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**An analysis of merger and amalgamation transactions under the Companies
Act 71 of 2008 and the Income Tax Act 58 of 1962**

by

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LLD

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Abstract

In law it is common to encounter two separate pieces of legislation which govern a single matter or transaction, for example, the Companies Act 71 of 2008 (the Companies Act) and the Securities Transfer Act 25 of 2007 both of which address the sale of shares. Similarly, the Income Tax Act 58 of 1962 (the Income Tax Act) and the Companies Act both have regulations which govern, respectively, tax law and company law matters in South Africa. These two Acts overlap in various business and commercial fields as tax is frequently an important component of any business transaction undertaken by a company.

Issues, however, arise when the regulations in these two Acts, are inconsistent. This can be observed if one compares the current South African Income Tax and Companies Act, specifically as regards the sections involving merger and amalgamation transactions.

Section 44 of the Income Tax Act governs merger and amalgamation transactions from a tax perspective and provides for tax rollover relief if certain requirements are met. The regulations governing mergers and amalgamations under the Companies Act are contained in sections 113, 115 and 116 of the Act.

Although these sections in both Acts address the same transaction – a merger or amalgamation between two or more companies – there are several discrepancies between the regulations in the two Acts which appear to operate entirely independently of one another.

In practice, one often sees that other sections in the Companies Act and Income Tax Act are used to achieve a merger due, in the main, to the uncertainties in the application of the relevant merger sections in the two Acts and the limited interaction between them.

This study identifies and assesses the impact of the discrepancies identified in these two Acts in relation to merger and amalgamation transactions. The study makes recommendations to address these discrepancies and to align the South African Companies Act and Income Tax Act as regards merger/amalgamation transactions.

Keywords

Taxation, Company, Merger, Amalgamation, Tax, Group-Rollover Relief, Income Tax Act, Companies Act, Capital Gains Tax, Scheme of Arrangement

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CHAPTER 1: INTRODUCTION

1.1 Contextual framework

1.1.1 *The origin and definition of the terms “merger” and “amalgamation”*

The term “merge” can be traced back to 1630, and is believed derive from the Latin, “*mergere*” which means “to dip, dip in, immerse or plunge”.¹ The legal meaning of the term is derived from Anglo-Norman French (1728) and means “to sink, disappear into something else, be swallowed up, lose its identity”.²

The use of the term in a business sense originates from the United States of America (USA) and means:

“The combination or amalgamation of a commercial company, institution, etc., with another, or the consolidation of two or more companies, etc., into one.”³

The *Collins Dictionary* defines “merger” as “the joining together of two separate companies or organizations so that they become one”.⁴

The first business-related use of the term “merger” can be traced back to 1851 where, in a US Supreme Court Report,⁵ the court stated the following:

“The moment, then, the stock was destroyed by the merger of that company in another, or, the transfusion or intermingling of it with that of the other companies, its distinctive character was destroyed.”⁶

The term “amalgamate” originates in the field of chemistry and stems from Old French, “*amalgame*” which means “a blend of mercury with another metal”.⁷ The non-chemical use of the term can be traced back to 1775 when the term “amalgamation” meant “a combining of different things into one uniform whole”.⁸

¹ <https://www.etymonline.com/word/merge> (accessed 27 January 2021).

² <https://www.lexico.com/definition/merge> (accessed 27 January 2021).

³ <https://www-oed-com.uplib.idm.oclc.org/view/Entry/116763?rskey=ERjWgk&result=1#eid> (accessed 8 February 2021).

⁴ <https://www.collinsdictionary.com/dictionary/english/merger> (accessed 27 January 2021).

⁵ *Philadelphia and Wilmington Railroad Co v Maryland* 51 US (10 How) 376 (1851) 390 www.loc.gov/item/usrep051376/ (accessed 3 April 2022).

⁶ *ibid.*

⁷ https://www.etymonline.com/word/amalgam?ref=etymonline_crossreference (accessed 8 February 2021).

⁸ https://www.etymonline.com/word/amalgamation#etymonline_v_26155 (accessed 8 February 2021). Also see *Re SA Supply & Cold Storage Co; Wild v SA Supply & Cold Storage Co* 1904 2 Ch 268 287:

The *Oxford English dictionary* defines “amalgamation” as:

“The action of combining distinct elements, races, associations, into one uniform whole.”⁹

According to *Claassen’s Dictionary of legal words and phrases*, an amalgamation involves the blending of two concerns into one.¹⁰

A “take-over” is defined as a transaction through which a person acquires control over the assets of a company, either by acquiring the assets directly, or by acquiring them indirectly by obtaining control of the management of the company.¹¹

Weinberg and Blank distinguish between a take-over and a merger. For them, a take-over sees the direct or indirect control over the assets of the acquired company pass to the acquirer (one company acquires control over another); while in a merger the shareholding in the combined enterprise is spread between the shareholders of the two companies (there is a marriage between two companies).¹²

This study focuses on mergers and amalgamations as opposed to take-overs.

1.2 Types of merger

In a business sense, the term “merger” is today primarily used for the absorption of one company by another company.¹³ As a result of a merger the merged company (or target company) “disappears into”¹⁴ the merging company (or acquiring company) – it ceases to exist as an independent separate entity.

In *R v Black and Decker Manufacturing Co*,¹⁵ Dickenson J describes a merger as:

“The end result is to coalesce to create a homogeneous whole. The analogies of a river formed by the confluence of two streams, or the creation of a single rope through the intertwining of strands have been suggested by others.”

“... the rolling somehow or other, of two concerns into one. You must weld two things together and arrive at an amalgam – a blending of two undertakings.”

⁹ <https://www-oed-com.uplib.idm.oclc.org/view/Entry/5979?redirectedFrom=amalgamation#eid> (accessed 8 February 2021).

¹⁰ Claassen *Dictionary of legal words and phrases* (2022).

¹¹ Weinberg, Blank, Greystoke *et al Take-overs and mergers* 106.

¹² *ibid* 103 – 104.

¹³ https://www.gov.za/sites/default/files/gcis_document/201409/26493gen1183a.pdf 41 (accessed 15 February 2023): “...it will be necessary to make provisions in company law for mergers in the true sense of the word, namely, the absorption of one company into another, with the assets and liabilities of the former becoming the assets and liabilities of the latter and with the former ceasing to exist”.

¹⁴ <https://www.etymonline.com/word/merge> (accessed 27 January 2021).

¹⁵ *R v Black and Decker Manufacturing* 1975 1 SCR 411 (SCC) 421.

The various popular types of merger are discussed below to illustrate, first, the concept of a merger, and second, the various ways in which a merger can be structured. An in-depth discussion of the requirements for and considerations informing a merger under South African legislation is presented in the following chapters.

1.2.1 New company merger

In this merger structure a new company is incorporated and target companies are fused into the new company. The shareholders of the target companies receive shares in the new company in exchange for the assets and liabilities of the target company that were transferred to the new company. Following the merger, the target companies cease to exist. Technically, this is seen as a consolidation, but the term “merger” is generally used interchangeably for these two structures.¹⁶

Consider the following example:

Company Z (the target company) merges with company A (the acquiring company). A new company (NewCo) is created and Z and A transfer all their assets and liabilities to NewCo. In exchange, NewCo issues shares to Z and A which in turn transfer the shares they hold in NewCo to their shareholders as a dividend *in specie*.¹⁷ Z and A are then dissolved. In practice, Z and A are referred to as the disappearing companies and NewCo as the surviving company. This new company merger transaction can be illustrated as:

¹⁶ Gaughan *Mergers, acquisitions, and corporate restructurings* 12.

¹⁷ A dividend *in specie* is a distribution made to shareholders in a form other than cash. See <https://www.sars.gov.za/faq/faq-what-is-a-dividend-in-specie/> (accessed 9 October 2021) and s 64EA of the Income Tax Act.

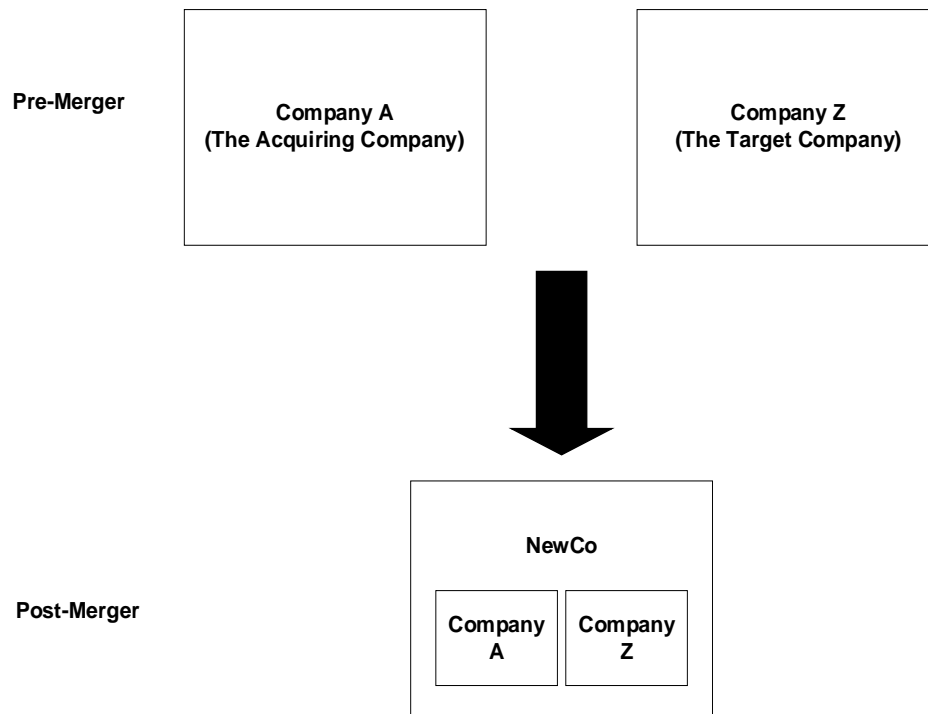


Figure 1-1 New Company Merger Structure

Source: Cassim F *et al* *Law of business structures* (2012) page 381.

1.2.2 Surviving-company merger

In the following example company Z (the target company) merges with company A (the acquiring company). Z transfers all its assets and liabilities to A and in exchange A issues shares to Z. Z transfers those shares – now held in A – to company Z’s shareholders as a dividend *in specie*¹⁸ and is then dissolved. In practice, Z is the disappearing company and A is the surviving company.¹⁹

¹⁸ *ibid.*

¹⁹ See also the discussion in para 1.2.4 below regarding “*Pooling-Type Mergers*”.

The above surviving company merger transaction²⁰ can be illustrated as:

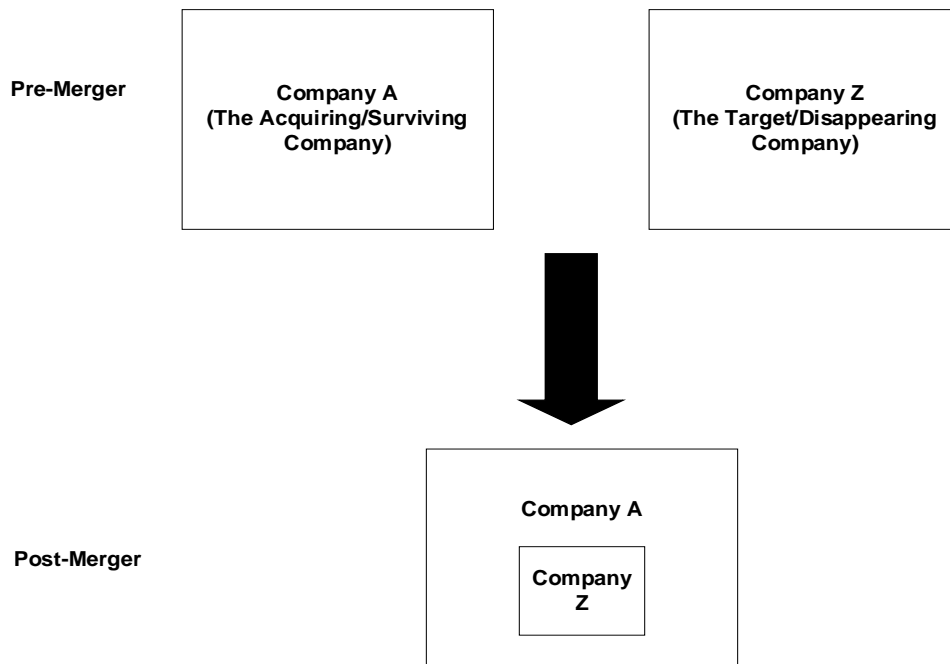


Figure 1-2 Surviving Company Merger Structure

Source: Cassim F *et al* *Law of business structures* (2012) page 382.

1.2.3 Cash merger

A cash merger is permissible in terms of the Companies Act 71 of 2008 (the Companies Act).²¹ This is interesting, because in other countries it appears that stringent regulations apply to a merger transaction involving a “cash consideration” .²²

The implication of a cash merger, according to Cassim, is that cash is paid to the shareholders of the disappearing company and these shareholders no longer have a vested right to continue to hold their investment in the form of shares in the surviving merged entity – they have, effectively, been “cashed-out”.²³ A cash merger more closely resembles a sales transaction than a traditional merger transaction.²⁴

²⁰ This can be compared to a tax free “reorganization A” which generally constitutes a statutory merger where one company acquires shares in the other company in exchange for shares. See Ravazzini 1996 *Golden Gate Univ LR* 553 – 555.

²¹ “Amalgamation or merger” definition in s 1 read with s 113(2) of the Companies Act.

²² Cassim MF (*Part 1*) 2008 *SA Merc LJ* 26.

²³ *ibid.*

²⁴ Clark *Corporate law* 435.

A cash merger can also be used to “squeeze-out” minority shareholders of a company by compelling them to sell their shares for cash.²⁵ A cash merger is often also referred to as a “freeze-out merger”.²⁶

1.2.4 Pooling-type merger

A pooling-type merger reflects the traditional concept of a merger.²⁷ It is essentially the same as a surviving-company merger where two companies are pooled into one surviving company which holds the combined assets and liabilities previously held individually by the two companies. The shareholders of the two distinct companies are also pooled and continue to participate as shareholders in the merged company.²⁸

In a typical pooling-type merger, the shareholders of the disappearing company (or target company) receive their consideration in the form of shares in the surviving company (acquiring company).²⁹

1.2.5 Triangular and reverse-triangular mergers

The first merger structure to be addressed under this heading is the triangular or forward-triangular merger. As the name suggests, there are three parties to this merger: two of which are in a holding company – subsidiary relationship – while the third is the target company.³⁰

An important benefit of the triangular merger is that it allows the acquiring company to avoid assuming the liabilities of the target company.³¹ This is because the target company becomes a subsidiary of the holding company and therefore remains a separate legal entity distinct from the holding company. This is beneficial as the liabilities of the target company are ringfenced in a separate legal entity.³²

A triangular merger structure is illustrated by the below figure:

²⁵ Cassim MF (*Part 1*) 2008 SA Merc LJ 26.

²⁶ Cassim MF (*Part 2*) 2008 SA Merc LJ 147.

²⁷ Cassim F *et al Business structures* 394.

²⁸ *ibid.*

²⁹ *ibid.*

³⁰ *ibid* 395.

³¹ *ibid*; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 344. A corporate veil is interposed between the holding company and the liabilities of the target company. In addition, as the target company survives the merger, one can avoid triggering approval rights with the target company's contracts and franchises.

³² Cassim F *et al Business structures* 397.

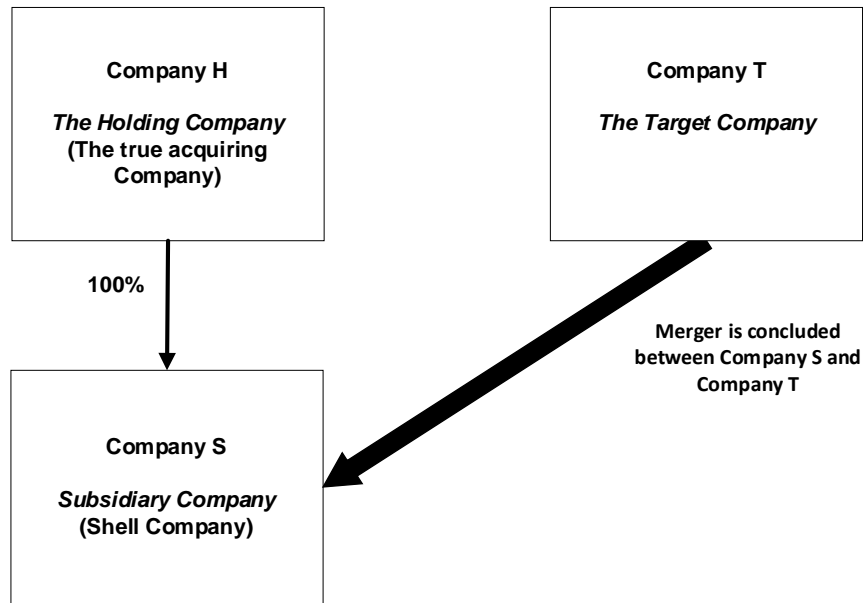


Figure 1-3 The Triangular Merger

Source: Cassim F *et al* *Law of business structures* (2012) page 396.

In the example above, H is the sole shareholder in S, a shell company acquired for purposes of the merger. T is the target company. All the assets and liabilities of T are transferred to S in exchange for shares in H. After the merger T is wound up. This means that once the merger has been completed, T (the disappearing company) will have merged into S (the surviving company)³³ and T's shareholders receive shares in H (the holding company).³⁴ The end result of the triangular merger is illustrated in Figure 1-4 below.

³³ *ibid* 396.

³⁴ Section 368(a)(2)(D) of the Internal Revenue Code; Cassim F *et al* *ibid*.

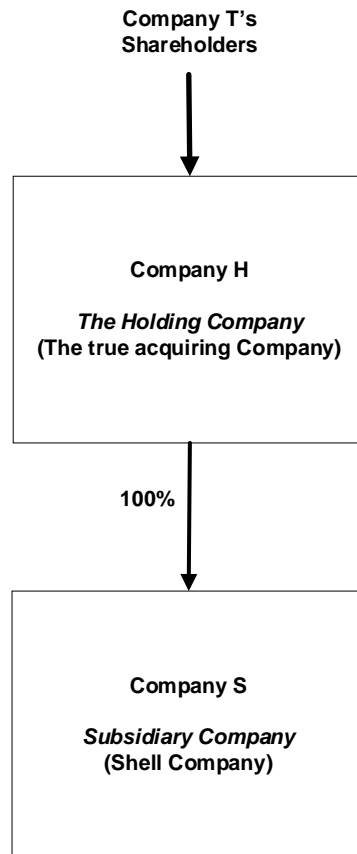


Figure 1-4 Triangular Merger Outcome with Shares as Consideration
 Source: Cassim F et al *Law of business structures* (2012) 396.

The reverse-triangular merger is considered next. This merger structure operates similarly to the triangular merger save that S in the diagram above, is merged into T, and T (the target company in the above example) is the surviving company.³⁵ This is generally the structure of choice where it is important to preserve the corporate personality of the target company – eg, where the target company holds important contracts which would terminate were T to disappear.³⁶ The consideration – shares in the holding company (H) in the case of a reverse merger – is paid to the shareholders of the target company.³⁷

Some of the internal inconsistencies in the Companies Act, specifically as regards triangular mergers, are discussed further in Chapter 2.³⁸

³⁵ Section 368(a)(2)(E) of the Internal Revenue Code; Cassim F et al/397.

³⁶ Cassim *ibid.*

³⁷ *ibid.*

³⁸ See discussion in para 2.7.2.

1.2.6 Short-form merger

A short-form merger takes place when a holding company and its subsidiary merge (vertical short-form merger), or where two subsidiaries of the same holding company merge with one another (horizontal short-form merger).³⁹

A short-form merger typically allows for vertical and horizontal short-form mergers to take place within a group of companies simply by resolution of the board of directors of each merging company.⁴⁰ It allows for a group of companies to reorganise their group structure in a swift, simple, and cost-effective manner. In any event, shareholder approval would be redundant in a short-form merger as the sole shareholder of the subsidiary(ies) is the holding company which would be in favour of the merger. There would also be no new shareholders following the conclusion of the merger.⁴¹

In addition, in the case of a short-form merger between wholly owned companies there are no minority shareholders and prejudice to the creditors is less likely.⁴²

Cassim notes that in certain USA states the short-form merger is used even where the subsidiary is not wholly owned by the parent company, which is often referred to as a short-form freeze-out merger.⁴³ In terms of such a merger the minority shareholders are eliminated from the subsidiary unilaterally by way of board resolutions and the implementation of a shareholder vote on the merger.⁴⁴ Cassim, however, suggests that such a short-form freeze-out merger would not be appropriate in South Africa in that it would be out of line with the spirit of the Companies Act which is shareholder-centric and places a high premium on the protection of minority shareholders.⁴⁵

1.3 Determinants for entering into merger transactions

It is important to understand what drives companies to enter into merger and acquisition (M&A) transactions, specifically, to merge with one another.⁴⁶

³⁹ Cassim F *et al Business structures* 398.

⁴⁰ Cassim MF (*Part 2*) 2008 SA Mer LJ 147 156.

⁴¹ *ibid.*

⁴² Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 357.

⁴³ Cassim MF (*Part 2*) 2008 SA Mer LJ 156; Davids, Norwitz and Yuill *ibid* 345.

⁴⁴ Section 253 of the Delaware General Corporation Law <https://delcode.delaware.gov/title8/c001/sc09/index.html> (accessed 9 March 2023); Cassim MF *ibid* 156 157.

⁴⁵ Cassim MF *ibid.*

⁴⁶ Emmer 2014 22/1 *European Review* 109.

1.3.1 Growth

The most fundamental reason for a company to enter into a merger arrangement is to grow.⁴⁷ Growth can be achieved through internal growth (eg, developing new products or expanding operations geographically) or external growth (eg, through a merger).⁴⁸

A merger can serve as a tool for pursuing faster growth, which can be achieved post-merger, by the expansion of the company's capital base, geographic reach, market share, and new product lines or customer segments.⁴⁹

1.3.2 Synergy

A further reason for entering into a merger is to achieve "synergy".⁵⁰ This is where combined components produce a more valued effect than would have been achieved by each component individually.⁵¹ For mergers this synergy translates as higher profitability after the merger of the companies than that achieved by the pre-merger companies.⁵² This ties in with the neoclassical theory in M&A that new mergers offer a higher asset value as a result of synergy gains than the value of pre-merger assets.⁵³ In other words, the new asset combination is more valuable than the sum of the individual assets pre-merger in that the combined assets generate higher cash flows through the better use of existing assets.⁵⁴

1.3.3 Diversification

A further reason for a M&A may be to diversify the business. This is typically referred to as a "conglomerate merger" and takes place where the merging companies are not competing in the same industry.⁵⁵ History has shown that many companies regret their attempt to diversify their business through acquisition. However, an example of a company which has gained significantly from conglomerate M&A activities is General Electric Company⁵⁶ which currently operates in aviation, healthcare, renewable

⁴⁷ Gaughan *Mergers, acquisitions, and corporate restructurings* 117.

⁴⁸ Tamosiuniene and Duksaite 2009 2/4 *KSI Transactions on Knowledge Society* 11.

⁴⁹ *ibid* 12.

⁵⁰ "For example, a synergistic reaction occurs in chemistry when two chemicals combine to produce a more potent total reaction than the sum of their separate effects. Simply stated, synergy refers to the phenomenon of $2 + 2 = 5$." Gaughan *Mergers, acquisitions, and corporate restructurings* 124.

⁵¹ *ibid*.

⁵² Tamosiuniene and Duksaite 2009 2/4 *KSI Transactions on Knowledge Society* 11.

⁵³ Morresi and Pezzi "The M&A phenomenon" 1.

⁵⁴ *ibid*.

⁵⁵ Gaughan *Mergers, acquisitions, and corporate restructurings* 117.

⁵⁶ *ibid* 136.

energy, and power, to name but a few areas.⁵⁷ The company has in recent years started to divest certain operations in order to simplify the business and focus on its core operations of realising growth and improving shareholder value.⁵⁸

1.3.4 Other economic drivers - Tax

Although tax considerations may not be a driver for entering into a merger deal, they are an important factor when contemplating such action and sellers may require a tax-neutral transaction as a prerequisite to entering into a merger agreement.⁵⁹

The aim of a merger is well illustrated in the *obiter dictum* of Dickinson J in *R v Black & Decker Manufacturing Co* 1975 1 SCR 411 SCC 420-2:

“The purpose is economic: to build, to consolidate, perhaps to diversify existing businesses; so that through union there will be enhanced strength. It is a joining of forces and resources in order to perform better in the economic field.”

1.4 The history of mergers

1.4.1 The VOC consolidation (1602)

One of the earliest mergers on record is a consolidation (merger) between Dutch shipping and trade merchants in 1602.⁶⁰ Various Dutch merchants established small companies for shipping and trade with Asia.⁶¹ The government of Holland intervened in this trade arrangement and mediated a merger between these small Dutch trading companies to form a single company, the renowned *Vereenigde Oost-Indische Compagnie* (VOC).⁶²

Before this consolidation, the Dutch trade companies were not only in competition with one another⁶³ (intercity rivalries) but also with Portuguese, English, and Spanish spice

⁵⁷ General Electric Company “Annual Report 2019” <https://www.ge.com/in/sites/www.ge.com.in/files/Annual%20Report%202019-20.pdf> (accessed 3 April 2022).

⁵⁸ <https://www.ge.com/news/press-releases/ge-focuses-portfolio-growth-and-shareholder-value-creation> (accessed 3 April 2022).

⁵⁹ Gaughan *Mergers, acquisitions, and corporate restructurings* 165; Auerbach and Reishus “The Impact of Taxation” 70.

⁶⁰ Emmer 2014 22/1 *European Review* 109; De la Rey 1986 27/2 *Codicillus* 24.

⁶¹ Emmer *ibid.*

⁶² *ibid* 109.

⁶³ Gelderblom, de Jong and Jonker 2013 73/4 *Journal of Economic History* 5.

traders.⁶⁴ The merger of the Dutch trade companies resulted in the VOC combining the various Dutch companies into one which effectively afforded the VOC a monopoly in trade from India to the Cape of Good Hope.⁶⁵ Following the consolidation, the Estates General issued the VOC with a Charter⁶⁶ granting it a 21-year monopoly on Asian trade.⁶⁷

The VOC merger was not a full-scale merger of the trade companies but rather a partial merger or consolidation in terms of which each company remained responsible for its own share in the joint operations of the VOC.⁶⁸

However, the reason for the VOC consolidation or merger remains relevant for current merger agreements: to gain market share and to extend the companies' global client base (in this case, the creation of a monopoly in the market).

1.4.2 Merger waves throughout history

A merger wave can be described as a notable increase in a cluster of merger activities in a specific period.⁶⁹ There have been six periods of high M&A activity in the history of the USA.⁷⁰ As the business concept of a merger originated in America, it is useful briefly to discuss the history of mergers, specifically the merger waves experienced in the USA.

Merger control in the USA can be traced back to 1904,⁷¹ while merger statistics were introduced in the country towards the end of the 19th century.⁷² From a European perspective, the first merger wave was experienced from 1987 with the introduction of the Single European Act which came into force from 1 June 1987.⁷³ As a result, there

⁶⁴ Nijman 1994 13/3 *Political Geography* 220.

⁶⁵ *ibid* 220.

⁶⁶ This Charter is often considered the blueprint for corporate governance with modern features such as permanent capital, freely transferable shares, separation of management and ownership, entity shielding, and limited liability. See Gelderblom, de Jong and Jonker "An Admiralty for Asia" 15.

⁶⁷ *ibid*.

⁶⁸ Gelderblom, de Jong and Jonker 2013 73/4 *Journal of Economic History* 6.

⁶⁹ Gaughan *Mergers, acquisitions, and corporate restructurings* 41.

⁷⁰ *ibid*.

⁷¹ The Sherman Anti-Trust Act of 1890 read with *Northern Securities Co v United States* 193 US 197, 24 S Ct 436, 48 L Ed 679 (1904). The court held that horizontal mergers were in violation of the Sherman Act which effectively hindered new monopolies being established by way of horizontal mergers.

⁷² Kleinert and Klodt "Causes and consequences of merger waves" Kiel Institute of World Economics Kiel Working Paper No 1092 2002.

⁷³ Vancea 2013 1/2 *Annals of Faculty of Economics* 272.

is a longer history of merger waves in the USA than in Europe and more data and information on the merger waves over the past 100 years in the USA.

Research has identified three triggers (or “shocks” as they are referred to in practice) for the onset of a merger wave:

- a) economic shocks;⁷⁴
- b) regulatory shocks;⁷⁵ and
- c) technological shocks.⁷⁶

The end of a merger wave is typically the result of a crisis or a recession, such as the subprime debt crisis which ended the sixth merger wave in 2007.⁷⁷ A merger wave is, therefore, an efficient response to changes in economic conditions, regime shifts, and technological development.⁷⁸

The following table provides a brief summary of the past six merger waves:⁷⁹

⁷⁴ *Economic shock*. Typically, this shock is due to economic expansion which motivates companies to grow rapidly. Inorganic growth (by way of a merger) is an accelerated method used by companies to achieve growth. Tamosiuniene and Duksaite 2009 2/4 *KSI Transactions on Knowledge Society* 11; Gaughan *Mergers, acquisitions, and corporate restructurings* 42.

⁷⁵ *Regulatory shock*: This shock can occur when there are regulatory changes that remove previous barriers that may have prevented a merger. Gaughan *ibid*. For example, in *Northern Securities Co v United States* 193 US 197, 24 S Ct 436, 48 L Ed 679 (1904) the court held that horizontal mergers were in violation of the Sherman Anti-Trust Act (1890). This judgment, read with the Sherman Act, resulted in the next merger wave in the form of vertical mergers.

⁷⁶ *Technological shock*: This could be a dramatic change to industry resulting from technical changes. Gaughan *ibid*.

⁷⁷ Ferris and Pettit *Valuation for mergers and acquisitions* 3.

⁷⁸ Blunck, Bartholdy and Poulsen *What drives private and public merger waves in Europe?* (2009) SSRN <https://ssrn.com/abstract=1338347> accessed 15 August 2023.

⁷⁹ Gaughan *Mergers, acquisitions, and corporate restructurings* 42–74.

Merger Wave	Period	Main types of merger during the period
First Merger Wave	1897 - 1904	Horizontal integration ⁸⁰
Second Merger Wave	1916 - 1929	Vertical integration ⁸¹
Third Merger Wave	1955 - 1969	Conglomerates ⁸²
Fourth Merger Wave	1984 - 1989	Hostile mergers
Fifth Merger Wave	1992 – 2001	Cross-border mergers
Sixth Merger Wave	2004 - 2007	Private equity, Leveraged buy-outs (LBOs)

Table 1: The six USA merger waves

Source: Gaughan P *Mergers, Acquisitions, and Corporate Restructurings* (John Wiley & Sons 2015) pages 42–74.

The lowest level of global deal making in a decade was recorded in the second quarter of 2020 due to the Covid-19⁸³ pandemic.⁸⁴ However, parties suggest that the seventh merger wave commenced in June 2021 despite the widespread uncertainties that the global pandemic caused worldwide.⁸⁵

The study now focuses specifically on the history of mergers in South Africa, with particular attention to company law and tax law legislation.

⁸⁰ A horizontal integration can be described as a merger between companies that operate in the same industry. Such a merger is typically concluded to gain market share and to grow the business inorganically. Weinberg, Blank, Greystoke *et al Take-overs and mergers* 107.

⁸¹ A vertical integration is a merger between a company and its distributors or suppliers. Such a merger is typically concluded to gain control over supply chains and lower transaction costs. See Weinberg, Blank, Greystoke *et al* *ibid*.

⁸² Conglomerates are mergers between companies that do not compete in the same industry. Such a merger is typically concluded to diversify the company. See Weinberg, Blank, Greystoke *et al* *ibid*.

⁸³ A type of infectious disease caused by the Corona virus which was first recorded in December 2019 in Wuhan, China <https://pubmed.ncbi.nlm.nih.gov/32226823/> (accessed 3 April 2022).

⁸⁴ Aliaj, Fontanella-Khan and Wiggins “Global dealmaking drops to lowest level in more than a decade” *Financial Times* 1 July 2020 <https://www.ft.com/content/92c13865-6c67-4f48-b96b-3429194c2ea2> (accessed 3 April 2022).

⁸⁵ <https://www.financierworldwide.com/boom-time-riding-the-seventh-great-ma-wave#.YkmfrXpBzIU> (accessed 3 April 2022); <https://www.afr.com/companies/financial-services/the-seventh-great-m-and-a-wave-is-here-20210620-p582ll> (accessed 3 April 2022).

1.5 A brief history of mergers in South African tax and company legislation

1.5.1 Introduction of the statutory merger and amalgamation concept in the Companies Act

The Companies Act 61 of 1973 (the 1973 Companies Act) was partially repealed and replaced by the Companies Act 71 of 2008 (the Companies Act) which was signed into law on 8 April 2008 and came into effect from 1 May 2011.⁸⁶

The 1973 Companies Act, as repealed, did not cater for statutory merger transactions⁸⁷ which were typically achieved by way of either a sale of shares⁸⁸ or a scheme of arrangement.⁸⁹ An earlier version of the 1973 Companies Act contained takeover provisions (ordinary takeover offer⁹⁰) but these sections were repealed in 1989.⁹¹

In terms of sections 311, 312 and 313 of the 1973 Companies Act an application must be made to court to sanction the compromise or the arrangement between the relevant parties or to obtain a subsequent court order with regard to, *inter alia*, the transfer of the whole or any part of the undertaking and of the property or liabilities of any transferor company to the transferee company.⁹² This regulation in the 1973 Companies Act is a costly and administratively onerous process by which to effect a merger transaction. It, however, remained the preferred method for effecting amalgamation transactions and is analysed in greater detail in Chapter 2.⁹³

⁸⁶ Companies Act 71 of 2008. The 1973 Companies Act was preceded by the 1926 Companies Act which is discussed in ch 2.

⁸⁷ Pretorius “A new era for mergers and amalgamations” Cliffe Dekker Hofmeyer (2010). <https://www.sataguide.co.za/a-new-era-for-mergers-and-amalgamations/> (accessed 14 July 2023).

⁸⁸ Section 141 of the 1973 Companies Act.

⁸⁹ Section 311 of the 1973 Companies Act; Pretorius “A new era for mergers and amalgamations” Cliffe Dekker Hofmeyer (2010) <https://www.sataguide.co.za/a-new-era-for-mergers-and-amalgamations/> (accessed 14 July 2023).

⁹⁰ De Villiers 1973 90/4 SALJ 350–368.

⁹¹ Sections 314–321 of the 1973 Companies Act were deleted by s 6 of Act 78 of 1989. See para 2.2.3 for a discussion of the repeal of the ordinary takeover offer in the 1973 Companies Act.

⁹² Section 313(1)(a) of the 1973 Companies Act.

⁹³ See para 2.2.4.

The aim of the introduction of a new Companies Act in South Africa in 2008 included providing for “equitable and efficient amalgamations, mergers and takeovers of companies”.⁹⁴

The enactment of the new Companies Act in South Africa marked a momentous shift in company law in that, as a whole, it is more focused on a deal-centric methodology than the 1973 Companies Act which applied a traditional methodology, aimed primarily at protecting the minority shareholder.⁹⁵ The provisions in the Companies Act attempt to create a balance between these two approaches, providing companies with an opportunity for economic growth, *inter alia*, through the introduction of the statutory merger, whilst still protecting the rights and interests of the minority shareholders⁹⁶ of the merging companies.⁹⁷

The South African government engaged with various global professionals in the M&A sphere to obtain their input on the introduction of specific merger regulations in the Companies Act. Remarkably, the statutory merger concept introduced in the Companies Act is largely adopted from the USA with input from various other countries such as the United Kingdom (the UK), Australia, and Canada.⁹⁸ This is an interesting adoption of American state law as it departs from South Africa’s usual preference for English law concepts as opposed to the more distinct and liberal concepts of US state law.⁹⁹

Canada has also adopted the statutory merger approach from American state law, while the UK and countries like Australia, have retained the more conservative

⁹⁴ Preamble to the Companies Bill 2007. In the Explanatory Memorandum, the Bill further stated at 5 that the aim of the Companies Act is, amongst others, that “the mergers and takeovers regime should be reformed so that the law facilitates the creation of business combinations”.

⁹⁵ Section 7 of the Companies Act sets out the purposes of the Act; Chong *Tax issues*.

⁹⁶ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337; *Re National Bank Ltd* 1966 1 WLR 819, 1966 1 All ER 1006 (ChD) 828–830.

⁹⁷ Section 164 of the Companies Act provides protection for dissenting shareholders by way of their appraisal rights. “Appraisal rights” refer to a statutory right of a minority shareholder to approach the court to have his or her shares fair-valued and to oblige the company to repurchase the shares from the minority shareholder at the determined price.

⁹⁸ Part 15 “Fundamental changes” ss 181 – 186 of the Canada Business Corporations Act (RSC 1985 c C-44); ss 174 – 177 of the Business Corporations Act RSO 1990 c B-16 (Ontario); Davids, Norwitz and Yuill 2010 *Acta Juridica* 337.

⁹⁹ Cassim MF (*Part 1*) 2008 SA Merc LJ 1.

approach of English law which requires the court's approval for merger and amalgamation transactions.¹⁰⁰

The Companies Bill 2007¹⁰¹ differentiated specifically between the term "merger" and "amalgamation". In terms of the Companies Bill, a "merger" means:

"A transaction, or series of transactions, involving two or more companies, resulting in one or more of those companies together holding all of the assets and liabilities previously held by the several merging companies."¹⁰²

An "amalgamation" is also defined in the Companies Bill as:

"[A] transaction or series of transactions, involving two or more companies, resulting in the formation of one or more new companies, which, together hold all of the assets and liabilities previously held by the several amalgamating companies."¹⁰³

In essence, as drawn from the above definitions, there is a distinction between a merger, which is a collapse of one company into another company, and an amalgamation which is a combination of different companies into a new company.¹⁰⁴ However, the distinction between the two terms has not been retained in the current Companies Act and the terms are used interchangeably in practice.¹⁰⁵

In terms of the definition of "amalgamation or merger" in section 1 of the Companies Act it is clear that the Act provides for two broad types of merger/amalgamation whereby:¹⁰⁶

- (i) One or more new companies are created, referred to as either the merged or amalgamated companies¹⁰⁷ and there is a dissolution of the merging or amalgamating companies.¹⁰⁸ In other words, there is one or more new company(ies) to which all the assets and liabilities of the

¹⁰⁰ Part 26 of the UK Companies Act 2006; Part 5.1 of the Australian Corporations Act 2001; Cassim *ibid.*

¹⁰¹ Draft Companies Bill 2007.

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ Cassim MF (*Part 1*) 2008 SA Merc LJ 1.

¹⁰⁵ See the definition of "amalgamation or merger" in s 1 of the Companies Act.

¹⁰⁶ *ibid.*; Lewis 2011 27 May *Tax Alert*.

¹⁰⁷ Definition of "amalgamated or merged Companies" s 1 of the Companies Act.

¹⁰⁸ *Ibid.*

merging or amalgamated company are transferred prior to the dissolution of the latter companies.¹⁰⁹

- (ii) One or more company(ies) (the merging or amalgamating company(ies)) merges or combines with another company(ies) (the merged or amalgamated company(ies)) by transferring all its assets and liabilities to that/those company(ies) and the merging or amalgamated company(ies) is/are then deregistered.¹¹⁰

Broadly, either a new company is created, and all the assets and liabilities of the existing companies are transferred to it before the dissolution of the existing companies; or an existing company collapses into another existing company by transferring its assets and liabilities to the latter company.

The merger or amalgamation transaction, as governed by section 113 read with sections 115 and 116 of the Companies Act, is discussed in detail in Chapter 2.¹¹¹

Noticeably, with the implementation of statutory mergers under section 113 of the Companies Act, the liabilities and assets are automatically transferred to the surviving company(ies) by operation of law (*ex lege*). “By operation of law” is defined in *Black’s legal dictionary* as a process: “...by which a right or a liability is created for a party regardless of the party’s actual intent”.¹¹² In other words, a transfer by operation of law is not effected by the consensus of the parties regarding the transfer, but rather the transfer takes place by virtue of a statute.¹¹³ This means that there is no legal formality linked to the transfer as it takes place automatically. This makes the merger procedure simple, cost effective, and expeditious.¹¹⁴

¹⁰⁹ Definition of “amalgamation or merger” in terms of s 1(a): “[T]he formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies.”

¹¹⁰ Definition of “amalgamation or merger” in terms of s 1(b): “[T]he survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.”

¹¹¹ Refer to ch 2 para 2.4.12.4.1.

¹¹² Garner and Black *Black’s law dictionary* (2014).

¹¹³ Nicol 2013 *SA Merc LJ* 35.

¹¹⁴ Dachs and La Grange 2012 *The Taxpayer* 5: “No formalities with regard to cession, novation and delegation are required when the rights and obligations vest by operation of law.”

1.5.2 The introduction of corporate rollover relief for amalgamation transactions under the Income Tax Act

Part III of the Income Tax Act 58 of 1963 (the Income Tax Act) was introduced in the Act in 2001 and replaced in 2002 with a deemed effective date from 6 November 2002.¹¹⁵ Part III (referred to in practice as “group-rollover relief” or “the corporate rules”) provides for special rules relating to asset-for-share transactions, substitutive share-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions, and liquidation distributions.¹¹⁶ Collectively these provisions in sections 41–47 of the Income Tax Act will, going forward, be referred to as the corporate rules. Amalgamation transactions are specifically governed by section 44 of the Income Tax Act.

This group tax relief was introduced simultaneously with the implementation of Capital Gains Tax (CGT) which has applied in South Africa since 1 October 2001.¹¹⁷ In the light of the introduction of the new CGT regulations, and so as not to obstruct businesses from continuing to structure their group affairs in a tax efficient and cost-effective way, National Treasury introduced Part III in the Income Tax Act.¹¹⁸ In effect, using an amalgamation transaction as an example, the resultant (surviving) company “steps into the shoes” of the amalgamated company in respect of the asset disposed of.¹¹⁹ The CGT liability is essentially “rolled over” until the resultant company disposes of or realises the asset.¹²⁰

¹¹⁵ Part III inserted by s 44(1) of Act 60 of 2001 and substituted by s 34(1) of Act 74 of 2002.

¹¹⁶ Sections 42 – 47 of the Income Tax Act.

¹¹⁷ <https://www.sars.gov.za/wp-content/uploads/Legal/AmendActs/LAPD-LPrim-AA-2001-03-Second-Revenue-Laws-Amendment-Act-2001.pdf>; <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2001-02-Explanatory-Memorandum-Taxation-Laws-Amendment-Bill-2001.pdf>; <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2001-04-Memorandum-Objects-Second-Revenue-Laws-Amendment-Bill-2001.pdf> (accessed 18 April 2022); Stiglingh *et al* *SILKE* 537.

¹¹⁸ <https://www.sars.gov.za/wp-content/uploads/Legal/AmendActs/LAPD-LPrim-AA-2001-03-Second-Revenue-Laws-Amendment-Act-2001.pdf>; <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2001-04-Memorandum-Objects-Second-Revenue-Laws-Amendment-Bill-2001.pdf> (accessed 18 April 2022); Stiglingh *et al* *ibid* 713.

¹¹⁹ Section 44(2)(a)(ii) provides that where there is a disposal of a capital asset, the resultant company and amalgamated company will be deemed to be one and the same person for purposes of determining any capital gain or capital loss with the subsequent disposal of the capital asset by the resultant company. Sections 44(2)(b) and 44(3) contain similar provisions regarding the disposal of trading stock and allowance assets.

¹²⁰ Section 44(2)(a)(ii) of the Income Tax Act; Botha 2019 18 July *Tax and Exchange Control Alert*.

The 2002 Explanatory Memorandum on the Revenue Laws Amendment Bill¹²¹ issued by National Treasury further provided the following regarding the introduction of section 44 of the Income Tax Act:

“Section 44 – Amalgamation transactions

Subsection (1): The scope of the current corporate rules does not include the merger or amalgamation of companies. It is therefore proposed that specific rules be introduced to provide relief for amalgamation transactions. An amalgamation transaction means any transaction— in terms of which a company (amalgamated company) which is a resident, disposes of all its assets and transfers all of its obligations to another company (resultant company) which is a resident, by means of an amalgamation, conversion, merger or similar scheme; as a result of which that amalgamated company’s existence will be terminated; and in respect of which that amalgamated company and that resultant company have jointly elected that this section applies.”

Currently, section 44(1)(a) of the Income Tax Act provides for an “amalgamation transaction” in terms of which any resident company (amalgamated company) disposes of all its assets (save for those assets identified to settle any debt incurred in the company’s ordinary course of trade and/or to satisfy any reasonably anticipated liabilities to government, and the costs of administration relating to winding-up or liquidation) to another resident company (the resultant company) by means of an amalgamation, conversion, or merger. As a result, the amalgamated company will be terminated.¹²² The amalgamation transaction and its requirements and anti-avoidance provisions are discussed in detail in Chapter 3.

Similar to the specifications contained in subparagraph (a), section 44 also provides in subparagraph (b) for an “amalgamation transaction” between a foreign company (the amalgamated company) and a resident resultant company,¹²³ and in subparagraph (c) provides for an “amalgamation transaction” between two foreign companies.¹²⁴ Foreign mergers and amalgamations, do not, however, fall within the scope of this thesis.

Corporate rollover relief provisions contain so-called “anti-avoidance” provisions which act as a claw-back for tax purposes. In simple terms, if these anti-avoidance provisions

¹²¹ Explanatory Memorandum on the Revenue Laws Amendment Bill 2002 “Corporate restructuring rules” 39 <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2002-03-Explanatory-Memorandum-Revenue-Laws-Amendment-Bill-2002.pdf>.

¹²² Section 44(1)(a) of the Income Tax Act.

¹²³ Section 44(1)(b) of the Income Tax Act.

¹²⁴ Section 44(1)(c) of the Income Tax Act which contains various requirements set out in para (ii).

are triggered, any gain/tax that was deferred in terms of the corporate rules will be realised. The anti-avoidance provisions governing amalgamation transactions are contained in section 44(5), with exclusions from the application of the section contained in section 44(13) and (14). This is discussed further in Chapter 3.

Section 44 of the Income Tax Act provides tax relief for three parties to the amalgamation transaction – the amalgamated company, the resultant company, and the shareholders of the amalgamated company. This, too, is discussed in detail in Chapter 3.

Although section 44 is specifically aimed at amalgamation transactions, there are other corporate rules that can be used to achieve the same outcome. These are also discussed in Chapter 3.

1.6 Comparing the provisions of the two Acts as regards merger and amalgamation transactions

Based upon the study and analysis of the functions and provisions of these two Acts as regards the governance of merger and amalgamation transactions any discrepancies or irregularities that arise can be identified.

The Standing Committee on Finance considered the alignment of the Income Tax Act and the Companies Act in 2010 – before the Companies Act came into effect – but found that as the two Acts have different aims it would not make sense to align them.¹²⁵

National Treasury noted in its 2012 Annual Budget Review that the Income Tax Act and the Companies Act are not aligned:

“The comprehensive rewrite of the Companies Act (2008) has given rise to a set of anomalies in relation to tax, especially in the case of reorganisations and other share restructurings.”¹²⁶

In 2018, the Davis Tax Committee issued a report in which it found that the corporate rules are “rules-based” (mechanical) as opposed to “principle-based” (conceptual).

¹²⁵ Standing Committee on Finance “Report Back Hearings on the Taxation Laws Amendment Bill 2010” <https://www.sars.gov.za/wp-content/uploads/Legal/RespDocs/LAPD-LPrep-Resp-2010-01-Response-Documents-Taxation-Laws-Amendment-Bills-2010.pdf> (accessed 3 October 2023)

¹²⁶ <http://www.treasury.gov.za/documents/national%20budget/2012/review/Annexure%20c.pdf> (accessed 20 December 2021).

This means that there are very detailed and specific requirements which, if not met, disqualify the taxpayer from receiving the relevant rollover relief.¹²⁷ The Committee further recognised in this regard that this could,¹²⁸

“[give] rise to unintended difficulties, especially *when they interact with sections outside the reorganisation provisions*” (emphasis added).

These sources indicate that although the two Acts address different aspects of merger transactions, a comparative study is required to establish if there are conflicts or inconsistencies between the two Acts or between the rollover provisions and other provisions in the other tax Acts. In Chapter 4, the two Acts are compared to identify relevant differences, the impact of circumventing these issues by use of other mechanisms in the Acts, and the legal principles when dealing with inconsistencies between Acts are evaluated.

1.7 Recent amendments by government to address certain discrepancies relating to merger and amalgamation transactions

This type of discrepancy between two Acts has previously been brought to government’s attention. In December 2017 an inconsistency between the terms “debt” and “liabilities” in the Companies Act and the Income Tax Act was corrected and the provisions aligned. The term used in the Companies Act for the transfer between the merged company and merging company is “liabilities”,¹²⁹ while the Income Tax Act referred to the assumption of the amalgamated company’s “debt”¹³⁰ by the resultant company.

Although, at first glance, the difference between these seemingly similar terms appears negligible, the term “debt” specifically excludes any contingent liabilities, while the term “liabilities” generally covers all forms of liability.

The impact of this interpretation is that for tax purposes only non-contingent liabilities could previously have been transferred to the merging company, while the merged

¹²⁷ <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 13 February 2023).

¹²⁸ *ibid.*

¹²⁹ See the definition of “amalgamation or merger” in s 1 of the Companies Act.

¹³⁰ Section 44(4) of the Income Tax Act.

company would have had to maintain its own contingent liabilities. This was amended with effect from 18 December 2017 by the insertion of the definition of “debt” in section 41 which provides that “debt” specifically includes any contingent liabilities.

Further, on 21 July 2019 National Treasury released the Draft Taxation Laws Amendment Bill 2019,¹³¹ amending the corporate reorganisation rules to cater for company deregistration by operation of law.¹³² Amendments were made to section 41 of the Income Tax Act to align the Act with the concept in the Companies Act relating to mergers and amalgamations.

Before this amendment there was a discrepancy between section 41(4)(a)–(d) of the Income Tax Act and section 116(5)(b) of the Companies Act regarding the deregistration of the merged company.

The Companies Act provides that the merged company is automatically deregistered as a result of the merger. In terms of section 116 of the Companies Act, after the resolution to approve the merger or amalgamation has been adopted, a notice must be sent to the Companies and Intellectual Property Commission (CIPC).¹³³ Once such a notice of the merger adoption has been received by the CIPC, the Act authorised the Companies Commissioner to deregister the merging or amalgamating companies (the companies that do not survive the merger or amalgamation).¹³⁴ According to the interpretation adopted by Davids *et al*¹³⁵ and Chong and van der Linde, this deregistration effectively takes place by operation of law.¹³⁶

The Income Tax Act, however, requires that the merged or amalgamated company must be terminated soon after the amalgamation. This excludes the taxpayer from qualifying for the corporate rollover relief in section 44 if the necessary steps to

¹³¹ Draft Taxation Laws Amendment Bill 2019 published on 21 July 2019.

¹³² During the Budget Speech on 20 February 2019 the Minister of Finance stated that: “In some corporate reorganization rules, to qualify for the tax neutral transfer of assets, one or more of the companies involved should cease to exist after the transaction. The legislation lists steps that show a taxpayer meeting this requirement. However, the steps do not take into account deregistration by operation of law. It is proposed that the rules be amended to include this option.”

¹³³ Form CoR89 (Notice of Amalgamation or Merger) <https://www.cipc.co.za/wp-content/uploads/Forms/Companies/CoR89.pdf> (accessed 12 July 2023).

¹³⁴ Section 116(5)(b) of the Companies Act.

¹³⁵ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 368: “The merger procedure thus has a significant advantage over a straight sale of business in that it provides for the automatic assumption by the merged entity of the property and obligations of the merging entities, as well the dissolution by operation of law of the non-surviving entities without needing to go through formal liquidation proceedings.”

¹³⁶ Chong and Van der Linde 2014 3 *Stell LR* 482.

liquidate, wind up, or deregister the company have not been taken within 36-months of the transactions. If taxpayer does not act within this period, it effectively forfeits the tax deferral benefit under section 44 in terms of the amalgamation transaction. Section 41 did not previously make provision in the list of steps for the deregistration of a statutory merger or amalgamation or a deregistration that takes place by way of “automatic extinction” as provided for in the Companies Act.¹³⁷

The Tax Law Amendment Bill 2019 aligned the Income Tax Act and the Companies Act in this instance and added to the list of steps for deregistration of a company specifically to include statutory mergers where the company is deregistered by operation of law. The amendment came into operation on 1 January 2020 and applies to acquisitions made on or after that date.¹³⁸

1.8 Problem statement

To consider whether the regulations governing merger transactions under section 44 of the Income Tax Act and section 113 read with sections 115 and 116 of the Companies Act, can and should be aligned to ensure consistency and clarity the treatment of mergers in South Africa.

1.9 Research objective

The objective of the research is to compare and analyse the regulation of the two relevant Acts as regards merger and amalgamation transactions and to highlight significant differences in the Acts regarding the treatment of mergers.

The disconnect between the two Acts creates various uncertainties, potential tax leakage, and appears to complicate doing business in South Africa unnecessarily, specifically when it comes to group restructuring. I explore this further in Chapters 4 and 5.

The ease of doing business in South Africa remains an important factor for groups of companies investing in South Africa. In fact, South Africa has introduced the Ease of

¹³⁷ Section 116(5) of the Companies Act; Gad and McCormack (2018) *ENSight*.

¹³⁸ See s 41(4)(b)(i)(bb) of the Income Tax Act.

Doing Business Bill which provides for regulatory measures to be assessed to consider “the detection and reduction of red tape and the cost of red tape for businesses” and to “provide for assistance to businesses in overcoming red tape and other challenges”.¹³⁹

While the red tape, uncertainties, and disconnect between the two Acts persist, it comes as no surprise that in practice legal and tax advisers have been able to “work around” these difficulties when advising clients.¹⁴⁰ For example, the use of a schemes of arrangement under section 114 of the Companies Act remains a preferred mechanism by which to effect a merger.¹⁴¹ In addition, tax-rollover relief can be achieved through a merger transaction by applying one of the other corporate-rollover relief provisions in the Income Tax Act. However, these alternative mechanisms used to effect a merger typically trigger various other tax and legal implications. This is considered further in Chapter 4.

1.10 Research questions

1.10.1 Research question 1

What mechanisms are provided in the current Companies Act and the 1973 Companies Act that can be utilised to effect a merger or amalgamation transaction?

1.10.2 Research question 2

Can corporate rules other than section 44 of the Income Tax Act (amalgamation transactions) be used to effect a merger or amalgamation transaction and what are their requirements?

1.10.3 Research question 3

Does applying alternative sections in both Acts to merger transactions resolve the misalignment between the two Acts, or does it merely produce unintended consequences and additional requirements that must be met?

¹³⁹ https://www.parliament.gov.za/storage/app/media/Bills/2021/B6_2021_Ease_of_Doing_Business_Bill/B6_2021_Ease_of_Doing_Business_Bill.pdf (accessed 4 February 2023).

¹⁴⁰ See para 4.34.3.

¹⁴¹ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 86.

1.10.4 Research question 4

What is the impact of the misalignment of the Companies Act and Income Tax Act as regards merger and amalgamation transactions and how can these discrepancies best be addressed?

1.11 Research methodology

This study is qualitative in nature and interprets, contextualises, and analyses the research topic. The study is desk-bound and draws on relevant existing materials on the topic including legislation, law journals, articles, dissertations, case law, binding private rulings, and textbooks.

The study considers certain foreign legislation that governs mergers and amalgamations, but does not constitute a comparative study.

1.12 Conclusion

In conclusion, the aim of this thesis is, first, to study the specific provisions governing mergers in the Companies Act and Income Tax Act. Alternative transfer mechanisms in the Companies Act and the other corporate rules in the Income Tax Act that can be used to effect a merger transaction are also considered. Second, the thesis identifies the various discrepancies arising in the Income Tax Act and the Companies Act in relation to the regulation of mergers and amalgamations in South Africa and their impact. Third, how best these discrepancies can be addressed and whether or not alignment of the two Acts is required is established.

Where potential solutions are identified, I make recommendations in Chapter 5 by proposing solutions to be adopted in the South African legislation to address the existing discrepancies in the Income Tax Act and Companies Act so as better to align the two Acts.

CHAPTER 2: MERGERS AND AMALGAMATIONS IN TERMS OF THE COMPANIES ACT 71 OF 2008

2.1 Background

The first national, post-Union Companies Act in South Africa, the Companies Act 46 of 1926 (the 1926 Companies Act) came into effect on 1 January 1927.¹⁴² English law has had a significant influence on South African company law¹⁴³ since the English established a British colony in the Cape (the Cape colony) in 1806.¹⁴⁴ Although South Africa became a Union in 1910, it remained under British rule (a dominion within the Commonwealth) until 1961, when South Africa became a Republic.¹⁴⁵ The 1926 Companies Act was aligned with English company law¹⁴⁶ and was amended periodically to keep it in line with changes made to English legislation.¹⁴⁷

The 1926 Companies Act provided for two procedures by which complete control over a company could be acquired: an ordinary take-over offer followed by a compulsory acquisition in terms of section 103*ter*;¹⁴⁸ and by way of a scheme of arrangement in terms of section 103.¹⁴⁹

In an earlier version of the 1926 Companies Act section 103*bis* governed amalgamations (provision facilitating reconstruction or amalgamation).¹⁵⁰

Briefly, section 103*bis* provided that where an application was made to court to sanction an arrangement (in terms of s 103) and the court was informed that the proposed arrangement was either for the purpose of a reconstruction or for an

¹⁴² The Companies Act 46 of 1926. The predecessor to this Act was the pre-Union Transvaal Companies Act 31 of 1909 which was modelled on the English Companies Consolidation Act of 1908. South Africa became a Union on 31 May 1910. De la Rey 1986 27/2 *Codicillus* 2 24.

