds at least 95% of the equity shares in a liquidating company, apply only in a

¹⁴⁸ Section 47(3)(a)

¹⁴⁹ Section 47(3)(b)

¹⁵⁰ Section 47(3A)

¹⁵¹ Section 47(4)

group of companies scenario (i.e. the liquidating company and the holding company must be part of the same group of companies in order to qualify for the section 47 roll-over relief).

As in the case of most of the corporate rules sections, the effect of the section 47 relief is merely to delay the tax events which could arise in the future. This would appear to be in line with group taxation principles internationally.

It is submitted that these are the only aspects of section 47 which display attributes of a group taxation regime.

Based on the comments made with respect to the corporate rules above, it is submitted that the corporate rules as set-out in sections 41 to 47, whilst not qualifying as a group taxation regime *per se*, do represent elements consistent with those of a group taxation regime.

University of Cape Town

Chapter 7: Other Group Taxation reliefs in the tax legislation

The discussion in this chapter addresses whether or not there are any other sections in the Income Tax Act (other than the corporate rules) which display characteristics or attributes of a group taxation regime. Whilst an attempt has been made to highlight most of the sections displaying attributes or characteristics of group taxation, the sections highlighted should not be considered to be an exhaustive list of such provisions.

As indicated in the introductory remarks in Chapter 6, group taxation characteristics or aspects which are to be found in the Value-Added Tax Act, the Securities Transfer Tax Act and the Transfer Duties Act will also be addressed in this chapter.

7.1 Provisions in the Income Tax Act which could be construed as containing group taxation type provisions (other than the corporate rules)

7.1.1 Connected Persons Definition

Whilst the 'connected person' definition¹⁵² itself is not a group relief provision, it is submitted the part of the definition dealing with companies has, in the context of a group of companies, a feeling of group taxation to it. Section 1 defines a 'connected person' in the context of a company, as:

"...any other company that would be part of the same group of companies as that company if the expression 'at least 70 per cent' in paragraphs (a) and (b) of the definition of a 'group of companies' in this section were replaced by the expression 'more than 50 per cent';..."

Clearly therefore, in the context of a group of companies (i.e. in terms of the 70% requirement) all companies within the group would be connected persons in relation to each other. There are other elements to the 'connected person' definition in as far as its

¹⁵² Section 1 of the Income Tax Act

reference to a company is concerned. These have however not been dealt with as they are not deemed relevant for the purposes of this research paper.

7.1.2 *Controlled Foreign Companies (“CFC’s”)*

The taxation of CFC’s is dealt with in terms of section 9D¹⁵³. The provisions of section 9D are very complex and wide ranging. The comment on section 9D in the context of group taxation (and for purposes hereof) is at a conceptual level only. Accordingly, no in-depth analysis and comment on section 9D is required for purposes hereof.

The significance of CFC’s is that where more than 50% of the voting rights or the participation rights in a foreign company are held by a South African resident, or held together with other South African residents, the income of that foreign company would generally be attributed to the taxable income of the South African resident in accordance with the voting or participation rights in the foreign company, unless certain exemptions apply. In circumstances such as these, the foreign company is regarded as a CFC of the South African resident.

There are certain instances in which the section 9D CFC rules would not apply, for example, in terms of the foreign business establishment exemption¹⁵⁴. This exemption could apply in certain limited instances. The most popular one is where the foreign company is able to demonstrate that it has a place of business in the form of an office, shop, factory, warehouse or other structure that is used by the CFC for the carrying on of its business and is used for the period of more than one year, and further, is suitably staffed with on-site management and staff of that CFC, who are employed to render services on a full-time basis¹⁵⁵. It is furthermore required in terms of this definition that the CFC’s place of business must be suitably equipped, has proper facilities, is located outside South Africa and is used for *bona fide* business purposes.

¹⁵³ Income Tax Act

¹⁵⁴ Section 9D(9)(b)

¹⁵⁵ Paragraph (a) of the definition of a ‘foreign business establishment’ as defined in section 9D

As the requirement for a foreign company is based on a 'more than 50%' level, it follows that where 70% or more of the equity shareholding (which includes 70% of the voting or participation rights) of a foreign company are held by a South African resident, that a CFC in this context could form part of a group of companies in terms of the wider section 1 'group of companies' definition.

