

TAX IMPLICATIONS FOR BUSINESS RESCUES IN SOUTH AFRICAN LAW

by

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Submitted in partial fulfilment of the requirement for the degree of

LLM (Master Degree) in Insolvency Law

LLM INSOLVENCY MINI-DISSERTATION

UNIVERSITY OF PRETORIA

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2 November 2012

SUMMARY

The South African Revenue Service has in the past had difficulty in applying debt forgiveness in cases of corporate and business rescues. Taxation legislation was drafted to counter innovative section 311 schemes of arrangements where the sole purpose was to obtain maximum taxations benefits in relation to entities in financial difficulties. This approach was only concerned with the interests of the Revenue authorities.

The central theme of this study focuses of the procedures now available to tax authorities and debtors alike when compromises were and are considered in South Africa in terms of income tax and company legislation.

The South Africa Revenue Service's approach the corporate rehabilitation is examined which is vital for investors, creditors and debtors alike.

A comparative study with similar procedures in England is undertaken to establish how valid the procedures are in establishing a viable corporate rescue environment in South Africa in the future.

KEY TERMS

Administration;
Alternative Dispute Resolution;
Business rescue;
Capital Gains Tax;
Company Voluntary Arrangement;
Compromise;
Corporate rescue;
Corporations Tax Act;
Her Majesty's Revenue & Customs (HMRC);
Income Tax Act;
Judicial management;
Scheme of arrangement;
Section 311 Schemes of Arrangement;
Section 91A settlements;
South African Revenue Service;
The Crown;
The Tax Administration Act;
Value Added Tax.

ACKNOWLEDGEMENTS

I express my gratitude to the libraries at Head Office South African Revenue Service and the University of Pretoria for kindly allowing me to make use of their libraries for purposes of my research.

I thank my wife and children, friends and colleagues for their encouragement and unwavering support.

November 2012

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THE TAX IMPLICATIONS FOR BUSINESS RESCUES IN SOUTH AFRICAN LAW.

CHAPTER 1

INTRODUCTION

1 BACKGROUND

Historically two mechanisms were available when corporate rescue measures were considered in South African Law, namely, judicial management and section 311 schemes of arrangements.¹

These rescue measures were replaced by the new business rescue provisions as set out in Chapter 6 of the Companies Act 71 of 2008, which came into force during the course of 2011, and also provides for a compromise with creditors outside business rescue proceedings.²

The intention of the new procedures is to provide for the efficient rescue and recovery of financially distressed companies, but in such a way as to balance the rights of the affected parties.³

The problem identified for further examination in this dissertation concerns the question as to how the Receiver of Revenue, one of the major creditors and affected parties in South Africa, has dealt with corporate rescue measures in the past and is likely to deal with them in the future, from a taxation point of view.

In a comparative study of business rescue procedures, England is examined to establish how they deal currently with taxation in corporate rescues. The interplay and the approach by Her Majesty's Revenue and Customs to corporate rescues were chosen, because of the influence of English company law on South African law. In addition, English insolvency law has undergone extensive law reforms, which made provision for two statutory business rescue procedures.⁴

1 Judicial management – came into operation in terms of Companies Act 46 of 1926; section 311 schemes of arrangement - Companies Act 61 of 1973.

2 Business Rescue provisions - Companies Act became operational from the 1st of May 2011.

3 Section 7 (k) of the Companies Act 71 of 2008.

4 A Company Voluntary Arrangement (CVA) under the Insolvency Act of 1986 and section 382(3) of Companies Act 2006.

The Crown's taxation approach to debtors subjected to corporate rescues could assist to identify deficiencies in a complex taxation environment within the South African legal jurisdiction.

2 METHODOLOGY

An overview of judicial management and the weaknesses that led to its failure is presented in the first part of Chapter 2. The second part of Chapter 2 deals with schemes of arrangements in terms of section 311. The various types of schemes with their respective purposes as well as the reasons for their popularity are considered. At this juncture the Receiver of Revenue's (SARS) approach within a strict creditor - orientated legal system is noted with specific reference to and comments about the application of sections 20(1)(a)(ii) and 103(2) of the Income Tax Act.⁵

Chapter 3 focuses on the changes to tax legislation that have come into effect since the turn of the century. The focus is on the alternative dispute resolution processes where tax disputes exist, including compromises that can be reached when appropriate to do so.⁶ In addition, section 91A of the Income Tax Act, is investigated. It deals with the settlement of debts in cases where there are no tax disputes, as well as tax debts which are compromised under certain conditions together with the regulations that apply thereto.⁷ The chapter closes with a discussion of The Tax Administration Act that came into operation on 1 October 2012 and specifically Chapter 14 which deals with the writing off or compromises of tax debts.⁸

Chapter 4 deals with business rescue proceedings and the provision for a business rescue plan to be adopted providing for the discharge of debts and claims in terms of the Companies Act 71 of 2008 and their subsequent taxation implications. Further investigation deals with the views of the revenue authorities where they are confronted with business rescue applications in general.

Chapter 5 deals with the business rescue procedures in English law. These procedures were specifically chosen for examination and discussion due to the influence that English corporate law had and still has on South African company law. Similarly, the taxation laws in England and Wales also deal with concepts relatively similar to South African taxation laws and, income tax, but specifically to capital gains tax and value added tax.

5 Income Tax Act 58 of 1962.

6 Section 88A – 88D of the Income Tax Act 58 of 1962.

7 Section 91A of the Income Tax Act of 58 of 1962.

8 Act 28 of 2011.

In addition, England's taxation authorities have been wrestling with the question of how to deal with corporate rescue measures over an extended period of more than 25 years, as this period was characterised by extensive changes to their insolvency laws, which requires an in-depth investigation.

The conclusion in chapter 6 examines whether the South African tax authorities would be more inclined in the future to consider alternative options when business rescues are considered and move away from a very strict creditor-orientated approach to a moderate debtor-friendly approach within our legal jurisdiction.

3 ISSUES THAT ARE EXAMINED

The central theme in this dissertation focuses on the procedures available to the tax authorities and debtors when compromises are considered in South Africa in terms of income tax -and company legislation in order to establish under which conditions or circumstances corporate rehabilitation could occur. The approach by the South African Revenue authorities are examined which is vital for investors, creditors and debtors alike.

The comparative study of English law on the subject is in the main to establish whether South African tax authorities could learn from their English counterpart, where the company, insolvency and taxation issues are relatively similar in nature.

4 ABBREVIATIONS AND REFERENCES

In the text, the initial(s) and surname of the writer(s) and keywords taken from the title are used when reference is made to textbooks and articles. The full reference of every cited source is in the bibliography. The full citation of court cases is provided on every occasion where reference is made thereto.

For practical reasons the masculine form is used throughout and should be assumed to include the feminine form.

Reference is made regularly to "SARS" which means the South African Revenue Service or the "Commissioner" which means the Commissioner for the South African Revenue Service appointed in terms of section 6 of the SARS Act and "Receiver" is used interchangeably. The same applies to England and Wales where reference to the Crown and "Her Majesty's" Revenue & Customs" or "HMRC" is used interchangeably.

I have compiled a Table of Contents and I have used the same structure and numbering of parts in each chapter.

To the best of my knowledge and belief, the law stated in this dissertation was correct as at 2 November 2012.

CHAPTER 2

SOUTH AFRICA

1 JUDICIAL MANAGEMENT

Since 1926, judicial management had undergone no major changes.⁹ In the case of a debtor company, where the recovery possibly lay in the fact that the debtor had the ability to repay all its debts in full, a petition could be presented to court for the appointment of a judicial manager to administer the debtor. The essential components of judicial management were that the company in question had to be registered under the Companies Act. The company had the benefit of a moratorium on all the claims against it and had the ability to settle all of its debts in full, and which during the period of protection would be administered by a judicial manager.¹⁰ The reasons for the low success rate of judicial management included the fact that it was expected from the debtor company to settle its debts in full. In addition, the exorbitant costs of high court litigation only worsened the financial position of the debtor and the fact that judicial management in general became a preliminary process before winding-up occurred.¹¹ Another disadvantage was the complete lack of regulatory control over the qualifications for judicial managers and the absence of a provision in the Act to remove judicial managers, which opened the door for abuse due to the lack of proper oversight.¹²

2 SECTION 311 SCHEMES OF ARRANGEMENT

Section 311 schemes of arrangement were more popular where the company negotiated with its members or creditors with the aim to alter existing rights in their common interest. In addition they were utilized to gain tax benefits rather than to accomplish a proper business rescue.¹³

9 Judicial management requirements were in essence dealt with in terms of Companies Act 61 of 1973, specifically sections 427 – 432; Loubser “Judicial Management as a Business Rescue Procedure in SA Corporate Law” (2004) *Mercantile Law Journal* 137.

10 Companies Act 61 of 1973.

11 See Olver “Judicial Management - a Case for Law Reform” for the history of problems experienced and measures to counter them; Kloppers “Judicial Management” and -Rajak and Henning “Business Rescues for South Africa” 1999 *SALJ*.

12 Loubser “Judicial Management as a Business Rescue Procedure in SA Corporate law” (2004) *SA Mercantile Law Journal* 137; Loubser “-Some comparative Aspects of Corporate Rescue in South Africa Company Law” (Doctorate 2010) at page 43.

13 Pieter Kloppers “Judicial Management – In Need of Reform?” at page 428; *Names (Edms) Bpk v Kommissaris van Binnelandse Inkomste* 1994 2 SA 265 (A) 278 C – D.