¹⁴³ De la Rey *ibid*.

¹⁴⁴ <https://www.sahistory.org.za/article/english-settlement-south-africa> (accessed 3 April 2021).

¹⁴⁵ <https://www.sahistory.org.za/dated-event/republic-south-africa-established> (accessed 3 April 2021).

¹⁴⁶ The Department of Trade and Industry "South African Company Law for the 21st Century Guidelines for Corporate Law Reform" GG 1183 of 23 June 2004.

¹⁴⁷ *ibid*.

¹⁴⁸ The offer and acceptance of an offer to acquire control of a company were governed by the common-law of contracts as the 1926 Act did not prescribe formalities regarding the form or content of the ordinary take-over offer. See De Villiers 1973 *SALJ* 350 – 351.

¹⁴⁹ Section 103 of the 1926 Companies Act served as the predecessor of the scheme of arrangement in s 311 of the Companies Act 61 of 1973 and provides for the same process for a proposed scheme of arrangement. See also Suzman *South African Companies Act* 242.

¹⁵⁰ Section 103*bis* of the 1926 Companies Act; Suzman *ibid* 243. Section 103*bis* was inserted by Act 23 of 1939.

amalgamation of any two or more companies under that scheme, the whole or any part of the undertaking or asset of the transferor company would be transferred to another company (the transferee company). The section also provided that the court may make additional orders in this regard.¹⁵¹ These provisions included:¹⁵²

- a) transfer to the transferee company of the whole or any part of the undertaking and of the properties and liabilities of any transferor company;
- b) allocation or appropriation by the transferee company of any shares, debentures, or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;
- c) continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- d) dissolution, without winding-up, of any transferor company;
- e) provision for any persons who within such time and manner as the court may direct dissent from the compromise or arrangement;
- f) such incidental, consequential, and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

The two successive Companies Acts – the Companies Act 61 of 1973 (the 1973 Companies Act) and Companies Act – are discussed in greater detail in this chapter, specifically as regards to the relevant mechanisms in each Act that can be used to achieve a merger or amalgamation.

2.2 Compromise, amalgamation, arrangement, and take-overs under the 1973 Companies Act

2.2.1 Introduction

The 1926 Companies Act was replaced by the the 1973 Companies Act which came into effect from 1 January 1974.¹⁵³ Although the 1973 Companies Act was aimed at

¹⁵¹ Section 103*bis*(1) of the Companies Act 46 of 1926.

¹⁵² Section 103*bis*(1)(a) – (f) of the Companies Act 46 of 1926.

¹⁵³ The Companies Act 61 of 1973.

introducing innovative company law in South Africa, many of the provisions and principles from English law were adopted from the previous Companies Act.¹⁵⁴ Chapter XII of the 1973 Companies Act governed “Compromise, Amalgamation, Arrangement, and Take-over”.¹⁵⁵

The 1973 Companies Act continued to cater for an ordinary take-over offer in terms of sections 314 – 320 which was followed by a compulsory acquisition in terms of section 321.¹⁵⁶ These sections were, however, repealed in 1989.¹⁵⁷

The 1973 Companies Act also provided for schemes of arrangement in terms of section 311 read with section 313 and required an application to be made to court to sanction the scheme of arrangement. The scheme of arrangement process in terms of the 1973 Companies Act is discussed in further detail below.

MacGregor notes in his research that during the period 1966 to 1975 there was a decline of use of the ordinary take-over offer method in the latter years, as opposed to the use of the scheme of arrangement method.¹⁵⁸ The popularity of the use of a scheme of arrangement had been predicted by De Villiers, five years earlier in 1973:

“It is safe to predict that, in practice, the effect of the new take-over provisions will be that much greater use will be made of schemes of arrangements to effect take-overs, if only as a mode of avoiding the more onerous provisions imposed on take-over offers by the 1973 Act.”¹⁵⁹

¹⁵⁴ The Department of Trade and Industry “South African Company Law for the 21st Century Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004.

¹⁵⁵ Sections 311 – 321 of the Companies Act 61 of 1973. Sections 314 – 321 were repealed by s 6 of Act 78 of 1989. These sections dealt with takeovers including take-over offers (s 314); the content of the take-over statement by the offeror (s 315); and the power to acquire shares in a minority in a take-over scheme (s 321).

¹⁵⁶ De Villiers 1978 *SALJ* 355.

¹⁵⁷ https://www.gov.za/sites/default/files/gcis_document/201503/act-78-1989.pdf (accessed 2 August 2021). See the discussion in paras 2.2.3 and 2.2.4 below regarding the various factors that contributed to these sections falling into disuse and their ultimate repeal.

¹⁵⁸ Macgregor 1978 *SALJ* 330.

¹⁵⁹ De Villiers 1973 *SALJ* 367. A contributing factor to the demise of the take-over provisions was the stamp duty levied on take-over procedures under ss 314 – 321 of the 1973 Companies Act for the acquisition of shares. No such stamp duty was initially levied on schemes of arrangements where the take-over was effected by the cancellation of shares. The obvious cost benefit was one of the contributing factors for parties to prefer using schemes of arrangement over the take-over provisions. See the discussion in para 2.2.3 below regarding the amendment of s 23(10) of the Stamp Duties Act 77 of 1968 which removed this stamp duty advantage for schemes of arrangement.

Other factors are discussed in Cilliers and Benade *et al Maatskappyereg* 342 n 19:

“Die reëlinskemaprocedure bied talryke voordele bo die oornamaanbodprosedure. Hulle is kortliks:

- (i) die kleiner meerderhede wat vir die goedkeuring van die skema vereis word;
- (ii) die tydsbesparing omdat die reëlinskemaprocedure vinniger is;

MacGregor notes further that there continued to be a steady decline of the use of the ordinary take-over offer method for implementing mergers, and that by 1977 the method had essentially fallen into disuse.¹⁶⁰ Although this is not the sole factor contributing to this decline, the relevant sections governing the ordinary take-over offer were repealed by Act 78 of 1989.¹⁶¹ See the relevant discussion on the repeal of the take-over provisions in paragraph 2.2.3 below.

The detailed reasoning for this preferred use of schemes of arrangement over the ordinary take-over offer method or the subsequent statutory merger¹⁶² is discussed in further detail later in this Chapter.

Another mechanism governing take-overs in the 1973 Companies Act was the disposal of the undertaking or a greater part of the assets of the company under section 228 of the 1973 Companies Act. However, this study focusses, in the main, on the use of schemes of arrangement and mergers or amalgamation transactions where control of the company is changed, rather than on the disposal of the assets of the company, and so does not include an in-depth discussion of this mechanism.¹⁶³

2.2.2 Scheme of arrangement

Rights against companies typically rest with a large group of persons (eg, shareholders, creditors, liquidators, etc) and it would prove difficult, if not impossible, to negotiate on an individual basis with each these parties regarding their rights.¹⁶⁴ As

-
- (iii) besparing aan seëlregte;
 - (iv) die sekerheid wat dit bied—die aanbieder sal nie aan 'n gedeeltelik voltooide oorname gebind word nie;
 - (v) veel minder regulering en verantwoordelikheid vir die direkteure van die aanbieder.”

See also Weinberg *Take-overs and amalgamations* (1967) 63 – 65.

¹⁶⁰ Macgregor 1978 *SALJ* 334. See further the discussion in paras 2.2.2.2 and 2.2.3 below.

¹⁶¹ https://www.gov.za/sites/default/files/gcis_document/201503/act-78-1989.pdf (accessed 2 August 2021).

¹⁶² Introduced in s 113 of the Companies Act 71 of 2008.

¹⁶³ The disposal all or a greater part of the company's undertaking or assets in terms of s 112 of the Companies Act is discussed in para 2.6 as I believe there are elements of the section that could be extended to apply to mergers.

¹⁶⁴ *Ex parte Lomati Landgoed (Edms) Bpk* 1985 2 SA 517 (W) para 520: “The purpose of s 311 of the Act can be concisely put as being an attempted solution of the problem attendant upon attaining an agreement in the case of a large number of widely distributed people who must be contacted with a view to negotiating the same agreement with each one. Section 311 is therefore particularly applicable where it is impossible or difficult to approach everybody individually with a view to submission of the offer.” See also *Guardian Assurance Company* 1917 1 Ch 431 449 – 450: “Now if it were possible in a large undertaking to obtain the consent of each shareholder to such a proposal there is no doubt that it could be carried out, because there would be nothing to prevent any shareholder, if he pleased, transferring his shares, or a certain number of his shares, to anybody to whom he chooses to transfer them; but of course it is difficult to obtain in a large undertaking like this

a result, where there is a potential arrangement or compromise, section 311 of the 1973 Companies Act provides a method for collective negotiation with various groups with rights against the company regarding an arrangement or compromise.¹⁶⁵ Section 311 effectively allows companies to negotiate collectively with parties who have claims against them and to hold these parties to the outcome agreed to by the majority.¹⁶⁶

A compromise¹⁶⁷ is generally reached between a company and its creditors, while an arrangement¹⁶⁸ is entered into between a company and its members.¹⁶⁹ The arrangement or comprise mechanisms governed by section 311 of the 1973 Companies Act are generally referred to as “schemes of arrangement”.

the actual consent of the individual shareholders. But assume that such an agreement has been made between all the shareholders and the company, it seems to me to be quite obvious that that would be an arrangement made between the shareholders and the company.” See also Cassim F *et al Business structures* 406; Allan 1986 *De Rebus* 99.

¹⁶⁵ *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 411 – 412; *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd* 1988 1 SA 616 (D) 618 621 – 622; Allan *ibid*.

¹⁶⁶ *Ex parte Kaplan NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W) 418 – 419; *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 411 – 412; *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd* 1988 1 SA 616 (D) 618 621 – 622; Lehloenyane 2007 SA *Merc LJ* 531.

¹⁶⁷ De la Rey is of the view that a “comprise” occurs between a company and its creditors while an “arrangement” is concluded between a company and its members. De la Rey *Skikkings* 34 and 44. See also *In Re NFU Development Trust Ltd* 1973 1 All ER 135 (CH) where Brightman J refers to *ratio decidendi* in *Re Alabama, New Orleans & Pacific Junction Railway Co* 1891 1 CH 213: “...and that no arrangement or compromise can be said to be reasonable in which you can get nothing and give up everything”. In *Ex Parte Cyrildene Heights (Pty) Ltd* 1966 1 SA 307 (W) 309 it is stated that: “A ‘compromise’ there presupposes some dispute about rights to be compromised or some difficulty in enforcing them.”

¹⁶⁸ Collectively referred to as the “Transvaal cases” (*Satbel* (1984) and *Natal Coal* (1985)), the judges followed *In re NFU Development Trust Ltd* (1973) in finding that an arrangement requires some form of “give and take” and an arrangement where shares are cancelled against a payment by the company does not constitute an “arrangement” in terms of s 311 of the 1973 Companies Act. However, van den Heever J, in the unreported case, *Ex parte Suiderland Development Corporation* (1986), disagreed and stated that an arrangement merely requires a “compensating advantage” and such compensating advantage need not be in the form of the retention of rights as members of the company but could constitute something like a cash payment. Also see *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) and the discussion of the full bench’s views on the requirements for an “arrangement” in para 2.2.2.1.

¹⁶⁹ There is a distinction between the two terms “arrangement” and “compromise”. For example, in *Ex parte Bruyns: In re Coverite (Pty) Ltd* 1968 1 SA 51 (W) the court held that the scheme before the court constituted both an arrangement and a compromise as it “arranges for the company to dispose of all its assets...the concurrent creditors compromising... to receive... their pro rata share”. Also see *Ex Parte Cyrildene Heights (Pty) Ltd* 1966 1 SA 307 (W) 309.

A scheme of arrangement¹⁷⁰ under the 1973 Companies Act can be used to implement an arrangement or a compromise for purposes of a reconstruction¹⁷¹ or amalgamation scheme between a company and its creditors, its members, or any class of either¹⁷² where the whole or a part of the undertaking or property of a company is transferred to another company. This is governed by section 313 of the 1973 Companies Act (provisions facilitating reconstruction or amalgamation) and is discussed in further detail below.

The scheme of arrangement must be sanctioned by a court, and section 311 allows the court, on the *ex parte* application by the company or any creditors or members of the company,¹⁷³ to order a meeting of the creditors, a class of creditors, members of the company, or a class of members to be summoned as the court may direct. At the meeting the majority of the members or creditors must support the arrangement or compromise (at least 75 per cent of the votes exercisable by members or a class of members, or 75 per cent in value of creditors or a class of creditor)¹⁷⁴ for an application to be made to court to sanction the arrangement or compromise.

Section 312 of the 1973 Companies Act (information as to compromises and arrangements) governed the information required for such compromises and arrangements. Where a meeting of creditors or members (or any class of either) is convened to agree to a compromise or arrangement under section 311, a notice

¹⁷⁰ This is an established procedure that can be traced back to the Joint Stock Companies Arrangement Act of 1870. *In re NFU Development Trust Ltd* 1973 1 All ER 135 (CH) 140; *Ex parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W) 359; *Ex parte Kaplan NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W) 418 – 419; *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 411 – 412; *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd* 1988 1 SA 616 (D) 618 621 – 622. De la Rey *Skikkings* states at 32: "dat reëling geen presiese betekenis het nie, maar dat die Howe, binne sekere grense, maatskappye die grootste moontlike vryheid toelaat om skemas te ontwerp om by hul besondere omstandighede aan te pas. Hierdie skemas kan wissel van 'n eenvoudige akkoord of moratorium tot 'n samesmelting van verskeie maatskappye, met 'n volledige reorganisasie van hul aandele en leningskapitaal."

¹⁷¹ Williams "Companies, Part 3" 38.

¹⁷² Delport *et al Henochsberg on the Companies Act 71 of 2008 (2011)* s 311 "General note". Also see various cases relating to schemes of arrangements specifically concluded between a company and its creditors, such as the "standard scheme" (*Ex parte Kaplan NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W)); "partial cession scheme" (*Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405); and "preference share scheme" (*Sackstein NO v Boltstone (Free State) (Pty) Ltd (in liquidation)* 1988 2 All SA 463 (O)). A discussion of these types of scheme falls outside the scope of this thesis.

¹⁷³ In the case of a company being wound up, an application may be made to court by the liquidator, or if the company is subject to a judicial management order by a judicial manager in terms of s 311(1) of the 1973 Companies Act.

¹⁷⁴ Section 311(2)(a) and (b) of the 1973 Companies Act.

convening the meeting must be issued and either sent directly to the creditor or member, or be provided by way of advertisement.¹⁷⁵ Briefly, the notice summoning the meeting must be accompanied by a statement explaining the effect of the compromise or arrangement,¹⁷⁶ providing all relevant information material to the value of the shares or debentures concerned in the arrangement¹⁷⁷ – in particular any material interest of the directors of the company (as a director, member, or creditor of the company) and the impact of the compromise or arrangement on such interests in so far it differs from the effect on the like interests of other persons.¹⁷⁸

Section 313 of the 1973 Companies Act re-enacts section 103*bis* of the 1926 Companies Act.¹⁷⁹ If an application to the court is made in terms of section 311 to sanction a proposed compromise or arrangement, and the court is notified that the proposed compromise or arrangement is aimed at reconstruction¹⁸⁰ of a company¹⁸¹ or companies, or the amalgamation¹⁸² of any two or more companies, the court may sanction the compromise or arrangement or make certain orders regarding it.¹⁸³

¹⁷⁵ Section 312(1)(a) and (b), (3) of the 1973 Companies Act. Where the notice is given by way of advertisement, the advertisement must include a statement as mentioned in s 312(1)(a), or a notification but be provided in the advertisement of the place and time and way creditors or members entitled to attend such a meeting can obtain copies of the statement. Any non-compliance with this section by a company will render the company and every director or officer of the company who is party to the default, guilty of an offence (s 312(4)). Exclusion of such guilt may apply in certain instances. See s 312(4) for further details in this regard. This offence is punishable by way of fine or imprisonment (Delpont *et al Henochsberg* (2011) s 312(4)).

¹⁷⁶ Section 312(1)(a)(i) of the 1973 Companies Act.

¹⁷⁷ Section 312(1)(a)(ii) of the 1973 Companies Act.

¹⁷⁸ Section 312(1)(a)(iii) of the 1973 Companies Act.

¹⁷⁹ Delpont *et al Henochsberg* (2011) s 313 “General note”.

¹⁸⁰ The term “reconstruction” is not a legal term. A “reconstruction” is, for Pennycuik J in *Brooklands Selangor Holdings Ltd v IRC* 1970 2 All ER 76 86: “[T]he transfer of the undertaking or part of the undertaking of an existing company to a new company with substantially the same persons as members as were members of the old company.” Also see *Re SA Supply & Cold Storage Co; Wild v SA Supply & Cold Storage Co* 1904 2 Ch 268: “Where an undertaking is being carried on by a company, and is in substance preserved and transferred, not to an outsider, but to another company, consisting substantially of the same shareholders, with a view to its being continued by the transferee company, that is a reconstruction.” A “reconstruction” will exist where an undertaking is in substance transferred to another company that consists of substantially the same shareholders, with the intention that the transferred undertaking will be continued by the transferee company. See Delpont *et al Henochsberg* (2011) s 313.

¹⁸¹ Notwithstanding s 311(8) of the 1973 Companies Act, it must be a “company” in terms of s 1 of the 1973 Companies Act.

¹⁸² As discussed above, an amalgamation is the blending of two or more companies’ undertakings into one undertaking and each of these companies becomes the substantial shareholder in the blended undertaking. See Delpont *et al Henochsberg* (2011) s 313.

¹⁸³ Section 313(1) of the 1973 Companies Act.

2.2.2.1 Requirements for a scheme of arrangement in terms of the 1973 Companies Act

The primary requirement for the application of sections 311 – 313 was that there must be an “arrangement” in place. The term “arrangement” is wide¹⁸⁴ but must be applied within the context of the section as the arrangement must aim to impact on the rights and obligations of the company and its members.¹⁸⁵ In terms of section 311(8), the term “arrangement” includes a reorganisation of the company’s share capital by the consolidation of shares of different classes, the division of shares into shares of different classes, or both these methods. Effectively, an “arrangement” generally involves a rearrangement of members’ rights comprising of a share¹⁸⁶ in the company.¹⁸⁷

In *Ex parte NBSA*,¹⁸⁸ Coetzee DJP quoted from *Australian Company Law*,¹⁸⁹ stating that the term “arrangement” has been given an extensive and liberal meaning, and unless the arrangement is *ultra vires*,¹⁹⁰ almost any arrangement which concerns the rights and obligations of a company or its members will fall within the ambit of the term. This school of thought applies a very wide meaning to the term “arrangement” which would allow for most forms of agreement

¹⁸⁴ Trollop J in *Du Preez v Garber: In re Die Boerebank Bpk* 1963 1 SA 806 (W) para 813: “Gower on *Modern Company Law*, 2nd ed., pp 554-5, says that ‘arrangements’ covered by the section are of the widest character and... ‘the only limitations are that the scheme cannot authorize something contrary to the general law or wholly ultra vires the company and that if capital is to be reduced the formalities.’” In *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 406 the court states: “The word ‘arrangement’ in s311 of the Companies Act 61 of 1973 ... is something conceptually of the widest character, limited only by what is contrary to general law or ultra vires the company.”, while in *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) 786 it was stated that: “No dictionary, judge or textbook writer has succeeded in explaining it or defining it in less abstruse terms.”

¹⁸⁵ Delpont *et al Henochsberg* (2011) s 311. As seen in *Ex Parte Federale Nywerhede Bpk* 1975 1 SA 826, there will be no arrangement if there are no mutually enforceable rights between the parties. Also see Sher 1982 *SA Company LJ* 49 51.

¹⁸⁶ Coetzee DJP in *Ex parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W) para 359, stated that an expropriation of the shareholders’ rights does not constitute a “reorganisation or rearrangement of the rights of the shareholders but requires... a continued existence in a different form”.

¹⁸⁷ Brightman J *In re NFU Development Trust Ltd* 1973 1 All ER 135 140: “Confiscation is not my idea of an arrangement. A member whose rights are expropriated without any compensating advantage is not, in my view, having his rights rearranged in any legitimate sense of the expression.” Delpont highlights that the above case dealt with expropriation without compensation. Expropriation with compensation was not dealt with in the case and was not specifically excluded from constituting an “arrangement”. See Delpont 1994 *De Jure* 168.

¹⁸⁸ *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) 786 – 789.

¹⁸⁹ Paterson and Ednie *Australian company law* 2375.

¹⁹⁰ *Ultra vires*: “Acting beyond the powers of that person” Claassen *Dictionary of legal words and phrases* (2022).

concluded between a company and its members to constitute an “arrangement”.

However, for purposes of section 311 the scheme of arrangement must aim to affect the respective rights and obligations between a company and its members or its creditors.¹⁹¹ It is further suggested in *Henochsberg* that the use of a scheme of arrangement must be necessary, in the sense that the objective cannot be conveniently achieved by any other means – eg, by an independent arrangement or contract between the company and the affected parties.¹⁹² It is suggested by Cilliers and Benade *et al*¹⁹³ that the restriction that a section 311 arrangement may not be applied for any other purposes in the 1973 Companies Act (eg, for a take-over or merger), is not applied in very strictly in practice. This indicates that a wide application of the term “arrangement” is applied in practice as the scheme of arrangement method may be used by a company even if a different provision in the 1973 Companies Act is available. However, the conclusion of a scheme of arrangement must hold some advantage for the members or creditors concerned,¹⁹⁴ and a confiscation of the rights of members does not constitute an arrangement.¹⁹⁵

There has in the past been confusion regarding what qualifies as an “arrangement” and how wide an interpretation must be applied to the term in section 311. This can be illustrated by the judicial opinions voiced in various cases during the 1980s.¹⁹⁶ Delpont opines that a wide application of section 311 for purposes of schemes of arrangements is used to implement reconstructions

¹⁹¹ Delpont *et al Henochsberg* (2023) s 311.

¹⁹² *ibid* and *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T); *Ex parte Lomati Landgoed Beherende (Edms) Bpk* 1985 2 SA 517 (W) 521 – 524.

¹⁹³ Cilliers and Benade *Maatskappyereg* 319.

¹⁹⁴ *In re NFU Development Trust Ltd* 1973 1 All (ER) 135 140; Lehloenya 2007 SA Merc LJ 528; *In Ex parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W) and *Ex parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) the court held that for the schemes to qualify as an “arrangement”, members whose shares have been cancelled should receive a compensating advantage in the form of other rights (“give and take”), as opposed to a mere cash payment. This view was disregarded in *Ex parte Suiderland Development Corporation Ex Parte Kaap-Kunene Beleggings Bpk* (see n 168 above).

¹⁹⁵ *In Re NFU Development Trust Ltd* 1973 1 All ER 135 (CH) 140; *Ex Parte Federale Nywerhede Bpk* 1975 1 SA 826 235.

¹⁹⁶ *Ex parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W); *Ex parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W); *Ex parte Federale Nywerhede Bpk* 1975 1 SA 826 284 – 285; *Ex parte Suiderland Development Corporation Ex Parte Kaap-Kunene Beleggings Bpk* 1986 4 SA 442 (C); *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T); Lehloenya 2007 SA Merc LJ 528.

and take-overs, whilst other provisions in the 1973 Companies Act are available to execute these specific transactions, the confusion and uncertainties within the Act will unfortunately remain.¹⁹⁷

The second requirement is that the arrangement must take place between the company and its members. In *Henochsberg* it is advanced that a scheme must take place between a company and its members for it to qualify as an “arrangement”.¹⁹⁸

There are opposing views as to whether the scheme-of-arrangement method can be applied to take-overs in terms of which the members lose their rights in return solely for a payment for their shares on cancellation or acquisition of the shares under section 311.¹⁹⁹ In *Henochsberg*, read with *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T), it is stated that:

“[A]n expropriation (for cash) of the shares of one member by another member or the substitution of shares in one company for shares in another company cannot qualify as an arrangement as envisaged by the section as it is not between a company and its members”²⁰⁰ (emphasis added).

The majority judgment in *Ex parte NBSA Centre Ltd* was that normal mechanisms must be used to action a procedure,²⁰¹ so the court’s *obiter dictum* was that where there is an expropriation by way of a reduction in capital (a compulsory purchase by a company of its shares) it cannot be actioned solely as an “arrangement” in terms of section 311; the appropriate reduction of capital mechanisms must be followed.²⁰²

¹⁹⁷ Delpont 1994 *De Jure* 175.

¹⁹⁸ Delpont *et al Henochsberg on the Companies Act 61 of 1973* (2011) s 311.

¹⁹⁹ See n168 above; Delpont *et al ibid*; *Namex (Edms) Bpk v Kommissaris van Binnelandse Inkomste* 1994(2)SA 265 (A) 271; *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 412.

²⁰⁰ Delpont *et al ibid*.

²⁰¹ *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) headnote: “A scheme which is tantamount to a compulsory purchase of its shares by a company with the inevitable effect of a reduction of capital is illegal if done using the scheme of arrangement procedure. Proceedings for the reduction of capital have to be put into effect.” Also see *Ex Parte Cyrildene Heights (Pty) Ltd* 1966 1 SA 307 (W) 309E – F; *Ex parte Lomati Landgoed Beherende (Edms) Bpk* 1985 2 SA 517 (W) 524.

²⁰² *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) 46 – 47 50 – 52. Coetzee DJP pointed out that: “If the s311 procedure is to be employed at all, it can only be done in conjunction with the reduction [of capital] procedure and it cannot take the place of the latter.” Gordon AJ correctly points out that the question in this case, regarding expropriation, is whether there is an arrangement in place, not whether the second requirement (it must be between a company and its shareholders) has been met. See Delpont 1994 *De Jure* 172.

However, the full bench in *Ex parte NBSA Centre Ltd* was divided on the matter. In his minority judgment, Goldstone J pointed out that in *In re NFU Development Trust* Brightman J made no mention that a cash consideration in exchange for shares (an expropriation with compensation) would fall outside the ambit of an “arrangement”. In fact, he added that expropriation for fair compensation indeed constitutes the required “give and take”.²⁰³ Goldstone also asked whether:

“If some shareholders agree to their shares being expropriated by another shareholder, why should that not be an 'arrangement' within the ambit of s 311?”

In *Henochnsberg* reference is made to Goldstone’s question in the *Ex parte NBSA* case and that in principle such an expropriation is permissible provided it arises from an arrangement between a company and its members as required by section 311(1) of the 1973 Companies Act.²⁰⁴

The view that expropriation of shares between members is not an “arrangement” (as it is not between the company and its members) is indicative of the fact that in a take-over transaction where shareholders receive cash in exchange for their shares or receive shares in another company, this requirement of an “arrangement” cannot be met.²⁰⁵

Interestingly, Gower and Davies argue that the courts have construed “arrangement” very widely to cover virtually every type of legal transaction. Further, where it involves a reduction in capital (which it frequently does) the authors state that it can be sanctioned by a court without having to adhere to separate prescribed proceedings for the reduction of capital.²⁰⁶ However, they also point out that in a scheme of arrangement, the company must be a party

²⁰³ *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) 62(6).

²⁰⁴ Section 311(1) of the 1973 Companies Act requires that the arrangement take place between company and its creditors or any class of them or between a company and its members or any class of them; Delpont *et al Henochnsberg* (2011) s 311.

²⁰⁵ *Ex Parte Federale Nywerhede Bpk* 1975 1 All SA 228 (W) 232 – 233: “Daar is geen rede waarom n oornameaanbod nie by wyse van 'n reëling onder art. 103 vermag kon word nie, mits dit natuurlik inderdaad “'n skikking of reëling...tussen 'n maatskappy... en sy lede, of 'n klas van hulle...’ was”; “Artikel 311 is wesenlik 'n herverordering van art.103 van die vorige Wet wat vir baie dekades bestaan het.”

²⁰⁶ Davies, Worthington, Micheler *et al Gower and Davies' Principles* (2012) 29-3. Kindly note that this view expressed in the 9th (2012) edition of this work (that a reduction of capital can be sanctioned by the court without the need to adhere to the separate prescribed proceedings for the reduction of capital) is not included in the subsequent 10th (2016) and 11th (2021) editions.

to the transaction²⁰⁷ in line with the above view that the scheme must be *between* the company and its members.

Paterson and Ednie hold the view that in terms of section 181 of the Australian Companies Act 1961 (since repealed), where a scheme of arrangement involves a reduction of capital, the provisions governing the reduction of capital must be met.²⁰⁸

The 1966 English Chancery decision in *Re National Bank Ltd*²⁰⁹ regarding schemes of arrangement was influential in the findings of the Commission of Enquiry into the Companies Act (chaired by Mr Justice J Van Wyk de Vries and commonly referred to as “the Van Wyk de Vries Commission”).²¹⁰ The Van Wyk De Vries Commission was tasked “to consider what major amendments are required in the Law relating to the constitution, incorporation, registration, management, administration and winding-up companies and other associations and matters incidental thereto”.²¹¹ The Commission found in its 1972 Report that a scheme of arrangement (under section 103 of the 1926 Companies Act) is not being misused if it is used to effect compulsory acquisitions (effectively avoiding the requirements in section 103*ter* of the 1926 Companies Act).²¹² This opened the door for parties in South Africa to choose between using either a scheme of arrangement or the take-over provisions to effect a compulsory acquisition.²¹³

Noticeably, section 313 allows the court to make certain provisions relating to schemes of arrangement entered into for purposes of a reconstruction or an amalgamation. Even so, the Act does not cater for an amalgamation or merger in the true sense of the terms, so it effectively allows the court to make certain

²⁰⁷ Davies, Worthington, Micheler *et al* (2012) *Gower and Davies' principles* 29-3.

²⁰⁸ Paterson and Ednie *Australian company law* 431. In current Australian legislation, Part 5.1 of the Corporations Act 2001 governs arrangements.

²⁰⁹ *Re National Bank Ltd* 1966 1 WLR 819, 1966 1 All ER 1006 (ChD).

²¹⁰ Government Notice (Staatskennisgewing) 636 of 25 October 1963.

²¹¹ Government Notice 636 of 25 October 1963 <https://archive.gazettes.africa/archive/za/1963/za-government-gazette-dated-1963-10-25-no-636.pdf> (accessed 7 March 2023).

²¹² Commission of Enquiry into the Companies Act, Supplementary Report and Draft Bill, 18 February 1972, para 77.01.

²¹³ De Villiers 1973 90/4 SALJ 351.

provisions regarding the transfer between companies through an “amalgamation” and the resulting winding-up of the transferor company.

Once it is established that there is an arrangement between the company and its members, the scheme of arrangement process can commence. As mentioned above, this involves, first, an application to court for an order to convene a meeting to consider the proposed scheme of arrangement.²¹⁴

In terms of Section 311(2) of the 1973 Companies Act, the compromise or arrangement must be agreed to by a majority in number representing three quarters in value of the creditors or class of creditors, or a majority representing three quarters of the votes exercisable by the members or class of members must vote at the meeting. Ultimately, a minimum of 75 per cent of the creditors or members must agree to the compromise or arrangement and once it has been sanctioned by the court it will be binding on all members and creditors.²¹⁵

Once the majority vote has been secured, an *ex parte* application is made to court by the company or its members or creditors or any class of either, to sanction the scheme of arrangement. The court will consider the number of members or members of a class present or represented at the meeting for the vote in favour of the compromise or arrangement when deciding whether to sanction such compromise or arrangement.²¹⁶

The court will also consider the statement issued by the company regarding the effect of the compromise or arrangement as required by section 312. The section 312 statement must be considered by the court and before the court sanctions the arrangement or compromise it must be satisfied that the statement has sufficiently informed the members and/or creditors of the effect of the compromise or arrangement.²¹⁷

²¹⁴ Section 311(2) of the 1973 Companies Act. Also see *Verimark Holdings Limited v Brait Specialised Trustees (Pty) Limited* NO 2009 ZAGPJHC 45 regarding the sub-classes of shareholders that may be established to be present and vote on a scheme of arrangement. Note however that the case specifically dealt with a compromise.

²¹⁵ Section 311(2) of the 1973 Companies Act.

²¹⁶ Section 311(5) of the 1973 Companies Act.

²¹⁷ *Du Preez v Garber: In re Die Boerebank Bpk* 1963 1 SA 806 (W) 814 825 – 826; In *Delpont et al Henochsberg* (2011) it is argued that the proposed statement is not essential for the application for the calling of the meeting as the Act does not require it as this stage and court should proceed on the

In terms of a scheme of arrangement proposed for purposes of a reconstruction or an amalgamation which entails the transfer of the whole or any part of the undertaking or property from the transferor company to the transferee company, section 313 empowers the court to make certain additional orders.²¹⁸

2.2.2.2 Implementation and effect of the scheme of arrangement

An order by the court sanctioning the compromise or arrangement will not be effective or of force until a certified copy of the order has been lodged with the Registrar²¹⁹ and has been registered.²²⁰ Once registered the order is binding on the company and its members, including members who did not vote in favour of the scheme of arrangement or who did not attend the meeting.²²¹

It is possible for a court to sanction an arrangement which is subject to a suspensive condition.²²² In such a situation the obligations under the agreement are suspended until the fulfilment of the relevant conditions. Where the suspensive conditions are not met in terms of a scheme of arrangement or compromise that has been sanctioned by the court, the parties cannot withdraw from the contract until the compromise or arrangement has been set aside by the court.²²³ In *Henochsberg*, it is submitted that the court should not allow the meeting under section 311 to be convened if it is not satisfied that there is a probability that the conditions will be fulfilled by the time the *ex parte* application for the court's sanction of the scheme of arrangement comes before the court.²²⁴

2.2.3 Repealed take-over provisions

The take-over provisions in the 1973 Companies Act were governed in sections 314 to 321 of the Act. These sections set out the procedure for an ordinary take-over offer

assumption that the statement will be provided and that the statement may change dramatically by events succeeding the court application. Delpont *et al Henochsberg* (2011) s 312.

²¹⁸ Section 313(1)(a) – (f) of the 1973 Companies Act.

²¹⁹ “Registrar” means the Registrar of Companies appointed under s 7 of the 1973 Companies Act.

²²⁰ Section 311(6) of the 1973 Companies Act.

²²¹ Delpont *et al Henochsberg* (2011) s 311.

²²² Allan 1986 March *De Rebus* 103.

²²³ *ibid.*

²²⁴ Delpont *et al Henochsberg* (2011) s 311.

(ss 314 – 320), followed by a compulsory acquisition in terms of section 321 of the 1973 Companies Act.

The sections were introduced in the light of the recommendations of the Van Wyk de Vries Commission. The Commission concluded in its Supplementary Report that certain regulations regarding take-overs were necessary in the interest of the public as the current state of law was inadequate in providing the desired protection.²²⁵ The Report found that the offeree shareholders' interests required protection in a take-over or merger transaction and the necessary safeguard was the price offered for their shares.²²⁶

The Commission recommended that a broad framework of principles be introduced regarding the regulation of take-overs in terms of the Draft Companies Bill (the Bill preceding the 1973 Companies Act) to ensure the inclusion of adequate protection and safeguards.²²⁷ Based on these recommendations, sections 314 to 321 of the 1973 Companies Act were enacted.²²⁸

Ever since their introduction, the take-over provisions have been criticised by the courts. For example, in *Ex Parte Federale Nywerhede Bpk* 1975 1 SA 826, the court held that section 314 does not apply in that the proposed scheme involved an extinguishing of shares and not the acquisition of shares, as required under section 314. Section 314(1) defines a "take-over scheme" as:

"[A] scheme involving the making of an offer *for acquiring shares* of the offeree company which, together with any shares of that company already held by the offeror, would have the effect either: (a) of vesting the control of the offeree company directly or indirectly in the offeror; or (b) of the offeror acquiring all the shares (or all the shares of a particular class) of the offeree company" (emphasis added).

This oversight in section 314 significantly limited the application of the take-over procedure as a take-over can be executed in various ways (eg, reduction of capital or redeemable-preference-share method), but the section only provides for the take-over to be executed by way of acquisition of shares. Due to the limited application of section

²²⁵ Commission of Enquiry into the Companies Act, Supplementary Report and Draft Bill, 18 February 1972 para 71.04.

²²⁶ *ibid* para 71.08.

²²⁷ *ibid* para 75.02.

²²⁸ *ibid*.

314, it was easy for offerors to circumvent the take-over procedure and rather opt for the scheme of arrangement to effect the take-over.²²⁹

Sections 314 – 321 of the 1973 Companies Act were deleted by section 6 of Act 78 of 1989. There appears to have been various reasons for the repeal of the take-over provisions in 1989, but one of the main reasons appears to have been tax related.²³⁰ Stamp duty was initially levied under section 23(10) of the Stamp Duties Act 77 of 1968 on the transfer of shares, but not on the cancellation of shares,²³¹ a consideration which at the time made the scheme of arrangement more attractive than a take-over offer. This aspect of stamp duty was subsequently addressed in the Revenue Laws Amendment Act 87 of 1982²³² and thereafter schemes of arrangements were also subject to stamp duty.²³³

One can argue that section 103 read with section 20(1)(a)(ii) of the Income Tax Act also played a role in the repeal of the take-over sections. Without going into an in-depth discussion of the section in this Chapter, section 103 governs transactions, operations, or schemes for purposes of avoiding or postponing liability for or reducing amounts of tax on income. In other words, the section serves as an anti-avoidance provision regarding the abuse of assessed losses.²³⁴

Section 103(2) of the Income Tax Act, as it currently reads, sets three requirements:²³⁵

²²⁹ Oberholzer *Regulations of Mergers* 42.

²³⁰ Another significant reason is the so-called “squeeze-out-percentage” requirements. In terms of s 311 (scheme of arrangement) the majority required is 75 per cent of each class, as opposed to the 90 per cent required in terms of s 314 (take-over). In addition, this majority is determined on different bases in these two sections: with a scheme of arrangement, 75 per cent of those present and voting at the class meeting counts towards the majority, whilst for a take-over offer, 90 per cent of all members of a class is required. Also see Katz 1979 *Modern Business Law* 53 – 60.

²³¹ Stamp Duty Act 77 of 1968 as amended by s 20(1)(h) of the Revenue Laws Amendment Act 103 of 1969.

²³² The Stamp Duty Act was amended in terms of the Revenue Laws Amendment Act 87 of 1982 and scheme of arrangements in terms of s 311 was made subject to stamp duty. See section 23(10) and Item 15(4) of the Stamp Duty Act 77 of 1968.

²³³ See n 159 above for the effect of stamp duty on the demise of the take-over provisions.

²³⁴ An assessed loss is where admissible tax deductions exceed the income from which such deductions are admissible. In other words, the costs deducted exceed the related income, placing the taxpayer in a loss position as their taxable income is negative. The assessed loss can be rolled forward to future years and be utilized against future taxable income of that taxpayer (effectively reducing such future taxable income).

²³⁵ Section 103(2) of the Income Tax Act and *obiter dictum* by Trollip J in *ITC 1123* 1968 31 SATC 48 para 49. Section 103 as amended in terms of Act 101 Of 1978 set the following three requirements, where the Secretary was satisfied that any transaction, operation or scheme existed: (a) it was entered into to avoid or postpone the liability for the payment of any tax duty or levy that had been imposed by this Act or a previous Income Tax Act, (b) it was carried out in a manner not normally employed in a transaction, operation or scheme of that nature, or has created rights or obligations which are not

- 1) there must have been a change in shareholding;
- 2) which has resulted, either directly or indirectly, in the receipt or accrued of income to that company during the year of assessment; and
- 3) the change in shareholding was solely or mainly (more than 50 per cent) for purposes of using the company's assessed loss to avoid its tax liability or any other person's liability for tax on such income.

Section 20(1)(a) of the Income Tax Act²³⁶ provides that when determining the taxable income derived from a person carrying on a trade a set-off is permitted against that person's income. This set-off consists of any balance of assessed loss incurred by that person in a previous year which has been carried forward from the preceding year of assessment.²³⁷ That said, section 20(1)(a)(ii) as it then read placed a limitation on the carry forward of the balance of assessed losses in terms of a compromise between the company and its creditors. The balance of assessed losses is reduced by the amount or value of any benefit received by or accruing to the person where his or her liabilities have been reduced or extinguished. This limitation of the balance of assessed losses naturally reduces the attraction of the take-over.²³⁸

One way in which to limit the assessed loss is to avoid a compromise with creditors where a benefit accrues to the company, and rather come to an arrangement in terms of which the creditors cede their claims to an acquiring company (a third party) in exchange for the agreed reduced number of cents in the Rand.²³⁹ Given the sheer number of creditors, negotiations, and cession agreements to be concluded, it stands

normally created between persons dealing at arm's length and (c) it was entered into for the sole or main purpose of avoiding paying a tax liability (or duty or levy).

²³⁶ Provisions (i) and (ii) of s 20(1)(a) apply to companies, while provision (iii) is applicable to persons other than companies.

²³⁷ Section 20(1)(i) of the Income Tax Act 58 of 1962 requires that in order to carry forward an assessed loss the company must be carrying on a trade. However, in terms of s 20(1)(a)(ii) of the Income Tax Act (as it then read), a limitation was placed on carrying the balance of an assessed loss forward, in that the balance of the assessed loss was reduced by the amount or value of any benefit received by or accrued to a person resulting from a concession or a compromise made with his or her creditors, whereby his or her liabilities to them were reduced or extinguished, provided that the liabilities arose from the ordinary course of trade. As a result, for an assessed loss to be carried forward in the event of a compromise (s 311 of the 1973 Companies Act), the compromise had to have been between the company and its creditors and such compromise or concession's value would have had to be kept at a minimum to avoid eroding the assessed loss that may be carried forward. Various types of scheme in terms of s 311 aimed at avoiding the application of section 20(1)(a)(ii) have been developed. The assessed loss must then still pass the s 103(2) test of the Income Tax Act. See *Ex parte Kaplan and Others NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W) and *Maloka Assessed Loss* 5 – 10.

²³⁸ Jooste 1987 26 *Income Tax Reporter* 323 – 324.

²³⁹ *ibid* 324.

to reason that the solution would be to enter into a scheme of arrangement in terms of section 311 of the 1973 Companies Act.²⁴⁰ In terms of these “standard” schemes of arrangement, the company and its creditors must agree to a compromise (in order to qualify as a scheme of arrangement which is an arrangement between a company and its creditors) in terms of which the creditors forfeit one cent in the Rand of their claims. After this reduction, the creditor’s claims are transferred to a third-party acquiror at a specific price.²⁴¹

These “standard” schemes were rejected in *Ex Parte Kaplan NNO: In re Robin Consolidated Industries Ltd*²⁴² and *Ex parte Millman: In re Multi-bou (Pty) Ltd*.²⁴³ However, in *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd*²⁴⁴ the standard scheme was upheld, leaving the Supreme Court of Appeal divided on this matter, as pointed out by Jooste.²⁴⁵

However, even if a scheme can circumvent the application of section 20(1)(a)(i) of Income Tax Act, the section 103(2) test must still be met.

Take-overs can typically be tax driven if the acquisition is made for the main or sole purpose of setting-off the assessed loss of the acquired company against a taxable income.²⁴⁶

As an illustration of the application of section 103(2) of the Income Tax Act, brief reference is made to the case *ITC 1123 (1968)*²⁴⁷ where the taxpayer, a company, had acquired the majority shareholding in a non-trading company with a significant assessed loss. It was presented to the court that the taxpayer had acquired the majority of the shares in the company for the main purpose of using the company’s assessed loss to set-off against the company’s own future taxable income. The court held that the Commissioner had been correct to disallow the set-off of the taxpayer’s

²⁴⁰ *ibid* 324 – 325.

²⁴¹ *Ex parte Kaplan and Others NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W) 423; Jooste *ibid*.

²⁴² *Ex parte Kaplan and Others NNO: In re Robin Consolidated Industries Ltd* 1987 3 SA 413 (W).

²⁴³ *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405.

²⁴⁴ *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd* 1988 1 SA 616 (D).

²⁴⁵ Jooste 1988 7/17 *Businessman's Law* 200. Also see Jooste 1989 28/7 *Income Tax Reporter* 325.

²⁴⁶ Getz and Jooste 1995 *Acta Juridica* 56.

²⁴⁷ *ITC 1123* 1968 31 SATC 48.

income against the assessed loss²⁴⁸ as all the requirements of section 103(2) had been met.²⁴⁹

2.2.4 Continuous preference for scheme of arrangement over the years preceding the enactment of the Companies Act

Even though the take-over sections in the 1973 Companies Act were still in effect, take-overs or mergers were almost exclusively effected on the basis of the scheme of arrangement method under section 311.²⁵⁰ A take-over in terms of section 311 was effected by casting it in the form of a reorganisation of the authorised and issued share capital where the purchaser steps into the shoes of the existing shareholders.²⁵¹

To execute this reorganisation under section 311, a scheme of arrangement must be concluded between the company and its shareholders whose shares will be impacted by the scheme. The scheme generally states that the issued share capital not already owned (directly or indirectly) by the offeror, will be cancelled by way of a capital reduction. The profit arising from the cancellation of the shares is credited to a special capital reserve account and once the court has sanctioned the scheme of arrangement the offeror pays the consideration to the former shareholders of the target company. The result is that the offeror becomes the new holder of the issued shares in the target company.²⁵²

Ex Parte Federale Nywerhede Bpk 1975 1 SA 826 is often cited when addressing whether section 311 can be used to effect a take-over in preference to the repealed take-over sections. Delpont argues that the repealed take-over provisions related to the acquisition of shares, while the process considered in *Ex parte Federale Nywerhede Bpk* related to shares being extinguished (a reduction in capital). On this

²⁴⁸ Section 20 of the Income Tax Act 58 of 1962 governs the set-off of assessed losses. Section 20(2) defines an “assessed loss” as any amount by which the deductions admissible under s 11 (general deductions) exceed the income in respect of which they are so admissible. In other words, the deductible expenditure exceeds the income connected to the deductions and this puts the company in an assessed loss position.

²⁴⁹ Also see *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 4 SA 715 (A) 727H – 728A where the court indicated that s 103 is directed at addressing tax avoidance schemes and also see *Conshu (Pty) Ltd v Commissioner for Inland Revenue* 1994 4 SA 603 (A).

²⁵⁰ Cilliers and Benade *et al Maatskappyereg* 342.

²⁵¹ *ibid.*

²⁵² *ibid.*

reasoning the two procedures cannot be said to act as alternatives for effecting take-overs.²⁵³

Yet, despite criticism, a take-over or merger can be executed by way of a section 311 scheme of arrangement.²⁵⁴ Delpont asks for what reasons are reconstructions, or even take-overs, implemented by way of and in conjunction with a scheme of arrangement in terms of section 311 of the 1973 Companies Act if the relevant mechanisms for these types of transactions exist?²⁵⁵

In *Ex parte NBSA Centre Ltd* the court concluded that where there are normal mechanisms in place to reach an agreement, a scheme of “arrangement” will not apply.²⁵⁶ So why does a preference for actioning a take-over by way of a scheme of arrangement persist? There appears to have been a strong tax consideration where the scheme involved a compromise (where the agreement is concluded between a company and its creditors) in terms of section 20(1)(a)(ii) read with section 103(2) of the Income Tax Act,²⁵⁷ and the cost of stamp duty (which is no longer a consideration as pointed out above).

Given the limited application of section 314 based on its wording (limited to the acquisition of shares), and the wide phrasing of “arrangement” in section 311, it is understandable that there were so many court decisions relating to whether or not various types of transaction (like take-overs) would qualify as arrangements to allow the use of section 311 to conclude the transaction.

In 1973, De Villiers²⁵⁸ explored the various advantages of a scheme of arrangement offer as opposed to a take-over offer.²⁵⁹ These included:

²⁵³ Delpont 1994 27/1 *De Jure* 174.

²⁵⁴ Cilliers and Benade *et al Maatskappyereg* 454 at 25.12 and 465 at 25.33; Boardman 2010 *Acta Juridica* 314.

²⁵⁵ Delpont 1994 27/1 *De Jure* 175 suggests that various reasons are advanced for this, such as tax considerations and better protection of minority shareholders.

²⁵⁶ Coetzee DJP refers to the *ratio decidendi* of Younger J in *In re Guardian Assurance Company* 1917 1 Ch 431 441, who opined that a so-called “arrangement” cannot constitute an “arrangement” if it can only be effected in a prescribed way, eg, a reduction in capital. If it is a reduction in capital the appropriate statutory procedure must be followed as it falls “outside” the ambit of an arrangement. An arrangement can, therefore, not substitute the statutorily prescribed process, but the latter can be implemented by the former. Coetzee J in *Ex parte Federale Nywerhede Bpk* (1975) mentioned that he found it odd that the take-over provisions could be so easily circumvented (by using s 311) but opined that if there was a need to remedy such a circumvention it lies in the hands of the Legislature.

²⁵⁷ See the discussion of ss 20(1)(a)(ii) and 103(2) of the Income Tax Act 58 of 1962.

²⁵⁸ De Villiers 1973 90/4 *SALJ* 352.

²⁵⁹ Section 103*ter* of the Companies Act 46 of 1926.

- a) The shorter time required for a take-over by way of a scheme of arrangement as opposed to the time attached to a take-over offer followed by a compulsory acquisition.²⁶⁰
- b) The certainty a scheme of arrangement offers. The company and members can never be bound to a partially implemented scheme, as the scheme must be approved by the majority at the meeting and only becomes binding once sanctioned by the court.
- c) Savings on stamp duty. The cancellation of stock pursuant to a scheme-of- arrangement-related take-over is not deemed to be a disposal of shares in terms of section 23(10) of the Stamp Duties Act 77 of 1968, while a take-over offer would attract stamp duty on the transfer of the shares in the offeree company²⁶¹. This has since been amended in 1989 and stamp duty is effectively from then onward payable on schemes of arrangement executed in terms of section 311.
- d) There is a lower majority requirement for the approval of a schemes of arrangement (75 per cent) as opposed to that required for take-over offers (90 per cent).

Katz adds to (d) above by pointing out that not only is a lower majority required for a scheme of arrangement, but also that it is a majority of a different base.²⁶² The 75 per cent required for a scheme of arrangement is of those “present and voting” at the class meeting, while a take-over offer requires the majority of 90 per cent of all members of the class.²⁶³

De Villiers also considers the regulations set for take-over offers in the 1973 Companies Act. He highlights an important consideration: the take-over procedure in the 1973 Companies Act is fraught with uncertainty and onerous provisions, and where there is uncertainty regarding a procedure it could lead to its circumvention by making use of an alternative procedure which offers greater certainty.²⁶⁴ De Villiers’s study concludes that, unfortunately, different procedures and safeguards exist for the same

²⁶⁰ Interestingly, Macgregor’s research found that a scheme of arrangement takes much longer than proposed by De Villiers as the 3 month period is rarely achieved.

²⁶¹ The Stamp Duty Act was amended by the Revenue Laws Amendment Act 87 of 1982 and a scheme of arrangements in terms of s 311 was made subject to stamp duty.

²⁶² Katz 1979 *Modern Business Law* 53 – 60.

²⁶³ Section 311(2)(b) of the 1973 Companies Act and s 314(2)(a) read with s 321(1) of the 1973 Companies Act.

²⁶⁴ De Villiers 1973 90/4 *SALJ* 357 and 367.

take-over transaction to be executed – ie, by way of a take-over offer or by way of a scheme of arrangement.²⁶⁵ Where the procedures and safeguards differ based on the mechanism used but the same transaction is implemented, a discrepancy arises and it comes as no surprise that the offerors will choose the path of least resistance. This could impact negatively on the offeree shareholders.²⁶⁶ Macgregor agrees with De Villiers that the choice of the take-over procedure lies with the offeror, who will be inclined to choose the procedure that best suits its own interests and which is less onerous than those that best suit the interests of the shareholders of the offeree company.²⁶⁷

This preference for schemes of arrangement can be traced back even further to section 103 of the 1926 Companies Act in terms of which offerors often chose to effect take-overs by way of an offer in a scheme of arrangement between the offeree company and its shareholders.²⁶⁸

Considering international merger legislation, this phenomenon is not exclusive to South Africa. Gower and Davies state that in the UK it is popular to use a scheme of arrangement to effect a take-over or merger (as opposed to using a take-over offer), further indicating that the scheme method is an increasingly popular mechanism in the UK.²⁶⁹

Given these differences between the safeguards and principles of the two transfer methods there is a clear discrepancy in that the objective of protecting the shareholders in a take-over offer is not served as offerors merely opt for the scheme of arrangement method to effect a take-over which fails to offer the same level of shareholder protection.

²⁶⁵ *ibid* 367. For example, the test for fairness is applied for a scheme of arrangement which is not as effective for addressing inconspicuous schemes, whilst the take-over offer applies a substantial objective safeguard in that section 321 requires in respect of squeeze-outs that the offer be accepted by 90 per cent of the offeree shareholders.

²⁶⁶ De Villiers *ibid*.

²⁶⁷ Macgregor 1978 95/3 *SALJ* 330; De Villiers *ibid* 366 – 367. Also see Katz 1979 *Modern Business Law* 53 – 60.

²⁶⁸ De Villiers *ibid* 351.

²⁶⁹ Davies, Worthington, Micheler *et al* *Gower and Davies' principles (2021)* 29-3. The City Code on Takeovers and Mergers had originally not referred to schemes of arrangement, however, due to the increased use of schemes to effect takeovers, it was recognised that specific regulations must be adopted. Appendix 7 (schemes of arrangement) was included in the City Code in 2007.

As a result of the 1989 repeal of the take-over sections in the 1973 Companies Act, the scheme-of-arrangement method remained one of the chief methods by which to effect take-overs and amalgamations until the 1973 Companies Act was repealed in 2011 by the enactment of the Companies Act 71 of 2008.

2.3 The Introduction of fundamental transactions, take-overs, and offers in the Companies Act

2.3.1 Introduction

The current Companies Act came into effect from 1 May 2011 and effectively repealed the 1973 Companies Act.²⁷⁰ The Companies Act governs what is collectively termed “fundamental transactions” in its Chapter 5. It hosts the longstanding transfer mechanisms that were seen in the 1973 Companies Act, such as the disposal of all or the greater part of the company’s undertaking or assets (s 112) and schemes of arrangement (s 114). Nevertheless, the schemes of arrangement procedure changed substantially from that applied under the 1973 Companies Act.²⁷¹ Significantly, the Companies Act also introduced a new process that had not appeared in any of the previous Companies Acts: a merger or amalgamation process (s 113) in the true sense of the terms, that allows for the “fusion” of two or more companies.²⁷²

The South African Department of Trade and Industry and Competition (formerly the DTI and hereafter referred to as the DTIC²⁷³) issued “Guidelines for corporate law reform in South Africa” in May 2004.²⁷⁴ In the foreword, the Minister of Trade and Industry, Mandisi Mpahlwa,²⁷⁵ states that the decision to review and modernise company law in South Africa was based on the need to bring South African law in line

²⁷⁰ *Government Gazette* 34239 of 26 April 2011. However, Chapter 14 of the 1973 Companies Act remains in force despite the repeal of the 1973 Companies Act. It applies to the winding-up and liquidations under the Companies Act subject to subitems (2) and (3) of the 5th Schedule to the Companies Act, until such time that the Minister announces a date for the Chapter to cease to have effect by notice in the *Government Gazette*.

²⁷¹ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 340. For example, the process is no longer subject to court sanctions.

²⁷² *ibid.*

²⁷³ Department of Trade, Industry and Competition.

²⁷⁴ The Department of Trade and Industry “South African Company Law for the 21st Century: Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004.

²⁷⁵ Mr Mpahlwa was the Minister of Trade and Industry of South Africa from 29 April 2004 until 10 May 2009 <https://www.gov.za/about-government/contact-directory/mandisi-bongani-mabuto-mpahlwa-mr-0> (assessed 16 April 2022).

with international trends and to address the changing business environment, both locally and globally.²⁷⁶ The previous Companies Acts were very much cast in the mould of English law and the design of the Companies Act aimed to be appropriate for the South African legal, economic, and social contexts.²⁷⁷

A key aim of the Companies Act is “to facilitate the creation of business combinations ...provide flexibility and enhance efficiency in the economy”.²⁷⁸ This is evident from the significant changes to existing M&A procedures and the introduction of a new merger mechanism which brings South Africa in line with countries such as the USA, Canada, and New Zealand as regards statutory merger provisions.²⁷⁹ Take-overs and fundamental transactions are viewed as benefitting corporate proficiency, the economy, and the creation of wealth. Creating flexibility for companies in South Africa to restructure their businesses will advance economic growth.²⁸⁰

The 1973 Companies Act contained no specific merger mechanism that could combine companies through absorption of one company into another.²⁸¹ There was, in other words, no mechanism in the 1973 Companies Act to execute a true merger which requires some form of absorption. It only provided mechanisms for the transfer of control or transfer of assets by one company to another company – eg, by way of a scheme of arrangement,²⁸² a take-over,²⁸³ or the disposal of all or a greater part of a company’s assets.²⁸⁴

The Companies Act introduced a new corporate-combination method in the form of a statutory merger in its section 113. In terms of this section, two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company satisfies the solvency and liquidity test.²⁸⁵ The requirements for a statutory

²⁷⁶ Department of Trade and Industry “South African Company Law for the 21st Century Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004 4.

²⁷⁷ *ibid* 8.

²⁷⁸ “Memorandum on the Objects of the Companies Bill, 2008” paras 1.2.3(d) and 9.

²⁷⁹ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 77.

²⁸⁰ Department of Trade and Industry “South African Company Law for the 21st Century: Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004 43; Cassim MF 2008 *Juta’s Business Law* 40.

²⁸¹ Department of Trade and Industry *ibid* 43.

