Is it practically possible to comply with the qualifying interest requirement when entering into a section 42 asset-for-share transaction concerning immovable property, given the applicable time of disposal rules and the application of the Companies Act?

by

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PLAGIARISM DECLARATION

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3. This work has not been previously submitted in whole, or in part, for the award of any degree in this or any other university. It is my own work. Each significant contribution to, and quotation in, this dissertation from the work, or works of other people has been attributed, and has been cited and referenced.

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ABSTRACT

The South African Income Tax Act No 58 of 1962 ("the ITA") contains several group relief provisions aimed to facilitate corporate restructuring. In the ITA there are various examples of roll-over relief provisions generally that contain no time restrictions, nor which are determined with reference to a specific moment in time.

That notwithstanding, section 42 of the ITA, colloquially known as referring to asset-for-share transactions, requires a transferor company (the company disposing of an asset) to hold a qualifying interest in a transferee company (the company receiving the asset in exchange for the issue of shares) at the close of day on which the asset is disposed of. Accordingly, the ITA is prescriptive regarding the timing provision and when a qualifying interest in section 42 is required to be held.

In this study, the author considers the practical application of the qualifying interest requirement and how compliance with this requirement is problematic when considering other legislative enactments. In doing so, the author identifies possible impediments for compliance with the section 42 qualifying interest requirement and furthermore attempts to adopt an interpretation in which the legislative enactments can either be reconciled or interpreted widely to ensure that the requirements of the ITA are complied with.

The aim of this study and the question that the author attempted to address in its analysis above is whether it is practically possible to comply with the qualifying interest requirement when entering into a section 42 asset-for-share transaction concerning immovable property, given the applicable time of disposal rules and the application of the Companies Act?

In this study and as part of the key findings of this paper, the author identifies several ambiguities arising from the application of various legislative enactments. The Companies Act and the impediments imposed by it to comply with the "qualifying interest" requirement enacted in section 42 of the ITA, specifically insofar as the issue of shares for adequate consideration is concerned in clearly highlighted by the author.

To align the provisions of the various legislative enactments and in an attempt to reconcile them the author argued that a purposive approach to statutory interpretation should be adopted in which the practical application and functionality of the provision should be called into question.

CHAPTER 1: INTRODUCTION

1.1 Background

South African companies forming part of the same group frequently have the commercial desire to restructure within their group. The South African Income Tax Act No 58 of 1962 (“the ITA”) makes provision for a number of ‘rollover’ tax relief provisions to facilitate corporate restructuring. These provisions, colloquially known as the group relief provisions, are enacted in sections 41 to 47 of the ITA and contain various claw-back provisions to curtail their use. In essence, these provisions, if and when applicable, act to defer the taxation of income and capital gains tax. Accordingly, these relief mechanisms allow a group of companies to achieve the desired commercial outcome, whether it be the expansion or contraction of the group’s business operations, on an income tax-beneficial basis.

This dissertation will specifically focus on section 42, asset-for-share transactions, and critically analyse some of the practical implications resulting from its application. In simple terms, a section 42 asset-for-share transaction entails the disposal of assets, as defined in paragraph 1 of the Eighth Schedule to the ITA, in exchange for the issue of equity shares by a company. The qualifying criteria for the roll-over relief in section 42 are divided into pre-transaction and post-transaction requirements.

Compliance with pre-transaction requirements (such as the market value of the assets being disposed of) is measured before the "asset-for-share transaction", whilst post-transaction requirements (such as the "qualifying interest" requirement) are measured after the "asset-for-share transaction".

The ITA is prescriptive regarding the timing provision and when a "qualifying interest" is required to be held. The definition of an asset-for-share transaction in section 42(1) requires a person, whether it be a company, natural person, or trust, to hold a qualifying interest in the company to which the asset is disposed at the close of the

day of such asset's disposal or to be engaged on a full-time basis in the business of that company.[1]

Following this transaction, from the perspective of the transferor, it is deemed to dispose of the asset (whether it is a capital asset or trading stock) at its base cost, ensuring that no capital gains tax cost arises through the transfer of assets.[2] The base cost of the newly issued shares acquired by the transferor in the transferee by virtue of the asset-for-share transaction is, moreover, deemed to be equal to the amount of the base cost of the asset transferred to the transferee. One of the section 42 claw-back provisions, acting as an anti-avoidance measure, will apply should the transferor cease to hold a qualifying interest in the transferee company (whether through the disposal of shares, a reduction due to the introduction of new shareholders, or otherwise) within a period of 18 months after the effective date of the asset-for-share transaction.[3] In such instance, the transferor will be deemed to dispose of the remaining interest it holds in the transferee company at market value (measured as at the date of the section 42 transaction) and realise a capital gain and its consequent tax cost, and will further be deemed to have reacquired the remaining interest at the same market value, thereby, "resetting" its base cost.

Section 42 remains subject to section 24BA, which acts as an anti-avoidance measure and potentially gives rise to onerous tax consequences where asset-for-share transactions are not carried out on an arm's length basis. Nonetheless, no adverse tax consequences would ensue when the market value of the consideration received, i.e., the shares issued by the transferee company, is equal to the market value of the assets disposed. The issue of shares by the transferee company, furthermore, does not constitute a "transfer" as defined in section 1 of the Securities Transfer Tax Act No 25 of 2007 ("STT Act"); hence no STT liability will arise.

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[1] As required in the definition of an "asset-for-share transaction" in section 42(1).
[2] Section(42)(a)(i).
[3] Section (42)(6).

Importantly, and notwithstanding the basic application of section 42 asset-for-share transactions, the term qualifying interest requires further attention.[4]

1.2 Qualifying interest

The term *qualifying interest* for purposes of section 42 asset-for-share transactions is defined as follows:[5]

> *"**qualifying interest** of a person means—*
>
> *(a) an equity share held by that person in a company which is a listed company or will become a listed company within 12 months after the transaction as a result of which that person holds that share;*
>
> *(b) an equity share held by that person in a portfolio of a collective investment scheme in securities;*
>
> ***(c) equity shares held by that person in a company that constitute at least 10 per cent of the equity shares and that confer at least 10 per cent of the voting rights in that company**; or*
>
> *(d) an equity share held by that person in a company which forms part of the same group of companies as that person;*
>
> *(e) any equity share held in a portfolio of a hedge fund collective investment scheme."* [own emphasis]

The position where a person holds a qualifying interest in a company includes the situation where they hold: i) equity shares that constitute at least 10 per cent of the equity shares of that company, and ii) which equity shares confer at least 10 per cent of the voting rights in that company to that person. It is uncontentious that qualifying interest incorporates a measure of control that is aimed to provide relief for substantial shareholdings i.e., more than a mere insignificant shareholding.

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[4] To qualify as an asset-for-share transaction, the transferor of the asset must hold a qualifying interest in the transferee. Assuming that the transferor is not an individual who will be employed full-time by the transferee or a group company of the transferee.
[5] See the definition of "qualifying interest" as defined in section 42(1).

The qualifying interest definition has undergone various legislative amendments throughout the years, which amendments will be considered more closely below.

1.3 History and development of qualifying interest

Section 41 acts as a general provision apposite to all other corporate rules and embodies all defined terms relevant to corporate restructuring. The term qualifying interest was previously defined in section 41, which application was limited to section 42 asset-for-share transactions and section 44 amalgamation transactions, with modifications required in respect of each of these sections.[6] The qualifying interest requirement embodied in section 41 initially introduced a percentage margin of 25 per cent, which percentage was later amended in 2005 to a revised margin of 20 per cent.[7]

The lower qualifying interest threshold of 20 per cent was applied to effectively take the underlying assets of influenced companies into account in determining the DFIHC[8] and FFIHC[9] status of a group of companies.[10] The definitions of "associated group of companies," "influencing company" and "influenced company" introduced the wider concept of a group which was based on the percentage used for international financial reporting where significant influence was presumed.[11]

Section 41 was subsequently amended to delete the definition of qualifying interest there and to incorporate it into sections 42 and 44, respectively.[12] The 2011 Taxation Laws Amendment Act introduced an extension of the group relief provisions to cover the transfer of equity shares in a foreign company to a controlled foreign company to permit foreign intra-group relief. Notably, the 2011 Taxation Laws Amendment Act

[6] Explanatory Memorandum on the Revenue Laws Amendment Act No 31 of 2005 page 29.
[7] Explanatory Memorandum on the Revenue Laws Amendment Act No 31 of 2005 page 29.
[8] Domestic Financial Instrument Holding Company.
[9] Foreign Financial Interest Holding Company.
[10] Explanatory Memorandum on the Revenue Laws Amendment Act No 31 of 2005 page 29.
[11] Explanatory Memorandum on the Revenue Laws Amendment Act No 31 of 2005 page 29.
[12] Explanatory Memorandum on the Taxation Laws Amendment Act No 3 of 2008.

subsequently removed reference to the qualifying interest requirement insofar as section 44 amalgamation transactions are concerned.[13]

Considering that the 20 per cent participation exemption was relatively high by international standards and to moreover to align it with other ownership thresholds in the ITA, the 2011 Taxation Laws Amendment Act reduced the participation exemption threshold to a margin of 10 per cent.[14]

The amendments in the 2011 Taxation Laws Amendment Act resulted in a mismatch between the 20 per cent qualifying interest threshold underlying asset-for-share transactions and the participation exemption for cross-border dividends and share disposals.[15] As a result, the qualifying interest threshold was also considered relatively high by international standards and specifically problematic as asset-for-share transactions included cross-border rollovers.

Subsequent to these amendments, the 2012 Taxation Laws Amendment Act reduced the qualifying interest threshold to a 10 percent margin effective for all transactions entered on or after 1 January 2013.[16]

1.4 Context of qualifying interest

Following the legislative amendments and historic development pertaining to qualifying interest, the qualifying threshold appears to align with the participation exemption for dividends and share disposals. It logically follows that the qualifying interest requirement is deliberately amended to align with the participation exemption.

[13] Explanatory Memorandum on the Taxation Laws Amendment Act No 24 of 2011 page 157. The removal of the "qualifying interest" requirement previously contained in section 44 of the ITA was removed because of technical anomalies and to prevent any unfair results arising from its application against minority shareholders who may be "involuntary" participants.

[14] Explanatory Memorandum on the Taxation Laws Amendment Act 22 of 2012 page 36.

[15] Explanatory Memorandum on the Taxation Laws Amendment Act 22 of 2012 page 36.

[16] Explanatory Memorandum on the Taxation Laws Amendment Act 22 of 2012 page 36.

1.5 Problem statement

Transactions concerning immovable property are governed by a number of rules regarding transfer and the timing underlying the transfer of immovable property. These rules, as discussed in depth in the body of this dissertation, may be problematic when applying the requirements underlying the qualifying interest requirement as enacted in section 42 of the ITA and moreover when such qualifying interest is required to be held.