The section 311 procedure was utilized by the company to ensure that all creditors or class of creditors were bound by an agreement reached by the prescribed majority of creditors.¹⁴

The acquisition of a company in financial difficulty or on the verge of being liquidated was motivated by the singular fact that the company in question had an assessed loss that could be utilised for income tax purposes.¹⁵

Assessed loss for purposes of section 20(2) is described in the Income Tax Act as ‘any amount by which deductions admissible under section 11 exceeded the income in respect of which they are so admissible’.¹⁶

Creditors were in general inclined to accept a reduced pay-out of their claims due to the drawn-out process involving liquidations, which included expensive litigation and administrative costs.

Section 20(1) (a) of the Act provides that in calculating the taxable income derived by any person from carrying on any trade, an assessed loss brought forward may be set-off against such income.¹⁷ A limitation on such set-off is, however, provided by section 20(1) (a) (ii), namely that the balance of the assessed loss shall be reduced by the amount or the value of any benefit received by or accruing to a person resulting from a concession granted by or a compromise made with his creditors, whereby his liabilities to them have been reduced or extinguished, provided such liabilities arose in the ordinary course of trade.¹⁸

The effect of section 20(1) (a) (ii) is that the assessed loss will be reduced to the extent of the compromise. The provision in question reduced the appeal of the acquisition in general. In conjunction with section 20(1) (a) (ii), there is the possibility of applying section 103(2) of the Income Tax Act 58 of 1962 resulting in the disallowance of the set-off of the assessed loss.¹⁹ Section 103 of the Act deals with transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income.²⁰

14 Companies Act 61 of 1973 – Section 311(2) (a) & (b).

15 Pieter Kloppers “Judicial Management – In Need of Reform?” at page 429.

16 Income Tax Act 58 of 1962.

17 Income Tax Act 58 of 1962.

18 Income Tax Act 58 of 1962.

19 Income Tax of 58 of 1962 (set-off of assessed losses).

20 Income Tax Act 58 of 1962. (Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income.)

Section 103(2) states that whenever the Commissioner is satisfied that any agreement affecting any company or trust; or any change in the shareholding in any company; or the members' interest in any company which is a close corporation; as a direct result of which income has been received by or accrued to that company; or any proceeds received by or accrued, has at any time been entered into or affected by any person solely or mainly for the purpose of utilising any assessed loss, as the case may be, incurred by the company or trust, in order to avoid liability on the part of the company or trust or any other person for the payment of any tax, duty or levy on income, or to reduce the amount thereof will result in the disallowance of the set-off against income, taxable capital gain and any capital loss or assessed capital loss.²¹

To avoid the application of section 103(2) the taxpayer can utilise the objection and appeal process and must be able to prove that the utilization of the assessed loss was not the sole purpose in acquiring the company in question.²²

The scheme of arrangement in terms of section 311 in general showed no concern for either the creditors or employees of the company. The target company was either in provisional liquidation or final liquidation. The use of section 311 was aimed at the rescue of the corporate shell rather than the rescue of a viable commercial enterprise making an economic contribution to the welfare of the community at large.²³

2.1 Various schemes of arrangement

Various schemes were employed for acquisition purposes by utilizing the section 311 mechanism with the aim of preserving the assessed loss.

2.1.1 Standard scheme of arrangement

The standard scheme featured an investor who made a sum of money available to a receiver who was required to distribute it as a dividend to the creditors of the company in liquidation. In return for a dividend, the creditors relinquished all rights against the company. Their claims were ceded to the investor, who thereby acquired a loan account effectively equal to the company's total existing liability. The last provision was developed to establish that the scheme was an agreement between the company and its creditors, as required by section 311 of the Companies Act. It was constructed in such a way as not to reflect merely an agreement between the investor and the creditors.

21 Income Tax Act 58 of 1962.

22 Section 103(4) of the Income Tax Act 58 of 1962.

23 Pieter Kloppers "Judicial Management – In Need of Reform?" at page 429.

The effect of the standard scheme was to vest control of the company in the investor who acquired a company with a clean slate and which was not subjected to the influence of outside creditors.²⁴ The investor could then seek to take advantage of any assessed losses in the company and utilise the loan account to draw income from the company with tangible tax benefits.²⁵

2.1.2 Partial cession scheme arrangement

The essential feature of the partial cession scheme was that the acquirer would receive by way of cession, a substantial portion of each creditor's claim against payment of a fixed amount. The company would then borrow on loan account from the acquirer a further amount to be paid to the creditors for the remaining insignificant portion of their claims. Both amounts would be paid to a receiver who would be responsible for making a distribution to creditors on sanctioning of the scheme. If the relevant scheme was sanctioned, it would lead to a preservation of the assessed loss. The idea behind the scheme was thus to ensure that section 20(1) (a) (ii) of the Income Tax Act had no application under these circumstances.²⁶

2.1.3 Preference share scheme arrangement

The preference share scheme entailed that the claims of creditors were converted into preference share capital and the creditors were then deemed to have renounced their entitlement to the issue and allotment of such preference shares in favour an investor nominated by the company.²⁷ The rights of all creditors under such arrangement were limited to the right to claim payment of the dividends receivable by them under the arrangement. Most of the preference share schemes utilized the method of redeemable preference shares, but the terms and conditions thereof tended to vary.²⁸

24 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed Loss" 1995 Acta Juridica at pages 58-60.

25 Namex (Pty) Ltd v Commissioner for Inland Revenue 1992 (2) SA 761 (C) at 767 – 768B.

26 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed Loss" 1995 Acta Juridica at pages 60-64; Ex parte Millman & others NNO: In re Multibou (Pty) Ltd & others 1987 (4) SA 405.

27 Sackstein NO v Boltstone (Free State) (Pty) Ltd (in Liquidation) 1988 (4) SA 556 (O).

28 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at pages 64 – 70.

The preference share scheme had its difficulties from a taxation point of view and had to be approached with some caution as it was suggested that it could fall foul of section 20(1) (a) (ii).²⁹

The assessed loss arises due to certain expenditures and allowances being deductible for income tax purposes, and as there are no income against which to set off the expenditure and allowances. The intention is to allow the carrying forward of such expenditure and allowances and the set-off thereof against future income. However, where the taxpayer is relieved in whole or part of the liability in respect of such expenditure, which is outstanding, it is illogical to allow it to be deducted.

This state of affairs is the reason for the presence of section 20(1) (a) (ii).³⁰

2.1.4 Excluded creditor scheme arrangement

Another scheme that was prevalent at the time to circumvent the effect of section 20(1) (a) (ii) was the excluded creditor scheme.

In summary the company compromises with its creditors for a monetary consideration, acquired from money lent to the company by the proposer of the scheme, save that the claims of certain creditors are excluded from the ambit of the scheme.

The claims of the scheme creditors are compromised and discharged in return for payment of a monetary dividend. On the other hand, the claims of the excluded creditors are dealt with independently of the scheme by way of a separate agreement of cession between the creditor and the proposer of the scheme and to which the company was not a contractual party.³¹ The final result of the excluded creditors' scheme is the full discharge of the claims of scheme creditors against the company and the vesting in the proposer of the ceded claims of the excluded creditors with an insignificant reduction in the assessed loss of the company.³²

29 The Taxpayer, Volume 38 No 2 February 1989; Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at page 64-70.

30 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at page 71.

31 Cooper v A & G Fashions (Pty) Ltd 1999 (4) SA 204 (C).

32 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at page 72-76.

2.1.5 Debenture scheme arrangement

The debenture scheme was another option utilised by proposers.³³ In summary funds necessary to enable the company to enter into the scheme of arrangement with its creditors are lent to the company by the proposer. The capital is distributed to creditors as a dividend in respect of their claims. The claims of all the creditors against the company, reduced by their dividends in terms of the scheme of arrangement, are converted to unsecured subordinated debentures. Creditors are deemed to have renounced their rights to the debentures in favour of the proposer. The rights of all creditors are confined to the right to claim payment of the said dividend, where-after no creditor had any claim against the company. The company is directly involved in the scheme as it pays the capital sum in terms of the scheme to creditors.

The creditors were involved as they agreed to the conversion of their claims into debentures. It is suggested that it was tax effective in preserving the assessed loss, subject to the possible application of section 103(2) of the Income Tax Act.³⁴

2.1.6 Evaluation

The decision in *The Commissioner for Inland Revenue v Datakor Engineering (Pty) Ltd* raised serious doubt whether the practice of protecting the assessed loss in any scheme of arrangement would continue. The Supreme Court of Appeal had to consider whether the creditor granted a concession to the taxpayer as envisaged in section 20(1) (a) (ii) of the Income Tax Act. The court found that there was in fact a benefit to the taxpayer. It held that the provision was widely framed to include any benefit and that whether the benefit was affected or reduced by other factors was of no consequence. The benefit was to be found in the reduction or extinction of a debt.³⁵

Where the debtor had derived a benefit in consequence of the forgiveness of any indebtedness, it had to be considered in conjunction with the claw-back provision that applied when a debtor was relieved or partially relieved from the obligation to make payment of any expenditure actually incurred by the debtor. In addition, where the debtor has an assessed tax loss and any debt owing by the debtor is forgiven, then the assessed loss will firstly be reduced by the amount of the debt forgiven. Then to the extent that the assessed loss has been fully utilised, the excess debt will be recouped and treated as ordinary income in the hands of the debtor for income tax purposes.

33 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at page 77.

34 Getz & Jooste "Section 311 of the Companies Act: Preserving the Assessed loss" 1995 Acta Juridica at page 77 – 78.

35 1998 (4) SA 1050 (SCA); Pieter Kloppers "Judicial Management-In Need of Reform? At page 434.

Debt forgiveness could also have value-added tax (hereinafter referred to as VAT) implications. If the debtor, being a VAT vendor, has to account for output tax or reduce its input tax deductions in situations where any VAT owed to the creditor is forgiven and the debtor has previously deducted input tax in relation to the supply. Likewise the creditor will be entitled to deduct as input tax the VAT amount of any debt forgiven.³⁶

Where a debt owed by a debtor to a creditor is reduced or discharged for less than the face value of the debt, the debtor is in effect deemed to have disposed of an asset for proceeds equal to the amount of the debt forgiven for capital gains tax purposes.³⁷

Since the debtor does not have any base cost in respect of the debt, the full deemed proceeds will constitute a taxable capital gain in the debtor's hands.