²⁸² *ibid*; ss 311 and 313 of the 1973 Companies Act.

²⁸³ Sections 314 – 321 of the 1973 Companies Act which had been repealed.

²⁸⁴ Section 228 of the 1973 Companies Act.

²⁸⁵ Sections 113(1) and 113(2)(d) of the Companies Act 71 of 2008.

merger under the Companies Act are discussed in further detail below, but in broad terms a merger agreement is concluded in writing by the parties to the merger and is supported by a special resolution of the shareholders of the merging companies.²⁸⁶

The consideration in a typical merger (referred to as a pooling-type merger) is to issue the shareholders of the merging or target company with shares in the acquiring or surviving company.²⁸⁷ The wording in section 113 regarding the consideration in a merger transaction is, however, very broad and the consideration can take the form of cash or even securities of another juristic person.²⁸⁸ This means, for example, that a holding company can issue shares to a company amalgamating or merging with its subsidiary.²⁸⁹

It should be noted that the merger process in the Companies Act is generally not subject to court approval. Dissenting shareholders who are against the merger can opt out by making use of their appraisal rights.²⁹⁰

The implementation of the merger is governed by section 116 of the Companies Act. Once a merger is complete all the assets and liabilities of the merging companies are transferred to the merged companies by operation of law.²⁹¹

Section 114 of the Companies Act contains the new regulations for schemes of arrangement between a company and its shareholders. Interestingly, given all the past disputes on the matter, the Companies Act does not define the terms “arrangement” or “compromise” in sections 114 or 115²⁹² but it is submitted that the previous case law regarding these terms remains relevant.²⁹³

In terms of section 114, the board of a company may propose and implement any arrangement between the company and holders of any class of its securities. These

²⁸⁶ Cassim MF 2008 *Juta's Business Law* 40; ss 113 and 115(2) of the Companies Act.

²⁸⁷ Cassim F *et al Business structures* 394.

²⁸⁸ Section 113(2)(c) and (d) of the Companies Act; Delpont *et al Henochsberg (2023)* s 113.

²⁸⁹ In the form of a triangular merger, see paragraph 1.2.5; Delpont *et al* *ibid*.

²⁹⁰ Section 164 of the Companies Act provides that the dissenting shareholders who object to the special resolution can withdraw the fair value of their shares in cash by exercising their appraisal rights; Cassim MF 2008 *Juta's Business Law* 40.

²⁹¹ Section 116(7) of the Companies Act; Magubane 2010 *De Rebus*; s 116(7) of the Companies Act.

²⁹² Delpont *et al Henochsberg (2023)* s 114. Cassim MF 2008 *Juta's Business Law* 40; Davids, Norwitz, and Yuill 2010 *Acta Juridica* 337 343: [O]f particular importance in this regard is the fact that there is only recourse to the courts in limited circumstances, thus ensuring that the procedure is considerably quicker and possibly less expensive than would ordinarily be the case with a court driven process.”

²⁹³ Delpont *et al Henochsberg (2023)* s 114.

arrangements include, amongst others, an expropriation of securities from the holders,²⁹⁴ exchanging any of its securities for other securities, or a reacquisition by the company of its securities.²⁹⁵ The section further requires that a report on the proposed arrangement by an independent expert be provided to the board setting out the minimum requirements for the report listed in section 114(3).²⁹⁶ Section 114 does not require compliance with a solvency and liquidity test as found in section 113 of the Companies Act.

Section 112, another fundamental transaction under Chapter 5 of the Companies Act, governs where there is a disposal of all or the greater part of a company's assets or undertaking. This is touched upon, but the main focus of the study remains merger or amalgamation transactions and schemes of arrangement.²⁹⁷

The fundamental transactions governed by Chapter 5 of the Companies Act (ss 112, 113, and 114 specifically) are subject to the procedure prescribed in section 115. Section 115 of the Companies Act contains the requirements for the approval of these "fundamental transactions" as they are collectively referred to in the Companies Act.

²⁹⁴ This is an interesting addition to the schemes of arrangement, as under s 311 of the 1973 Companies Act the court held in both *Ex parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W) and *Ex Parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) that expropriation or compulsory purchase is not an "arrangement" as there had to be a compensating advantage in the form of other rights and not merely a cash payment in order to qualify as an "arrangement". (See discussion under para 0 above, specifically n 168). However, in 1987 a full bench in *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) held that a specific distinction was made between a confiscation of shares (which is equal to an expropriation without a compensating advantage) and an expropriation of shares. In *Ex parte Federale Nywerhede Bpk* 1975 1 SA 826, 831 Coetzee J refers to the *obiter dictum* of Lord Brightman in *In Re NFU Development Trust Ltd* 1973 1 All ER 135 (CH), where the judge pointed out that confiscation, and similarly an expropriation without any compensatory advantage, would not meet the "give and take" requirement to enable meetings to be authorised for the consideration of a scheme of arrangement. Goldstone further indicated that: "Expropriation for fair compensation is indeed a case of 'give and take'" and should therefore qualify as a scheme of arrangement. In *Henochoberg* it is submitted that if an expropriation is effected in terms of s 114, nothing prevents the compensating advantage from being in the form of cash, provided that the expropriation for cash is done by the company and for and on behalf of the company, otherwise it would not qualify as an arrangement between the company and its shareholders. See also Delpont *et al Henochoberg* (2023) s 114. Currently, expropriation is specifically included in s 114 of the Companies Act.

²⁹⁵ Section 114(1) of the Companies Act.

²⁹⁶ Section 114(2) and (3) of the Companies Act.

²⁹⁷ See discussion in para 2.6.

2.3.2 Definitions

The following definitions relevant to this study are found in section 1 of the Companies Act:

- **“amalgamation or merger”** See Ch 1 para 1.5.1 above for the definition.
- **“amalgamated or merged company”** “means a company that either—
 - a) was incorporated pursuant to an amalgamation or merger agreement; or
 - b) was an amalgamating or merging company and continued in existence after the implementation of the amalgamation or merger agreement, and
 - c) holds any part of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.”
- **“amalgamating or merging company”** “means a company that is a party to an amalgamation or merger agreement.”
- **“all or the greater part of the assets or undertaking”**, means:
 - “when used in respect of a company, means:
 - (a) in the case of the company’s assets, more than 50 per cent of its gross assets at fair market value, irrespective of its liabilities; or
 - (b) in the case of the company’s undertaking, more than 50 per cent per cent of the value of its entire undertaking, at fair market value;”
- **“special resolution”** “means:
 - (a) in the case of a company, a resolution adopted with the support of at least 75 per cent of the voting rights exercised on the resolution, or a different percentage as contemplated in section 65 (10):
 - (i) at a shareholders meeting; or
 - (ii) by holders of the company’s securities acting other than at a meeting, as contemplated in section 60.
 - (b) in the case of any other juristic person, a decision by the owner or owners of that person, or by another authorised person, that requires the highest level of support in order to be adopted in terms of the relevant law under which that juristic person was incorporated.”

2.4 Statutory mergers and amalgamations in terms of section 113 of the Companies Act

As is evident from the different forms of consideration permitted under a merger transaction, the Companies Act does not only allow for a typical pooling-type merger.²⁹⁸

Yet, if any shares of one merging company are held by another merging company, the merger agreement must provide for such shares to be cancelled and they may not be converted into shares of the surviving merged company.²⁹⁹ This is to avoid an indirect reduction in the capital by way of the merged company holding shares in itself.³⁰⁰

When choosing a merger structure there are various considerations which must be taken into account – eg, the tax consequences arising from the type of consideration.³⁰¹

A brief explanation of the various popular types of merger structure can be found in Chapter 1 above.

2.4.1 Requirements for a merger or amalgamation in terms of the Companies Act

2.4.1.1 Written merger or amalgamation agreement

The first requirement is that the parties to the merger must conclude a written merger agreement.³⁰² This agreement must contain the terms and manner in which the merger will be effected and must set out the following:³⁰³

- a) the proposed Memorandum of Incorporation of any new company to be formed by the amalgamation or merger;
- b) the name and identity number of each proposed director of any proposed amalgamated or merged company;

²⁹⁸ Section 113(2)(e) of the Companies Act; Cassim MF (*Part 1*) 2008 SA Merc LJ 25.

²⁹⁹ Section 113(3) of the Companies Act; Cassim MF *ibid*; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 349.

³⁰⁰ Cassim MF *ibid*.

³⁰¹ *ibid*.

³⁰² Section 113(2) of the Companies Act.

³⁰³ Section 113(2)(a) – (h) of the Companies Act.

- c) how the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property;
- d) if any securities of any of the amalgamating or merging companies are not to be converted into securities of any proposed amalgamated or merged company, the consideration³⁰⁴ that the holders of those securities are to receive in addition to or in the place of securities of any proposed amalgamated or merged company;
- e) how payment of any consideration *in lieu* of the issue of fractional securities in an amalgamated or merged company or in any other juristic person the securities of which are to be received in the amalgamation or merger;
- f) details of the proposed allocation of the assets and liabilities of the amalgamating or merging companies among the companies that will be formed or continue to exist once the amalgamation or merger agreement has been implemented;
- g) details of any arrangement or strategy necessary to complete the amalgamation or merger, and to provide for the subsequent management and operation of the proposed amalgamated or merged company or companies; and
- h) the estimated cost of the proposed amalgamation or merger.

2.4.1.2 *Solvency and liquidity test*

The second step is that the board of directors of each merging company must reasonably believe that the proposed merged company(ies) will satisfy the solvency and liquidity test once the merger agreement is implemented.³⁰⁵

³⁰⁴ Section 1 of the Companies Act defines “consideration” as:
“anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including—

- (a) any money, property, negotiable instrument, securities, investment credit facility, token or ticket;
- (b) any labour, barter or similar exchange of one thing for another; or
- (c) any other thing, undertaking, promise, agreement or assurance, irrespective of its apparent or intrinsic value, or whether it is transferred directly or indirectly”.

³⁰⁵ Section 113(4) of the Companies Act.

Section 4 of the Companies Act provides that, for purposes of the Companies Act, a company satisfies the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company at that time:

- (a) “the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and
- (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of—
 - (i) 12 months after the date on which the test is considered; or
 - (ii) in the case of a distribution contemplated in paragraph (a) of the definition of “distribution” in section 1, 12 months following that distribution.”

When applying the solvency and liquidity test consideration is given to the financial records of the company based on its accounting records and financial statements.³⁰⁶

If the board of directors reasonably believes that the solvency and liquidity test has been met, it may submit the merger agreement for approval by the shareholders of the merging companies.³⁰⁷

2.4.1.3 *Notice to shareholders*

The shareholders of the merging companies must be notified of the meeting which must include a copy or summary of the merger agreement, the approvals required for the transaction (in terms of s 115), as well as the appraisal rights of the shareholders in terms of section 164 of the Companies Act.³⁰⁸

2.4.1.4 *Regulatory approvals*

The third step requires the merger to be approved by the shareholders at the relevant meeting.³⁰⁹ In terms of the merger procedure each constituent merging company must adopt a special resolution to support the merger.³¹⁰

The quorum for the meeting is constituted by the number of persons that can, in aggregate, exercise at least 25 per cent of all the voting rights of persons

³⁰⁶ Section 4(2)(a) of the Companies Act.

³⁰⁷ Section 113(4)(b) of the Companies Act.

³⁰⁸ Section 113(5) of the Companies Act; Cassim F *et al Business structures* 386.

³⁰⁹ Section 115(2) of the Companies Act; Cassim F *et al* *ibid*.

³¹⁰ Section 113(4)(b) of the Companies Act read with s 115(2) of the Companies Act.

authorise to vote on the matter.³¹¹ The merger must be approved by the shareholders by special resolution, meaning that it must be approved by at least 75 per cent of the voting rights cast on the resolution.³¹²

Section 311(2)(b) of the 1973 Companies Act provided that, in regard to the voting requirements for an arrangement, 75 per cent of the votes exercisable by the members or class of members were required, but these members had to be present and voting in person or by proxy.³¹³ The wording in section 311(2)(b) meant that no numerical majority of members present (quorum) was required. This means that an arrangement could be established by agreement based on a single member who held the required three-fourths of the exercisable votes.³¹⁴ This wording could easily lead to an oppression of minority shareholders, and the sanction by the court served as the only “gatekeeping” measure by which court could refuse to sanction such an agreement.³¹⁵

This scenario is now addressed in section 115 of the Companies Act which requires that a proposed transaction be adopted by way of a special resolution by persons entitled to exercise voting rights on such a matter, and requires that sufficient persons must be present to exercise their voting rights.³¹⁶ Both the quorum and the shareholder approval are based on voting rights and not on the number of shareholders or number of shares held.³¹⁷

³¹¹ Section 115(2) of the Companies Act; Cassim F *et al Business structures* 386.

³¹² Section 1 definition of “special resolution” in the Companies Act.

³¹³ Section 311(2)(b) of the 1973 Companies Act.

³¹⁴ Delpont *et al Henochsberg (2011)* s 311; De la Rey *Skikkings* 375 – 376.

³¹⁵ Delpont *ibid*: “A majority in number representing three-fourths in value of the creditors or class of creditors present and voting; a majority representing three-fourths of the votes exercisable by the members or class of members present and voting.”

³¹⁶ Section 115(2)(a) of the Companies Act 71 of 2008. *Verimark Holdings Limited v Brait Specialised Trustees (Pty) Limited* NO 2009 ZAGPJHC 45 serves as authority for the creation of sub-classes of only the shareholders affected by the scheme being in the meeting and voting. It is, however, noteworthy that *Verimark* dealt with a compromise, not an arrangement. In *Henochsberg* it is submitted that although s 115 does not expressly provide for class meetings of shareholders (as seen in s 311(2) of the 1973 Companies Act), the wording appears to indicate a subdivision into classes in respect of meetings and special resolutions at those meetings. Also see *Sand Grove Opportunities Master Fund and Others v Distell Group Holdings Ltd and Others* 2022 2 All SA 855 (WCC) regarding who may vote at a company meeting on the special resolution proposing a scheme of arrangement.

³¹⁷ Cassim F *et al Business structures* 386.

In the recent case of *Sand Grove Opportunities Master Fund v Distell Group Holdings Ltd*,³¹⁸ the court had to consider whether separate company meetings are required for holders of different classes of shares in order to vote on a proposed scheme of arrangement under section 114 of the Companies Act.³¹⁹ The court held that despite shareholders holding different classes of share in terms of section 37 of the Companies Act (ie, holding different interests), shareholders may be regarded as falling within a single class for purposes of voting on a special resolution for a scheme of arrangement under section 114 (based on their rights held being similar).³²⁰ This is based on the principle set in *Sovereign Life Assurance Co v Dodd*³²¹ that: “their rights are not so dissimilar as to make it impossible for them to consult together with a view of their common interests”.³²² To establish whether or not the rights are dissimilar, one asks what is being offered and to whom in terms of the proposed scheme of arrangement.³²³ It should be noted that in *Henochsberg* it is pointed out that the class of rights for creditors in a compromise and for shareholders in an arrangement, differ.³²⁴ *Sand Grove Opportunities Master Fund v Distell Group Holdings Ltd* was in respect of an arrangement between the company and shareholders, but the *ratio decidendi* was based on *Sovereign Life Assurance Co v Dodd*, which concerned creditors and it is therefore doubtful whether cases in respect of creditors would serve as authority as regards shareholders.³²⁵

³¹⁸ *Sand Grove Opportunities Master Fund and Others v Distell Group Holdings Ltd and Others* 2022 2 All SA 855 (WCC).

³¹⁹ *ibid* paras 68 – 91.

³²⁰ Delpont *et al Henochsberg* (2023) s 114.

³²¹ *Sovereign Life Assurance Co v Dodd* 1892 2 QB 573; *Verimark Holdings Limited v Brait Specialised Trustees (Pty) Limited* NO 2009 ZAGPJHC 45 para 10.

³²² Also see commentary in this regard in Delpont *et al Henochsberg* (2023) s 114. *Sand Grove Opportunities Master Fund and Others v Distell Group Holdings Ltd and Others* 2022 2 All SA 855 (WCC) para 74: “The idea that the shareholders’ rights should be sufficiently similar as to make it feasible for them to consult together did not imply that it had to also be apparent that they would agree with each other on whether or not to approve the scheme.”

³²³ *Sand Grove Opportunities Master Fund and Others v Distell Group Holdings Ltd and Others* 2022 2 All SA 855 (WCC) para 72. In *Henochsberg* (2023) it is indicated in the commentary of s 115 that: “To require a special resolution of all the classes of holders of securities, i.e., of the company as in terms of s 65, in respect of the arrangement in respect of a particular class would not be logical and lead to ... ‘insensible and unbusinesslike results...’ ”.

³²⁴ Delpont *et al Henochsberg* (2023) s 114.

³²⁵ *ibid*.

Noticeably, section 115(4) provides that, under certain circumstances, any voting right controlled by an acquiring party, a person related to the acquiring party, or a person acting in concert with either of those parties, must be disregarded in calculating the percentage of voting rights. The circumstances under which these voting rights must be disregarded are where the percentage of voting rights requires the parties to be present, or actually present in determining whether the quorum requirements have been met, or where the percentage of required voting rights is calculated for a vote in support of a resolution, or actually voted in support of the resolution.³²⁶ Cassim *et al* argue that this prevents a conflict of interest where the party is simultaneously both the acquiring company and a shareholder in the target company and they welcome this provision in section 115(4).³²⁷ This subsection, however, excludes the possibility of implementing triangular mergers, reverse-triangular mergers, or even short-form mergers in terms of the Companies Act. This is discussed in further detail as a potential issue raised by the statutory merger in paragraph 2.7.2.1 below.

2.4.1.5 Notice to creditors

Once the resolution to merge has been approved in terms of section 115, each of the companies must notify every known creditor of the company of the merger in the proposed manner and form.³²⁸ Section 116 provides that within 15 business days after the delivery of such a notice a creditor may seek leave to apply to a court for review of the merger. The only ground for review available to the creditor is that he or she will be materially prejudiced by the merger.³²⁹

A court may grant the applicant (the creditor) leave to review if it is satisfied that he or she is acting in good faith, if the merger were to be implemented it would

³²⁶ Section 115(4) also includes in this voting, rights controlled by a person related to an acquiring company or a person acting in concert with either of them.

³²⁷ Cassim F *et al Business structures* 387.

³²⁸ Section 116(1)(a) of the Companies Act; Delpont *New Entrepreneurial Law (2020)* 208. Latsky opines that there is no basis for the conclusion that the legislature only intended that the extent of this creditor right to be limited only to financial claims, while depriving those creditors with claims for the performance of services or other obligations. A wide application must be given to the term “creditor” in terms of s 116 and must include all parties with contractual claims against an amalgamating or merging company. Latsky 2014 25 *Stell LR* 361 374.

³²⁹ Section 116(1)(b) of the Companies Act.

materially prejudice the creditor, and no other remedies are available to him or her.³³⁰

2.4.1.6 *Filing notice of the merger with the Companies and Intellectual Property Commission (CIPC) and deregistration of the amalgamated company*

If the creditors institute no legal proceedings the merger can be implemented after the 15 days following the notice of the merger was sent to all the known creditors.³³¹ A notice of amalgamation must be filed with the Companies Commissioner along with documentation, including the memorandum of incorporation of any newly incorporated company in terms of the merger agreement and confirmation that the merger has satisfied the requirements in sections 113 and 115.³³²

The Companies Commissioner will then proceed to deregister any companies that disappear under the merger agreement without the need for the companies to be formally wound-up.³³³

2.4.2 *Implementation and effect of the merger*

2.4.2.1 *Transfer of all property and obligations by operation of law*

Where the merger has been implemented successfully, all the assets and liabilities of the merged companies automatically “become” those of the surviving company or the new company, depending on the merger structure used.³³⁴ In other words, the transfer of all the assets and liabilities of the merged companies takes place by operation of law.

A significant deterrent to companies arising from this legal principle is that all liabilities (including unliquidated liabilities, contingent liabilities, and even liabilities of which the surviving/new company may be unaware) are transferred to the acquiring company.³³⁵

³³⁰ Section 116(1)(c) of the Companies Act.

³³¹ Section 116(3) of the Companies Act.

³³² Section 116(4) of the Companies Act.

³³³ Section 116(5) of the Companies Act; Cassim F *et al Business structures* 389.

³³⁴ *ibid* 383.

³³⁵ *ibid*.

A proper due diligence must be conducted by the acquiring company before the merger as contractual rights are generally also transferred upon merger. However, certain contractual clauses may provide that the contract will not survive a merger.³³⁶

Section 116(6)(b) of the Companies Act provides that a merger does not affect the existing liabilities of a party to the merger from being prosecuted in terms of any applicable law, or any civil, criminal, or administrative action or proceedings pending by or against the merging company. Such proceedings may continue to be prosecuted by or against any amalgamated or merged company.³³⁷ Any conviction against, or ruling, order, or judgment in favour of or against a merging company may still be enforced against the merged company.³³⁸

Section 116(7) provides that once a merger agreement has been implemented, the property of the amalgamating or merging company(ies) becomes the property of the surviving merged or newly amalgamated company. In addition, each newly amalgamated or surviving merged company is liable for all the obligations of every amalgamated or merged company.³³⁹ In other words, in terms of section 116(7), parties are not allowed contractually to exclude obligations from being transferred under a statutory merger and all the obligations must be taken up, jointly and severally, by the surviving company or companies.³⁴⁰

Henochsberg states that the wording of section 116(7) that “each company...is liable for all the obligations ... in accordance with the amalgamation or merger agreement”, effectively results in each company being jointly and severally liable for the whole of the obligations for every other company.³⁴¹ The allocation of the obligations transferred to the amalgamated companies can be regulated by contract provided that, after all the obligations are transferred and following

³³⁶ See discussion below on transfer of contracts with non-transfer clauses as well as para 4.2.1; Cassim F *et al* 383.

³³⁷ Section 116(6)(b)(ii) of the Companies Act; Delpont *et al Henochsberg* (2023) s 116.

³³⁸ Section 116(6)(b)(iii) of the Companies Act.

³³⁹ Section 116(7)(b) of the Companies Act.

³⁴⁰ Section 116(7) of the Companies Act; Dachs and La Grange 2012 January *The Taxpayer* 9; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 367.

³⁴¹ Delpont *et al Henochsberg* (2023) s 116.

the allocation of obligations, the company would still pass the solvency and liquidity test.³⁴²

This transfer process takes place by operation of law but also in accordance with the provisions of the merger agreement or any other relevant agreement.³⁴³ Dachs and La Grange agree that the wording of section 116(7)(b) of the Companies Act does not allow for the parties to the merger agreement to be able contractually to exclude any obligations from the transfer.³⁴⁴ The authors suggest that the phrase “in accordance with the provisions of the merger or amalgamation agreement” is intended to address situations where there is more than one surviving company and the property and obligations are distributed amongst the various surviving entities in terms of the merger agreement.³⁴⁵ Effectively, all the property and obligations vest³⁴⁶ in the surviving company(ies).³⁴⁷

2.4.2.2 *Non-transferable third-party contracts*

Nicol points out that section 116(7) specifically addresses the transfer of property and obligations but is silent on the transfer of contracts. However, contractual rights fall within the ambit of property and contractual obligations and would, therefore, also fall within the ambit of obligations, per section 116(7).³⁴⁸

The reference to “any other relevant agreement” in section 116 appears to imply that the merger agreement may be subject to terms in other agreements, for example, agreements concluded with third parties. Does this mean that terms in a third-party contract – eg, an anti-transfer provision (*pactum de non*

³⁴² *ibid.*

³⁴³ *ibid* s 116 reads: “The qualification that the liability for all the obligations is to be transferred to the amalgamated or surviving merged company in accordance with the amalgamation or merger agreement or any other relevant agreement, implies that the allocation as between the amalgamated or surviving merged company/ies can be regulated by contract, provided that all the obligations are transferred and that the allocation will ensure solvency and liquidity.”

³⁴⁴ Dachs and La Grange 2012 January *The Taxpayer* 5 – 6.

³⁴⁵ *ibid* 6. Also see Delpont *et al Henochsberg* (2023) s 116.

³⁴⁶ Delpont *ibid*, where reference is made to the *dictum* in *Mörsner v Len* 1992 3 SA 626 (A) 631. The court in this case had to consider the vesting of all the rights and obligations in a company when a closed corporation is converted to the form of a company.

³⁴⁷ See discussion on the automatic vesting of the property, rights, and obligations despite anti-transfer clauses in contracts in para 2.4.2 above.

³⁴⁸ Nicol 2013 25 SA *Merc LJ* 30; Dachs and La Grange 2012 January *The Taxpayer* 4 – 5; Delpont *et al Henochsberg* (2023) s 116. See discussion of non-transfer clauses in contracts in para 4.2.1.

cedendo) – can limit the scope of the transfer of assets and liabilities to the merged entity?³⁴⁹

In *Henochsberg* it is pointed out that a transfer that occurs by way of a merger agreement in terms of which the property “becomes the property of the newly amalgamated, or surviving merged, company or companies”³⁵⁰ takes place *ex lege*³⁵¹ and not by way of contractual consent.³⁵² As a result, the transfer would not trigger the *pactum de non cedendo* clause in the contract as there is no consensual *causa* effecting the transfer of the property.³⁵³

In *Henochsberg* reference is made to section 11.07(a)(3) of the Model Business Corporation Act of the American Bar Association which in its comments on this section, clarifies the vesting of the property (including contracts) in the surviving company:³⁵⁴

"[O]f all real and personal property and becomes subject to all the liabilities, actual or contingent, of each party that is merged into it. *A merger is not a conveyance, transfer, or assignment.* It does not give rise to a claim that a contract with a party to the merger in effect on the grounds of non-assignability, unless the contract specifically provides that it does not survive a merger" (emphasis added).

If third parties do not wish the specific contract to be transferable in terms of a merger agreement, the third-party contract may provide that the contract will be cancelled in the event of a merger-related transfer.³⁵⁵ If the contract is then transferred in terms of a merger agreement,³⁵⁶ the contract may be cancelled (ie, the contract would not survive the merger).³⁵⁷

³⁴⁹ Soobyah *Mergers and Amalgamations* 32 – 33. Based upon the comment from *Henochsberg* and *Absa Bank Limited v Van Biljon and Another* 2000 1 SA 1163(W) para 1169H-J and *Tecmed (Pty) Ltd v Nissho Iwai Corporation* 2010 1 SA 35 (SCA) para 21, it appears that this is not the case, and all the assets and liabilities are still transferred upon implementation of the merger. The merged entity effectively steps into the shoes of the merging entity by operation of law.

³⁵⁰ Section 116(7)(a) of the Companies Act.

³⁵¹ “*Ex lege*” means by operation of law.

³⁵² Delpont *et al Henochsberg* (2023) s 116.

³⁵³ *ibid.*

³⁵⁴ *ibid.*

³⁵⁵ *ibid.*

³⁵⁶ Based on the fact that the contract “becomes the property” of the surviving company on an *ex lege* basis in terms of the merger agreement. See discussion in para 4.2.1.

³⁵⁷ Delpont *et al Henochsberg* (2023) s 116.

For further discussion on the impact of non-transfer clauses in contracts specifically relating to conditions in the contract, see paragraph 4.2.1 below.

2.4.2.3 *Additional requirement for the transfer of property*

On a different note, as regards the transfer of property in terms of a statutory merger section 116(8) provides that:

“If, as a consequence of an amalgamation or merger, *any property that is registered in terms of any public regulation* is to be transferred from an amalgamating or merging company to an amalgamated or merged company, a copy of the amalgamation or merger agreement, together with a copy of the filed notice of amalgamation or merger, constitutes sufficient evidence for the keeper of the relevant property registry to effect a transfer of the registration of that property”(emphasis added).

Cameron opines that this is an exception to the automatic vesting of rights as something extra is required.³⁵⁸ As an example, she mentions the registration of the transfer of ownership, the substitution of mortgage bonds in the Deed's Office, and cession of material licences which could all contribute to a huge cost and administrative burden to effect the transfer using a merger agreement. She argues that this burden does not outweigh the benefit of other property and obligations that are transferred by operation of law as these could have been transferred by way of other mechanisms with relative ease.³⁵⁹

An opposing view is that section 116(7)(a) of the Companies Act provides the *causa* for the registration of the transfer of the immovable property. Read with section 116(8) and section 3(1)(v) of the Deeds Registries Act 47 of 1937,³⁶⁰ it can be deduced that the Registrar of Deeds may by way of an application (the notice of the merger filed with the CIPC) endorse the transfer of the immovable property.³⁶¹ This is based on the important distinction that the wording in section

³⁵⁸ Cameron 2016 2 *Journal of Corporate and Commercial Law & Practice* 82.

³⁵⁹ *ibid* 82 – 83.

³⁶⁰ Section 3(1)(v) of the Deeds Registries Act 47 of 1937 provides:

“[t]he registrar shall, subject to the provisions of this Act make, in connection with the registration of any deed or other document, *or in compliance with the requirements of any law*, such endorsements on any registered deed *or other document* as may be necessary to give effect to such registration *or to the objects of such law*”(emphasis added). This implies that in terms of the Companies Act (by operation of law), the Registrar shall give effect to such automatic (*ex lege*) transfer of property in terms of a merger agreement.

³⁶¹ Rodrigues F “Company amalgamations and a lender's security under a mortgage bond” (Sept 2023) <https://www.werksmans.com/legal-updates-and-opinions/company-amalgamations-and-a-lenders-security-under-a-mortgage-bond/>.

116(8) of the Companies Act provides that the filed notice of the merger “constitutes sufficient evidence for the keeper of the relevant property registry to effect a *transfer of the registration of that property*” (*emphasis added*). The wording shows that the Registrar of Deeds is to effect a *transfer* of the registration, not a registration of the transferred property. It may as a result be argued that the Registrar shall, upon receipt of the notice of the merger, endorse the transfer of the property’s registration by effecting the transfer of the registration of the relevant property.³⁶² This is supported by the wording in section 116(8), which does not require the Registrar to register the actual transfer of the property by way of a full transfer in terms of the general deed transfer requirements. The Deeds Registries Act provides that, in addition to the general deed registration process, the Registrar must give effect to a registration or transfer of registration in compliance with law and in terms of a relevant documentation that gives effect to the registration (e.g. in terms of the automatic transfer of the immovable property under a merger agreement that has been filed with the CIPC as required in the Companies Act). This interpretation implies that there is no additional administrative burden as the transfer may merely be endorsed by the Registrar of Deeds if the transfer occurs in terms of a merger agreement.

It should however be noted that the issued Chief Registrar’s Circular (“CRC”) 1 of 2022 provides that if a bond is registered over the property of the amalgamating or merging company, it is not regarded as property of such amalgamating or merging company, but as property of the mortgagee.³⁶³ As a result, such a bond must first be cancelled or, where possible, the person and property released therefrom, or a substitution of debtor must be registered in terms of section 57 of the Deeds Registries Act. This, arguably, compounds the

³⁶² CRC of 1 of 2022 <https://www.lssa.org.za/wp-content/uploads/2023/01/CRC-1-of-2022-Companies-Act.pdf> (Accessed 9 January 2024):

“Although the Act is silent in this regard, an endorsement by the Registrar of Deeds to effect transfer of property, being land and bonds, as provided for in section 116(8) of the Act, must be effected only on the lodgment of an application in terms of section 3(1)(v) of the Deeds Registries Act, together with a copy of the amalgamation or merger and a copy of the filed notice of amalgamation or merger, and all the relevant title deeds/bonds.”

³⁶³ CRC of 1 of 2022 <https://www.lssa.org.za/wp-content/uploads/2023/01/CRC-1-of-2022-Companies-Act.pdf> (Accessed 9 January 2024).

administrative requirement for the merger parties where there is a mortgage bond registered over the property being transferred under the merger.³⁶⁴

Therefore, if Cameron's interpretation is adopted, that in certain instances there is an added administrative requirement when it comes to the transfer of immovable property under a merger agreement the question arises whether the statutory merger in the Companies Act provides a notable benefit over another restructure mechanism, such as the scheme of arrangement, if the benefit of the *ex lege* transfer of property and obligations is in fact limited.

2.5 Scheme of arrangement in terms of section 114 of the Companies Act

Probably the most significant changes to the 1973 Companies Act's scheme of arrangement are that the scheme of arrangement in section 114 of the Companies Act does not require approval by a court,³⁶⁵ and that it can only be proposed by the board.³⁶⁶

In terms of section 114 of the Companies Act, the board of a company may propose and implement any arrangement between the company and the holders of any class of its securities, including:

- a) consolidation of shares of different classes;
- b) division of shares into different classes;
- c) expropriation of shares from shareholders;
- d) share exchange;

³⁶⁴ Rodrigues recommends that a condition precedent must be added to the merger agreement that, prior to the merger date, the merger companies will either cancel the existing bond and register a new bond, or register a substitution of the debtor under the existing bond. See Rodrigues F "Company amalgamations and a lender's security under a mortgage bond" (Sept 2023). <https://www.werksmans.com/legal-updates-and-opinions/company-amalgamations-and-a-lenders-security-under-a-mortgage-bond/> (Accessed 9 January 2024).

³⁶⁵ See section 311(1) and (5) of the 1973 Companies Act for the requirements of having the scheme of arrangement sanctioned by the court; Boardman 2010 *Acta Juridica* 315. Note, however, that court approval is required in circumstances provided for in s 115(3)-(6). For example, in terms of s 115(3), despite a resolution having been adopted, a company may not proceed to implement that resolution without the approval of a court if the resolution was opposed by at least 15 per cent of the voting rights exercised on that resolution and, within five business days after the vote, any person who voted against the resolution requires the company to seek court approval.

³⁶⁶ Section 113(4) of the Companies Act requires that the board of each amalgamating or merging company consider whether, upon implementation, each amalgamated company will satisfy the solvency and liquidity test and, if it believes it will satisfy the test, the board may submit the agreement for consideration at a shareholders meeting of that amalgamating company.

- e) share re-acquisition; or
- f) a combination of the methods contemplated in this subsection.

In terms of the general principles of statutory interpretation this list is not exhaustive as it is preceded by the phrase “amongst other things”. This indicates that other arrangements concluded between a company and its holders of securities may constitute a scheme of arrangement.³⁶⁷

That said, in *Constantia Insurance Company Limited v Master of the High Court, Johannesburg*³⁶⁸ the court applied a more restrictive interpretation and held that a similar list was in fact a closed list. The court in this case acknowledged that: “the word ‘includes’ in section 45(1) of the Companies Act denotes a term of extension”³⁶⁹ and introduces a meaning or meanings that stretch beyond only the primary meaning of the term defined, in this case “financial assistance”.³⁷⁰ Nevertheless, despite the use of the word “includes” in the definition of “financial assistance” in section 45(1)(a) of the Companies Act, the court found that all the matters listed in the section following the word “includes”, would fall within the primary meaning of the definition of “financial assistance” and would not be an extension of the definition (ie, the list is regarded as exhaustive). The court held that the use of the word “includes” in section 45(1)(a) is

³⁶⁷ The term “*eiusdem generis*” (of the same kind) is based on the principle *noscutir a sociis* (known by its associates – *Claassen’s Legal Dictionary*). Where general words follow specific words, the general words must be confined to the things of the same class or kind as those specified words (*Commissioner of Customs v Joffe* 1934 WLD 8 10). In *Santam Versekeringsmaatskappy Bpk v Kruger* 1978 4 All SA 199 (A) Miller JA pointed out: “That argument appears to invoke the “*eiusdem generis*” rule, but in an unusual form or sense. Craies *Statute Law* 7th ed at 181 points out: “To invoke the application of the *eiusdem generis* rule there must be a distinct genus or category. The specific words must apply not to different objects of a widely differing character but to something which can be called a class or kind of objects. Where this is lacking, the rule cannot apply . . .” (emphasis added). Also see *Director of Education, Transvaal v McCagie and Others* 1918 AD 616 where Innes CJ held that: “[T]he words “other evidence,” are, no doubt, wide, but their interpretation must be affected by what precedes them. General words following upon and connected with specific words are more restricted in their operation than if they stood alone. *Noscutir a sociis*; they are coloured by their context, and their meaning is cut down so as to comprehend only things of the same kind as those designed by the specific words – unless, of course, there is something to show that a wider sense was intended” (emphasis added). See Botha *Statutory interpretation* 184 – 186. Also see Carney *Linguistics for Legal Interpretation* 61 – 64.

³⁶⁸ *Constantia Insurance Company Limited v Master of the High Court, Johannesburg and Others* 2022 JOL 56548 (SCA).

³⁶⁹ *ibid* paras 22 – 24.

³⁷⁰ The court acknowledges that, generally, the word “includes” in a definition determines the list to be non-exhaustive. The High Court (the court of first instance) held that the word “includes” indicates a non-exhaustive list. The Supreme Court of Appeal was not in agreement with the High Court and overturned the judgment by finding that the definition of “financial assistance” is an exhaustive list, despite the use of the word “includes”.

aimed at determining the ambit of the definition with certainty and, therefore, the matters listed under “financial assistance” are exhaustive of the term.³⁷¹

It is submitted that the wording of section 114, such as “any arrangement between the company and holders of any class of its securities...amongst other things” indicate that section 114 of the Companies Act is intended to have a broad application, as opposed to the restrictive interpretation applied by the court to section 45(1) of the Companies Act in *Constantia Insurance Company Limited*.³⁷² As indicated earlier in this chapter,³⁷³ the scheme of arrangement – and in particular what constitutes an “arrangement” – has a very broad application and must meet only certain requirements, including that it must be between the company and its shareholder or between the company and its creditor.³⁷⁴ It would, therefore, be nonsensical to apply a restrictive interpretation to section 114(1) of the Companies Act when the very concept that it is governing has “the widest character”.³⁷⁵

One must also consider that the section 114 and 115 requirements must be met in certain circumstances, even where there is no scheme of arrangement. If shares are

³⁷¹ The court referred to *R v Debele* 1956 4 SA 570 (A) where Fagan JA found that where matters are listed as being included in a definition, they fall within the primary meaning of the defined term and that this indicates an intention to establish the ambit of the term. Accordingly, the court in *Constantia Insurance Company Limited* found that the listed matters under the definition of “financial assistance” are exhaustive in the meaning of the term. This view can potentially be further attributed to the fact that s 45(1)(b) of the Companies Act also specifically lists the matters that are excluded from the definition of “financial assistance”. It is submitted is that if the definition was intended to be a closed list, the legislator would rather have used the word “means” (limiting the application) than “includes” (points to a broader application). As highlighted by Carney *Linguistics for Legal Interpretation* 64: “Hyponymy assists in categorising items vertically from broad inclusive terms to examples that are more specific. The hyponyms of each superordinate are key to understanding the superordinate, but also allow us to explore the conceptual field in terms of each hyponym’s cohyponym (its neighbour). Knowing a contested word’s semantic family helps to understand the concept overall.”

³⁷² See *S v Kohler* 1979 1 SA 861 (T) where the court had to consider if permission is required for keeping a peacock in a residential area, as the ordinance referred to “poultry” which the ordinance describes as “any chicken, duck, goose, turkey, guineafowl, partridge, pheasant, pigeon and their chicks or any other bird.” The court applied the *eiusdem generis* principle and held that a peacock is a type of pheasant and so falls within the class of birds described in the ordinance. The peacocks were accordingly held illegally as no official permission had been obtained. See Carney *Linguistics for Legal Interpretation* 61 64 who explains that “hyponymy” as a relation of inclusion, as the extension of an item can include another item as a subset of the first item. It helps us to classify items vertically from terms that are broad and inclusive to examples that are more specific.

³⁷³ See discussion in para 2.2.2.1.

³⁷⁴ *ibid.*

³⁷⁵ *Du Preez v Garber: In re Die Boerebank Bpk* 1963 1 SA 806 (W) para 813; *Ex parte Millman: In re Multi-bou (Pty) Ltd* 1987 4 SA 405 406.

acquired in terms of section 48 of the Companies Act³⁷⁶ (not in terms of a scheme of arrangement) where a company repurchases more than five per cent of its issued shares of any particular class, the transaction must also comply with the provisions of sections 114 and 115 of the Companies Act.³⁷⁷ As concluded in *Capital Appreciation Ltd v First National Nominees (Pty) Ltd*,³⁷⁸ it is clear that in terms of section 48(8)(b) of the Companies Act: “a share repurchase above a particular threshold is regarded as a fundamental transaction”. The court in this case also referred to Cassim *et al* who point out that the rationale behind section 48(8) is to reconcile share buy-backs, as it would not be sensible to allow for a share buy-back by board approval if effected in terms of section 48, but to require a special resolution for approval of a share buy-back in terms of section 114.³⁷⁹ There is, therefore, a direct link between repurchases in terms of section 48 and schemes of arrangement in terms of section 114.³⁸⁰

Section 114 also requires that a qualified, impartial, and independent expert³⁸¹ prepare a report for the board concerning the proposed arrangement which must be distributed to all holders of the company’s securities.³⁸² The report must include, *inter alia*, the categories of shareholder identified who would be affected by the proposed arrangement and detail the material effects that the proposed arrangement will have on the rights and interests of such persons.³⁸³ The report must also evaluate any adverse material effects of the proposed arrangement against the compensation that any of those persons will receive in terms of that arrangement; and any reasonably probable beneficial and significant effect of that arrangement on the business and prospects of the company.³⁸⁴

As required with other fundamental transactions in the Companies Act, a scheme of arrangement must be approved by special resolution by persons entitled to exercise

³⁷⁶ Section 48 enables and governs the acquisition by a company or its subsidiary of that company’s shares. See *Capital Appreciation Ltd v First National Nominees (Pty) Ltd and Others* (280/2021) 2002 ZASCA 85 (8 June 2022).

³⁷⁷ Section 48(8)(b) of the Companies Act.

³⁷⁸ *Capital Appreciation Ltd v First National Nominees (Pty) Ltd and Others* (280/2021) 2002 ZASCA 85 (8 June 2022).

³⁷⁹ Cassim F and Cassim MF *Contemporary company law* 300.

³⁸⁰ *Capital Appreciation Ltd v First National Nominees (Pty) Ltd and Others* (280/2021) 2002 ZASCA 85 (8 June 2022) para 28; s 114(4) which refers to repurchases under s 48 and s 48(8)(b) of the Companies Act.

³⁸¹ Section 114(2)(a) and (b) of the Companies Act.

³⁸² Section 114(3) of the Companies Act.

³⁸³ Section 114(3)(b) and (c) of the Companies Act.

³⁸⁴ Section 114(3)(d) of the Companies Act.

voting rights on such a matter, at a meeting called for that purpose and at which sufficient persons are present to exercise, in aggregate, at least 25 per cent of all of the voting rights entitled to be exercised on that matter in terms of section 115.³⁸⁵

It is pointed out in *Henochsberg*³⁸⁶ in the commentary on section 114 that: "...s114 does not indicate what the legal basis and effect of this arrangement is, but it can be enforced as provided for in terms of s 115(9)".³⁸⁷ The effect of the implementation of a scheme of arrangement is not mentioned in section 114, as we saw with statutory mergers in terms of section 116 of the Companies Act.

Boardman holds the view that, in broad terms, the scheme of arrangement can constitute anything that the company and its members can properly agree upon.³⁸⁸ This includes using a scheme of arrangement to bring about a merger, demerger, or an internal reorganisation.³⁸⁹ As sections 114 and 115 of the Companies Act do not define what constitutes an "arrangement", the common law (case law) established in terms of the 1973 Companies Act remains relevant.³⁹⁰ Seligson, however, argues that sections 114 and 115 are clearly not mirrors of section 311 of the 1973 Companies Act as the procedure for approval, the role of the court, and the mechanisms used to protect minority shareholders differ significantly in the two Acts.³⁹¹ He further opines

³⁸⁵ Section 115(2)(a) of the Companies Act 71 of 2008; Latsky 2014 *Stell LR* 361 370. Also see the discussion in para 2.4.1.4 above on "present and voting" as required in the 1973 Companies Act versus the required "exercisable voting rights" in terms of s 115(2) of the Companies Act 71 of 2008; *Sand Grove Opportunities Master Fund and Others v Distell Group Holdings Ltd and Others* 2022 2 All SA 855 (WCC).

³⁸⁶ Delport *et al Henochsberg* (2023) s 114.

³⁸⁷ Section 115(9) provides:

"If a transaction contemplated in this Part has been approved, any person to whom assets are, or an undertaking is, to be transferred, may apply to a court for an order to effect:

- (a) the transfer of the whole or any part of the undertaking, assets and liabilities of a company contemplated in that transaction;
- (b) the allotment and appropriation of any shares or similar interests to be allotted or appropriated as a consequence of the transaction;
- (c) the transfer of shares from one person to another;
- (d) the dissolution, without winding up, of a company, as contemplated in the transaction;
- (e) incidental, consequential, and supplemental matters that are necessary for the effectiveness and completion of the transaction; or
- (f) any other relief that may be necessary or appropriate to give effect to, and properly implement, the amalgamation or merger."

³⁸⁸ Boardman 2010 *Acta Juridica* 314.

³⁸⁹ *ibid.*

³⁹⁰ Delport *New Entrepreneurial Law* 210 – 211. See discussions on what constitutes an "arrangement" in para 0 above.

³⁹¹ Seligson 2013 4 *Business Tax and Company Law Quarterly* 12.

that it is, therefore, doubtful that decisions under section 311 of the 1973 Companies Act regarding an “arrangement” would still be applicable under the Companies Act.³⁹²

Schemes of arrangement have the benefit that they need not be subjected to a solvency and liquidity test as required under section 113 mergers or amalgamations.³⁹³ This offers a considerably more flexible means of effecting a take-over than by way of business acquisition or the standard take-over offer process.³⁹⁴ Section 114(1) of the Companies Act does, however, provide that a scheme of arrangement may not be concluded where the company is in liquidation or in business rescue.

A typical scheme of arrangement can be illustrated by Delport’s example in *New Entrepreneurial Law*:³⁹⁵

Example:

Holding Company (Company H), holds 80 per cent of the shares in a subsidiary (Company S), with the remaining shares being held by other minority shareholders. Company H wants to wholly own the shares in Company S and to achieve this restructure, Company S proposes an arrangement with the minority shareholders in terms of which either their shares will be cancelled and they will receive either a cash or shares in Company H, as consideration. Alternatively, the arrangement can be that the minority shareholders swap their shares in Company S for shares in Company H.

In the light of the clear preference for a scheme of arrangement under the 1973 Companies Act even today, the scheme of arrangement remains a popular choice for actioning restructures such as mergers, amalgamations, or take-overs from a commercial perspective. Annually, the Take-over Regulation Panel issues a report analysing the types of transaction it has reviewed.³⁹⁶

³⁹² *ibid* 12.

³⁹³ Cassim F *et al Business structures* 208.

³⁹⁴ Boardman 2010 *Acta Juridica* 314.

³⁹⁵ Delport *New Entrepreneurial Law (2020)* 210.

³⁹⁶ In terms of s 119 the Takeover Panel must regulate any “affected transaction” or offer in accordance with this Part, Part C and the Takeover Regulations. An “affected transaction” is defined in s 117 of the Companies Act:

“‘affected transaction’ means—

(i) a transaction or series of transactions amounting to the disposal of all or the greater part of the assets or undertaking of a regulated company, as contemplated in section

Below is a table showing the types of transaction submitted to the Take-over Panel for review between 2015 and 2021. From this it is clear that statutory mergers remain the most unpopular of the three fundamental transactions that reach the Take-over Panel for review.

Fundamental transactions	2021	2020	2019	2018	2017	2016	2015
Section 112: Disposal of assets	6	3	5	3	5	3	6
Section 113: Mergers	-	-	-	-	-	-	-
Section 114: Scheme of Arrangement	22	29	20	15	23	30	39

Table 2: Analysis of transactions reviewed by the Take-over Panel Executive

It must be noted that not all fundamental transactions are required to be reviewed by the Panel, but of the transactions that fall under the jurisdiction of the Panel there remains a clear preference for schemes of arrangement.

2.6 The disposal of all or greater part of a company’s assets or undertaking in terms of section 112 and section 115 of the Companies Act

Section 112 of the Companies Act governs proposals to dispose of all or the greater part of the assets or undertakings of a company. This section is also subject to certain requirements, such as the approval by special resolution in section 115 of the Companies Act.

The meaning of “disposal” in this context is a transaction that permanently deprives a company of its right to ownership of the asset – in other words, a transfer of ownership.³⁹⁷ The phrase “all or the greater part” is defined in section 1 of the

112, subject to section 118 (3);

- (ii) an amalgamation or merger, as contemplated in section 113, if it involves at least one regulated company, subject to section 118 (3);
- (iii) a scheme of arrangement between a regulated company and its shareholders, as contemplated in section 114, subject to section 118 (3) ...”

‘regulated company’ means a company to which this Part, Part C and the Takeover Regulations apply, as determined in accordance with section 118 (1) and (2).”

³⁹⁷ Cassim F *et al* *Business structures* 398; *The Standard Bank of South Africa v Hunkydory Investments 194 (Pty) Ltd* 2009 JDR 0705 (WCC) para 23.

Companies Act and denotes more than 50 per cent of the company's gross assets fairly valued (disregarding liabilities), or more than 50 per cent of the value of the company's entire undertaking (fairly valued).

Section 112 lists exceptions to when the section itself (and s 115) will not apply to a disposal:

- a) "that is pursuant to or contemplated in a business rescue plan adopted in accordance with Chapter 6;
- b) between a wholly-owned subsidiary and its holding company; or
- c) between or among—
 - (i) two or more wholly-owned subsidiaries of the same holding company; or
 - (ii) a wholly-owned subsidiary of a holding company, on the one hand, and its holding company and one or more wholly-owned subsidiaries of that holding company, on the other hand."

The exemptions in paragraphs (b) and (c), specifically, are to avoid unnecessary delays in intragroup transactions, especially where the disposing company is a wholly-owned subsidiary and all the voting rights are held by the purchaser (the holding company).³⁹⁸

This carve-out in section 112 is important and reference will be made to it when considering whether a similar carve-out should be introduced in section 115(4) of the Companies Act regarding short-form and triangular mergers.

Technically, section 112 is not a merger provision but it is classified as a fundamental transaction under Chapter 5 of the Companies Act and is, therefore, considered in this study. The section can be used to gain control over an undertaking of a company,³⁹⁹ for example, in an intra-group disposal. This mechanism may also be tax neutral if all the relevant group rollover-relief requirements are met.⁴⁰⁰

³⁹⁸ Cassim F *et al Business structures* 404. In such a scenario a special resolution would be a superfluous formality since the holding company holds all the shares and voting rights in the subsidiary.

³⁹⁹ Delpont *New Entrepreneurial Law* 194.

⁴⁰⁰ See para 4.3.1.2 below for a full discussion.

2.7 Conclusion

2.7.1 Summary of the history of transfer mechanisms in the Companies Acts

There is a long history of company law in South Africa with an important milestone being the enactment of the Companies Act in 2011 which moved away from the robust influence of English company law to focus on establishing company law that is appropriate in the South African legal, economic, and social context.⁴⁰¹

As emerged from this Chapter, there is extensive use of transfer mechanisms such as the scheme of arrangement and take-over offer in company law. These methods provide for the transfer of the shares or undertakings of a company and, in specific circumstances, for the transfer of assets and liabilities.⁴⁰² Throughout history it appears that the scheme of arrangement has retained its place as the more popular mechanism for implementing an arrangement or even a reconstruction, amalgamation, or compulsory take-over.⁴⁰³

There have been numerous judgments as to what qualifies as an “arrangement” concluded “between a company and its members” and whether a scheme of arrangement can be the preferred mechanism where the same result can be achieved by way of agreement.⁴⁰⁴ The prevailing view is that a scheme of arrangement can be used, not in place of other normal, mandatory, prescribed procedures but rather in conjunction with such other procedures.⁴⁰⁵

The scheme of arrangement has also undergone significant changes since the 1973 Companies Act, notably that the procedure in the Companies Act is now, like the statutory merger, court-free. This places both the scheme of arrangement and the statutory merger on equal footing as regards costs, time, and disclosure.⁴⁰⁶

Earlier Companies Acts were silent as regards the facilitation of a “true” merger which allowed for the fusion of two or more companies. This concept, adopted from American state company law, was introduced in the Companies Act in the form of the statutory

⁴⁰¹ The Department of Trade and Industry “South African Company Law for the 21st Century: Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004 8.

⁴⁰² Section 313 of the 1973 Companies Act.

⁴⁰³ Cilliers and Benade *et al Maatskappyereg* 324; De Villiers 1973 90/4 *SALJ* 367.

⁴⁰⁴ See above discussions on case law in para 0.

⁴⁰⁵ *Du Preez v Garber: In re Die Boerebank Bpk* 1963 1 SA 806 (W); *Ex parte NBSA Centre Ltd* 1987 2 SA 783 (T) 801; Delpont *et al Henochsberg* (2023) s 114.

⁴⁰⁶ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 86.

merger. This is an interesting development which points to a move away from South Africa's traditional reliance on English company law. The statutory merger process is also not subject to court approval again reflecting the approach in the USA and Canada⁴⁰⁷ as opposed to that in the UK⁴⁰⁸

2.7.2 Issues identified with the statutory merger

As one writer has asked, does the statutory merger mechanism in the Companies Act merely give us an American headache?⁴⁰⁹

The general view is that the merger mechanism is fraught with uncertainty and discrepancies.⁴¹⁰ Certain of these have been identified and are unpacked in the discussion below.

2.7.2.1 Conflicting sections impacting triangular and short-form mergers

First, as discussed in Chapters 1 and 2, section 113 allows for various types of consideration in a merger transaction which as a result allows for various merger structures, such as triangular mergers, reverse-triangular mergers, and cash mergers.⁴¹¹

However, section 115(4) of the Companies Act counteracts a multiplicity of merger structures by prohibiting the inclusion of certain votes for purposes of calculating the voting and quorum requirements for a merger or amalgamation.

This includes where any of the voting rights are controlled by:

- a) an acquiring party;
- b) a person related to an acquiring party; or
- c) a person acting in concert with either of them.

⁴⁰⁷ In Canada, a merger can be achieved by either an amalgamation or a plan of arrangement. A plan of arrangement is a court approved process in terms of s 192(1)(b) read with subsections (3) and (4) of the Canada Business Corporations Act. RSC 1985. Amalgamations in Canada are court-free transactions and governed in terms of sections 181 – 183 of the Business Corporations Act ; Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 86. Canada also governs short-form amalgamations which is discussed in more detail in para 5.3.2.1.

⁴⁰⁸ There is no specific legislation in the UK allowing for statutory mergers (merger by absorption) amongst private UK companies, only public companies. However, mergers may be actioned under Part 26 of the UK Companies Act 2006 (as a scheme of arrangement), which requires the arrangement to be sanctioned by the court. See ss 895, 896, 899 and 900 of the Companies Act 2006 in this regard.

⁴⁰⁹ Kleitman 2013 July *Without Prejudice*.

⁴¹⁰ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 87.

⁴¹¹ Typical merger structures would include pooling-type structures, triangular mergers, reverse-triangular mergers, and cash mergers to name but a few.

Kershoff writes that a conflict exists between sections 113(2) and 115(4) of the Companies Act in relation to triangular mergers.

In terms of section 113(2) merger consideration can take various forms, including shares in the merged company and any other property, which includes a cash consideration or shares in another company.⁴¹² As consideration in a merger transaction can be in the form of cash or shares in another company, it appears that the Act sanctions the use of triangular mergers.

As highlighted, section 113(2) allows for a triangular merger but the use of triangular merger structures is stymied by the requirements in section 115(4) of the Companies Act.⁴¹³ Section 115(4) provides that the voting rights of an acquiring company or person related to the acquiring company must not be included in calculating the percentage of voting rights required for a quorum or for the voting required in support of a resolution.

As indicated by Latsky, this conflict means that a holding company that wholly owns a subsidiary cannot vote on a resolution for the merger of two of its wholly-owned subsidiaries, or even for a merger between itself and its subsidiary. This makes it impossible to comply with the requirements in section 115 of the Companies Act.⁴¹⁴

As a holding company and its subsidiary are related in a triangular merger structure, neither the shareholder voting requirement nor the quorum requirement can be satisfied where a triangular merger structure is implemented as required in terms of section 115.⁴¹⁵

Latsky argues that the legal principle *lex non cogit ad impossibilia aut inutilia* (the law does not operate for an impossible purpose) should be applied in this scenario, and points out that the parties in an intra-group merger should be excused from performing a requirement which is objectively impossible to perform lawfully.⁴¹⁶ As highlighted by Cassim, the legislator had a clear reason

⁴¹² Section 113(2) of the Companies Act; Kershoff 2015 27/2 SA Merc LJ 325 327.

⁴¹³ Kershoff ibid 326.

⁴¹⁴ Latsky 2014 25 Stell LR 361 377.

⁴¹⁵ Kershoff 2015 27/2 SA Merc LJ 330.

⁴¹⁶ Latsky 2014 25 Stell LR 361 377.

for including section 115(4) which prevents a conflict of interests where the party is simultaneously both the acquiring party and the shareholder in the target company.⁴¹⁷

In addition, if the merger were to be challenged and proceed to court, one must remember that the court is limited when interpreting the law in that it may not fill *lacunae* in legislation to give effect to what it perceives to have been the aim of the legislator.⁴¹⁸ Applying the legal principle suggested by Latsky only seeks to circumvent a clear prohibition in section 115(4) which cannot be achieved legally.

If one considers section 112 which governs the disposal of all or a greater part of a company's assets or undertakings, there are certain exemptions or carve-outs in section 112(1). In summary, the requirements of sections 112 and 115 do not apply if the disposal takes place between a wholly-owned subsidiary and its holding company; or between two or more wholly-owned subsidiaries of the same holding company; or a wholly-owned subsidiary of a holding company, on the one hand, and its holding company and one or more wholly-owned subsidiaries of that holding company, on the other. This carve-out clearly allows for disposals between companies that exist in a group without imposing unnecessary requirements for the parties.