The dissertation seeks to answer the following question:

Is it practically possible to comply with the qualifying interest requirement when entering into a section 42 asset-for-share transaction concerning immovable property, given the applicable time of disposal rules and the application of the Companies Act? Accordingly, can a company practically issue shares for adequate consideration where the ownership of the property, in exchange for which the shares are issued, is still reflected in the name of the transferor at the time of such share issue?

Considering the practical issues arising from the *qualifying interest* requirement as contained in section 42 of the Act, a couple of questions can be raised in an attempt to address possible shortfalls and to shed light on possible practical and commercial solutions.

To this effect, the overreaching problem statement will result in various consequent questions and concerns, such as the time of disposal of immovable property and whether the ITA aligns with other legislative enactments insofar as time of disposal rules are concerned. Of essence in this regard will be the determination of whether the transfer of immovable property is subject to a suspensive condition in which its time of disposal is delayed until its registration (i.e., transfer) in the Deeds Office.

This dissertation will further undertake a substantive analysis of the Companies Act No 71 of 2008, specifically concerning the issue of shares for adequate consideration

where immovable property has been disposed of pending the registration of ownership in the name of the transferee. As part of this section of the analysis reference will briefly be made to the determination and treatment of adequate consideration in the United Kingdom, New Zealand, California and Delaware. It will further be considered whether the Companies Act and the ITA can be reconciled or alternatively whether their provisions can be interpreted in such a manner than no reconciliation is required.

1.6 Structure of the dissertation

To address the problem statement, this paper will begin with an analysis in chapter 2 of the time of disposal rules as contained in the Eighth Schedule to the ITA. The importance hereof is to ascertain whether the disposal of immovable property is subject to a suspensive condition in that its time of disposal is delayed until the condition in question has been fulfilled or whether the immovable property in question can be said to be disposed of on the transaction date. Accordingly, it should be determined whether registration of immovable property in the Deeds Office, in the absence of a specified condition in the agreement, may be said to constitute a suspensive condition.

As part of this chapter, reference will be made to other legislative pieces as an indication of how the time of disposal of immovable property is regulated in other legislative enactments. Considering that section 42 is prescriptive regarding the timing provision (i.e., the time at which the qualifying interest must be held) the time of disposal of immovable property is important as it will be determinative of when the qualifying interest requirement in section 42 would have to be met. In other words, should a conclusion be reached that the disposal of immovable property occurs on the transaction date, the qualifying interest requirement would similarly have to be met on this date. A conclusion to the contrary, i.e., that the disposal of immovable property only occurs at such time that all the suspensive conditions have been met (including that ownership has been registered in the name of the transferee), would result in the

qualifying interest requirement to be delayed until such time that all the conditions have been fulfilled.

Upon consideration of the time of disposal of immovable property, the focus of this study will shift in chapter 3 to the Companies Act No 71 of 2008 to determine whether shares can be issued by a company for adequate consideration upon disposal of the immovable property by the transferor, irrespective of the fact that the property has not yet been registered in the name of the transferee company. This determination will focus on whether a company is permitted to issue authorised shares for inadequate consideration where the asset in exchange for which the shares are issued has not yet been actually received by such company. In other words, is a company ever able to issue shares on the date of "disposal" as determined in accordance with the ITA, or would such a company only be authorised to issue the shares upon receipt of the property in its name, in exchange for which the shares are issued?

The study will thereafter, as part of chapter 4, examine whether a person (a natural person, a company, or a trust) can ever be considered to hold a qualifying interest in a company without such a person being a shareholder.[17] Put differently, it will be considered whether the term 'hold a qualifying interest' requires a person's name to be reflected on a share certificate or whether the mere right to shares is sufficient to conclude that a person holds a qualifying interest in the transferee company.

In chapter 5, this study will summarise each of the conclusions reached in the underlying chapters and ultimately conclude on the research question. It will also indicate possible recommendations for remedying the practicalities.

1.7 Limitation of scope

This study will not consider the detailed tax consequences of section 42 asset-for-share transactions but rather consider the practical implications arising from the

[17] Again, assuming that the transferor is not an individual who will be employed full-time by the transferee or a group company of the transferee.

qualifying interest requirement when immovable property is disposed of in terms of a section 42 asset-for-share transaction. Although regard will briefly be given to certain aspects of Value-Added Tax and transfer duty, these will not be considered in depth as part of this study.

1.8 Research methodology

The methodology adopted to answer the underlying research questions, and problem statement are doctrinal in nature and will include a review of relevant literature, including but not limited to the Act, Explanatory Memoranda, other relevant legislative acts, and authoritative scholars in the field of taxation. Most of the literature, if not all, will consist of South African legislation.

CHAPTER 2: THE TIME OF DISPOSAL OF IMMOVABLE PROPERTY IN TERMS OF SECTION 42 ASSET-FOR-SHARE TRANSACTIONS

2.1 General

The part of the study will consider the time of disposal rules as envisaged in the Eighth Schedule to the ITA, and the application thereof on the disposal of immovable property in terms of section 42 asset-for-share transactions. Time of disposal is an important consideration for asset-for-share transactions as it is determinative of when the qualifying interest requirement enacted in section 42 would have to be met. As part of this determination, reference will be made to how the time of disposal of immovable property is regulated in other legislative enactments and whether these enactments give rise to a mismatch when it comes to the disposal of immovable property and issue of shares as contained in the section 42 of the ITA. Section 41 specifically defines the term disposal with reference to the definition thereof as contained in paragraph 1 of the Eighth Schedule to the ITA.[18]

[18] All references to “paragraph” are to the paragraphs of the Eighth Schedule to the ITA, unless the context otherwise indicates.

As part of this chapter, the question arises whether a disposal, as defined in paragraph 1, is intended to mean a transfer of ownership in an asset, or whether a disposal could come about upon the occurrence of events or *causae* other than the transfer of ownership.[19]

2.2 Time of disposal

2.2.1 General

Tax acts have special (deemed) timing rules[20] for certain transactions. These rules serve only to regulate the timing of certain taxing events. In the absence of a specific timing rule, the common law rules apply.

Considering that this study specifically concerns the situation whereby an agreement is concluded between two contracting parties (the transferor and transferee) for the disposal of immovable property in which the consideration in question is the issue of shares by the transferee company, several points become relevant. To satisfy the "qualifying interest" requirement embedded in section 42 of the ITA, the transferor company should hold at least 10% of the equity shares in the transferee company at the close of the day on which the immovable property is disposed of.

In what follows, consideration will be given to the term 'disposal' and, more specifically, the 'disposal' of immovable property, whereafter, the rules underlying the time of disposal of immovable property as regulated in various legislative enactments will be considered.

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[19] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 311-325.

[20] See, for example, paragraph 13 of the Eighth Schedule to the IT Act dealing with the time of disposal of assets for capital gains tax purposes, as well as section 9 of the VAT Act, dealing with the time of supply of goods and services.

2.2.2 Eighth Schedule to the ITA

Capital gains and losses are generally triggered by an asset's disposal (or deemed disposal). The term disposal is defined to include the following:[21]

> *"…an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Act (being the ITA) treated as the disposal of an asset, and 'dispose' must be construed accordingly."*

Reading this together with paragraph 11 (which paragraph repeats the wording of disposal in paragraph 1) results in the conclusion that the distribution, sale, donation, or any type of alienation or transfer of the ownership of an asset will constitute a disposal for capital gains tax purposes.[22] The definition of a disposal, as set out above, read together with paragraph 11, produces an unclear result as to whether a disposal is effected upon the conclusion of an agreement between the parties to dispose of an asset (such as a section 42 asset-for-share transaction), or whether the disposal of the asset is only effected upon the transfer of the ownership in that asset i.e., for immoveable property upon successful registration in the Deeds Office.[23] Despite the fact that these two events may, in most instances, occur simultaneously, there are various instances in which the time and place of conclusion of an agreement to dispose of an asset and the transfer of ownership thereof produce a mismatch.[24]

Notably, the preamble to paragraph 11(1) refers only to the transfer of an asset and not the transfer of ownership in that asset.[25] It is, therefore, uncontentious that the

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[21] See paragraph 1 to the Eighth Schedule to the ITA.
[22] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 314.
[23] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 314.
[24] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 311-325.
[25] Ownership is nevertheless referred to in subparagraph (a) to paragraph 11(1), although excluded in the other subparagraphs.

disposal of immovable property in terms of a section 42 asset-for-share transaction constitutes the disposal of an asset for capital gains tax purposes.

In other words, paragraph 11 produces the result that an asset is disposed of when the asset in question is transferred from one party to another without any requirement as to the transfer of ownership in or to such asset. There thus appears to be a mismatch as to the transfer of ownership per the common law requirements and the disposal of an asset (such as immovable property) and subsequently the transfer of ownership in such asset as regulated in the ITA.

A more contentious issue would be to consider the time of disposal rules, as enacted in paragraph 13. Paragraph 13 states that:

> *"The time of disposal of an asset by means of –*
>
> *(a) a change of ownership effected or to be effected from one person to another because of an event, act, forbearance, or operation of law is, in the case of –*
>
> *(i) an agreement subject to a suspensive condition, the date on which the condition is satisfied;*
>
> *(ii) any agreement which is not subject to a suspensive condition, the date on which the agreement is concluded…"*

With reference to the various *causae* contained in paragraph 13, an apprehension is created that the legislature attempts to deem the transfer of ownership to be effected upon the occurrence of the *causae* in question and not upon fulfilment of the common law requirements[26] for the transfer of ownership.[27]

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[26] The common law requirements underlying the transfer of ownership in an asset are dependent on the nature of the asset in question. Insofar as immovable property is concerned, the transfer of ownership is effected by means of registration. See JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002 page 317.

[27] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002 page 316.

Notwithstanding the above, regard must first be had to the disposal and time of disposal of immovable property as regulated in the ITA, as this is the primary source setting out the requirements for the disposal of, and tax consequences pertaining to, section 42 asset-for-share transactions.

Following on from the above, it should be considered whether the disposal of immovable property in terms of an asset-for-share transaction, when considering the time of disposal rules in paragraph 13, is subject to a suspensive condition, or whether ownership is effected or deemed to be effected on the date on which the agreement is concluded i.e., the date of the asset-for-share transaction.

In the absence of a suspensive condition, the time of disposal of immovable property is the date on which the agreement is concluded. The determination as to the time of the agreement's conclusion is subject to the application of the law of contract. An unconditional contract of sale in which the transfer of ownership occurs after the conclusion of the agreement between the contractual parties typically involves two disposals, namely:[28]

i) the disposal of a personal right to the buyer (the right to claim delivery); and

ii) the transfer or delivery of the asset sold.

