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TAX ALERT

IN THIS **ISSUE**

OUR NEW TEAM MEMBERS

We are delighted to welcome Mark Linington and Dries Hoek to our Tax team. Mark and Dries have extensive tax advisory experience, focussed mainly on mergers and acquisitions (M&A) and corporate matters in Sub-Saharan Africa. In particular, they have advised on some of the biggest and most prominent private equity and corporate transactions concluded in South Africa and have been at the forefront of lobbying efforts to ensure that the tax legislation creates a level playing field for investors.

TAX CONSEQUENCES OF A LIQUIDATION DISTRIBUTION FOLLOWED BY AN AMALGAMATION TRANSACTION

The South African Revenue Service (SARS) released Binding Private Ruling 210 (Ruling) on 11 November 2015. The Ruling sets out the tax consequences of a 'liquidation distribution', as defined in s47(1)(a) of the Income Tax Act, No 58 of 1962 (Act), followed by an 'amalgamation transaction' as contemplated in s44(1)(a) of the Act.

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Mark and Dries are chartered accountants (SA) and have been practising as tax professionals for 22 and 11 years respectively.

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Mark and Dries are chartered accountants (SA) and have been practising as tax professionals for 22 and 11 years respectively. Their extensive experience complements our continued recognition as a leading M&A law firm. In 2014, Cliffe Dekker Hofmeyr claimed 1st place by deal count in the Africa and Middle East region of Mergermarket's M&A 2014 Global League Tables. Our firm also achieved top honours in the DealMakers Awards for M&A deal flow and deal value.

As we continue to broaden our service offering to ensure that our clients receive holistic and innovative advice, we are confident that Mark's and Dries' appointments will enhance our existing team of talented tax specialists. We are proud to have them on board.

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The Applicant and Co-Applicant proposed that the two companies amalgamate and consolidate their operations.

By way of background, s47(1)(a) of the Act defines a 'liquidation distribution' as any transaction in terms of which a liquidating company, which is a resident (as defined), distributes all of its assets to its shareholders in anticipation of or in the course of the liquidation, winding-up or deregistration of the liquidating company, to another company which forms part of the same group of companies on the date of that disposal; whereas, the definition of 'amalgamation transaction' in s44(1)(a) envisages an amalgamation transaction in terms of which a South Africa resident company disposes of its assets to another resident company by means of an amalgamation, conversion or merger and as a result of which the amalgamated company's existence will be terminated.

The Ruling concerns two South African resident companies (Applicant and Co-Applicant) who are fellow subsidiaries and have common shareholders. A further South African resident company (SubCo) is the wholly-owned subsidiary of the Applicant. There no longer exists any commercial rationale for the operation of the separate companies. Consequently, the Applicant and Co-Applicant proposed that the two companies amalgamate and consolidate their operations.

The Applicant and Co-Applicant proposed that the following steps would be undertaken to achieve the abovementioned result:

Step 1

SubCo would distribute all its assets to the Applicant in terms of a 'liquidation distribution', following which, its corporate existence will be voluntarily terminated within 36 months of such distribution.

Step 2

In terms of an amalgamation agreement as envisaged in s113 of the Companies Act, No 71 of 2008 (Companies Act), the Applicant and Co-Applicant will be amalgamated as follows:

- the Applicant will transfer, as a going concern, its business and all its assets to the Co-Applicant;
- as consideration for the transfer of the Applicant's business and its assets to the Co-Applicant, the Co-Applicant will assume all debts and contingent liabilities of the Applicant. In addition, the Co-Applicant will issue equity shares to the Applicant;
- the Applicant will distribute the equity shares issued by the Co-Applicant to its shareholders pro rata to their shareholding in the Applicant; and

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TAX CONSEQUENCES OF A LIQUIDATION DISTRIBUTION FOLLOWED BY AN AMALGAMATION TRANSACTION

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The distribution of SubCo's assets to the Applicant will constitute a 'liquidation distribution' in terms of s47(1) of the Act.