The resultant capital gain will be taxed in the hands of the debtor in accordance with the applicable inclusion rate.³⁸

Taxation legislation was drafted to counter specifically elaborate and innovative section 311 schemes with the sole purpose of obtaining maximum taxation benefits in relation to an entity in financial difficulty. The fact that rather strict and rigid legislation applied to these compromise transactions reflected the protective attitude of the tax authorities to collect taxes owing, which were due and payable.

The tax authorities' modus operandi was exclusively technical and the details of every transaction were carefully perused and considered to establish whether the parties to a specific scheme arrangement have fallen foul of section 20(1) (a) (ii) read in conjunction with section 103(2). Socio-economic factors, including neither an entity of national interest nor the interest of other creditors, employees or shareholders had been of concern to the tax authorities. Cooperation and coordination amongst the various stakeholders had been non-existent with no effort to approach the revival of an entity in conjunction with other creditors, shareholders or employees. The aim was simply to ensure that the tax authorities collected monies which were due and payable, without effectively compromising on any of the valid tax debt outstanding.

This approach was about the interests of the tax authority only. At this juncture the tax authorities exercised their rights in a strict pro-creditor orientated legal jurisdiction with no consideration for the interests of the debtor or other stakeholders.

36 Section 22 (3) (ii) of the VAT Act 89 of 1991 (irrecoverable debts).

37 Paragraph 12 (5) (a) (i) & (ii) of the 8th Schedule (Capital Gains Tax) read with section 41 of the Income Tax Act 58 of 1962.

38 Paragraph 20 (2) (b) of the 8th Schedule (Capital Gains Tax). The 8th Schedule was inserted by sec 38 of Act No 5 of 2001.

CHAPTER 3

SOUTH AFRICAN INCOME TAX LEGISLATION

3.1 Background

Historically the approach by the Receiver until early 2000 was to adhere to the strict and rigid principle of collecting all possible taxes due and owing, without taking any surrounding circumstances into account pertaining to the affairs of the taxpayer. Strong emphasis was placed on the rights of the tax authorities to ensure due and proper collection, without considering any compromises and the Receiver viewed the strict and rigid collection drive as a benefit to society at large.

In fact the stark reality was that the Receiver was no longer as effective as in the past, as numerous entities were simply placed in liquidation, as no agreement could be reached with the Receiver where circumstances warranted a possible compromise of the debt owing.

Very often objections to assessments for a particular financial year led to situations where the matters would be heard in a Tax Court a number of years later, which also affected the financial outlook in subsequent financial years for the debtor taxpayers. The tax burden could eventually be such that it was simply impossible for an entity to settle their debt. Under those circumstances it opted for liquidation or the section 311 schemes of arrangement in terms of the previous Companies Act, with limited success.

3.2 Tax amendments since 2001

To address this negative time consuming effect on commercial entities, Part IIIA was inserted by section 74 of the Tax Amendment Act 45 of 2003 that deals specifically with tax disputes and settlements³⁹ between the Commissioner for Inland Revenue and the taxpayer debtor.

³⁹ Section 88A of the Income Tax Act 58 of 1962 provides definitions for dispute and settlement.

3.2.1 Tax disputes and settlements

The purpose of this amendment reflected on the fact that the Commissioner's principal duty is to assess and collect taxes and duties according to the laws enacted by Parliament and not to forgo any such taxes, duties, levies and charges properly chargeable and payable.⁴⁰

However, there may be circumstances where the strictness and rigidity of this principle can be tempered, where it would be to be best advantage of the state.⁴¹

It prescribes then the circumstances under which it would be inappropriate or appropriate to temper the basic principle and to settle a dispute.⁴²

Circumstances are stipulated where it would be inappropriate to settle and not to the best advantage of the state to settle.⁴³

This includes amongst a number of reasons intentional tax evasion or fraud⁴⁴; that a settlement would be contrary to the law or clearly established practice of the Commissioner⁴⁵; that it would be in the public interest to have judicial clarification of the issue and the case is appropriate for this purpose⁴⁶; that the pursuit of the matter will significantly promote compliance with the tax laws⁴⁷ and that non-compliance by the taxpayer is of such serious nature that the Commissioner will not consider any settlement.⁴⁸

Circumstances are also mentioned and described where it would be appropriate and in the best interest of the Commissioner to settle a tax dispute, in whole or in part. It will be considered on the basis that it would be fair to the taxpayer debtor and the Commissioner.⁴⁹

40 Section 88B (1) of the Income Tax Act 58 of 1962.

41 Section 88B (2) of the Income Tax Act 58 of 1962.

42 Section 88B (3) of the Income Tax Act 58 of 1962.

43 Section 88C of the Income Tax Act 58 of 1962.

44 Section 88C (a) of the Income Tax Act 58 of 1962.

45 Section 88C (b) of the Income Tax Act 58 of 1962.

46 Section 88C (c) of the Income Tax Act 58 of 1962.

47 Section 88C (d) of the Income Tax Act 58 of 1962.

48 Section 88C (e) of the Income Tax Act 58 of 1962.

49 Section 88D of the Income Tax Act 58 of 1962.

This included the question whether the settlement would be in the best interest of the good management of the tax system, overall fairness and the best use of the Commissioner's resources.⁵⁰

The cost of litigation will be considered as well taking into account the prospects of success in court, the prospects of collection of the amounts due and the costs associated with the collection process.⁵¹

In addition, whether the settlement of the dispute will promote compliance with tax laws by the person concerned or a group of taxpayers or a section of the public in a cost-effective way.⁵²

Section 107A states that the Minister of Finance may, after consultation with the Minister of Justice, promulgate rules prescribing the procedures to be observed in lodging an objection and noting an appeal against an assessment and the conduct and hearing of an appeal before a tax court.⁵³

The rules contemplated in subsection (1) may provide for alternative dispute resolution procedures in terms of which the Commissioner and the person aggrieved by an assessment may resolve a dispute.⁵⁴

The rules promulgated meant that taxpayers who felt aggrieved by an assessment could object to an assessment, which objection had to be in writing specifying in detail the grounds upon which it is made.⁵⁵

The Commissioner must on receipt of the objection, alter the assessment or disallow the objection in accordance with section 81(4) of the Act, reduce the assessment or withdraw the assessment, and must notify the taxpayer of his decision in writing.⁵⁶

50 Section 88D (a) of the Income Tax Act 58 of 1962.

51 Section 88D (b) of the Income Tax Act 58 of 1962.

52 Section 88D (c) of the Income Tax Act 58 of 1962.

53 Section 107A inserted by section 63(1) of Act No 60 of 2001.

54 Section 107A (2).

55 Income Tax Regulations: rules prescribing procedures to be observed in lodging objections & noting appeals against assessments and alternative dispute resolutions: Rule 4 (b).

56 Section 107A (1) read with rule 5 (3).

Any taxpayer entitled to an assessment and who is dissatisfied with the decision of the Commissioner in terms of section 81(4) of the Act, may appeal the decision.⁵⁷

The taxpayer's notice of appeal must indicate which of the grounds specified in his objection he is appealing; and may indicate whether the taxpayer wishes to make use of the alternative dispute resolution (herein after referred to as ADR) procedures contemplated in rule 7, should these procedures be available.⁵⁸

Where the taxpayer has indicated that he wishes to make use of the alternative dispute resolution process, the Commissioner is obliged to inform the taxpayer by notice whether they agree that the matter is appropriate for alternative dispute resolution and may be resolved by way of procedures contemplated by this rule.⁵⁹

Should the taxpayer not indicate in his notice of appeal that he wishes to make use of alternative dispute resolution, and the Commissioner is of the opinion that the matter is appropriate for alternative dispute resolution, the Commissioner must inform the taxpayer accordingly. The taxpayer must deliver a notice stating whether he agrees thereto within a period of 10 days of the date of the notice by the Commissioner.⁶⁰

A dispute may be resolved in accordance with the alternative dispute resolution procedures contemplated in this rule, which will only take place if the taxpayer accepts the terms set out in Schedule A.⁶¹

The main rule in terms of Schedule A is that both the Commissioner and the taxpayer have to agree to the ADR process for any settlement to have an effect.⁶²

The ADR process may be initiated by either the taxpayer or the Commissioner.⁶³

A facilitator must be appointed by the Commissioner to facilitate the ADR process. In addition, the Commissioner must inform the taxpayer who has been appointed as a facilitator.⁶⁴

57 Section 107A (1) read with rule 5 (6).

58 Section 107A (2) read with rule 7.

59 Section 107A (2) read with rule 7 (1) (a).

60 Section 107A (2) read with rule 7 (1) (b).

61 Section 107A (2) read with rule 7 (2) (b).

62 Schedule A – The Terms of the Alternative Dispute Resolution (“ADR”) – Paragraph 1.

63 Schedule A (Paragraph 2).

64 Schedule A (Paragraph 6).

The main objective with regard to the ADR process is to resolve the dispute between the parties by consent.⁶⁵

The aim thereafter is in fact that any settlement reached between the parties must be recorded in writing and must be signed by both the taxpayer and a designated official of the Commissioner's office.⁶⁶

In terms of the Income Tax provisions as set out in section 88A-88H of the Income Tax Act, circumstances are prescribed to settle tax debt under specific circumstances in terms of which it is appropriate to settle, where there are disputes between taxpayers and the Commissioner. There are therefore disagreements on either the facts or the law or both. In the same vein it is made clear under which circumstances it would be inappropriate to settle.