Each of these rights constitutes a disposal for capital gains tax purposes under paragraph 11. Firstly, the buyer's personal right to claim delivery results in the creation of an asset, and failure on the part of the seller to effect delivery would result in the buyer being entitled to the normal contractual remedies. The second disposal takes place through the change of ownership when the real right in the asset is transferred by means of delivery to the buyer.[29] Concerning immovable property, delivery is

[28] The South African Revenue Service Comprehensive Guide to Capital Gains Tax (Issue 9) (5 November 2020) ("Guide to Capital Gains Tax") at 6.3.5.
[29] Guide to Capital Gains Tax at 6.3.5.

effected through registration of the property in the Deeds Registry. Paragraph 13(1)(a)(ii) creates a legal fiction as both disposals described above are taken back to the date of contract conclusion and any appreciation in the value of the asset from the date of contract conclusion to the time of delivery is disregarded for capital gains tax purposes.[30]

The Guide to Capital Gains Tax published by the South African Revenue Service ("SARS") contains guidance on the operation of suspensive conditions. A suspensive condition operates to suspend the full operation of the obligation under a contract which moreover renders the operation of the contract dependent on an uncertain future event.[31] A clause included in a contract of sale stating that the sale will only be confirmed upon the one party obtaining a mortgage bond to a specified amount is a typical example of a suspensive condition. Suspensive conditions can furthermore be distinguished from contractual terms. Botha J held in *Design & Planning Service v Kruger*[32] that:

> *"In the case of a suspensive condition, the operation of the obligations flowing from the contract is suspended, in whole or in part, pending the occurrence or non-occurrence of a particular specified event. A term of the contract, on the other hand, imposes a contractual obligation on a party to act, or to refrain from acting, in a particular manner. A contractual obligation flowing from a term of the contract can be enforced, but no action will lie to compel the performance of a condition."*

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[30] Guide to Capital Gains Tax at 6.3.5.
[31] Guide to Capital Gains Tax at 6.3.3.
[32] *Design & Planning Service v Kruger* 1974 (1) SA 689 (T) at 695; Guide to Capital Gains Tax at 6.3.3.

In *Macsteel Genprop (Pty) Ltd v Groot*[33] De Villiers, JA made reference to the 7th edition of the Law of Contract in South Africa in which Christie RH discussed conditional contracts and held as follows.

> *"This part of the law is much bedevilled by semantics…"*

De Villiers JA, as part of this discussion, further refers to the judgment of *R v Katz*[34] in which the court held:

> *"…The word 'condition' in a contract, is sometimes used in a wide sense as meaning a provision of the contract, i.e. an accepted stipulation, as for example in the phrase 'conditions of sale'. In this sense the word includes for example* ***ordinary arrangements as to time and manner of delivery and of payment of the purchase price****, etc – in other words the so called accidentalia of the contract.* ***In the sense of a true suspensive or resolutive condition, however, the word has a much more limited meaning, viz. of a qualification which renders the operation and consequences of the whole contract dependent upon an uncertain future event****…*
>
> *Where the qualification defers the operation of the contract, the condition is suspensive, and where it provides for dissolution of the contract after interim operation, the condition is resolutive. The exact dividing line between the two classes is sometimes difficult to draw, because failure of a suspensive condition may have a resolutive effect, and a resolutive condition in a sense suspends dissolution of the contract.* ***What is of importance is the distinction between true conditions of either kind and ordinary stipulations falling outside***

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33 *Macsteel Genprop (Pty) Ltd v Groot* (9728/2016) [2017] at para 7.
34 *R v Katz* 1959 (3) SA 408 (C) at 417D – 418D.

> ***their category.****"* (emphasis as provided in *Macsteel Genprop (Pty) Ltd v Groot*)

Following the above, it is clear that a distinction must be drawn between a contractual term and a condition in the true sense of the word, whether it be suspensive or resolutive.

The timing of the transfer of ownership of immovable property for purposes of the Eighth Schedule is therefore deemed to occur when all the suspensive conditions in the contract are met. The only condition that can thus delay the time of disposal of immovable property, for tax purposes, is the inclusion of a suspensive condition in a contract of sale, such as in a 42 asset-for-share transaction agreement.

Whether the delivery of immovable property by means of registration in the deeds office in and of itself constitutes a suspensive condition becomes an important consideration, specifically concerning the time of disposal thereof.

2.2.3 Deeds Registries Act

The Deeds Office, operative under the rules and regulations of the Deeds Registries Act No 47 of 1937 ("Deeds Registries Act"), is responsible for the registration, maintenance, and management of the property registry in South Africa. Section 16 of the Deeds Registries Act deals with the transfer of real rights in relation to property which section states that:[35]

> *"…the ownership of land may be conveyed from one person to another only by means of a deed of transfer executed or attested by the registrar, and other real rights in land may be conveyed from one person to another only by means of a deed of cession attested to by a notary public and registered by the registrar…"* [own emphasis]

[35] See section 16 of the Deeds Registries Act.

The application of section 16 of the Deeds Registries Act makes it clear that ownership of immovable property in South Africa only takes place once the deeds office registers the transfer of ownership pertaining to the property in question. Accordingly, a purchaser of immovable property can only be said to be regarded as the lawful owner of the property upon successful registration of the transfer thereof in the Deeds Office. Following the above, the mismatch between the timing of transfer of ownership of immovable property as regulated by the ITA (i.e. as soon as the agreement is concluded or unconditional) and the registration of ownership of the said immovable property in the Deeds Registries Act becomes apparent.

If one were to apply the principles of the Deeds Registries Act to the disposal of immovable property in terms of an asset-for-share transaction, the time of disposal would be delayed until the registration of the transfer of ownership thereof by the Deeds Office. However, that is not what the ITA requires. It looks at conditions. The question then is: Is registration of ownership in the Deeds Office a condition or an administrative requirement for fulfilment of the contract of sale.

Based on the principles of the Deeds Registries Act and if it were to apply in the context of asset-for-share transactions the immovable property in question can only be said to be disposed of at such a later point in time (upon registration by the Deeds Office), and as a consequence, the issue of the consideration shares for the acquisition of the property (in accordance with an asset-for-share transaction) is delayed until the property has been registered in the name of the transferee company. Whether the application of the Deeds Registries Act i.e., the delay between the transaction date and registration of immovable property in the Deeds Office, can be adopted to constitute a suspensive condition for tax purposes as envisaged in paragraph 13 of the Eighth Schedule, should thus be considered.

The court has previously addressed this question in *Milnerton Estates Ltd v Commissioner for South African Revenue Service*[36] ("*Milnerton Estates*"). Despite the fact that *Milnerton Estates* considered the application of section 24 of the ITA in the event of a sale of immovable property, it nonetheless provides insight regarding the transfer of immovable property and the application of suspensive conditions.

The court in *Milnerton Estates* addressed the question as to whether the purchase price of erven in a township, sold by a property developer, was deemed to accrue in the year of assessment in which the property developer concluded the sale agreements or whether it was deemed to have accrued in the year of assessment in which the properties were transferred. In this judgment, the property developer argued that its entitlement to the purchase price remained conditional on its performance of the remaining tasks necessary to effect the transfer of the stands in question.[37] Following this argument, the property developer omitted the inclusion of the purchase prices in its gross income in the year of assessment in which the purchase agreements were concluded. SARS, on the other hand, contended that the purchase price in relation to each erf accrued to the property developer in the year in which the purchase agreements were concluded by virtue of the application of section 24 of the ITA.[38]

Furthermore, the property developer held that the application of section 24(1) is limited to the sale of immovable property on credit and does not concern itself with cash sale agreements. In other words, the property developer tried to distinguish between cash sales and the sale of immovable property where the purchase price is effected by means of instalments over a period of time, with transfer only effected once the full purchase price was paid.[39]

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[36] *Milnerton Estates Ltd v Commissioner for South African Revenue Service* 2019 (2) SA 386 (SCA) 81 SATC 193.
[37] *Milnerton Estates* 81 SATC 193 at page 194.
[38] *Milnerton Estates* 81 SATC 193 at page 194.
[39] *Milnerton Estates* 81 SATC 193 at page 195.

The property developer pointed out that ownership of immovable property will only pass when the property transfer from the seller to the buyer has been registered by the Deeds Registry. It is common practice for a guarantee to be provided for the payment of the full purchase price once proof of registration in the name of the purchaser is provided.[40]

In reaching its decision, the court held that a restrictive interpretation of the language of section 24(1) is not permitted and that the guarantees provided by the sellers to the property developer constituted payment of the purchase price, with such payment being concurrent with the transfer of ownership. The sale agreements provided for the property developer to transfer ownership to the underlying purchasers upon or after receipt of the whole purchase price in terms of section 24(1) of the ITA, which was deemed to be received when the sale agreement was entered into.[41]

Following the court's conclusion and principles laid down in *Milnerton Estates* an argument that the passing of ownership is suspended as ownership can, under an agreement only pass, after the transfer of the immovable property in question is inappropriate. A contract of sale of immovable property cannot, simply because the transfer thereof is subject to the protracted process of registration in the Deeds Office, be said to be subject to a suspensive condition. If the author were to be mistaken on this conclusion, and if the contract of sale of immovable property were indeed subject to a true suspensive condition, where the only outstanding action is the deeds office registration, no contract of sale would exist up until the registration is effected by the Deeds Office. This outcome appears to be one that could not have been intended by the legislature.

Notwithstanding the above, and even though the application and principles of the Value-Added Tax Act No 89 of 1991 ("the VAT Act") and the Transfer Duty Act No 40 of 1949 ("Transfer Duty Act") do not affect the suspensive condition and recognition

[40] *Milnerton Estates* 81 SATC 193 at page 195.
[41] *Milnerton Estates* 81 SATC 193 at page 195.

therefor per the Eighth Schedule to the ITA, they are nonetheless briefly considered below as part of the legislative analysis.

2.2.4 VAT Act

The term “goods” are, for purposes of the application of the VAT Act defined as follows:[42]

> *“corporeal movable things,* ***fixed property****, any* ***real right in*** *any such thing or* ***fixed property****, and electricity, but excluding –*
>
> *(a) money;*
>
> *(b) any right under a mortgage bond or pledge of any such thing of fixed property;*
>
> (c) *any stamp, form or card which has a money value…”* [own emphasis]

Immovable property i.e., fixed property, thus constitutes ‘goods’ for VAT purposes, the time of supply of which is regulated in terms of section 9 of the VAT Act. Where goods, consisting of fixed property or any real right in fixed property, are supplied under an agreement of sale, the time of supply shall be deemed to take place at the earliest of the registration of transfer in the Deeds Registry or the date on which payment in respect of the consideration for such supply is made.[43] Accordingly, the time of supply of immovable property for VAT purposes is deemed to occur at the earliest of registration of the immovable property in the deeds office, or the date of payment.