Kershoff asks why similar exemptions or carve-outs cannot be included in section 113 to allow for triangular mergers, a popular merger mechanism that is effectively disallowed if one considers section 115(4) of the Companies Act. Due to the restrictions in section 115(4), and because of the relationship between a holding company and a wholly-owned subsidiary, neither the shareholder voting requirement nor the quorum requirement in section 115(4) can be met making it impossible to implement triangular mergers.⁴¹⁹

In my view the proposed exemption for mergers should not rest there. An exemption should be introduced to allow for short-form mergers between

⁴¹⁷ Cassim F *et al Business Structures* 387.

⁴¹⁸ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 SCA.

⁴¹⁹ Kershoff 2015 27/2 SA Merc LJ 325 330.

wholly-owned subsidiaries and holding companies without the need to notify all known creditors or receive shareholder approval as required by section 115.

The merger mechanism can potentially serve as a vital tool for companies to clean-up and streamline their group structure by merging entities and removing unwanted divisions from the group structure.⁴²⁰

However, due to the current disconnect between sections 113 and 115(4), this mechanism may not be used in a holding company – subsidiary scenario (triangular merger or vertical short-form merger) or sister-companies scenario (horizontal short-form merger). This is unfortunate in that a short-form merger limits the risk for creditors of the merging companies as the ultimate control of the target company remains the same and shareholder approvals would be a pointless exercise.⁴²¹

The existing discrepancy between these two sections is disheartening as it significantly limits the merger structure options available. One of the key aims of the Companies Act is: “to facilitate the creation of business combinations ...provide flexibility and enhance efficiency in the economy”.⁴²² It appears unlikely that flexibility is created for business combinations based on this clear discrepancy. I support Cassim’s approach that a short-form, freeze-out merger would not be in the spirit of the Companies Act as it is shareholder centric and has stringent safeguards in place to protect minority shareholder rights.⁴²³ However, in the case of wholly-owned subsidiaries, there are no dissenting minority shareholders, the merging parties all support the merger, and no special shareholders’ resolution would, therefore, be required.⁴²⁴

⁴²⁰ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 80.

⁴²¹ *ibid* 84.

⁴²² Memorandum on the Objects of the Companies Bill, 2008 paras 1.2.3(d) and 9.

⁴²³ Cassim MF (*Part 2*) 2008 20 *SA Merc LJ* 147 156.; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 345.

⁴²⁴ Also see s 57(2) of the Companies Act which provides that if a profit company (other than a state-owned company) has only one shareholder:

“(a) that shareholder may exercise any or all of the voting rights pertaining to that company on any matter, at any time, without prior notice or compliance with any other internal formalities, except to the extent that the company’s Memorandum of Incorporation provides otherwise and (b) sections 59 to 65 do not apply to the governance of that company.”

In terms of s 57(1), for Part F of the Act the definition of a “shareholder” is as set out in s 1, but also includes a person “who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached”.

Davids, Norwitz and Yuill suggest that in an internal group reorganisation between holding companies and their subsidiaries, or between two subsidiaries with no minority shareholders, a simpler procedure should be implemented.⁴²⁵ For example, the authors suggest requiring only board approval for the internal group reorganisation as a carve-out for internal-group restructures use the merger mechanism.⁴²⁶

The authors also refer to the carve-out in section 112 which allows disposals between a wholly-owned group company and its parent company and/or sister companies and suggest a similar carve-out be introduced for short-form mergers.⁴²⁷

I am in full agreement that such a carve-out is required to, firstly, allow for the merger mechanism to be used in an internal group restructuring context, and secondly, to address the discrepancy regarding merger structures. Such a carve-out would effectively allow short-form and triangular mergers within a group of companies.

2.7.2.2 *Transfer of non-transferable contracts by operation of law*

Second, in terms of the issues arising in regard to the statutory merger in the Companies Act, there is uncertainty about the transfer that takes place by operation of law. In terms of the wording of section 116(7) subjecting the merger to “any other agreement”, it is uncertain whether a third-party agreement that contains an anti-transfer clause will affect the automatic transfer of rights from the merging entity to the merged entity.⁴²⁸ What happens if a contract contains a non-assignment clause?

Generally, most contracts are silent on assignment and would automatically pass to the surviving entity without the consent of the third party without triggering assignment or novation.⁴²⁹ Cassim argues that even if a contract expressly prohibits assignment it would generally vest in the surviving company in a merger on the basis that the non-assignment clause was not intended to

⁴²⁵Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 357.

⁴²⁶ *ibid.*

⁴²⁷ *ibid.*

⁴²⁸ Soobyah *Mergers and Amalgamations* 35.

⁴²⁹ Cassim MF (*Part 1*) 2008 1 SA Merc LJ 5.

apply to a transfer by operation of law unless the clause specifically states that the contract will not survive a merger.⁴³⁰ Cassim et al argue that where there is an express provision against assignment by operation of law that clause would be effective and the contract would not be transferable. However, where the clause does not specifically prohibit assignment by operation of law, the stronger argument is that the parties did not contemplate this mode of assignment.⁴³¹

Notwithstanding, this is not as clear in the case of ambiguous anti-assignment clauses. It appears that there is still some uncertainty around these anti-assignment clauses and their possible impact on a merger agreement. For example, if an anti-transfer clause is not identified during the due diligence it may result in the company being held liable for breach of contract, renegotiation of the contract on less favourable terms, or the contractual right being open to an interdict.⁴³² It may even lead to litigation and delay the implementation of the merger or amalgamation. In the worst scenario it may even render the merger impractical so effectively collapsing the entire transaction.⁴³³

2.7.2.3 *Transfer of property by operation of law*

Third, there are further considerations arising from the transfer of the assets and liabilities operation of law.⁴³⁴ The automatic transfer of assets and liabilities by operation of law sees the merging entity step into the shoes of the merged entity. Some may view this negatively in that in addition to all the assets, all the liabilities are automatically transferred to the surviving companies. Others, however, see the automatic transfer by operation by law is one of the great advantages of the statutory merger in the Companies Act.

As highlighted by Cameron, in terms of section 116(8) there is an additional administrative burden associated with the transfer of property in terms of a statutory merger. In her view the considerable benefit that an *ex lege* transfer offers is diminished. This is because the transfers could have just as easily have

⁴³⁰ *ibid.*

⁴³¹ Cassim F and Cassim MF *Contemporary company law* 683.

⁴³² Nicol 2013 25 SA Merc LJ 33.

⁴³³ *ibid.*

⁴³⁴ Section 116(7) of the Companies Act.

been achieved through the use of other transfer mechanisms in the Companies Act.⁴³⁵

2.7.2.4 *No tax-law incentive to pursue a statutory merger*

Lastly, from a tax perspective there is not sufficient provision in the Income Tax Act to provide group rollover relief for various merger structures.⁴³⁶ Instead, tax relief is available only for a very basic and straightforward merger structure, which could just as easily be implemented as a scheme of arrangement.⁴³⁷ Consequently, the tax regulations governing mergers indirectly steer parties towards using other mechanisms to effect their merger agreements – ie, they elect to follow the more established and potentially more tax-effective option.

In addition, other transfer mechanisms – such as the scheme of arrangement – are well-established. The scheme is now, in terms of the Companies Act, a court-free process without the onerous requirements of notifying each known creditor and passing a solvency and liquidity test as required by the statutory merger.

It is ironic today to recall that in 2010 the Standing Committee on Finance, rejected the alignment of the provisions of the Companies Act and the Income Tax Act governing amalgamations, stating that the two Acts have different aims and it would make no sense to align them.⁴³⁸ Chapter 3 covers the provisions of section 44 of the Income Tax Act and its impact on merger transactions in South Africa in detail.

⁴³⁵ See discussion in para 2.4.2.3; Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 82 – 83.

⁴³⁶ Section 44 of the Income Tax Act 58 of 1962.

⁴³⁷ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 82.

⁴³⁸ <http://www.treasury.gov.za/public%20comments/Full%20Response%20Doc%20Draft%2025%20August%202010.pdf> (accessed 31 August 2021):

“**Comment:** The amalgamation rules have not been amended in line with section 40 of the new Companies Act.

Response: Not accepted. The Income Tax Act currently caters for amalgamations of different types (i.e. ‘amalgamations, conversions and mergers’). The purposes of the amalgamation rules as contained in the Income Tax Act versus the Companies Act differ as these Acts seek to achieve diverse aims. For instance, amalgamations referred to in the Companies Act seem to include de-mergers while amalgamations within the Income Tax Act are limited to company combinations (with demergers addressed under the unbundling provisions).”

All the above uncertainties seem to contribute to the continued preference for parties to use a scheme of arrangement to implement a merger transaction.

2.7.3 The continuing preference for schemes of arrangement

If one looks back at the history of take-over mechanisms in South Africa, the scheme of arrangement remains a popular transfer mechanism in company law even today⁴³⁹ with the statutory merger mechanism in place.

As pointed out by De Villiers in 1973, different requirements and safeguards for the various transfer mechanisms ensure that the mechanisms are not on an equal footing in many regards.⁴⁴⁰ Why would an offeror company choose to comply with onerous provisions if they can take a less onerous or more beneficial route to achieve the same goal – even if it is at the cost of the shareholders of the offeree company? De Villiers correctly states that:

“A statute should not, by its wording, encourage circumvention of its provisions and consequent disregard of the safeguards it seeks to provide... The statute should ensure that, irrespective of the method of take-over, the same information and protection is available to shareholders of the offeree company in respect of compulsory acquisition of their shares.”⁴⁴¹

This has been achieved, to some extent, by providing that certain requirements, such as shareholder approval in section 115 of the Companies Act, are applied uniformly to the fundamental transactions and so to both the scheme of arrangement and the statutory merger.⁴⁴² I believe that here we see a level playing field in that the same requirements apply to both mechanisms. Yet, from the points raised above, the statutory merger mechanism needs some distinct advantage over schemes of arrangement to tip the scales in its favour.

In addition, the statutory merger remains less popular as a transfer mechanism because the market is reluctant to test uncharted waters.⁴⁴³ There has to date been no court case addressing the uncertainties of the statutory merger in section 113 of

⁴³⁹ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 77 – 78.

⁴⁴⁰ De Villiers 1973 90/4 *SALJ* 367.

⁴⁴¹ *ibid.*

⁴⁴² As well as disposals of all or the greater part of a company's assets or undertakings (s 112 of the Companies Act).

⁴⁴³ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 78 – 79.

the Companies Act and the mechanism, therefore, remains untested by our courts.⁴⁴⁴ As a result, the public is left without common-law precedent to guide the interpretation and application of the section.⁴⁴⁵ It appears that this is a risk companies are not willing to take if they can rather conclude the same transaction by way of a familiar, tried-and-tested method – the scheme of arrangement.⁴⁴⁶

The question then arises: As section 113 currently reads, how applicable is it really in practice? Do the discrepancies, uncertainties, and lack of attractive features mean that section 113 is, or is becoming, redundant? Will we soon see it repealed as happened with the take-over provisions in the 1973 Companies and 1926 Companies Acts?

As I suggest above, an advantage can be added to statutory mergers if short-form mergers, triangular mergers, and even reverse-triangular mergers (all within an intra group setting) were permitted and freed from the excessive red tape of notifying every known creditor and special shareholder resolutions. This would make the statutory merger mechanism a vital tool for internal group restructures, especially, if the merger mechanism applied in terms of the Companies Act also qualified for the relevant tax relief. This is discussed in Chapters 3 and 4.

⁴⁴⁴ *ibid* 79 and 85.

⁴⁴⁵ *ibid* 79.

⁴⁴⁶ *ibid* 78 – 79.

CHAPTER 3: MERGERS AND AMALGAMATIONS IN TERMS OF THE INCOME TAX ACT 58 OF 1962

3.1 Introduction and definitions

3.1.1 Introduction

In the early 2000s National Treasury recognised the need for rules to govern amalgamations, mergers, or conversions between two resident companies. As a result, section 44 of the Income Tax Act was introduced in 2002.⁴⁴⁷

The Explanatory Memorandum to the Second Revenue Laws Amendment Bill in 2001 set out the following reasoning for the introduction of the corporate rules:

“These measures are generally based on the view that where the group or the shareholders have *retained a substantial interest in the assets transferred*, it is appropriate to *permit the tax-free transfer of assets* to the entity where they can be most efficiently used for business purposes.

International experience has, unfortunately, also shown that these measures *are often abused to avoid tax*. A balance must, therefore, be struck between the breadth of the concessions these measures introduce and the potential for tax avoidance”⁴⁴⁸ (emphasis added).

The impact of these corporate rules allows for a tax-neutral transaction to take place in special circumstances: asset-for-share transactions (s 42), substitutive share-for-share transactions (s 43), amalgamation transactions (s 44), intra-group transactions (s 45), unbundling transactions (s 46), and liquidation distributions (s 47). If these types of transaction are completed within the bounds of the corporate rules the transactions will be tax neutral. For example, where equity shares are received as consideration for the disposal of assets and the corporate rules apply, there are no immediate tax consequences arising from this corporate transaction. This is because the beneficial interest⁴⁴⁹ of the ultimate owner of the assets does not change and there is no

⁴⁴⁷ Revenue Law Amendment Bill 2002, Explanatory Memorandum: http://www.treasury.gov.za/legislation/bills/2002/rlab_2002_memo.pdf (accessed 9 October 2021).

⁴⁴⁸ <https://osall.org.za/docs/2011/02/2001-Second-Revenue-Laws-Amendment-Bill.pdf> (accessed 2 October 2021).

⁴⁴⁹ The term “beneficial interest” is defined in s 1 of the Companies Act and means (in relation to a company’s securities): “the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to—
(a) receive or participate in any distribution in respect of the company’s securities;

economic profit derived from the transactions.⁴⁵⁰ As a result, the tax liabilities which would ordinarily have been triggered by the disposal of assets are deferred or “rolled forward”, making the transaction tax neutral.⁴⁵¹

This tax neutrality is explained in the Explanatory Memorandum on the Revenue Law Amendment Bill 2002, which provides that the transferor and transferee are deemed to be one and the same in respect of the transfer of assets in that the transferee effectively “steps into the shoes” of the transferor regarding the date of the acquisition of the asset and any expenditure incurred in effecting the acquisition (eg, the base cost of a capital asset).⁴⁵² For example, where section 44 applies and all the requirements have been met, the resultant company inherits the tax position of the amalgamated company in relation to the assets⁴⁵³ because the resultant company acquires the respective assets of the amalgamated company at their respective base costs and tax values.⁴⁵⁴

Clark explains that as regards the deferral of tax in the case of a merger transaction, the deferred taxation applies where the merging company’s shareholders continue to hold their investment but in a modified form – there is a continuity of ownership interest

(b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company’s securities; or
(c) dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities,

but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002)”. In 2023 the CIPC established a Beneficial Ownership register, to enable the CIPC to obtain and hold records of natural persons who own or exercise control over a company. Section 64D of the Income Tax Act defines the term “beneficial owner” in relation to a dividend as the person entitled to the benefit of the dividend attaching to a share. The Companies Act Bill of 2021 identified a potential disparity between the “beneficial owner” and the “registered owner” of the company’s securities and has introduced the concept of “beneficial ownership” in order to establish who the true owner is of the company’s securities.

This is a dilemma also faced in cross-border tax matters, where taxpayers engage in “treaty shopping” (attempting artificially to gain access to certain “beneficial” treaties) by obscuring who and where the ultimate beneficial owner of for example, the dividend is. See Article 10 -12 of the OECD Model Tax Convention and the OECD Commentary, which clarifies that the “beneficial owner” of a dividend is the person “who has the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person.” See para 12.4 of the Commentary on the OECD Model Tax Convention 2017.)

⁴⁵⁰ Chong and Van der Linde 2014 3 *Stell LR* 479.

⁴⁵¹ *ibid* 472.

⁴⁵² Revenue Law Amendment Bill Explanatory Memorandum http://www.treasury.gov.za/legislation/bills/2002/rlab_2002_memo.pdf (accessed 9 October 2021). Also see *Tecmed (Pty) Ltd v Nissho Iwai Corporation* 2010 1 SA 35 (SCA) para 21.

⁴⁵³ Shama *Statutory mergers* 81.

⁴⁵⁴ Rudnicki 2017 8/3 *Business Tax and Company Law Quarterly* 3.

in the surviving company.⁴⁵⁵ The tax consequences of the transaction are therefore deferred until there is a disinvestment which then triggers the tax consequences.

Tax neutrality does not only refer to the transaction being tax neutral from an income-tax perspective, as the tax neutrality resulting from the application of the corporate rules extends to other taxes such as security transfer tax (STT), value added tax (VAT), or transfer duty. These other rollover relief provisions are discussed in paragraph 3.3 below.

Section 41 of the Income Tax Act sets out general provisions pertaining specifically to the corporate rules.⁴⁵⁶ Significantly, section 41(2) provides that the corporate rules apply notwithstanding any provision to the contrary in the Income Tax Act, other than the specific statutory provisions mentioned.⁴⁵⁷ In other words, the corporate rules supersede the vast majority of sections in the Income Tax Act.

Unfortunately, as is clear from the above quote from the 2001 Explanatory Memorandum on the Second Revenue Laws Amendment Bill, these sections are often abused and all the corporate rules therefore contain their own anti-avoidance provisions. As indicated by Rudnicki,⁴⁵⁸ the application of these anti-avoidance rules often stretches over a lengthy period which means that adverse tax consequences can be triggered years after concluding the corporate rollover transaction.⁴⁵⁹

In its report on the efficiency of corporate income tax in South Africa the Davis Tax Committee notes that the fragmented anti-avoidance rules in the corporate rules create unnecessary complexities and recommend a review of the rules to remove these complexities.⁴⁶⁰ The Committee further recommended that reliance be placed

⁴⁵⁵ Clark *Corporate Law* 406 – 407.

⁴⁵⁶ The section contains, *inter alia*, certain definitions that must be read in conjunction with s 1 definitions of the Act.

⁴⁵⁷ The exemptions to the override status given to the corporate rules are s 24BA (Assets acquired as consideration for shares issued), s 24I (Foreign exchange gains and losses), s 25BB(5) (Disallowance of amounts claimable by a REIT or a controlled company in respect of immovable property), s 103 (Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income), and Part IIA of Chapter III (Impermissible avoidance arrangements) and para 11(1)(g) of the Eighth Schedule (Value shifting arrangements).

⁴⁵⁸ Rudnicki 2011 2 *Business Tax and Company Law Quarterly* 16.

⁴⁵⁹ For example, the 6-year anti-avoidance provision in s 45(4)(b) of the Income Tax Act discussed below.

⁴⁶⁰ <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 13 February 2023).

on the general anti-avoidance rules (GAAR)⁴⁶¹ and that only certain specific anti-avoidance provisions be retained in the corporate rules.⁴⁶²

This study focuses on amalgamation transactions governed in section 44 of the Income Tax Act, which is compared to the sections governing statutory mergers in the Companies Act. Nevertheless, as discussed in Chapter 2, there is more than one way to skin the proverbial cat. In Chapter 2, I also showed that given all the uncertainties surrounding the statutory merger under the Companies Act, many parties chose to use alternative methods in the Companies Act to facilitate a merger transaction – eg, a scheme of arrangement or disposal of all or the greater part of the company's assets.⁴⁶³

Similarly, in this chapter, I consider the alternatives by which to effect a merger or amalgamation type of transaction in terms not only of section 44, but also of the other corporate rules.

The corporate rules are exceptionally complex and detailed sections in the Income Tax Act, each with its own intricacies and specific rules. I, therefore, consider only the following under each corporate rule discussed in this chapter:

- a) the requirements for the specific corporate rule;
- b) the rollover relief provided in terms of the specific corporate rule; and
- c) the specific anti-avoidance provisions of the relevant corporate rule.

The aim is to illustrate that even though a merger transaction can be tax neutral by using the other corporate rules, there are other rollover relief requirements that may be more onerous than those in section 44 or may have more extensive anti-avoidance provisions than section 44.

Section 42 (asset-for-share transactions), section 45 (intra-group transactions), and section 47 (liquidation distributions) are discussed in this chapter. A discussion of section 43 (substitutive share-for-share transactions) and section 46 (unbundling

⁴⁶¹ Sections 80A – 80L of the Income Tax Act.

⁴⁶² <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 13 February 2023).

⁴⁶³ See paras 2.5 and 2.6.

transactions) is not undertaken as these sections are not generally used to effect a merger or an amalgamation.⁴⁶⁴

Section 47 is specifically discussed as, first, it can be used as a second step in a two-step approach to achieve the effect of a merger in combination with a section 42 and section 45 transaction. Alternatively, a so-called “upstream amalgamation” (an amalgamation between a subsidiary and its holding company) can be achieved by using section 47 and the statutory merger provisions in the Companies Act.⁴⁶⁵

3.1.2 Definitions

3.1.2.1 Amalgamation transaction

The term “amalgamation transaction” is defined in section 44 as any transaction:

- “(a) (i) in terms of which any *company* (hereinafter referred to as the ‘amalgamated company’) *which is a resident disposes of all of its assets* (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) *to another company* (hereinafter referred to as the ‘resultant company’) *which is a resident, by means of an amalgamation, conversion or merger, and*
- (ii) as a result of which the existence of that *amalgamated company will be terminated,*”⁴⁶⁶ (emphasis added).

Consequently, an “amalgamation transaction” in terms of section 44(1)(a) is a transaction in terms of which an amalgamated company disposes of all of its assets to a resultant company (both companies being South African tax residents) by means of a merger, amalgamation, or conversion.⁴⁶⁷

⁴⁶⁴ Section 46 can be used to achieve a tax neutral demerger (or spin-off) but falls outside the scope of this thesis.

⁴⁶⁵ Shama *Statutory mergers* 89.

⁴⁶⁶ Section 44(1) of the Income Tax Act 58 of 1962. It should be noted that mergers involving foreign companies fall outside the scope of this study and subsections (b) and (c) of the definition will not be discussed.

⁴⁶⁷ Section 44(1)(b) and (c) provide that the definition of an amalgamation transaction also allows for foreign companies to be party to the amalgamation transaction. A full discussion hereof falls outside the scope of this thesis, but it is raised as one of the identified discrepancies in Chapter 4.

3.1.2.2 Resident

Certain highlighted words in the definition above need to be examined further. For tax purposes, a “resident” company is a person (other than a natural person) which is incorporated, established, or formed in the Republic, or which has its place of effective management in the Republic.⁴⁶⁸

3.1.2.3 Asset

The term “asset” is widely defined in paragraph 1 of the Eighth Schedule to the Income Tax Act to include a right or interest of whatever nature in property of whatever nature, excluding currency.⁴⁶⁹ Something such as goodwill constitutes property in the ordinary wide sense of the word.⁴⁷⁰ This means that in a transfer of assets, goodwill will qualify as an “asset” for tax purposes. In addition, a share would also qualify as an “asset” under the definition.

3.1.2.4 Disposal

The term “disposal” is also found in the Eighth Schedule to the Income Tax Act and like “asset”, it has a wide application including even deemed disposals.⁴⁷¹ Subject to certain exclusions, a disposal is “any event, act, forbearance, or operation of law which results in the creation, variation, transfer, or extinction

⁴⁶⁸ Section 1 of the Income Tax Act 58 of 1962. The concept, “place of effective management” is not defined in the Income Tax Act. One must then consider the ordinary meaning of the word by considering both local and international judicial and other interpretations of the term. See *Oceanic Trust Co Ltd NO v C: SARS* (2011) 74 SATC 127 and the English case *Customs v Smallwood and Anor* [2010] EWCA Civ 778 in this regard. Following the *Oceanic Trust* judgment, SARS amended its Interpretation Note 6 to align with the judgment and the OECD’s definition of a place of effective management. The Interpretation Note now provides that: “[A] company’s place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made.”

If a company is tax resident in South Africa due to having its place of effective management in South Africa or being incorporated in South Africa, the provisions of a Double Tax Treaty must also be considered. This is because the relevant Double Tax Agreement may provide that the company is tax resident in a different jurisdiction, or may serve as a tie breaker where the company is dual resident in two jurisdictions for tax purposes. This also has tax consequences for the merger and acquisition transactions.

⁴⁶⁹ “Asset” includes property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including coins made mainly of gold or platinum, and a right or interest of whatever nature to or in such property.

⁴⁷⁰ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.32.

⁴⁷¹ Para 11(1) of the Eighth Schedule to the Income Tax Act.

of an asset”.⁴⁷² It includes “the sale, donation, expropriation, conversion, grant, cession, exchange, or any other alienation or transfer of ownership”.⁴⁷³

The definition also specifically includes the distribution of an asset by a company to a holder of shares.⁴⁷⁴ This would generally constitute a dividend *in specie*⁴⁷⁵ and is discussed in further detail below.⁴⁷⁶ The above definition of a “disposal” includes “operation of law”,⁴⁷⁷ meaning that something that takes place by operation of law triggers a disposal in terms of paragraph 11 of the Eighth Schedule.

3.1.2.5 Debt

The term “debt” in section 41 of the Income Tax Act was amended in 2017 specifically to include any contingent liability.⁴⁷⁸ This has resolved the uncertainty as to whether the assumption of debt by the resultant company in terms of the Income Tax Act included the assumption of any contingent liabilities.⁴⁷⁹ An example of a contingent liability is a liability subject to uncertain timing or amount such as a provision for bonuses.⁴⁸⁰

3.1.2.6 Group of companies

A “group of companies” is defined in section 1 read with section 41 of the Income Tax Act. A “group of companies”⁴⁸¹ means two or more companies in which one company (the controlling group company) directly or indirectly holds

⁴⁷² Para 11(1)(a) of the Eighth Schedule to the Income Tax Act.

⁴⁷³ Ibid.

⁴⁷⁴ See s 47 discussed below.

⁴⁷⁵ A dividend *in specie* refers to distribution to shareholders in a form other than cash. See <https://www.sars.gov.za/faq/faq-what-is-a-dividend-in-specie/> (accessed 9 October 2021).

⁴⁷⁶ See para 3.2.3.6.

⁴⁷⁷ See n 291.

⁴⁷⁸ Interpretation Note 94 issued by SARS in 2016 provides that: “A contingent liability means an obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events and, if confirmed, will result in expenditure being incurred to settle the confirmed obligation.” See <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2016-08-IN94-Contingent-liabilities-assumed-in-the-acquisition-of-a-going-concern.pdf> (accessed 9 October 2021).

⁴⁷⁹ The Companies Act refers to “liabilities”, while the corporate rules refer to “debt”, which does not generally include contingent liabilities. See Sloane *Comparison of Company Legislation and Tax Legislation* 112; Dachs and La Grange 2012 January *The Taxpayer* 5.

⁴⁸⁰ The International Accounting Standard (“IAS”) 37 <https://www.ifrs.org/issued-standards/list-of-standards/ias-37-provisions-contingent-liabilities-and-contingent-assets/> (accessed 5 January 2022).

⁴⁸¹ Section 1 and s 41 of the Income Tax Act 58 of 1962.

shares in at least one other company (the controlled group company) to the extent that:

- a) “at least 70 per cent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies, or any combination thereof; and
- b) The controlling group company holds at least 70 per cent of the equity shares in at least one controlled company directly.”

Not all the corporate rules require a group of companies as defined. Nevertheless, in sections where it is a requirement (eg. section 47) the minority shareholders would not qualify for the tax rollover relief, as they do not meet the “group of companies” requirement, due to their low shareholding percentage.

3.1.2.7 *Contributed tax capital*

The concept of a contributed tax capital (or CTC as it is often termed in practice) is a concept that arises only in the tax context⁴⁸² and constitutes a notional amount.⁴⁸³ The term is defined in section 1 of the Income Tax Act⁴⁸⁴ and was introduced by the Revenue Laws Amendment Bill of 2008.⁴⁸⁵

Conceptually, the CTC system works as follows:

The balance of contributed tax capital is the amount contributed to the company by its shareholders when they subscribe for shares, less any capital distributions of these amounts that have been made to the shareholders.⁴⁸⁶

⁴⁸² There is no direct correlation with company law regarding the issue of share capital of a company and the contributed tax capital, but these two amounts may coincide. De Koker and Williams *Silke on South African Income Tax* ch 13 para 9.6.

⁴⁸³ Ibid.

⁴⁸⁴ “Contributed tax capital” as defined in s 1 of the Income Tax Act; De Koker and Williams *ibid* explain that the term, broadly speaking, means: “...in relation to a class of shares of a company, as the consideration received by that company for the issue of shares of that class, reduced by so much of the amount as the company has transferred for the benefit of a shareholder and which has been determined by the directors of the company to be a reduction of the contributed tax capital of the company.”

⁴⁸⁵ See Revenue Amendment Act 60 of 2008 https://www.gov.za/sites/default/files/gcis_document/201409/3178114.pdf (accessed 28 November 2022). Interestingly, around the same time the 1973 Companies Act was replaced by the Companies Act. The 1973 Act required, under ss 76 and 77, that record must be kept of share capital and share premium accounts. There was no such requirement in the Companies Act, which could have had a far-reaching impact on the calculation of income taxes if the concept of contributed capital had not been introduced. See Tredoux and Van Zyl 2018 21 *PER/PELJ* 9.

⁴⁸⁶ Contributed tax capital is effectively equal to stated capital less the stated capital or share capital and share premium that would have constituted a dividend. See De Koker and Williams *ibid*.

If a distribution – generally in the form of a dividend – is made to shareholders it is as a rule based on the shares they hold and is taken, in the main, from profits or cash reserves (sources other than shareholder contributions).⁴⁸⁷ This means that it is usually subject to dividends tax.⁴⁸⁸ However, if the distribution is made from the balance of contributed capital made by the shareholders (from the share capital or share premium account), the distribution would constitute a “return of capital”.⁴⁸⁹ A return of capital is drawn from the balance of CTC and is, therefore, not subject to dividend tax on the distribution.⁴⁹⁰

The balance of CTC may not be in the negative (ie, where the distribution amount exceeds the contribution) and if it is the distribution would be subject to dividends tax.

Notably, the Income Tax Act does not define the terms, “amalgamation”, “merger”, or “conversion” referred to in the definition of an “amalgamation transaction” in section 1. These terms should, in my view, be given their ordinary, literal meaning⁴⁹¹ but with consideration of the context in which they are used.⁴⁹² Rudnicki states that these three words have broad features of bringing two or more companies either into a newly incorporated company, or trans-positioning them into one of the merged companies, with the shareholders of the transferring companies receiving shares in the merged

⁴⁸⁷ Stiglingh *et al* SILKE 758 – 760.

⁴⁸⁸ See ss 64D – 64G of the Income Tax Act.

⁴⁸⁹ Defined in s 1 of the Income Tax Act as any amount transferred by a resident company for the benefit or on behalf of any person in respect of any share held in that company, to the extent that that transfer results in a reduction of contributed tax capital of the company and can be transferred by way of a distribution being made by that company. See the definition for specific restrictions.

⁴⁹⁰ Section 1 definition of “contributed tax capital” paragraph (a)(iii). The directors of the company must determine that the amount being transferred is contributed tax capital (may be done by way of a company resolution) by the date of the transfer to the shareholders. See Stiglingh *et al* SILKE 760.

⁴⁹¹ Claasen’s *Dictionary of legal words and phrases* defines “amalgamation”: “Is not a legal, but a commercial expression, and bears exact definite meaning. It involves the blending of two concerns into one; ‘substantially’ the whole of the two undertakings must pass, and ‘substantially’ all the incorporators must be parties; and it may take place by the transfer of two undertakings to a new corporation, or by the continuance of both undertakings on the terms that the shareholders of one shall become shareholders of the other.” In *Re SA Supply & Cold Storage Co; Wild v SA Supply & Cold Storage Co* 1904 2 Ch 268 287, Buckley J stated: “The difference between reconstruction and amalgamation is that in the latter is involved the blending of two concerns one with the other...”. “Merger” is defined in the *Oxford English Dictionary* as: “The combination or amalgamation of a commercial company, institution, etc., with another, or the consolidation of two or more companies, etc., into one”; while “Merger” is defined by Weinberg, Blank, Greystoke *et al* 103 as “a marriage between two companies, usually of roughly equal size”. “Conversion” is defined in the *Oxford English Dictionary* as “the act or process of changing something from one form, use, or system to another”.

⁴⁹² See the discussion of interpretation of statutes in para 4.4.1.

company(ies).⁴⁹³ He further suggested in 2017, that the term “conversion” appears misplaced in section 44 and perhaps even redundant, as such a change in economic interest would likely in any event constitute an amalgamation or merger.⁴⁹⁴

Notwithstanding, it is clear that the definitions of a “amalgamation transaction” contrasted with that of an “amalgamation or merger” in the Companies Act, are not aligned⁴⁹⁵ – this is further explored in Chapter 4.

3.2 Amalgamation transactions in terms of group rollover relief in section 44 of the Income Tax Act

3.2.1 Introduction

The basic principle underlying section 44 is to allow for two or more companies to merge their businesses into a single entity and that following the merger or amalgamation, the amalgamated company will be terminated.⁴⁹⁶

As mentioned earlier in this chapter,⁴⁹⁷ the amalgamation transaction was not part of the initial corporate rules in 2001, but was added soon after National Treasury recognised the need for a tax-neutral way for resident companies to effect amalgamations, mergers, or conversions.⁴⁹⁸

Broadly speaking, an amalgamation transaction in terms of section 44(1)(a) of the Income Tax Act provides that the amalgamated company transfers assets to the resultant company (both South African resident companies), in exchange for shares in the resultant company. Following the merger, the amalgamated company must be terminated and its shareholders will, as a result, receive shares in the resultant company.

⁴⁹³ Rudnicki 2014 5/3 *Business Tax and Company Law Quarterly* 36.

⁴⁹⁴ Rudnicki and Ashe 2017 8/3 *Business Tax and Company Law Quarterly* 5.

⁴⁹⁵ Gad and Strauss (*Part 1*) 2012 *Tax ENSight*.

⁴⁹⁶ Section 44(1)(a)(ii) of the definition of “Amalgamation transaction”.

⁴⁹⁷ See para 3.1.

⁴⁹⁸ Revenue Law Amendment Bill 2002, “Explanatory Memorandum” http://www.treasury.gov.za/legislation/bills/2002/rlab_2002_memo.pdf (accessed 9 October 2021).

3.2.2 The requirements for section 44 and the tax rollover relief

Based on the definitions above, there are certain essential criteria that must be met for a transaction to qualify as an amalgamation under section 44:

- a) The transaction must take place between companies. What constitutes a “company” for purposes of this study is defined in section 1 of the Income Tax Act.⁴⁹⁹ Accordingly, individuals and trusts are excluded from the application of section 44.⁵⁰⁰
- b) There must be a disposal by a resident company (amalgamated company) of all its assets to another resident company (the resultant company). Notably, the definition allows for certain assets earmarked to settle debts incurred in the ordinary course of its trade to be retained by the amalgamated company.⁵⁰¹
- c) The consideration must take the form of an “equity share”⁵⁰² or, under certain circumstances, the assumption by the resultant company of “qualifying debt”⁵⁰³ of the amalgamated company. This is addressed later in this chapter.
- d) As a result of the amalgamation or merger the existence of the amalgamated company must be terminated.⁵⁰⁴

⁴⁹⁹ For purposes of this study, which is aimed at local mergers and amalgamations, a “company” is defined in s 1 to include: “any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law”; “any co-operative”; “any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public”; or “a close corporation”. Section 41 defines a company as: “does not include a headquarter company and, for the purposes of sections 42 and 44, includes any portfolio of a collective investment scheme in securities or any portfolio of a hedge fund collective investment scheme”.

⁵⁰⁰ Rudnicki 2014 5/3 *Business Tax and Company Law Quarterly* 32.

⁵⁰¹ Section 44(1) of the Income Tax Act 58 of 1962; Rudnicki *ibid* 33. Rudnicki argues that the term “any debt incurred by it in the ordinary course of its trade”, will include working capital related debt, in other words, a liability incurred to finance the company’s income producing activities.

⁵⁰² Section 44(4)(a) of the Income Tax Act 58 of 1962. The term “equity share” is defined in s 1 of the Income Tax Act 58 of 1962 as “any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution”.

⁵⁰³ Section 44(4)(b) of the Income Tax Act 58 of 1962.

⁵⁰⁴ Section 44(1)(a)(ii) of the Income Tax Act 58 of 1962.

It is interesting to note that a section 44 amalgamation transaction can be carried out even where there is no “group of companies” which is generally a requirement for the application of the corporate rules.⁵⁰⁵

Relief under the corporate rules, relief is generally applied electively but can also in certain instances be automatic depending on the section involved. This means that if the specific requirements for corporate rollover relief are met, the tax rollover relief applies automatically to the transaction and parties need not agree to “opt into” the application of the section. For amalgamation transactions, the rollover relief is applied automatically unless the parties elect otherwise.⁵⁰⁶ Section 44(14) provides that the section 44 rollover relief will not apply where, in terms of an “amalgamation transaction”, the resultant company and the shareholders of the amalgamated company form part of the same “group of companies” immediately before and after the disposal should the resultant company, amalgamated company, and shareholders jointly so elect.⁵⁰⁷

3.2.3 Tax rollover relief for the amalgamated company and the resultant company

Depending on the type of asset to be transferred in an amalgamation transaction, certain rollover relief is triggered for both the amalgamated company and the resultant company. As a result, depending on the nature of the asset being disposed of, either no income or profit (trading stock), no capital gain (capital asset), or no recoupment (allowance asset) is triggered in the hands of the amalgamated company when it disposes of its assets to the resultant company.⁵⁰⁸

In addition, the resultant company acquires the tax cost of the assets based on the tax cost in the hands of the amalgamated company, along with the characteristics of that asset.⁵⁰⁹ It must be reiterated that the relief measures in sections 44(2) and 44(3) will only apply to the extent that the amalgamated company receives consideration in the

⁵⁰⁵ A “group of companies”, as defined in s 1 read with s 41, is required for s 45, s 46 and s 47 transactions. Unlike the requirement in s 42(1)(a), for a s 44 transaction the shareholders of the amalgamated company are not required to hold a qualifying interest in the resultant company as a result of the amalgamation transaction.

⁵⁰⁶ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁵⁰⁷ Section 44(14) of the Income Tax Act.

⁵⁰⁸ Section 44(2) and (3) of the Income Tax Act; Stiglingh *et al* *SILKE* 800.

⁵⁰⁹ Section 44(2)(a)(ii), s 44(2)(b)(ii) and s 44(3)(a)(ii) and s 44(3)(b)(ii) of the Income Tax Act; Stiglingh *et al* *ibid* 821.

form of equity shares in the resultant company, and/or the resultant company assumes a debt incurred by the amalgamated company.⁵¹⁰ The rollover relief available based upon the type of asset transferred is analysed below.

3.2.3.1 *Establishing the type of asset disposed of*

The primary concern when considering the disposal of an asset for tax purposes is to establish the nature of the asset being disposed of. Based on whether the asset is classified as capital or revenue in nature has different tax outcomes in the hands of the seller.⁵¹¹ This tax principle will briefly be touched on but a detailed study is required when determining the nature of the asset being disposed of for tax purposes.

As mentioned, the profit arising from the disposal of an asset can be classified as either as capital or revenue in nature.⁵¹² If it is a capital asset its disposal is subject to the capital gains tax regulations in the Eighth Schedule to the Income Tax Act. If the disposal of the asset qualifies as revenue, the proceeds arising from its disposal will be included in the seller's gross income under the definition of "gross income" in section 1 of the Income Tax Act.

There is no single test to determine whether receipts arising from an asset is capital or revenue in nature⁵¹³ and each case must be considered on its own facts. However, the courts have over the years established various tests and

⁵¹⁰ Section 44(4) of the Income Tax Act; Clark *Corporate Law* 406 – 407. Clark explains that the deferred taxation applies where the merging company's shareholders continue their investment (in a modified form), while if the consideration in the merger is cash, effectively the shareholders of the selling company terminate their investment (in exchange for cash) and there is no longer a continuity of ownership interest in the surviving company.

⁵¹¹ Briefly, if the profit is revenue in nature, the full amount received or accrued to the taxpayer will be included in the taxpayer's gross income in terms of s 1 of definition of "gross income" in the Income Tax Act. The definition however specifically excludes amounts of a capital nature and, therefore, it must be established whether or not the amount is capital in nature. The amount included in the taxpayer's "gross income" may be reduced by certain qualifying deductions incurred in relation to the generation of such income (eg, s 11(a) of the Income Tax Act and the basic framework for calculating a person's taxable income). If the profit received is of a capital nature, the capital gains tax regulations in the Eighth Schedule to the Income Tax Act must be considered. The Income Tax Act may have certain "specific inclusions", meaning that the nature of the income is capital, but it is specifically included in the taxpayer's gross income.

⁵¹² As seen in the case of *Pyott Ltd v CIR* 1945 AD 128 136, all receipts and accruals must be categorised either as revenue or capital, they can never be neither ("non-capital" or "non-income").

⁵¹³ *CIR v Pick and Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A) at 56G-I: "There are a variety of tests for determining whether or not a particular receipt is one of a revenue or capital nature. They are laid down as guidelines only - there being no single infallible test of invariable application."

considerations when making this determination⁵¹⁴ and I discuss several of these judgments below. Olivier argues that in the light of extant case law, the courts have identified at least three tests for determining the nature of an amount: the fruit versus tree test, the profit-making-scheme test, and the fixed versus floating capital test.⁵¹⁵

In *CIR v Visser*⁵¹⁶ the fruit and tree analogy is presented in which Maritz J likens “income” (revenue) to fruit and “capital” to the tree that produces the fruit. While this is a useful test for determining the nature of an amount, it should be noted that what constitutes a “tree” for one taxpayer could constitute “fruit” in the hands of another taxpayer.⁵¹⁷

An example would be the proceeds arising from the sale of shares. For the average individual investor (who is not speculating on the market), shares are generally purchased with a view to holding them long term and earning dividends. If these shares are subsequently sold the proceeds received would generally be capital in nature as they constitute the equivalent of the “tree” in *Visser*. This is based on the fact that in the hands of the investor the shares are used to produce income (fruit) in the form of dividends. This said, the sale of the same shares in the hands of a share trader would generally produce receipts which qualify as revenue in that they form part of the seller’s trade of buying and selling shares on a daily basis (the fruit).

The second test applied by the courts relates to whether the taxpayer had embarked upon a profit-making scheme. Drawing on the same example and the judgment in *De Beers Holding (Pty) Ltd v CIR*,⁵¹⁸ a profit-making scheme may be illustrated as:

“[T]he dealer acquires the shares with the intention of ultimately disposing of them as part of a scheme of profit-making. This distinguishes his trade from

⁵¹⁴ Olivier, L, 2012, *Capital versus revenue: Some guidance* 2012 45/1 *De Jure* 173.

⁵¹⁵ *ibid.*

⁵¹⁶ *CIR v Visser* 1937 TPD 77, 8 SATC 271 82: “‘Income’ is what ‘capital’ produces or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principle or tree in the hands of one man may be interest in the hands of another. Law books in the hands of a lawyer are a capital asset, in the hands of a bookseller they are a trading asset.”

⁵¹⁷ Van Zyl and Oguttu 2017 80 *Journal of Contemporary Roman Dutch Law* 425.

⁵¹⁸ *De Beers Holding (Pty) Ltd v Commissioner for Inland Revenue* (127/85) 1985 ZASCA 86; 1986 1 All SA 310 (A) 30.

that of an investor in shares who buys shares to hold them as a capital asset and reap a return in the form of dividends.”

In *CIR v Pick and Pay Employee Share Purchase Trust*,⁵¹⁹ the taxpayer established a trust to provide shares to employees in a typical employee share scheme. The company purchased the shares in the market (at market value) and then sold them on to its employees on a continuous basis at a fixed price.⁵²⁰ The use of a fixed price meant that on occasion the trust made a profit on the sale of the shares to the employees. Accordingly, the question arose: is the profit incidental (capital in nature) or has the taxpayer embarked upon a scheme of profit making (revenue in nature)?⁵²¹

The court found that the trust did not intend to make a profit on the sale of the shares – the profit was purely fortuitous; it was not “designedly sought for and worked for”.⁵²² On this basis, the majority judgment was that the profit made by the trust did not arise from a profit-making scheme (it was merely fortuitous) and, therefore, was held to be capital in nature.⁵²³

The profit-making-scheme test is two-fold. First, one must establish whether the taxpayer is carrying on a trade (the objective test) and second, whether that trade is carried on for the sole or main purpose of making a profit (the subjective test).⁵²⁴

Another test applied by the courts to determine the nature of an amount is the fixed capital versus floating capital test. Typically, where an amount is received from the disposal of fixed capital⁵²⁵ it is regarded as capital in nature, whereas a disposal of floating capital⁵²⁶ is classified as revenue in nature.⁵²⁷ This test was applied in *CIR v George Forest Timber Co Ltd* 1924 AD 516 where the court had to consider whether the purchase price of a forest may be deducted from the proceeds from sale of timber from the forest by the taxpayer. The

⁵¹⁹ *CIR v Pick and Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A).

⁵²⁰ *ibid* 6 – 13.

⁵²¹ *ibid* 8 – 9.

⁵²² *ibid* 6.

⁵²³ *ibid* 11.

⁵²⁴ Olivier 2012 45/1 *De Jure* 173; Van Zyl and Oguttu 2017 80 *Journal for Contemporary Roman Dutch Law* 423.

⁵²⁵ *CIR v George Forest Timber Co* 1924 AD 516 525): “...fixed capital...though it produces fresh wealth, it remains intact”.

⁵²⁶ *ibid* 525 “...floating capital is consumed or disappears in the very process of production...”.

⁵²⁷ Olivier 2012 45/1 *De Jure* 174.

Appellate Division held that the initial purchase price of the forest was capital in nature (the property was added to the fixed capital stock of the company⁵²⁸) and that the cost of acquisition could, therefore, not be deducted from the taxpayer's gross income.⁵²⁹

In addition to the above three tests, there are certain factors that a court may consider in determining the nature of an amount. One of the most prominent of these is "the intention" of the taxpayer which includes considering: the intention of the taxpayer at both the time of acquisition of the asset and the time of its sale⁵³⁰ – a mixed intention⁵³¹ or a change of intention.⁵³²

In *Natal Estates Ltd*,⁵³³ the intention of the taxpayer was considered in determining whether the asset had been held for investment purposes (capital in nature), or whether the taxpayer had embarked on a profit-making scheme, which would mean the proceeds of the sale of the asset were no longer capital in nature but constituted revenue. Holmes JA famously compared such a change of intention to the crossing of the Rubicon, the river crossed by Julius Caesar in declaring war on the Roman Republic.⁵³⁴

"In deciding whether a case is one of realizing a capital asset or of carrying on a business or embarking upon a scheme of selling land for profit, one must think one's way through all of the particular facts of each case. Important considerations include, inter alia, the intention of the owner, both at the time of buying the land and when selling it (for his intention may have changed in the interim) ... From the totality of the facts one enquires whether it can be said

⁵²⁸ *CIR v George Forest Timber Co Ltd* 1924 AD 516 531.

⁵²⁹ *ibid* 523, and at 527: "Now, money spent in creating or acquiring an income producing concern must be capital expenditure... There is a great difference between money spent in creating or acquiring a source of profit, and money spent in working it. The one is capital expenditure, the other is not."

⁵³⁰ The intention may have changed between the acquisition and the sale of so it is important to consider the intention of the taxpayer at both these points.

⁵³¹ See *COT v Levy* 1952 2 All SA 371 (A) 379: "[W]here the purposes of an individual taxpayer are mixed the only course, on principle as well as for practical reasons, is to seek and give effect to the dominant factor operating to induce him to effect the purchase."

⁵³² See *Natal Estates Ltd v SIR* 1975 4 SA 177 (A), 37 SATC 193 and *John Bell and Co (Pty) Ltd v SIR* 1976 4 SA 415 (A) 419 and 429, where it was indicated that a change of intention would constitute a change in, first, the character of the asset and, second, a change in the nature of the dealings with such asset. The determination of intention is a subjective test it makes it difficult to establish categorically whether or not if there has been a change of intention. A taxpayer is entitled to realise an asset at the highest possible price without it necessarily constituting a change of intention (eg, a change from a capital asset to stock-in-trade). See *CIR v Stott* 1928 AD 252 264: "Every person who invests his surplus funds in land or stock or any other asset is entitled to realize such asset to the best advantage and to accommodate the asset to the exigencies of the market in which he is selling. The fact that he does so cannot alter what is an investment of capital into a trade or business for earning profits."

⁵³³ *Natal Estates Ltd v SIR* 1975 4 SA 177 (A), 37 SATC 193.

⁵³⁴ <http://www.eyewitnesstohistory.com/caesar.htm> (accessed 10 October 2021).

that the owner had crossed the Rubicon and gone over to the business, or embarked upon a scheme, of selling such land for profit, using the land as his stock-in-trade.”

This notwithstanding, it should be noted that the disposal of an asset which has been held for investment purposes (as capital) at a profit does not automatically mean that the taxpayer’s intention has changed. In other words, where an asset is disposed of for a profit, it does not automatically change the nature of the receipt arising from the disposal from capital to revenue in nature.⁵³⁵ The taxpayer has the right to realise the asset to its best advantage⁵³⁶ and, accordingly, something more than a mere disposal must be required for the profit arising from the disposal to qualify as revenue in nature.⁵³⁷

For tax purposes, certain factors can be considered in determining a company’s intention.⁵³⁸ For example, in *Elandsheuwel Farming (Edms) Bpk v SBI*, the court held that the shareholders’ intentions should be attributed to the company.⁵³⁹ In *CIR v Richmond Estates (Pty) Ltd*, the court held:

“A company is an artificial person with no body to kick and no soul to damn and the only way of ascertaining its intention is to find out what its directors acting as such intended. Their formal acts in the form of resolutions constitute evidence as to the intentions of the company of which they are directors...”⁵⁴⁰

In *SIR v The Trust Bank of Africa Ltd*, the court held that one should not only be limited to considering the formal acts of the company (such as the company resolution) when determining the company’s intention.⁵⁴¹ Botha JA stated that he could see no reason, in principle, why the persons who are in effective

⁵³⁵ *CIR v Richmond Estates (Pty) Ltd* 1956 1 All SA 449 (A) 455: “The decision was to sell capital assets and the fact that a taxpayer decides to sell capital assets at a profit cannot per se make the resulting profit subject to tax.”

⁵³⁶ *CIR v Stott* 1928 AD 252 264.

⁵³⁷ *ibid* 265: “[T]here is no definite test which can always be applied in order to determine whether a gain or profit is income or capital, but in order to convert what is on the face of it an ordinary investment of surplus funds into a profit-making business there must be proof of some special acts which in the ordinary experience of men shows that the taxpayer has conceived some scheme for profit-making and has made it his business to carry it out.”

⁵³⁸ See *SIR v The Trust Bank of Africa Ltd* 1975 3 SA 652 (A) 19 – 20: “The intention of a corporate body is not confined to its formal resolutions passed by its Board of Directors: it may be gathered in appropriate circumstances from the thoughts and acts of its controlling or managing officers.”

⁵³⁹ *Elandsheuwel Farming (Edms) Bpk v SBI* 1978 1 SA 101 (A) 103: “[A]lthough appellant, as a legal persona, had its own identity apart from that of its shareholders, it could nevertheless be reasonably inferred from the relevant facts that the new shareholders involved appellant as a party in the execution of their scheme: the intention of the new shareholders would inevitably be attributed to the appellant.”

⁵⁴⁰ *CIR v Richmond Estates (Pty) Ltd* 1956 1 All SA 449 (A) 453.

⁵⁴¹ *SIR v The Trust Bank of Africa Ltd* 1975 3 SA 652 (A) 22 – 23.

control of a company cannot give evidence as to the intention of the company on any matter.⁵⁴²

3.2.3.2 *Capital asset*

Where an amalgamated company disposes of a capital asset, the resultant company acquires it as a capital asset since the nature of the asset does not change with the transfer.⁵⁴³ The same principle applies to trading stock and allowance assets (see discussion in paras 3.2.3.3 and 3.2.3.4 below) which the resultant company acquires in the nature they had when disposed of by the amalgamated company.⁵⁴⁴ When determining the capital gain or capital loss on the disposal of the capital asset by the resultant company, the two companies are deemed to be one and the same person as regards the date of acquisition of the asset and the amount and date of expenditure incurred to acquire it. This includes any qualifying expenditure under of paragraph 20 of the Eighth Schedule.⁵⁴⁵

In terms of section 44(2)(a)(i) of the Income Tax Act, an amalgamating company which transfers a capital asset to a resultant company under an amalgamation transaction is deemed to have disposed of the asset for an amount (the proceeds) equal to the base cost of that asset. In other words, no capital gain or loss will be triggered as the formula for calculating capital gains or capital losses is: proceeds⁵⁴⁶ minus base cost⁵⁴⁷ equals either a capital gain⁵⁴⁸ or a capital loss.⁵⁴⁹ Where the proceeds exceed the base cost a capital gain is triggered on disposal of the asset;⁵⁵⁰ where the proceeds are less than the asset's base cost a capital loss is triggered on its disposal.⁵⁵¹ However, as provided for in section 44(2)(a)(ii), where the proceeds are deemed to be equal to the base cost the capital gain or capital loss is nil.

⁵⁴² *ibid.*

⁵⁴³ De Koker and Williams ch 13 para 13.34.

⁵⁴⁴ *ibid.*

⁵⁴⁵ Section 44(2)(a)(ii)(aa) of the Income Tax Act; De Koker and Williams *ibid.*

⁵⁴⁶ Part VI of the Eighth Schedule to the Income Tax Act para 35.

⁵⁴⁷ Part V of the Eighth Schedule to the Income Tax Act para 20.

⁵⁴⁸ Para 3 of the Eighth Schedule to the Income Tax Act.

⁵⁴⁹ Para 4 of the Eighth Schedule to the Income Tax Act.

⁵⁵⁰ Para 3 of the Eighth Schedule to the Income Tax Act.

⁵⁵¹ Para 4 of the Eighth Schedule to the Income Tax Act.

For example, Company A (the amalgamated company) disposes of machinery used in its operations (a capital asset) to Company B (resultant company) for R200 000 (the proceeds). Company A initially purchased the machine after valuation date⁵⁵² for R500 000 (the base cost). Under normal circumstances, a capital loss of R300 000 will be triggered upon disposal as the base cost of the asset being disposed of exceeds the proceeds received.⁵⁵³ However, if the transaction meets the requirements of section 44 and is transferred by way of an amalgamation transaction, the proceeds will be deemed to be equal to the base cost (in this example, R500 000) resulting in the capital gain or loss being nil.⁵⁵⁴ No capital gain or capital loss is, therefore, incurred on the transfer of the asset if the corporate rules apply. The same principle applies where, in the above example, a capital gain was triggered by the disposal of a capital asset in terms of section 44 of the Income Tax Act.

The change of intention of a taxpayer regarding the use of an asset is an important consideration as it in itself holds specific tax implications.⁵⁵⁵ Where there is a change in the nature of an asset a deemed disposal is triggered for capital gains purposes.⁵⁵⁶ De Koker and Williams illustrate this with an example specifically involving an amalgamation transaction.⁵⁵⁷

Example:

A resultant company acquires an asset as a capital asset but changes its intention and starts using the asset as trading stock. The resultant company will be deemed to have disposed of the asset at its market value at the date of conversion (when the company started using the asset as trading stock). The resultant company will be deemed to have re-acquired the asset at the same market value at the same date (as

⁵⁵² 1 October 2001, in terms of the definition of “valuation date” in para 1 of the Eighth Schedule to the Income Tax Act.

⁵⁵³ Taxable gain is included at 80 per cent in paragraph 10(1)(c) of the Eighth Schedule to the Income Tax Act, while 100 per cent of the profit is included in gross income if the disposal was revenue in nature.

⁵⁵⁴ Proceeds less base cost (R500 000 – R500 000) equals the capital gain/capital loss (R0).

⁵⁵⁵ See discussion of the change of intention in para 3.2.3.1.1

⁵⁵⁶ Para 12(2) of the Eighth Schedule to the Income Tax Act.

⁵⁵⁷ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

there is a deemed disposal of the asset), and it will be able to deduct the amount for normal tax purposes as the cost of trading stock.⁵⁵⁸

In a reverse scenario, where the resultant company acquires trading stock but changes its intention and starts using the asset as a capital asset, it will be deemed to have recouped an amount equal to the market value of the asset.⁵⁵⁹ This recouped amount will be included in the resultant company's gross income in the year it ceased to hold the asset as trading stock, and it will be liable for tax on the amount.⁵⁶⁰

3.2.3.3 *Trading stock*

"Trading stock" is defined in section 1 of the Income Tax Act to include "anything produced, manufactured, constructed, assembled, purchased, or in any other manner acquired by a taxpayer for manufacture, sale, or exchange by or on behalf of the taxpayer".⁵⁶¹ The definition further provides that the proceeds from the disposal of such trading stock will, subject to certain exclusions, form part of the taxpayer's gross income.⁵⁶²

There are special rules governing the taxation of trading stock. De Koker and Williams explain that under the general principles of tax, closing stock (the value of trading stock on hand at the end of the year) would not qualify as "gross income" as it does not constitute a receipt or accrual.⁵⁶³ Similarly, opening stock (the value of the trading stock at the beginning of the year) would not be deductible under section 11(a) of the Income Tax Act as the expenditure involved in the acquisition of such stock was incurred in a previous year of

⁵⁵⁸ Section 22(3) of the Income Tax Act read with para 12(2)(c) of the Eighth Schedule to the Income Tax Act.

⁵⁵⁹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁵⁶⁰ Section 22(3) of the Income Tax Act read with para 12(3) of the Eighth Schedule to the Income Tax Act.

⁵⁶¹ Section 1 definition of "trading stock" in the Income Tax Act. Also see s 41 definition of "trading stock".

⁵⁶² Section 1 definition of "trading stock" in the Income Tax Act.