In canvassing the relevant taxation legislation at that stage, no provision was initially made to settle tax debt matters, where there are no disputes on the taxes outstanding. The assessments that were raised were in fact correct and accepted by the taxpayer debtor. Debtors would approach the Commissioner often on the possibility of a compromise concerning taxes due and payable, while not in a position to settle the taxes due.

The challenge then was to address these matters, where no dispute on the taxes outstanding existed, and to consider valid grounds for a compromise on taxes due and payable within a legislated framework.

3.2.2 Section 91A settlements (no tax disputes)

Section 91A of the Income Tax Act was thus inserted to address the problem that emanated from the challenge of being able to resolve matters which could be settled on various other grounds acceptable to the Commissioner, where there are in fact no disputes concerning the taxes due and payable. Circumstances may therefore exist where the agreed tax debt can be written off either wholly or partly, depending on the circumstances of each case.

65 Schedule A (Paragraph 8).

66 Schedule A (Paragraph 11).

Section 91A stipulates that the Minister of Finance may by regulation prescribe the circumstances under which the Commissioner may waive, write off or compromise in whole or in part any amount of tax, duty, levy, charge or other amount payable by a person in terms of any Act administered by the Commissioner, where that waiver, write off or compromise would be to the best advantage of the State.⁶⁷

The purpose of these regulations is to prescribe the circumstances under which the basic rule may be tempered and where the Commissioner may take a decision to write off a tax debt on a temporary or permanent basis.⁶⁸

These regulations only apply in respect of a tax debt owed by a debtor where the liability to pay the debt is not disputed by the debtor.⁶⁹

In terms of the general provisions a compromise is defined as an agreement entered into between the Commissioner and a debtor in terms of which the debtor undertakes to pay an amount (whether as a single payment or in instalments) which is less than the full amount of the tax due by that debtor in full satisfaction of that tax debt. Likewise, the Commissioner undertakes simultaneously not to pursue the recovery of the remaining portion of that tax debt on the condition that the debtor complies with the undertaking set out in the debtor's undertaking and any further conditions as may be imposed by the Commissioner.⁷⁰

In terms of Part 5 to the regulations issued under section 91A, the Commissioner may compromise a portion of a tax debt upon the written request by the debtor, which complies with paragraph 10, with the proviso that the purpose of that compromise will secure the highest net return from the recovery of that tax debt taking into account considerations of good management of the tax system and administrative efficiency.

In terms of paragraph 10 a request by a debtor for a tax debt to be compromised by the Commissioner must be signed by the debtor and be supported by a detailed statement setting out amongst a number of issues, all the assets and liabilities of the debtor, reflecting the current market value of those assets.⁷¹

⁶⁷ Section 91A deals with waiver, write off or compromise of amounts payable as was inserted by section 15 of Act 32 of 2005.

⁶⁸ Regulations issued under sec 91A of the ITA 58 of 1962 – paragraph 2 (3).

⁶⁹ Regulations issued under sec 91A – paragraph (3).

⁷⁰ Regulations issued under sec 91A- Part 1 defining a compromise under the general provision.

⁷¹ Regulations issued under sec 91A – Regulations Part 5, paragraph 10 (1) & 10 (1) (a).

In addition, all amounts received by or accrued to and expenditure incurred by the debtor during the 12 months immediately preceding the request must be stipulated.⁷²

The debtor has to reflect all assets disposed of, as well as the consideration received or accrued to the debtor. Facts about the identity of the person who acquired the assets and the relationship between the debtor and the person, who acquired the assets, if any, must be indicated.⁷³

In terms of the requirements set the debtor's future interests in any assets, whether certain or contingent as well as all assets over which the debtor has any direct or indirect power of appointment or disposal must be stated as well.⁷⁴

The debtor has to provide details of any connected persons in relation to the said debtor.⁷⁵

The debtor's present sources and level of income and the anticipated sources and level of income for the next three years, with an outline of the debtor's financial plans for the future and the debtor's reasons for seeking a compromise are required in terms of the said request.⁷⁶

The request must be accompanied by evidence in support of the debtor's claims for not being able to make payment in full of the tax debt outstanding.⁷⁷

The debtor must warrant that the information provided in the application is accurate and complete.⁷⁸

In addition, the Commissioner may require that the application be supplemented by such further information as may be required.⁷⁹

In considering the request for a compromise of the tax debt the Commissioner must have regard to a number of factors and facts which may result in a compromise.⁸⁰

72 Part 5, paragraph 10 (1) (b).

73 Part 5, paragraph 10 (1) (c), 10 (1) (d).

74 Part 5, paragraph 10 (1) (e).

75 Part 5, paragraph 10 (1) (g).

76 Part 5, paragraph 10 (1) (h) & 10 (1) (i).

77 Part 5, paragraph 10 (2).

78 Part 5, paragraph 10 (3).

79 Part 5, paragraph 10 (4).

80 Part 5, paragraph 11.

Factors to be considered include the savings in the costs of collection, the collection occurring at an earlier date than would be otherwise the case without the compromise and the collection of a greater sum than would otherwise have been recovered. Specific attention is to be paid as to whether the debtor abandoned some claim or right, which has a monetary value, arising under any Act administered by the Commissioner, including any right to carry forward any assessed loss or assessed capital loss.⁸¹

In determining the position without the compromise, the Commissioner must have regard to the value of the debtor's present assets and the future prospects of the debtor, as well as past transactions of the debtor and the position of any connected person in relation to the debtor.⁸²

In paragraph 12 circumstances are mentioned that would render a compromise to a tax debt as inappropriate, which requires consideration and comment.

It is indicated that notwithstanding paragraph 9, the Commissioner may not compromise any amount of tax debt, if the amount payable by the debtor in terms of the agreement to compromise will be less than the market value of the total assets of the debtor, which can be applied to reduce the tax debt, after deducting the liabilities of that debtor other than the tax debt.⁸³

Should the compromise prejudice other creditors (unless the affected creditors consent to the compromise) or where other creditors will be placed in a position of advantage relative to the Commissioner, the compromise will not be considered.⁸⁴

Any compromise will be inappropriate, if any other creditor has communicated its intention to initiate or has initiated liquidation or sequestration proceedings.⁸⁵

In cases where the tax affairs of the debtor (other than the outstanding tax debt) are not up to date a compromise will not be considered.⁸⁶

81 Part 5, paragraph 11 (1) (a) – (d).

82 Part 5, paragraph 11 (2) (a) – (d).

83 Part 5, paragraph 12 (a).

84 Part 5, paragraph 12 (b).

85 Part 5, paragraph 12 (c).

86 Part 5, paragraph 12 (d).

It would be inappropriate to settle if the only reason to support the request to compromise is the debtor's claim of hardship in paying the tax debt, including the need to sell a home or a business.⁸⁷

A compromise will not be considered where the sole purpose of the decision is to assist a debtor who has become overcommitted .⁸⁸

The Commissioner will not be amenable to save a business from failure or closure simply because it employs a large number of people or those very people depend on the business for employment or the activities of the business serve a national interest.⁸⁹

A request by the debtor addressed to the Commissioner to alleviate harsh or unfair operation of a tax law in particular circumstances will not ensure a compromise.⁹⁰

If the reason for the compromise should be to further a charitable objective or to create a benevolent public image for the Commissioner, the Commissioner will not be interested in considering a compromise.⁹¹

A compromise bid will not be entertained if there is no benefit for the Commissioner in the compromise other than collecting an amount equal to the return that would flow from the sequestration or liquidation of the debtor.⁹²

Should a compromise adversely affect broader taxpayer compliance, the compromise will not be considered.⁹³

There will be no favourable consideration of a compromise request, if the debtor within a period of five years immediately before the request for the compromise was made⁹⁴ was a party to an earlier agreement with the Commissioner to compromise an amount of tax debt⁹⁵ or sequestrated or liquidated, ⁹⁶ or a party to an arrangement with the debtor's

87 Part 5, paragraph 12 (e).

88 Part 5, paragraph 12 (f) (i).

89 Part 5, paragraph 12 (f) (ii).

90 Part 5, paragraph 12 (f) (iii).

91 Part 5, paragraph 12 (f) (iv).

92 Part 5, paragraph 12 (g).

93 Part 5, paragraph 12 (h).

94 Part 5, paragraph 12 (i).

95 Part 5, paragraph 12 (i) (i).

96 Part 5, paragraph 12 (i) (ii).

creditors, as contemplated in section 311 of the previous Companies Act (Act 61 of 1973), which was sanctioned by the court.⁹⁷

In cases where the debtor is a company or a trust and any director, trustee or person acting in the management of the debtor⁹⁸ has been involved in fraud or tax evasion⁹⁹ or has a past history of being involved in failed companies or trusts; and the Commissioner has not first explored action against or recovery from the personal assets of those directors, trustees or persons, the Commissioner will not consider a compromise under these circumstances.¹⁰⁰

If the Commissioner compromises a tax debt, the Commissioner and the debtor must sign an agreement setting out¹⁰¹ the amount payable by the debtor in full satisfaction of the debt.¹⁰² In addition, there must be an undertaking by the Commissioner not to pursue recovery of the balance of the tax debt.¹⁰³ Further, all other conditions subject to which the tax debt is compromised by the Commissioner must be outlined, which may include a requirement that the debtor must comply with subsequent obligations imposed in terms of any Act administered by the Commissioner.¹⁰⁴

The Commissioner will not be bound by the compromise if ¹⁰⁵the debtor failed to make full disclosure of all material facts to which the compromise relates¹⁰⁶ or supplied any materially incorrect information to which the compromise relates.¹⁰⁷ Should the debtor in addition fail to comply with any provision or condition contained in the agreement contemplated in paragraph 13 ¹⁰⁸or the debtor is liquidated before that debtor has fully