In the context of an asset-for-share transaction (assuming that the transaction is not a non-supply as contemplated in section 8(25) of the VAT Act), the time of disposal of immovable property (time of supply) would then either be when the immovable property has been registered in the name of the transferee company or when the

[42] See the definition of “goods” in section 1(1) of the VAT Act.
[43] Section 9(3)(d) VAT Act.

transferee company issues shares as consideration for the acquisition of the property. The date of payment i.e., the date on which the consideration shares are issued by the transferee company, would practically always precede the registration of transfer in the Deeds Office as these shares would be issued on the transaction date. The time of disposal of immovable property will thus, for VAT purposes, always be the date of payment i.e., the date of the issue of the shares. The two events can thus coincide.

2.2.5 Transfer Duty Act

The Transfer Duty Act does not contain specific rules as to when ownership of immovable property is deemed to take place. That notwithstanding, the acquisition of property for transfer duty purposes is considered to be the date on which the transaction is entered into, being the date on which it is signed by the last contracting party.[44] This would apply even if the contract's effective date stipulates a different date and even if the contract is subject to a suspensive or a resolutive condition. The property in question can therefore be said to have been acquired as soon as the contracting parties have signed the sales agreement, which would generally occur on the transaction date.[45] Notably, the Transfer Duty Act makes provision for a specific exemption insofar as asset-for-share transactions as contemplated in section 42 of the ITA is concerned.[46]

It is apparent from the application of the various tax Acts that a number of inconsistencies arise pertaining to the time of disposal rules, specifically concerning the disposal of immovable property. The time differences in the passing of ownership

[44] See the definition of "date of acquisition" as defined in section 1 of the Transfer Duty Act; The South African Revenue Service Transfer Duty Guide (Issue 6) (25 July 2023) at 2.3.1; D Kruger "Sale of Immovable Property: Selected Transfer Duty and Value-Added Tax Implications" Business Tax & Company Law Quarterly Vol. 9 Issue 3 (September 2018) at page 26.

[45] The South African Revenue Service Transfer Duty Guide (Issue 6) (25 July 2023) at 2.3.1; D Kruger "Sale of Immovable Property: Selected Transfer Duty and Value-Added Tax Implications" Business Tax & Company Law Quarterly Vol. 9 Issue 3 (September 2018) at page 26.

[46] Section 9(1)(l)(i) of the Transfer Duty Act.

would result in transactions being treated differently for capital gains tax, VAT, and transfer duty purposes.

Based on the discussions above, the registration of immovable property in the Deeds Office does not in and of itself give rise to a suspensive condition, the time of disposal, which would therefore be deemed to be the date on which the agreement is concluded i.e., transaction date. At most, an agreement concerning the disposal of immovable property where there are no suspensive conditions can be said to be subject to a resolutive condition in which the agreement will be fully operative, but for the transfer of immovable property in the Deeds Registry. Accordingly, the agreement underlying the disposal of immovable property will continue to operate, but for the registration of the immovable property in the name of the purchaser.

That notwithstanding, the inclusion of either a suspensive or resolutive condition insofar as the time of disposal of immovable property is concerned presents a notable challenge, particularly in the context of asset-for-share transactions. These conditions introduce uncertainty into the transaction process, potentially impeding the seamless execution of back-to-back asset-for-share transactions. Delays or uncertainties in this realm could disrupt the entire transactional chain.

2.3 Conclusion

In accordance with the provisions of the common law, a number of requirements would have to be satisfied for a valid transfer of ownership to be effected. A distinction is also drawn in this regard between the transfer of ownership, which constitutes a real relationship or contract, and a personal contract which refers to the agreement itself. The absence of any of these requirements would not result in the transfer of ownership to be effected, notwithstanding the conclusion of a perfectly legal agreement.[47]

[47] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 311-325.

The result that follows is that the conclusion of an agreement does not in and of itself result in the transfer of ownership. The court in *Lendalease Finance v Corpor Mercedes Agricola* (1976) confirmed this view and held that: *"according to our law, unlike certain other legal systems, ownership cannot pass by virtue of the contract of sale alone. There must, in addition, be at least a proper delivery to the purchaser of the contract goods"*.[48]

Irrespective of the fact that the conclusion of an agreement between contractual parties to dispose of an asset and the subsequent transfer of ownership of that asset are two separate and distinct legal acts, they are, for tax purposes, conflated as a result of the specific rules applicable to tax legislation. In other words, in the absence of a suspensive condition, the time of disposal, insofar as it concerns immovable property, is considered to be the date of contract conclusion (i.e when all the suspensive conditions are fulfilled, irrespective of the delayed transfer thereof in the Deeds Registry. The registration of property in the Deeds Registry is simply an administrative fulfilment of the contract and does not give rise to a suspensive condition in the true sense of the word.

CHAPTER 3: THE APPLICATION AND IMPACT OF THE COMPANIES ACT NO 71 OF 2008

3.1 General

The current Companies Act No 71 of 2008[49] only became effective in May 2011 due to various delays and problems with its implementation.

Upon taking effect in 2011, the Companies Act imposed various challenges in the income tax environment.[50] A number of provisions in the Companies Act interrelate in

[48] JS Wilcocks & JJ Strydom *"The concept of 'disposal' for the purposes of capital gains tax in South Africa"* Meditari Accountancy Research Vol. 10 2002: 320.
[49] The Companies Act No. 71 of 2008 ("the Companies Act").
[50] M Rudnicki, *The Companies Act and its Impact on the Income Tax Act* Business Tax & Company Law Quarterly Volume 1 Issue 2 June 2010.

one way or another with the provisions of the ITA.[51] In addition, the Taxation Laws Amendment Bill of 2010, proposed amendments to the ITA to ensure that it aligns and reforms with the Companies Act as contemplated at the time.[52]

Following the conclusion that a disposal of immovable property occurs on the date on which the agreement is concluded and, furthermore, that for section 42 to apply, the transferor company should hold a qualifying interest in the transferee company on this date, a further question arises in terms of the Companies Act.[53] This nuanced issue centralises around whether a company can issue shares for adequate consideration on conclusion of the sales agreement between the contracting parties (i.e., in agreement with the ITA) but nonetheless, in the absence of it having received the immovable property, in the sense that transfer in the Deeds Office has not been effected, that effectively serves as consideration for the shares to be issued. Whether an unconditional agreement that gives to a right in or to the immovable property in question is sufficient will be considered as part of this analysis.

In other words, can a company[54] issue authorised shares for adequate consideration on the date of contract conclusion, or should such shares only be authorised by the board when the ownership of the property has been registered in the name of the transferor company? A further consideration would be that the potential exists, as per any other sales agreement, for the property to never be registered in the name of the transferee company, whereas the transferor company may already have exercised the right to vote and already have received dividends in accordance with their right to dividends by virtue of having been issued the shares.

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[51] Notably, some of the provisions of the ITA and the Companies Act do not properly align, for example, section 44 of the ITA and the amalgamation provisions in section 113 of the Companies Act.
[52] M Rudnicki, *The Companies Act and its Impact on the Income Tax Act* Business Tax & Company Law Quarterly Volume 1 Issue 2 June 2010.
[53] The Companies Act No. 71 of 2008 ("the Companies Act").
[54] G B Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) at 616; *Basson v Hanna* (37/2016) [2016] ZASCA 198 (6 December 2016) at para 22.

That notwithstanding and in the event than one of the contracting parties fail to comply with their obligations underlying the agreement concluded between them, contractual remedies can be relied upon by the injured party. Should a breach of contract occur, five contractual remedies are available including specific performance, an interdict, declaration of rights, cancellation and damages.[55] The former three remedies serve as methods of enforcement, whereas the last two may be regarded as recompenses for non-performance. The choice as to which remedy will be relied upon rests with the plaintiff i.e., the injured party who may rely on these remedies in the alternative or together as long as the plaintiff's claim is consistent and does not result in him being overcompensated.

In the context of the transfer of immovable property in terms of an asset-for-share transaction, and should the property never be registered in the name of the transferee company, the transferee company will be able to rely on the contractual remedies above. Although this study will not unpack the contractual remedies in detail the remedies available to the transferee company would include, a claim for specific performance i.e., the registration of the property in the Deeds Office, a claim for damages suffered as result of the transferor company's non-compliance and/or the cancellation of the contract in its entirety in which the shares will revert back to the transferee company.

In what follows, this chapter will focus on some of the key provisions of the Companies Act, such as adequate consideration for the issue of shares, and whether these provisions can be reconciled with the provisions and requirements of the ITA, specifically insofar as it concerns asset-for-share transactions.

[55] G B Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) at 616; *Basson v Hanna* (37/2016) [2016] ZASCA 198 (6 December 2016) at para 22.

3.2 The issue of shares

Antecedent to the introduction of the Companies Act, the now repealed 1973 Companies Act[56] prohibited the allotment and issue of shares unless the full issue price for those shares had been paid for by the subscribing party and received by the issuing company.[57] Accordingly, it was impossible to issue shares on credit or to issue shares for the performance of services to be rendered in the future. That notwithstanding, the advent of the 2008 Companies Act made it possible for a company to issue authorised shares where the consideration for the shares is in the form of an instrument, the value of which is only to be realised at a later date, or where the consideration is in the form of an agreement for future services, future benefits or future payment by the subscribing party.

The circumstances in which a company is entitled to issue shares without receiving immediate "adequate consideration" in respect of those shares, namely where the consideration payable by the subscribing party is in the form of a negotiable instrument, an agreement for future services, benefits or future payment is strictly regulated and detailed.[58] Before considering the rules relating to the issue of shares in these circumstances and whether the sale of immovable property in terms of an asset-for-share transaction would fall within its scope, it is firstly important to understand what the term "adequate consideration" entails in this context.

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[56] The Companies Act No 61 of 1973.

[57] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012).

[58] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012).