Despite the fact that section 9D is a provision which is more anti-avoidance in nature (as it seeks to attribute the income of a passive offshore entity into the South African tax net), it is submitted that section 9D (to the extent that the income of a CFC is attributed to a South African resident group holding company), could be viewed as a group taxation provision. It is akin to the income of a subsidiary being attributed to a parent, and as if the parent and subsidiary form part of a single unit.

7.1.3 Section 24I(10) of the Income Tax Act

The provisions of section 24I govern the taxation of gains and losses arising in terms of transactions concluded in foreign currency. Whilst section 24I is a fairly comprehensive provision and deals with many different instances in which foreign exchange gains and losses could arise, it is the implications of section 24I(10) (and only in the context of its application to a group of companies) which are relevant for the purposes of this discussion.

Section 24I(10) essentially provides that foreign exchange differences arising in certain instances involving related companies must be ignored for income tax purposes. Of relevance for the purposes hereof are that group companies are impacted by the provisions of section 24I(10)¹⁵⁶.

¹⁵⁶“(10) ..., no amount shall in terms of this section be included or deducted from the income of-

The effect of the provisions quoted below¹⁵⁷ is that foreign exchange differences arising in terms of the following transactions are deferred for income tax purposes:

- Transactions between a South African resident (“SA Co”) and a foreign company who is a connected person in relation to SA Co;
- Transactions between SA Co and a CFC of SA Co (or any other South African company who is in the same group of companies as SA Co); or
- Transactions between a CFC of SA Co and any other CFC of SA Co (or a CFC of another South African company resident company in the same group as SA Co).

From the above it is clear that the deferring for income tax purposes of the foreign exchange differences in transactions involving the aforementioned parties in a group of

(a) *any resident in respect of any exchange difference determined on the translation of an exchange item to which that resident and any company are parties, where that company is–*

(i) *a connected person in relation to that resident; or*

(ii) *a controlled foreign company in relation either to that resident or to any other company, which is a resident, and which other company forms part of the same group of companies as that resident; or*

(b) *...; or*

(c) *any controlled foreign company in relation to a resident in respect of any exchange difference determined on the translation of an exchange item to which that controlled foreign company and any other controlled foreign company in relation to either that resident or to any other resident company and which forms part of the same group of companies as that resident are party;...*

¹⁵⁷ i.e. in terms of footnote 156

companies' scenario, could be of assistance to a group company where, for example, a foreign exchange gain would have to be ignored for income tax purposes. Deferring a foreign exchange loss on the other hand, would mean that the foreign exchange loss could not be claimed as a deduction against the taxable income of the SA company. It is submitted that these provisions, to the extent that they relate to companies and groups of companies, are provisions containing elements of group taxation.

7.1.4 Donations Tax

Part V of the Income Tax Act contains the donations' tax provisions. In terms of these provisions, donations' tax is payable on the value of any property disposed of under any donation by a South African resident¹⁵⁸. A donation is defined as a gratuitous disposal of property or any waiver or renunciation of a right¹⁵⁹. Donations' tax is payable at the rate of 20% on the value of the donation¹⁶⁰.

Section 56 of the Income Tax Act however exempts certain donations from donations' tax. More specifically, and in the context of a group of companies, a company donating property ('donor') to a South African resident company who is a member of the same group of companies as the donor, is exempted from liability for donations' tax¹⁶¹.

The relief provided for in this provision is clearly aimed specifically in the group of companies' scenario. The exemption from donations' tax in this context appears to be consistent with the treatment applied in terms of a consolidation tax regime in which intra-group transfers are ignored for tax purposes and is therefore submitted to be an element of group taxation.

¹⁵⁸ Section 54; Huxham and Haupt, 2009, p.666

¹⁵⁹ As defined in section 55

¹⁶⁰ Section 64; Huxham and Haupt, 2009, p.666

¹⁶¹ Section 56(1)(r)

7.1.5 Dividends and STC

STC at the rate of 10 % is generally payable by a company declaring a dividend to its shareholders. A detailed definition of a dividend (not relevant for the purposes of this research paper) is contained in section 1 of the Income Tax Act. Of relevance however would be the exclusions in terms of the dividend definition.

In this regard, paragraph (g) of the definition of a 'dividend' provides that an amount distributed by a company to its holding company in circumstances where the company and its holding company form part of the same group of companies (in terms of the section 41 definition), the amount distributed would not be a dividend to the extent that the holding company reduces the cost of the shares held in the declaring company in accordance with the generally accepted accounting practice, as a result of that distribution¹⁶².

