DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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IN THIS ISSUE

AMALGAMATION TRANSACTIONS FOLLOWING ASSET-FOR-SHARE TRANSACTIONS

The South African Revenue Service (SARS) recently released Binding Private Ruling 159 (Ruling), which deals with the disposal of assets, being shares, in terms of an amalgamation transaction immediately after having acquired those shares in terms of an asset-for-share transaction.

The facts were that companies A and B are controlled by various shareholders (individuals and family trusts). The shareholders wanted to hold their investments through a single company and not through both companies A and B.

The proposed transaction entailed the following:

Asset-for-share transaction

- A new company C would be formed as a wholly-owned subsidiary of B.
- Company B and C would enter into an asset-for-share transaction in terms of which B would dispose of its assets (except for selected assets) to C in return for shares in C in terms of s42 of the Income Tax Act No 58 of 1962 (Act).
- C would assume certain of B's debts as payment for the selected assets and section 42 of the Act would not apply to these assets.
- C would also recognise an amount of goodwill in its books.
- After the implementation of the said asset-for-share transaction, the only assets held by B would be the shares in C.

Amalgamation transaction

- Companies A and B would then enter into an amalgamation transaction in terms of section 44 of the Act whereby B would dispose of its newly acquired shares in C to A, in exchange for shares in A.
- B would then distribute the shares that it has acquired in A to the shareholders.
- B would be wound up.

Generally, when a person acquires shares in terms of an asset-for-share transaction in terms of s42 of the Act, there are restrictions imposed on the disposal of those shares within a certain time period.

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A direct restriction is contained in s42(5) of the Act. It provides that:

- should a person dispose of shares acquired in terms of an asset-for-share transaction within 18 months of the transaction; and
- more than 50% of the market value of the assets that the person transferred to the company (in terms of any transaction) is attributable to allowance assets or trading stock,

the person must be deemed to have disposed of the shares as trading stock to the extent that any amount received by or accrued to the person in respect of the disposal is less than or equal to the market value of the shares at the beginning of the 18 month period.

A further, more indirect, restriction is contained in s42(6) of the Act. It provides that, should a person cease to hold a qualifying interest in the company (by for example disposing of its shares) within 18 months of the asset-for-share transaction, any roll-over relief obtained by virtue of s42 of the Act would effectively be reversed.

However, explicit exceptions exist in s42(5) and 42(6) of the Act for when the shares are disposed of (or the qualifying interest lost) as a result of a transaction in terms of s45 (intra-group transaction), 46 (unbundling transaction) or 47 (liquidation distribution) of the Act. There is no exception in respect of s44 of the Act (amalgamation transaction).

In the current instance, the issue facing company B was that it would presumably fall foul of s42(5) of the Act in that it would dispose of the shares in company C within 18 months of the asset-for-share transaction by entering into the amalgamation transaction. It is assumed that more than 50% of the value of the assets transferred would be attributable to allowance assets or trading stock. It is not clear from the Ruling whether company B would also have fallen foul of s42(6) of the Act.

SARS effectively ruled that the shares would not be treated as trading stock in terms of s42(5) of the Act. The reason given is that, based on all the facts and circumstances, including all the transaction steps, as a whole the parties involved would not deal with the assets as trading stock.

In respect of s42(6) of the Act it is merely stated that that section would not find application.

From the Ruling it is clear that SARS is willing to bend the rules in certain circumstances, even though s42 of the Act does not make provision for relief where the relevant shares are disposed of as a result of entering into an amalgamation transaction in terms of s44 of the Act within 18 months.

A further interesting aspect in respect of the Ruling relates to the treatment of the goodwill. In terms of paragraph (a)(i) of the definition of 'asset-for-share transaction' in s42(1) of the Act, the disposal of goodwill is excluded from the ambit of an asset-for-share transaction.

However, for purpose of s42(5)(b), the value of the goodwill transferred must be taken into account in establishing whether 50% of the market value of the assets transferred to the company is attributable to allowance assets or trading stock.

Heinrich Louw

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ON SOUTH AFRICAN TAX COMPLIANCE, TAX MORALITY AND TAXPAYERS' FREEDOM TO DO TAX PLANNING – CANADA, IRELAND AND SOUTH AFRICA ARE NOT WORLDS APART

The upcoming Budget Speech comes against the backdrop of a depressing South African growth rate, stubbornly high unemployment, a depreciating Rand (with more US tapering still to come), continued strikes in the mining sector, deadly service delivery protests and declining tax revenues.