3.3 Adequate consideration

In terms of the Companies Act,[59] a company's board may only issue authorised shares for "adequate consideration"[60] as determined by the board.[61] The board of the company is therefore required to determine the consideration for the shares and whether the consideration as determined is, in their opinion, adequate. The reason for the adequacy requirement and the purpose of regulating the consideration for the shares issued are generally for the protection of existing shareholders to ensure that their rights are not diluted when new shares are issued for inadequate consideration.[62] In the case of a 100% shareholder, the reason for this provision is not entirely necessary but must be considered, nonetheless. The term "consideration" is defined in section 1 of the Companies Act as follows:

> *"anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including*[63]*-*
>
> *(a) any money, property, negotiable instrument, securities, investment credit facility, token or ticket;*
>
> *(b) any labour, barter or similar exchange of one thing for another; or*

[59] Section 40(1)(a) of the Companies Act.
[60] Unless in terms of conversion rights associated with previously issued securities of the company or as capitalisation shares as contemplated in section 47 of the Companies Act.
[61] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012).
[62] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 319 and again at 321.
[63] In *AB LLC and BD Holdings LLC v Commissioner of the South African Revenue Services* (13276) [2015] ZATC 2 the court considered the meaning of the word "including" and found that "include" in a statute is often used to extend or enlarge the meaning of a thing or concept. It brings within the scope of the thing or concept others that are not ordinarily or naturally part of the thing or concept. The extended items or factors need not as a matter of ordinary meaning fall into the primary item or factor. Accordingly, since "including" is used, "any other thing" as envisaged in paragraph (c) of the definition need not necessarily be "given and accepted" merely because the expression is used in the body of the definition and precedes the phrase in paragraph (c).

> *(c) <u>any other thing</u>, undertaking, promise, agreement or assurance, <u>irrespective of its apparent or intrinsic value</u>, or whether it is transferred directly or indirectly;"* [own emphasis]

The inclusion of "anything of value", "any other thing of value", and "any other thing" makes it clear that "consideration" needs to be interpreted very widely, and it is common for companies to issue shares for non-cash consideration.[64] In my view,[65] "consideration" can therefore take on a form other than a monetary counter-performance, including, for example, the discharge of an obligation to pay debt, given the wide definition that should be ascribed to the term. There is, furthermore, no requirement that a monetary value must be determined for "consideration".[66] There is merely a requirement for adequate "consideration". This determination is a matter for the board[67] and must be made before the shares are issued.[68]

While the Companies Act does not prescribe the manner and form that a determination of the adequacy of "consideration" should take on, this would arguably include an analysis of the value of shares that are issued, as well as the benefits obtained and value attributable from the receipt of immovable property, as "consideration" for the shares subsequently issued.

A determination by the board on the adequacy of the "consideration" may not be challenged on any basis other than that the determination constitutes a breach of the director's fiduciary duty of care and skill.[69] Section 40 of the Companies Act does not

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[64] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 319. The Supreme Court of Appeal has in the past confirmed that "any" is "a word of wide and unqualified generality" (*R v Hugo* 1926 AD 271) and may be considered as a synonym for the word "every" (*Thompson v Kama*; *Stilwell v Kama* 1917 AD 217).

[65] Although in the context of Black Economic Empowerment credentials and specifically concerning the application of section 58 of the ITA, SARS had ruled on at least four occasions that non-monetary factors can be considered in determining the adequacy requirement. Binding Private Ruling: BPR 095 dated 24 February 2011 and Binding Private Ruling: BPR 253 dated 19 October 2016.

[66] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 319 and again at 321.

[67] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 321.

[68] Section 40(2) of the Companies Act requires that the terms on which shares are issued be determined before the share issue.

[69] Section 40(3) of the Companies Act read with section 76 and section 77(2) of that act.

in and of itself include a provision dealing with directors' liability. That notwithstanding the implication of the reference in section 40(3) to section 76, read with section 77(2), is that the company's directors could be held liable for any loss suffered by the company due to inadequate consideration.[70] The determination of a loss resulting from the inadequacy of consideration will not be discussed in detail as part of this study.

3.4 What constitutes "adequate consideration"?

Considering that the transferee company is obliged to issue consideration shares (constituting at least 10% of its equity shares) to the transferor company upon the disposal of the immovable property in terms of a section 42 asset-for-share transaction, the more pertinent question arising from a company law perspective is whether the transferee company will have received adequate consideration for the shares to be issued in exchange for the immovable property and in pursuance of the said asset-for-share transaction. In the current instance and based on the disposal of immovable property in terms of an asset-for-share transaction, the "consideration" received for the issue of shares by the transferee company should be measured against the adequacy benchmark (see below).

Upon conclusion of the asset-for-share transaction, the transferee company holds the right to claim delivery of the property against the transferor, i.e., the right to have ownership of the property reflected in its name. This further begs the question as to whether this right to claim delivery by means of registration of ownership in the deeds office is a valuable right and whether this right constitutes adequate consideration for the subsequent issue of shares by the transferee company.

[70] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 323.

The transferee's right to demand transfer of the immovable property in question clearly constitutes an asset.[71] The test for adequate consideration, effectively allows for a wide range of circumstances and factors to be considered and taken into account as part of the assessment. Thus, the determination as to whether consideration is adequate or not can be made with reference to an array of non-monetary factors and is not just limited to market value considerations.

Whether the consideration in question is considered to be adequate or not is a factual question and needs to be tested against, and with reference to, the specific circumstances. In determining the adequacy of the consideration, the board should afford consideration to the current market, the financial status of the company, and the value of its existing shares.[72] Courts generally tend to be reluctant in opposing valuations adopted by board members, unless in circumstances where the inadequacy is obviously evident or where the valuation is evidenced by fraud.[73] Although there are no clear guidelines in our law as to what board members should do in determining the adequacy of the consideration in question, it is nonetheless clear that a *bona fide* valuation of the consideration should be adopted in all instances.[74]

Accordingly, where the value of the consideration that is paid for the shares is in a non-monetary form, such as in the form of immovable property, it should at least be fair, reasonable, and equal to the value of the amount to be credited in respect of the shares issued. A decision by the board that the consideration in question is adequate would result in the issue of shares by the transferee company in the absence of any further impediment imposed by the Companies Act.

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[71] The definition of an "asset" as defined in paragraph 1 is widely defined to include a right or interest in or to property. On this basis, an argument can be made that given the wide definition of what an "asset" entails, it is likely that the right to demand the transfer of the property (in these limited circumstances) constitutes an asset, the value of which is to be determined with reference to the value of the underlying property.
[72] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 323.
[73] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 324.
[74] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 324.

That notwithstanding, to the extent that the consideration in question is considered inadequate by the board, the operation of sections 40(5), (6), and (7) of the Companies Act, as discussed in more detail below, becomes apparent.

3.5 (In)adequate consideration

As already mentioned above, the Companies Act affords an opportunity for the issuance of shares by a company in instances where the consideration underlying the shares cannot be determined upon a time after it has been issued or where the subscribing party complied with all its obligations underlying the agreement. Section 40(5) of the Companies Act deals with the following instances:

i) The consideration for the shares issued cannot be realised by the company until a date in future after it has been issued; and

ii) An agreement for future services, future benefits, or future payment by the subscribing party has been entered into between the contracting parties.[75]

In circumstances where the consideration takes the forms referred to in i) and ii) above, it will only be regarded as having been received by the company at the time and to the extent that:

i) The value of the shares issued has been realised by the company; or

ii) To the extent that the subscribing party to the agreement has fulfilled its obligations in terms of the agreement concluded between them.

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[75] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 325. D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012) at 24.

Accordingly, even though the company may not yet have received the consideration, the shares must be issued immediately after entering into the agreement, whatever the case may be. In these circumstances, the company that issues the shares must cause the shares to be transferred to a third party for the shares to be held in trust and thereafter be transferred to the subscribing party in accordance with the trust agreement.[76]

Notably, for the purposes of this requirement, the company does not transfer the shares to the subscribing party directly, instead the shares are issued and held in trust until such time that the consideration can be realised by the company, or when the subscribing party has fulfilled its obligations in terms of the agreement concluded between them.

The requirement that the shares must be issued and held in trust has an impact on the rights attached to those shares, specifically the right to dividends.

In the context of an asset-for-share transaction, the subscribing party (the transferor company) must ensure the property's delivery to the transferee company. In other words, it can be argued that adequate consideration is only received when the subscribing party has fulfilled its obligations in terms of the asset-for-share transaction and that this is only when the property has been registered in the name of the transferee company. Importantly, despite the fact that the asset has been disposed of to the transferee company for income tax purposes, the transferee company may, as a result of the application of the Companies Act, not be able to issue all the shares directly to the subscribing party (the transferor company) until the transfer of ownership of the property has taken place. Notably, compliance with the "qualifying interest" requirement is at stake.

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[76] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012) at 24, section 40(5)(b) of the Companies Act.

In circumstances where the shares are not fully paid for, and where some or all of the consideration is outstanding, the company that issued the shares could be exposed. Consequently, sections 40(6) and (7) of the Companies Act aim to provide protection in addition to that provided for in section 40(5). The default position underlying the rights attaching to the shares that are issued and held in trust for the benefit of a subscribing party is regulated as follows:[77]

i) Voting and appraisal rights associated with the issued shares may not be exercised;

ii) Pre-emptive rights associated with the issued shares may only be exercised to the extent that the instrument becomes negotiable, or the subscribing party has fulfilled its obligations under the agreement;

iii) Any distribution associated with the issued shares must be paid and credited to the subscribing party to the extent that the instrument has become negotiable, or the subscribing party has fulfilled its obligations under the agreement. The subscribing party's entitlement to the benefit of any dividends associated with the shares held in trust is limited until the subscribing party's contractual obligations are fulfilled;

iv) The transferability of the issued shares held in trust is restricted;

v) The issued shares may only be transferred to the subscribing party when the instrument becomes negotiable (not applicable in the current instance as we are not dealing with an instrument) or upon satisfaction of the

[77] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012) at 24, section 40(6) of the Companies Act.

subscribing party's outstanding obligations in terms of the agreement (i.e., the section 42 asset-for-share agreement).

To the extent that the subscribing party fails to fulfil its obligations under the agreement, the issued shares that were held in trust must be returned to the company, on its demand, after which the shares must be cancelled. The company that issued the shares can only demand the return of the shares 40 days after the subscribing party has failed to comply with its stated obligations underlying the agreement.[78]

South Africa is not the only country in which the issue of shares in circumstances where the consideration is outstanding or inadequate is regulated. In the United Kingdom, public companies may only allot shares if at least one-quarter of the nominal value and the full premium of the shares has been paid, whereas private companies can issue shares in the absence of the receipt of any consideration for such an issue. Notably, the implications of unpaid or partly paid shares are largely left to the articles of incorporation of United Kingdom companies.[79]

The legislation in New Zealand does not require the receipt of any consideration on the issue of shares. That notwithstanding, provision is made for the continued liability of the person who initially undertook to pay the issue price and the refusal of registration of the transferred shares by the directors of the company. Unlike the South African Companies Act, no provision is made in New Zealand for the regulation of voting and dividend rights. [80]

The regulation of dividends is more comprehensive in Delaware and California (both American states), as dividends are provided in proportion to the consideration actually paid.[81] This position appears to be similar to the position in South African law. It is

[78] Section 40(6)(d)(iv) read with section 40(7)(b).
[79] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 327.
[80] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 327.
[81] Yeats *et al*: Commentaries on the Companies Act of 2008 (Volume 1) at 328.

apparent from the above that the issue of shares by a company in the absence of adequate consideration, whether it be unpaid, or partly paid, is a matter that requires detailed and strict regulation.