The effect of this paragraph is that if a company becomes part of a group of companies, any realised and unrealised pre-acquisition profits can be paid to the holding company without triggering a liability to pay STC¹⁶³.

Whilst this appears to be a form of group relief, all it succeeds in doing is giving rise to a CGT liability in the hands of the company, as the distribution is a repayment of capital for CGT purposes¹⁶⁴.

Part VII of the Income Tax Act contains the STC provisions which come into operation once a dividend declaration has occurred. Section 64B(5) however also contains a provision which at the election of the company declaring the dividend, exempts dividends

¹⁶² Paragraph (g) of the definition of a 'dividend as provided for in section 1 of the Income Tax Act

¹⁶³ Huxham and Haupt, 2009, page 346

¹⁶⁴ Id. P.346; Paragraph 74 of the 8th schedule to the Income Tax Act

from attracting STC. In this regard, section 64B(5)(f) requires the following to be applicable in order for the exemption from STC to apply:

- The company declaring the dividend, and its shareholder, in whose favour the dividend is declared, must form part of the same group of companies. (Note however that the declaration of a dividend by the shareholder company to its subsidiary cannot qualify for this exemption);
- The dividend is taken into account in the determination of the profits of the shareholder company;
- The shareholder company would be subject to STC where the shareholder company on-declares the dividend and not elect for the section 64B(5)(f) relief to apply to this dividend;
- The dividend does not consist of shares in the shareholder company; and
- In electing for the section 64B(5)(f) election to apply, the company declaring the dividend has to notify SARS in writing (of the election) in the appropriate form prescribed by no later than the day on which the STC would have been due¹⁶⁵.

Important to note further is the fact that the receipt of a dividend which was subject to the section 64B(5)(f) exemption cannot be taken into account by the shareholding company in calculating its available STC credits¹⁶⁶.

The 64B(5)(f) exemption is clearly only available to the extent that the company declaring the dividend and the shareholding company (in whose favour the dividend has been declared) form part of the same group of companies. This accordingly represents a form of group taxation relief. As in the instance of the corporate rules however, the relief

¹⁶⁵ Section 64B(5)(f)

¹⁶⁶ Section 64B(3A)(a)

is of a temporary nature, as STC could be triggered (if the shareholding company does not have STC credits at its disposal which exceed the dividend on-declared) when the shareholding company on-declares the dividend received from its subsidiary.

7.1.6 Deemed Dividends

The Income Tax Act also contains provisions in terms which certain transactions are deemed to be dividends. These provisions are aimed at countering schemes in which amounts are distributed by a company in a form other than the declaration of a dividend or a deemed declaration as contemplated in section 64B¹⁶⁷. These deemed dividends give rise to a liability for STC in the hands of the company that is deemed to have declared the dividend. As in the case of section 64B, section 64C, which identifies in which instances a deemed dividend would arise, contains an exemption-provision which provides for relief from STC. In this regard, section 64C(4)(k) provides that the amounts contemplated below, which are distributed, transferred, released, relieved, paid, settled, used, applied, granted or made available for the benefit of a shareholder who forms part of the same group of companies as the person that is deemed to have declared the dividend, or a connected person to that shareholder, if the connected person and the shareholder form part of the same group of companies, would be exempted from the section 64C deeming provisions.

The exemptions from the section 64C deeming provisions are the following:

- Any cash or asset distributed or transferred by a company to or for the benefit of its shareholder or any connected person in relation to that shareholder¹⁶⁸;
- Where the shareholder or a connected person in relation to it is released from a monetary obligation owed by the shareholder or the connected person to a

¹⁶⁷ Huxham and Haupt, 2009, page 364

¹⁶⁸ Section 64C(2)(a)

company, provided that the amount owing has not already been deemed to be a dividend¹⁶⁹;

- Where the company pays a debt owing by its shareholding company or a connected person of the shareholder¹⁷⁰;
- An amount applied or used by a company, other than in the aforesaid ways, for the benefit of the shareholder, or a connected person of that shareholder¹⁷¹; and
- A loan or advance granted to the shareholder or a connected person of that shareholder¹⁷².

