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TAX ALERT

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SHAREHOLDERS LIABLE FOR TAX DEBTS OF COMPANIES ON WINDING UP

The Tax Administration Act, No 28 of 2011 (TAA) took effect on 1 October 2012.

Among other things, the TAA makes third parties liable for the tax debts of taxpayers, under certain circumstances. In terms of s181 of the TAA, shareholders of a company can be liable for the tax debts of a company on winding up.

In terms of s181(1) of the TAA the provision applies "where a company is wound up other than by means of an involuntary liquidation without having satisfied its tax debt…." Put simply, a tax debt is an amount of tax due in terms of any law administered by the South African Revenue Service (SARS).

Section 181(2) of the TAA states that persons who are shareholders of the company within one year prior to its winding up are jointly and severally liable to pay the unpaid tax debt to the extent that:

- they receive assets of the company in their capacity as shareholders within one year prior to its winding up; and
- the tax debt existed at the time of the receipt of the assets or would have existed had the company complied with its tax obligations.

The term 'asset' is defined very widely in s1 of the TAA. As an example, the shareholders of a company (company A) resolve to voluntarily wind up company A. In the process of winding up, company A distributes cash or shares that it owns to its shareholders. The shareholders will be liable (jointly and severally between them) for the unpaid tax debts of company A.

In terms of s181(3) of the TAA, the liability of the shareholders is secondary to the liability of the company. That is SARS must first try and recover the unpaid tax from the company and may only thereafter recover the unpaid tax from the shareholders. The people who are liable for tax of a company may avail themselves of any rights against SARS, which would have been available to the company as per s181(4) of the TAA.

In terms of s181(5) of the TAA, the provisions of s181 of the TAA do not apply in respect of:

- a company where its shares are listed on a recognised securities exchange (for instance, the Johannesburg Stock Exchange (JSE); or
- a shareholder of a company whose shares are so listed.

In my view, the provision is inequitable. Shareholders do not manage the day to day affairs of companies, this is the role of the directors of the company. In closely held companies the shareholders and directors are often the same people. But

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in many cases, shareholders are passive investors and do not necessarily have knowledge about the affairs of the company, particularly the tax affairs of the company. It is unfair to saddle those shareholders with the tax debts of the company simply by virtue of their shareholding.

This consideration is even more relevant in the case where a person acquires shares from a third party. For example, a person (B) buys shares in a company (company C) from the shareholder (D). B decides to wind up company C and to procure that company C distributes all its assets to B. In that case, B will be jointly and severally liable with D for the tax debts of company C, despite the fact that B was not a shareholder of company C when the tax debts arose.

The term 'shareholder' in s1 of the TAA is essentially a person who holds a beneficial interest in a company. A person holding a preference share in a company would accordingly also be caught in the net under s181 of the TAA if the company is voluntarily wound up while they are a shareholder. It is perhaps even more unfair for a preference shareholder who typically may only have a limited right to the profits and assets of a company to be liable jointly and severally with ordinary shareholders for the tax debts of the company.

Section 181 of the TAA only appears to apply in the case of a voluntary winding up of a company; it does not appear to apply in the deregistration of the company. Winding up and deregistration are not the same thing. The distinction is recognised for instance in s45 and s64B of the Income Tax Act, No 58 of 1962. Presumably, the legislature purposefully omitted the application of the provision in the event of deregistration because the liability of directors and shareholders do not cease in the event of deregistration – compare s83(2) of the Companies Act, No 71 of 2008.

Section 181(5) of the TAA is not clear. Presumably, the intention is that s181 of the TAA will not apply in the case where a company whose shares are listed on an exchange is wound up, and will not apply to the shareholders of such a company being wound up. However, if it is read literally, the provision appears to suggest that if a person holds shares in any listed company, the shareholder will never be liable under s181 of the TAA, even in relation to the receipt of assets on winding up of another company. The legislature should consider clarifying the provision.

Shareholders of companies should be aware of their potential liabilities under s181 of the TAA. People who acquire shares from third parties should ensure that they obtain the appropriate security from the third parties in the event that they should become liable for the debts of the company on winding up after acquiring the shares.

Ben Strauss

MUTUAL ASSISTANCE PROVISIONS IN DOUBLE TAX AGREEMENT BETWEEN UNITED KINGDOM AND SOUTH AFRICA

In the recent case of *Ben Nevis (Holdings) Limited & Metlika Trading Limited v The Commissioners for HMRC (Her Majesty's Revenue and Customs) [2013] EWCA*, the Court of Appeal of England and Wales considered the interpretation of the mutual assistance provisions in the double tax agreement (DTA) between the United Kingdom (UK) and South Africa (SA).

The first appellant, Ben Nevis (Holdings) Limited (Ben Nevis), was a company incorporated in the British Virgin Islands and owned and controlled by South African businessman, David King. The final determination of a tax appeal in South Africa in October 2010 resulted in Ben Nevis being found liable for taxes (for the 1998 to 2000 assessments) to the South African Revenue Service (SARS), amounting to R2.6 billion. SARS was of the opinion that during the subsistence of their investigation of Ben Nevis, assets totalling £7.8 million were transferred to the second appellant, a company also incorporated in the British Virgin Islands. SARS relied on article 25A of the protocol amending the DTA between the UK and SA (in force on 13 October 2011),

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which made provision for mutual assistance in the collection of taxes, and enlisted the assistance of the HMRC to collect Ben Nevis's outstanding tax debt.

HMRC accordingly assisted SARS and intervened in the transfer of assets by Ben Nevis to the second appellant. Ben Nevis subsequently took legal action in the UK, arguing that HMRC could not enforce the South African tax liability because it relates to a period prior to the DTA's coming into force in 2002. The protocol to the DTA contained the mutual assistance provisions under article 25A. Ben Nevis further argued that article 27 of the DTA, which governs the entry into force of the DTA, has the effect of precluding mutual assistance in the collection of tax debts which relate to periods prior to 1 January 2003. Essentially, the argument was against retrospective application of the mutual assistance provisions.

The Court of Appeal held that article 27 of the DTA did not limit the temporal application of the protocol and article 25A. Furthermore, article 25A, read free of article 27, was found to apply to requests for assistance in the enforcement of tax liabilities arising before the protocol came into force. The court noted that article 28 of the Vienna Convention forbids retrospectivity of treaties unless the contrary intention appears from such treaty, but found that this was not a peremptory norm of international law. Ultimately, the intention of the parties would be the deciding factor in the retrospective application.

The parties agreed, as is apparent from article VI of the protocol, that article 25A would apply to all enforcement requests made on or after the date on which the protocol entered into force (13 October 2011). The court went on to state that the application of article 25A in the present instance was not truly retrospective. Furthermore, there was no unfairness in its application which permitted cross-border collection of the tax debts, although the debts related to years of assessment commencing before the 2002 DTA came into force.

Yet a further argument by Ben Nevis was that s173 of the Finance Act 2006, giving effect to arrangements relating to international tax enforcement, did not apply retrospectively to allow for enforcement of the DTA. The court held that the rule forbidding collection of taxes assessed by a foreign tax authority was amended in the Finance Act 2006, to allow for international tax enforcement. The change allowed the collection of foreign taxes arising before the amendment came into force. The previous rule impeding the enforcement had been a matter for the states involved and did not create a legitimate expectation for the taxpayer that it would be retained in the future.

It appears that the united front presented by the HMRC and SARS proved successful in pinning down the taxpayer and it remains to be seen to what extent mutual assistance for enforcement of tax collection will be relied on in future.

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