DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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APPLICATIONS FOR WINDING UP PENDING OBJECTION OR APPEAL

An interesting judgment was handed down in the North Gauteng High Court on 3 October 2013 in the matter of *Commissioner for the South African Revenue Service v Miles Plant Hire (Pty) Ltd (case no 23533/2013).*

Miles Plant Hire (Pty) Ltd (taxpayer) was involved in a dispute with the South African Revenue Service (SARS) in terms of which an appeal was pending.

The taxpayer adopted a resolution to file for business rescue.

When SARS became aware of the resolution, it brought an application for the setting aside of the resolution, and for the taxpayer to be wound up in terms of s177(1) of the Tax Administration Act, No 28 of 2011 (TAA).

The court was mainly concerned with the application by SARS for the winding up of the taxpayer.

Section 177(3) of the TAA provides that, where a tax debt is subject to objection or appeal, SARS may only apply for the winding up of the taxpayer 'with leave of the court before which the proceedings are brought'.

SARS did not initially request such leave, but subsequently amended its notice of motion to include a prayer for leave to institute the proceedings.

The taxpayer argued that SARS should first, prior to the current proceedings, have applied for leave to bring an application for the winding up of the taxpayer. Because SARS failed to do so, the application had to be dismissed.

SARS argued that two separate applications are not required, but that it may, in the same proceedings, ask for leave to pursue an application for winding up, and ask for the actual winding up order.

In essence, the question for determination was whether s177(3) of the TAA requires that, when SARS seeks an order for the winding up of a taxpayer, there must be two separate applications, the one preceding the other. In other words, whether there must first be an application for leave to institute winding up proceedings, and secondly, if leave is granted, whether there must be a further application for the actual winding up of the taxpayer.

The court effectively sided with SARS and held that two separate applications are not required.

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In the court's view, the correct interpretation of s177(3) of the TAA is that it obliges and empowers a court to, before it considers the substantive merits of the application for winding up, but during the same proceedings, to also consider the merits of the pending objection or appeal. Only then may it make an appropriate order.

In other words, the court held that the purpose of s177(3) of the TAA is to allow a court before which a winding up application is brought, to also evaluate, without deciding, the grounds of the objection or appeal.

For example, should the court find that there is merit in the objection or appeal, it may postpone the proceedings until such time as the dispute has been finally resolved, and then only make an order in respect of the winding up of the taxpayer.

The court therefore confirmed that the purpose of s177(3) of the TAA is to prevent abuse of the 'pay-now-argue-later' principal and to subject applications by SARS for the winding up of taxpayers to judicial scrutiny in circumstances where an objection or appeal is pending.

In the current matter, the court considered the grounds of appeal of the taxpayer, but found that the taxpayer did not seriously contest the capital amount of tax due – the taxpayer mainly disputed the imposition of a penalty. In respect of the undisputed capital amount alone, the court found that the taxpayer was 'hopelessly insolvent', and the court therefore granted the winding up order.

Heinrich Louw

WHAT IS CONTRIBUTED TAX CAPITAL?

The concept of contributed tax capital (CTC) was introduced into the Income Tax Act, No 58 of 1962 (Act) with effect from 1 January 2011. Despite the concept forming part of our law for a number of years now, the question still often arises - what is contributed tax capital?

The relevance of the concept of CTC is that it is one of the main exclusions from the definition of a dividend. A dividend is defined as any amount transferred or applied by a company that is a resident for the benefit of any person in respect of a share but does not include any amount transferred/applied that "results in a reduction of contributed tax capital of the company". A distribution by a resident company to its shareholders, which results in a reduction of CTC will thus not constitute a dividend. If no election is made by the directors of the company (or persons with comparable authority) that a distribution results in a reduction of CTC, the distribution will by default constitute a dividend (unless one of the other exclusions are applicable).

Before considering what constitutes CTC for purposes of the Act, it is important to appreciate that it is a tax concept. The accounting and company law classification of a particular distribution is now irrelevant. For instance, if for accounting purposes an amount is distributed out of profits, it will not constitute a dividend for tax purposes if the company elects to reduce its CTC. It is also worth noting that previously it was debatable whether or not it was possible to create negative reserves. Under the CTC regime, it is not possible to have negative CTC and any distribution after the CTC has been reduced to nil will thus constitute a dividend.

If we turn to the definition of CTC in s1 of the Act, it makes a distinction between the CTC of a company that is not a resident that becomes a resident on or after 1 January 2011 and the CTC of any other company. To obtain a general understating of the concept of company's CTC we only discuss the later scenario. In that instance, the CTC is an amount equal to the sum of:

- the stated capital or share capital and share premium of that company immediately before 1 January 2011 in relation to shares in that company of that class issued by that company before that date (the so called pure share capital/premium); **less**
- so much of that stated capital or share capital and share premium as would have constituted a dividend, as defined before that date, had that stated capital or share capital and share premium been distributed by that company immediately before that date (the so called tainted share capital/premium); **plus**
- the consideration received by or accrued to that company for the issue of shares of that class on or after 1 January 2011; **less**
- CTC has transferred on or after 1 January 2011 for the benefit of any person holding a share in that company of that class in respect of that share.

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In simple terms, a company's CTC, in relation to each class of shares, is calculated by determining its effective date CTC (that is the pure share capital/premium reduced by the tainted share capital/premium) and adding any additional consideration received for the issue of that particular class of shares after 1 January 2011. If the directors (or similar authorised persons) decide to make a distribution to the shareholders and reduce the CTC as a result thereof, the CTC in respect of that particular class of shares must then be reduced proportionately. The CTC definition requires that a separate CTC balance is determined and maintained for each separate class of shares.

The above is a very high-level introduction in respect of what constitutes CTC. It is important to note that that CTC is essentially a tax concept. For a more detailed discussion on the topic, refer to the South African Revenue Service's draft Comprehensive Guide to Dividends Tax (the Draft Guide), which was recently released for public comment. The Draft Guide discusses these issues in detail, including the distinction between tainted and pure share capital/premium. It also provides some helpful guidance and examples on the determination of a company's CTC where a transaction is implemented using the company reorganisation rules in s42, 44 and 46 of the Act.

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