The aforementioned section 64C exemptions, as in the case of the section 64B exemption is dependant solely on the existence of a group of companies, without which, no exemption from STC would be available. This too can be considered to be an element of group taxation.

7.1.7 The 8th Schedule to the Income Tax Act

Tax relief provisions which are premised on the existence of a group of companies are also to be found in the 8th schedule to the Income Tax Act.

7.1.7.1 Paragraph 12

Paragraph 12 of the 8th schedule applies in terms of events treated as disposals and acquisitions thereby giving rise to a CGT liability. Paragraph 12(5) applies where a

¹⁶⁹ Section 64C(2)(b)

¹⁷⁰ Section 64C(2)(c)

¹⁷¹ Section 64C(2)(d)

¹⁷² Section 64C(2)(g)

creditor discharges, or reduces a debt owed by a person to a creditor for no consideration, or where the creditor reduces the debt owed, the debtor would be regarded as having made a profit on the sale of a claim. The provisions of paragraph 12(5) would not apply however, where the debtor and creditor are both part of the same group of companies, provided the transactions were not part of a scheme to avoid any paragraph 12(5) liability and the debt had been acquired outside the group of companies or the companies became part of the group of companies only after the debt arose¹⁷³.

The aforementioned could be considered to be a form of group relief from a CGT perspective. As the relief available in paragraph 12(5) is dependant on the existence of a group of companies, it is submitted that this too is an element of group taxation.

7.1.7.2 Paragraph 39

An example of a restrictive provision in the 8th schedule of the Income Tax Act is to be found in paragraph 39. In terms of this paragraph, a company ('transferor') must disregard a capital loss arising from the disposal of an asset to another company that is a member of the same group of companies as the transferor immediately after the disposal¹⁷⁴. This is another example of an attribute which could be found in a group taxation regime.

7.1.7.3 Paragraph 64B

A further example of a group taxation provision is the 'participation exemption' relief in terms of paragraph 64B of the 8th schedule¹⁷⁵. This paragraph exempts from CGT, the disposal by a person ('transferor') who holds at least 20% of the equity share capital and

¹⁷³ Paragraph 12(5)

¹⁷⁴ Huxham and Haupt, 2009, page 816; paragraph 39 of the 8th schedule to the Income Tax Act. This paragraph also has application with reference to a disposal by a person to a connected person in relation to that transferor prior to the disposal

¹⁷⁵ Of the Income Tax Act

the voting rights in a foreign company (for a period of at least 18 months prior to the disposal) and the disposal is to a non-resident who is not a controlled foreign company (“CFC”), or in terms of a deemed disposal as a result of a person or CFC ceasing to be a resident, or further, in terms of a disposal to the CFC of the transferor, or a CFC who forms part of the same group of companies as the transferor¹⁷⁶.

The relief attributable to a group of companies is that the ‘at least 20%’ requirement in terms of the equity shareholding and voting rights would also be satisfied if the joint equity shareholding and the voting rights of two or more companies forming part of the same group of companies together, make up at least 20%¹⁷⁷. Paragraph 64B does contain certain anti-avoidance provisions. A discussion thereof is however not deemed necessary for the purposes hereof.

It is submitted that the aforementioned provisions, in addition to the corporate rules referred to in Chapter 6, represent elements present in the Income Tax Act which are consistent with the workings of a group taxation regime.

7.2 Elements of group taxation existing in other South African tax legislation

This part seeks to identify to what extent elements of group taxation exist in other South African tax legislation, such as the VAT Act, the Transfer Duties Act and the Security Transfer Tax Act.

7.2.1 The VAT Act

Section 8(25) of the VAT Act applies to transactions taking place in terms of the corporate rules as provided for in the Income Tax Act. In this regard where transactions involve the transfer of goods and services from one vendor to another in terms of sections

¹⁷⁶ Paragraph 64B of the 8th schedule to the Income Tax Act

¹⁷⁷ Paragraph 64B(a)

42, 44, 45 or 47, the VAT Act treats these transactions as non-supplies as both vendors are treated as one and the same person¹⁷⁸. It is submitted that the underlying approach in terms of section 8(25) (in the context of the corporate rules) appears to be that the VAT Act treats a group of companies as one unit and, as in the case of a group taxation regime, for example a consolidation regime, ignores the intra-group transfer of assets.