⁵⁶³ Section 1 definition of "gross income"; De Koker and Williams *Silke on South African Income Tax* ch 13 para 8.111.

assessment.⁵⁶⁴ As a result, the only basis for dealing with trading stock is to make an adjustment to the taxpayer's taxable income.⁵⁶⁵

Swart points out that as opening and closing stock cannot be taken into account under the ordinary tax principles in that they represent neither a receipt/accrual in kind nor an expenditure in kind. He indicates that the only way to take them into account is to treat opening stock as a notional acquisition at the beginning of the year and closing stock as a notional sale at the end of the year.⁵⁶⁶

Consequently, for purposes of determining a taxpayer's taxable income one must consider both the opening⁵⁶⁷ and the closing stock⁵⁶⁸ in terms of section 22 of the Income Tax Act. To track "the movement" of the difference in the trading stock for a year of assessment, closing stock is added to the taxable income of the taxpayer and opening stock is deducted.⁵⁶⁹ In effect, section 22 allows for the determination of the deductible portion of trading stock (akin to the cost of sales in accounting).⁵⁷⁰

Depending on the value of the closing stock (added to taxable income) and that of the opening stock (deducted from taxable income), the difference between these two values will constitute an amount to be either deducted from or added to taxable income.⁵⁷¹

If the trading stock is sold, the proceeds from the sale will be included in the taxpayer's gross income in the relevant year of assessment while the initial expenditure incurred to acquire the trading stock may be deducted under section 11(a) of the Income Tax Act during the year of assessment in which the

⁵⁶⁴ Section 11(a) of the Income Tax Act; De Koker and Williams *ibid*.

⁵⁶⁵ *Duple Motor Bodies Ltd v Ostime* 1961 2 All ER 167 (HL), 1961 39 TC 537 569 – 570: "If the amount of stock-in-trade has increased materially during the year then in effect sums which would have gone to B swell the year's profits are represented at the end of the year by tangible assets, the extra stock-in-trade which they have been spent to buy; and similar reasoning will apply if the amount of stock-in-trade has decreased. So to omit the stock-in-trade would give a false result."

⁵⁶⁶ Swart *Taxation of trading stock* 171.

⁵⁶⁷ Section 22(2) of the Income Tax Act.

⁵⁶⁸ Section 22(1) of the Income Tax Act. Closing stock represents the non-deductible portion of the aggregate amount claimed as a deduction in respect of opening stock and trading stock acquired during the year of assessment. See Swart 1997 9/2 SA Merc LJ 188 193.

⁵⁶⁹ The cost of trading stock may only be deducted in terms of s 22 if the stock has been disposed of by means of sale or exchange. If trading stock is disposed of in a different manner, eg, lost in a fire, it may be claimed separately in terms of the general deduction formula or another specific deduction. See Swart 1997 9/3 SA Merc LJ 363.

⁵⁷⁰ See International Accounting Standard (IAS) 2 and Stiglingh *et al* SILKE 509.

⁵⁷¹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 8.111.

asset was acquired – provided that all the relevant requirements have been met.⁵⁷²

In terms of an amalgamation transaction, where a resultant company acquires trading stock from the amalgamated company the amalgamated company is deemed to have disposed of that trading stock for an amount equal to the cost or trading stock value of the stock disposed of.⁵⁷³

As with capital assets, the resultant company and amalgamated company are deemed to be one and the same person for purposes of the date of acquisition of the trading stock and the costs or trading stock value.⁵⁷⁴

The impact of a change of intention by the taxpayer has been discussed above,⁵⁷⁵ and the tax implications triggered by the change of intention as to the use of an asset after it has been acquired by the resultant company.

3.2.3.4 Allowance asset

An “allowance asset” is defined in section 41 of the Income Tax Act as a capital asset in respect of which a deduction or an allowance is permitted for purposes of determining a capital gain or capital loss.⁵⁷⁶

Generally, with a normal disposal of an allowance asset a recoupment of the allowances claimed is triggered in the hands of the seller.⁵⁷⁷

Section 44(3)(a)(i) of the Income Tax Act sets out the effect of a transfer of an allowance asset between an amalgamated company and a resultant company. It specifically provides that there will be no recoupment in the hands of the amalgamated company in the year of transfer.

In the case of the disposal of an allowance asset between an amalgamated company and a resultant company, the companies will be deemed to be one

⁵⁷² *CIR v Nemojim (Pty) Ltd* 1983 4 SA 935 (A) 939: “The cost of acquiring the shares must be regarded as current expenditure allowable as a deduction in terms of s 11 (a) of the Act in the year in which the purchases were made, while the proceeds of the sales of those shares must be regarded as ‘gross income’.”

⁵⁷³ Section 44(2)(b)(i) and (ii) of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch13 para 13.34.

⁵⁷⁴ *ibid.*

⁵⁷⁵ See para 3.2.3.1 above.

⁵⁷⁶ Para (a) of the definition of “allowance asset” in s 41 of the Income Tax Act.

⁵⁷⁷ Section 8(4) of the Income Tax Act.

and the same person for purposes of determining the allowance or deduction to which the resultant company is entitled – ie, what is to be recovered or recouped in the hands of the resultant company (which will only be triggered if that asset is later sold by the resultant company).⁵⁷⁸

3.2.3.5 *Other allowances (contracts)*

De Koker and Williams highlight that a “special rule” comes into play where the amalgamated company disposes of a contract to the resultant company as part of the disposal of the business as a going concern.⁵⁷⁹

Section 44(3)(b) of the Income Tax Act provides that this “special rule” applies where a debtor allowance,⁵⁸⁰ a future expenditure allowance,⁵⁸¹ or a future repair on ships⁵⁸² was allowed in terms of the specific contract in the year preceding the transfer of that contract or would have been allowed in the year of the transfer had the contract not been transferred. In terms of the rule itself, no allowance is permitted to be deducted by the amalgamated company and it must be included in its income for the year of the transfer.⁵⁸³

The amalgamated and resultant companies are deemed to be the same person for purposes of determining the allowance amount to which the resultant company is entitled in terms of these sections (ss 24, 24C and 24P), or which must be included in its income under those sections.⁵⁸⁴

3.2.3.6 *Distribution of shares*

As discussed in paragraph 3.1.2 above, a share constitutes an “asset” as defined in the Act and a “disposal” in terms of paragraph 11(1)(e) of the Eighth Schedule to the Income Tax Act and includes a distribution of an asset by a company to a holder of shares. This means that a distribution of a share to a shareholder could trigger a capital gains tax event.

⁵⁷⁸ Section 44(3)(a)(ii) of the Income Tax Act.

⁵⁷⁹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁵⁸⁰ Section 24 of the Income Tax Act.

⁵⁸¹ Section 24C of the Income Tax Act.

⁵⁸² Section 24P of the Income Tax Act.

⁵⁸³ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁵⁸⁴ Section 44(3)(b)(ii) of the Income Tax Act.

This type of distribution of a share would typically take place within a merger or amalgamation transaction as the assets in the merger transaction are generally transferred to the resultant company in exchange for consideration in the form of equity shares in the resultant company. These shares are then distributed to the shareholders of the amalgamated company on termination of the existence of the amalgamated company.⁵⁸⁵

Section 44(8) of the Income Tax Act provides that an amalgamated company must disregard the disposal of shares in the resultant company to the amalgamated company's shareholders where the shares in the resultant company had been acquired under an amalgamation transaction.

Generally, without the application of the corporate rules, such a distribution of shares by a company to its shareholders would constitute a distribution of a dividend *in specie*⁵⁸⁶ or a return of capital.⁵⁸⁷ If the share constitutes a capital asset, the distribution could trigger capital gains tax consequences for the distributing company.⁵⁸⁸

The impact of section 44(8) read with section 44(6)(c) is twofold. First, in terms of section 44(8) the distribution of the shares would not trigger capital gains tax for the amalgamated company as the section provides that the distribution to its shareholders must be disregarded. Second, in terms of section 44(6)(c), the distribution to the amalgamated company's shareholders is deemed not to be an amount transferred or applied for the benefit of its shareholders and will, therefore, not be treated as a dividend or a return of capital in the hands of the shareholders. This means that both dividends tax and income tax consequences are avoided in the hands of the shareholders. Consequently, in terms of section 44 tax is deferred in the hands of the distributing company (no dividend *in specie* tax consequence) and in the hands of the shareholder (no dividend tax or income tax consequence).⁵⁸⁹

⁵⁸⁵ See definition of an "amalgamation transaction" in s 44(1)(a) of the Income Tax Act read with s 44(6)(c) and section 44(8) of the Income Tax Act.

⁵⁸⁶ A dividend *in specie* refers to distribution to shareholders in a form other than cash. See <https://www.sars.gov.za/faq/faq-what-is-a-dividend-in-specie/> (accessed 9 October 2021).

⁵⁸⁷ Section 1 definitions of "contributed tax capital" and "return of capital" the Income Tax Act.

⁵⁸⁸ Para 75 of the Eighth Schedule to the Income Tax Act.

⁵⁸⁹ The tax deferred in terms of section 44(6) is governed in paras 76, 76A and 76B of the Eighth Schedule to the Income Tax Act.

The remaining balance of contributed tax capital of the amalgamated company is also transferred to the resultant company's contributed tax capital balance once the amalgamation transaction has taken place.⁵⁹⁰

3.2.4 Tax rollover relief for the amalgamated company's shareholders

In an amalgamation transaction the shareholders of the amalgamated company exchange their shares held in the amalgamated company for shares in the resultant company.⁵⁹¹

Relief available to the shareholders of the amalgamated company is governed by section 44(6) of the Income Tax Act. Broadly the relief can be set out as follows.⁵⁹²

Section 44(6)(b)(i) provides that the shareholder is deemed to have disposed of its equity shares in the amalgamated company at an amount equal to its tax cost (ie, base cost).⁵⁹³ When applying the capital gains tax formula (proceeds minus base cost) it is clear that the provision deems the proceeds to be equal to the base cost, and as a result the transaction triggers no capital gain or capital loss in the hands of the amalgamated company's shareholders.

Section 44(6)(b)(ii) provides that the shareholder is deemed to have acquired the equity shares in the resultant company on the same date it acquired the shares in the amalgamated company and at the same cost.⁵⁹⁴ This subsection provides that the shareholder carries across the historic date and cost of the shares to the new equity shares being held in the resultant company. Shama states that the effect of section 44(6)(b) is to provide a tax-neutral replacement in the hands of the shareholders for the shares now held in the resultant company. This in effect defers any inherent gain until the shareholder realises the shares held in the resultant company.⁵⁹⁵

In terms of section 44(6)(c), an equity share held in the resultant company that is acquired by the shareholders of the amalgamated company, is deemed not to be an amount transferred or applied for the benefit of its shareholders and will not be treated

⁵⁹⁰ Section 44(4A) of the Income Tax Act; Stiglingh *et al* SILKE 821.

⁵⁹¹ Section 44(4) of the Income Tax Act; Stiglingh *et al* *ibid*.

⁵⁹² For the relief to apply section 44(6)(a) must be complied with.

⁵⁹³ Section 44(6)(b)(i) of the Income Tax Act.

⁵⁹⁴ Section 44(6)(b)(ii) of the Income Tax Act.

⁵⁹⁵ Shama *Statutory mergers* 73.

as a dividend or a return of capital in the hands of the shareholders. It is, therefore, a tax-neutral transaction.⁵⁹⁶

There are also several tax implications that can be triggered for the shareholders. If the rollover relief did not apply and shares were distributed to the company's shareholders, the base cost of the shares (held in the distributing company) could be reduced by the market value of the distributed assets (ie, the shares in the resultant company).⁵⁹⁷ Where the market value of the assets being distributed exceeds the value of the base cost of the original shares held a capital gain can be triggered in the hands of the shareholders.⁵⁹⁸

3.2.5 Limitations on the application of section 44

The most important limitation of the application of section 44 is consideration.

Section 44 limits the applicable consideration for the assets being disposed of for equity shares and/or the assumption of qualifying debt.⁵⁹⁹ The rollover relief available in section 44 will, therefore, only apply to the extent that the assets are disposed of for equity shares or the assumption of debt.⁶⁰⁰ In practice, one often sees transactions with so-called "mixed consideration" – eg, a portion of the consideration consists of equity shares and a portion of cash. However, for tax purposes the section 44 rollover relief will only apply to the extent that the assets are disposed of in exchange for equity shares or the assumption of qualifying debt.⁶⁰¹ This leaves the cash portion of the consideration subject to normal tax.⁶⁰²

Gad and Strauss hold the view that there is a third type of "consideration" in exchange for the asset which they term "no consideration".⁶⁰³ They point out that based on the amendment in the 2011 Tax Law Amendment Act, there is no longer a requirement that the assets be acquired for a consideration, leaving the option of acquiring the

⁵⁹⁶ Section 44(6)(c) of the Income Tax Act.

⁵⁹⁷ Paragraph 76B(2) of the Eighth Schedule to the Income Tax Act.

⁵⁹⁸ Paragraph 76B(3) of the Eighth Schedule to the Income Tax Act.

⁵⁹⁹ Section 44(4) of the Income Tax Act.

⁶⁰⁰ *ibid.*

⁶⁰¹ De Koker and Williams *Silke on South African Income Tax* para 13.34.

⁶⁰² Clark *Corporate Law* 435. Clark suggests that in its essential characteristics a cash merger is clearly a sale and would not qualify for tax deferred treatment as it would "run afoul of the judicially created continuity of ownership interest requirement".

⁶⁰³ Gad and Strauss (*Part 1*) 2012 *Tax ENSight* 5.

assets for no consideration.⁶⁰⁴ This may be regarded as a practical view, especially in a situation where the amalgamating company and the resultant company are both held by the same holding company. In such a case, an issue of equity shares following an amalgamation transaction would seem superfluous.

Gad and Strauss further suggest that the term “consideration other than” indicates that if there is consideration, it must be in the prescribed forms. However, it also implies that there can be no consideration given in exchange for the disposal of assets for the rollover relief still to apply.⁶⁰⁵ This argument is problematic in that it does, in my view, not properly align with the intention of the Legislator or with the proper reading and interpretation of the legislation for an amalgamation transfer to be permitted for no consideration; this would be decidedly “unbusinesslike”.⁶⁰⁶

If read in context, the section is aimed at limiting the scope of consideration permitted in an amalgamation transaction by addressing situations where consideration other than equity shares is received or accrued in a merger transaction. In such an event, the rollover relief will not apply to such “other” consideration. The term “consideration” in law is defined in the *Cambridge Dictionary* as:⁶⁰⁷

“something with financial value that is given in exchange for something else” (emphasis added).

It shows that for something to be seen to constitute “consideration” there must be some financial value attached to it in exchange for something else. The term “consideration” is defined in the Companies Act as anything of value given and accepted for any property, service, act, omission or forbearance, or any other thing of value.⁶⁰⁸ To argue that “no consideration” falls within the ambit of the scope of section

⁶⁰⁴ Because there is no consideration, there is no consideration that can fall foul of section 44(4). Section 44(4) refers to tax relief not applying to a disposal of assets “to the extent that” such assets are disposed of for “consideration other than” equity shares or debt. See Gad and Strauss (*Part 1*) 2012 *Tax ENSight* 5.

⁶⁰⁵ Gad and Strauss *ibid*.

⁶⁰⁶ See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) para 18: “A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document... The ‘inevitable point of departure is the language of the provision itself’, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.” See para 4.4.1 for the interpretation of legislation following the judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA).

⁶⁰⁷ <https://dictionary.cambridge.org/dictionary/english/consideration> (accessed 12 December 2022).

⁶⁰⁸ Section 1 definition of “consideration” in the Companies Act. The definition specifically includes:

“(a) any money, property, negotiable instrument, securities, investment credit facility, token or ticket;

44(4) of the Income Tax Act is, in my view, clearly flawed in that there is no value attached thereto.

In any event, provisions such as sections 7, 24BA, 40CA and paragraphs 11(1)(g) and 38 of the Eighth Schedule, or potentially even donations tax provisions,⁶⁰⁹ must still be considered as anti-avoidance rules that could be triggered when a transfer takes place at no consideration.

For example, even if there is no consideration in exchange for the assets, or if consideration is less than market value, there may still be a tax impact for both the seller and the purchaser in terms of paragraph 38 of the Eighth Schedule. This paragraph deems the disposal to take place at market value for purposes of calculating capital gains tax where there has been a disposal to a person (the purchaser) who is a “connected person”⁶¹⁰ in relation to that person (the seller) for a consideration which does not reflect an arm’s-length price.⁶¹¹ In addition, the purchaser will be deemed to have acquired that asset at market value (which will serve as the base cost of the asset in the hands of the purchaser).⁶¹²

It is, however, important to recall that section 44 does not require a “group of companies” for its application and the above anti-avoidance provision may therefore not be applicable to an amalgamation transaction where the “connected person” definition is not met as regards the amalgamated and resultant companies.

A further requirement for an amalgamation transaction is that the amalgamated company must cease to exist.⁶¹³ Section 44(13) of the Income Tax Act requires that the amalgamated company must, within 36 months from the date of the amalgamation

-
- (b) any labour, barter or similar exchange of one thing for another; or
 - (c) any other thing, undertaking, promise, agreement or assurance, irrespective of its apparent or intrinsic value, or whether it is transferred directly or indirectly.”

⁶⁰⁹ Sections 54 – 64 of the Income Tax Act.

⁶¹⁰ A “connected person” is defined in s 1 of the Income Tax Act. In relation to a company, a “connected person” is any other company that would be part of the same group of companies, but with more than 50 percent of the voting rights or equity shares, as opposed the required 70 per cent in the “group of companies” definition.

⁶¹¹ Para 38(1)(a) of the Eighth Schedule to the Income Tax Act.

⁶¹² Para 38(1)(b) of the Eighth Schedule to the Income Tax Act.

⁶¹³ Section 44(13) of the Income Tax Act.

transaction, or such further period as the SARS Commissioner may allow, have taken the steps under section 41(4) to liquidate, wind-up, or deregister the company.⁶¹⁴

As mentioned in Chapter 1, there was previously a vast disconnect between the Companies Act and the Income Tax Act in this regard.⁶¹⁵ The Companies Act saw the amalgamated company cease to exist by operation of law, while the Income Tax Act required certain steps to be taken to liquidate, wind-up, or deregister the company. Section 41 did not previously provide for the liquidation or winding-up of a company by operation of law, which resulted in a significant disconnect between the Companies Act and the Income Tax Act.

Section 41 was subsequently amended in 2019 to read:

“(b) in the case of a deregistration of a company-

- (i) ...
- (ii) *a notice of amalgamation or merger has in terms of section 116 of the Companies Act been filed in respect of that company,*

in the prescribed form and manner with the Companies and Intellectual Property Commission” (emphasis added).

Noticeably, for future discussion, that the provisions of section 44 do not apply to a transaction that constitutes a liquidation distribution in terms of section 47 of the Income Tax Act.⁶¹⁶ The aim of this exclusion is to prevent an overlap in the application of the corporate rules⁶¹⁷ where an upstream amalgamation (an amalgamation between a subsidiary and its holding company) can be achieved by way of a liquidation distribution.

Interestingly, *Binding Private Ruling 210* was issued in November 2015, which allowed for a liquidation distribution in terms of section 47 followed by a section 44 amalgamation transaction between South African tax resident companies.⁶¹⁸ This shows that the sequence of steps in a corporate restructuring is significant – a

⁶¹⁴ See the discussion of the confusing terminology when comparing the Companies Act and the Income Tax Act in para 4.2.3. The wording here appears to imply that the amalgamated company must either be liquidated, wound-up, or deregistered. Each of these concepts has vastly different consequences from a company law perspective.

⁶¹⁵ See para 1.7 above.

⁶¹⁶ Section 44(14)(a) of the Income Tax Act.

⁶¹⁷ <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2012-01-Explanatory-Memorandum-Taxation-Laws-Amendment-Bill-2012.pdf> (accessed 29 November 2021).

⁶¹⁸ South African Revenue Service *Binding Private Ruling 210* “Liquidation Distribution Followed by an Amalgamation Transaction” 11 November 2015. Binding Private Rulings are only binding on SARS and the applicant taxpayer.

liquidation distribution could not have followed an amalgamation transaction in terms of section 44(14).

Following the proposed steps, the subsidiary company (SubCo) would distribute all its assets to its holding company, the applicant, in terms of a liquidation distribution. The existence of SubCo would then be voluntarily terminated within 36 months of the date of the distribution. As a second step, it was proposed that the applicant and a sister company,⁶¹⁹ referred to as the co-applicant, be amalgamated in terms of a statutory merger under section 113 of the Companies Act. The applicant would transfer all its assets and its business to the co-applicant in exchange for equity shares and the assumption of debt. The applicant would then distribute the newly acquired co-applicant shares to its shareholders based *pro rata* on their shareholding in the applicant. Having followed these steps, the applicant would be deregistered in terms of section 116 of the Companies Act. In the Ruling SARS held that the section 47 transaction may be followed by a section 44 transaction and the relevant rollover relief will apply.

3.2.6 The anti-avoidance provisions in section 44 and other relevant sections

As discussed above, the 2001 Explanatory Memorandum on the Second Revenue Laws Amendment Bill set out the reasoning for the introduction of the corporate rules and also highlighted concerns regarding abuse of these corporate rules.⁶²⁰

Section 44(5) of the Income Tax Act serves as the amalgamation transaction's anti-avoidance provision.

Typically, the abuse arises where a company wishes to transfer assets which, had it not been for the corporate rules, would have triggered a gain for a company with an assessed loss.⁶²¹ The company in the assessed loss position would then dispose of these assets and use the existing loss to set off any tax payable on the gains realised on disposal of the assets.⁶²² This tax-avoidance arrangement renders both transactions tax neutral – the first transfer takes place in terms of the corporate rules;

⁶¹⁹ Applicant and co-applicant have common shareholders and are, therefore, referred to as sister companies or fellow subsidiaries.

⁶²⁰ See para 3.1.1 above: "International experience has, unfortunately, also shown that these measures are often abused to avoid tax. A balance must, therefore, be struck between the breadth of the concessions these measures introduce and the potential for tax avoidance."

⁶²¹ Shama *Statutory mergers* 75.

⁶²² *ibid* 75.

while the second uses an assessed loss to set off against the gain triggered on realisation of the asset.

Section 44(5) provides that where, following the acquisition of the assets in terms of sections 44(2) and 44(3) of the Income Tax Act, a resultant company disposes of that asset within 18 months of acquiring it, certain tax implications are triggered.⁶²³ The section is a “difficult read” as it cannot be said to have been drafted in clear and simple language. In summary, however, if the resultant company disposes of the assets within 18 months from date of acquisition under an amalgamation transaction, the section deems the tax effect in the resultant’s hands to have arisen when the amalgamated company disposed of the relevant assets to the resultant company, without the relief in sections 44(2) and 44(3) of the Income Tax Act.⁶²⁴ This will effectively trigger a capital gain or recoupment in the hands of the resultant company whether or not any assessed loss is available.⁶²⁵

De Koker and Williams offer an example.⁶²⁶

Example:

The base cost of an asset at date of acquisition (in terms of an amalgamation transaction) is R40 and its market value is R100.

The resultant company disposes of the asset within 18 months of the date of the amalgamation transaction for R150. This disposal results in a capital gain of R110 (R150 – R40).

Of this amount, R60 (R100 – R40) constitutes a gain for CGT purposes irrespective of any other gains or losses of the company during the year (it is, in other words, ringfenced). Consequently, R48 (R60 x [80] per cent inclusion rate for companies⁶²⁷) is, therefore, included in the taxable income of the resultant company.

⁶²³ Section 44(5) of the Income Tax Act.

⁶²⁴ Section 44(5)(a) and s 44(5)(b)(ii) of the Income Tax Act.

⁶²⁵ An exception exists for trading stock in s 44(5)(b)(i) of the Income Tax Act.

⁶²⁶ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁶²⁷ The example in De Koker and Williams refers to an inclusion rate of 66,66%, which was the previous capital gains tax inclusion rate for companies. The inclusion rate for companies was increased to 80% with effect from 1 March 2016. Also see para 10 of the Eighth Schedule to the Income Tax Act.

The rest of the capital gain (ie, R110 – 60 = R50) may be used by the resultant company to determine its net capital gain or net capital loss during the year (in other words, this portion of the gain is not ringfenced in terms of the anti-avoidance provisions in s 44).

It should be noted that the anti-avoidance provision in section 44(5) does not apply to the disposal of trading stock within 18 months of the section 44 transaction if the trading stock is regularly and continuously disposed of by the resultant company.⁶²⁸

3.3 Other tax relief for amalgamation transactions

There are other potential tax implications that arise from a sale-and- purchase transaction where, for example, section 44 of the Income Tax Act does not apply. These taxes are STT and either VAT or transfer duty.⁶²⁹ These tax implications are highlighted in the following paragraphs but do not merit a full detailed discussion of each. One must take into consideration that these taxes will typically also be triggered if the other corporate rollover relief provisions do not apply.

From the outset that there appear to be certain inconsistencies in the application of these taxes⁶³⁰ if the parties to the transaction opt out of the application of the corporate rules.⁶³¹ Kruger submits that based on its wording, section 8(25) of the VAT Act does not apply if the parties opt out of the application of the corporate rules.⁶³² Contrarily, Kruger points out that given wording in the STT Act,⁶³³ even if parties elect to opt out of the application of the corporate rules, the rollover of relief in the STT Act will still apply.⁶³⁴ In my view, this is confirmed in *Binding Private Ruling 195* in which SARS

⁶²⁸ Section 44(5)(b)(i) of the Income Tax Act.

⁶²⁹ See s 9(15) of the Transfer Duty Act which provides that no Transfer Duty shall be payable in respect of the acquisition of any property under any transaction which, for purposes of the Value-Added Tax Act 1991, is a taxable supply of goods to the person acquiring such property if relevant requirements are met.

⁶³⁰ The taxes discussed in paras 3.3.1, 3.3.2 and 3.3.3.

⁶³¹ For example, in terms of s 45(6)(g) of the Income Tax Act at the time of the disposal the transferor and transferee company agree in writing that the section will not apply to the disposal of the assets.

⁶³² Section 8(25) applies, for example, where the provisions of s 45 are “complied with”. Kruger submits that the provisions of s 45 cannot be “complied with” if the parties have agreed that the corporate rule provisions do not apply to that disposal. See Kruger (*Part 2*) 2020 11/12 *Business Tax & Company Law Quarterly* 30 – 31.

⁶³³ Securities Transfer Tax Act 25 of 2007.

⁶³⁴ Section 8(1)(a)(i) of the STT Act reads that “the security is transferred to a person...in terms of an asset-for-share transaction referred to in section 42 of the Income Tax Act.” Kruger opines that the transaction “referred to” in s 42 is sufficiently broad to include a situation in which all the provisions of s

ruled that the exemption from STT in terms of section 8(1)(a)(i) of the STT Act remains applicable even where the parties have opted out of the application of section 42 of the Income Tax Act.⁶³⁵

Considering the Transfer Duty Act,⁶³⁶ I argue that, based on the wording of section 9(1)(l) of the Act, the relief from transfer duty would also still be allowed even where the parties have opted out of the corporate rules. This is because for the exemption to apply the section in the Transfer Duty Act merely requires that the transaction meet the definition of the relevant corporate rule “as defined” in the relevant section of the Income Tax Act. This implies that provided the definition of, for example, an asset-for-share transaction in section 42 has been met, the transaction is exempt from transfer duty, even if the parties have opted out under section 42(8A) of the Income Tax Act.⁶³⁷

From the above discussion on amalgamation transactions, the income tax implications for the disposal of an asset⁶³⁸ (including the disposal of shares) depend on how the asset has been held: as a capital asset, allowance asset, or as trading stock. If it is held as a capital asset its disposal may be subject to capital gains tax,⁶³⁹ if it is held as trading stock it may be included in the seller’s gross income,⁶⁴⁰ and if it

42 have been applied save for the election made by the parties for the section not to apply to their transaction. See Kruger, D, 2020 *VAT and Corporate Transactions: The Dragons Slumber: Part 2*, 2020 11/12 (Part 2) *Business Tax & Company Law Quarterly* 30 – 31.

⁶³⁵ *Binding Private Ruling 195* (26 June 2015) <https://www.sars.gov.za/wp-content/uploads/Legal/Rulings/BPR/LAPD-IntR-R-BPR-2015-10-BPR195-STT-Exemption-where-election-was-made-that-s42-will-not-apply.pdf> (accessed 22 November 2022).

⁶³⁶ Transfer Duty Act 40 of 1949.

⁶³⁷ Section 9(1)(l) of the Transfer Duty Act:

“No duty shall be payable in respect of the acquisition of property by—
any company in terms of—

- (i) an asset-for-share transaction as defined in section 42 of the Income Tax Act, 1962 (Act No. 58 of 1962);
- (iA) a substitutive share-for-share transaction as defined in section 43 of the Income Tax Act, 1962 (Act No. 58 of 1962);
- (iB) an amalgamation transaction as defined in section 44 of the Income Tax Act, 1962 (Act No. 58 of 1962);
- (ii) an intra-group transaction as defined in section 45 of the Income Tax Act, 1962 (Act No. 58 of 1962);
- (iii) a liquidation distribution as defined in section 47 of the Income Tax Act, 1962 (Act No. 58 of 1962); or
- (iv) a transaction which would have constituted a transaction or distribution contemplated in subparagraphs (i) to (iii) regardless of whether that company acquired that property as a capital asset or as trading stock,

where the public officer of that company has made a sworn affidavit or solemn declaration that such acquisition of property complies with the provisions of this paragraph.”

⁶³⁸ Para 1 definition of an “asset” in the Eighth Schedule to the Income Tax Act 58 of 1962.

⁶³⁹ See discussion under para 3.2.3.1.

⁶⁴⁰ See discussion under para 3.2.3.3.

is an allowance asset it may be subject to recoupment of allowances or deductions claimed prior to the disposal.⁶⁴¹

These other tax implications for the seller are highlighted below.

3.3.1 Value Added Tax

For purposes of VAT, when a VAT vendor⁶⁴² renders a supply⁶⁴³ of either goods or services it will be subject either to a standard rate of VAT (15 per cent), to zero-rated VAT (which still constitutes a taxable supply),⁶⁴⁴ or the supply will constitute an exempt supply which is free from VAT.⁶⁴⁵

Section 11 of the VAT Act⁶⁴⁶ provides for the zero-rating of the supply of certain goods or supplies. Subparagraph (e) specifically provides that where there is a supply of an enterprise,⁶⁴⁷ or part of an enterprise, to a registered vendor and the supplier and recipient have agreed in writing that the supply of the enterprise, or part thereof, is being disposed of as a going concern, that supply may be zero rated. This is, however, subject to certain provisos:

- a) The supplier and recipient must at the time of the conclusion of the agreement for the disposal of the whole or part of the enterprise, have agreed in writing that such enterprise or part of it, will be an income-earning activity on the date of its transfer.⁶⁴⁸

⁶⁴¹ See discussion under para 3.2.3.4.

⁶⁴² A "vendor" is defined as any person who is, or is required to be, registered for VAT under the VAT Act.

⁶⁴³ A "supply" is defined in s 1 of the VAT Act to include performance in terms of a sale, rental agreement, credit agreement, and all other forms of supply, whether voluntary, compulsory, or by operation of law, irrespective of when the supply is effected, and any derivative of "supply" shall be construed accordingly.

⁶⁴⁴ A "taxable supply" is a supply of goods or services which is chargeable with tax in terms of s 7(1)(a), including charges at zero rate in terms of s 11 of the VAT Act. See s 1 definition of "taxable supply" in the VAT Act.

⁶⁴⁵ An "exempt supply" means a supply that is exempt from tax under s 12 of the VAT Act 89 of 1991. Section 12(1)(a) provides that the supply of any goods or services shall be exempt from tax if the supply constitutes any financial services, excluding the supply of financial services which, but for this exemption, would be charged at a zero rate in terms of s 11 of the VAT Act 89 of 1991.

⁶⁴⁶ VAT Act 89 of 1991.

⁶⁴⁷ The term "enterprise" is defined in s 1 of the VAT Act 89 of 1991 and includes any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course of which goods or services are supplied to any other person for a consideration, whether for profit or not. This definition would include a typical company that is conducting a form of trade as part of its activity or enterprise.

⁶⁴⁸ Section 11(e)(i)(aa) of the VAT Act.

- b) The assets necessary for carrying on the enterprise or part of it, are disposed of by the supplier to the recipient.⁶⁴⁹
- c) In respect of supplies on or after 1 January 2000, the supplier and the recipient have at the time of the conclusion of the agreement for the disposal of such enterprise or part of it, agreed in writing that the consideration agreed upon for that supply is inclusive of VAT at the rate of zero per cent.⁶⁵⁰

SARS' Interpretation Note 57 on the sale of an enterprise as part of a going concern, explains that when dealing with a going concern the assets necessary for the carrying on of an enterprise must be disposed of by the seller to the purchaser.⁶⁵¹ The seller can, for example, decide to keep certain assets, or the purchaser may decide not to purchase certain assets – eg, old stock or book debts.⁶⁵²

It is submitted that, if the parties opt out of the corporate rules, section 8(25) of the VAT Act will not apply. However, nothing prevents the vendor from relying on section 11(1)(e) of the VAT Act to still have the transaction zero-rated if the relevant requirements have been met. Section 11(1)(e) of the VAT Act is broadly worded in that it also caters for the sale of a part of a going concern which means that only the assets necessary for carrying on an enterprise or part of an enterprise are disposed of by the supplier to the recipient.⁶⁵³

As such, a potential disconnect between the application of both section 11(e) of the VAT Act and statutory merger requirements in the Companies Act emerges. To qualify

⁶⁴⁹ Section 11(e)(i)(bb) of the VAT Act.

⁶⁵⁰ Section 11(e)(i)(cc) of the VAT Act.

⁶⁵¹ SARS Interpretation Note 57 5: <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed on 18 November 2022). Note that interpretation notes issued by SARS are not legally binding, they merely serve as guidance and as SARS' interpretation of the Act. See s 5 of the Tax Administration Act 28 of 2011 (practice generally prevailing) and *Marshall and Others v CSARS* 2018 ZACC 11 para 10, which cautions against relying reliance on interpretation notes in a dispute between the taxpayer and SARS: "Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided."

⁶⁵² Section 11(e)(i)(bb) of the VAT Act; SARS Interpretation Note 57 5: <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed on 18 November 2022).

⁶⁵³ Section 11(1)(e)(i)(bb) of the VAT Act.

as a statutory merger under the Companies Act all the assets and liabilities must be transferred to either a new company or the surviving company. This is not the case with the sale of a going concern in terms of section 11(e) of the VAT Act as the parties have a choice to withhold assets not necessary for carrying on an enterprise. It is logical that section 11(e) caters for situations where only a part of a company – eg, a division – is transferred as a going concern and to allow such a supply to be zero rated. Parties must, therefore, be mindful of the statutory merger requirements in the Companies Act versus the requirements for the zero rating of a going concern under section 11(e) of the VAT Act.

In addition, if the VAT supplier (the amalgamating company) withholds certain assets in a merger transaction to settle certain trade debt, administrative costs, or government-related liabilities (as provided for in the Income Tax Act) the realisation of those assets (to generate cash to settle outstanding debts) would most likely constitute a supply for VAT purposes and trigger standard rated VAT in the hands of the amalgamated company. This can effectively trigger additional, potentially unforeseen, costs for the amalgamated company. See the discussion in paragraph 4.2.1 which highlights a similar disconnect between section 44 of the Income Tax Act and the Companies Act.

A change in ownership of an enterprise through the sale of shares does not constitute the supply of a going concern.⁶⁵⁴ The transaction could, however, be exempt from VAT in terms of section 12(a) of the VAT Act if all the relevant requirements are met.⁶⁵⁵

Furthermore, where a supply of any goods or services is effected in terms of the corporate rules, one must consider section 8(25) of the VAT Act which applies automatically. In terms of section 8(25) where any goods or services are supplied by one VAT vendor to another VAT vendor, the vendors will, for purposes of that supply, be deemed to be one and the same person if the provisions of sections 42, 44, 45 or 47 of the Income Tax Act are complied with. It must, however, be noted that section

⁶⁵⁴ SARS Interpretation Note 57 *ibid*.

⁶⁵⁵ Section 12(1)(a) of the VAT Act provides that the supply will be exempt from VAT where there is a supply of any financial services. “Financial services” is defined in s 1 read with s 2 of the VAT Act and an interest in or right to a share in the capital of a juristic person would constitute an “equity security” and any issue, allotment, or transfer of ownership of an equity security would be deemed to be “financial services”.

8(25) will not apply in certain cases of a section 42 or section 45 transaction.⁶⁵⁶ Subparagraph (i) represents an instance in which the section will apply where the supply is of an enterprise or part of an enterprise that can operate independently, and the parties have agreed in writing that the enterprise is disposed of as a going concern. Effectively, section 8(25) provides that the vendors (the seller and the purchaser) are deemed to be “one and the same person” so there is no supply (as one cannot supply to oneself) and, therefore, no VAT obligation on the amalgamation transaction.⁶⁵⁷

A proviso to section 8(25) was added with effect from 1 April 2021 which provides that section 8(25) of the VAT Act shall not apply to a supply as contemplated in sections 42 or 45 of the Income Tax Act where the supplier and recipient have agreed in writing that the provisions of section 7⁶⁵⁸ and section 11(e) of the VAT Act will apply. The issue addressed by this amendment is explained in the 2020 Explanatory Memorandum for the Tax Law Amendment Bill.⁶⁵⁹ If certain assets do not qualify for income tax corporate rollover relief under sections 42 or 45, those assets will also not qualify for the VAT relief in section 8(25), despite their forming part of the transaction as a whole.⁶⁶⁰ This limitation of relief in the two sections in the Income Tax Act holds unintended consequences for VAT as these assets – which did not qualify for the income tax corporate rollover relief – would unintentionally be subjected to the standard rate of VAT. As the entire transaction could qualify for VAT relief in terms of section 11(e) of the VAT Act, it was proposed to permit vendors to elect to agree in writing that the provisions of sections 7 and 11(1)(e) of the VAT Act will apply to the

⁶⁵⁶ See section 8(25)(i) – (iii) for requirements for s 8(25) to apply to a s 42 or s 45 transaction. For purposes of this thesis it is assumed that goods and services disposed of in terms of s 44 of the Income Tax Act are used wholly for taxable purposes by the seller. See Kruger 2020 11/12 (*Part 2*) *Business Tax & Company Law Quarterly* 26 – 30 for a discussion of the VAT impact of a partly taxable portion of goods and services being disposed of in terms of a s 44 transaction.

⁶⁵⁷ Shama *Statutory mergers* 79 – 80.

⁶⁵⁸ Section 7(1) of the VAT Act provides that subject to exemptions, exceptions, deductions, and adjustments provided for in the VAT Act, VAT shall be levied on any vendor of goods or services supplied by him or her on or after the commencement date in the course or furtherance of any enterprise he or she carries out.

⁶⁵⁹ <http://www.treasury.gov.za/legislation/acts/2020/Explanatory%20Memorandum%20on%20the%2020%20TLAB.pdf> (accessed 16 December 2021).

⁶⁶⁰ <http://www.treasury.gov.za/legislation/acts/2020/Explanatory%20Memorandum%20on%20the%2020%20TLAB.pdf> (accessed 16 December 2021).

transfer between the group companies (under a section 42 or section 25 transaction).⁶⁶¹

On another front, one must remember that in terms of the Companies Act, a merger can see a new company formed pursuant to the statutory merger.⁶⁶² Shama submits that this means that the merger agreement can be concluded with a company that is yet to be formed.⁶⁶³

Chong and van der Linde disagree. They point first to a practical concern: the new company to be formed cannot be a party to a legal agreement such as a merger as it has no legal existence at the time of the conclusion of the merger agreement.⁶⁶⁴ Second, all the corporate rules – and, in fact, section 113 of the Companies Act – require the legal existence of at least two companies.⁶⁶⁵ As such, the provisions in part (a) of the definition of “amalgamation or merger” in the Companies Act does not allow for any rollover relief for tax purposes as the new company will only be formed *in terms of* (or pursuant to) the merger agreement.⁶⁶⁶

Chong and van der Linde state that, in practice, one would most likely prefer to use a pre-existing company, such as a shelf company, as party to the statutory merger in terms of part (b) of the definition of “amalgamation or merger”, and to ensure that the shelf company is a registered VAT vendor before the conclusion of the merger agreement.⁶⁶⁷

SARS’ Interpretation Note 57 provides:⁶⁶⁸

“In the event that the purchaser is not yet registered as a vendor at the time of concluding of the agreement, it is advisable that the agreement provide for the application of the zero rate, subject to the purchaser being a registered vendor with

⁶⁶¹

<http://www.treasury.gov.za/legislation/acts/2020/Explanatory%20Memorandum%20on%20the%202020%20LAB.pdf> (accessed 16 December 2021).

⁶⁶² See definition of “amalgamated or merged company” in s 1 of the Companies Act.

⁶⁶³ Section 113(2)(a), s 116(4)(b), and s 116(5)(a) of the Companies Act; Shama *Statutory mergers* 83.

⁶⁶⁴ Chong and Van der Linde 2014 3 *Stell LR* 481.

⁶⁶⁵ *ibid.*

⁶⁶⁶ *ibid.*

⁶⁶⁷ *ibid* 480 – 482. The authors also opine that s 113(1) and (2) of the Companies Act does not recognise an arrangement under which another company acts as merging company in the merger agreement as a *stipulation alteri* for the new company that will be formed.

⁶⁶⁸ SARS Interpretation Note 57 para 4.3 <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed on 18 November 2022).

effect from the date the agreement is concluded, and to furnish a copy of the VAT 103 to the seller as soon as it is available. Should this not occur, the seller should ensure that the contract makes provision to increase the consideration payable to cater for the imposition of VAT at the rate of 14%.”⁶⁶⁹

The Interpretation Note also addresses the supply of a going concern where the purchaser has commenced its enterprise but has not yet registered for VAT. It is advised that in such a case, the seller must ensure that the purchaser has at least applied to be registered as a vendor before concluding the agreement for the purchase of the enterprise.⁶⁷⁰ If such an application has not been launched before the conclusion of the agreement, the supply cannot be zero rated.⁶⁷¹

In practical terms, section 11(e) of the VAT Act and Interpretation Note 57 allow for a grace period in that the purchaser must be registered as a VAT vendor *at the time of transfer of the assets* but not necessarily *at the time of the conclusion of the merger agreement*. However, by the time of the conclusion of the merger agreement, the purchaser must have at the least applied to have the new company registered for VAT.⁶⁷²

3.3.2 Transfer duty

Transfer duty is payable by the purchaser of immovable property based upon the value of the property but is subject to the exemptions in section 9 of the Transfer Duty Act 40 of 1949. A relevant exemption is section 9(15) which provides that where VAT is payable on the transfer of property, the transfer will be exempt from transfer duty. A supply can be subject to VAT at zero rate under section 11 of the VAT Act 89 of 1991 for the exemption in section 9(15) to apply. This would typically be where there is a supply of an enterprise to a registered vendor and that enterprise is disposed of as a going concern.⁶⁷³ In such a case, no transfer duty is levied.

Specifically applicable to amalgamation transactions, section 9(1)(l)(iB) of the Transfer Duty Act provides an exemption from transfer duty where a property has been

⁶⁶⁹ Note that the VAT rate was increased from 14 per cent to 15 per cent with effect from 1 April 2018.

⁶⁷⁰ SARS Interpretation Note 57 para 4.5: <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed 18 November 2022).

⁶⁷¹ SARS Interpretation Note 57 3: <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed 18 November 2022).

⁶⁷² *ibid.*

⁶⁷³ Section 11(e) of the VAT Act 89 of 1991.

acquired by a company under section 44 of the Income Tax Act. However, the public officer of the relevant company must make a sworn affidavit or solemn declaration to this effect.

As mentioned earlier, the other corporate-rule transaction may also be exempt from transfer duty if the relevant requirements are met.

3.3.3 Securities Transfer Tax

Section 2 of the Securities Transfer Tax Act 25 of 2007 provides that STT is payable on the transfer⁶⁷⁴ of the shares from the seller to the purchaser at a rate of 0,25 per cent of the taxable amount of that share. The STT is payable by the company that issued the unlisted shares⁶⁷⁵ (ie, the seller). Nevertheless, the Act also provides that the STT paid to SARS can be recovered from the person to whom the share is being transferred (ie, the purchaser).⁶⁷⁶

Specifically, as regards amalgamation transactions, section 8(1)(a)(ii) of the STT Act provides that any share (security) transferred by way of an amalgamation transaction referred to in section 44 of the Income Tax Act is exempt from STT.

There is, however, a requirement that the public officer of the relevant company must make a sworn affidavit or solemn declaration to this effect.⁶⁷⁷ Section 8(1)(a)(ii) of the STT Act refers to “transfer” and this would, therefore, apply to both the disposal of any shares to a resultant company and to distributions made by the amalgamated company to its shareholders.⁶⁷⁸

As mentioned earlier, the other corporate rule transaction may also be exempt from STT if the relevant requirements are met.

⁶⁷⁴ Section 1 of the Securities Transfer Tax Act defines “transfer” as: “[T]he transfer, sale, assignment or cession, or disposal in any other manner, of a security or the cancellation or redemption of that security, but does not include—

(a) any event that does not result in a change in beneficial ownership;

(b) any issue of a security; or

(c) a cancellation or redemption of a security if the company which issued the security is being wound up, liquidated or deregistered or its corporate existence is being finally terminated.”

⁶⁷⁵ Section 6(2) of the Securities Transfer Tax Act 25 of 2007.

⁶⁷⁶ Section 7(2) of the Securities Transfer Tax Act 25 of 2007.

⁶⁷⁷ Section 8(1)(a) of the Securities Transfer Tax Act 25 of 2007.

⁶⁷⁸ Shama *Statutory mergers* 80.

3.4 Asset-for-share transactions in terms of group rollover relief in section 42 the Income Tax Act

3.4.1 Introduction

The basic aim of the asset-for-share transaction (hereafter a section 42 transaction), is to provide a tax-neutral transaction where a person⁶⁷⁹ disposes of an asset to a resident company (the transferee company) in exchange for equity shares in that company.⁶⁸⁰ The relief is granted as the section 42 transaction merely converts a direct interest in an asset to an indirect interest (through the shares being received in exchange for the assets)⁶⁸¹ subject to the proviso that all the relevant requirements are met.

The principal requirement under section 42 is that the market value of the capital asset exchanged for the equity share must be equal to or exceed the asset's base cost.⁶⁸² Where trading stock is exchanged, the requirement is that the market value of the trading stock must be equal to or exceed the trading stock's cost or value as closing stock.⁶⁸³

As discussed above in the case of section 44, certain principles in the corporate rules will also apply to section 42. First, the asset will retain its nature after the exchange (a capital asset remains a capital asset, et cetera),⁶⁸⁴ and second, the capital gain (or gain included in gross income if trading stock is exchanged for the equity shares) will be rolled forward and will only be taxable in the transferee company's hands once the assets are realised.⁶⁸⁵

In terms of section 42(8A), both parties can agree in writing that section 42 relief does not apply to the transaction failing which the tax relief will apply automatically. This

⁶⁷⁹ Section 42 does not restrict the type of person that may transfer the assets to the company in exchange for shares. A "person" is defined in s 1 of the Income Tax Act to include an insolvent estate, the estate of a deceased person, any trust, and any portfolio of a collective investment scheme. The definition does not however include a foreign partnership.

⁶⁸⁰ Section 42(1)(a)(i) of the Income Tax Act, definition of "asset-for-share transaction".

⁶⁸¹ Stiglingh *et al* *SILKE* 807.

⁶⁸² Section 42(1)(a)(i)(aa) of the Income Tax Act.

⁶⁸³ Section 42(1)(a)(i)(bb) of the Income Tax Act. Also see SARS *Binding Private Ruling 59* "Corporate Rules – Transfer of The Assets of Businesses Conducted by A Sole Proprietor To Companies and Close Corporations" 30 October 2009.

⁶⁸⁴ Section 42(1)(a)(ii) of the Income Tax Act.

⁶⁸⁵ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

may appear counterintuitive, but if the person transferring the assets has tax losses it will want to trigger the capital gain to set it off against its existing losses.⁶⁸⁶

If the consideration for the assets consists of both equity shares and another type of consideration – eg, cash, any consideration outstanding on loan account, or any shares other than equity shares – the disposal will be apportioned for purposes of the application of the rollover relief.⁶⁸⁷ In other words, the transaction will be separated into the part of the transaction that qualifies for rollover relief in terms of section 42 (ie, the equity shares consideration), and any other consideration mentioned above, which would trigger normal tax consequences.⁶⁸⁸

Despite the anti-avoidance provisions in section 42(7) which are discussed below, SARS has issued *Binding Private Rulings 288*⁶⁸⁹ and *249*⁶⁹⁰ in which it confirmed that back-to-back section 42 transactions are permitted but will still trigger the anti-avoidance provision in section 42(7) of the Income Tax Act.

This notwithstanding, it was stated in *Binding Private Ruling 288* that no gain or loss was triggered by the anti-avoidance provision as the shares were transferred at the same price (proceeds) at which they were acquired (base cost). In other words, if a taxpayer transfers a capital asset to a transferee company in exchange for shares in that company and:

- a) the section 42 requirements are met in the first transaction;
- b) the transferee company then immediately disposes of that capital asset to another company (transferee company 2) in exchange for shares in that other company (transferee company 2); and
- c) the requirements of section 42 of the Act are again met in the second transaction,

then both transactions may qualify for the tax “rollover” relief (as back-to-back section 42 transactions) even if the anti-avoidance provisions in section 42(7)

⁶⁸⁶ Stiglingh *et al* *SILKE* 815.

⁶⁸⁷ Section 42(4) of the Income Tax Act; Stiglingh *ibid* 813. The apportionment is made based on the market values of the various elements of the consideration for the assets.

⁶⁸⁸ Section 42(4) of the Income Tax Act.

⁶⁸⁹ SARS *Binding Private Ruling 288* “Consecutive Asset for Share Transactions within 18 Months” 17 January 2018. Also see SARS *Binding Private Ruling 168* “Corporate Rules: Disposal of Assets Within 18 Months of Acquisition” 17 April 2014.

⁶⁹⁰ SARS *Binding Private Ruling 249* “Corporate Group Restructuring Involving Multiple Transactions” 27 September 2016.

apply.⁶⁹¹ Nevertheless, binding private rulings are only binding on the parties and are specific to the facts in the relevant ruling application.⁶⁹² The above ruling, therefore, does not freely give taxpayers licence to conclude successive section 42 transactions.

As indicated earlier, corporate rules other than section 44 may be used to effect a merger. A section 42 transaction that is used to merge or amalgamate two businesses into a single company, can be visually illustrated as follows:

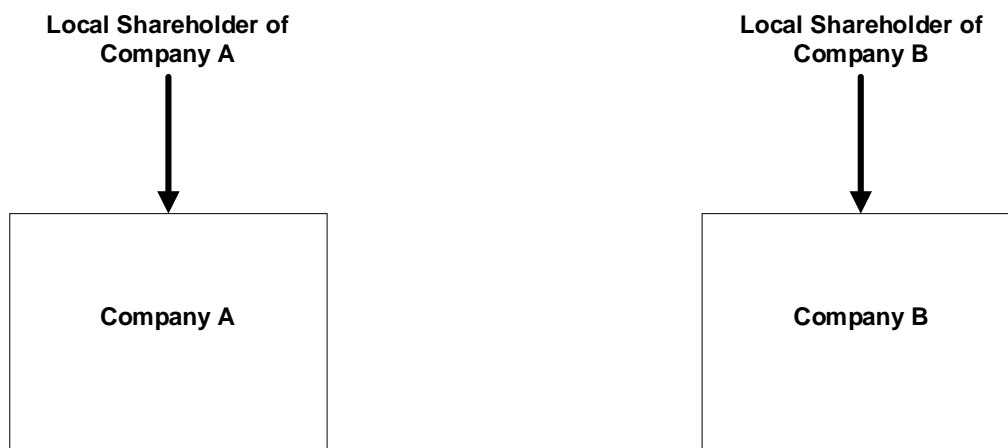


Figure 2-1 Pre- Section 42 Transaction

Source: Rudnicki M “Asset-for-share and amalgamation roll-over relief provisions – A comparison” 2015 6/1 *Business Tax and Company Law Quarterly* 23.

⁶⁹¹ In other words, s 42(7), an anti-avoidance provision, will be triggered with a successive asset-for-shares transaction, but if the shares are transferred at the price for which they were acquired the gain or loss triggered by the anti-avoidance provision will be nil. The purchase price and base cost of the shares would in all likelihood coincide in an immediate back-to-back transaction.

<https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-19-january-Consecutive-asset-for-share-transactions.html> (accessed 26 October 2021); Seligson 2019 10

Business Tax and Company Law Quarterly 7.

⁶⁹² Section 83 of the Tax Administration Act.

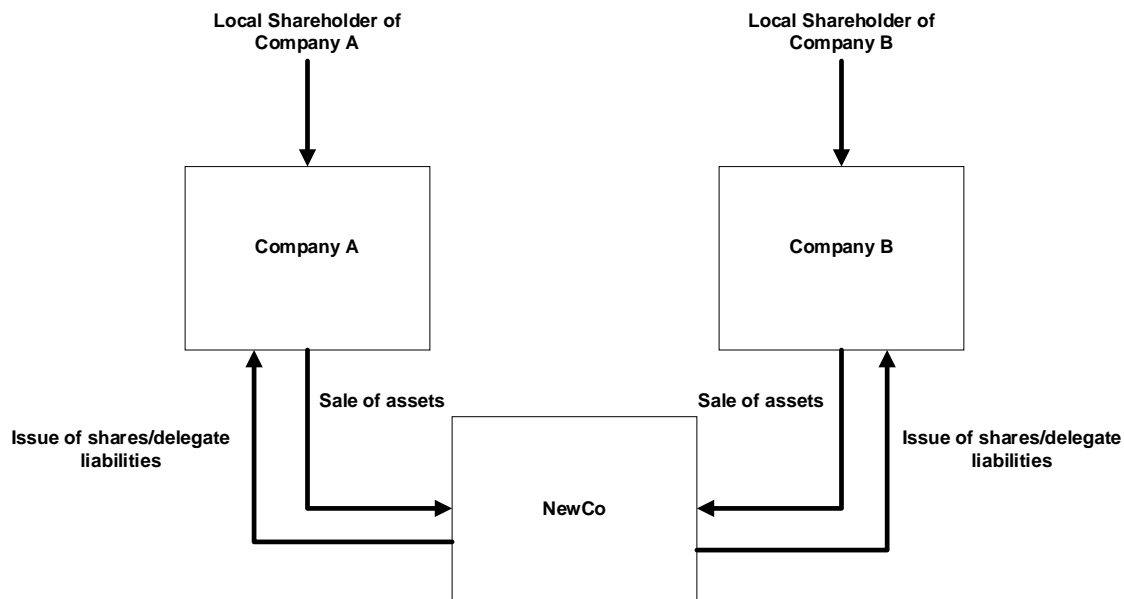


Figure 2-2 Application of section 42 transaction

Source: Rudnicki “Asset-for-share and amalgamation roll-over relief provisions – A comparison” 2015 6/1 *Business Tax and Company Law Quarterly* 23.

As regards the above example, a merger is achieved by way of a section 42 transaction. First, a new company, NewCo, is established. Second, Company A and Company B sell their assets to NewCo in exchange for the issue of shares in NewCo or the delegation of liabilities. A and B effectively merge their businesses into NewCo and are now shareholders in NewCo. There is no requirement in section 42 that A and B must be terminated.

In terms of this type of merger there need not be a termination of the amalgamated company as the Companies Act allows for a merger in which at least one of the amalgamating or merging companies (A and B in this example) survive with or without the formation of one or more new companies (NewCo in this example), and the vesting in the surviving company, together with such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.⁶⁹³ Due to the limited application of section 44 of the Income Tax Act which requires the termination of the amalgamated company or companies, section 42 provides tax rollover relief for the second type of merger or amalgamation transaction provided for in the Companies Act.

⁶⁹³ Section 1 definition, of “amalgamation or merger” para (b) of the Companies Act 71 of 2008.

Section 42 can also be used to effect a merger or amalgamation where the amalgamated company is terminated⁶⁹⁴ by using, first, a section 42 transaction which is then followed by a section 47 liquidation distribution. This ensures that the merger transaction is also tax neutral if all the relevant requirements have been met.

3.4.2 The requirements for section 42 and the tax rollover relief

To qualify for section 42 rollover relief the following requirements must be met.

- a) First, the purchaser of the asset must be a South African tax resident company.⁶⁹⁵
- b) Second, the market value⁶⁹⁶ of the asset must exceed the base cost of the asset.⁶⁹⁷ In other words, the rollover provisions do not apply where a loss is triggered on disposal of the assets in terms of a section 42 transaction.
- c) Third, the consideration for the assets must be in the form of “equity shares”⁶⁹⁸ or “prescribed debt”.⁶⁹⁹
- d) Lastly, it is required that at close of the day of the disposal of the assets the transferor continues to hold a qualifying interest⁷⁰⁰ in the transferee company after the disposal of the assets.⁷⁰¹

A “qualifying interest” as defined in section 42(1)(c) of the Income Tax Act, means, *inter alia*, equity shares held by that person⁷⁰² in a company which constitute at least ten per cent of the equity shares and voting rights. In terms of a company, a “qualifying

⁶⁹⁴ Section 1 definition of “amalgamation or merger” paragraph (a) of the Companies Act 71 of 2008.

⁶⁹⁵ See the definition of “resident” in s 1 of the Income Tax Act.

⁶⁹⁶ Market value is the sale price concluded between two independent and willing parties in the open market. The arm’s length price of the sale.

⁶⁹⁷ Section 42(1)(a)(i) of the Income Tax Act.