97 Part 5, paragraph 12 (i) (iii).

98 Part 5, paragraph 12 (j).

99 Part 5, paragraph 12 (j) (i).

100 Part 5, paragraph 12 (j) (ii).

101 Part 5, paragraph 13 (1).

102 Part 5, paragraph 13 (1) (a).

103 Part 5, paragraph 13 (1) (b).

104 Part 5, paragraph 13 (1) (c).

105 Part 5, paragraph 14.

106 Part 5, paragraph 14 (a).

107 Part 5, paragraph 14 (b).

108 Part 5, paragraph 14 (c).

complied with all the conditions contained in the agreement as contemplated in paragraph 13 it will ensure the demise of the compromise agreement.¹⁰⁹

In addition, the Commissioner must maintain a register of all tax debts written off or compromised in terms of these regulations.¹¹⁰

The register contemplated in subparagraph (1) must contain¹¹¹ the details of the debtor, including name, address and tax reference numbers.¹¹² The amount of the tax written off or compromised and the periods to which the tax debts relate must be reflected as well as¹¹³ the reason for writing off or compromising the tax debt.¹¹⁴

The amount of tax debts written off or compromised during any financial year must be disclosed in the annual financial statements of the South African Revenue Service relating to administered revenue for that year.¹¹⁵

The Commissioner must on an annual basis provide to the Auditor-General and the Minister of Finance with a summary of all tax debts which were written off or compromised in whole or in part during the period covered by that summary.¹¹⁶ It must be in such format which, subject to section 4(1)(b) of the Income Tax Act, 1962, does not disclose the identity of the debtor concerned.¹¹⁷ It will be submitted at such time as may be agreed between the Commissioner and the Auditor-General or the Minister of Finance, as the case may be.¹¹⁸ The report will contain details of the number of tax debts written off or compromised, the amount of revenue forgone and the estimated amount of savings in costs of recovery, which was reflected in respect of main classes of taxpayers or sections of the public.¹¹⁹

109 Part 5, paragraph 14 (d).

110 Part 6, paragraph 15 (1).

111 Part 6, paragraph 15 (2).

112 Part 6, paragraph 15 (2) (a).

113 Part 6, paragraph 15 (2) (b).

114 Part 6, paragraph 15 (2) (c).

115 Part 6, paragraph 16 (1).

116 Part 6, paragraph 16 (2).

117 Part 6, paragraph 16 (2) (a).

118 Part 6, paragraph 16 (2) (b).

119 Part 6, paragraph 16 (2) (c).

The power to write off or compromise any amount of tax debt in terms of these regulations may be exercised by the Commissioner personally or by any official delegated by the Commissioner for that purpose.¹²⁰

The Commissioner or relevant delegated official may not exercise any power to write off or compromise any tax debt, if he or she has, or at any stage had a personal, family, social, business, professional, employment or financial relationship with the debtor concerned.¹²¹

The settlement agreements and compromises reached are strictly between the Commissioner and the taxpayers concerned and are not up for public scrutiny, due to the secrecy provisions as set out in sections 4 and 6 of the Income Tax Act, 58 of 1962 and the Value Added Tax Act, 89 of 1991 respectively.

Creditors cannot intervene on behalf of the taxpayer, when a possible settlement or compromise is considered and a compromise deals exclusively with the financial interests and concerns of the Commissioner and the taxpayer. During the compromise process (section 91A), the exposure the taxpayer has concerning secured, preferential and concurrent creditors will be taken note of by the Commissioner, but the Commissioner is not at liberty to discuss the financial affairs with the relevant creditors, due to the relevant secrecy provisions.

3.2.3 Tax Administration Act 28 of 2011.

The Tax Administration Act came into operation on the 1 October 2012 and the aim is to include all the generic provisions of the Income Tax Act in this piece of legislation. It is suggested that the processes and procedures regarding income tax legislation have been simplified to make it more transparent, fair and accessible for the taxpayer debtor.¹²²

Chapter 14 deals with the writing off or compromise of tax debts. Tax debt relief may be afforded to taxpayers under certain conditions. No major changes were made to the current law, except that circumstances were made less restrictive, by removing factors that disqualified the tax debtor from a compromise agreement.

Chapter 14 applies only in respect of a tax debt owed by a debtor if the liability to pay the debt is not disputed by the debtor.¹²³

120 Part 7, paragraph 17.

121 Part 7, paragraph 18.

122 Act 28 of 2011, as gazetted on 4 July 2012.

123 Clause 194 of Act 28 of 2011.

Clauses 200 to 205 of the Tax Administration Act deals with compromises, which reflect similar requirements as stipulated in the Income Tax Act.¹²⁴

The provisions regarding circumstances where it is inappropriate to compromise such as hardship, a debtor being overcommitted, or to save a business from failure, regardless of whether a large number of people depend on the business for employment or where the activities of a business serve a national interest have fallen away in terms of the Tax Administration Act.

In addition, clause 203 of the Tax Administration Act reflects that a senior SARS official may not compromise any amount of a tax debt under section 200 if the debtor was a party to an agreement with SARS to compromise an amount of tax debt within a period of three years immediately before the request for the compromise.¹²⁵

The initial period has now been reduced from five years to three years.

Debtors will now be in a position to approach the Commissioner and instances of hardship, or of a debtor being overcommitted and an entity at risk that plays a significant role of national importance will now be considered for compromise purposes.

3.3 Evaluation

The tone was set by the legislative changes discussed herein which enabled the Commissioner to consider settlements and compromises. The Commissioner had difficulty in collecting taxes, which could be due and payable, but for a lengthy and very costly litigation process that was stalled due to the lack of having access to the Tax Courts within a reasonable time frame. It became evident that a more cost effective process was required that needed to be developed to ensure efficiency and fairness. Participation by taxpayers and the personnel within the Commissioner's office, having confidence in a system where speedy resolutions were possible became the norm since 2001 with the implementation of the alternative dispute resolution process.

124 Part D – Compromise of Tax debt.

125 Clause 203 (a) of the Tax Administration Act 28 of 2011.

Perusal of the regulations issued under section 91A, paragraph 12(b) seems to be out of sync with the Income Tax provisions regarding secrecy. It stipulates that a compromise should not be considered that would prejudice other creditors in terms of a compromise offer in that the interest and consent of affected creditors should be taken into account. In practice the South African Revenue Service never approaches affected creditors in any matter relating to any taxpayer, as the affairs of the taxpayer is regarded as confidential in terms of the secrecy provisions as set out in taxation legislation.

In addition, the said paragraph stipulates that such a compromise will not be considered should other creditors of the taxpayer debtor be placed in a position of advantage relative to the Commissioner. Section 91A compromises are the exclusive domain of a possible compromise agreement between the Commissioner and the taxpayer debtor, where cooperation and discussion amongst all affected stakeholders, including other creditors are non-existent.

In paragraph 12(e) it is mentioned that should hardship be the sole reason for the compromise, it would be inappropriate to consider such an application for a section 91A compromise. Hardship is not defined in the Income Tax Act or any other legislation under the supervision of the Commissioner. Suffice it to say that the ordinary meaning should be attached thereto, which includes severe financial suffering or privation.¹²⁶

Hardship should be classified as an appropriate reason to settle. This requirement seems to undermine the whole purpose of section 91A. Financial hardship should be an appropriate reason in its own right, which allows a taxpayer to approach the Commissioner with a compromise offer in terms of section 91A.

Paragraph 12(f) state amongst a number of reasons that where a debtor has to be assisted who is overcommitted or to save a business from closure, regardless of whether or not a large number of people depend on the business for employment or the activities of the business serve a national interest, it would be inappropriate to compromise the tax debt.

The factors mentioned seem to be ideal reasons for a favourable consideration of a compromise offer in terms of section 91A and very appropriate in terms of the conditions mentioned. If a large number of people depend on the business for employment surely it will have socio-economic consequences for that particular community and in some cases for society at large. To state that activities of a business that serve a national interest would be inappropriate for compromise purposes seem to undermine the very essence of what a compromise is all about ,as the interests of a community or society are simply ignored.

126 Concise Oxford English Dictionary, 11th Edition revised, page 650.

CHAPTER 4

BUSINESS RESCUE PROCEEDINGS SOUTH AFRICA

4.1 Background

Enter Chapter 6 of the new Companies Act 71 of 2008 that came into operation on 1 May 2011, and deals with business rescue procedures that can be regarded as a form of corporate rehabilitation.¹²⁷

The main aim is to assist an entity that is financially distressed. In terms of the definition of an entity that is financially distressed it appears reasonably unlikely that the company will be able to pay all its debts when they become due and payable or if the company will be insolvent within the ensuing six months.¹²⁸

Two avenues are available in terms of the Companies Act of 2008 to commence with business rescue proceedings, namely a resolution by the board of directors or an order of court.¹²⁹ A business rescue practitioner must be appointed when a company is placed under business rescue and he has a variety of duties including the preparation and implementation of a business rescue plan.¹³⁰

The business rescue plan may provide for the discharge of debts and claims relating to the company. During the business rescue proceedings any claim against the company is suspended for the duration of the business rescue proceedings in general. The exception though is section 133(1)(f) of the Companies Act, as the general moratorium on legal proceedings is not applicable in the case of proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner. It seems that there will be no moratorium on SARS collecting the taxes owed to it.¹³¹

127 H Rajak "Insolvency Law Theory & Practice" at page 322-323.

128 Section 128 (1) (f) (i) & (ii) of the Companies Act 71 of 2008.

129 Section 129 & section 131 of the Companies Act 71 of 2008.

130 Section 138 of the Company Act 71 of 2008.

131 Henochsberg on the Companies Act 71 of 2008, Volume 1, 1st edition (2012-loose leaf).

4.2 Income Tax Consequences

Placing a company under business rescue does not appear to give rise to income tax consequences. The suspension of a debt is not a complete waiver of a debt and has no negative tax consequences. The waiver or reduction of a debt during the proceedings is, however, a discharge from a debt owed to the creditor. This will in all probability lead to Capital Gains Tax in terms of paragraph 12(5) of the Eighth Schedule to the Income Tax Act. The reason is that the discharge of a debt results in a capital gain in the hands of the company under business rescue proceedings.¹³²

An exception to this rule as defined in the Income Tax Act is where the creditor in question and the company under business rescue form part of the same group of companies. Unless the waiving or discharge of the loan was part of a tax avoidance scheme, it will not attract Capital Gains Tax.¹³³

It seems that the consequences of Capital Gains Tax could be very detrimental to any attempt to rehabilitate a financially distressed company by imposing Capital Gains Tax on an entity that is already in a precarious financial position.