The issue of shares by a company in these circumstances, alongside the restrictions and limitations imposed on the rights that attach to those shares, may result in an unfavourable commercial result for the subscribing party. A share is, in essence, a bundle of contingent personal rights a shareholder has against a company.[82] To this end, it would be commercially undesirable for the subscribing party to hold shares in a company where the personal rights attached thereto are restricted and severely limited. It is counter-intuitive to hold shares in a company but, in the same breath, to not be able to exercise the right to vote and, furthermore, be restricted from receiving any dividend distributions resulting from those shares.[83]

It is apparent from the above that the Companies Act restricts the issue of shares in certain instances, which makes it impossible for the Companies Act to be reconciled with the provisions of the ITA. In accordance with the ITA, shares are required to be issued by the transferee company on the date on which the immovable property is disposed of i.e., in the absence of a suspensive condition the date of conclusion of the section 42 asset-for-share transaction, whereas the transferee company is only entitled to issue authorised shares to the transferor company upon receipt of adequate consideration. The consequence that follows is that the Companies Act produces a delay in compliance with the qualifying interest requirement in section 42 of the ITA, irrespective of the time of disposal (for income tax purposes) of the immovable property in question. Accordingly, the Companies Act, insofar as it relates to the issues

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[82] In *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc* 1983 (1) SA 276 (A) at 288 the Appellate Division confirmed that a share is a bundle, or conglomerate, of personal rights entitling the holder thereof to a particular interest in the company, its assets, and dividends, thereby confirming the position that a share consists of voting, capital, and dividend rights.

[83] In the context of our discussion of the disposal of immovable property in terms of a section 42 asset-for-share transaction, this restriction of rights will continue until the property has been registered in the Deeds Office.

of shares, introduces an impediment for compliance with the provisions of the ITA, specifically concerning the section 42 qualifying interest requirement. Whether a transferor can be considered to hold a qualifying interest in a transferee company in circumstances where the shares are held in trust will be considered and analysed as part of the next chapter of this study.

3.6 The issue of shares on loan account

3.6.1 A potential solution to the practical pitfall

A potential and practical solution in this regard would be to issue shares to the transferor company on loan account. In this instance, the transferor company (the subscribing party) would be able to freely exercise the rights attached to the shares issued in terms of the agreement concluded between them, while the loan would be repaid once the property is registered in the name of the transferee company. The loan between the two contracting parties would constitute an asset in the hands of the transferee company, whilst a corresponding liability is created for the transferor company.

To the extent that this is considered a mechanism to issue shares and, furthermore, to comply with the qualifying interest requirement in section 42 of the ITA, the provisions enacted in sections 44 and 45 of the Companies Act are to be considered further.

3.6.2 Financial assistance

The provision of financial assistance by companies forming part of the same group (although not a requirement for the application of section 44 and 45 of the Companies Act), occurs frequently and is often in the form of a guarantee of the performance of a contractual obligation. Financial assistance can be provided directly or indirectly

through a loan, a guarantee, or the provision of security to the assisted company.[84] The 1973 Companies Act prohibited financial assistance directly or indirectly by a company that aimed to finance the purchase of or subscription for its shares. Following a change of policy in 1999 and the subsequent deviation from the strict capital maintenance regime, section 38 of the 1973 Companies Act was amended to exclude from the statutory prohibition the giving of financial assistance for the purchase and subscription of shares in specific circumstances.[85] The 2008 Companies Act replaced the provisions underlying financial assistance by enacting sections 44 and 45 of the said Act.[86]

Thus, a company's provision of financial assistance is now governed by sections 44 and 45, respectively. Section 44 regulates the provision of financial assistance by a company in the following instances:

> *"…for the purpose of, or in connection with, the purchase of or subscription for securities issued by the company, or a related or inter-related company."*

Where a company provides financial assistance to its directors or to a related or inter-related company, which includes holding companies and their subsidiaries (*albeit* not necessarily a group for tax purposes), section 45 comes into play. A decision by the board of a company to provide financial assistance is subject to compliance with various requirements, each governed in one of the respective sections.

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[84] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 2.
[85] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 2.
[86] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 3.

3.6.2.1 Financial assistance for the purchase of or subscription of a company's securities

Section 44 of the Companies Act enacts requirements to be satisfied by the board of directors of a company to authorise financial assistance for the purpose of, or in connection with, the subscription of securities issued or to be issued by the company or any of its related or inter-related companies.[87]

In terms of section 44(2) of the Companies Act:

> *"[e]xcept to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may authorise the company to provide financial assistance by way of a loan, guarantee, the provision of security or otherwise to any person for the purpose of, or in connection with, the subscription of any option, or any securities, issued or to be issued by the company or a related or inter-related company, or for the purchase of any securities of the company or a related or inter-related company, subject to subsections (3) and (4)."*

A decision by the board to authorise the granting of financial assistance is subject to the following requirements:[88]

i) The provision of the financial assistance in question must be pursuant to a special resolution adopted by the shareholders of the company, which resolution must be adopted by the shareholders within the preceding two years before the assistance is granted. In this regard, the company's shareholders can approve the granting of financial assistance for a specific recipient or a group of potential recipients.

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[87] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 3.
[88] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 3.

ii) The provision of financial assistance may only be authorised by the board if the latter is satisfied that the company would satisfy the solvency and liquidity tests immediately after providing the financial assistance in question, and only to the extent that the terms underlying the financial assistance are reasonable and fair.

iii) The company's board must see to it that any conditions or restrictions concerning financial assistance insofar as contained in the company's Memorandum of Incorporation are satisfied.

In interpreting what the term "otherwise" would involve, as used in section 44(2) in the context of the Memorandum of Incorporation providing "otherwise", an *ejusdem generis* approach appears to be apposite. Only in invoking this rule of statutory construction can one have a proper regard to the context within which the word "otherwise" is used.[89]

In this regard, Solomon JA pointed out in the judgment of *R v Jones*[90] that:

> *"…the [ejusdem generis] maxim… is often useful in ascertaining the intention of the legislator, but it is not a hard and fast rule to be applied in every case, where general words follow upon special ones. Certainly, there would be no justification for applying it where the legislator evidently intended that the words should have their full effect."*

Following on from the above, financial assistance will not be authorised by the board where such a decision is in conflict with the requirements enacted in section 44 of the Companies Act and, moreover, to the extent that it is in conflict with or prohibited by a

[89] See *Telkom SA SOC Limited v Commissioner for the South African Revenue Service* [2020] 2 All SA 763 (SCA) where the SCA held context to be an important consideration when interpreting legislation, notwithstanding the minority decision by Majiedt JA and Davis AJA in *Commissioner for the South African Revenue Services v Daikin Air Conditioning South Africa* (*Pty*) *Limited* [2018] ZASCA 66.
[90] *R v Jones* 1925 AD 117 at 129.

condition or requirement of the company's Memorandum of Incorporation. To the extent that the company's Memorandum of Incorporation contains any indication, whether it be by means of a condition or requirement, to the contrary (i.e., to the extent that it provides otherwise), a decision by the board to provide financial assistance will not be validated.

3.6.2.2 Loans or other financial assistance

Section 44 of the Companies Act will only apply to the extent that the financial assistance in question concerns the purchase or subscription of a company's securities. Accordingly, the application of section 44 will only be invoked for this specific purpose. Section 45 of the Companies Act is less specific in this regard, as its application is automatic, and regard is not had to the purpose of the financial assistance provided.[91]

Financial assistance, as contemplated in section 45, includes the lending of money, undertaking a loan or other obligation, and securing any debt or obligation. Specifically excluded from the ambit of section 45 is the lending of money in the ordinary course of business by a company, the primary operations of which is the lending of money.[92] A valid authorisation of financial assistance is subject to similar requirements as discussed as part of the application of section 44 of the Companies Act above (the company must be able to meet its financial obligations, in respect of both debt and liability as and when they become due and payable). Furthermore, in both instances, personal liability will ensue for the directors of the company pursuant to the application of section 77(3)(e)(v) in instances where the financial assistance is inconsistent with

[91] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 4.
[92] M Seligson SC *"Exploring Sections 44 and 45 or the New Companies Act: The perils of providing financial assistance"* Business Tax and Company Law Quarterly Vol. 4 Issue 1 (March 2013) page 5.

the respective sections or where the company's Memorandum of Incorporation provides otherwise.

Despite financial assistance imposing a possible solution in this regard, (i.e., the issue of share on loan account to ensure compliance with section 42 of the ITA) it is problematic in the sense that it creates a double risk for the transferee company. Firstly, the company has not yet received the immovable property underlying the asset-for-share transaction, and secondly, it has to provide financial assistance to the transferor company to obtain the shares it will issue, in the absence of the transferor having fulfilled its obligations in terms of the agreement. In considering whether a company should provide financial assistance or not, companies would need to be vigilant and consideration must be given to an array of factors that may have an impact on such decision.

In light of the challenges highlighted in this chapter, it appears counterintuitive for a company to engage in multiple transactions solely to meet the requirements of a single transaction. Such a strategy would result in increased complexity, operational inefficiencies, and additional costs for the contracting parties. Considering the above, and despite the mechanisms scrutinised to potentially reconcile the provisions of the ITA and the Companies Act the practical difficulties and conflict between the provisions remain evident.

In what follows, the legal nature of a share and the term "shareholder" as defined for purposes of the ITA and Companies Act will be more closely considered.

CHAPTER 4: CAN A PERSON EVER BE CONSIDERED TO HOLD A "QUALIFYING INTEREST" IN THE ABSENCE OF THEM BEING A SHAREHOLDER?

4.1 General

Following the conclusion in chapter 3, it is evident that there is a mismatch between the provisions of the Companies Act and the ITA insofar as it relates to the issue of shares and the qualifying interest requirement embedded in asset-for-share transactions. In other words, even though the ITA requires shares to be issued to the transferor company on the date of contract conclusion (i.e., the time of "disposal" of immovable property), the Companies Act impedes this requirement as authorised shares can only be issued by a company for adequate consideration, which includes fulfilment of the terms of a contract.[93] In most instances, the consideration will only be considered adequate once ownership of the property has been registered in the name of the transferee company, which would generally only occur sometime after the date of contract conclusion.

In the absence of receiving immediate adequate consideration as discussed as part of chapter 3, an opportunity is nonetheless afforded for the transferee company to issue shares immediately after entering into the agreement (i.e., an asset for share transaction).[94] That notwithstanding, the shares must be issued and held in trust and will only be transferred to the transferor company (the subscribing party) when the subscribing party has fulfilled its obligations in terms of the agreement.

