DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

THE CONVERSION OF PAR VALUE SHARES INTO NO PAR VALUE SHARES FOR COMPANY LAW PURPOSES

Since the introduction of the new Companies Act on 1 May 2011, consultants have battled with the problem as to whether the conversion of par value shares by a company into no par value shares will result in a tax liability for purposes of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (the Act).

Even though SARS has indicated that no formal general ruling will be issued to this effect, some guidance has been given in the fourth edition of the Capital Gains Tax Guide (the Guide) that was published during December 2011.

It is important to note that existing companies do not automatically need to convert par value shares into no par value shares to the extent that existing authorised share capital is still available for this purpose. The shares only need to be converted if no sufficient authorised share capital is available so as to cater for the issue of the new shares. In particular, regulation 31(3) indicates that one cannot issue par value shares if no shares in that class have been issued out of the authorised shares in that class or, if they have been issued, they were all repurchased.

Any conversion into no par value shares may not be designed substantially or predominantly to evade the requirements of any applicable tax legislation in terms of regulation 31(6). It is not clear what the rationale is of this potential tax avoidance provision in the company laws, as it is submitted that there are more than sufficient protection mechanisms built into the Act. In fact, it seems that the avoidance provision in regulation 31(6) only has one requirement, ie any design substantially or predominantly to evade the requirements of any applicable tax legislation. Generally the concept of "substantially" can be interpreted to be

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significant as opposed to being more than 50%. In other words, it is a very wide anti-avoidance provision that has now been incorporated in a regulation, which is not even part of the substantive legislation. It is doubtful whether this provision will stand up to any attack from a constitutional or administrative perspective.

Should a decision be made to convert the par value shares into no par value shares, the board of directors of a company is required to prepare a report that sets out amongst others the following issues:

- The material effects that the conversion will have on the rights of the holders of the securities; and

- An evaluation of any material adverse effect of the conversion against the compensation that any of the shareholders may receive in terms of the conversion process.

Before any conversion takes place, a copy of the proposed resolution must be filed with the CIPC as well as SARS. SARS is then entitled to apply to the court for a declaratory order at any time before the shareholders meeting is called.

In the Guide, it is indicated that a share constitutes a bundle of rights. However, paragraph 11(1)(a) provides that any conversion of an asset constitutes a disposal for purposes of the Eighth Schedule. In the Guide, it is indicated that there will be no disposal if the rights of the shareholders remain unchanged following the conversion process. If some of the rights are lost or diminished, it is indicated that there will be a disposal or part disposal. Whether the reduction in rights triggers a disposal "is a question of degree and will depend on the facts of the particular case". Should a shareholder receive compensation, that would clearly constitute proceeds.

Although the indication in the Guide can be welcomed, shareholders unfortunately have to continue dealing with a state of uncertainty given the absence of any specific guidance from SARS. Even though we agree with the views expressed in the Guide, the risk is always that an overzealous assessor can adopt a technical interpretation to the conversion of the par value shares into no par value shares, resulting in a company having to incur substantial costs so as to justify the argument that there is no disposal in circumstances where the conversion takes place from a company law perspective. It is also not clear to what extent taxpayers will have to embark on an administrative process to satisfy SARS each time that the conversion process is not subject to attack. SARS can expect to be swamped with reports as and when companies can no longer issue shares from existing authorised share capital.

A more controversial issue relates to whether any securities transfer tax is payable on the substitution of the par value shares with no par value shares. In the Securities Transfer Tax Act, reference is made to the fact that a transfer includes the transfer, sale, assignment or cession, or disposal in any other manner of a security, including the cancellation or redemption thereof. Given the fact that it is settled that any buyback of shares is subject to securities transfer tax (STT), it may well be that from a technical perspective STT will become payable on the conversion of par value shares into no par value shares given the fact that the existing shares are technically cancelled and substituted.

Emil Brincker

UK COURT RULES ON INDEPENDENT NATURE OF CONSULTANTS

You've seen them at large department stores and duty free shops – the individuals promoting and selling an endless array of beauty products and fragrances to fuel our endless pursuit of smelling better, looking younger and living longer. From a UK tax perspective, it appears that these individuals, where supplied through employment agencies, are not treated as employees for purposes of monthly employees' tax deductions.

In the case of *Talentcore Ltd (trading as Team Spirits) v Revenue and Customs Commissioner [2011] UKUT 423 (TCC)*, the court held that there was no 'contract of service' between the parties owing to the unique arrangement between Talentcore and its 'consultants'. By way of background, Talentcore supplied consultants to major cosmetic companies for counter and promotional work at airport duty free shops.

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The majority of Talentcore's work was to find consultants to service promotions by selling the products being promoted. There was no framework agreement between Talentcore and the consultants, it was not obliged to offer work to the consultants and the consultants were free to accept or decline the work offered. No training of consultants took place but there was a code of practice setting out, among others, a dress code, which was explained to consultants during interviews. The cosmetic companies provided some training but there was little supervision of the consultants and no control over sales techniques. Talentcore did, however, enter into contracts for each shift where the consultant agreed to work and would invoice the cosmetic companies by attaching a list of people and the time they worked.

An interesting and decisive aspect of the arrangement between Talentcore and the consultant was that if the consultant was unable (due to sickness for example) or unwilling (laziness perhaps?) to work in an agreed timeslot, it was incumbent on that individual to inform Talentcore and if possible find a suitable replacement. This unfettered right of substitution proved successful for Talentcore in the lower courts and in the present case. The lower court's view that such an unfettered right of substitution was inconsistent with a 'contract of service' was upheld on appeal and further held that there was no obligation to provide personal services within the ambit of UK tax legislation.

From a South African perspective, when looking at the generally mesmerising issues surrounding independent contactors, regard must be given to whether a contract of service exists. In its basic form, a contract of service is a bilateral contract between two parties agreeing typically to at least two things – the services to be rendered and the remuneration to be paid. The focus is on effort and personal service to be rendered and not on a specific result. This is typically found in a normal employment contract.

Where a contractual relationship, such as the Talentcore case exists in South Africa, there is a possibility that a similar conclusion could be reached in finding that the remuneration earned is from an independent trade and hence not subject to employees' tax. This is on the basis that the statutory tests in the Fourth Schedule and the additional common law tests should not represent a significant stumbling block. Each case must however be judged on its own facts and circumstances.

Ruaan van Eeden

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
Director
National Practice Head
T + 27 (0)11 562 1063
E emil.brincker@dlacdh.com

Alastair Morphet
Director
T + 27 (0)11 562 1391
E alastair.morphet@dlacdh.com

Natalie Napier
Director
T + 27 (0)11 562 1109
E natalie.napier@dlacdh.com

Ben Strauss
Director
T + 27 (0)21 405 6063
E ben.strauss@dlacdh.com

Johan van der Walt
Director
T + 27 (0)11 562 1177
E johan.vanderwalt@dlacdh.com

Ruaan van Eeden
Director
T + 27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Andrew Lewis
Senior Associate
T + 27 (0)11 562 1085
E andrew.lewis@dlacdh.com

Heinrich Louw
Associate
T + 27 (0)11 562 1187
E heinrich.louw@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 randburg and Dx 42 Johannesburg
T + 27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T + 27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

5th floor Protea Place Protea Road Claremont 7708, PO Box 23110 Claremont 7735 South Africa
Dx 5 Cape Town
T + 27 (0)21 683 2621 **F** +27 (0)21 671 9740 **E** ctn@dlacdh.com