The business rescue mechanism expands the number of affected parties, as provision is now made not only for the rights of creditors, but includes employees independently or employees as represented by trade unions and shareholders.¹³⁴ Suddenly the Receiver is no longer regarded as a preferential creditor for purposes of business rescue proceedings but as a mere concurrent creditor in a pool of unsecured creditors as per the current legislative provisions.¹³⁵

In considering whether to approve a business rescue plan presented by the business rescue practitioner, SARS have thus far not presented any specific interpretation note on the taxation method or methods to be utilised when confronted by a business rescue application.

132 Paragraph 12(5)(a)(i) &(ii) of the Eight Schedule.

133 Section 41 of the Income Tax Act 58 of 1962.

134 Section 128 (1) (a) (i) (ii) & (iii) of the Companies Act 71 of 2008.

135 The Commissioner for The South African Revenue Service v Mark Bradley Beginsel & Others (WC) case number 15080/12 delivered by P B Fourie J on 31 of October 2012; Mars The Law of Insolvency in South Africa 9th edition (2008)(section 99 of The Insolvency Act 24 of 1936).

SARS does have the services of an advanced tax rulings department (ATR section) that can be approached against the payment of a fee to obtain on an urgent basis a binding ruling that will be of some comfort to the business rescue practitioner as to how SARS will react and tax a particular business rescue plan before it is presented and approved by the majority of creditors.¹³⁶

If the original business rescue plan is rejected by the majority of creditors, but the subsequent alternative plan is approved, it could either lead to positive or negative taxation consequences. The business rescue practitioner should be aware of those consequences and inform the affected parties accordingly.

4.3 Evaluation

Currently it appears that SARS will deal with every business rescue matter on its own merits. In the first instance it needs to be established whether any separate application was made previously to SARS in terms of income tax provisions that reflects a compromise of tax debt within a period of three to five years. If in the affirmative it can be expected that SARS will not be in favour of a business rescue proposal, taking the tax legislative measures into account.

Secondly, whether the financial affairs of the entity in question are up to date and whether there are for instance outstanding returns and the number of years affected.

Thirdly, to establish who the directors are or were of the company and the number of years they have been involved in the management of the entity in question.

Historically the number of years that the debt has been outstanding is taken into account. It is irrelevant whether the debt outstanding be Income Tax or Value Added Tax (VAT) or pay as you earn (PAYE). VAT and PAYE are regarded as sacrosanct as the emphasis is placed on the fact the latter is regarded as trust monies that are held by taxpayers and vendors on behalf of a third party, namely South African Revenue Service (SARS).

Ultimately SARS values the proper management of the financial affairs of the entity by the directors, where corporate governance is the ultimate goal from the Commissioner's perspective. In case of improper conduct on the part of directors, SARS will in all likelihood opt to reject the business rescue plan in case of maladministration. Subsequently SARS' approach is to pursue the directors for personal liability in terms of section 48(9) of the VAT Act and section 97 of the Income Tax Act.

¹³⁶ Tax Administration Act 28 of 2011, Chapter 7, Advance Rulings - Clauses 75 – 90.

5.1 Background

Taxation in English Law has diverse consequences when dealing with corporate rescue. Under English law a company voluntary arrangement (also referred to as CVA) is a procedure which enables an insolvent company to agree with its creditors how its debts should be dealt with, short of a formal insolvency procedure.¹³⁷

The Insolvency Act defines a voluntary arrangement as either a composition in satisfaction of the company's debts or a scheme of arrangement of its affairs. The arrangement is set out in a document and will normally provide for debts to be compromised. In essence it is payment to a particular proportion of a debt which is treated as satisfied.¹³⁸

The procedure is very flexible and there are no constraints on the form and content of the voluntary arrangement. The duties and powers of the supervisor will be set out in the voluntary arrangement. The voluntary arrangement will terminate upon completion of the arrangement, at which point notice will be given to the members, the creditors, the court and the Registrar of Companies, together with a report summarising the receipts and payments.¹³⁹

The Insolvency Act 2000 introduced provisions for a moratorium on proceedings against a company where a voluntary arrangement is proposed if the company is a small company and if certain criteria are met.¹⁴⁰ No court hearing is required to make the moratorium effective, but certain documents must be filed including the proposed arrangement and a statement from the nominee that he has consented to act and that the proposal has a reasonable prospect of being approved and implemented.¹⁴¹

An alternative to a CVA is a scheme of arrangement under the Companies Act.¹⁴²

137 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 2.

138 Section 1 of the Insolvency Act 1986.

139 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 3.

140 Section 382 (3) of the Companies Act 2006.

141 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 3.

142 The Companies Act 2006, Part 26.

It is a compromise or arrangement between a company and its creditors or its members or a class of creditors or a class of members. After it has received the agreement of over 50 per cent in number and 75 per cent in value of creditors or members and been sanctioned by the court, it becomes binding on all the creditors.¹⁴³

5.2 Administration

Most forms of administration were introduced in the Insolvency Act of 1985 and are now found in Insolvency Act of 1986.¹⁴⁴ They were amended by the Enterprise Act of 2002.¹⁴⁵ Formerly the administration order had to be made by the court and could only be made on the petition of the company, its directors or a creditor. The court retains this power, with some differences. However, it is now possible to commence an administration more informally in that a company, its directors and the holders of certain floating charges can each appoint an administrator directly provided that they comply with certain procedures. If they do so, the notice of appointment must be filed with the court before the administration can take effect. It is compulsory to include a statutory declaration dealing with a number of issues, including that the company is unable to pay its debts.¹⁴⁶

The effect of the administration is that there is a statutory moratorium on further insolvency proceedings and other legal processes unless the administrator consents or the court allows it.¹⁴⁷

The administrator's key objectives are to either rescue the company as a going concern or achieve a better result for the company's creditors than would be likely if the company were wound up. This is in addition to realising property in order to make a distribution to one or more secured creditors.¹⁴⁸ The administrator must perform his functions in the interests of the company's creditors as a whole. The process is designed to facilitate company rescues.¹⁴⁹

143 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 3.

144 The Insolvency Act 1986, Schedule B1.

145 The Enterprise Act of 2002 with effect from 15 September 2003.

146 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 4.

147 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 4.

148 The Insolvency Act 1986, Schedule B1 paragraph 3.

149 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 4.

An administrator must make proposals for the achievement of the purpose of the administration and liaise with creditors of which he is aware, the shareholders and the Registrar of Companies as soon as reasonably practicable and within eight weeks of the company entering administration, unless the period is extended.¹⁵⁰

The proposals will often include a proposal for a CVA or a scheme under the Companies Act of 2006. It must be approved at a meeting of creditors.¹⁵¹

The administrator acts as agent for the company and the administration terminates automatically after one year unless it is extended. The process is also terminated when the administrator is convinced that the purpose of the administration has been sufficiently achieved.¹⁵²

The current position in England and Wales is that administrators are in a similar position as liquidators in that direct tax liabilities arising in the administration period are payable as expenses of the administration. Administrators have to account for VAT chargeable on supplies made after their appointment. In addition, administrators are also liable for deduction and payroll taxes during their tenure as administrators of the company in question.¹⁵³

Since the Enterprise Act of 2002, the position of the administrator is that he or she may be required to pay interest on pre-appointment claims. In addition, the administrator may be liable to account for interest and penalties on liabilities arising in the course of his appointment.¹⁵⁴

150 The Companies Act 2006, Part 26; A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 5.

151 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 5.

152 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 5.

153 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at pages 14, 65-67 and 96; Insolvency Act 1986, Schedules 1 and B1.

154 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 164.

5.3 The Crown – Her Majesty’s Revenue & Customs (HMRC)

The Crown have in the past given public statements on their approach to CVA’s. In one such statement in June 1990 they said:¹⁵⁵

‘The Inland Revenue will deal with every Administration Order and Voluntary Arrangement on its own merits taking into account all known features of the case. When deciding to vote, the Revenue give consideration to amongst other things, the way in which the taxpayer has attended to his tax obligations, the level of uncertainty over assets and liabilities and whether a voluntary arrangement is the appropriate course for the Revenue to approve as a creditor. The Revenue is also very much aware of the interests of other parties and the purpose of the voluntary arrangement procedure.’