A further point to take note of is a practice of SARS, in the context of the intra-group supply of goods and services, in circumstances where the group companies have failed to account for both input and output VAT due, for example, to the existence of an error on their accounts payable and accounts receivable systems. The net result of such an error occurring is that there would be an under-declaration to SARS of output VAT (in terms of the company rendering the taxable supply), as well as an under-claim of input VAT (in terms of the company receiving the taxable supply). Based on the first-hand knowledge of the writer and in terms of taxpayers whose identity cannot be disclosed for the purposes of this research paper, SARS has in instances such the one described above, remitted both interest and penalties raised on assessment, based on the argument that the intra-group supply of goods and services give rise to an 'in-and an out', in the sense that the group company rendering the taxable supply would typically pay over output VAT to SARS, whereas the other group company would simultaneously, be entitled to a claim for input VAT in terms of the acquisition of the supplies. This approach of SARS is an indication that even SARS is prepared, in certain instances (in the absence of legislation to that effect), to accept the implications of the existence of a group of companies and the practical realities of intra-group transactions.

7.2.2 *The Transfer Duty Act*

Transfer duty is in terms of section 2 of the Transfer Duty Act imposed on the transfer of, *inter alia*, fixed property situated in South Africa, with the transfer duty being payable by

¹⁷⁸ Section 8(25) of the VAT Act

the acquirer of the property¹⁷⁹. Transfer duty is payable by either a natural person or a company, as the case may be.

Section 9 of the Transfer Duty Act is an exemption provision and exempts, *inter alia*, a company from paying transfer duty on the transfer of property in terms of:

- An amalgamation transaction¹⁸⁰;
- An intra-group transaction¹⁸¹; and
- A liquidation distribution¹⁸².

The exemption from transfer duty in terms of asset-for-share transactions is dealt with under a different exemption provision¹⁸³. In terms of this provision, the asset-for-share transactions¹⁸⁴ are exempted from transfer duty if the section 8(25) VAT exemption¹⁸⁵ applies and a declaration confirming the VAT exemption is furnished.

It appears that transfer duty is exempted as a result of the transferee company (or the resultant company, or the holding company of the liquidating company, as the case may be) effectively stepping into the shoes of the transferor company (or the amalgamating company, or the liquidating company, as the case may be). It is submitted that these exemptions too, are premised on the philosophy of group taxation.

¹⁷⁹ 'property' is defined in section 1 of the Transfer Duty Act and includes real rights in land (excluding mortgage bonds and certain leased property and lots, the rights or sub-lease of the rights, the shares or member's interest in a residential property company and certain contingent rights to property)

¹⁸⁰ Income Tax Act, section 44

¹⁸¹ Ibid, section 45

¹⁸² Ibid, section 47

¹⁸³ Section 9(15A) of the Transfer Duty Act; Huxham and Haupt, 2009, page 903

¹⁸⁴ In terms of the provisions of section 42 of the Income Tax Act

¹⁸⁵ Section 8(25) of the VAT Act

7.2.3 *Securities Transfer Tax*

Securities Transfers Tax is a tax imposed on the transfer of all shares in companies (and the members' interest in close corporations) incorporated in South Africa, and on transfer of shares in foreign companies listed on a South African stock exchange¹⁸⁶. The Securities Transfer Tax Act effectively replaced the Stamp Duties Act¹⁸⁷ with reference to the transfer of the beneficial interest in a share or a security¹⁸⁸.

Section 8 of the Securities Transfer Tax Act exempts from Securities Transfer Tax the transfer of securities in terms of section 42 to section 47 of the Income Tax Act. As in the case of transfer duty, it is submitted that this exemption from securities transfer tax is premised on the philosophy of group taxation as this particular exemption is clearly aimed to give the same protection provided in terms of the Income Tax Act, the VAT Act and the Transfer Duty Act.

Based on the views highlighted in the discussion in chapter 6, as well as the discussion in this chapter, it is submitted that the provisions highlighted therein are clear indicators that many elements of group taxation exist presently in the South African context. The key features of the classic group taxation regimes, for example, the consolidation regime and group relief regime (i.e. the entitlement of a group of companies to consolidate into one entity for income tax purposes, or the ability to transfer losses between companies forming part of the same group of companies) do not however, apply in the South African context. It is the absence of these key features which lead people to conclude that group taxation does not exist in South Africa, whereas a careful study of the South African tax legislation would highlight that there are elements of group taxation present, as opposed to not being present at all.

