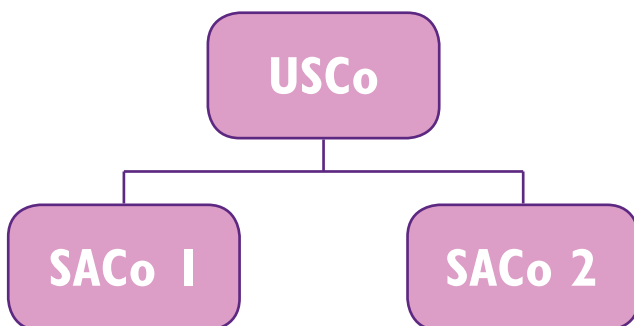


DETERMINING A 'GROUP OF COMPANIES' FOR PURPOSES OF THE CORPORATE RULES

The Income Tax Act, No 58 of 1962 (the Act) contains a definition of a 'group of companies' in s1 of the Act. However, a narrower definition of the term 'group of companies' is contained in s41 of the Act, which applies to certain corporate tax roll-over rules and other provisions contained in the Act. It is important to identify which companies fall within the different definitions of a 'group of companies' in order to determine whether one qualifies for the applicable tax relief.

The South African Revenue Service (SARS) released Interpretation Note No. 75 on 24 October 2013 (IN 75) to provide guidance on the interaction of the definitions of 'group of companies' as found in s1(1) and 41(1) of the Act. To obtain a better understanding of SARS's interpretation of the proviso to the 'group of companies' definition in s41 of the Act and the 'group of companies' definition in s1 of the Act, it is helpful to consider the following basic example of a foreign tax resident holding company (USCo) that holds directly 100% of the equity shares in two South Africa tax resident companies (SACo 1 and SACo2):



In determining whether USCo, SACo 1 and SACo 2 form part of the same 'group of companies' for purposes of section 41(1) of the Act, IN 75 submits that:

- The first requirement of s41(1) of the Act would be satisfied in that there is a 'group of companies' as defined in s1(1) of the Act. USCo holds at least 70% of the equity shares in SACo 1 and SACo 2. SACo 1 and SACo 2 are therefore the 'controlled group companies' of USCo.

- Paragraph (i)(ee) of the proviso to the 'group of companies' definition in s41 of the Act excludes a company incorporated under the law of any other country other than the Republic of South Africa (unless that company has its place of effective management in South Africa). USCo, being a non-resident, should be excluded from consideration as being part of the 'group of companies'.
- The definition contained in s1(1) of the Act should be 're-applied' to assess whether the remaining companies fall within the 'group of companies' definition in s1 of the Act. If one applies this approach, USCo would be excluded from the consideration of the 'group of companies' definition in s1 of the Act and there would be no 'controlling group company' in relation to SACo1 and SACo2. As result, SACo 1 and SACo 2 would not form part of the same 'group of companies' for purposes of s41 of the Act.

IN 75 concludes that it is not permissible to interpret the proviso as an independent enacting clause and its provisions must be read as if they form part of the opening words of the definition in s41(1) (that is the 'group of companies' definition in s1). The exclusion by the proviso of, for example, a controlling company from a group of companies will accordingly impact whether its controlled companies remain part of a group of companies under the corporate rules.

continued

We are aware that the South African Institute of Chartered Accountants (SAICA) submitted comments on the draft IN 75. In particular, SAICA submitted that "[w]hat section 41 definition requires is that a group of companies must be determined in accordance with the section 1 definition. Paragraph (i) of the proviso then requires that the specified companies are excluded from that group of companies for purposes of section 41. Nowhere does it suggest that the section 1 definition must be reapplied without having regard to the specified companies."

If one were to adopt the above interpretation and apply it to the aforementioned example, for purposes of s41 of the Act :

- US Co would not form part of the same 'group of companies' as SACo 1 or SACo 2 (excluded by the provision in paragraph (i)(ee) of the 'group of companies' definition in s41 of the Act); and

- SACo 1 and SACo 2 would still form part of the same 'group of companies' on the basis that they fall within the 'group of companies' as defined in section 1 and do not fall within any of the provisos to the 'group of companies' in s41 of the Act.

However, with the release of IN 75 it is clear that SARS does not accept the above interpretation. It is critical that taxpayers carefully analyse whether their transactions fall within the relevant 'group of companies' definitions, otherwise the anticipated tax implications of the transaction may be queried by SARS.

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