The three factors mentioned by the Revenue remain relevant in that the company’s tax-paying history will affect the Crown’s attitude towards the arrangement. The Receiver is concerned with the prospects of future punctiliousness in payment of tax and is sensitive to failure to account for PAYE. In addition the Receiver is interested as to whether individuals who have previously been involved in the company’s affairs will continue to be involved. Thirdly the tax authorities would be interested in the number of overdue tax returns before the arrangement is finalised.¹⁵⁶

A further statement in 2000 announced the creation of a special unit to consider voluntary arrangements, the Voluntary Arrangements Service (VAS) and said that they would:

‘...consider Voluntary Arrangement (VA) proposals in the future in a similar way to commercial creditors. VAS will be considering each proposal on its individual merits and on the basis that approval of the VA will lead to an improved recovery of existing debts. To achieve this VAS will be looking to adopt private sector expertise to augment public sector skills. There will also be a need to build closer relationships to support the efforts of businesses to meet future liabilities after the VA is put in place’.¹⁵⁷

155 Institute of Chartered Accountants in England and Wales (ICAEW) Technical release 799, paragraph 2 (a).

156 A C R Davis & G L Nouel LLP, “Taxation in Corporate Insolvency and Rescue”, 6th Edition October 2009, at page 111.

157 A C R Davis & G L Nouel LLP, “Taxation in Corporate Insolvency and Rescue”, 6th Edition October 2009, at page 111.

In preparing the arrangement for the approval of creditors, it will be necessary for the nominee to be fully informed as to the past tax record of the company. He should ensure that the information in the proposal concerning the company's financial affairs is not significantly less comprehensive or accurate than the information available to HMRC, and that the arrangement will require PAYE to be correctly operated during the supervision period. The mere fact that the financial return to HMRC is likely to be greater in a voluntary arrangement than a liquidation will not be the most influential factor in their decision whether to approve the proposal, particularly where past PAYE tax is unpaid. The HMRC perspective may be wider than that of the insolvency practitioner proposing the arrangement, since Revenue will be concerned with preserving the integrity of the collection system and dealing with the perceived abuse, not merely whether the balance is favourable in a particular case between the arrangement and other possible outcomes of the insolvency.¹⁵⁸

In preparing the proposal, different tax consequences may follow depending on the beneficial ownership of the assets held for the purposes of the arrangement. It is common in voluntary arrangements for certain assets to be set aside for the benefit of creditors who are bound by the arrangement and these assets are often held 'on trust' for the creditors concerned. Conflict arises between the legal nature of the relationship between the parties to a CVA and the principles that apply for tax purposes, where the funds are held for the benefit of a creditor and are applied in discharging a company's debts. The assets in general remain beneficially owned by the company.¹⁵⁹

If it be the case that a company's assets are held on trust for creditors and are not beneficially owned by the company, a number of adverse tax consequences would follow. In particular any income which arises from a trust fund will be subject to taxation on a stand-alone basis and will not be eligible for offset of losses.¹⁶⁰

The administrator is and will be the proper officer of the company. This means that the administrator will be responsible for the signing of the corporation returns, for post-appointment periods. The administrator ensures that the company has made its payments on time and met the legislative documentation requirements.¹⁶¹

158 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at pages 111 - 112.

159 English Sewing Cotton Co Ltd v CIR CA, [1947] All ER 679.

160 A C R Davis & G L Nouel LLP "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at pages 114 – 115.

161 A C R Davis & G L Nouel LLP "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 258.

Failure to do so can lead to significant penalties. Pre-appointment returns, given the uncertainty of the information, are likely to be signed, but with a covering letter from the administrator to explain the situation.¹⁶²

Following the appointment of an Enterprise Act 2002 administrator, an accounting period will be brought to an end, the day before and a new accounting period will begin from the date of the appointment. This can have significant ramifications on the availability of trading losses brought to offset income or gains in the post-appointment period. This is because trading losses brought forward from the pre-appointment period can only be offset against future trading income of the same trade where the company continues to trade.¹⁶³

Consequently, for any capital gains disposals in the post appointment period, unless there are sufficient current year trading losses and if the company continues to trade, there may not be enough loss shelter to mitigate any tax liability arising from a disposal, giving rise to a capital gain.¹⁶⁴

In general tax will be an expense of administration in post-appointment periods. Tax on profits or income earned in the administration period will be paid out in priority to the administrator's fees. This means in effect that an administrator will have to give due consideration to tax planning and the timing of disposals, especially in the light of the potential mismatch of losses and gains in order to reduce the amount of tax payable as an expense in the administration.¹⁶⁵

The profits and losses to be brought into account include those arising from related transactions. The Corporation Tax Act 2009(CTA 2009), expressly states that the extinction of a debt by redemption or release is to be taken as a disposal of it and therefore as a related transaction. Thus the release or forgiveness of a liability to make payments of interest or principle debt to an unrelated party will normally be a related transaction and will give rise to an accounting profit and so a tax charge for the debtor. Where a fair value basis applies, the value which could be obtained for a release will also be taken into account in determining the fair value.¹⁶⁶

162 The Tax Management Act 1970, section 108 (3), as amended by the Finance Act (FA) 2003.

163 Income and Corporation Taxes Act 1988 (ICTA), section 393 (1).

164 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 258.

165 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 258.

166 Section 304 of the Corporation Tax Act 2009.

The administrator is empowered to make distributions to creditors. Prior to making such distribution, the administrator should ensure that a prudent tax provision has been prepared. The administrator should seek a pre-closure tax clearance from HMRC. This consists of a written assurance that HMRC have no further claims. This clearance is completely non-statutory and exists to ensure there is no additional tax liability after the expiry of the administration period.¹⁶⁷

On an informal basis the Inspector's confirmation can be sought that there are no further liabilities to corporation tax.¹⁶⁸

Where an administration is followed by a scheme of arrangement or a CVA, care would be required with the wording of the relevant documents and the treatment of tax liabilities pre and post a scheme of arrangement.¹⁶⁹

The issue for a debtor in restructuring trade debts is how any variation or release of the debt will be taxed.¹⁷⁰

In order to obtain a tax deduction under the loan relationship rules, there are three tests which an expense has to pass. In the first instance the expense must meet the standard requirement that a debt must be recognised in determining the company's profit and loss for the specific accounting period. This may even be spread between more accounting periods depending on the transaction. Secondly, the expenses must fall within the statutory requirement as expenses incurred by the company for the purposes of the loan relationships and related transactions. Finally the expenses are limited to those which are deductible and incurred directly in bringing the loan relationships into existence.¹⁷¹

Amendment of terms and conditions of a loan relationship which is not a connected companies relationship may result in a tax charge for the debtor, if the amendment results in positive adjustments being made in the debtor's accounts.¹⁷²

167 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 265.

168 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 265.

169 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 266.

170 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 275.

171 Corporation Tax Act 2009, section 307(2) and section 307(4).

172 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 279.

An example for instance would be, because of a new repayment schedule under which interest previously accrued ceases to be payable or becomes payable in a different period.¹⁷³

A different approach may involve partial or full repayment of existing debt, using new borrowings or issuing new bonds in place of old debt. Again the tax treatment of the repayment of the old debt and the incurring of the new debt will normally follow the accounting treatment of the debtor. This means that a tax deduction will normally be given for costs and expenses of new debt incurred to pay existing debt, including refinancing costs.¹⁷⁴ If the debt is bought by a member of the same group, and the purchase is not on arm's length terms, the debtor can be taxed on any undervalue as a 'deemed release' which does not enjoy the standard relief for releases between connected parties.¹⁷⁵

A release is considered to be a 'related transaction' as it is a disposal of a liability and this includes a release. Generally the release or waiver of a loan relationship between parties at arm's length will be reflected by adjustments in the debtor's accounts and potentially give rise to a tax charge for the debtor.¹⁷⁶

The Crown indicated that they do not consider a debt released, if the creditor merely writes off the debt, fails to invoice or demand payment, or fails to present a cheque tendered in payment. The release of a debt must involve a contractual agreement. In general all releases must involve the debtor giving consideration for the release. The consideration may be in non-monetary form, for example shares.¹⁷⁷

A debt for equity swap may occur by contract between the debtor and its creditors, who will forego part or all of their loans and receive in consideration shares, often with warrants or options to acquire further shares. This may occur in the course of a CVA. In the case of a number of publicly quoted companies, these transactions have taken place as schemes of arrangement under the Companies Act of 2006, so that, following approval by the court, the arrangement is binding on minority shareholders and creditors.¹⁷⁸

173 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at pages 276 - 277.

174 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 281.

175 Section 358(3) & section 361 Corporation Tax Act 2009.

176 The Income and Corporation Taxes Act 1988 (ICTA), section 94 (1), now Corporation Tax Act 2009, section 94.

177 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 284.

178 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 285.

This transaction has the benefit of a specific relief in the loan relationship rules. The debtor has the benefit that no loan relationship credit is required to be brought into account on a release under an amortised cost basis of accounting under the Corporation Tax Act 2009.¹⁷⁹ As regards the creditor, on the other hand, there is an exception to the general rule in that no impairment loss or release debit under a connected company's relationship can be claimed under a connected companies relationship. This is intended to cover the situation where the debt is exchanged for so much of the share capital of the debtor as to bring it under the control of the creditor, and the creditor has other debt owed to it by the debtor, but it is a 'one off' relief and only applies to existing debt and to the actual debt for equity swap where the connection is established.¹⁸⁰

The conditions for a favourable treatment differ under two provisions. The requirement under the CTA 2009 is that the release is in consideration of shares forming part of the ordinary share capital of the debtor company or in consideration of any entitlement to such shares. It will be seen that it is important that the debt is released in consideration of the issue of or entitlement to the shares. A separate release under separate terms for a different consideration or none at all, will not benefit from the tax exemption even if it is part of the same overall arrangement.¹⁸¹

The Corporation Tax Act stipulates that there are three conditions which must all be satisfied. In the first instance the creditor company must treat the liability as discharged. Secondly, that the creditor does so in consideration of any shares forming part of the ordinary share capital of the company on which the liability would otherwise have fallen, or any entitlement to such shares. Thirdly, that there would be no connection between the two companies for the accounting period in which the consideration is given if the question whether there is such a connection were determined by reference only to times before the creditor company acquired possession to those shares or acquired any entitlement to them.¹⁸²

Instead of paying interest, a debtor may agree with creditors to relieve its cash flow problems by issuing an instrument acknowledging its indebtedness for the interest, redeemable in cash on a future date. Essentially it is a promissory note given instead of actual payment. These instruments are called funding bonds.¹⁸³

179 Section 322(4) of the Corporation Tax Act 2009.

180 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 285.

