TAX

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BEWARE WHEN YOU ISSUE SHARES

Generally there are no tax consequences when a company issues shares. This is the case regardless of whether the shares are issued for cash or in order to settle the purchase consideration that may have arisen pursuant to the acquisition of assets by the company. This follows from the provisions of paragraph 11(2)(b) of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act) to the extent that there is no disposal of an asset by a company in respect of the issue of a share in the company.

Unfortunately there are some exceptions to the general rules. The first issue that one should consider is whether the market value of the shares is commensurate with the market value of the assets that are acquired by the company. Section 24BA of the Act applies when the consideration would have been different had the asset been acquired in exchange for the issue of the shares in terms of a transaction between independent persons dealing at arm's length.

In particular, if the market value of the assets so acquired exceeds the market value of the shares after the issue by the company, the difference is not only deemed to be a capital gain in the hands of the company, but the disposer must also reduce the base cost of the shares in the hands of the disposer. Conversely, should the market value of the shares exceed the market value of the assets, the difference is deemed to be a dividend that has been distributed by the company *in specie* and is deemed to have been paid by the company on the date of the issue of the shares. It is thus quite important for both the purchaser and the seller to consider the value of the assets and shares in these circumstances. These deeming provisions do not apply in scenarios where the seller and the purchaser form part of the same group of companies.

More importantly, however, is that there are also negative tax consequences for parties where a company issues shares and acquires, directly or indirectly, shares in foreign companies as part of the issue of the shares. In particular, paragraph 11(2)(b) provides that there is a disposal of an asset to the extent that the shares issued by a company are in exchange, directly or indirectly, for shares in a foreign company. In other words, should a company in South Africa (X) issue shares with a view to settle the purchase consideration by X acquiring shares in a foreign company (B), then X will be subject to capital gains tax on the issue of the shares even though there is no cash involved in the transaction.

Unfortunately, this deeming provision is not only limited to a scenario where there is a direct issue of shares in exchange for the acquisition of shares in the foreign company. The adverse tax consequences will also apply where, for example, company B issues shares to a South African resident (A), in circumstances where A, in turn, holds interests in foreign companies.

Recently there have been a number of transactions where parties did not fully take into account these deeming provisions, especially to the extent that international interests were acquired, directly or indirectly. The original intention behind these provisions may have been to prohibit a reverse takeover in circumstances where the number of shares that are issued by the South African company may result in a change in control, but the technical interpretation of this section has the unintended result of a number of 'innocent transactions' falling foul of this deeming provision. This is one of the reasons why the Budget proposals recently indicated that the deeming provision may be revisited. The proposals acknowledged that the relevant provisions may have affected legitimate commercial transactions, curtailing the growth in expansion of South African multinationals. In other words, multinationals would not be able to compete in the international market as the norm in international transactions is to at least partly issue shares in order to fund the acquisition of international interests. It was indicated that National Treasury will consider relaxing these provisions even though the original intention – to counter untaxed corporate migration out of South Africa - will prevail. The issue will thus need to be solved by carefully worded amendments and specific consideration needs to be given to what extent, if at all, these amendments are retrospective from the date of the announcement.

In the meantime corporates must beware of issuing shares as part of multilayer transactions, especially to the extent that indirect interests may be acquired in foreign companies as part of the issue of shares.

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APPROVAL OF FINAL NOTICE AND REGULATIONS FOR TAX FREE INVESTMENTS

On 20 February 2015, National Treasury issued a media statement indicating that the Minister of Finance approved the final notice and regulations introducing tax free investments, which came into effect on 1 March 2015.

The preamble of the regulations, which should be read in conjunction with s12T of the Income Tax Act, No. 58 of 1962 (Act), provides some insight into the Government's objectives in introducing tax free investments, namely to enable the provision of financial products that:

- are simple to understand;
- are offered in a transparent manner;
- carry fees and charges that are reasonable; and
- are suitable for those persons who are not necessarily expert investors.

In support of the Government's objectives, there are certain compliance requirements that financial product providers will have to adhere to. A financial product provider will have to advertise a tax free investment as being just that: tax free. The designation of the tax free investment must contain the words 'tax free'. A financial product provider may not accept an amount in respect of tax free investments in excess of the annual contribution limit (R30,000), or in excess of the lifetime contribution limit (R500,000) and has a duty to inform an investor of these limits and the consequences of exceeding these limits.

Where a tax free investment is subject to a fixed term but no guaranteed return, the financial product provider must disclose to an investor, in a manner that is readily understandable, all charges, fees or similar costs payable:

- directly or indirectly by the investor out of any amount which forms part of the assets underlying the tax free investment; and
- implicit in the trading or holding of any derivative instrument or other assets underlying the tax free investment.

Any fees charged in respect of tax free investments must be reasonable. If an investor makes repetitive payments of amounts at regular intervals, an issuer may not charge a fee and therefore be penalised if the investor:

- does not pay all of those amounts;
- ceases to pay those amounts;
- pays any amount less than any of those amounts;
- pays a part of the sum of all those amounts; or
- pays the sum of all those amounts.

The regulations further provide that fees may only be expressed as a percentage of the value of the tax free investment in certain circumstances, and limits any fees relating to the withdrawal of an amount from a tax free investment.

The regulations also prescribes the requirements relating to the composition of tax free investments; for example, where the tax free investment has exposure to a share, no more than 10% of the value of that investment may be derived from shares in a single company and no less than 80% of any shares must be listed on a recognised exchange as defined in the Act.

Tax free investments may not be utilised for certain transactions, such as accounts:

- against which debit orders or stop-orders may be debited;
- from which payments or withdrawals may be made from any automatic teller machine or any similar device that dispenses cash to an account holder; or
- from which payments may be made with a debit or credit card.

In addition, an amount in respect of a tax free investment that has a maturity date must be payable to an investor by any product provider within 32 business days or, other than a tax free investment with a maturity date, must be payable to an investor by a product provider within 7 business days after the investor has requested the payment.

At this stage, pre-existing financial instruments or policies owned by investors may not be reclassified or converted into tax free investments. An investor may further not transfer any amount in respect of a tax free investment prior to 1 March 2016. However, it appears to be the National Treasury's intention to expand the regulations next year to allow individuals to transfer any amount in a tax free investment from one institution or financial product provider to another.

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