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[93] A contract to this end will usually provide that the company will issue the shares when it receives the property. This will only be on the date of transfer, not on the date of the agreement.

[94] **This is only allowed in very limited circumstances and is subject to strenuous requirements**. Should a default occur on the side of the subscribing party, the shares must be returned and cancelled by the transferee company on its demand in accordance with section 40(6)(d)(iv) read with section 40(7)(b) of the Companies Act.

In this regard, the obligation in terms of the agreement will be considered as met once the ownership of the property has been registered in the name of the transferee company. Notably, the rights underlying the shares issued[95] and held in trust (although for the benefit of the subscribing party) will be restricted in the sense that they are only exercisable to the extent that the subscribing party has fulfilled its obligations in terms of the agreement and furthermore any distributions (i.e., dividends) must be paid and credited to the subscribing party only to the extent of such party's fulfilment with its obligations under the agreement.[96]

In what follows, the nature of a share and the term shareholder will be considered to ascertain whether a person can be regarded as a shareholder (to such extent that they also meet the qualifying interest requirement) in circumstances where such person cannot exercise the rights that essentially underwrite a share. Of importance throughout this chapter would be to consider whether the Companies Act and the ITA can be reconciled insofar as the issue of shares is concerned or, alternatively, whether the provisions of these legislative enactments can be interpreted in such a way that no reconciliation is required.

4.2 The "shareholder" concept and the rights underlying shares

Before considering the nature of shares, it is essential to understand what the concept "shareholder" entails. The term "shareholder" is not defined for purposes of the ITA.[97] On the other hand, the Companies Act defines the term shareholder as the holder of a share issued by a company, and who is entered in either the certificated or uncertificated securities register.

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[95] The rights underlying a share issued include the right to vote, which is a specific requirement for the qualifying interest requirement in section 42 of the ITA.
[96] D Kruger and B Dickinson *Issuing Shares in Exchange for a Negotiable Instrument or for Future Services* Business Tax and Company Law Quarterly Volume 3 Issue 3 (September 2012) at 24, section 40(6) of the Companies Act.
[97] The term "shareholder" was previously defined in section 1 of the ITA but was subsequently removed by the 2011 Taxation Laws Amendment Act.

Section 50 of the Companies Act regulates the entrance of shareholders in a company's security register. To the extent that the shares are issued and held in trust, the transferor company cannot be considered to be a shareholder, as its name will not be reflected in the transferee company's securities register up until the transfer to it by the trust.

The definition of "shareholder" is subject to the application of section 57(1) of the Companies Act in which the term is extended to include any person who is entitled to exercise any voting rights in relation to a company irrespective of the form, title or nature of the securities to which those voting rights are attached.[98] In simple terms, a shareholder is considered the holder of shares issued by a company.

Following the above, it appears that a shareholder can only be considered a person (whether it be a natural person or a corporate entity) registered in a company's securities register. This is not the end of the enquiry as the qualifying interest requirement in section 42 of the ITA does not explicitly refer to shareholding. The wording of the ITA rather reads to require a person to "hold" equity shares that constitute at least 10 per cent of the equity shares and confer at least 10% of the voting rights of the transferee company at the close of day on which the asset, i.e., the immovable property is disposed of.

Of importance at this stage is to consider what a "share" entails and whether a person can ever hold a share without being a shareholder (i.e., registered in the securities register).

Section 1 of the Companies Act defines a "share" as one of the units into which the proprietary interests of a profit company[99] are divided. The ITA defines "share" similarly in section 1 to entail the following:

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[98] See section 57(1) of the Companies Act.
[99] Defined in section 1 of the Companies Act as *"a company incorporated for the purposes of financial gain for its shareholders"*.

"…any unit into which the proprietary interest in that company is divided…" [own emphasis]

In *De Leef Family Trust NNO v CIR*,[100] the Appellate Division refers with approval to *Randfontein Estates Ltd v The Master*[101] in which Innes CJ, discussing the nature of shares, held that shares:

"… are simply rights of action – jura in personam – entitling their owner to a certain interest in the company, its assets and its dividends."

In *De Leef Family Trust*, the court referred to *Palmer's Company Law* to explain the rights which a share embodies as follows:[102]

"1. the right to dividend if, while the company is a going concern, a dividend is declared;

2. the right to vote at the meeting of members; and

3. the right, in the winding up of the company, after the payment of debts to receive a proportionate part of the capital or otherwise to participate in the distribution of assets of the company." [emphasis supplied by the Court]

Fidelis Oditah[103] further explains the legal nature of shares:

"Shares are a bundle of intangible property rights shareholders receive from the company in return for their contribution of cash or non-cash

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[100] *De Leef Family Trust NNO v Commissioner for Inland Revenue* 55 SATC 207.

[101] *Randfontein Estates Ltd v The Master* 1909 TS 978 at 981-2.

[102] *De Leef Family Trust NNO v Commissioner for Inland Revenue* at page 215.

[103] 'Takeovers, Share Exchanges and the Meaning of Loss' (1996) 112 *Law Quarterly Review* 424 at 426-427 as referred to in *Cassim et al*, "*Contemporary Company Law*", Second Edition published in 2017 at page 214.

assets to the company. Shares define and allocate (a) income rights ie rights of participation in the company's cashflow, usually in the form of a dividend; (b) the incidence of the risk of loss, usually in the form of priority rights in relation to capital; and (c) power of control, principally through voting rights."

In *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc*,[104] the Appellate Division confirmed that a share is a bundle, or conglomerate, of personal rights entitling the holder thereof to a particular interest in the company, its assets, and dividends, thereby confirming the position that a share consists of voting, capital, and dividend rights.

From the above, it is clear that a share is a bundle of contingent personal rights a shareholder has against a company. Can a person ever be considered a shareholder and moreover hold a qualifying interest as required in section 42 of the ITA in circumstances where the rights attached to the underlying shares are restricted and only exercisable at a later point in time.

In circumstances where the shares are issued and held in trust, it is likely that the trust be considered the shareholder for the time being (as all rights attaching to the shares, including voting and dividend rights are not exercisable by the subscribing party), furthermore resulting in non-compliance with the qualifying interest test embedded in section 42 of the ITA.

It logically follows that even though the Companies Act affords an opportunity for shares to be issued and held in trust (*albeit* in limited circumstances) compliance with the section 42 qualifying interest requirement will nonetheless still not be met as the Companies Act restricts the right to vote when held in trust until fulfilment of the

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[104] *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc* 1983 (1) SA 276 (A) at 288, relied upon in SARS' Comprehensive Guide to Capital Gains Tax (Issue 9) ("SARS' CGT Guide") at 50 and 89.

transferor's contractual obligations underlying the agreement concluded between the parties. Registration in the Deeds Office appears to operate as a condition for Company Law purposes.

Accordingly, the transferor company will only be considered to hold a qualifying interest as required in section 42 of the ITA once the shares have been transferred to it by the trust (upon fulfilment of the contractual obligations underlying the agreement) and furthermore provided that the shares issued constitute a least 10% of the equity shares and voting rights of the transferee company. The fact that the shares are, in the interim held in trust does not afford itself reconciliation with the ITA as it restricts the rights underlying the shares so issued, specifically the right to vote.

Following this conclusion, a further question that arises is whether (given the difficulties highlighted above) it is strictly necessary for a company to issues shares in order to comply with the qualifying interest requirement in section 42 of the ITA. In other words, can a person (whether it be a natural person of a corporate entity) "hold" the bundle of personal rights as required for it to hold a qualifying interest in terms of section 42 of the ITA (i.e., 10% of the equity shares and voting rights) without being a shareholder as defined in the Companies Act. Would it not be sufficient if the asset-for-share transaction concerning the transfer of immovable property concluded between the contracting parties make provision for the right to become a shareholder and moreover afford the bundle of rights underlying shareholding on the day of contract conclusion?

In what follows, emphasis will be placed on the meaning of the term "hold" as contained in the qualifying interest requirement in section 42 asset-for-share transactions to ascertain whether a wider interpretation can be adopted and embraced extending beyond mere shareholding.

4.3 When can a person be said to "hold" a qualifying interest?

4.3.1 General

In respect of the "qualifying interest" requirement in section 42, the ITA is prescriptive regarding the timing provision and when a "qualifying interest" is required to be held, being at the "close of the day" on which the asset is disposed, which is an undefined term. Although "day" is not defined in the Act, nor in the Interpretation Act,[105] a literal meaning ascribed to "day" is:

> *"the period of time, the calendar day, of 24 hours duration reckoned from one midnight to the next".*[106]

4.3.2 Statutory interpretation

Until recently, the "golden rule"[107] of interpretation was applied in South Africa to establish the content of a legislative provision. In terms of this approach it was determined that – with greater or lesser reference to the context within which it is used – the ordinary grammatical meaning of words should be attributed to a statute, unless absurdity or ambiguity would arise from such an application of a dictionary meaning of the words:[108]

> *"It is trite that the primary rule in the construction of statutory provisions is to ascertain the intention of the legislature; in the present matter it is, more pertinently, the intention of the rule-maker that needs to be determined. One seeks to achieve this, in the first instance, by giving the words of the provision under*

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[105] Interpretation Act No. 33 of 1957.
[106] Collins English Dictionary.
[107] See *Grey and other v Pearson and Others* (1857) H.L.C 61, which case is credited with formulating the "golden rule".
[108] *Manyasha v Minister of Law and Order* 1999 2 SA 179 (SCA) at 185B.

consideration the ordinary grammatical meaning which their context dictates, unless to do so would lead to an absurdity so glaring that the rule-maker could not have contemplated it."

Our courts have latterly acknowledged that a contextual and purposive interpretation is required to play a greater role to frame the content of a statutory provision.[109] The "new" approach to statutory interpretation was formulated in 2012 in the seminal judgment of *Natal Joint Municipal Pension Fund*:[110]

> *"Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the*

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[109] See *Bastian Financial Services (Pty) Ltd v General Hendrik Schoeman Primary School* 2008 (5) (SA) (1) (SCA).

[110] *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] 2 All SA 262 (SCA) at 18 and further. The principles set out in *Natal Joint Municipal Pension Fund* has subsequently been endorsed by the Constitutional Court in *Airports Company South Africa v Big Five Duty Free (Pty) Ltd and Others* [2018] ZACC 33.