⁶⁹⁸ See the definition of “equity share” in s 1 of the Income Tax Act.

⁶⁹⁹ Section 42(1)(a)(i) read with s 42(8) of the Income Tax Act sets certain conditions for the debt as consideration for the equity shares. For example, the debt must have been incurred more than 18-months prior to the s 42 transaction. Alternatively, if the debt arose within the 18 month period it must have arisen simultaneously with the acquisition of the asset, or, if the debt arose within the 18 months prior to the s 42 transaction, it is merely a re-financing of either of its debts.

⁷⁰⁰ Section 42(1) of the Income Tax Act.

⁷⁰¹ Section 42(1)(a)(i)(A) of the Income Tax Act.

⁷⁰² There is no limitation on the term “person” in terms of s 42 transactions so, in terms of the definition of a “person” in s 1 of the Income Tax Act, it can even include a trust.

interest” means the person holds equity shares in a company that forms part of the same group of companies as that person holding the equity shares.⁷⁰³

3.4.2.1 Relief for the person who transferred the assets and acquired the equity shares

Capital assets disposed of in terms of a section 42 transaction are deemed to have been disposed of at their asset base cost.⁷⁰⁴ As noted above, there is no capital gain or capital loss triggered by the transfer.

Trading stock disposed of in terms of a section 42 transaction is deemed to have been disposed of for the expenditure incurred or the value included in opening and closing stock.⁷⁰⁵

The disposal of an allowance asset in terms of a section 42 transaction is not subject to a taxable recoupment in the hands of the seller.⁷⁰⁶

In terms of the disposal of contracts subject to a deduction on future expenditure, limited section 42 rollover relief applies but only where the contract forms part of a business sold as a going concern.⁷⁰⁷

As in section 44, section 42 also provides that the person (the seller) and the company (the purchaser) are deemed to be one and the same person for purposes of calculating tax implications.⁷⁰⁸ For example, regarding capital assets the company and the person are deemed to be one and the same person for purposes of calculating any taxable income by that company from its trade or any capital gain or loss in respect of a disposal of that asset by that company with respect of the date of acquisition of the asset and the amounts of expenditure incurred in respect of that asset in terms of paragraph 20 of the Eighth Schedule.⁷⁰⁹ In other words, the date of acquisition and qualifying costs incurred by the purchaser to acquire the asset being exchanged in the section

⁷⁰³ Section 42(1)(c) of the definition of “qualifying interest”.

⁷⁰⁴ Section 42(2)(a)(i) of the Income Tax Act (subject to s 42(4) and s 42(8)).

⁷⁰⁵ Section 42(2)(a)(ii)(bb) of the Income Tax Act (subject to s 42(4) and s 42(8)).

⁷⁰⁶ Section 42(3)(a) of the Income Tax Act (subject to s 42(4) and s 42(8)).

⁷⁰⁷ Section 42(3)(c) of the Income Tax Act; Rudnicki 2015 6/1 *Business Tax and Company Law Quarterly* 26

⁷⁰⁸ Section 42(2)(b), section 42(3)(a)(ii) of the Income Tax Act.

⁷⁰⁹ Section 42(b)(i) and (ii)(aa)(A) and (B) of the Income Tax Act.

42 transaction, are deemed to be the acquisition date and costs incurred by the seller.

3.4.2.2 Relief for the company issuing the equity shares and acquiring the assets

In terms of the rollover relief provided for the company that acquired the assets and in exchange issued equity shares, the tax costs of the assets will be the same as the tax costs in the hands of the person who transferred the assets to the company.⁷¹⁰

In terms of the company's contributed tax capital under a section 42 transaction, the contributed tax capital is carried forward to the purchaser of the asset and is deemed to be an amount equal to the base cost of the asset or the cost of the trading stock.⁷¹¹ The contributed tax capital balance is only increased for the value of assets acquired in exchange for equity shares, not for the assumption of any debt.⁷¹²

3.4.3 The anti-avoidance provisions in section 42

There are numerous subsections in section 42 that govern anti-avoidance provisions.

3.4.3.1 Preventing the conversion of revenue gains into capital gains

The first of these is triggered when the transferor (the person who acquired equity shares in the transferee company) disposes of the acquired equity shares in the transferee company within 18 months of receiving them⁷¹³ other than by way of a liquidation distribution,⁷¹⁴ an unbundling transaction,⁷¹⁵ an intra-group transaction,⁷¹⁶ a disposal triggered on death, or an involuntary disposal.⁷¹⁷

⁷¹⁰ Sections 42(2)(b) and 42(3)(a)(ii) of the Income Tax Act.

⁷¹¹ Section 42(3A) of the Income Tax Act.

⁷¹² Rudnicki 2015 6/1 *Business Tax and Company Law Quarterly* 28.

⁷¹³ Section 42(5) of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷¹⁴ Section 47 of the Income Tax Act.

⁷¹⁵ Section 46 of the Income Tax Act.

⁷¹⁶ Section 45 of the Income Tax Act.

⁷¹⁷ In terms of para 65 of the Eighth Schedule to the Income Tax Act.

Where, immediately before such a disposal, more than 50 per cent of the market value of all the assets disposed of to the transferee company was attributable to trading stock, allowance assets, or both, the transferor must, to the extent that the amount received or accrued in respect of that disposal of the shares is less than or equal to the market value of that share at the beginning of the 18 month period, include the amount received or accrued in its income.⁷¹⁸ The excess amount will be taxed based on the intention of the taxpayer – ie, either as capital or as revenue.⁷¹⁹

Van der Zwan explains the aim of this anti-avoidance transaction.⁷²⁰ The objective is to prevent revenue gains being converted into capital gains by making use of a section 42 transaction.⁷²¹

Typically, Person X⁷²² owns assets which, if disposed of, would result in income (trading stock) or recoupments (allowance assets) as a tax consequence. Person X enters into a section 42 transaction in terms of which the assets are transferred to Company A. This is a tax-neutral transaction. Person X still holds an indirect interest in the assets (now owned by the company in which Person X holds equity shares). Person X can, therefore, dispose of the “assets” by disposing of its equity shares (held as an investment which means the shares constitute a capital asset). Without the anti-avoidance rule, this disposal of the equity shares held in Company A can be construed to be capital in nature even though the entire underlying value of the shares is linked to assets to which income gains attach (as the assets would have triggered income or recoupments had they been sold directly).

⁷¹⁸ Section 42(5) of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷¹⁹ Section 42(5) of the Income Tax Act; Stiglingh *et al* *SILKE* 815.

⁷²⁰ Stiglingh *et al* *ibid*.

⁷²¹ *ibid*. The capital gain is subject to less income tax than the revenue gain.

⁷²² “Person” is defined in s 1 of the Income Tax Act, which includes an insolvent estate, the estate of a deceased person, any trust, and any portfolio of a collective investment scheme, but does not include a foreign partnership. As s 42 does not place a restriction on the person being party to an asset-for-share transaction it can be any person as defined in s 1.

3.4.3.2 *Person ceases to hold a qualifying interest within 18 months of the section 42 transaction*

Another anti-avoidance provision is where the transferor disposes of an asset and no longer holds a qualifying interest in the transferee company, all within a period of 18 months of the date of the section 42 transaction.⁷²³ This will trigger a deemed disposal event in the hands of the transferor and trigger the initial capital gain that had originally been deferred on the conclusion of the section 42 transaction.⁷²⁴ In addition to the deemed disposal, the person will be deemed immediately to have reacquired all the equity shares at a cost equal to the market value at the beginning of the 18 month period.⁷²⁵ De Koker and Williams clarify that the base cost of the retained shares is adjusted to their market value at the time of re-acquisition of the shares.⁷²⁶

3.4.3.3 *Ringfencing of gains*

There is also a third anti-avoidance measure in section 42 aimed at the transferee company, where the transferee company disposes of a transferred asset within 18 months of date of acquisition. The gains realised by the transferee company will be ringfenced⁷²⁷ as this prevents the transferee company from abusing the rollover relief provisions to shift “built-in-gain assets” to a company with excess losses so that the built-in gain can be set off against the tax losses.⁷²⁸

3.4.3.4 *Mismatch between the market values of the assets and equity shares being exchanged*

Although not governed in section 42 of the Income Tax Act, another anti-avoidance section that may come into play with a section 42 transaction is section 24BA. This section governs transactions where assets are acquired as consideration for shares issued.⁷²⁹ Briefly, on the one hand, the section allows

⁷²³ Section 42(6)(a) of the Income Tax Act.

⁷²⁴ *ibid*; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷²⁵ Section 42(6)(a)(bb) of the Income Tax Act.

⁷²⁶ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷²⁷ The effect of ringfencing this gain is that it may not be set-off against any assessed capital loss or balance of assessed capital loss. The gain must be kept separate if it is ringfenced.

⁷²⁸ Section 42(7) of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷²⁹ Section 24BA of the Income Tax Act.

for a determination to be made to ensure that the market value of the assets matches the market value of the shares issued as consideration.⁷³⁰ A discrepancy between the two could lead to a value-shifting arrangement which will trigger certain tax implications.⁷³¹ Where the market value of the shares exceeds the value of assets given in consideration, the excess will be deemed to be a dividend *in specie*, resulting in a 20 per cent dividend tax liability⁷³² (unless an exemption applies).⁷³³ On the other hand, where the market value of the assets exceeds the value of the shares given as consideration, the excess is deemed to be a capital gain for the acquiring company, and where the shares are held as a capital asset the excess amount will reduce the base cost of those shares.⁷³⁴

Section 24BA will, however, not apply where the company and the person form part of the same group of companies immediately after the company acquires the assets, or where the person will hold all the shares in that company immediately after that company acquires the assets.⁷³⁵

3.5 Intra-group transaction in terms of group rollover relief in section 45 of the Income Tax Act

3.5.1 Introduction

An “intra-group transaction” is defined in section 45 of the Income Tax Act as any transaction where a company (the transferor company) disposes of an asset to another resident company (the transferee company) and at the end of the day of the

⁷³⁰ *ibid.*

⁷³¹ *ibid.*

⁷³² Section 64EA(b) read with s 64E of the Income Tax Act.

⁷³³ Section 24BA(3)(b) of the Income Tax Act read with s 64FA of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.33.

⁷³⁴ Section 24BA(3)(a) of the Income Tax Act. De Koker and Williams *ibid.* Also consider section 40CA which governs the situation where assets are acquired in exchange for shares. As seen in *CSARS v Labat Africa Ltd* (669/10) [2011] 1 All SA 613 (SCA), there is no cost incurred by the company to acquire the asset by issuing its own shares as consideration for that asset. As a result, such a company would not be entitled to claim allowances on the acquired asset in this regard. Following this case, section 40CA was enacted. The section provides, amongst others, that where a company acquires an asset in terms of a s 42, s 43, or s 44 transaction and there is a deemed capital gain (triggered in terms of s 24BA(3)(a)) in respect of the acquisition of that asset, the acquiring company must be deemed to have incurred an amount of expenditure equal to that deemed capital gain on the date of the relevant transaction. This deemed expenditure is in addition to the amount of expenditure for which the asset is deemed to have been acquired by the company under the relevant corporate rules.

⁷³⁵ Section 24BA(4) of the Income Tax Act.

transaction, the two companies form part of the same group of companies and the assets acquired, which constituted a capital asset or trading stock, are held by the transferee company in the same capacity.⁷³⁶

If the parties do not wish section 45 to apply to their transaction, they may opt out of its application by agreement in writing.⁷³⁷

The requirement that the parties to the section 45 agreement must remain a group of companies following the transaction justifies a revisit of the definition of “group of companies”. The definition requires that the controlling group company hold at least 70 per cent of the shares directly in at least one controlled group company.⁷³⁸

Following a section 45 transaction, it should be noted that in order not to trigger the anti-avoidance provisions, only a maximum of 30 per cent of the share capital of the company may be owned by non-group persons (eg, a BEE partner) as any higher percentage would give rise to a “de-grouping” and trigger the anti-avoidance provisions.⁷³⁹

3.5.2 The requirements for section 45 and the tax rollover relief

The requirements for a section 45 transaction are set out below.

- a) First, the disposal of the asset must take place between a company (the transferor company) and another resident company (the transferee company).⁷⁴⁰
- b) Second, both companies must form part of the same group of companies after the section 45 transaction.⁷⁴¹
- c) Third, there is no specific requirement as to consideration but certain limitations are listed in section 45(6) of the Income Tax Act. For example, section 45 does not apply where the asset was disposed of by the transferor company in exchange for equity shares issued by the transferee company.⁷⁴² This limitation specifically addresses the

⁷³⁶ Section 45(1)(a)(i) and (ii) of the Income Tax Act.

⁷³⁷ Section 45(6)(g) of the Income Tax Act.

⁷³⁸ Section 1 definition of “group of companies” read with s 41 definition of “group of companies”. Rudnicki 2011 2 *Business Tax and Company Law Quarterly* 18.

⁷³⁹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35.; Rudnicki *ibid* 20.

⁷⁴⁰ Section 45(1)(a)(i) of the Income Tax Act.

⁷⁴¹ Section 45(1)(a)(i) of the Income Tax Act.

⁷⁴² Section 45(6)(c) of the Income Tax Act.

potential overlap of section 42 (an asset-for-share transaction) and the intra-group transaction in section 45 of the Income Tax Act.

The other limitations are discussed below.

Under section 45(1)(a)(ii) of the Income Tax Act where an asset was held as a capital asset or trading stock by the transferor company before the transaction, after the transaction it will be held in the same manner by the transferee company.

In a section 45 transaction in which a transferor company disposes of a capital asset to a transferee company, the transferor company is deemed to have disposed of the asset for an amount equal to its base cost (ie, there is no capital gain or loss in the hands of the transferor company) on the date of disposal.⁷⁴³ Similarly, where trading stock or an allowance asset is disposed of there will be no gain, loss, or recoupment.

As in the discussion of sections 42 and 44 of the Income Tax Act above, certain “adoption” rules also apply to section 45.⁷⁴⁴ The transferor and transferee are deemed to be the one and the same person as regards the asset, for any disposal by the transferee company, regarding the date of acquisition of the asset by the transferee company, and for acquisition costs incurred to acquire the asset.⁷⁴⁵

Section 45 differs from section 42 in that – unlike section 42 – it allows for the issue of preference shares as consideration.⁷⁴⁶

Certain exclusions to the application of section 45 which appear in section 45(6), are aimed at avoiding an overlap of the various corporate rollover relief provisions. For example, in terms of section 45(6)(c), section 45 does not apply to a transaction where the asset is disposed of by the transferor company in exchange for equity shares issued by the transferee company. This avoids an overlap with section 42 of the Income Tax Act.

⁷⁴³ Section 45(2)(a)(i) of the Income Tax Act.

⁷⁴⁴ See paras 3.2 and 3.4 above.

⁷⁴⁵ Section 45(2)(A)(ii) of the Income Tax Act. See s 45(2)(b) regarding the deemed disposal amount and the adoption of the date and acquisition costs relating to trading stock. Also see s 45(3) regarding the non-recovery of recoupments and the determination of the amount of recoupment that the transferee company would be entitled to and that must be recouped in the hands of the transferee company. Also see s 45(3)(b) regarding the transfer of contracts.

⁷⁴⁶ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35 and s 45(3A) of the Income Tax Act.

3.5.3 Anti-avoidance provisions in section 45

3.5.3.1 Six-year anti-avoidance rule

The first anti-avoidance provision to be considered under section 45 is often referred to as the “six-year anti-avoidance rule” and is found in section 45(4)(b) of the Income Tax Act. Basically, where there is a de-grouping⁷⁴⁷ (where a company ceases to be part of the same group of companies) within six years of the section 45 transaction having been concluded, the tax neutral treatment of the transaction will be reversed under this anti-avoidance rule.⁷⁴⁸

Where a transferee company has acquired an equity share in terms of a section 45 transaction and de-groups within a period of six years without disposing of those equity shares at the time of the de-grouping, a “de-grouping charge” will be triggered (a deemed disposal).⁷⁴⁹ The de-grouping charge⁷⁵⁰ is a deemed capital gain in the year of assessment during which the transferee company ceases to form part of the group of companies. It is applied to increase the base cost of the equity shares.⁷⁵¹

The deemed disposal triggered by this six-year anti-avoidance rule activates a “built-in gain” in respect of an asset. This gain is taxed in the hands of the transferee company but is limited to the lesser of:

- a) the greatest capital gain that would have been determined in respect of any disposal of the asset in terms of the section 45 transaction within a period of six years preceding the date upon which the transferee company ceases to form part of the same group of companies;⁷⁵² or
- b) the capital gain that would have been determined had the asset been disposed of on the date on which the transferee company ceased to

⁷⁴⁷ In terms of section 45(4)(b)(i)(aa) de-grouping can occur in two instances: first, when a transferee company ceases to form part of any group of companies in relation to the transferor company; or second, when a transferee company ceases to form part of any controlling group company of a group of companies in relation to the transferor company.

⁷⁴⁸ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35.

⁷⁴⁹ Section 45(4)(bA) of the Income Tax Act; De Koker and Williams *ibid*.

⁷⁵⁰ The de-grouping charge refers to the tax charge for which the transferee company will be liable.

⁷⁵¹ Section 45(4)(bA) of the Income Tax Act; De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35.

⁷⁵² Section 45(4)(b)(i)(aa) of the Income Tax Act.

form part of the group of companies for an amount equal to the market value of the asset on that date.⁷⁵³

The transferee will be deemed to have acquired the asset at its original base cost plus the amount of the deemed capital gain.

This anti-avoidance rule is best illustrated by the following basic example from De Koker and Williams.

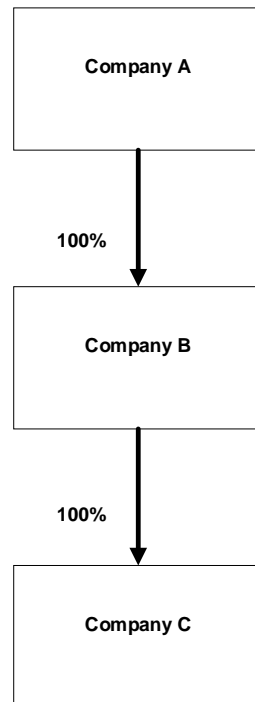


Figure 2-3 Illustrative Example of the six-year anti-avoidance rule in section 45(4)(b) of the Income Tax Act

Source: De Koker, AP., Williams, RC., *Silke on South African Income Tax* (2021) ch 13 para 13.35.

From Figure 2-3, Company A owns all the shares directly in Company B and indirectly in Company C. In terms of a section 45 transaction in 2017, B transfers an asset to C. At the time of the transfer the asset has a market value of R100 and a base cost of R20. In 2019, A disposes of its shareholding in C so triggering a de-grouping.

At the time of the de-grouping the market value of the asset is R115 and its base cost is R25. Because the anti-avoidance provision is triggered, C will

⁷⁵³ Section 45(4)(b)(i)(bb) of the Income Tax Act.

reflect a “built-in gain” at the time of the conclusion of the section 45 transaction of R80 (R100 – R20) and one of R90 (R115- R25) at the time of the de-grouping. The gain which is subject to tax will be limited to R80, whereas if the market value of the asset at time of de-grouping was, for example R95, the gain would have been limited to R75 (R95 – R25) as the gain taxed in the hands of the transferee company is limited to the *lesser* of the two gains identified in terms of section 45(4)(b) of the Income Tax Act.

There is an interesting carve-out in section 45 regarding the de-grouping which favours a statutory merger being effected by way of a section 45 transaction.⁷⁵⁴ Where the de-grouping occurs due to a group company’s liquidation, winding-up, or de-registration and the holding company is a South African resident holding at least 70 per cent of the equity shares in the company that is to be liquidated, wound-up, or deregistered, the holding company and the company are deemed to be one and the same. In effect, this rolls forward any de-grouping charges triggered under the six-year anti-avoidance rule.⁷⁵⁵

3.5.3.2 *Two-year anti-avoidance rule*

Another anti-avoidance rule is the so-called “two-year anti-avoidance rule”.⁷⁵⁶ The purpose of this anti-avoidance rule is to keep the value of an asset transferred between the group companies within the group for a period of at least two years.⁷⁵⁷ In terms of this rule, a deemed de-grouping is triggered for the transferor company and the transferee company if, within two years of the section 45 transaction, the transferor company (or any member of the same group) disposes of:

- a) any consideration received or accrued in respect of a section 45 transaction; or
- b) more than ten per cent of the amount derived directly or indirectly from such consideration, to a person who does not form part of the same group of companies as the transferor company for:

⁷⁵⁴ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35.

⁷⁵⁵ Section 45(4)(c) of the Income Tax Act.

⁷⁵⁶ Section 45(4B) of the Income Tax Act.

⁷⁵⁷ Section 45(4B) of the Income Tax Act; Rudnicki 2011 2 *Business Tax and Company Law Quarterly* 21.

- i. no consideration; or
- ii. consideration that does not reflect an arm's length price; or by means of a distribution.⁷⁵⁸

3.5.3.3 Zero base cost anti-avoidance rule

The aim of the anti-avoidance rule in sections 45(3A) and 45(3B) is to address cases where the intra-group transaction relief is obtained, following which there is a de-grouping by way of the group divesting itself of its interest in the consideration paid in terms of the intra-group transaction.⁷⁵⁹

In terms of the anti-avoidance rule in section 45(3A), where there has been an intra-group transaction any amount serving as consideration incurred by the transferee company for the acquisition of the asset and which has specifically been issued or used to fund or facilitate the intra-group transaction, the tax cost⁷⁶⁰ of that consideration⁷⁶¹ is deemed to be nil.⁷⁶² This means that if the consideration is subsequently disposed of by the transferor a capital gain will be triggered.

The three requirements for the tax cost of the debt or non-equity shares (the consideration) to be deemed nil are set out in section 45(3A).

- a) The consideration given by the transferee company in the section 45 transaction is funded by debt or non-equity shares.⁷⁶³
- b) The debt or non- equity shares are issued by a company that forms part of the same group of companies as the transferor or transferee company.⁷⁶⁴

⁷⁵⁸ *ibid.*

⁷⁵⁹ Draft Explanatory memorandum on the 2022 draft Tax Law Amendment Bill ("TLAB") 29 July 2022, 14

https://www.treasury.gov.za/comm_media/press/2022/2022%20DraftTax/Draft%20Explanatory%20Memorandum%20on%20the%202022%20Draft%20TLAB-%2029%20July%202022.pdf ; Stiglingh *et al* *SILKE* 828 – 829.

⁷⁶⁰ Section 45(3A)(b) of the Income Tax Act.

⁷⁶¹ In terms of s 45(3A)(a)(i) of the Income Tax Act the consideration is funded directly or indirectly by the issue of any debt or share other than an equity share

⁷⁶² Section 45(3A)(b)(i) of the Income Tax Act. The section also provides that expenditure cost incurred to acquire the debt or share would be deemed to be nil.

⁷⁶³ Section 45(3A)(a) of the Income Tax Act

⁷⁶⁴ Section 45(3A)(ii)(aa) of the Income Tax Act.

- c) The debt or non-equity shares are used directly or indirectly for the funding of the section 45 transaction.⁷⁶⁵

The following example illustrates this anti-avoidance rule:

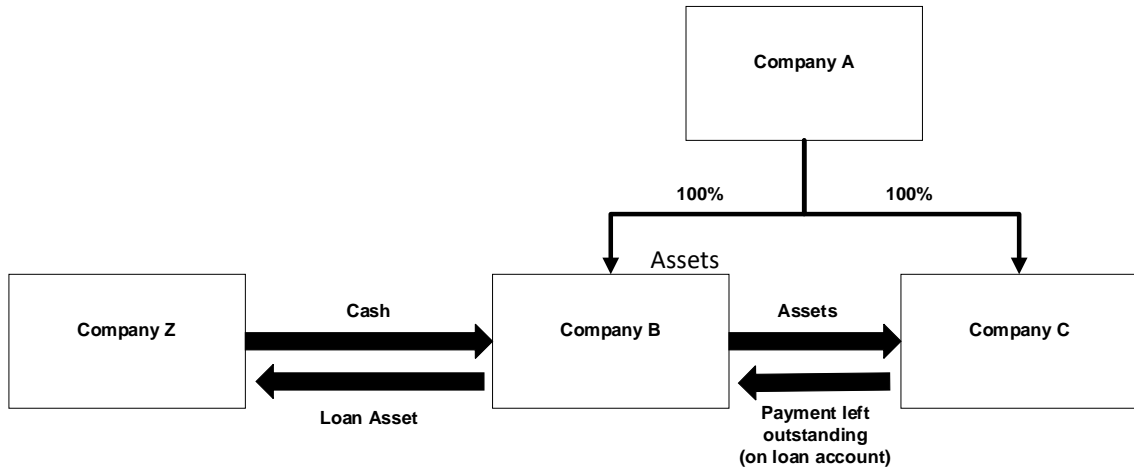


Figure 3-4 - Zero Base Cost Anti-Avoidance Rule Example

Source: Stiglingh M et al *SILKE: South African Income Tax* (2023) 828 – 829.

In the above example, a section 45 (an intra-group) transaction has taken place between Company B and Company C. B (the transferor) sold assets to C (transferee) in exchange for payment on the loan account. Without this anti-avoidance rule, B could, following the intra-group transaction, choose to realise the loan asset for cash by transferring it to a third party. If the proceeds received in cash from the external third party match the tax cost of the loan asset there would typically be no tax implications triggered in the hands of the transferor.⁷⁶⁶

For purpose of the example assume that the payment for the assets was funded by debt⁷⁶⁷ and had specifically been issued to fund the intra-group transaction by a company that forms part of the same group of companies as B and C.⁷⁶⁸

For the purpose of this example, assume further that the asset disposed of by B to C has a market value of R1,2 million and a base cost of R400 000. B now holds debt (as an asset) to the value of R1,2 million and may choose to realise

⁷⁶⁵ Section 45(3A)(i)(bb) of the Income Tax Act.

⁷⁶⁶ Stiglingh *et al* *SILKE* 828 – 829.

⁷⁶⁷ Section 45(3A)(a)(i) of the income Tax Act which also allows for the amount incurred as consideration for the acquisition of the asset to be funded directly or indirectly by the issue of any debt or share (other than an equity share).

⁷⁶⁸ Section 45(3A)(i) and (ii) of the Income Tax Act.

this asset (for cash) by transferring it to an external person (a person outside the group of companies) in exchange for R1,2 million in cash. Under the regular capital gains tax rules, the capital gain would be nil as the base cost of the consideration was R1,2 million and it was sold for R1,2 million (the proceeds).

If all the relevant requirements are met, section 45(3A)(b) provides that the base cost of the consideration in this example would be deemed to be nil and trigger a capital gain of R1,2 million in the hands of B on the subsequent disposal to the external party. De Koker and Williams capture the effect of this anti-avoidance rule accurately:

“[T]he issue of preference shares or debt within a group to finance an intra-group acquisition is CGT neutral, provided the debt or share is redeemed while both companies are within the same group. But if the debt or share is disposed of outside the group, any amounts received will constitute proceeds and must be accounted for CGT purposes.”⁷⁶⁹

Section 45(3B) was introduced in 2020 initially to address potential double taxation where a zero-base cost anti-avoidance rule (in terms of s 45(3A)) was triggered, as well as a subsequent de-grouping charge and the reversal of the tax deferral benefits.⁷⁷⁰

3.5.3.4 *Eighteen-month rule*

In addition to the above anti-avoidance provisions, section 45(5) also provides for an anti-avoidance provision to be triggered where the transferee company disposes of an asset within a period of 18 months of acquiring it under a section 45 transaction.⁷⁷¹ The effect of this anti-avoidance provision is that, for example, in the case of a capital asset the gain (or loss) as at the date of the section 45 transaction will be triggered if the asset is sold at market value at the

⁷⁶⁹De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.35.

⁷⁷⁰Draft Explanatory Memorandum on the 2022 Draft Tax Law Amendment Bill (“TLAB”) 29 July 2022, 14

https://www.treasury.gov.za/comm_media/press/2022/2022%20DraftTax/Draft%20Explanatory%20Memorandum%20on%20the%202022%20Draft%20TLAB-%2029%20July%202022.pdf; Further changes were made in 2022 refining the reversal of the zero-base cost anti-avoidance rules. The proposed changes are to extend the rules dealing with the reversal of the rule.

⁷⁷¹Section 45(5) of the Income Tax Act. This rule does not apply to involuntary disposals in terms of para 65 of the Eighth Schedule to the Income Tax Act.

beginning of the 18 month period. It must, however, be ringfenced and, therefore, disregarded in calculating the net capital gain or loss.⁷⁷²

In other words, even if the transferee company has an assessed loss or a balance of assessed loss available in that year of assessment, the gain triggered by section 45(5) of the Income Tax Act may not be set-off against that loss and must, therefore, be treated as the transferee company's taxable capital gain in terms of paragraph 10 of the Eighth Schedule to the Income Tax Act.

3.6 Liquidation in terms of group rollover relief in section 47 of the Income Tax Act

3.6.1 Introduction

Generally, in the case of the liquidation, winding-up, or deregistration of a company there will be a transfer of its assets to its holding shareholder(s) which may invariably give rise to adverse tax implications such as dividends tax and capital gains tax.⁷⁷³

The parties to a section 47 transaction may elect in writing that the provisions of section 47 will not apply to the transaction (the parties may opt out of the rollover relief).⁷⁷⁴

The section 47 rollover relief will be "forfeited" where the liquidating company has not, within a period of 36 months from the date of the liquidation distribution, taken the steps contemplated in section 41(4) to liquidate, wind-up, or deregister the company,⁷⁷⁵ or has withdrawn any steps to do so, or does something to invalidate any steps taken with the result that the company will not be liquidated, wound up, or deregistered.⁷⁷⁶

This had previously been a major disjunct between the Income Tax Act and the Companies Act. Section 41(4) of the Income Tax Act sets out the steps that would be deemed steps taken to liquidate, wind-up, or deregister a company but no provision

⁷⁷² Section 45(5)(a)(i) of the Income Tax Act.

⁷⁷³ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.38. A distribution of assets *in specie* to a shareholder would constitute a disposal and would be taxable in terms of paras 75, 76, and 77 of the Eighth Schedule to the Income Tax Act.

⁷⁷⁴ Section 47(6)(b) of the Income Tax Act.

⁷⁷⁵ Section 47(6)(c)(i) of the Income Tax Act.

⁷⁷⁶ Section 47(6)(c)(ii) of the Income Tax Act.

was made for the deregistration of a company due to the operation of law in terms of section 116 of the Companies Act in the case of an amalgamation or merger transaction. This gap was identified, and in terms Taxation Laws Amendment Bill 34 of 2019 section 41(4)(b), was amended to include that a company will be deemed to have taken steps to deregister where a notice of the amalgamation or merger has been filed with the CIPC in the prescribed form and manner as required by section 116 of the Companies Act.

A section 47 procedure would generally be used in conjunction with a section 42 or section 45 transaction to achieve the outcome of an amalgamation or merger where the existence of the merging company is terminated. The section can also be used in an upstream merger as provided for in *Binding Private Ruling 122*.⁷⁷⁷ In this Ruling, where the subsidiary (co-applicant) merged with its sole shareholder (the applicant) in terms of section 113 of the Companies Act, SARS ruled that the transaction would be tax neutral in terms of section 47 of the Income Tax Act.

3.6.2 The requirements in section 47 and the tax rollover relief

A “liquidation distribution” is defined in section 47 of the Income Tax Act as a transaction in terms of which a resident liquidating company disposes of all its assets to its holding company in anticipation of or during the company’s liquidation, winding-up, or deregistration.⁷⁷⁸ This excludes assets that have been identified to satisfy and settle any reasonably anticipated liabilities owed to any sphere of government of any country and costs of administration of the liquidation.⁷⁷⁹ It also excludes assets that have been identified to settle any debts incurred in the ordinary course of the liquidating company’s trade.⁷⁸⁰

As pointed out earlier, the rollover relief is limited to the extent that it only applies to those assets distributed to a resident holding company which forms part of the same group of companies as the liquidating company on the date of the distribution.⁷⁸¹ This has the effect that the section 47 rollover relief would not apply to distributions made

⁷⁷⁷ South African Revenue Service *Binding Private Ruling 122* “Transfer of a Business of a Company as a Going Concern to its Holding Company as a Result of an Amalgamation or Merger Transaction” 11 October 2012.

⁷⁷⁸ Section 47(1)(a) of the Income Tax Act.

⁷⁷⁹ Section 47(1)(a) of the Income Tax Act.

⁷⁸⁰ Section 47(1)(a) of the Income Tax Act.

⁷⁸¹ Section 47(1)(a) of the Income Tax Act.

to minority shareholders which generally do not form part of the same group of companies as the liquidating company due to their low percentage of shareholding.⁷⁸² The relief will also not apply to liquidation distributions made to natural persons as they do not qualify as part of the same group of companies as the liquidating company.⁷⁸³

As emerges from the definition above, the requirements for a local section 47 transaction (a liquidation distribution) are:

- a) First, a resident company (the liquidating company) must dispose of all its assets to its shareholder (the holding company); and
- b) Second, the assets must be disposed of in anticipation of or during the liquidation, winding-up, or deregistration of the company.

The rollover relief can be identified on the basis of the type of assets transferred in the liquidation distribution. For example, where a capital asset is transferred to the shareholder and is held by the shareholder as a capital asset, the liquidating company is deemed to have distributed that asset for an amount equal to its base cost.⁷⁸⁴ As a result, no capital gain or loss is realised for the liquidating company upon distribution. Similarly, no gain or loss is triggered on disposal of trading stock,⁷⁸⁵ or on any recoupments on disposal of allowance assets.⁷⁸⁶

In determining the holding company's capital gain or loss (capital asset),⁷⁸⁷ taxable income (trading stock),⁷⁸⁸ and allowance or deduction available (allowance asset),⁷⁸⁹ the holding and liquidating companies are deemed to be one and the same person. In other words, the tax cost of the assets in the hands of the holding company will be equal to the tax cost of the asset in the hands of the liquidating company.⁷⁹⁰ In addition,

⁷⁸² De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.38. See the definition of "group of companies" in s 1 read with the s 41 definition of the same term.

⁷⁸³ See the definition of "group of companies" in s 1 read with the s 41 definition of the same term. Stiglingh *et al* *SILKE* 835 example 20.25.

⁷⁸⁴ Section 47(2)(a)(i) of the Income Tax Act.

⁷⁸⁵ Section 47(2)(b)(i) of the Income Tax Act.

⁷⁸⁶ Section 47(3)(a)(i) of the Income Tax Act.

⁷⁸⁷ Section 47(2)(a)(ii) of the Income Tax Act.

⁷⁸⁸ Section 47(2)(b)(ii) of the Income Tax Act.

⁷⁸⁹ Section 47(3)(a)(ii) of the Income Tax Act. Disposal of contracts as part of a disposal of a business as a going concern with allowances in terms of ss 24 and 24C is governed in s 47(3)(b) of the Income Tax Act.

⁷⁹⁰ Stiglingh *et al* *SILKE* 836.

the nature of the asset acquired by the holding company corresponds to its nature when the liquidating company held the asset.⁷⁹¹

The section 47 rollover relief is, however, subject to certain conditions in terms of section 47(3A) of the Income Tax Act.

In terms of section 47(3A) of the Income Tax Act, the relief only applies to the extent that:

- a) the equity shares held in the liquidating company are disposed of as a result of the liquidation, winding-up, or deregistration of the liquidating company;⁷⁹² and
- b) the holding company assumes the debt incurred by the liquidating company more than 18 months before the disposal. If the debt was incurred within 18 months of the date of disposal, the debt must represent a refinancing of debt, or must have arisen in the ordinary course of the business of the liquidating company when it is disposed of to the holding company as a going concern.⁷⁹³

In terms of the section 47 transaction, the holding company will first receive the asset distribution and will then “dispose” of its shares in the liquidating company when the existence of the liquidating company is terminated.⁷⁹⁴ The relief for the holding company under section 47 further provides that for purposes of determining its taxable income, assessed loss, or aggregate capital gain or loss, the holding company must disregard the disposal of its shares held in the liquidating company if the disposal is as a result of the liquidation, winding-up, or deregistration of the company.⁷⁹⁵ Similarly, any return of capital in the form of cash or a dividend *in specie* distributed in

⁷⁹¹ For example, if the asset was held as a capital asset by the liquidating company the holding company will acquire it as a capital asset.

⁷⁹² Section 47(3A)(a) of the Income Tax Act.

⁷⁹³ Section 47(3A)(b) of the Income Tax Act.

⁷⁹⁴ Section 47(5) of the Income Tax Act; Stiglingh *et al* SILKE 836.

⁷⁹⁵ Section 47(5) of the Income Tax Act. Para 77 of the Eighth Schedule deems a disposal to take place with the distribution received by the holder of shares in terms of a liquidation or deregistration. In terms of this paragraph the shareholder must be regarded as having disposed of its shares held in the liquidating company upon liquidation or deregistration. If there is a return of capital received or accrued by the shareholders of the liquidating company (in the form of cash or assets *in specie*) in terms of the liquidation or deregistration, the return of capital must be treated as a capital gain in determining that shareholder’s aggregate capital gain or loss for that year of assessment. However, as seen with s 47(5) this deemed disposal must be disregarded if the liquidation is actioned in terms of s 47.

anticipation of the company's liquidation, winding-up, or deregistration must be disregarded by the holding company.⁷⁹⁶

3.6.3 Anti-avoidance provisions in section 47

Section 47(4) provides the anti-avoidance provision for section 47 of the Income Tax Act. The subsection includes a ringfencing provision in terms of which if the assets acquired by the holding company under the liquidation distribution are realised within 18 months of the liquidation distribution, those gains and losses arising from the realisation will be ringfenced.

3.7 Conclusion

It is clear from this chapter that parties involved in mergers and amalgamation transactions must be cognisant of the relevant tax rollover relief provisions when negotiating and contracting a merger transaction. A lack of the relevant tax rollover relief can give rise to adverse tax consequences that could have a negative impact on the companies' cash flow and tax efficiencies associated with the transaction.

As each corporate rollover relief provision has its own detailed set of requirements, limitations, and anti-avoidance measures, this is not a simple tick-box exercise. The Davis Tax Committee notes that the mechanical nature of the corporate rules and the onerous and cumbersome anti-avoidance rules are shrouded in uncertainty.

“Because of a combination of the high pecuniary value typically associated with mergers, acquisitions and group restructuring, the onerous compliance burdens imposed on taxpayers seeking to employ the corporate restructuring rules and the dexterity required to negotiate the anti-tax avoidance provisions woven into the corporate rules, SARS is inundated with requests for binding private rulings to ensure certainty regarding SARS's interpretation of the corporate rules as they apply to proposed transactions, prior to taxpayers assuming the tax risks of embarking upon them.”⁷⁹⁷ ... “The rules-based nature of the provisions makes them very mechanical and thus *not user friendly or necessarily achieving their objectives*”⁷⁹⁸ (emphasis added).

Under section 44, the corporate rollover relief specifically aimed at regulating amalgamation transactions has a very limited application in the field of mergers and

⁷⁹⁶ Section 47(5) of the Income Tax Act.

⁷⁹⁷ <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 13 February 2023).

⁷⁹⁸ *ibid.*

amalgamations and, regrettably, this means that the flexibility created for mergers and amalgamations in the Companies Act is lost when it comes to tax.⁷⁹⁹ This loss in flexibility relates, in the main, to two aspects of consideration in an amalgamation transaction: first, the forms of consideration permitted under section 44 of the Income Tax Act; and second the consideration which is also payable only to the shareholders of the amalgamated company.⁸⁰⁰

In practice, merger consideration takes various forms, not only equity shares or assumption of debt payable to other parties but also for the consideration to be payable to other parties, as seen with a triangular or reverse-triangular merger. Regrettably, section 44 does not afford tax relief for these more complex forms of merger and amalgamation transactions.

In a scenario where the shareholders receive any form of consideration other than that prescribed in section 44 – eg, cash – the shareholders will be deemed to have disposed of the shares in the amalgamated company and the non-qualifying part of the transaction will be fully taxable in the hands of the shareholders of the amalgamated company.⁸⁰¹ In the hands of the amalgamated company, if there is consideration other than that prescribed in section 44 of the Income Tax Act, a disposal of proportional amounts of trading stock, allowance assets, capital assets, et cetera will be triggered and normal tax liabilities will apply, including VAT, transfer duty, and STT.⁸⁰² These limitations in the corporate rules, and in section 44 specifically, may limit the popularity of the merger mechanism in practice and see the merger transaction driven by the realisation of tax efficiency.⁸⁰³

This leads to the use of alternative corporate rollover relief sections to achieve tax efficiency through a merger or amalgamation transaction. Depending on the circumstances surrounding the merger transaction it can alternately be effected under an asset-for-share transaction (s 42), an intragroup transaction (s 45), or a liquidation distribution (s 47).⁸⁰⁴ But this comes at a cost in that each of these sections has its

⁷⁹⁹ Chong and Van der Linde 2014 3 *Stell LR* 498.

⁸⁰⁰ *ibid.*

⁸⁰¹ *ibid* 500.

⁸⁰² *ibid.*

⁸⁰³ *ibid.*

⁸⁰⁴ *ibid* 498.

own elaborate requirements and anti-avoidance provisions. Without an alternative way of achieving tax efficiency in the merger or amalgamation transaction, parties are obliged to comply with these additional onerous provisions.

Below is a table setting out the various corporate rollover relief provisions discussed in this chapter. It allows one to compare the various aspects of the sections and the requirements and anti-avoidance provisions set in each.

	Subject of sale	Consideration	Requirements	Anti-avoidance measures
Section 44	Disposal of all assets.	Limited to equity shares and the assumption of debt.	<ul style="list-style-type: none"> • Assets disposed of by one resident company to another resident company. • All assets must be disposed of (save for those earmarked to settle debt incurred in ordinary course of business. • Consideration must be in the form of equity shares or the assumption of the amalgamated company's debt. Existence of the amalgamated company must be terminated. 	<ul style="list-style-type: none"> • Disposal within 18 months of amalgamation transaction will trigger tax liabilities in the hands of the resultant company (s 44(5)).
Section 42	Disposal of individual assets.	Limited to equity shares and assumption of debt.	<ul style="list-style-type: none"> • The purchaser of the asset(s) must be a SA tax resident. • The market value of the asset exchanged for equity shares must exceed the base cost of the asset. • Consideration must be in the form 	<ul style="list-style-type: none"> • Prevention of converting revenue gains into capital gains (s 42(5)). • Person ceasing to hold a qualifying interest within 18 months of the date of the s 42 transaction (s 42(6)(a)).

			<p>of equity shares or the assumption of the company's debt.</p> <ul style="list-style-type: none"> • At close of the day of the disposal of the asset, the transferor must continue to hold a qualifying interest in the transferee company. 	<ul style="list-style-type: none"> • Ringfencing of the gains (s 42(7)). • Disjunct between the market values of the assets and the equity shares exchanged (s 24BA).
Section 45	Disposal of individual assets.	No prescribed consideration, subject to certain limitations, eg, consideration may not be equity shares.	<ul style="list-style-type: none"> • Transfer must take place between a company (transferor company) and another resident company (transferee company). • Both companies must form part of the same group of companies at the end of the day on which the s 45 transaction takes place. • No prescribed consideration but certain limitations apply. 	<ul style="list-style-type: none"> • The six-year anti-avoidance rule (s 45(4)(b)). • The two-year anti-avoidance rule (s 45(4B)). • Disposal of an asset within 18 months of acquiring it in terms of a s 45 transaction (s 45(5)). • Zero base cost anti-avoidance rule (ss 45(3A) and 45(3B)).

<p>Section 47</p>	<p>Distribution of all the company's assets to shareholders (resident holding company) in anticipation of the company's winding-up, liquidation, or deregistration.</p>	<p>Disposal of shareholder's shares in the liquidating company.</p>	<ul style="list-style-type: none"> • A resident company disposes of all its assets (except those earmarked to settle debt incurred in the ordinary course of trade of the company). • The assets must be disposed of in anticipation of or during the liquidation, winding-up, or deregistration of the company. • Resident holding company and liquidating company must form part of the same group of companies. 	<ul style="list-style-type: none"> • Ringfencing of gains and losses arising from the realisation of assets acquired by the holding company in a s 47 liquidation distribution within 18 months of the liquidation distribution being concluded.
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Table 3: Summary of the relevant corporate rules discussed in Chapter 3

Based on this table, section 44 does not have specific qualifying requirements as seen in sections 42 and 45. This makes it easily accessible. In addition, it does not set numerous onerous anti-avoidance provisions, only the 18 month anti-avoidance provision under section 44(5) of the Income Tax Act. It is, however, required that the amalgamated company be terminated following the section 44 transaction and steps must be taken to deregister or liquidate the amalgamated company within 36 months of the date of the amalgamation transaction.⁸⁰⁵ Section 44 also limits the type of consideration that can qualify for the rollover relief in section 44 of the Income Tax Act.

In terms of a section 42 transaction, the requirements principally mandate that the market value of the assets to be transferred exceed their base cost value⁸⁰⁶ and that,

⁸⁰⁵ Section 44(13) of the Income Tax Act. The provisions of s 44 will not apply where the amalgamated company has not, within 36 months from the date of the s 44 transaction, taken steps to liquidate, wind-up or deregister in terms of s 41(4). If an amalgamation transaction is actioned in terms of the Companies Act it will be deregistered automatically by operation of law which is now provided for in s 41(4) of the Income Tax Act.

⁸⁰⁶ Section 42(1)(a)(i) of the Income Tax Act.

following the transaction, a qualifying interest is held by the transferor company in the transferee company.⁸⁰⁷ Section 42 also contains several more anti-avoidance provisions⁸⁰⁸ than section 44. Like section 44, section 42 only allows for consideration in the form of equity shares and/or the assumption of certain debt.

Yet, as highlighted above, section 42 does not require that the existence of a company be terminated following the merger transaction. This allows for certain merger and amalgamation transactions that do not meet the requirements of section 44 to be actioned under section 42. If section 42 is used to effect a merger or amalgamation transaction and the parties still wish to terminate the amalgamated company, section 47 would allow for a liquidation distribution on a tax-neutral basis subject to all the requirements being met.

Section 45 brings flexibility regarding the consideration permitted in that there is no prescribed consideration as one finds in sections 42 and section 44, although there are certain limitations.⁸⁰⁹ The section does, however, contain relatively onerous anti-avoidance provisions which could be triggered up to six years after the conclusion of the section 45 transaction. A section 45 transaction can also be followed up by a section 47 liquidation distribution which will see the existence of the transferor company terminated following the intra-group transaction.

As indicated earlier, section 47 can be used in combination with a section 42 or section 45 to achieve a merger or amalgamation transaction that is tax neutral. Nevertheless, parties can also action a section 47 liquidation distribution in terms a statutory merger in the Companies Act in which the liquidating company distributes all its assets and liabilities (the business of the liquidating company) to its holding company in anticipation of a liquidation⁸¹⁰ in an upstream amalgamation.

In Chapter 4, the discrepancies between the Income Tax Act and the Companies Act relating to merger and amalgamation transactions are discussed.

⁸⁰⁷ Section 42(1)(a)(i)(A) of the Income Tax Act.

⁸⁰⁸ Section 42(5), s 42(6)(b), s 42(7), and s 24BA of the Income Tax Act.

⁸⁰⁹ See s 45(6)(c) of the Income Tax Act.

⁸¹⁰ Section 44(14)(a) prohibits the application of s 44 where there is a liquidation distribution made as contemplated in s 47. This means a s 47 liquidation transaction cannot follow a s 44 transaction. The limitation is restricted to the definition of a liquidation distribution in s 47 and does not exclude liquidation proceedings in terms of the Companies Act.

CHAPTER 4: DISCREPANCIES BETWEEN THE TWO ACTS GOVERNING MERGERS AND AMALGAMATIONS AND THEIR IMPACT ON THE RELEVANT PARTIES

4.1 Introduction

As highlighted in Chapter 1 and in the Abstract, one often encounters more than one Act governing a certain aspect of the law. In this case the example is the corporate and tax legislation governing merger and amalgamation transactions.

The corporate rules were implemented under the Income Tax Act long before the commencement of the Companies Act and the introduction of the concept of a statutory merger.⁸¹¹ Although the two Acts have very different aims, there must be a “synergy” between their interaction, especially where there are clear disconnects between their provisions on mergers and amalgamations and when both Acts apply to a single transaction.

As early as 2010, Davids, Norwitz and Yuill identified issues required to be addressed between the Income Tax Act and the Companies Act as regards merger transactions. They state:⁸¹²

“In particular, tax legislation will need to be amended to deal with the tax implications of such mergers, and indeed the tax treatment of mergers (as compared to the other procedures available for implementing business combinations) is likely to play a significant role in the extent to which the merger procedure is utilised in practice.”

In recent years, government has addressed some of the discrepancies identified. These are discussed in paragraph 1.7 above. Although these are positive steps in addressing anomalies, other discrepancies between the two Acts in relation to mergers and amalgamations remain and are discussed in paragraph 4.2. As highlighted in the two preceding chapters, there are also internal issues in each of the amalgamation and merger sections themselves, which, to a certain degree, make the provisions unpopular in practice.

⁸¹¹ Section 44 was introduced in the Income Tax Act in 2002. Revenue Law Amendment Bill 2002, Explanatory Memorandum http://www.treasury.gov.za/legislation/bills/2002/rlab_2002_memo.pdf (accessed October 2021)

⁸¹² Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 351.

For example, the disconnect between the exclusion of certain voting rights in section 115(4) of the Companies Act in contrast to the various types of merger structures provided for in section 113, and the very limited flexibility provided by section 44 of the Income Tax Act as regards the relief granted for amalgamation transactions. The existing issues in these sections result in the use of alternative sections in the two Acts to effect a merger transaction.

Another example, as discussed in Chapter 2, is that a scheme of arrangement or sale of a business can be used to effect a merger.⁸¹³ The analysis in Chapter 3 shows that various corporate rollover provisions in the Income Tax Act, too, can be used to action a merger – e.g., a section 42, 45, or 47 transaction.⁸¹⁴

As various sections in the two Acts allow for numerous combinations by which to effect a merger or amalgamation each with its own requirements – and in the case of tax, anti-avoidance provisions – complications are inevitable. This chapter highlights the extant disconnects between the Companies Act and the Income Tax Act in relation to the sections governing mergers and amalgamations.

I then consider the alternative combinations available for implementing a merger transaction through sections in the Companies Act and Income Tax Act.

Lastly, the legal principles of interpretation applicable to Acts that are inconsistent or in conflict with one another are considered and which of the two Acts prevails is determined.

4.2 Identifying discrepancies between the Income Tax Act and the Companies Act as regards mergers

For purposes of the discussion of the disconnects between the two Acts, a summary in table form identifying the discrepancies between the merger provisions in the Companies Act and the Income Tax Act is provided below. Each table item is then discussed in greater detail.

⁸¹³ See paras 2.5 and 2.6 above.

⁸¹⁴ See paras 3.4, 3.5, and 3.6 above.

NR	DISCREPANCY	INCOME TAX ACT 58 OF 1962	COMPANIES ACT 71 OF 2008
1	Transfer of all the assets	In the definition of an “amalgamation transaction” it is required that all assets of the amalgamated company (transferor) be transferred to the resultant company, with the exception of certain assets elected to be used to settle certain debts.	An “amalgamation or merger” is defined in the Companies Act as the transfer all the assets and liabilities from the amalgamating company(ies) (transferor) to the surviving company(ies). No exceptions are permitted.
2	Residency of parties to the merger	Section 44 allows for the parent companies of the amalgamated company and resultant company to be non-residents of SA.	Section 113 only applies to local SA companies. It refers to “two or more profit companies”. A profit company is defined in s 1 as juristic person incorporated in terms of SA company legislation.
3 3	Confusing definitions and terminology	3.1 In Income Tax Act the transferor is referred to as the “amalgamated company” and the transferee is referred to as the “resultant company”. 3.2 The requirement is that the amalgamated company be “terminated”, which means the company can be “terminated” in	3.1 In the Companies Act the transferee is referred to as the “amalgamated company” (or surviving company) and the transferor is referred to as the “amalgamating company”. 3.2 The Companies Act provides for a unique situation where CIPC is notified of the merger or amalgamation and the company

		terms of s 41(4) by being deregistered, wound-up, or liquidated.	is then subsequently deregistered by the Companies Commissioner. It does not allow for a liquidation or winding-up of the company and does not follow the normal deregistration procedure.
4	Type of consideration allowed	Specific stipulation of the type of consideration allowed: equity shares or the assumption of debt.	No express stipulation on the form of consideration or if any consideration is required. Section 113(2)(c) – (e) merely implies an issue or transfer of securities.
5	Type(s) of merger structures allowed	Section 44 requires that after the transaction, the amalgamated company be terminated. Only provision for one type of merger.	Part (a) of the definition of an “amalgamation or merger” allows for a merger effected by the creation of a new company. Part (b) of the definition refers to a merger where the amalgamating company is deregistered.
6	Party eligible to receive and pay the consideration	Specific stipulation that the merger consideration (equity shares or qualifying debt assumption) must be made to amalgamated company in exchange for the disposal of the assets (a bilateral asset disposal).	Companies Act, allows for consideration other than securities to be paid to third parties (triangular mergers etc).
7	Upstream mergers	Section 44 does not allow for a merger between a subsidiary and its holding company in the form of	Allows for a statutory merger to occur between two or more profit companies, including a holding company and its subsidiary.

		a liquidation distribution (s 44(14)).	
8	Creation of a new company pursuant to the merger	Tax regulations do not allow for a new company to be created pursuant to a merger agreement.	The Companies Act provides for the creation of a new company pursuant to a merger or amalgamation.
9	Causa and implementation of the merger transaction	The Income Tax Act appears to provide that a <i>quid pro quo</i> is required in the amalgamation transaction.	The principle that the transfer takes place by operation of law (ie, automatically), serves as the <i>causa</i> for the implementation method of the transaction.
10	The assumption of debt as consideration	The Income Tax Act has restrictions on the assumption of debt.	The Companies Act has no restriction on the transfer of debt assumed as part of consideration, except that creditors may object to the transfer if they are prejudiced by the merger.
11	Finality of the merger agreement	Tax consequences can arise up to 18 months after the amalgamation transaction.	Once it has been registered with the CIPC, the statutory merger is finalised.

Table 4: Identifying the disparities between the Income Tax Act and Companies Act in relation to mergers and amalgamations.

4.2.1 Transfer of all the assets

The most prominent anomaly between the merger provisions in the Companies and Income Tax Acts is in the definition of an “amalgamation or merger”⁸¹⁵ and that of an “amalgamation transaction”.⁸¹⁶

The Companies Act defines an “amalgamation or merger” to include the transfer of all the assets and liabilities from the amalgamating company(ies) to the surviving company(ies).⁸¹⁷ This applies without exception. In the event of there being no surviving company, all the assets and liabilities must, immediately before implementation of the merger agreement and dissolution of the amalgamating or merging company, be transferred to the newly formed company.⁸¹⁸

The Income Tax Act also provides in its definition of an “amalgamation transaction” that all the assets must be transferred. However, it allows the amalgamated company to retain certain assets identified for use to settle any debts incurred by the company in the ordinary course of its trade other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country, and administration costs for the liquidation or winding-up of the company.

The Companies Act and Income Tax Act are clearly not aligned on this point, and non-compliance with the Companies Act means the transaction does not meet the requirements for an amalgamation or merger and will, therefore, not be effected under the provisions governing sections 113, 115 and 116 of the Companies Act. The greatest impact for the companies is that the transfers will not take place by operation of law as set out in section 116 of the Companies Act and one of the other fundamental transactions in the Companies Act would need to be considered as a means of effecting the merger.

See specifically paragraph 4.4.3.2 where I discuss the impact of the current Act in the event of such a conflict or inconsistency.

⁸¹⁵ Section 1 of the Companies Act.

⁸¹⁶ Section 44(1) of the Income Tax Act.

⁸¹⁷ Section 1 definition of “amalgamation or merger” of the Companies Act, para (b) read with s 116(7)(b) of the Companies Act. Also see para 1.2.2 for an example of a surviving company merger.

⁸¹⁸ Section 1 definition of “amalgamation or merger” of the Companies Act, paragraph (a). Also see para 1.2.1 above for an example of a new company merger.

Strauss suggests that since the resultant company will in any event become automatically liable for the obligations of the amalgamating company following the merger in terms of the Companies Act, the settling of the existing trade debt of the amalgamating company prior to the amalgamation transaction appears to be a somewhat futile exercise.⁸¹⁹

In terms of section 116(7) of the Companies Act, the parties are not permitted to exclude by contract, obligations from being transferred under a statutory merger and all the obligations must be taken up by the surviving company.⁸²⁰ This aligns with the Companies Act's definition which requires that all assets and liabilities be transferred to or vested in the surviving company(ies). In *Henochsberg* it is submitted that each surviving company is held jointly and severally liable for all of the obligations of every other company involved.⁸²¹

One must then ask why the Income Tax Act specifically allows for the settling of debt prior to the transfer of the remaining assets. The Explanatory Memorandum to the Taxation Laws Amendment Act 2014 provides in clause 57 that:

“The proposed amendments to subsection (1)(a) and (b) allow the amalgamated company *to retain assets to satisfy anticipated liabilities as well as the cost of administration relating to liquidation or winding-up of the amalgamated company*”⁸²² (emphasis added).

Unfortunately, this does not provide much clarity as regards the reasoning behind the amendment to allow for the settling of outstanding trade debts in an amalgamation transaction. In any event, with reference to the Explanatory Memorandum there should not be much administrative cost relating to deregistration of the amalgamated company if the merger has been effected by way of a statutory merger in that the deregistration would take place by operation of law.