¹⁸⁶ Section 2 of the Securities Transfer Tax

¹⁸⁷ No.77 of 1968

¹⁸⁸ Huxham and Haupt, 2009, page 903

Chapter 8 seeks to address the question on why South Africa does not have a formal group taxation regime in place and whether or not South Africa is at a disadvantage as a result thereof.

University of Cape Town

Chapter 8: Is South Africa disadvantaged by not having Group Taxation (incorporating the informal views of a senior official of National Treasury)?

Chapters 6 and 7 highlighted the provisions in the Income Tax Act, which in the view of the writer could be construed as containing elements of group taxation.

This chapter will seek to address why the Katz Commission's recommendations on group taxation were not implemented, what National Treasury's view on group taxation is, and what it intends doing in terms of implementing group taxation.

In this regard, an informal interview was held with a senior official in the Department of National Treasury. The views expressed by this senior official are the views of the individual concerned, but in all likelihood represent what the thinking behind National Treasury's lack of action in terms of group taxation is.

The following represent the informal views expressed by the senior official concerned in response to the questions raised below:

8.1 Why have the recommendations of the Katz Commission not been implemented?

Group taxation has always been on National Treasury's agenda as an issue that requires addressing. The main challenge however is one of priority. Addressing the concept of group taxation is not viewed as one that requires prioritization at this stage. Therefore, the failure to respond to the recommendations of the Katz Commission does not indicate that National Treasury is not entertaining any thoughts on the implementation of group taxation.

Furthermore, from National Treasury's perspective (i.e. the official's perspective), elements of group taxation exist in the Income Tax Act, for example, intra-group transactions in terms of the corporate rules, STC exemptions and foreign currency legislation (as set-out above in previous chapters).

8.2 *Was the introduction of the corporate rules only in response to the advent of CGT (as indicated in the explanatory memorandum to the 2001 Amendment Act), or was its introduction to some extent motivated by group taxation considerations?*

The introduction of CGT goes beyond group taxation, as group taxation is but one of the elements of CGT. It was as a result of CGT that the corporate rules were introduced, as in the absence thereof, mergers, in the context of a multi-tier group could give rise to adverse CGT consequences for companies within the group. This is viewed as being in line with international practice.

8.3 *What is National Treasury's view on group taxation?*

Save for re-iterating that group taxation is always an item that remains on National Treasury's 'to-do' list, the question really is what do people want out of group taxation?

From the senior official's perspective the debate remains at a theoretical level (i.e. consolidation or group relief ('loss transfer')) as opposed to dealing with group taxation at a practical level. At the practical level, the main issues appear to be the following:

- Loss sharing;
- The treatment of intra-group charges such as interest, royalties and management fees;
- Whether a group of companies should file one tax return or many returns;
- Liability for tax: Should this lie with the parent or the subsidiary or should there be a joint liability for the tax;

- The possible strengthening of the corporate rules;
- Is group taxation beneficial or burdensome? This is based on the view that a full-blown group taxation regime is very complex and compliance with it would be very burdensome and complicated and would take up a significant amount of SARS' resources;
- Is group taxation feasible or beneficial? As to whether or not it would be beneficial, the reality is that out of a population of 45 million, only 8 million are taxpayers. Of these 8 million taxpayers, approximately 250 – 300 are listed companies. It is these few companies which potentially stand to gain from group taxation. From this perspective, one has to question whether or not it is worthwhile to go for full group taxation.

Going forward, the senior official is of the view given that group taxation is potentially very complex, it is likely to drain a considerable amount of the *fiscus*' resources and the issue is whether one goes for a full-blown group taxation regime such as in the case of Australia, or does one deal with selected aspects of group taxation.

8.4 *What should be done:*

The official is of the view that the following would go a long way towards settling the debate on group taxation in the South African context:

- Permitting the sharing of losses between group companies;
- Requiring all tax returns to be filed at one common SARS office;

- Addressing how intra-group charges such as interest, royalties and management fees should be treated;
- The possible ring-fencing of a company's losses prior to it joining a group;
- The possible adjustment of base costs in intra-group transfers. At present, base costs do not adjust in terms of intra-group transactions, which could give rise to artificial losses;
- Attributing all CFC income to one company in South Africa;
- Substance should follow form. In the SA context the substance has difficulty following the form and the challenge would be to get the form back to where the substance is; and
- Addressing what one would consider to be a sufficient shareholding requirement in a group, for example a 70% or a 50% holding requirement.