181 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 285.

182 Corporation Tax Act 2009, section 356.

183 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 287.

The position is now that the issue of a funding bond is treated as a payment of interest at the time of issue and for tax purposes the bond is treated during the period from issue to redemption like any other security.¹⁸⁴

5.4 Pre-packaged administration

A pre-packaged administration or 'pre-pack' is an arrangement under which the sale of assets or of an entire business is negotiated with a purchaser prior to insolvency, and the practitioner then effects the sale when or shortly after he is appointed.¹⁸⁵ These arrangements were originally entered into by secured creditors to enable them to acquire key assets from the insolvent company with the view of increasing the value or using the revenues to repay the debtor's original debts over time.¹⁸⁶ Pre-packs have recently become a more common way of disposing of the business in administrations as they have a number of commercial advantages, including the benefit to employee morale and retention, procedural simplicity and obtaining a better price than in an insolvency fire sale.¹⁸⁷

The tax treatment of pre-packs depends on the assets which are sold. Tax charges crystallised on the sale of assets such as land or pre-2002 intellectual property can become an expensive exercise if the tax has to be paid as an expense of administration, even though capital gains may have accrued over many years. The new provisions entitle groups to re-allocate chargeable gains and losses in terms of the Taxation of Chargeable Gains Act 1992.¹⁸⁸

5.5 Evaluation

Every restructuring has taxation consequences. The taxation of profits due to restructuring is problematic. When creditors accept a waiver of demands or debt equity swap, the liabilities of the entity in question is restructured and consequently there is a balance sheet surplus of the asset or assets over the liabilities and therefore a profit.¹⁸⁹

184 *Finance Ltd v Inspector of Taxes (No 2)*, 2005 STC (SCD) 407.

185 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 301.

186 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 301.

187 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 301.

188 Taxation of Chargeable Gains Act (TCGA) 1992, sections 171A – 171C; A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 301.

189 R Bork – "Rescuing Companies in England and Germany" at page 290.

The effect for taxation purposes is that this profit, after the deduction of loss carry forwards is subject to corporation tax. It is possible that a freshly restructured company is plunged back into tax debt, which seems to be self-defeating from a corporate rescue point of view.¹⁹⁰

It could be an option to regard 'restructuring profits' as tax exempt. It's argued that restructured profits should be exempted given that such profits did not arise because of the company's trade, but rather through the creditors' waiver of their demands. It is an artificial profit rather than a product of a company's commercial activities.¹⁹¹

Her Majesty's Revenue and Customs is a mere unsecured creditor under English Law.¹⁹² Its priority was abolished under section 251 of the Enterprise Act 2002. English tax laws require debt forgiveness to be declared as income under sections 313(4), 304(2) and 293 of the Corporations Tax Act 2009. Loss carry forwards can only be deducted if the identity of the company and of the business remains the same.¹⁹³ In administration the tax obligations thus arising have priority as expenses of the administration.¹⁹⁴ However, section 322 of the Corporation Tax Act 2009 sets out tax exemptions where the creditors' forgiveness arises out of an insolvency law arrangement which includes the CVA, the scheme of arrangement and a comparable foreign law mechanism.¹⁹⁵

Another exemption in terms of section 322 includes a true debt-equity swap, in which the creditor gains a share of base capital and which is agreed independently of a formal restructuring or insolvency procedure.¹⁹⁶

The result is that the bare waiver of loans outside the scope of an arrangement or formal insolvency procedure is detrimental for tax purposes and any bilateral restructuring of liabilities beyond the scope of a debt-equity swap is hindered by taxation.¹⁹⁷

190 R Bork – "Rescuing Companies in England and Germany" at page 290-291.

191 R Bork – "Rescuing Companies in England and Germany" at page 292.

192 R Bork – "Rescuing Companies in England and Germany" at page 292.

193 R Bork – "Rescuing Companies in England and Germany" at page 292.

194 R Bork – "Rescuing Companies in England and Germany" at page 292.

195 R Bork – "Rescuing Companies in England and Germany" at page 292.

196 A C R Davis & G L Nouel LLP, "Taxation in Corporate Insolvency and Rescue", 6th Edition October 2009, at page 285.

197 R Bork – "Rescuing Companies in England and Germany" at page 293.

CHAPTER 6

CONCLUSION

6.1 General Comments

The South African Revenue Service in general keeps to a strict adherence of the general principle to collect all taxes, duties, levies and penalties within a pro-creditor legal system. The tax authority tended in the past only to consider compromises that will secure the highest net return from the recovery of the debt outstanding. This has been done in consideration of the good management of the tax system and administration efficiency.

The application of sections 20(1)(a)(ii) and 103(2) of the Income Tax Act reflects the protective attitude the South African tax authority has taken to counter the elaborate section 311 schemes of arrangement in terms of the previous Companies Act, 61 of 1973, which were aimed at preserving the assessed tax loss for beneficial tax purposes.

However, the legislative changes with specific reference to the alternative dispute resolution process, settlements in terms of section 91A as well as the Tax Administration Act, which became operational from October 2012, have set in motion a system of moderate change, as there is an acceptance that alternatives have to be considered in compromises of tax debts outstanding.

Relief measures are now in place which enables the Commissioner currently to consider compromises which had in the past been difficult to achieve. Income tax legislation has over the last decade created a number of legal avenues and opportunities to settle matters where tax debts outstanding can be compromised based on legitimate grounds.

In addition to the above relief measures, debtors have the additional options available to utilise the business rescue and compromise provisions as set out in the Companies Act of 71 of 2008 in instances of financial distress. It is to be expected that each and every business rescue plan and compromise with its unique characteristics will have particular taxation implications. This could lead to an array of issues concerning capital gains and value added tax implications in cases where inputs and outputs initially declared and claimed are affected.

The South African Revenue Service generally follows a pragmatic view when considering compromises in terms of income tax legislation, which one can presume will be extended to business rescue applications and compromises outside of business rescue proceedings.

Issues to be considered include the number of returns and the amount of debt outstanding. The directors involved in the entity or who were involved in the management of the financial affairs of the entity will be an issue to be considered by the tax authorities. The type of taxes, whether it is income tax, value added tax or payroll taxes, will influence the Commissioner's decision to approve or reject any compromise of tax debt owing.

The interests of other affected parties within the business rescue environment ensure that the Receiver of Revenue has to take note of other stakeholders' concerns as well. In negotiating and liaising with all affected parties, could in future ensure that cooperation amongst the various vested interests leads to more prudent decisions in the field of business rescue and compromises.

England and Wales consider similar aspects when compromises of tax debts are considered by the Crown, namely the taxpaying history, future punctiliousness in payment of taxes and overdue returns.

The difference between the two tax authorities in this respect lies in the fact that England and Wales have a specific dedicated unit that considers each and every compromise proposal for consideration. In South Africa the compromise and business rescue applications are served on the respective branch offices where the taxpayer debtor is on register and dealt with by the respective debt collections sections, who liaise with their respective legal divisions. Revenue auditors will be requested to assist in certain cases in providing an audit history of the matter and assess returns lodged in the meantime.

In preparing the proposal, different tax consequences will follow of which the administrator (England and Wales) has to be aware. In the case of a company voluntary arrangement and a scheme of arrangement, care is therefore required in the wording of the relevant documents. The treatment of tax liabilities pre-and post a scheme of arrangement needs special attention. It appears that the same will in all probability apply to a business rescue practitioner in South Africa in the future.¹⁹⁸ In addition, any amendments to the terms and conditions will also have an effect on the subsequent tax consequences, whether positive or negative.

The administrator's key objective is to perform his functions in the interests of creditors as a whole and to rescue the company as a going concern.

198 Section 140(1)(a) of the Companies Act 71 of 2008 (Chapter 6).

The business rescue practitioner in South Africa's main aim is to implement a viable business rescue plan for the entity in financial distress on behalf of all affected parties, which includes creditors, shareholders and employees, if at all possible.¹⁹⁹

The administrator (England) must account for VAT chargeable after his appointment. He is also liable for deduction and payroll taxes during his tenure as administrator of the company. The business rescue practitioner is likely to deal with similar obligations after his appointment, especially where the business rescue period is extended.²⁰⁰

The administrator (England) is entitled to continue trading the losses available to set-off against the profits to reduce the company's tax liabilities. In general it is unlikely that the business rescue practitioner is expected to trade due to the very short legislative period set aside for consideration and implementation of a business rescue plan.²⁰¹

In canvassing the taxation laws of England and Wales it seems that the tax authorities wrestle with similar challenges when corporate rescue matters are considered for approval or rejection. Factors that influence the Crown's decisions in corporate rescues will in all probability be utilised by South African tax authorities as well.

The effect of a corporate rescue have value added tax and capital gain consequences in England depending on the facts and nature of the compromise in every matter, which applies in principle to the taxation environment in South Africa as well.

The comparative study seems conclusive that in both legal systems the tax authorities apply a pragmatic view when business rescues are considered. Both take into account certain particular facts relating to the affairs of the company that are considered in motivating its decision in the rejection or approval of a corporate or business rescue.

Fertile ground has been created for a more positive approach towards business rescue applications and compromises in terms of the Companies Act 71 of 2008 through the Income Tax Act amendment provisions that were inserted since 2001. The consideration of settlements and compromises in terms of Income Tax legislation (ADR, section 91A settlements) has created a culture within SARS to consider and approve business rescue proposals and to settle accordingly, if it is in the interests of the South African tax authority.

199 Section 150(1) of the Companies Act 71 of 2008 (Chapter 6).

200 Section 132(3)(a)(b) of the Companies Act 71 of 2008 (Chapter 6).

201 Section 129; Section 147; Section 148; Section 150(5)(a)(b) of the Companies Act 71 of 2008 (Chapter 6).

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