⁸¹⁹ Strauss *Development of merger and amalgamation transactions* 35. She argues that the provision in s 44 of the Income Tax Act which allows for assets to be selected by the amalgamated company to settle outstanding trade debt is in actual fact redundant. This is based on the fact that the resultant company will, in any event, become liable for such trade debts if the merger agreement is effected by operation of law (where all property of the amalgamating company becomes the property of the resultant company).

⁸²⁰ Section 116(7) of the Companies Act; Dachs and La Grange 2012 January *The Taxpayer* 9; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 367.

⁸²¹ Delpont *et al Henochsberg* (2023) s 116.

⁸²² <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2014-02-Explanatory-Memorandum-on-the-TLA-Bill-13-of-2014.pdf> (accessed 20 December 2021)

This, however, becomes a relevant consideration where parties do not use a statutory merger to effect the merger transaction. In other words, they use the regular liquidation and winding-up methods. This can be a costly exercise for the amalgamated company, especially if it does not have sufficient funds to settle these debts. As highlighted in paragraph 3.3.1 above, there may also be VAT leakage where the merged company retains assets to settle outstanding debt in that the supply (sale) of these assets to generate funds for the settlement would most likely attract VAT on the sale at the standard rate.

As highlighted in paragraph 2.4.2.2, there are also concerns regarding the transfer of “property” in terms of a merger agreement. First is where the transfer is by contract which has a non-transfer clause that disallows the consensual cession of such a contract. If the non-transfer clause is triggered on transfer by way of a merger agreement the parties may be liable for breach of contract. This leaves them with the problem of deciding which contracts can be transferred and which not.⁸²³ As pointed out in *Henochsberg* a transfer that occurs by way of merger means that the transfer takes place automatically by operation of law and there is no consensual *causa* effecting the transfer.⁸²⁴

During the due diligence process merger parties should, however, check the relevant contracts to see whether they contain non-transferable clauses which specifically provide that the contract will not survive a transfer by way of a merger.

A further concern regarding the transfer of contracts in terms of a merger transaction is where a contract to be transferred contains conditions which could impact on its transfer under the merger agreement. If these conditions are not met, the contract may not be transferred. For example, section 11(1) of the Mineral and Petroleum Resources Development Act 28 of 2002 provides that:

“A prospecting right or a mining right or an interest in any such right, or a controlling interest in a company or close corporation *may not be ceded, transferred, let, sublet, assigned, alienated or otherwise disposed of without the written consent of the Minister, except in the case of change of controlling interest in the listed companies*” (emphasis added).

⁸²³ Nicol 2013 25 SA Merc LJ 33.

⁸²⁴ Delpont *et al Henochsberg* (2023) s 116.

Regarding the above example, it is submitted in *Henochsberg* that the transfer would not be subject to the prior permission of the Minister, as a transfer that takes place *ex lege* (by operation of law) is not included or implied in the above section.⁸²⁵

Even though Strauss points out that the election to withhold certain assets to settle debts of the amalgamated company in the Income Tax Act is unnecessary, it still creates confusion as to whether or not it is an option available to the parties to a statutory merger. It appears, in the light of the current wording of the Act, that it would be best to comply with the requirements in the Companies Act to secure the benefit of having the merger actioned by operation of law. This is based on the fact that the Companies Act requires the transfer of all the assets and liabilities, whilst the election provided for in the Income Tax Act is merely a concession or an option accorded to the amalgamated company.

If the parties choose to exclude certain assets, they should rather tailor the merger as a sale of business in terms of section 112. This does, however, mean that they will face a more onerous administrative process in transferring the assets via regular transfer mechanisms as there is no provision in section 112 for the transfer to take place by operation of law.⁸²⁶ In addition, section 112 does not apply specifically to the transfer of obligations, and this limits the transfer to assets or the company's undertaking.⁸²⁷

From a tax perspective, where the parties do not wish to transfer all the assets they could consider using section 42⁸²⁸ which, unlike section 44 of the Income Tax Act, does not require that all the assets be transferred (with the exception of those assets earmarked for settling relevant debt).

⁸²⁵ Ibid.

⁸²⁶ This would include, but not be limited to, cession of contracts, transfer of employee contracts, and registering fixed property with the deed office.

⁸²⁷ See s 112 and the definition of "all or the greater part of the assets or undertaking" in s 1 of the Companies Act. The term "undertaking" refers to all aspects of the company's enterprise, see *Marble Gold 201 (Pty) t/a Extreme Engineering v Beam Joint Venture Structures (Pty) Ltd and Others* (97141/2009) 2009 ZAKZDHC 55 (17 November 2009) para 22. *Henochsberg* states that "all or the greater part of the assets or undertaking" refers to anything more than 50 per cent of the gross assets of the company fairly valued (therefore not considering the company's liabilities. See Delpont *et al Henochsberg* (2012) s 112.

⁸²⁸ An asset-for-share transaction (s 42 of the Income Tax Act).

4.2.2 Residency of the parties to the merger

Although a discussion on cross-border mergers falls outside the scope of this thesis, this discrepancy between the Companies Act and Income Tax Act must be considered.

On the one hand, the Income Tax Act was expanded in 2013 to include the application of the corporate rules to certain transactions with foreign parties.⁸²⁹ Section 44(1)(b) of the Act allows for the amalgamated company to be a foreign company and to dispose of all its assets to a resident resultant company. Subparagraph (c) of the subsection allows for the disposal by a foreign amalgamated company of all its assets in a merger transaction to another foreign resultant company. There are certain provisos to subparagraph (c) which require that the two foreign companies form part of the same group; the resultant company must be a controlled foreign company in relation to a resident that is part of that group of companies; and that the shares held directly or indirectly by the resultant company must be held as capital assets. Both subparagraphs (b) and (c) require the termination of the amalgamated company following the amalgamation transaction.⁸³⁰

The Companies Act, on the other hand, provides that the statutory merger provision applies only to “profit companies”.⁸³¹ This limits the application of statutory mergers to South African companies.

Dauids, Norwitz and Yuill criticise this narrow application in the Companies Act as regards the current global marketplace.⁸³² Cassim also argues that this approach should be reconsidered as many other countries provide for cross-border mergers and their inclusion could be in the interest of economic growth in South Africa.⁸³³

It would be interesting to note the impact of these sections from a tax perspective if, for example, an amalgamated company is incorporated in South Africa in terms of the Companies Act but has its place of effective management offshore (ie, the company

⁸²⁹ Act 22 of 2012 <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2012-01-Explanatory-Memorandum-Taxation-Laws-Amendment-Bill-2012.pdf> (accessed 28 December 2021).

⁸³⁰ Section 44(1)(b) and (c) as part of the “amalgamation transaction” definition.

⁸³¹ Section 113(1) provides that two or more profit companies may merge or amalgamate. The term “profit company” is defined in s 1 of the Companies Act to mean: “a company incorporated for the purpose of financial gain for its shareholders”. A “company” is defined in s 1 of the Companies Act to mean a juristic person incorporated in terms of the Companies Act or a preceding Act so limiting it to South African incorporated companies.

⁸³² Dauids, Norwitz and Yuill 2010 *Acta Juridica* 337 355.

⁸³³ Cassim MF (*Part 1*) 2008 1 *SA Merc LJ* 8.

is tax resident in a foreign jurisdiction). In such a case, it could be argued that the Income Tax Act may allow for corporate rollover relief for a foreign entity where the relevant requirements of section 44(1)(b) or (c) are met. In addition, the transaction can be effected in terms of a statutory merger under the Companies Act as the company remains legally incorporated in South Africa and so qualifies as a “profit company” as defined.⁸³⁴

4.2.3 Confusing definitions and terminology

It appears that even basic terminology in the Companies Act and Income Tax Act gives rise to confusion.

First, in the Income Tax Act, the parties to the merger are referred to as the “amalgamated company”. This comprises the transferor company that will be terminated on conclusion of the merger, and the “resultant company” which is the transferee company receiving the assets of the amalgamated company. The Companies Act uses different terminology for the parties to the merger. An “amalgamated company or merged company” is defined in the section 1 as a company that was incorporated pursuant to an amalgamation or merger agreement or a company that was party to the merger agreement and continued in existence after the implementation of the amalgamation or merger agreement. The definition further provides that the amalgamated company will hold the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.⁸³⁵ This clearly means that, in terms of the Companies Act, an “amalgamated company or merged company” refers to the “transferee company”, while the same term in the Income Tax Act refers to the transferor company. It is proposed that these terms, especially for purposes of defining the parties to the merger agreement, be aligned to avoid confusion between the conflicting terms in the two Acts.

Second, after the conclusion of the amalgamation transaction, section 44(1)(a)(ii) of the Income Tax Act provides that as a result of the merger the existence of the amalgamated company will be “terminated”. If one considers section 44(13), the relief

⁸³⁴ See para 4.4.3 regarding the interaction between the two Acts where there is a direct conflict between the two Acts.

⁸³⁵ Section 1 definition of “amalgamated company or merged company” in the Companies Act.

in section 44 will not apply if the amalgamated company has not, within a period of 36 months after the date of the amalgamation transaction, taken steps contemplated in section 41(4) to liquidate, wind-up, or deregister, or has withdrawn any such steps. This implies that the term used in section 44(1)(a)(ii) and section 44(13) points to the termination by way of either, deregistration, liquidation, or winding-up in terms of section 41(4) of the Income Tax Act.

However, the Companies Act refers to “dissolution”⁸³⁶ of the amalgamated companies in the definition of an “amalgamation or merger” and, in section 116, provides that once the Companies Commissioner has received the notice of the amalgamation or merger he or she must deregister any of the amalgamating or merging companies that did not survive the merger.⁸³⁷ It appears here that the Companies Act specifically provides for the deregistration to be completed only by the Commissioner. This appears to apply exclusively to an amalgamation or merger transaction as the Companies Act prescribes the general steps to be taken to deregister a company in its Part G.⁸³⁸

Section 41(4)(b) of the Income Tax Act has been amended to allow for deregistration by operation of law in an amalgamation transaction that had been registered with the Companies Commissioner in terms of section 116. This provides greater clarity on the amalgamated company ceasing to operate by operation of law.

That said, it is argued that the terminology is not yet clear in the Income Tax Act in that the term “termination” appears to include a choice of either liquidation, winding-up, or deregistration as a method by which to terminate the existence of the amalgamated company. If the transaction is a statutory merger enacted under sections 113 and 116, there can only be a direct deregistration actioned by the Companies Commissioner him- or herself, which is not even a deregistration in the traditional sense of the term.

The importance of the method by which a company is terminated relates to the permanence of the termination, especially for existing creditors. A deregistration

⁸³⁶ The concepts of dissolution and deregistration are governed in ss 82 and 83 of the Companies Act.

⁸³⁷ See discussion in para 2.4.1.6.

⁸³⁸ Sections 82 and 83 of the Companies Act. See discussion in para 3.2.4.

removes a company's legal existence as it ceases to exist as a legal person.⁸³⁹ Nevertheless, a debt due to a creditor by that company is not extinguished once the company has been deregistered; it merely becomes unenforceable.⁸⁴⁰ The deregistration is, therefore, not final and in terms of section 83(4) of the Companies Act as the liquidator and/or any person with an interest in the company may apply to court for an order declaring the dissolution void.⁸⁴¹ If the court declares the dissolution void any proceedings that may be taken against the company may proceed as if the company had not been dissolved.⁸⁴²

As the deregistration that takes place under section 116 is unique to merger and amalgamation transactions, it would be interesting to confirm whether or not the section 83(4) would apply to the deregistration.⁸⁴³ Weyers opines that it is not clear how a reinstatement of a statutory merger would work, given the complexity that may arise in "undoing" a merger that has already been implemented.⁸⁴⁴ He further points out that there is little need for such a remedy in that the aggrieved party can institute a claim against the surviving company rather than attempting to reinstate the merged company in order to institute a claim.⁸⁴⁵ Section 116(6)(b) of the Companies Act provides that the merger does not affect any civil, criminal, or administrative action or proceeding pending by or against an amalgamating or merging company, and any such proceeding may continue to be prosecuted by or against the company.

⁸³⁹ *Barclays National Bank Ltd v Kalk* 1981 4 SA 291 (W) 295D; ss 82(3) and 82(4) of the Companies Act. Also see *Miller and Others v Nafcoc Investment Holding Company Ltd and Others* (324/09) 2010 ZASCA 25 para 11: "Deregistration, on the other hand, puts an end to the existence of the company. Its corporate personality ends in the same way that a natural person ceases to exist on death." However, unlike a natural person, a company can be "resurrected" from its "death" (deregistration) by being restored in terms of the 1973 Companies Act. See Subramanien 2016 37(1) *Obiter* 191.

⁸⁴⁰ *Barclays National Bank Ltd v Kalk* 1981 4 SA 291 (W) 295D.

⁸⁴¹ Section 83(4) of the Companies Act.

⁸⁴² *Nulandis (Pty) Ltd v Minister of Finance and Others* (10760/12) 2013 ZAKZPHC 31, 2013 5 SA 294 (KZP) (24 May 2013) paras 41 and 59: "Section 83(4) is confined to voiding dissolution only without referring to deregistration. All that creditors require is an order voiding dissolution because s83(4)(b) enables proceedings to be taken against the company as if it had not been dissolved." ... "My interpretation is that s 83(4) empowers a court to declare the dissolution of a company to be void. However, the discretion to make any order that is 'just and equitable' does not go far enough to confer power on the court to order the reinstatement of Greenacres on the register of companies. That power remains exclusively within the realm of the Commission."

⁸⁴³ *Delport et al Henochsberg (2023)* s 116, submit that a company is dissolved on the date of deregistration (s 83(1) of the Companies Act) and the dissolution may be declared void by a court upon application by interested parties in terms of s 83(4)(a). Delport is of the view that s 83(4) of the Companies Act does apply to the dissolution of a company in terms of a merger agreement.

⁸⁴⁴ *Weyers Acquisition of a Business* 24.

⁸⁴⁵ *Ibid.*

A liquidation offers greater finality as creditors would no longer have a claim against the company once it has been voluntarily liquidated.⁸⁴⁶

It is clear that different terminology is used in the two Acts: The Income Tax Act refers to “termination” (see s 44(4A), the definition of “amalgamation transaction”) and it refers specifically to “deregistration” with regard to a merger in terms of section 116 of the Companies Act (see s 41(4)(b) of the Income Tax Act). In terms of section 44(13), section 44 relief will not apply if steps in terms of section 41(4) have not been taken to liquidate, wind-up, or deregister the amalgamated company. It appears that the wording of section 44 of the Income Tax Act may be intentionally wide so as to provide for any type of termination that may follow a merger or amalgamation transaction, be it liquidation (winding-up) or deregistration.⁸⁴⁷ This wide application of the terminology in the section is most likely to accommodate parties who use other fundamental transactions in the Companies Act to effect the merger or amalgamation – eg, a scheme of arrangement which may require steps to terminate the existence of the amalgamated company. However, section 41(4) of the Income Tax Act makes no reference to any of these other fundamental transactions in the Companies Act.

Conversely, the Companies Act refers to a “dissolution” (see the definition of “amalgamation or merger” in the Companies Act) and that following the receipt of the notice of the merger or amalgamation, the Commissioner must in terms of section 116 of the Companies Act, “deregister” an amalgamated company that has not survived the merger.

As highlighted in *Nulandis*,⁸⁴⁸ although the two concepts (dissolution and deregistration) are distinct from one another, they are conflated in the text of section 83(1) of the Companies Act as the wording of the section anticipates dissolution to be followed by deregistration as the natural consequence of a company being wound up.⁸⁴⁹

⁸⁴⁶ See ss 80 and 81 of the Companies Act.

⁸⁴⁷ The terms “winding-up” and “liquidation” are synonymous but it is interesting to note that the Income Tax Act lists these as separate methods of termination even though it is acknowledged on SARS’s website that the two terms are synonymous see <https://www.sars.gov.za/businesses-and-employers/liquidations/> (accessed 15 August 2023).

⁸⁴⁸ *Nulandis (Pty) Ltd v Minister of Finance and Others* (10760/12) 2013 ZAKZPHC 31, 2013 5 SA 294 (KZP) (24 May 2013) para 20.

⁸⁴⁹ *Ibid* paras 20 – 24.

It is also important also briefly to consider how the current and the previous Companies Acts approached deregistration and dissolution. The 1973 Act draws a clear distinction between a “dissolution” and “deregistration” and how the former can be voided and how the latter could be re-registered.⁸⁵⁰

The term “deregistration” is defined in section 1 of the 1973 Companies Act as “the cancellation by the Registrar of the registration of the memorandum and articles of the company”. The deregistration of a company is governed in section 73 of the 1973 Companies Act which makes no mention of the term “dissolution”.⁸⁵¹ The section specifically provides that if a company has failed to lodge annual returns for more than six months, or if the Registrar has reasonable cause to believe that the company is not in operation or is not carrying on business, he or she may, in accordance with the prescribed process, deregister the company.

Dissolution is governed in sections 419 – 422 of the 1973 Companies Act. In terms of section 419(1), once the affairs of the company have been completely wound up the Master shall send the Registrar of Companies a certificate to that effect.⁸⁵² The Registrar must then record the dissolution and publish a notice thereof in the prescribed manner. The date of the dissolution is the date that the Registrar records it.⁸⁵³ Section 420 provides that a dissolution can be voided upon application to court.

In Chapter XII (Compromise, Amalgamation, Arrangement, and Take-over) of the 1973 Companies Act the term “dissolution” is used. Reference is made to the dissolution of the company without winding-up where the compromise or arrangement provides for a discharge of the winding-up order (s 311(4)). In terms of section 313(1)(d), the court may provide for the dissolution without winding-up of any transferor company.⁸⁵⁴

⁸⁵⁰ Section 73(6) read with s 420 of the 1973 Companies Act. Also see *Nulandis* ibid paras 14 – 16.

⁸⁵¹ Section 73 of the 1973 Companies Act; *ABSA Bank Ltd v Companies and Intellectual Property Commission of South African and Others* (A29/13) 2013 ZAWCHC 57, 2013 4 SA 194 (WCC), 2013 3 All SA 34 (WCC) (19 April 2013) para 22.

⁸⁵² Section 419(1) of the 1973 Companies Act.

⁸⁵³ Section 419(3) of the 1973 Companies Act.

⁸⁵⁴ A proviso to the section is that no order for the dissolution without winding-up of any transferor company shall be made under this subsection prior to the transfer in due form of all the property and liabilities of the company.

In terms of the current Companies Act, the concepts of deregistration and dissolution are fused together in section 83(1).⁸⁵⁵ The section provides that a company is dissolved as of the date its name is removed from the companies register. This is distinct from the 1973 Companies Act in which the two measures were identified as two separate means by which a company's existence could be brought to an end.

When considering the Fundamental Transactions, Takeovers and Offers in Chapter 5 of the Companies Act, section 116(5) provides that the Companies Commissioner must deregister the amalgamated company once he or she receives a notice of the amalgamation or merger. As indicated earlier, this requirement is unique to mergers and amalgamations. It should also be borne in mind that in terms of section 83(1) the company will be dissolved as of the date of its deregistration.

When comparing the current and previous Companies Acts with regard to "deregistration" and "dissolution" in merger or amalgamation transactions, it appears that the 1973 Companies Act provided for a dissolution without winding-up when an amalgamation or merger is effected, and this dissolution is achieved as part of an application to the court to sanction the amalgamation. There was, therefore, no link between "deregistration" and "dissolution" with regard to merger and amalgamation transactions.

In comparison, the Companies Act provides for a court-free merger or amalgamation transaction. This means that the Commissioner is obliged to deregister the amalgamated company once notice of the merger or amalgamation is received. The date of deregistration will also be the date of dissolution in terms of section 83(1) of the Companies Act.

It is clear that, despite the 2019 amendment, the terms used in the Companies Act (deregistration and dissolution) and in section 44 the Income Tax Act (termination) continue to create confusion when it comes to mergers and amalgamations.

⁸⁵⁵ *ABSA Bank Ltd v Companies and Intellectual Property Commission of South African and Others* (A29/13) 2013 ZAWCHC 57, 2013 4 SA 194 (WCC), 2013 3 All SA 34 (WCC) (19 April 2013) para 37€.

4.2.4 Types of consideration in the merger

Section 44(4) of the Income Tax Act, provides that where there is a disposal of an asset in exchange for consideration, that consideration must be in the form of either:

- (a) an equity share or equity shares in the resultant company; or
- (b) the assumption of qualified debt⁸⁵⁶ by the resultant company.

If consideration is provided in a form other than the two options above, the rollover tax relief in sections 44(2) and 44(3) will not apply. The wording of section 44(4) provides that tax relief will not apply to the disposal of assets for “consideration other than” equity shares and/or the assumption of qualifying debt.

Shama suggests that the limited consideration allowed in terms of section 44 indicates that the legislature intended the rollover relief to apply only where the same bundle of rights in the form of equity shares (or the assumption of qualifying debt) is transferred as consideration in the amalgamation transaction so as to retain the shareholders’ effective interest in the transferred assets.⁸⁵⁷ If other consideration is allowed – eg, cash or property – the shareholders may divest themselves from the resultant company’s business following the amalgamation or merger transaction, which could trigger an inherent capital gain for the shareholders of the amalgamated company.⁸⁵⁸

Conversely, section 113 of the Companies Act does not prescribe specific consideration for a statutory merger. It does, however, require that the parties set out the manner of payment of any consideration in the merger agreement.⁸⁵⁹ As mentioned earlier, the term “consideration” is defined in section 1 of the Companies Act to include, anything of value that is given and accepted in exchange for any property, service, act, omission, or forbearance, or any other thing of value, including money, securities, barter et cetera. As emerges from this definition, it is far broader than the limited consideration allowed in section 44(4) of the Income Tax Act.

Dauids, Norwitz and Yuill point out that the statutory merger in the Companies Act does not merely contemplate a traditional pooling-type merger where the shares in the merging companies (transferor) are converted into shares held in the merged

⁸⁵⁶ Requirements for the debt are set out in s 44(4)(b)(i) and (ii) of the Income Tax Act.

⁸⁵⁷ Shama *Statutory mergers* 88.

⁸⁵⁸ See Clark’s view as discussed in n 510; Shama *ibid*; Lewis in Cliffe Decker Hofmeyr 2011 27 May *Tax Alert*.

⁸⁵⁹ Section 113(2)€ – € of the Companies Act implies a transfer of securities.

company (transferee).⁸⁶⁰ The Act allows for various types of consideration, such as cash or even consideration in the form of shares in a company other than the merged company⁸⁶¹ – as one finds in a reverse-triangular merger.⁸⁶² The Companies Act does, however, require that the shares be issued for adequate consideration as determined by the Board.⁸⁶³

Although a wide variety of merger structures are offered in the Companies Act in theory, if one considers the Income Tax Act most of these structures would result in adverse tax consequences due to the limited types of consideration which qualify for tax rollover relief.⁸⁶⁴

The limited consideration allowed in section 44 is justified since, as indicated by Clark, rollover relief is aimed at providing relief where there is a continued investment (in a modified form) after the transaction has taken place. If the consideration takes the form of cash, shareholders would in all likelihood choose to dispose of their interest in the surviving company.⁸⁶⁵

4.2.5 Types of merger structure permitted

This discussion harks back to the disconnect identified earlier in that it relates to the definitions of an “amalgamation transaction” in the Income Tax Act and “amalgamation or merger” in the Companies Act.

Section 44(1)(a) of the Income Tax Act allows for a simple, straightforward merger in terms of which all the assets (save those earmarked to settle specified debt) are disposed of by a resident company (the amalgamated company) to another resident company (the resultant company) by means of the merger, amalgamation, or conversion following the termination of the amalgamated company. The section confines the amalgamation transaction to a bilateral disposal from one resident

⁸⁶⁰ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 344.

⁸⁶¹ Section 113(2)(d) of the Companies Act.

⁸⁶² Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 344.

⁸⁶³ Section 40(1)(a) of the Companies Act. Non-compliance will not result in the merger agreement automatically being void. See Delpont *et al Henochsberg (2012)* ss 40 and 218: “The test for ‘adequate consideration’ will be objective, based, inter alia, on commercial justification of the transaction in all the circumstances and assuming that the parties would be acting in good faith and at arm’s length.”

⁸⁶⁴ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 87.

⁸⁶⁵ Clark *Corporate Law* 406 – 407. Clark explains that the deferred taxation applies where the merging company’s shareholders continue their investment (in a modified form), while if the consideration in the merger is cash, effectively the shareholders of the selling company terminate their investment (in exchange for cash) and there is no longer a continuity of ownership interest in the surviving company.

company to another resident company.⁸⁶⁶ Regrettably, this differs vastly from what one sees in practice. In practice, the transaction may include more than one party on either side of the merger or amalgamation and a mix of consideration payable.⁸⁶⁷ This results in a very limited application of the tax rollover relief provision in practice.

The statutory merger in the Companies Act is far more innovative as it allows for further types of mergers in the definition of an “amalgamation or merger”. It provides for an agreement between *two or more companies* resulting in:⁸⁶⁸

- (a) “The formation of *one or more new companies*, that were held by any of *the amalgamating or merging (transferor) companies* prior to the merger agreement being implemented and the subsequent dissolution of the amalgamating or merging companies; or
- (b) The survival of *at least one* of the amalgamating companies and vesting of all the assets and liabilities, that had been held by the *amalgamating companies* prior to the merger agreement implementation, in the *surviving company or companies*” (emphasis added).

The italicised phrases above emphasise that the statutory merger provides for more than one amalgamating company and more than one resultant company. This is supported by section 113(2)(f) of the Companies Act which provides that the parties must, in the written merger agreement, specify the allocation of the assets and liabilities of the amalgamating companies amongst the various resultant *companies* (plural) on the implementation of the merger agreement.⁸⁶⁹

This points yet again to the conclusion that although in theory the Companies Act allows considerable flexibility, if the merger structures fail to meet the limiting requirements of the Income Tax Act, they would likely lead to adverse tax consequences.⁸⁷⁰

⁸⁶⁶ Strauss *Development of merger and amalgamation transactions* 33.

⁸⁶⁷ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁸⁶⁸ Definition of “amalgamation or merger” in the Companies Act.

⁸⁶⁹ See discussion in para 2.4.1.

⁸⁷⁰ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 87.

4.2.6 Party eligible to receive and pay the consideration

Building on the two disconnects discussed above, there is also a discrepancy between the two Acts regarding the party or parties eligible to pay and receive the consideration.

As discussed in paragraph 4.2.5 above, the Income Tax Act only allows for a bilateral transaction between the amalgamated company which transfers all its assets to the resultant company in exchange for equity shares in the latter. This means that the only party eligible to receive the consideration for the assets is the amalgamated company which will on termination, in turn distribute these equity shares to its shareholders, leaving the amalgamated shareholders as shareholders of the resultant company.

However, as illustrated earlier, the Companies Act places little limitation on the substance of the merger agreement and the parties are free to structure the merger or amalgamation transaction to meet their individual requirements.⁸⁷¹ The Act is silent on both the form of the consideration in a merger or amalgamation agreement, and on providing by whom and to whom the consideration must be paid.

This contributes to the variety of possible merger structures permitted under the statutory merger in the Companies Act. For example, in a triangular merger, the target company effectively becomes a subsidiary of the holding company as the consideration takes the form of shares in the holding company even if the transfer is between the subsidiary company and the target company. The target company effectively merges with an existing subsidiary of the holding company and the shareholders of the target company receive shares in the holding company.⁸⁷² In this example, the merger takes place between an existing subsidiary and the target company, but the consideration is “paid” to the target company’s shareholders by a third party – the holding company – which may issue shares as consideration in the triangular merger.

It must be borne in mind that the Companies Act has its own “grey areas” in this regard, based on the limitation of certain voting rights under section 115(4) of the Act.⁸⁷³

⁸⁷¹ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 344.

⁸⁷² Cassim F *et al Law of Business Structures* 396.

⁸⁷³ Kershoff 2015 27/2 *SA Merc LJ* 325 326; Delpont *et al Henochsberg (2023)* s 115: “The ‘acquiring party’, ‘related party’, or ‘anybody acting in concert’ exclusion is important and may have the effect that neither the quorum nor the majority required in terms of s 115 may be attained, especially in respect of amalgamating and merging companies with related parties.”

4.2.7 Upstream mergers

An upstream or vertical merger is a merger between a subsidiary and its parent company in which the parent company emerges as the surviving company. A short-form merger is similar but takes place specifically between a holding company and a wholly owned subsidiary.⁸⁷⁴

Section 44(14)(a) of the Income Tax Act specifically does not allow for any transaction that constitutes a liquidation distribution as defined in section 47 of the Act. This means that the rollover relief in section 44 will not apply where a liquidating company disposes of all its assets to its shareholders in anticipation of or during a liquidation, winding-up, or deregistration process. However, as shown in Chapter 3, an alternative option for the parties would be to implement a liquidation distribution in terms of section 47 of the Income Tax Act. This would also see the transaction treated as tax neutral if the relevant requirements are met.

Cassim points out that it is disappointing not to see a specific provision for a short-form merger in the Companies Bill.⁸⁷⁵ The Act provides for mergers between a holding company and its subsidiary⁸⁷⁶ but fails to provide a special procedure for this.⁸⁷⁷ Cassim proposes that international examples be followed and that a special procedure for a short-form merger be introduced. This would see the board of directors simply approving the merger and avoid the delays, costs, and administrative burden of a shareholder meeting, the exercise of appraisal rights, the notification of all known creditors, et cetera.⁸⁷⁸

It is submitted that a short-form merger could be a beneficial introduction in the Companies Act as it would assist companies in efficiently restructuring and “cleaning-up” their group and eliminate specific subsidiaries. The Income Tax Act as it currently reads would, however, only provide tax relief for a vertical short-form merger in terms of a liquidation distribution under section 47.

⁸⁷⁴ Cassim MF (*Part 2*) 2008 20 SA Merc LJ 147 155.

⁸⁷⁵ Ibid.

⁸⁷⁶ Section 113(1) of the Companies Act provides: “Two or more profit companies, *including holding and subsidiary companies*, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test.”

⁸⁷⁷ Cassim MF (*Part 2*) 2008 20 SA Merc LJ 155.

⁸⁷⁸ Ibid 155 and 156.

4.2.8 Creation of a new company pursuant to the merger

The Companies Act essentially provides for two types of merger in the definition of an “amalgamation or merger” in section 1. The first provides for a transaction, or series of transactions, pursuant to an agreement between two or more companies which results in the formation of one or more new companies. Together, these new companies hold all the assets and liabilities previously held by any of the amalgamating or merging companies immediately before the implementation of the agreement. Each of the amalgamating or merging companies is dissolved.⁸⁷⁹

The statutory merger provisions consequently allow for the creation of a new company pursuant to a merger or amalgamation and this company serves as the resultant company. Section 116(5)(a) also provides that a new company must be registered with the CIPC if it has been newly incorporated in terms of the amalgamation or merger agreement. There is, however, some uncertainty surrounding this process as highlighted in *Henochsberg*.⁸⁸⁰ The Commissioner will register the newly incorporated company once he or she receives the notice of the amalgamation or merger (the CoR89 form), which must include the memorandum of incorporation of the newly incorporated company. The registration certificate of that newly incorporated company may only be issued after the filing of the CoR89.

Shama opines that the Legislature intended that parties to a statutory merger may transact with a company that is yet to be formed and registered.⁸⁸¹ Chong, however, points out that for practical reasons parties pursuing such a merger may consider using a shelf company as opposed to creating a new company. This, she argues, is because the new company to be formed cannot be party to the merger agreement as it does not have legal existence at the time of the conclusion of the agreement.⁸⁸² In addition, she submits that this issue cannot be overcome by using another company as the merging company – ie, as a *stipulatio alteri*⁸⁸³ for the new company to be formed

⁸⁷⁹ Section 1 definition of “amalgamation or merger” para (a) in the Companies Act.

⁸⁸⁰ Delpont *et al Henochsberg* (2023) s 116.

⁸⁸¹ Shama *Statutory mergers* 83.

⁸⁸² Chong *Tax Issues* 22.

⁸⁸³ “*Stipulatio alteri*” is a contract between two persons designed to enable a third party to come in as a party to contract with one of the other two. See Claasen *Dictionary of Legal Words and Phrases*.

– as this type of arrangement is not envisioned in section 113(1) and (2) of the Companies Act.⁸⁸⁴

Yet, the Income Tax Act makes no such concession for amalgamation transactions, and this may have far-reaching tax consequences. The definition of an “amalgamation transaction” refers to the disposal of assets to a “company” which is, in turn, defined in section 1 of the Income Tax Act read with section 41(1). This definition refers to various types of entities, but all of these are already incorporated – in other words, formed and registered.⁸⁸⁵ As a result, the corporate rules would not apply to a statutory merger where one of the parties is not yet in legal existence in that it will only come into being on implementation of the merger.⁸⁸⁶

Shama argues that section 41(4) now provides for the deregistration of a company by operation of law on the basis of a merger or amalgamation that has been filed with the CIPC in terms of section 116 of the Companies Act.⁸⁸⁷ She argues that this alignment to give effect to the operation of law should be extended in the definition of an “amalgamation transaction” to also allow for the *creation* of companies by operation of law in terms of section 116(5)(a) of the Companies Act.⁸⁸⁸ Shama’s suggestion is supported in principle. If the aim of the legislature was to align the Income Tax Act and Companies Act regarding the legal principle of the “operation of law” it must consider everything that occurs by operation of law during a statutory merger. This may include the creation of a new company under a merger agreement.

This is, however, not as simple as it may appear as there are other tax implications that should be considered where a company is created under a merger, specifically VAT.⁸⁸⁹

⁸⁸⁴ Chong *Tax Issues* 22;

⁸⁸⁵ Section 1 read with s 41(4) of the Income Tax Act. The definition includes “any association, corporation, or company (other than a close corporation) *incorporated or deemed to be incorporated* under law, or under previous law in force in the Republic” (emphasis added).

⁸⁸⁶ Chong *Tax Issues* 21 – 24.

⁸⁸⁷ Shama *Statutory mergers* 84.

⁸⁸⁸ Ibid. She suggests further that the legislature can add certain remedies section 44(13) where the compliance of the creation of a new company is not adhered to. Also, she opines that the proposed expansion of the definition of an “amalgamated company” should not provide opportunities for abuse as there are existing anti-avoidance provisions in place, such as the value shifting arrangement, anti-avoidance provisions, etc.

⁸⁸⁹ See the conclusion on this matter in para 5.3.1.4 below.

As discussed above, section 11(e) of the VAT Act which provides for the zero-rating of the sale of a going concern, requires that the supply be to a registered vendor, which implies the vendor is registered in terms of the VAT Act. Therefore, there will be a standard rate of VAT applied to the supplies made to a company which is not yet registered as a VAT vendor at the time of supply.

This notwithstanding, Interpretation Note 57 provides that the supply of a going concern may be zero rated subject to the purchaser being registered as a VAT vendor with effect from the conclusion of the agreement.⁸⁹⁰ The Interpretation Note advises in this regard that the supply may be zero rated, where the party has, as a minimum, applied to be registered as a vendor before the conclusion of the agreement.⁸⁹¹ In other words, the Interpretation Note provides that where a purchaser is not yet registered for VAT on conclusion of an agreement, proof that the purchaser has applied for VAT registration is sufficient for the zero rating of the supply.⁸⁹² The Interpretation Note, therefore, provides a “grace period” for the VAT registration between the signing of the merger agreement and the actual supply taking place.

This concession was introduced because of the VAT registration conundrum created by section 11(e) read with section 23 of the VAT Act. As highlighted above, section 11(e) requires the purchaser to be a registered VAT vendor if the supply is to be zero rated. Nevertheless, section 23 of the VAT Act requires that a VAT vendor must be making taxable supplies before it can register for VAT.⁸⁹³ In other words, an enterprise that is not yet in existence (and making taxable supplies) cannot register as a VAT vendor. Clearly, if this conundrum is to be resolved some form of concession is required. The solution lies in permitting a new enterprise to register as a VAT vendor before it meets the requirements set for becoming a VAT vendor (or an ought-to-be VAT vendor) and still to benefit from the zero rating of VAT under section 11(e) of the VAT Act.⁸⁹⁴

⁸⁹⁰ SARS Interpretation Note 57 5: <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-57-Sale-Enterprise-Part-Going-Concern.pdf> (accessed 18 November 2022).

⁸⁹¹ Ibid.

⁸⁹² Mpopo *The sale of a going concern* 43.

⁸⁹³ See s 23(1)(a) and s 23(1A) of the VAT Act.

⁸⁹⁴ Mpopo *The sale of a going concern* 44 – 45.

Section 8(25) of the VAT Act applies automatically to supplies of goods or services under certain of the corporate rules.⁸⁹⁵ The section only requires that “any goods or services are supplied by a vendor to another vendor”.

A “vendor” is defined in section 1 of the VAT Act to mean “any person who is *or is required to be registered* under this Act” (emphasis added). Therefore, in order for the relief in section 8(25) to apply the person must either be registered for VAT or there must be a requirement for that person to be registered for VAT.

Section 23(1)(b) of the VAT Act provides that every person who carries on any enterprise and is not yet registered for VAT, is liable to register for VAT at the commencement of any month where the total value of taxable supplies in terms of a written contractual obligation which is to be made by that person in a 12 month period from the commencement of that month and such supply will exceed R1 million. It is, therefore, dependent on whether the newly incorporated company will be required to register for VAT in terms of section 23(b)(1) of the VAT Act once the company is registered, to qualify for the VAT relief in section 8(25).

4.2.9 *Causa and implementation of the merger transaction*

The legal *causa* for a transaction is the reason or cause of the transaction.⁸⁹⁶ Examples of the traditional methods of contractual causes are cession, sale, delegation, et cetera.

A distinction must be drawn between the *causa* and its mode of implementation. In a statutory merger it is advanced that the underlying *causa* is the transfer of assets and liabilities between companies, either by way of merging two or more companies into one or by merging two or more companies into a new company.⁸⁹⁷

The interesting consideration here is *how* this *causa* is implemented. There are two methods in this regard: by operation of law; or via the merger agreement.

Strauss suggests that in a statutory merger, the *causa*⁸⁹⁸ for the transaction is not the underlying contract but the legal principle itself – ie, the operation of law.⁸⁹⁹ It is

⁸⁹⁵ Section 8(25) of the VAT Act.

⁸⁹⁶ Claasen *Dictionary of Legal Words and Phrases* “cause”: “(2) Reason: that which produces or contributes to an effect. See *Cole v Union Govt* 1910 AD 275.”

⁸⁹⁷ See discussion in para 1.2 on the different types of merger.

⁸⁹⁸ “Causa” means the reason or cause. <https://www.collinsdictionary.com/dictionary/english/causa>.

⁸⁹⁹ Strauss *Development of merger and amalgamation transactions* 18 – 20 36.

submitted that Strauss confuses the *causa* (the reason for the transaction) with the implementation of that *causa* (the transfer that takes place). Nonetheless, she correctly identifies that the implementation of a merger agreement can be confusing as regards whether it is implemented *ex lege* (by operation of law) or in terms of the merger agreement.

Nicol explains the principle as follows:⁹⁰⁰

“Black’s Law Dictionary defines ‘operation of law’ as ‘the means by which a right or a liability is created for a party regardless of the party’s actual intent.’ Accordingly, one could define ‘transfer by operation of law’ as the means by which a right or liability is transferred for a party regardless of the party’s actual intention. A transfer by operation of law is not effected by consensus but rather by sole virtue of a statute or common law rule, which applies to a particular factual circumstance: the statute or rule is sufficient, in and of itself, to effect the transfer. It is generally accepted that s 116(7) provides for the automatic transfer of property and obligations by operation of law” (emphasis added).

Strauss suggests that things are not that simple. Confusion can arise if one considers section 116(7) of the Companies Act which provides that the transfer of property and obligations takes place “in accordance with the provisions of the amalgamation or merger agreement”.⁹⁰¹ As a transfer in a merger takes place by operation of law, the transfer is not effected by consensus between the parties (as seen in an agreement), but by virtue of the *ex lege* principle – ie, the transfer takes place automatically. So why does section 116(7) provide that the transfer is “in accordance with the provisions of the merger agreement”?

As highlighted in paragraph 2.4.2, Dachs and la Grange suggest that the phrase in section 116(7) – “in accordance with the provisions of the amalgamation or merger agreement” – merely addresses a situation where more than one entity survives the merger and the property and obligations must be distributed amongst the surviving entities.⁹⁰² The merger agreement is, therefore, not the *causa* of the statutory merger, but is merely intended to regulate practical aspects of the statutory merger such as, for example, the allocation of assets and liabilities where there is more than one surviving entity, or the allocation of the consideration received.

⁹⁰⁰ Nicol 2013 25 SA Merc LJ 35.

⁹⁰¹ Section 116(7) of the Companies Act.

⁹⁰² Dachs and La Grange 2012 *The Taxpayer* 6.

Dachs and la Grange's view that the reference to a merger agreement in section 116(7) of the Companies Act is intended to regulate the practical aspects of the merger transfer, such as the allocation of property and obligations between the relevant remaining merger parties, is supported.⁹⁰³ This interpretation does not, in my view, create any confusion as to the *causa* or the implementation method of a merger agreement.

Gad and Strauss suggest that if the statutory merger is interpreted in broad terms, it covers a new method of transfer by operation of law and that the assets are effectively transferred for no consideration.⁹⁰⁴ Strauss further considers that the transfer in a merger takes place by operation of law even if the merger agreement fails to prescribe a proper allocation of consideration or assets and liabilities, provided that it meets the requirements for an "amalgamation or merger" as defined.⁹⁰⁵ She argues that this supports the view that the *causa* in a statutory merger is the transfer by operation of law as opposed to the merger agreement or the traditional transfer methods.

There are, however, flaws in Strauss's arguments. First, it is the implementation of the merger that takes place by operation of law; the method of implementation of the contract does not constitute the *causa* of the contract itself. This has the effect that the *causa* is the merger encapsulated in the relevant merger agreement. Nonetheless, section 116 of the Companies Act provides for a specific implementation method for such a merger agreement: *ex lege*. As a result, all the property and obligations are transferred by operation of law in disregard of the traditional methods of transfer regulated by contracts.

That said, the fact that the transfer takes place by operation of law does not render the merger agreement irrelevant in the implementation of the *causa*. In *Henochsberg* it is submitted that the property of the companies is "allocated" in ownership by operation of law, in accordance with the merger agreement or any other relevant agreement (subject to meeting the solvency and liquidity test and contractual or other restrictions in respect of that property transfer).⁹⁰⁶

⁹⁰³ *ibid.*

⁹⁰⁴ Gad and McCormack (2012) *Tax ENSight*. See the discussion in para 4.2.4 above where I dispute the suggestion of interpretation that a merger transfer may take place for no consideration.

⁹⁰⁵ Strauss *Development of merger and amalgamation transactions* 20.

⁹⁰⁶ Delpont *et al Henochsberg* (2023) s 116. Also see Dachs and La Grange 2012 *The Taxpayer* 6.

In *Henochsberg* it is acknowledged that there is uncertainty as to the position where a specific merger agreement fails to provide for the allocation of particular property.⁹⁰⁷ Regarding the transfer of obligations in terms of a merger agreement, the wording of section 116(7) would see each company liable for the whole of the obligations of every other company (each company is jointly and severally liable).⁹⁰⁸

The issue arises when the merger agreement is silent on the transfer of the property. It is submitted in *Henochsberg* that in such an event, a subsequent agreement in which the parties allocate the property amongst the surviving companies would constitute a contractual arrangement distinct from the actual merger agreement.⁹⁰⁹ This has the unfortunate effect of excluding to application of the *ex lege* principle to the supplementary contractual arrangement and the parties could trigger the anti-transfer clause in contracts transferred in terms of the arrangement so exposing themselves to a potential breach of contract.⁹¹⁰

By contrast, section 44(4) of the Income Tax Act prescribes the forms of consideration to be paid for the disposal of assets in an amalgamation transaction. This suggests that there is a disposal or sale that involves compensation in the prescribed form of consideration. The subsection reads that the rollover relief will not apply to a disposal of an asset by an amalgamated company to a resultant company as part of an amalgamation transaction to the extent that the asset is disposed of “*in exchange for consideration other than*” equity shares or qualifying debt. Gad and Strauss feel that this wording better aligns with the Companies Act than the previous wording, which was amended in 2011, as it also allows for “no consideration” which is in line with the legal principle that the transfer takes place *ex lege* in terms of the operation of law.⁹¹¹

⁹⁰⁷ Delpont *et al* *ibid*.

⁹⁰⁸ *ibid*.

⁹⁰⁹ *ibid*.

⁹¹⁰ *ibid*.

⁹¹¹ Gad and Strauss (*Part 1*) 2012 *Tax ENSight* point out that before the amendment in terms of the 2011 Taxation Laws Amendment Act, s 44 and the statutory merger in the Companies Act were irreconcilable as subsection read that rollover relief would only apply to the extent that the assets are “so disposed of in exchange for” equity shares or the assumption of the qualifying debts. In other words, the rollover relief in s 44 could only apply if there was consideration in the form of equity shares or qualifying debt, but the assets would transfer *ex lege* in terms of the statutory merger. Since the amendment in 2011, the subsection now reads “so disposed of in exchange for consideration other than” equity shares or the assumption of the relevant debts. In Gad and Strauss’s view, this 2011 amendment now provides that the exchange can take place for no consideration, which aligns better with the principle of a transfer by operation of law which does not, strictly speaking, require any consideration.

This view has been criticised in paragraph 3.2.5 above. Nevertheless, I recognise that the terminology in the Income Tax Act appears to imply a *quid pro quo* as opposed a transfer that occurs by operation of law.

The term “disposal” in the corporate rules refers to paragraph 11 of the Eighth Schedule which includes a transfer by operation of law as a method of disposal.⁹¹² Chong and van der Linde indicate that the question that now arises is whether the transfer or vesting of assets in terms of a statutory merger can rely on corporate rollover relief where the disposal is made *in exchange* for equity shares or assumption of debt, and not in the strict sense due to a transfer by operation of law which requires no *quid pro quo*.⁹¹³ They suggest that this disconnect can be addressed by acknowledging that the statutory merger provisions in the Companies Act do not prohibit the delivery of consideration for the transfer of the assets and that the Income Tax Act provides for a disposal to take place by operation of law.⁹¹⁴ Hence, the transfer takes place by operation of law and the consideration is then prescribed by the relevant corporate rules, so ensuring compliance with both Acts.⁹¹⁵

Rudnicki, however, argues that it is questionable whether the automatic merging of entities by way of a statutory merger contemplates a “disposal” for tax purposes.⁹¹⁶ He suggests that the Companies Act does not contemplate a disposal or a sale by means of a statutory merger, where the transfer takes place merely by operation of law. He proposes that section 44 of the Income Tax Act should be amended to include a reference to the relevant provisions in the Companies Act.⁹¹⁷ This refers to the definition of an “amalgamation transaction” which refers to a resident company which “disposes of all of its assets” which, from a legal perspective, is technically incorrect.

It is submitted that the inclusion of the transfer by way of operation of law in paragraph 11 of the Eighth Schedule indicates that the legislature intended that the term “disposal” encompass automatic transfers – such as a transfer by operation of law –

⁹¹² Section 41 definition of a “disposal” read with para 1 of the Eighth Schedule definition of a “disposal” and with para 11 of the Eighth Schedule.

⁹¹³ Chong and Van der Linde 2014 3 *Stell LR* 484 – 485. This transfer in exchange for equity shares can be seen in both a s 42 (asset-for-share transaction) and a s 44 (amalgamation transaction).

⁹¹⁴ *ibid.*

⁹¹⁵ *ibid.*

⁹¹⁶ Rudnicki and Ashe 2017 8/3 *Business Tax and Company Law Quarterly* 1 and 9.

⁹¹⁷ *ibid.*

even if, from a legal perspective, such a transfer technically involves no disposal or sale.

It should further be borne in mind that section 44 of the Income Tax Act may be used in conjunction with one of the other fundamental transactions in the Companies Act, for example, a scheme of arrangement, which requires the transfer to be effected by contractual consent and not by operation of law. In my view, the term “disposal” is, therefore, correctly used in section 44 as it includes both normal disposals by contract (scheme of arrangement) and disposals by operation of law (statutory merger) due to the wide definition of “disposal” in paragraph 11 of the Eighth Schedule.

4.2.10 The assumption of debt as consideration

The penultimate disconnect identified concerns the assumption of debt as consideration in a merger or amalgamation transaction.

The Income Tax Act limits the assumption of debt as consideration in section 44(4)(b) in an amalgamation transaction. It is often referred to in practice as “qualifying debt” as there are certain requirements for the debt to qualify as debt for purposes of consideration in an amalgamation transaction.

Section 44(4)(b) provides that the debt assumption must be related to debt incurred by the amalgamated company more than 18 months before the disposal.⁹¹⁸ Alternatively, the debt incurred within 18 months before the disposal, to the extent that the debt:

- (a) constitutes refinancing of the debt, or
- (b) where the debt arose in the ordinary course of the amalgamated company’s business, which is disposed of as a going concern to the resultant company and the debt was not incurred for purposes of procuring, enabling, facilitating, or funding the acquisition by the resultant company of any assets in terms of the amalgamation transaction.⁹¹⁹

⁹¹⁸ Section 44(4)(b)(i)(aa) of the Income Tax Act.

⁹¹⁹ Section 44(4)(b)(i)(bb) of the Income Tax Act.

This differs from the provisions in the Companies Act which prescribe that in the case of a statutory merger all obligations must be transferred to the transferee company (resultant company) or, if a new company is incorporated pursuant to the statutory merger, all the obligations must be transferred to such entity(ies).⁹²⁰

Section 116(7)(b) of the Companies Act provides that each of the surviving companies is liable for all of the obligations of every amalgamating or merging company. This is, however, subject to the surviving companies being able to satisfy the solvency and liquidity test, if applicable. The obligations allocated must, therefore, not render the surviving company insolvent and illiquid.

This is supported by the definition of an “amalgamation or merger” in the Companies Act which requires that all the liabilities be transferred from the amalgamating companies to the surviving companies.⁹²¹ Various writers agree that in the light of the wording of section 116(7)(b), no obligations may be excluded from the transfer.⁹²²

This, in my view, can potentially create a disconnect between the two Acts and may give rise to a practical issue in drafting the merger agreement, specifically the allocation of the assets and liabilities. If, in terms of the statutory merger all obligations must be transferred, while under the Income Tax Act only qualifying debt may be transferred as consideration, the following question arises: Does the tax rollover relief, therefore, not apply to obligations transferred that do not qualify as a “qualifying debt” in terms of section 44(4)(b) of the Income Tax Act?⁹²³ This appears to be the case as non-qualifying consideration would not qualify for tax rollover relief in terms of section 44(4) of the Income Tax Act.

This also means that parties would be required to have an adequate record of all debt to be transferred and, for tax purposes, would further be required to distinguish between debt which qualifies for tax relief and that which does not. This distinction

⁹²⁰ Section 116(7)(b) of the Companies Act.

⁹²¹ Definition of “amalgamation or merger” in s 1 of the Companies Act.

⁹²² Dachs and La Grange 2012 *The Taxpayer* 6; Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 344.

⁹²³ Strauss volunteers that where the amalgamating company has tainted debt the parties appear to have only one of two options: first, to settle the “non-qualifying debt” prior to the implementation of the merger agreement; or alternatively, risk losing their tax rollover relief for the non-qualifying part of the debt as consideration. See Strauss *Development of merger and amalgamation transactions* 20. I believe that the parties would not “lose” the full rollover relief but that there would have to be an apportionment of sorts to distinguish between the consideration that consists of “qualifying debt” and so-called “tainted debt”.

means that all debt must be considered in negotiating the purchase price from a legal perspective, but not all transferred debt would hold a tax benefit for the transferring party.

4.2.11 Finality of the merger agreement

The last identified disconnect is not a direct contradiction or inconsistency between the two Acts, but rather indicates that the timelines for achieving finality of the merger agreement differ significantly between the Companies Act and the Income Tax Act.

The statutory merger achieves finality once the Commissioner of the CIPC is notified of the merger. Section 116(5) requires the Commissioner to register each company that has been newly incorporated in terms of a merger agreement and to deregister any of the amalgamating or merging companies that have not survived the merger.

However, due to the anti-avoidance provisions in section 44(5) of the Income Tax Act, there are certain clawback provisions which could trigger tax consequences for up to 18 months after the conclusion of the merger transaction. Section 44(5) provides that where, following its acquisition of an asset, a resultant company disposes of that asset within 18 months of its acquisition, certain tax implications are triggered.⁹²⁴ In such a case, where the resultant company disposes of the assets within 18 months from date of acquisition in terms of the amalgamation transaction, there is a deemed tax effect in the resultant's hands which is deemed to have arisen initially, when the amalgamated company disposed of the relevant assets to the resultant company, however, now without the rollover tax relief.⁹²⁵ This will effectively trigger a capital gain or recoupment in the hands of the resultant company regardless of the availability of any assessed loss.⁹²⁶

In the light of the above, parties must remain vigilant for a period of up to 18 months following the conclusion of the merger agreement as adverse tax consequences may still arise from the amalgamation transaction; while from a Companies Act perspective the matter is finalised once notice is given to the Commissioner who performs the required registrations and deregistrations in terms of section 116.

⁹²⁴ Section 44(5) of the Income Tax Act.

⁹²⁵ Section 44(5)(a) and s 44(5)(b)(i) of the Income Tax Act.

⁹²⁶ An exception exists for trading stock in section 44(5)(b)(i) of the Income Tax Act.

4.3 The impact of circumventing the issues between the Income Tax Act and Companies Act in terms of mergers

The uncertainties in section 113 of the Companies Act and the limited application of amalgamation transactions in terms of section 44 of the Income Tax Act, along with the above identified discrepancies lead merger parties to consider using alternative provisions in both Acts.

I set out below the various combinations of corporate rules in the Income Tax Act that can be applied with the other provisions of the Companies Act to achieve the outcome of a merger whilst also producing a tax neutral transaction.

4.3.1 Using other provisions in the Companies Act to effect a merger

4.3.1.1 Scheme of Arrangement

Scheme of Arrangement	Corporate Rules
Section 114	Asset-for-share transaction (s 42)
	Amalgamation transaction (s 44)
	Intra-group transaction (s 45)
	Unbundling transaction (s 46)
	Liquidation distribution (s 47)

Table 5: Combination of scheme of arrangement with corporate rules

The first alternative provision that is considered to achieve a merger transaction is a scheme of arrangement. It should be noted, however, that this would not be a merger in the true sense of the word (the fusing of two companies),⁹²⁷ but the same outcome can be achieved by way of a scheme of arrangement (s 114) or a sale of business (s 112). These are discussed below.

⁹²⁷ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 340.

Chong indicates that a scheme of arrangement can be structured to rely on all the corporate rules.⁹²⁸ This means that parties may elect to use a section 114 scheme of arrangement in combination with section 42, 44, 45 or 47 to achieve a merger between companies. Section 46 (unbundling transaction) is not typically used to effect a merger (rather to action a demerger) but has been added to the above table for inclusiveness.

In Chapter 2 the various requirements surrounding a scheme of arrangement were discussed.⁹²⁹ It remains a popular mechanism by which to effect sales or M&A business transactions, including mergers.⁹³⁰ The central feature of a scheme of arrangement is that any arrangement between a company and its holders of securities (shareholders) may be concluded if the relevant requirements are met.⁹³¹ The arrangements listed for a scheme of arrangement between a company and its holders of shares include (but are not limited to) exchanging its securities for other securities,⁹³² which takes place when the merging company's shareholders exchange their shares in the merging company for shares in the resultant company following the merger transfer. An independent expert is required to write a report for submission to the board on the proposed arrangement.⁹³³

Benefits that the scheme of arrangement offers over the statutory merger are that it does not require a solvency and liquidity test⁹³⁴ and all known creditors need not be notified of the arrangement.⁹³⁵ Both the scheme of arrangement and statutory merger procedure require no court approval, and both require only shareholder approval as set out in section 115 of the Companies Act. Still, the scheme of arrangement has the added advantage of having been part of our law for many years and has been tried and tested in court.⁹³⁶

⁹²⁸ Chong *Tax Issues* 20.

⁹²⁹ See para 2.5 above.

⁹³⁰ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 78.

⁹³¹ Section 114(1)(a) of the Companies Act; Cameron *ibid* 79.

⁹³² Section 114(1)(d) of the Companies Act.

⁹³³ Section 114(2) and (3) of the Companies Act.

⁹³⁴ The company need not pass a solvency and liquidity test but s 114 will not apply if the company is in liquidation or in the course of business rescue.

⁹³⁵ As required for a merger in terms of s 116(1)(a) of the Companies Act.

⁹³⁶ See discussion of some of these court cases in para 2.2.2; Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 79.

4.3.1.2 Disposal of All or Greater Part of Assets or Undertakings

Disposal of all or greater part of assets or undertakings	Corporate Rules
Section 112	Asset-for-share transaction (s 42)
	Amalgamation transaction (s 44)
	Intra-group transaction (s 45)
	Liquidation distribution (s 47)

Table 6: Disposal of greater part of assets with corporate rules

A disposal of all or greater part of assets or a business's undertaking in terms of section 112 of the Companies Act offers an alternative to the statutory merger in section 113 of the same Act.

The main attraction of the statutory merger is that the transfer, deregistration of the company, and the conversion of the shares all take place by operation of law. This significantly reduces the administrative burden and the cost of having to transfer each of the assets by traditional methods – eg, by way of cession, the transfer of employee contracts, and the registration of fixed property with the deed's office.

The provisions of section 113, however, require that all the assets and liabilities, without exception, be transferred by operation of law.⁹³⁷

This makes section 112 a more attractive option in a sense, in that it allows the parties to choose which assets and liabilities are to be transferred and which are to be left behind, even if, as a result, the transfer of the assets will have to be effected in terms of more administratively burdensome methods. This is because section 112 does not provide for transfer by operation of law. The normal process for liquidation must be followed if the existence of the transferor

⁹³⁷ Section 1 read with s 116(7)(b) of the Companies Act.

company is to be terminated after the sale of the business,⁹³⁸ which can also be a time-consuming exercise.