8.5 *The way forward*

To the extent that further elements of group taxation are to be introduced, the official is of the view that an incremental approach to group taxation should be applied. The official is also of the view that National Treasury is less inclined towards introducing a full consolidation model such as the Australian model and is more inclined towards a blend between the fiscal unity approach (applied in the Netherlands which is much less complex) and the UK group relief (loss-sharing) regime. The official however did not elaborate on how the fiscal unity and the group relief approaches would be blended.

As stated in chapter 7 above, whilst certain elements of group taxation are prevalent in the South African tax legislation, the main elements of group taxation such as

consolidation or the ability to transfer losses between member group companies do not currently apply in the South African context.

Whilst, as indicated in Chapter 2 above, there has been a call for group taxation to be implemented in South Africa, the question that requires answering is whether or not South Africa is in need of a group taxation regime and whether or not South Africa is worse off for not having group taxation.

8.6 Does South Africa need group taxation?

The introduction of a group taxation regime in South Africa would put South Africa on par with other international tax jurisdictions already having such regimes in place. The presence of a group taxation regime, coupled with its potential tax benefits, would be a factor to be taken into account by potential foreign investors in deciding on whether or not to invest in South Africa, as tax is usually one of the determining factors in gauging the viability of a venture or investment.

Clearly, group taxation would only be of benefit to companies and not to individuals, who, in terms of their contributions towards national revenue actually contributed more than what companies had for the 2008/2009 tax year¹⁸⁹. It is however, evident that companies contribute significantly towards the South African economy. Not only from a tax perspective, but also from an employment perspective, as their business activities could, depending on their income producing activities and income producing structures, lead to employment opportunities for the greater South African public.

With reference to the potential tax benefits for a group of companies, one of the most significant features of a group regime would be the ability for group companies to transfer losses from a loss-making company to a profit-making company, thereby resulting in a lower tax burden for the group as a whole. The group would, depending on

¹⁸⁹ Media Statement – Minister of Finance, 1 April 2009, pp. 1 to 3

the form of group tax regime chosen, potentially be able to file just one tax return on behalf of the entire group.

The reality of the situation is however, that SARS in all likelihood, does not possess the level of sophistication and level of resources to implement a group taxation regime. This could be inferred given that SARS and National Treasury appear to be struggling from a logistical and administrative perspective, in terms of the implementation of the new dividend tax regime, as the commencement date thereof has now been pushed back to late 2010.

Given the apparent difficulties in terms of the coming into operation of the new dividend tax legislation, it begs the following question: Does SARS have the necessary resources and ability to implement a group taxation regime? The answer appears to have been provided by the National Treasury official interviewed, who clearly stated that one of the main factors weighing against adopting a group taxation regime would be resources and whether or not SARS would be able to maintain and service such a regime.

Moreover, the adoption of a group taxation regime could give rise to a loss of revenue to the *fiscus* as group member companies would be able to transfer losses to profit making companies. The counter argument to this would be that the loss of revenue should be viewed as an investment with the return on the investment being realized when foreign conglomerates decide to invest in South Africa, thereby potentially generating additional taxable and employment opportunities.

The difference however between the introduction of the new dividend tax regime as opposed to the introduction of a group taxation regime is that the dividend tax regime replaces an existing tax i.e. STC, whereas group tax would generally be a tax relief measure for groups of companies. Coupled with this is the fact, as stated by the National Treasury official, that group taxation, (given its potential complexity, and given the resources that would be required to ensure its efficiency and efficacy), would only be of benefit to a select grouping of taxpayers i.e. groups of companies.

Whilst the absence of a group tax regime results in group member companies not being able to transfer losses to profit-making companies, branches of a company are permitted to do so (as one is still dealing with one individual taxpayer). It is also a fact that certain petroleum companies and certain companies involved in the construction industry have various divisions within an operating company, with each division running its own business. These companies would, for example, draw up tax computations and raise doubtful debt provisions for each division, etc, where-after the results of all the divisions would be consolidated into one set of financial statements with one tax computation. The result is that the consolidation of the accounts of each division into one consolidated set of accounts of the operating company, bring about results very similar to those of group member companies in a consolidated regime scenario.