> *words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The "inevitable point of departure is the language of the provision itself", read in context and having regard to the purpose of the provision and the background to the preparation and production of the document."*

Important from the above is that the interpretative process is objective and not subjective. In other words, it is not aimed at arriving at the intention with which the parties in question drafted the relevant provision. Ultimately, interpretation is a question of law; not of fact.[111] It is concerned with arriving at the meaning of a provision that is borne out objectively from its wording, context and purpose, with context as to the purpose of the provision being provided by relevant, admissible background material. The interpretative process is furthermore an exercise which courts should engage in with a fair amount of constraint: notably, they remain interpreters, not legislators and as such cannot arrive at an interpretation which is not borne out and supported by the text of the legislation in question. It logically follows that a court can only attribute meaning to legislation; it cannot determine what – in the court's mind – the legislation ought to be.[112]

It follows from the above that a three-pronged approach is now required in a proper approach to interpretation, in which consideration is equally given to the context,

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[111] *KPMG Chartered Accountants (SA) v Securefin Ltd and Another* 2009 (4) SA 399 (SCA) at para 39.

[112] Kentridge AJ in *S v Zuma* 1995 (4) BCLR 401 (CC) at paras 17 & 18, discusses the principles of interpreting the Constitution, yet which undoubtedly apply similarly in the context of ordinary legislation: *"While we must always be conscious of the values underlying the Constitution, it is nonetheless our task to interpret a written instrument. I am well aware of the fallacy of supposing that general language must have a single 'objective' meaning. Nor is it easy to avoid the influence of one's personal intellectual and moral preconceptions. But it cannot be too strongly stressed that the Constitution does not mean whatever we might wish it to mean. We must heed Lord Wilberforce's reminder that even a constitution is a legal instrument, the language of which must be respected. If the language used by the lawgiver is ignored in favour of a general resort to "values" the result is not interpretation but divination."*

purpose and literal wording of a written instrument in arriving at the true content of the relevant provision contained in a document, with "*neither predominating over the other*".[113] Ultimately, though, the wording of the provision itself remains the "*inevitable point of departure*".[114] Whilst the wording of the provision necessarily remains of significant import,[115] context and purpose need to provide the framework within which the wording's content is to be considered.

Against the backdrop of these domestic rules to interpretation, a purposive and contextual interpretation of the word "day" would not differ from the ordinary meaning ascribed to it, and "close" of that "day" would be the end or final part of that day. Given the authoritarian nature of the provision, this specific post-transaction requirement must be adhered to at the end of that particular calendar day on which the immovable property is disposed of. The ITA does not provide an alternative interpretation.

Previously, the word "hold(s)" in relation to an equity share was defined to mean the holding by a person of an equity share in a manner that qualifies him as a shareholder.[116] Although stated in the past tense, guidance on the concept can now be found in case law:

> *"The word 'held', when used with reference to shares, connotes at least possession."*[117]

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[113] *Natal Joint Municipal Pension Fund* at para 19.

[114] *Re Sigma Finance Corp* [2008] EWCA Civ 1303 (CA) 98 as adopted in *South African Airways (Pty) Ltd v Aviation Union of South Africa and others* [2011] (3) SA 148 (SCA) para 25 to 30 as referred to in *Natal Joint Municipal Pension Fund* at para 18. See also *CSARS v United Manganese of Kalahari (Pty) Ltd* (264/2014) [2020] ZASCA (25 March 2020) at para 8.

[115] The wording itself remains important to such an extent that the ultimate interpretation afforded to the relevant provision cannot be clearly contrary to what is borne out by the clear, objective meaning of the words used. There is very little room – if at all – to argue that the legislature committed an oversight in adopting certain words in a statute. A contrarian approach would moreover cross the "divide" cautioned against in *Natal Joint Municipal Pension Fund.* See also *Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa* 2015 (1) SA 38 (SCA) para 27.

[116] Definition of "hold" in section 41(1) deleted by the Taxation Laws Amendment Act, No. 15 of 2016.

[117] *Bisset Rajak & Co v Taylor* 1967 (3) SA 515 (T).

For a person (whether it be a natural person or a corporate entity) to “hold” a qualifying interest, they would need to have possession of the equity shares on the particular date on which the disposal (date on which the transaction to dispose of the immovable property has been concluded) takes place. The term possession entails holding or occupancy, either with or without ownership rights.[118]

Accordingly, once equity shares are “issued” to a transferor company, it would also “hold” those equity shares and therefore meet that requirement. [119]What must now be considered is whether a person (the transferor company) can “hold” equity shares without being registered in the transferee company’s securities register (i.e. without ownership rights).

Would a transferor company “hold” the bundle of rights for section 42 purposes in instances where it is given the right to become a shareholder with the corresponding rights underlying shareholding? From the remarks above and the reference to the *Bisset Rajak & Co v Taylor* judgment it is clear that only possession is a requirement to be considered to “hold” equity shares and not ownership. To the extent that the section 42 asset-for-share agreement provides that the transferor is in possession of all the rights underlying the shares, but that its name will only subsequently be entered into the securities register, it should qualify to “hold” the equity shares in question. The term “possession” will generally necessitate physical control.

The above interpretation of the term “hold” could result in compliance with the qualifying interest requirement before the transferor company is a “shareholder” of the transferee company. This conclusion furthermore resolves the conflict and mismatch between the provisions of the Companies Act and the ITA insofar as the issue of shares and, moreover, the qualifying interest requirement is concerned. That notwithstanding, it is uncertain whether a person can have possession of a share that

[118] See the definition of possession as defined by dictionary.com.
[119] There must at least be a register or other form of record indicating such possession.

has not yet been issued to it. To remedy this position and to prevent any unfortunate result arising from the application of the legislative provisions, amendments to the current provisions would need to be made.

The legislative amendment that would be needed should entail the term "hold" in the context of qualifying interest to be amended to such an extent that the focus is not limited to shareholding but that it includes circumstances in which a person holds the unconditional right to become a shareholder of the transferee company and moreover where a binding agreement has been concluded between the contracting parties to this effect.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

To encourage corporate restructuring, section 42 provides roll-over relief when built-in gain assets are transferred for shares issued by a company in the prescribed circumstances. To enjoy this form of roll-over relief, it was confirmed that the transferor of the asset must hold a "qualifying interest" in the transferee company immediately after the transfer (*viz*, at the close of that day).

Various factors and legislative enactments were considered to ascertain whether it is practically possible to comply with the qualifying interest requirement when entering into a section 42 asset-for-share transaction concerning immovable property, given the applicable time of disposal rules and the application of the Companies Act.

It was found that the basic principle underlying an "asset-for-share transaction" is that a natural person or legal *persona* may dispose of assets (the market value of which is equal to or exceeds their base cost) to a resident company in exchange for "equity shares" being issued by the latter, without incurring a liability to capital gains tax or normal tax as a result. Instead (with certain exceptions), the capital gain or gross income that would have accrued to the transferor on disposal of the capital assets or

trading stock is “rolled over” and becomes taxable in the hands of the transferee company upon a subsequent disposal by it.

In determining whether an asset has been disposed of and, furthermore, when the qualifying interest requirement in section 42 is required to be met, the time of disposal of immovable property as regulated in the ITA was considered in chapter 2. Paragraph 13(1)(a)(ii) of the Eighth Schedule to the ITA, which regulates the time of disposal of immovable property, confirmed that the time of disposal of immovable property (in the absence of a suspensive condition) is the date on which the asset-for-share transaction is concluded, subject to the application of the law of contract. Following the disposal of immovable property, the transferor company is required to hold 10% of the equity shares (i.e., a qualifying interest) in the transferee company.

Upon conclusion that the time of disposal of immovable property occurs on the date of contract conclusion, chapter 3 considered the issue of shares for adequate consideration in pursuance of the qualifying interest requirement. During this part of the study, it became apparent that the provisions and application of the Companies Act introduce a mismatch with the requirements of the ITA, specifically concerning the issue of shares underlying asset-for-share transactions. To address the mismatch between these legislative enactments, the provisions of the Companies Act insofar as it relates to financial assistance were considered as a mechanism to provide relief and as an attempt to align the application of the provisions of the Companies Act and the ITA.

The focus of this study shifted to consider the nature of shares and the shareholder concept. As part of chapter 4, it was considered whether a person (whether it be a natural person or a corporate entity) can be said to hold a qualifying interest in a company in the absence of them being a shareholder in the strict sense of the word. Accordingly, can the qualifying interest requirement be interpreted so widely as to

include the unconditional right to receive shares in a transferee company, or is a narrow approach preferred in which qualifying interest is limited to shareholding?

Following the discussions and conclusions in chapter 4, and notwithstanding the potential interpretation of the term “hold” that would assist in the meantime, the need for clarity insofar as the disposal of immovable property in terms of asset-for-share transactions is concerned became apparent.

Given the uncertainties unpacked in this dissertation it would be helpful if the authorities provided clearer guidance on the practical considerations and implications underlying the disposal of immovable property in terms of a section 42 asset-for-share transaction. To this end, it would be necessary for National Treasury to consider amendments to the application of section 42 of the ITA to specifically provide guidance in instances where immovable property is disposed of in exchange for the issue of shares.

In the alternative, and as an interim solution SARS could consider issuing an Interpretation Note or a Guide on the application of section 42 of the ITA to provide that the term “hold” insofar as immovable property transactions are concerned are to be interpreted to not just entail shareholding but to include the unconditional right to become a shareholder upon registration of the immovable property in the Deeds Office.

Although a Guide or Interpretation Note does not constitute legislation (considering that it is issued by the Executive and not the Legislature) it can be employed as a useful tool to give guidance to taxpayers on the interpretation of legislation and the application of its underlying provisions. While such guidance would admittedly not amount to “practice generally prevailing”, SARS cannot publish opinions that it arbitrarily disregards due to considerations involving administrative justice. An Interpretation Note or a Guide endorsed by SARS would furthermore create a

legitimate expectation that legislation would be interpreted by the Legislature in a certain manner and would serve to erase any doubt as to the position the executive arm would enforce.[120]

That notwithstanding, and despite the practical difficulties imposed by the interaction between the various legislative enactments a purposive approach[121] to statutory interpretation should be followed in which the practical application and functionality of the provision is called into question. At the core of this determination would be a consideration of the purpose of the group relief provision enacted in section 42. Despite being full of unclear legislation this provision is clearly not intended to act as a penal provision and an interpretation that gives regard to its purpose (encourage corporate restructuring) should always be adopted.

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[120] In the constitutional era, *Marshall v Commissioner for the South Africa Revenue Service* 2019 (6) SA 246 (CC) recognised the need for consistent interpretation by those responsible for the administration of legislation. If this approach is not followed, there would be no certainty for those persons subject to the legislation (in this case, a taxpayer). Admittedly, as a cornerstone of constitutional supremacy, the opinions or interpretations by SARS cannot inform the interpretation of a legislative provision, but it should provide a taxpayer with certainty as to how SARS would apply such a legislative provision. In the absence of such reliance, the legitimate expectation of taxpayers would be undermined.

[121] *Natal Joint Municipal Pension Fund v Endumeni Municipality* (920/2010) [2012] ZASCA 13 (15 March 2012).

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