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CROSS-ISSUE OF SHARES AND TAX-FREE CORPORATE MIGRATIONS

In the 2015 Budget, the Minister of Finance indicated that paragraph 11(2)(b) of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act), which deals with the issue of shares by a company, would be reviewed. National Treasury has now released the first batch of proposals forming part of the draft Taxation Laws Amendment Bill 2015, which specifically addresses paragraph 11(2)(b).

The issue of shares by a company (whether for cash, shares or other assets) generally does not constitute a disposal for capital gains tax purposes, although there may be capital gains tax consequences in terms of s24BA of the Act to the extent that there is a mismatch between the value of the shares issued and the cash or assets received.

In 2013 paragraph 11(2)(b) was amended to specifically provide that the issue of shares by a resident company in exchange for shares in a foreign company (whether directly or indirectly) would constitute a disposal.

This was a 'blunt instrument' approach to dealing with certain transactions that resulted in tax-free corporate migrations. These transactions involved the issue of shares by a resident company to a non-resident company, in exchange for shares in that or some other non-resident company. The resident company would then be stripped of its foreign assets in a tax effective manner by relying on paragraph 64B of the Eighth Schedule. Following a change in the place of effective management of the resident company, it would become a non-resident, and the exit charge would be minimal given the preceding disposal of foreign assets.

The 2013 amendments to paragraph 11(2)(b) halted these transactions because it would result in an immediate capital gain for the resident company equal to the market value of the foreign shares, the shares issued by the resident company having a zero base cost.

However, the fact that paragraph 11(2)(b) applies to the direct or indirect exchange for shares in a foreign company had unintended consequences.

Even if the resident company issued the shares for a cash amount, but the amount is ultimately settled by the acquisition of shares in any foreign company, or the resident company in any other manner ends up with foreign shares, there would be a disposal.

The economic consequence is that it hampers the acquisition by local companies of foreign entities and the growing of South African multinationals.

It is now proposed that the 2013 amendments to paragraph 11(2)(b) be reversed, and that the issue of shares by a resident company in exchange for shares in a non-resident company, no longer constitute a disposal for purposes of capital gains tax.

Rather, paragraph 64B will be amended to provide that the disposal of shares in a foreign company by a resident company to a connected person, would be subject to capital gains tax. In other words, the exemption in paragraph 64B would not apply if the foreign shares are disposed of to a connected person.

In addition, s9H of the Act, which deals with changes in tax residence, will be amended to provide that any benefits that a resident company enjoyed under paragraph 64B and/or s10B(2)(a) of the Act within three years prior to ceasing to be a resident, will be reversed upon ceasing to be a resident.

The amendments are proposed to apply retrospectively with effect from June 2015.

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NOTICE OF JUDGMENT IN TERMS OF THE TAX ADMINISTRATION ACT

Judgment was handed down in the matter between *Lifman and others v The Commissioner for the South African Revenue Service and others* (case no 5961/15, as yet unreported) on 17 June 2015 in the Western Cape Division of the High Court.

The applicants were Mark Lifman and a number of close corporations of which he was the sole member.

During an enquiry in terms of s50 of the Tax Administration Act, No 28 of 2011 (TAA), conducted by the South African Revenue Service (SARS) into the affairs of the applicants, it came to light that the applicants owed SARS tax of approximately R13 million.

In November 2014, the parties had agreed that the applicants would make payment by 31 March 2015, and SARS indicated that, if payment was not made, it would take civil judgment against them.

The applicants also offered certain assets as security, and caveats were registered in respect of the assets.

SARS notified the applicants in a letter dated 5 February 2015 that the tax debt had to be settled by the end of March 2015.

On 3 March 2015, SARS sent another letter to the applicants, indicating that the tax debt must be paid, failing which SARS would take such steps as are available to them, including taking judgment, or if necessary, sequestration and liquidation proceedings.

It transpired that the applicants did not pay the outstanding tax debt by the agreed date, and SARS proceeded to take civil judgment against the applicants on 1 April 2015 in terms of s172 of the TAA.

The applicants then brought an application for an urgent interim interdict against SARS and the other respondents, being various sheriffs, to prevent them from executing on the judgment.

It was argued on behalf of the applicants that it is a requirement of s172 of the TAA that SARS first had to give at least 10 business days' notice to the taxpayer before judgment could be taken, and that SARS failed to give such notice to the applicants.

It was also argued that the letter from SARS dated 3 March 2015 did not constitute a valid notice as contemplated in s172 of the TAA. Essentially, it was contended that the notice could only be given after the agreed date for payment had arrived, and no payment was made. A letter pre-dating the agreed date for payment warning the taxpayer that legal action will be taken if payment is not made, does not constitute a valid notice.

In addition, the applicants argued that SARS's taking judgment in terms of s172 of the TAA was without sufficient reason, unfair, and arbitrary, and therefore in breach of s25 of the Constitution which guarantees the right not to be deprived of one's property. According to the applicants, the warning letter on which SARS relied also constituted a breach of their right to just administrative action as contemplated in s33 of the Constitution.

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SARS argued that the first requirement of s172 of the TAA is that there must be an outstanding tax debt, which was common cause in this matter. The second requirement was indeed that the taxpayer must be notified, but the form and content of such notice is not specified. It is also not specified whether the notice must inform the taxpayer that it has an outstanding tax debt, or whether it must inform the taxpayer that SARS intends to take judgment. SARS was of the view that the various letters that it had addressed to the taxpayer before the agreed payment date satisfied the second requirement of s172 of the TAA. Also, the letters should be viewed in the context of the relevant facts and circumstances, particularly the fact that the parties had concluded an agreement to the effect that the tax debt would be paid by the end of March 2015. The applicants knew where and when to pay, even though this was not stipulated in the letters. They had accepted liability, agreed to pay on a particular date and did not object to any of the assessments raised.

After considering the arguments of the parties, as well as the facts pertaining to the matter, the court held that the applicants' interpretation of s172 of the TAA was incorrect. The purpose of giving notice was to allow the taxpayer to make preparations. In the court's view, such preparations already started when the agreement was entered into in November 2014, and the applicants agreed to pay. After that, the applicants requested a deferral of payment, which SARS rejected. The letter dated 3 March 2015 gave the applicants sufficient notice to make preparations and to arrange their affairs. It was therefore unnecessary for SARS to explicitly state that the applicants had 10 days from 1 April 2015 to make payment, after which SARS would take judgment. A further 10 days after 1 April 2015 would in any event not have made a difference.

The court thus held that SARS had fully complied with the requirements of s172 of the TAA, and that the applicants did not make out a case for an interim interdict. The application was accordingly dismissed.

It is interesting to note that the court took a purposive approach to the interpretation of s172 of the TAA, despite the fact that specific reference is made to a 10 day notice period. The court also did not specifically answer the question as to whether the notice only has to be given in respect of the outstanding tax debt, or whether notice must also be given of SARS's intention to take judgment.

Another interesting aspect of the case was that, during the first part of April 2015, some of the applicants filed for business rescue in terms of Chapter 6 of the Companies Act, No 71 of 2008 (Companies Act). Generally, s133 of the Companies Act places a moratorium on legal proceedings once a company files for business rescue. In this matter, SARS obtained judgment on 1 April 2015, and the relevant applicants only filed for business rescue subsequently. The court noted that the moratorium does not apply retrospectively, and actions by some of the respondents (being certain sheriffs) after 1 April 2015 were therefore not in breach of s133 of the Companies Act.

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