It could also be argued that the introduction of a group taxation regime could result in the engineering of intricate and complex tax avoidance schemes aimed at securing tax benefits by employing ways and means not intended by National Treasury, as appears to have been the case with the section 45 intra-group rules¹⁹⁰. National Treasury had found that section 45 caused asymmetry between assets transferred and the consideration received in exchange for those assets. The assets transferred retained a rolled-over base cost, whereas the consideration received in exchange obtained a market value tax cost, with this asymmetry having been used by taxpayers to artificially cash-out subsidiary operations on a tax-free basis (an eventuality for which section 45 was never intended)¹⁹¹.

This notwithstanding, it is submitted that nothing would prevent SARS from utilizing the general anti-avoidance rules in thwarting any complex and intricate tax avoidance scheme devised by a taxpayer.

¹⁹⁰ National Treasury Media Statement, 2008, p.3

¹⁹¹ Id, p.3

Considering the aforementioned remarks and submissions, and given that only a small portion of the South African population, i.e. approximately 8 million¹⁹² are registered taxpayers, therefore resulting in the South African tax-base being very small, it is submitted that South Africa does not need group taxation at this stage. It is submitted that the Income Tax Act and the other tax legislation provide sufficient tax relief for group companies in South Africa, and that South Africa is not disadvantaged by not having a group taxation regime in place. In fact, it is submitted that the presence of a group taxation regime would lead to less taxes being collected from group companies in South Africa (as group companies would be capable of transferring losses amongst themselves), which could potentially prejudice the South African *fiscus*, should these companies not increase the level of their local investment or fail to create any additional employment opportunities.

The writer is however of the view that as the South African tax base and the South African economy grows, the adoption of a group taxation regime would become inevitable. Taking the decision to adopt group taxation would however be easier than deciding on the appropriate regime, i.e. Consolidation or Group (loss) relief?

¹⁹² As indicated by the senior official from the Department of National Treasury

Conclusion

This research paper's aim was to provide a contextual analysis of group taxation in South Africa. It is submitted that the contents of Chapters 2 to 8 have achieved this.

In doing so, an overview of what group taxation and the various forms in which it operates were highlighted. An overview of how a consolidated group regime operates in Australia and how a group relief regime operates in the UK was provided.

The recommendations of the Margo and Katz commissions on group taxation were also examined.

It was also established that elements of group taxation were present in terms of, *inter alia*, the corporate rules, the exemption provisions in terms of donations' tax, STC and CGT, as well as the exemptions in terms of VAT, Securities Transfer Tax and Transfer Duty.

The informal views of a senior official in National Treasury in terms of the practical issues which need to be addressed if group tax were to be implemented were highlighted, as well as the official's views on why the Katz Commission's recommendations were not followed. It would appear, based on the comments of the official concerned, that National Treasury has given serious consideration to the implementation of a group taxation regime.

As alluded to above and as highlighted in chapter 6, it is clear that the corporate rules, in particular section 45, but also sections 46, 47 and 42 do contain elements of a group taxation regime. The same could be said, for example, of the CFC rules in terms of section 9D, the donations' tax exemptions in terms of section 56, the STC exemptions in section 64B and section 64C, the provisions of paragraphs 12(5) and 64B of the 8th Schedule, and the VAT exemptions (in terms of the VAT Act), the Transfer Duty

exemptions (in terms of the Transfer Duties Act) and the Security Transfers Tax exemptions (in terms of the Security Transfers Tax Act).

The presence of the aforementioned, as well other provisions (highlighted in earlier chapters) provide sufficient evidence that but for the absence of the significant features of a group tax regime, for example, the ability to transfer losses between group companies, the South African tax legislation does contain many elements of a group taxation regime.

It is for this reason submitted that the absence of a formal group taxation regime does not currently place South African taxpayers at a distinct disadvantage, especially given the writer's views that South African is presently not ready for the introduction of group taxation.

Notwithstanding these views, and given National Treasury's recent propensity to borrow significantly from the tax legislation of other jurisdictions (for example, the general anti-avoidance rules, which appear to have been copied from the Canadian tax legislation), it cannot be discounted that a group taxation regime could be introduced in South Africa within the next 5 years. Were this to happen, it is hoped that common-sense prevails and that the group tax regime would be one which builds on the existing group tax-related provisions in the Income Tax Act.

Area for further research

Is South Africa ready for group taxation?

University of Cape Town

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