- as a final step, the Applicant will be deregistered under s116 of the Companies Act.

For purposes of the Ruling, it has been assumed that the shareholders of the Applicant hold the shares in the Applicant on capital account.

SARS made the following ruling with regard to the proposed transaction:

- the distribution of SubCo's assets to the Applicant will constitute a 'liquidation distribution' in terms of s47(1) of the Act and as a result, SubCo will not:
  - in accordance with s47(3)(a)(i) of the Act, recover or recoup allowances previously deducted by it in respect of the applicable allowance assets; or
  - realise any capital gain arising out of the transfer of those allowance assets as provided in s47(2)(a) of the Act.
- the Applicant and Co-Applicant will be deemed to be one and the same person for purposes of claiming allowances on allowance assets in the future and the recovery or recoupment of allowances in respect of allowance assets on the future disposal of those assets by the Applicant, as contemplated in s47(3)(a)(ii) of the Act;
- the Applicant must disregard any assessed tax loss, aggregate capital gain or aggregate capital loss, for the purposes of determining its taxable income in accordance with s47(5) of the Act, which results from:
  - the disposal of the equity shares held by the Applicant in SubCo as a consequence of the liquidation, winding-up or deregistration of SubCo; and
  - any return of capital which the Applicant receives from SubCo by way of a distribution of cash or an asset *in specie*.
- with regard to the transfer by the Applicant of all its assets to the Co-Applicant in terms of the amalgamation agreement, SARS ruled that such transfer will constitute an 'amalgamation transaction' as contemplated in s44(1) of the Act and as a result:
  - the Applicant will not recover or recoup any allowances previously deducted by either the Applicant or SubCo in respect of the applicable allowance assets, as contemplated in s44(3)(a) of the Act or realise a taxable capital gain as a result of the transfer of any capital assets, as per s44(2)(a)(i) of the Act;

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TAX CONSEQUENCES OF A LIQUIDATION DISTRIBUTION FOLLOWED BY AN AMALGAMATION TRANSACTION

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The Co-Applicant will be entitled to the same capital allowances in respect of the applicable allowance assets to which the Applicant was previously entitled.

- the transfer by the Applicant of the distributed assets to the Co-Applicant will not result in the application of s47(4) of the Act. Section 47(4) of the Act provides that where a holding company disposes of a capital asset acquired from a liquidating company within 18 months of acquiring it, a portion of the capital gain made cannot be set off against any assessed loss or capital loss of the holding company. Further, a portion of any capital loss must be disregarded.
- as contemplated in s44(3)(a)(ii) of the Act, the Co-Applicant will be entitled to the same capital allowances in respect of the applicable allowance assets to which the Applicant was previously entitled;
- the shareholders of the Applicant will be deemed to have:
  - disposed of their shares in the Applicant for their base cost amount in terms of s44(6)(b)(i) of the Act;
  - acquired the equity shares in the Co-Applicant at the base cost value of the Applicant's shares, as contemplated in s44(6)(b)(ii) of the Act; and
  - acquired the equity shares in the Co-Applicant on the date that they had acquired the shares in the Applicant, as contemplated in s44(6)(b)(iii) of the Act.
- the acquisition of equity shares in the Co-Applicant will not be subject to dividends tax or normal tax in the shareholders' hands. This is due to the fact that the equity shares acquired in the Co-Applicant by a shareholder of the Applicant will be deemed not to be an amount transferred or applied by the Applicant for the benefit or on behalf of that person in respect of the shares held by that person in the Applicant, as contemplated in s44(6)(c) of the Act; and
- all the liabilities to be assumed by the Co-Applicant in terms of the amalgamation agreement will qualify as 'debts' assumed by the Co-Applicant as consideration for purposes of s44(4) of the Act.

The Ruling is valid for a period of 3 years from 27 August 2015.

Dries Hoek and Gigi Nyanin

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