On a more positive note: In November 2013 Minister Gordhan pointed to the continued growth in tax compliance by South Africans and said: "… the ability to collect tax revenue … to finance the provision of public services and socioeconomic infrastructure has been a cornerstone of our democracy these 20 years."

Commentators question, however, whether such compliance gains are sustainable in light of wide-spread wasteful and fruitless State expenditure. There have been headlines warning that "Taxpayers' pockets are not bottomless" (BusinessDay, 15 Nov 2013), that "Profligacy threatens legitimacy of the tax system" (BusinessDay, 25 October 2013) and that "It is indeed an emergency when government throws away the tax revenue that could be fixing real problems" (Financial Mail, November 22 – 27, 2013).

The SARS Strategic Plan 2013/14 – 2017/18 recognises the risk:

"Research and empirical evidence show that taxpayer's attitude towards compliance, and their willingness to comply, is influenced by how they perceive public funds to be utilised. Concerns about corruption in the public sector remain an issue. Recent surveys show that corruption has replaced crime as the number one issue concerning South African citizens."

Despite the above, SA taxpayers should expect to hear, during Budget time, continued references to the notion of "tax morality", urging each one to pay his or her "fair share". As explained by the previous SARS Commissioner: "In SARS, we have for many years promoted the notion that there is a moral component to tax compliance and this has seen us at odds with some tax advisors and professionals who insist tax is simply a cost to be reduced wherever possible."

What should SA taxpayers' take on this be?

A recent Canadian tax case complemented the litigants for sticking to tax fundamentals and for keeping tax morality arguments out of the proceedings.

The judgment in *Mckesson Canada Corporation (Appellant) and Her Majesty The Queen (Respondent) (heard in the Tax Court of Canada in December 2013 (2013 TCC 404; 2013 Can. Tax Ct. LEXIS 323))* is both lengthy and complex. It deals with transfer pricing. But it makes the following observations regarding tax morality versus a taxpayer's freedom to do tax planning:

- "The Crown did not directly or indirectly raise any fair share or fiscal morality arguments that are currently trendy in international tax circles. It wisely stuck strictly to the tax fundamentals: the relevant provisions of the legislation and the evidence relevant thereto. Issues of fiscal morality and fair share are surely the realm of Parliament." [par 167].
- "There is certainly nothing wrong with taxpayers doing tax-oriented transactions, tax planning, and making decisions based entirely upon tax consequences (subject only to GAAR which is not relevant to this appeal). The Supreme Court of Canada reminds us regularly that the Duke of Westminster is alive and well and living in Canada." [par 275].

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The last quotation might as well have come from SA case law.

In *CSARS v NWK Ltd [2011] 2 All SA 347 (SCA)* Lewis JA held:

"It is trite that a taxpayer may organise his financial affairs in such a way as to pay the least tax permissible. There is, in principle, nothing wrong with arrangements that are tax effective." [par 42]

The footnote to the abovementioned passage mentions that the SA taxpayers' freedom to do tax planning was based on, and had been affirmed, in the *Duke of Westminster, Ladysmith* and *Conhage* cases.

A reminder: In *Inland Revenue Commissioners v. the Duke of Westminster (1936) AC 1*, Lord Tomlin proclaimed:

"Every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

It seems that the *Duke of Westminster* is alive and well and (also) living in South Africa.

At a major Global Tax Policy Conference (held in Dublin, Ireland during October 2013) Josephine Feehily who is the chair of the Irish Revenue Commissioners and chair of the OECD Forum on Tax Administration opined on the topic of tax morality. She stated that that tax morality was not the issue, but rather the enforcement of the correct tax payable. Such enforcement should be based on the laws made by government, and through reasonable and purposive interpretation of those laws rather than through tax morality that is difficult to enforce. She further said that, should the tax laws be abused, alternatively their intent and purpose not be clear, they should either be amended to clarify them or referred to the courts for interpretation. [Refer Conference feedback as reported in TaxTalk Journal, January / February, 2014 edition, at p. 14].

Clearly Canada, Ireland and South Africa are not worlds apart in saying that 'fair share' and 'tax morality' concepts belong in the realm of Parliament and that a taxpayer's tax liability should be determined with reference to the applicable statutory provisions.

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