Under section 112 the parties may also elect to transfer all the assets in the sale of business transaction.

Section 112 also does not require a solvency and liquidity test as is required in a statutory merger. But it should be noted that a section 112 transaction is not a true merger but is more akin to a sale of assets as the section does not allow for the transfer of obligations.

As noted in the table above, a section 112 disposal can be structured to rely on the relief provided in the corporate rules – in an asset-for-share transaction (s 42); amalgamation transaction (s 44); an intra-group transaction (s 45); and a liquidation distribution (s 47).⁹³⁹ This allows parties the option of combining a disposal in terms of section 112 with various corporate rules to ensure a tax effective outcome.

Chong suggests that in practice an asset-for-share transaction⁹⁴⁰ is typically used to transfer all the assets in a sale of business or section 112 disposal.⁹⁴¹

4.3.2 Using other provisions in the Income Tax Act to effect a merger

Statutory Merger	Corporate Rules
Section 113	Asset-for-share transaction (s 42)
	Intra-group transaction (s 45)
	Liquidation distribution (s 47)

Table 7: Statutory merger with the corporate rules other than amalgamation transaction (section 44)

⁹³⁸ Sections 79 and 80 of the Companies Act.

⁹³⁹ Chong *Tax Issues* 20.

⁹⁴⁰ Section 42 of the Income Tax Act.

⁹⁴¹ Chong *Tax Issues* 32.

The statutory merger has been part of the South African company law for the past 14 years but has not proved popular in practice.⁹⁴² Cameron suggests that the risks associated with the statutory merger include that it is untested in practice and by our courts leaving companies without precedent on which to rely when interpreting provisions of the statutory merger.⁹⁴³

A positive attribute of the statutory merger is that it reduces the legal formalities associated with the transfer of assets as the transfer takes place by operation of law. This makes it a cost and time effective mechanism.⁹⁴⁴

As discussed in Chapter 3, section 44 has a very narrow application, making it an unappealing section for concluding a tax-neutral transaction. Other sections in the corporate rules such as a section 42, 45, or 47 may be combined with a statutory merger to achieve a tax neutral transaction. In Chapter 3, I highlight that each of these sections has its own onerous requirements and anti-avoidance rules when compared with section 44.

As Cameron points out correctly, until the applicable tax legislation is amended, mergers and amalgamations that can be implemented in practice remain the purely “vanilla” structures, which could have just as well been implemented by way of a scheme of arrangement.⁹⁴⁵

4.4 Legal principles when dealing with inconsistencies between Acts

4.4.1 General principles of the interpretation of statutes

4.4.1.1 The position before the Endumeni case

Before the landmark decision in *Endumeni*, a different approach applied to statutory interpretation. In this previous approach “the intention of the legislature” was sought by applying the “ordinary grammatical meaning” of the language used unless this would give rise to an absurdity that could have never been contemplated by the legislature. In such an event, the ordinary meaning

⁹⁴² Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 77 – 78.

⁹⁴³ *ibid* 78 – 79.

⁹⁴⁴ See n 826 above.

⁹⁴⁵ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 82.

of the words could be departed from to eliminate the absurdity.⁹⁴⁶ This was characterised as the “golden rule” of statutory interpretation.⁹⁴⁷

This approach to statutory interpretation can be illustrated by the unanimous judgment delivered by Corbett JA in *Summit Industrial Corporations*:⁹⁴⁸

“The general rule is that the words of a statute must be given their ordinary, grammatical meaning unless to do so –

‘...would lead to absurdity so glaring that it could never have been contemplated by the Legislature, or where it would lead to a result contrary to the intention of the Legislature, as shown by the context or by such other considerations as the Court is justified in taking into account...’ (per Innes CJ in *Venter v R* 1907 TS 910 at 915).

In that event the Court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and give effect to the true intention of the Legislature.

...

As has been remarked in various judgments, it is dangerous to speculate on the intention of the legislature (see eg. the reference in *Savage v CIR* 1951 (4) SA 400, at p 409 A) and the court should be cautious about thus departing from the literal meaning of the words of a statute (see remarks of SOLOMON JA in *Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530, at p 554-5).”

Solomon JA in *Dadoo Ltd v Krugersdorp Municipal Council*⁹⁴⁹ warns against speculating about the aim of the Legislature as it could result in the court falling “into the mistake of crediting the Legislature with an object which was absent from its mind, and so may be led into the error of interpreting the words in a sense different from what was intended”.

⁹⁴⁶ See *Manyasha v Minister of Law and Order* 1999 2 SA 179 (SCA): “It is trite that the primary rule in the construction of statutory provisions is to ascertain the intention of the Legislature; in the present matter it is, more pertinently, the intention of the rule-maker that needs to be determined. One seeks to achieve this, in the first instance, by giving the words of the provision under consideration the ordinary grammatical meaning which their context dictates, unless to do so would lead to an absurdity so glaring that the rule-maker could not have contemplated it.”

⁹⁴⁷ *Venter v R* 1907 TS 910 is generally regarded as the *locus classicus* for the “golden rule”.

⁹⁴⁸ *Summit Industrial Corporation v Claimants Against the Fund Comprising The Proceeds Of the Sale of The MV Jade Transporter* 1987 2 SA 583 (A) para 596G – H.

⁹⁴⁹ *Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530.

The above “golden rule” was, however, slightly limited by a rule of construction that the words used must be considered within their context.⁹⁵⁰ Schreiner JA criticised the “golden rule” in *Jaga v Dönges* 1950 4 SA 653 (A):

“Certainly, no less important than the oft repeated statement that the words and expressions used in a statute must be interpreted according to their ordinary meaning is the statement that they must be interpreted in the light of their context.”

He further stated that one cannot understand words divorced from the circumstances in which they are used, and this context includes the statute’s scope, purpose, and within limits, the statute’s background.⁹⁵¹

In addition, there was a trend of applying a purposive construction only where the language used was ambiguous and uncertain.⁹⁵² In terms of this purposive approach, courts had, subject to their application of the “golden rule”, to consider the object or purpose of the legislation in question – but again only when the language was ambiguous or uncertain.⁹⁵³

4.4.1.2 *The position after the Endumeni case*

Seligson aptly illustrates the impact that *Endumeni* has had on the previous principles of statutory interpretation and construction by stating: “It seems fair to say that the decision in *Endumeni* has relegated the ‘golden rule’ of statutory construction to the dustbin of legal history.”⁹⁵⁴

In brief, the unanimous judgment delivered by Wallis JA is that context and language must be considered together with neither predominating the other, and that this is the approach that must be followed by South African courts.⁹⁵⁵

The court further highlighted that an “interpretation will not be given that leads

⁹⁵⁰ *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 4 SA 490 (CC), para 90: “The emerging trend in statutory construction is to have regard to the context in which the words occur, even where the words to be construed are clear and unambiguous.” Also see Wallis 2019 22 *PER / PELJ* 9; Seligson 2021 12/2 *Business Tax and Company Law Quarterly* 10.

⁹⁵¹ *Jaga v Dönges* 1950 4 SA 653 (A) 422.

⁹⁵² Seligson 2021 12/2 *Business Tax and Company Law Quarterly* 10.

⁹⁵³ *Bastian Financial Services (Pty) Ltd v General Hendrik Schoeman Primary School* 2008 5 SA 1 (SCA) paras 16 – 19; Seligson *ibid.*

⁹⁵⁴ Seligson *ibid.*

⁹⁵⁵ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA) para 19. Also see *Jaga v Dönges NO and Another; Bhana v Dönges NO and Another* 1950 4 SA 653 (A) 654.

to impractical, unbusinesslike or oppressive consequences or that will stultify the broader operation of the legislation or contract under consideration”.⁹⁵⁶

Wallis points out that *Endumeni* requires judges to articulate the reasons for their decisions with regard to both linguistics and context, to provide greater transparency in judicial decision making.⁹⁵⁷ Such transparency will allow litigants and courts to establish whether the court had the “complete picture” when reaching its conclusions and making the relevant judgment.⁹⁵⁸

The new approach to statutory construction and interpretation laid down in *Endumeni* had been referenced and applied in the recent Supreme Court of Appeal case of *CSARS v United Manganese of Kalahari (Pty) Ltd*⁹⁵⁹ 2020 4 SA 428 (SCA) where the court highlighted that context is important in the interpretation not only of contracts or similar documents, but also of statutes, but there will be a difference in context with regard to the different documents.⁹⁶⁰ The court continued to set out some of the aspects that can be taken into account when considering the context in interpreting a statute:⁹⁶¹

- a) section 39(2) of the Constitution;⁹⁶²
- b) the context of the entire enactment;
- c) when the legislation flows from a commission of enquiry, or a special drafting committee reference to their reports;
- d) the legislative history; and
- e) the general factual background to the statute such as the nature of its concerns and the social purpose at which it is directed.

In *Telkom SA SOC Limited v CSARS*,⁹⁶³ the court added that the same interpretive technique is applied whether interpreting contracts or statutes, always allowing for context, which includes the background to the preparation

⁹⁵⁶ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA) para 26.

⁹⁵⁷ Wallis 2019 22 *PER / PELJ* 21.

⁹⁵⁸ Wallis *ibid* 21 – 22.

⁹⁵⁹ *CSARS v United Manganese of Kalahari (Pty) Ltd* 2020 4 SA 428 (SCA).

⁹⁶⁰ *ibid* para 16.

⁹⁶¹ *ibid* para 17.

⁹⁶² Section 39(2) of the Constitution provides that when interpreting any legislation and when developing the common law or customary law, every court, tribunal, or forum must promote the spirit, purport, and objects of the Bill of Rights.

⁹⁶³ *Telkom SA SOC Limited v The Commissioner for the South African Revenue Service* 2020 ZASCA 19 (25 March 2020).

and production of a particular contract or statute or other document in issue (the purposive approach).⁹⁶⁴

Perumalsamy, however, points out that *Endumeni* did not have the stabilising effect that had been hoped for.⁹⁶⁵ He explains that the old interpretation rules are not “dead” following the judgment of *Endumeni*. He points out further that although many courts refer to the authoritative interpretation principles set out in *Endumeni*, the courts, in the same breath, continue to use old textual approach to interpretation.⁹⁶⁶

*Trinity Asset Management (Pty) Limited v Grindstone Investments 132 (Pty) Limited*⁹⁶⁷ serves as case in point. In this case the court mentions the interpretive principles laid down in *Endumeni*, but in the two paragraphs following this reference, it refers to two decisions by the Appellate Division (now the Supreme Court of Appeal) on interpretation of contracts. In these cases, the court stated that when interpreting contracts, one must consider the language used by the contracting parties and this must be given its ordinary grammatical meaning unless it results in an absurdity.⁹⁶⁸ This creates confusion, as the court acknowledges the new interpretation principles laid down in *Endumeni* but continues to rely on the old interpretation rules in establishing the intention of the parties.⁹⁶⁹

It is submitted that it is understandable that courts are not yet applying the principles set out in *Endumeni* consistently – the application of the new principles present a mammoth task for the courts and a complete overhaul of previous interpretive practices, without any methodical universal approach to serve as a guide to applying these new interpretation principles.

⁹⁶⁴ *ibid* para 14.

⁹⁶⁵ Perumalsamy 2019 22 *PER/PELJ* 3.

⁹⁶⁶ *ibid* 12 – 13.

⁹⁶⁷ *Trinity Asset Management (Pty) Limited v Grindstone Investments 132 (Pty) Limited* (CCCT248/16) 2017 ZACC 32, 2017 12 *BCLR* 1562 (CC), 2018 1 *SA* 94 (CC) (5 September 2017).

⁹⁶⁸ *ibid* paras 52 – 54.

⁹⁶⁹ *ibid* n 46.

4.4.2 Interpretation where there are inconsistencies between Acts

In practice, it is possible for conflicts or inconsistencies to exist between certain sections of two Acts.⁹⁷⁰ Devenish points out that the common-law interpretation principles require that, as far as possible, legislation must be interpreted to co-exist. In *Henochsberg* it is pointed out that in the context of the Companies Act, a conflict with other legislation could lead to interpretation problems and unintended consequences.⁹⁷¹

In the case of *Lindsay Keller & Partners v AA Mutual Insurance Association Ltd* 1988 2 SA 579 (W) 523, Coetzee DJP held that:

"[A] conservative interpretation of [the] section [s 3 of the 1973 Act] is called for and one should be careful to limit a finding of inconsistency only to a provision of the Insurance Act which is clearly inconsistent with the relevant provision or provisions of the [1973] Companies Act which remains the governing statute in purely company law matters"⁹⁷² (emphasis added).

This appears to suggest that, unless a very clear inconsistency exists that cannot be avoided by conservative interpretation, a more conservative reading must be applied to provisions to limit the chances of inconsistencies arising between the relevant provisions in different Acts. The court in this case held that the Companies Act (the 1973 Companies Act in this case) remains the governing statute in purely company law matters, meaning that the Companies Act would be the predominant Act in the case of a clear inconsistency.

However, the correct approach to the interpretation of statutes was clarified in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA):

"A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible, or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The 'inevitable point of departure is the language of the provision itself' read in context and having regard to the purpose of the provision and the background to the preparation and production of the document."⁹⁷³

⁹⁷⁰ Delpont *et al Henochsberg* (2023) s 116; Devenish *Interpretation of Statutes* 279.

⁹⁷¹ Delpont *et al Henochsberg* (2023) s 5.

⁹⁷² *ibid.*

⁹⁷³ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA) para 18.

When interpreting statutes, therefore, a balance must be struck between considering the context and the language used in the specific provision with neither predominating over the other.⁹⁷⁴

The court highlights in *Chotobai v Union Government (Minister of Justice) and Registrar of Asiatics* that in the interpretation process applied by the courts:⁹⁷⁵

“[T]he language of every part of a Statute should be construed as to be consistent, so far as possible, with every other part of that Statute, and with every other unrepealed statute enacted by the same Legislature.”

The courts must, therefore, as far as possible interpret the provisions to co-exist with one another to avoid ambiguous interpretations.

In the case of *C&J Clark Ltd v Inland Revenue Comrs*, the court had to consider conflicts between the provisions in statutes. The words “subject to” point to which provision prevails in the event of a conflict:⁹⁷⁶

“Where there is no clash, the phrase does nothing: if there is collision, the phrase shows what is to prevail.”

In *Handel v R*,⁹⁷⁷ van de Heever J stated the following regarding the word “conflict” in the legislative context:

“It is clear, therefore, that the constituent Legislature intended the word ‘conflict’ to connote the situation in which one version says one thing and the other the opposite. Where the two are reconcilable they must be reconciled. It is only when they are not capable of reconciliation, when they are mutually destructive, that a conflict arises.”

One can conclude from the *C&J Clark Ltd* and *Lindsay Keller* cases that in the event of a conflict between two statutes where the statutes cannot be interpreted to coincide, it is the prevailing Act to which the other Act would be subject.

⁹⁷⁴ *ibid* para 19. In paras 21 and 26 the court acknowledges that alongside the text and context, the purpose of the statute and the mischief that the Act it aimed at addressing should also be considered. See Delpont *et al Henochsberg* (2023) s 15: “The principles of language used, understood in the context in which it is used and having regard to the purpose of the provision (*Natal Joint Municipal Pension Fund case supra*) constitute the unitary exercise of interpretation and this ‘triad of text, context and purpose should not be used in a mechanical fashion’: *Capitec Bank Holdings Limited and Another v Coral Lagoon Investments 194 (Pty) Ltd and Others* [2021] 3 All SA 647 (SCA), 2022 (1) SA 100 (SCA) para 25; *Caxton and CTP Publishers and Printers Limited v Novus Holdings Limited* [2022] 2 All SA 299 (SCA) para 56.”

⁹⁷⁵ *Chotobai v Union Government (Minister of Justice) and Registrar of Asiatics* 1911 AD 33.

⁹⁷⁶ *C & J Clark Ltd v Inland Revenue Comrs* 1973 2 All ER 513 514.

⁹⁷⁷ *Handel v R* 1933 SWA 40.

4.4.3 The prevailing Act

4.4.3.1 Conflict or inconsistency?

But the question is whether, when dealing with mergers and amalgamations, there is “conflict” or an “inconsistency” between the provisions of the Companies Act and the Income Tax Act?

Drawing on the *obiter dictum* in the *Handel* case,⁹⁷⁸ the word “conflict” is intended to mean a situation in which one version says one thing and the other the opposite. In my reading of the two Acts, I do not find this to be the case with all the disconnects identified in this chapter. For example, the Companies Act has no express stipulation on the form of consideration permitted in a statutory merger. The Income Tax Act is very specific about the type of consideration allowed to qualify for the rollover relief in section 44. This is not a conflicting stipulation: the one Act is merely prescriptive while the other is not. The same applies to the discrepancies relating to whom merger consideration may be paid or what merger structures are allowed.

One may, of course, argue that there are conflicts (direct contradictions) in certain cases, for example:

- a) The residency of the parties to the merger agreement. The Companies Act specifically only allows for mergers between local companies, while the Income Tax Act provides specifically for cross-border mergers to be tax neutral if all the relevant requirements are met.
- b) The assumption of debt appears contradictory as the Companies Act has no restriction on the transfer of debt (save that creditors may object to the transfer if they are prejudiced by the merger), but requires that all liabilities be transferred to the surviving company which becomes liable for them.⁹⁷⁹ However, the Income Tax Act is prescriptive and restricts the type of debt that qualifies as consideration for the assets transferred.
- c) The Companies Act provides for upstream mergers between two or more profit companies, while section 44(14) of the Income Tax Act

⁹⁷⁸ *ibid.*

⁹⁷⁹ Section 116(7)(b) of the Companies Act.

specifically prohibits a liquidation distribution following an amalgamation transaction.

Shama avers that the Income Tax Act and Companies Act have certain conflicting policies or purposes which result in the statutory merger and amalgamation transaction not being perfectly aligned.⁹⁸⁰ I do not agree. I do not believe that one can say that the purposes of the two Acts are conflicting in that they are not in opposition to one another but are merely different.

In 2012, National Treasury noted in its Annual Budget review that:⁹⁸¹

“The comprehensive rewrite of the Companies Act (2008) has given rise to a set of anomalies in relation to tax, especially in the case of reorganisations and other share restructurings. *As many of the tax rules relating to company reorganisations have been in place for 10 years, a review is appropriate.* Government will hold a series of workshops to review the nature of company mergers, acquisitions, and other restructurings to better understand their practical use. These workshops will lay the foundation for tax changes (and possibly changes to company law) over a two-year period” (emphasis added).⁹⁸²

National Treasury has amended the Income Tax Act to better align the Income Tax Act and Companies Act,⁹⁸³ and I hope we see many more such amendments in the future.

In the case of *Myathaza v Johannesburg Metropolitan Bus Services (SOC) Ltd t/a Metrobus*, the Constitutional Court was required to consider the interaction between the Prescription Act 68 of 1969 (Prescription Act) and Labour Relations Act 66 of 1995 (LRA) relating to the prescription of an arbitral award and whether that award constituted “debt”.

The court referred to the first judgment⁹⁸⁴ handed down by Jafta J in which he pointed to the numerous differences between the Prescription Act and LRA. Importantly, reference was made to section 16 of the Prescription Act which excludes its own operation in the event of an inconsistency with another Act.⁹⁸⁵

⁹⁸⁰ Shama *Statutory mergers* 92.

⁹⁸¹ <https://www.treasury.gov.za/documents/national%20budget/2012/review/Annexure%20c.pdf> 190 (accessed 4 February 2023).

⁹⁸² From my research I could find no publication or record of these workshops having taken place.

⁹⁸³ Refer to para 1.7 above.

⁹⁸⁴ The first judgment (*per* Jafta J with Nkabinde ADCJ, Khampepe and Zondo JJ concurring).

⁹⁸⁵ *Myathaza v Johannesburg Metropolitan Bus Services (Soc) Ltd t/a Metrobus and others* 2017 4 BCLR 473 (CC) para 12.

It was held in the first judgment that the Prescription Act was incompatible with the LRA:

“In interpreting section 16 of the Prescription Act in the light of the Constitution, ‘inconsistency’ was to be afforded a meaning wider than contradiction or conflict. It was *enough if there were material differences between the two pieces of legislation*”⁹⁸⁶ (emphasis added).

In the second judgment⁹⁸⁷ Froneman J held that the Prescription Act and the LRA were complementary:

“The relevant provisions of the two Acts are capable of complementing each other in a way that best protects the fundamental right of access to justice, whilst at the same time preserving the speedy resolution of disputes under the LRA.”⁹⁸⁸

If the argument in the second judgment in the *Myathaza* case is applied to this discussion, can one argue that the Companies Act and Income Tax Act rather complement each other to govern merger and amalgamation transactions from a corporate law and a tax law perspective?

It is submitted that this argument is questionable – the clear disconnects highlighted in this chapter create uncertainties for parties to merger and amalgamation transactions, rather than providing assurance that the transaction is fully governed from these two legal aspects. In addition, if the two Acts are not aligned with one another and operate in virtual isolation, it is difficult to argue that the two Acts complement one another.

4.4.3.2 *The prevailing Act*

Section 5(4) of the Companies Act provides that where there is an inconsistency between any provision of the Companies Act and a provision of any other national legislation, the provisions of both Acts apply concurrently to the extent that it is possible to apply and comply with one of the inconsistent

⁹⁸⁶ *Myathaza v Johannesburg Metropolitan Bus Services (Soc) Ltd t/a Metrobus and others* 2017 4 BCLR 473 (CC) para 42.

⁹⁸⁷ The second judgment (*per* Froneman J with Madlanga, Mhlantla JJ, and Mbha AJ concurring).

⁹⁸⁸ *Myathaza v Johannesburg Metropolitan Bus Services (Soc) Ltd t/a Metrobus and others* 2017 4 BCLR 473 (CC) para 66.

provisions without contravening the other.⁹⁸⁹ Where this is not possible the provisions of Companies Act prevail.⁹⁹⁰

De Koker and Williams state that parties that wish to enjoy the fiscal benefits provided by the Income Tax Act for mergers and amalgamations (a tax-neutral transfer of property from the amalgamated company to the resultant company), they must bear in mind that to realise these benefits the amalgamation or merger must first have been effected in compliance with the provisions of the Companies Act.⁹⁹¹ The authors specifically state in this regard:⁹⁹²

“Failing such compliance (or if the process is subsequently taken on judicial review and set aside) there will have been no valid amalgamation or merger and consequently no valid transfer of property between the companies and hence no fiscal benefits or indeed any fiscal consequences for the arrangement.

If the parties desire that the arrangement will qualify for the tax benefits made available in terms of the Income Tax Act, the provisions of the latter Act must be fulfilled, *in addition to the requirements of the Companies Act*” (emphasis added).

This view confirms that the Income Tax Act is subject to the requirements of the Companies Act being met; but the Companies Act does not require that the provisions of the Income Tax be met in terms of merger transactions. If the requirements are not met in the Income Tax Act, tax will be triggered for the relevant transaction.⁹⁹³

Interestingly, *Binding Private Ruling 320*⁹⁹⁴ issued by SARS in 2019, suggested that the corporate rollover relief provided in section 44 can apply to a taxpayer who is party to the amalgamation – an unincorporated resident *universitas* – provided that the requirements of section 44 are met, including meeting the definition of a “company” in terms of section 1 of the Income Tax Act.⁹⁹⁵

⁹⁸⁹ Section 5(4) of the Income Tax Act.

⁹⁹⁰ Except to the extent provided otherwise in subsection (5) or s 118(4). Section 118(4) specifically addresses conflicts in terms of the Authority of Panel and Takeover Regulations (Part B), Regulation of affected transactions and offers (Part C), and the takeover regulations.

⁹⁹¹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁹⁹² *ibid.*

⁹⁹³ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34

⁹⁹⁴ SARS *Binding Private Ruling 320* “Conversion of Association to Private Company” 6 June 2019; Botha (2019) 18 July *Tax and Exchange Control Alert*.

⁹⁹⁵ A “company” is defined in s 1 of the Income Tax Act as: “[A]ny association, corporation or company incorporated or deemed to be incorporated under any law in force or previously in force in the Republic

This is thought provoking, as a *universitas* would not meet the definition of a “company” in section 1 of the Companies Act,⁹⁹⁶ but appears to qualify as a “company” under the definition in the Income Tax Act. This ruling shows that the Companies Act and the Income Tax Act operate separately and not necessarily in conjunction with one another.

The ruling itself binds only the parties concerned, but it is illustrative of how SARS did not consider the requirements of the Companies Act before issuing the binding ruling. This leaves us somewhat confused as to whether the requirements of the Companies Act must be met for the corporate rollover provisions to apply, or whether the Income Tax Act can operate without consideration of the Companies Act, specifically regarding fundamental transactions.

If the requirements of section 44 of the Income Tax Act are not met, but those of section 113 of the Companies Act are, it merely means that the parties could face adverse tax consequences arising from their statutory merger transaction.⁹⁹⁷ De Koker and Williams further warn that parties should not simply assume that compliance with the Companies Act automatically constitutes the fulfilment of the requirements of the Income Tax Act.⁹⁹⁸

It should also be borne in mind that the provisions of section 44 of the Income Tax Act apply automatically unless both parties to the amalgamation transaction opt out of their application.⁹⁹⁹ In contrast, the Companies Act

or any part thereof, or any body corporate formed or established or deemed to be formed or established by or under such law.”

⁹⁹⁶ A “company” is defined in s 1 of the Companies Act as, *inter alia*:

“means a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date—

(a) was registered in terms of the—

(i) Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act;”

In Delpont *et Henochsberg* (2023) s 1 it is submitted that the term “juristic person”, for purposes other than the definition of a “company”, includes a foreign company and a trust, irrespective where it was established.

⁹⁹⁷ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

⁹⁹⁸ *ibid*.

⁹⁹⁹ Section 44(13) of the Income Tax Act.

creates no legal obligation for parties to use the statutory merger provisions to implement an amalgamation.¹⁰⁰⁰

It is, therefore, imperative that merger parties and their lawyers consider both the provision in the Companies Act and the Income Tax Act provisions side-by-side when planning and drafting the merger agreement.

For example, the Income Tax Act provides that the amalgamated company may retain assets to settle certain debts, whilst the Companies Act requires all assets to be transferred in a statutory merger. This may appear a minor difference but in drafting of the merger agreement it must be clearly stated that the provisions of the Companies Act have been met and all assets transferred. Failing this the arrangement would not comply with the Companies Act, potentially rendering it null and void for corporate law purposes. This also means that, by extent, the parties would not be able to access the tax neutral benefit provided in the Income Tax Act.¹⁰⁰¹

In another example, the Companies Act makes no provision for cross-border mergers, but the Income Tax Act provides for cross-border amalgamation transactions under sections 44(1)(b) and 44(1)(c). These provisions in the Income Tax Act appear superfluous if the provisions in the Companies Act prevail. Given this inconsistency between the two Acts, the parties cannot enter into a legal statutory merger transaction with a foreign party. In reference to the argument proffered by De Koker and Williams, if there is no legal basis for the merger how can a fiscal benefit be derived from the transaction in the form of corporate rollover relief?

The Companies Act is not prescriptive as to how a statutory merger must be structured – it allows for various types of consideration, merger structures, and the assumption of debt. The problem arises when one considers the Income Tax Act which has a far more prescriptive and limited application. This means that parties are free to structure their merger agreement for corporate law purposes, but if they hope to obtain any tax benefit, the merger agreement

¹⁰⁰⁰ Rudnicki and Ashe 2017 8/3 *Business Tax and Company Law Quarterly* 2.

¹⁰⁰¹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 2021 12/2 *Business Tax and Company Law Quarterly* 13.34.

would need to meet the Income Tax Act requirements. This suggests that only basic merger structures will be allowed¹⁰⁰² where the parties to the merger transaction also wish to ensure that the transaction is tax neutral. I am of the view that this “disconnect” between the Companies Act and the Income Tax Act frustrates the whole purpose of the merger provisions, as illustrated in the *obiter dictum* of Dickinson J in *R v Black & Decker Manufacturing Co* 1975 1 SCR 411 SCC 420-2:

“The purpose is economic: to build, to consolidate, perhaps to diversify, existing businesses; so that through union there will be enhanced strength. It is a joining of forces and resources in order to perform better in the economic field.”

If parties lack the flexibility to restructure their businesses to create corporate wealth it will have a significant impact on economic growth.¹⁰⁰³

Despite the flexibility and efficacy offered by the statutory merger provisions in the Companies Act, the far-reaching tax consequences (where no rollover relief is applied), overshadow any benefit arising from the use of the statutory merger provisions.¹⁰⁰⁴ One saves time on administration with the transfers taking place by way of the operation of law, but significant and adverse tax consequences will be triggered. Simply put, this merely provides a merger party with more time and less money in its pockets.

4.5 Conclusion

In conclusion, there are clear disparities between the Companies Act and the Income Tax Act relating to merger and amalgamation transactions. In this regard, refer to the summary table in paragraph 4.2 for a summary of identified disparities discussed in this chapter.

As illustrated, these disparities arise due to disconnects between the two Acts which lead to confusion for merger parties relying on both Acts. Clearly, as far as possible

¹⁰⁰² Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 82.

¹⁰⁰³ Cassim MF 2008 *Juta's Business Law* 40 read with para 2.3.1 above: “Takeovers and fundamental transactions are viewed as being beneficial towards corporate proficiency, the economy and the creation of wealth, so by creating flexibility for companies in South Africa to restructure their businesses, economic growth will be advanced.”

¹⁰⁰⁴ Shama *Statutory mergers* 92.

the legislation must be interpreted in a way which allows for the sections, or Acts as a whole, to co-exist. However, where an inconsistency or conflict exists between the two Acts the Companies Act will prevail.¹⁰⁰⁵ In my view, it is important to identify where the conflicts between the two Acts are.

However, this is not a solution to the existing inconsistencies between the two Acts; it merely clarifies that the Income Tax Act is subject to the Companies Act if a conflict between the Acts arises.

The statutory merger provides considerable flexibility for the merging parties to structure a merger agreement to fit their specific needs. But it unfortunately means that to avoid a costly tax bill resulting from the merger transaction, the parties must also consider compliance with the Income Tax provisions for amalgamation transactions which only provide tax relief in limited circumstances and only to very specific and basic amalgamation transactions.

As a result of the disconnect, inconsistencies, and conflicts between the Income Tax Act and the Companies Act, many merger parties find themselves in the unfortunate position where they cannot obtain both the benefits of having the merger effected by operation of law and having a tax neutral transaction without too many requirements and anti-avoidance provisions (as seen in s 44). Parties, therefore, are compelled to consider alternative sections in the two Acts in an attempt to achieve the outcome they had aimed for through a combination of section 113 of the Companies Act and section 44 of the Income Tax Act. These alternative combinations may lead to unintended consequences and additional requirements to be met.

First, the various combinations do not bring about a true merger (the fusing of two or more companies) as one reverts to a mere sale of a business. The combinations also do not offer the parties the benefit of having the transfer take place by operation of law if they rely on other provisions for fundamental transactions in the Companies Act.

From a tax perspective, the different corporate rules can be applied in accordance with the needs of the parties but, unfortunately, each corporate rule is subject to its own requirements and strict anti-avoidance provisions. These anti-avoidance provisions

¹⁰⁰⁵ Section 5(4) of the Companies Act.

could be triggered up to six years¹⁰⁰⁶ after the conclusion of the amalgamation transaction.

I am, therefore, of the view that the implications arising from the use of alternative mechanisms could potentially have been avoided had the existing tax and company legislation – and specifically that governing mergers and amalgamations – been aligned to coincide to some degree.

¹⁰⁰⁶ See para 3.5.3.1 in this regard.

CHAPTER 5: CONCLUSION

5.1 Introduction

As shown in Chapter 1, history abounds with various mergers and many examples of merger-wave periods throughout the course of history.¹⁰⁰⁷ Clearly, certain factors as identified in Chapter 1 drive parties to enter into these transactions but the principal determinant or driver for entering into a merger transaction is growth.¹⁰⁰⁸ A merger transaction may serve as a powerful tool in achieving faster growth through merging with another company.¹⁰⁰⁹

Merger transactions can, therefore, be beneficial for corporate proficiency, the economy, and wealth creation. As a result, they create flexibility for companies in South Africa to restructure their businesses can advance economic growth.¹⁰¹⁰

In this thesis I, however, highlight the issues that arise within the current South African merger and amalgamation landscape with regard to company law and tax law. This has an obvious negative impact on the Sustainable Development Goals of South Africa for 2030, specifically Goal Eight: “Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.”¹⁰¹¹ Goal 8.3 is specifically aimed at promoting policies that encourage the formalisation and growth of companies in South Africa but the uncertainties surrounding statutory mergers, coupled with limited application of tax relief for amalgamation transactions, this goal is not, in my view, currently being promoted in this area of the law.

If the ease of doing business in South Africa¹⁰¹² can be improved by, for example, addressing identified uncertainties surrounding the legislation governing merger and amalgamation transactions, we can potentially attract future investment in South Africa

¹⁰⁰⁷ See para 1.4.

¹⁰⁰⁸ Gaughan *Mergers, Acquisitions, and Corporate Restructurings* 117.

¹⁰⁰⁹ Tamosiuniene and Duksaite 2009 2/4 *KSI Transactions on Knowledge Society* 12.

¹⁰¹⁰ The Department of Trade and Industry “South African Company Law for the 21st Century: Guidelines for Corporate Law Reform” *Government Gazette* 1183 of 23 June 2004 43; Cassim MF 2008 *Juta’s Business Law* 40.

¹⁰¹¹ http://www.statssa.gov.za/MDG/SDGs_Country_Report_2019_South_Africa.pdf (accessed 30 January 2023). Specifically goal 8.3: “Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalisation and growth of micro-, small- and medium-sized enterprises...” (emphasis added).

¹⁰¹² In 2020 South Africa was ranked 84th out of 190 countries in the “Ease of Doing Business” Index published by the World Bank Group. The Index was discontinued from 16 September 2021 <https://www.worldbank.org/en/news/statement/2021/09/16/world-bank-group-to-discontinue-doing-business-report> (accessed 4 February 2023).

and encourage growth within the corporate sphere. With the Ease of Doing Business Bill currently serving before the relevant parliament portfolio committee, it would be interesting to note, if enacted, what impact the Act would have on reducing the red tape and other challenges surrounding mergers in South Africa.¹⁰¹³

Before the enactment of the Companies Act, there were restructure mechanisms in place to effect a merger or amalgamation transaction but nothing was in place to effect a “true” merger – the “fusion” of two or more companies.¹⁰¹⁴ The concept of a statutory merger was first introduced in South African company law with the enactment of the Companies Act which came into effect from 1 May 2011.¹⁰¹⁵ Interestingly, years before the introduction of a statutory merger in the Companies Act, the Income Tax Act already provided for tax rollover relief specific to amalgamation transactions under section 44 of the Income Tax Act.¹⁰¹⁶

In my view, the nine-year hiatus between the introduction of the two Acts’ merger regulations, meant that during this period parties to the merger transactions were compelled to use alternative methods to effect a merger from a company law perspective (eg, a scheme of arrangement). The parties could then, where possible, rely upon the rollover relief provisions in the Income Tax Act to ensure the merger transaction was tax neutral.

One would assume that some form of alignment of the two Acts would have taken place given that both govern the same type of transaction, especially if a new legal concept had been introduced in one of the Acts. Nonetheless, even after the introduction of the statutory merger in the Companies Bill, the Standing Committee on Finance rejected an alignment between the two Acts stating that they are two different Acts serving two different purposes.¹⁰¹⁷

I feel this was a significant opportunity missed in that as things now stand, if issues between the two Acts are addressed this happens only as and when the need arises, sometimes only years after the issue has existed in law. An example is the amendment

¹⁰¹³ https://www.parliament.gov.za/storage/app/media/Bills/2021/B6_2021_Ease_of_Doing_Business_Bill/B6_2021_Ease_of_Doing_Business_Bill.pdf (accessed 4 February 2023).

¹⁰¹⁴ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 340.

¹⁰¹⁵ *Government Gazette* 34239 of 26 April 2011.

¹⁰¹⁶ Revenue Law Amendment Bill 2002 “Explanatory Memorandum” http://www.treasury.gov.za/legislation/bills/2002/rlab_2002_memo.pdf (accessed on 9 October 2021).

¹⁰¹⁷ See n 438.

to section 41(4) of the Income Tax Act in 2019 to account for amalgamated companies ceasing to exist by operation of law under section 116 of the Companies Act, and no formal “steps” to wind-up, liquidate, or deregister the company.¹⁰¹⁸ This amendment came after eight years of the two Acts’ co-existence. The Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2019 explained the proposal for the above amendment:¹⁰¹⁹

“In order to ensure that statutory amalgamations and mergers are not unfairly excluded from qualifying for tax deferral, it is proposed that the current list of steps taken for liquidation, winding-up and deregistration should be amended by including instances where companies lodge a notice to the Commissioner as contemplated in section 116 of the Companies Act” (emphasis added).

It appears from the above wording that before this amendment the Income Tax Act did not recognise the deregistration under section 116 of the Companies Act as a valid “step” for qualification for tax deferral. It appears inconceivable that for the eight years if merging parties submitted proof of deregistration under section 116 of the Companies Act, they would be denied a tax deferral on the basis that the necessary “steps” to liquidate, wind-up, or de-register an amalgamated company had not been taken within 36 months of the transaction having taken place.

It appears uncertain how long we may have to wait for the next clarification in law involving the discrepancies between the Companies Act and the Income Tax Act regarding mergers.

Even though there are attractive features in a statutory merger – eg, the transaction taking place by operation of law and being a court-free process – it has not gained significant popularity in merger transactions since its introduction in South African company law.¹⁰²⁰ Cameron opines that this may be attributed, amongst other things, to the “uncharted waters” presented by this relatively new statutory merger mechanism.¹⁰²¹ Although the procedural requirements for the current scheme of arrangement have been revised,¹⁰²² it is an age-old mechanism in South African

¹⁰¹⁸ See n 132.

¹⁰¹⁹ <https://www.treasury.gov.za/public%20comments/2019BTDraftBills/2019%20Draft%20Explanatory%20Memorandum%20to%20the%202019%20Draft%20TLAB%20-%202021%20July%202019.pdf>, 24 (accessed 4 February 2023).

¹⁰²⁰ See Table 2: Analysis of transactions reviewed by the Take-over Panel Executive above.

¹⁰²¹ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 78 – 79.

¹⁰²² The procedure no longer needs to be sanctioned by the court as was required under the 1973 Companies Act.

company law stretching back as far as the 1926 Companies Act. Various aspects of the mechanism have, therefore, been tested and clarified numerous times by the courts over the years, making it a less risky option for merger parties than the statutory merger which has yet to be tested in our courts.¹⁰²³

It stands to reason that parties to multi-million Rand merger transactions would be averse to the additional risk of the courts' interpretation of the statutory merger provisions in the Companies Act.¹⁰²⁴ In addition, as highlighted in Chapter 2, there are certain inconsistencies and uncertainties between sections in the Companies Act itself which parties would naturally prefer to avoid.¹⁰²⁵

The rollover relief provisions in the Income Tax Act governing amalgamation transactions are not without their own uncertainties and limitations. Due to the narrow drafting of section 44 – specifically as regards the consideration allowed – the tax relief will only apply in very limited circumstances removing the flexibility for parties to structure the statutory merger as they please and still qualifying for tax rollover relief.¹⁰²⁶

Even when comparing the other tax Acts as regards the corporate rules there appear to be inconsistencies as the Acts are not aligned. If the parties opt out of the application of the corporate rules, the VAT Act would no longer allow for the zero rating of the transaction in terms of section 8(25). However, the wording in the STT Act and Transfer Duty Act would seem to suggest that even if the parties opt out of the corporate rules, provided the relevant definitions in the Income Tax Act are met the parties may still benefit from rollover relief in terms of no STT or transfer duty being levied.¹⁰²⁷

One must, therefore, compare the Companies Act and Income Tax Act. In Chapter 4, I set out in detail the disconnects identified between the two Acts as regards mergers and amalgamations. These include, but are not limited to, confusing definitions and

¹⁰²³ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 79.

¹⁰²⁴ *ibid.*

¹⁰²⁵ See discussion in para 2.7.2.

¹⁰²⁶ See discussion in para 3.2.5.

¹⁰²⁷ See discussion in para 3.3.

terminology, the types of merger allowed, and what must or may not be transferred in terms of the merger transaction.¹⁰²⁸

It is clear that the company law and tax law provisions governing merger or amalgamation transactions are, each in its own right, flawed and unpopular mechanisms in practice. Adding to this is the disconnect between the two Acts. On this front these discrepancies effectively deprive merger parties of the benefit of having the statutory merger effected by operation of law and being tax neutral with minimal anti-avoidance rules in place. Parties are, as a result, required to consider alternative sections in both Acts to achieve their merger transaction, or at least the same intended outcome.

In this concluding chapter, I summarise the answers to the research questions posed in Chapter 1 and offer recommendations to address the issues identified in Chapter 4.

5.2 Review of research findings

The research questions in this thesis are identified in Chapter 1 and the findings of each of these questions are discussed below.

5.2.1 Research question 1:

What mechanisms are provided in the current Companies Act and the 1973 Companies Act that can be used to effect a merger or amalgamation transaction?

Chapter 2 sets out a clear history of fundamental transactions dating back to the 1926 Companies Act. The 1926 Companies Act provided for either a take-over offer, (followed by a compulsory acquisition in terms of s 103*ter*¹⁰²⁹) and a scheme of arrangement (in terms of s 103).¹⁰³⁰

¹⁰²⁸ See discussion in para 4.2.

¹⁰²⁹ The offer and acceptance of an offer to acquire control of a company were governed by the common law of contracts as the 1926 Act did not prescribe formalities for the form or content of the ordinary takeover offer. See De Villiers 1973 90/4 SALJ 350 – 351.

¹⁰³⁰ Section 103 of the 1926 Companies Act served as the predecessor of the scheme of arrangement in s 311 of the Companies Act 61 of 1973 and provides for the same process for a proposed scheme of arrangement. See Suzman *The South African Companies Act* 242.

The previous version of the 1926 Companies Act included provisions governing reconstruction or amalgamation transactions in terms of section 103*bis* but this section was repealed before the overall repeal of the 1926 Companies Act in 1973.

The 1973 Companies Act provided for take-over transactions in terms sections 314 – 321. Still, these sections remained unpopular in practice as, amongst other factors, schemes of arrangement did not at the time attract stamp duty (the advantage of not being required to pay stamp duty for schemes of arrangements was subsequently deleted) and these take-over sections in the 1973 Companies Act were eventually repealed in 1989.¹⁰³¹

The 1973 Companies Act provided for a court-sanctioned scheme of arrangement which was the most popular mechanism, even for effecting merger transactions. As mentioned earlier, the mechanism has over the years served before the courts and various interpretations have emerged – in the main, regarding what constitutes an “arrangement”.¹⁰³² As highlighted in *Re National Bank Ltd*¹⁰³³ read with the Van Wyk De Vries Commission Report, the Commission found that there is no abuse of the scheme of arrangement mechanism if it is used to effect a take-over or amalgamation. Delpont considers that it merely creates confusion if the scheme of arrangement may be used, despite specific provisions available in the 1973 Companies Act to execute these specific transactions.¹⁰³⁴ De Villiers points out that the transfer mechanisms in the 1973 Companies Act have different safeguards in place resulting in the mechanisms not operating on a level playing field. He further states that where the procedures and safeguards differ based on the mechanism used but both have the same outcome, it comes as no surprise that the offerors will choose the path of least resistance (scheme of arrangement, which is less onerous than the take-over procedure), which could impact negatively on the offeree shareholders (greater shareholder protection is offered by take-overs).¹⁰³⁵

¹⁰³¹ See discussion in para 2.2.3.

¹⁰³² See discussion in para 2.2.2.

¹⁰³³ *Re National Bank Ltd* 1966 1 WLR 819, 1966 1 All ER 1006 (ChD).

¹⁰³⁴ Delpont 1994 27/1 *De Jure* 175. Delpont further points out that the repealed take-over provisions in the 1973 Companies Act related to the acquisition of shares, while in *Ex Parte Federale Nywerhede Bpk* 1975 1 SA 826 shares were extinguished (a reduction of capital) and the two procedures cannot be considered as “alternative provisions for executing take-overs”.

¹⁰³⁵ De Villiers 1973 90/4 *SALJ* 367.

With the 1989 repeal of the take-over provisions in the 1973 Companies Act and the wide application of a scheme of arrangement,¹⁰³⁶ it stands to reason that the scheme of arrangement mechanism in section 311 would grow in popularity. Although section 313 of the 1973 Companies Act allows for the court to make certain provisions if the scheme aims to effect a reconstruction or amalgamation, it fails to cater for a true statutory merger.

In 2008, a momentous event occurred in South African company law with the draft Bill of the current Companies Act. The new Act changed many provisions to update South Africa's company law, including many new concepts such as the statutory merger.¹⁰³⁷ However, along with the introduction of a statutory merger there was a significant change to schemes of arrangement in the Companies Act; it was no longer a court-sanctioned process, but one to be proposed by the board of each of the amalgamating companies.¹⁰³⁸ De Villiers's point regarding different requirements and safeguards for schemes of arrangement and take-overs under the 1973 Companies Act is addressed in the Companies Act, as the requirements for take-overs, mergers, and schemes of arrangement are governed by section 115 of the Companies Act. Nevertheless, aligning the mechanisms to have the same safeguards and requirements, and both mechanisms being court-free processes, does not "level" the playing field for statutory mergers.

This may be ascribed to the history and wide application of schemes of arrangement as opposed to the uncharted waters presented by the fairly new American concept of statutory mergers adopted in the Act. The merger mechanism in the Companies Act needs to offer more significant advantages to tip the scales in its favour and increase its popularity as a restructuring mechanism. Cameron highlights some of the reasons for the continuing preference for a scheme of arrangement:¹⁰³⁹

¹⁰³⁶ De la Rey *Skikkings* 32: "dat reëling geen presiese betekenis het nie, maar dat die Howe, binne sekere grense, maatskappye die grootste moontlike vryheid toelaat om skemas te ontwerp om by hul besondere omstandighede aan te pas. Hierdie skemas kan wissel van 'n eenvoudige akkoord of moratorium tot 'n samesmelting van verskeie maatskappye, met 'n volledige reorganisasie van hul aandeleen leningskapitaal."

¹⁰³⁷ Memorandum on the Objects of the Companies Bill 2008 para 1.2.3(d) and 9: "to facilitate the creation of business combinations ... provide flexibility and enhance efficiency in the economy".

¹⁰³⁸ Section 113(4) of the Companies Act.

¹⁰³⁹ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 87.

- a) adverse tax consequences (due to discrepancies between the Companies Act and Income Tax Act and the limited access to tax rollover relief for merger transactions);
- b) the statutory merger requires notification to all known creditors (which is not required for schemes of arrangement);¹⁰⁴⁰ and
- c) the benefits of the statutory merger being effected by operation of law (vesting of the assets and liabilities of the merging company in the merged company) may be limited in certain circumstances.¹⁰⁴¹

This raises the question: Will the statutory merger mechanism remain a major transfer mechanism in company law or is it destined for the same fate as section 103*bis* in the 1926 Companies Act and sections 314 – 321 of the 1973 Companies Act and be repealed?

Given the historical preference for schemes of arrangement to effect merger transactions, I would argue that a revision of the statutory merger in the Companies Act is required to establish whether it should be retained or whether it can be amended (eg, by introducing short-form mergers) to become more relevant as a viable group restructuring tool.¹⁰⁴²

5.2.2 Research question 2

Can corporate rules other than section 44 of the Income Tax Act (amalgamation transactions) be used to effect a merger or amalgamation transaction and what are their requirements?

The simple answer to this research question is “yes” However, the follow-up question one must ask is if there is a specific tax rollover relief provision in the Income Tax Act, why would one need to consider the application of the other corporate rules?

¹⁰⁴⁰ Section 116(1)(a) of the Companies Act. Cameron points out that the term “creditor” is not defined, and this gives rise to uncertainty regarding the ambit of their obligations in terms of s 116(1)(a) of the Companies Act. See Cameron *ibid* 84.

¹⁰⁴¹ Section 116(8) provides that there is an exception to the automatic vesting of rights where the property being transferred is registered in terms of a public regulation, meaning additional steps are required for the transfer. See discussion in para 2.4.2 regarding Cameron’s arguments as to why the *ex lege* transfer of property and obligations is in fact limited. Also see discussion in para 4.2.1 regarding non-transfer clauses in contracts being transferred under a merger agreement.

¹⁰⁴² Refer to my recommendations made below in para 5.3.

As regards section 44, its scope of application is restricted on the basis of the consideration which qualifies for tax rollover relief.¹⁰⁴³ The section also requires that, as a result of the merger or amalgamation, the existence of the amalgamated company (the non-surviving company) must be terminated. In addition, section 44 requires that the transaction take place between companies (as defined in s 1) and that in a domestic merger, there must be a disposal by a resident company of all its assets and liabilities.¹⁰⁴⁴

Given the limitations placed on the application of section 44, the section would generally apply only to very specific merger transactions. Although tax saving is an important factor in the negotiation of a merger agreement, it is not the principal consideration and parties would generally not be satisfied to negotiate a merger agreement solely within the extreme confines of what section 44 allows in order to qualify for tax rollover relief.

It is evident and imperative that the Income Tax Act address and govern abuse of the rollover provisions and, therefore, each corporate rule has its own anti-avoidance provisions in place. That said, in an attempt to limit abuse of the section the scope of merger transactions that qualify for the section 44 rollover relief is significantly reduced. As aptly stated by Cameron, this results in plain “vanilla” merger structures qualifying for section 44 tax rollover relief.¹⁰⁴⁵

Section 44 has only one anti-avoidance rule governed by section 44(5) of the Income Tax Act and commonly referred to as the “eighteen-month rule”. In terms of this rule if a resultant company disposes of assets within 18 months of the date of their acquisition under an amalgamation transaction, the tax effect in the resultant’s hands is deemed to have arisen when the amalgamated company initially disposed of the relevant assets to the resultant company (at the beginning of the eighteen-month period) without the section 44 relief.¹⁰⁴⁶ This will effectively trigger a capital gain or recoupment in the hands of the resultant company, regardless of any available assessed loss.¹⁰⁴⁷

¹⁰⁴³ Section 44(4)(a) and (b) of the Income Tax Act.

¹⁰⁴⁴ Section 44(1)(a) allows for certain assets to be retained which had been earmarked to settle debts incurred in the ordinary course of the company’s trade.

¹⁰⁴⁵ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 82.

¹⁰⁴⁶ Section 44(5)(a) and s 44(5)(b)(ii) of the Income Tax Act.

¹⁰⁴⁷ An exception exists for trading stock in s 44(5)(b)(ii) of the Income Tax Act.

The corporate rules each has its own limitations in place in order to prevent an overlap with another corporate rule. For example, in terms of section 44 the section will not apply in respect of a transaction that constitutes a liquidation distribution¹⁰⁴⁸ in terms of section 47 (an upstream amalgamation would constitute a liquidation distribution).

This notwithstanding, as the Companies Act provides for various restructuring mechanisms to achieve a merger transaction, the transaction can be structured to fall within the requirements of one of the other corporate rules: section 42, section 45 or even section 47. The effect is that each corporate rule has its own requirements and anti-avoidance rules, several being more stringent and severe than those of section 44.

For example, a merger transaction can be tax neutral if the requirements of section 42 (asset-for-share transaction) are met. See Figure 2-1 and Figure 2-2 for an illustrative example in this regard. Given the requirement in section 44 that the amalgamated company or companies must be terminated following the transaction, section 42 provides tax rollover relief for a surviving company in a merger transaction.¹⁰⁴⁹ Section 42 does, however, come with onerous anti-avoidance provisions as discussed in paragraph 3.4.3 above.

Similarly, section 45 (intra-group transaction) may be used to achieve a tax neutral merger transaction. The section provides for tax relief regarding transactions that take place within a “group of companies”. The anti-avoidance provisions in section 45 are arduous and can be triggered up to six years after the conclusion of the section 45 transaction.¹⁰⁵⁰

Section 47 can be used as an upstream amalgamation or in combination with a section 42 or section 45 transaction to liquidate the non-surviving company. Like section 44, section 47 also has an “eighteen-month rule” anti-avoidance provision.

¹⁰⁴⁸ A “liquidation distribution” is defined in s 47 of the Income Tax Act as a transaction in terms of which a resident liquidating company disposes of all its assets to its holding company in anticipation of or during the company’s liquidation, winding-up or deregistration.

¹⁰⁴⁹ See illustrative example in Figure 1-2.

¹⁰⁵⁰ See discussion in para 3.5.3.

As concluded in Chapter 3, due to the limited application of section 44 of the Income Tax Act, merger parties are inherently left to try to comply with these other onerous corporate rollover provisions if they wish the merger transaction to be tax neutral.

The Davis Tax Committee noted in its 2018 report – *“The Efficiency of South Africa’s Corporate Income Tax System”* – that the rule-based nature of the corporate rules makes them non-user friendly, they also do not necessarily achieve their objectives. The Committee’s recommendations in this regard included that consideration be given to replacing the rule-based nature of the provisions with a more principle-based approach.¹⁰⁵¹ The Committee further recognised that the cumbersome and onerous anti-avoidance provisions in the Income Tax Act have undergone numerous amendments over the years, which points to a serious structural issue that needs to be addressed.¹⁰⁵²

It appears that in practice section 44 of the Income Tax Act is not the principal section relied on when structuring a merger transaction because of its limited application.¹⁰⁵³ Given the wider application of the relevant sections, parties can far more easily use other corporate rules to achieve a tax neutral merger. This, however, comes at a cost as sections such as section 42 and 45 have far more onerous anti-avoidance provisions than section 44.

This appears to mirror the finding under paragraph 5.2.2: a section in the Companies Act drafted specifically for statutory mergers, is not being used routinely to achieve mergers. Parties are rather turning to other restructuring mechanisms in the Companies Act, notably the scheme of arrangement, to achieve the same effect as a statutory merger.

Similarly, in the Income Tax Act, although there is a specific corporate rule governing the tax rollover relief for amalgamation and merger transactions, other corporate rules appear to offer greater flexibility in constructing a merger transaction that could be tax neutral.

¹⁰⁵¹ <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 13 February 2023).

¹⁰⁵² Ibid.

¹⁰⁵³ Chong and Van der Linde 2014 3 *Stell LR* 498.

I suggest that a revision similar to that suggested for the sections governing statutory mergers in the Companies Act be undertaken for section 44.¹⁰⁵⁴ The aim would be to establish if there are ways in which the section's application can be broadened or improved to make it a more attractive and practical option for achieving rollover relief in a merger transaction.

5.2.3 Research question 3:

Does applying alternative sections in both Acts to merger transactions provide an answer to the misalignment between the two Acts, or does it merely produce unintended consequences and additional requirements that must be met?

Chapter 4 is dedicated to identifying the various discrepancies between the Companies Act and the Income Tax Act relating to merger transactions. See Table 4 for a summary of these identified disparities.¹⁰⁵⁵

Paragraph 4.3 explores the impact of circumventing the issues in the Income Tax Act and the Companies Act as regards mergers. I indicate that a scheme of arrangement can be used to achieve the same outcome as a merger and can be constructed to rely on the corporate rules in the Income Tax Act.¹⁰⁵⁶

In Chapter 4 I also discussed the relationship between two Acts which are inconsistent or conflict with one another. Based on the principles governing the interpretation of statutes, one must consider context and language side-by-side with neither predominating over the other.¹⁰⁵⁷ This is the principle of interpretation that should be applied to the interpretation of all statutes and not only when a conflict or inconsistency arises, provided a sensible meaning is preferred.¹⁰⁵⁸

¹⁰⁵⁴ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 351: "In particular, tax legislation will need to be amended to deal with the tax implications of such mergers, and indeed the tax treatment of mergers (as compared to the other procedures available for implementing business combinations) is likely to play a significant role in the extent to which the merger procedure is utilised in practice."

¹⁰⁵⁵ The identified disparities are: (i) transfer of all the assets; (ii) residency of the parties to the merger; (iii) confusing definitions and terminology; (iv) types of consideration in the merger; (v) types of merger structure permitted; (vi) party eligible to receive and pay the consideration; (vii) upstream mergers; (viii) creation of a new company pursuant to the merger transaction; (ix) causa and implementation of the merger transaction; (x) the assumption of debt as consideration; and (xi) the finality of the merger agreement.

¹⁰⁵⁶ Chong *Tax Issues* 20.

¹⁰⁵⁷ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2 All SA 262 (SCA) para 19.

¹⁰⁵⁸ *ibid* para 18.

Section 5(4) of the Companies Act provides that where there is an inconsistency between any provision of the Companies Act and a provision of any other national legislation, the provisions of both Acts apply concurrently to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the other.¹⁰⁵⁹ Where this is not possible the provisions of Companies Act prevail.¹⁰⁶⁰

It is argued by De Koker and Williams that in order to qualify for the benefits of a tax-neutral merger, the transaction must first have been effected in compliance with the provisions of the Companies Act.¹⁰⁶¹ This appears to suggest that in terms of the corporate rules, the Income Tax Act is subject to Companies Act even if there are no inconsistencies between the two Acts. This interpretation makes the argument that the disconnects between the two Acts needs urgent attention.

The next exercise in Chapter 4 was to distinguish between a “conflict” and an “inconsistency”. Some direct contradictions or conflicts in the two Acts were identified,¹⁰⁶² for example, the residency of the parties to the merger agreement. The Income Tax Act recognises and provides tax deferral for cross-border mergers so allowing them to be tax neutral if the relevant requirements are met.¹⁰⁶³ Contrarily, the Companies Act only allows for mergers between South African resident companies.¹⁰⁶⁴ The cross-border provision in the Income Tax Act, therefore, appears superfluous, if the Companies Act provision prevails when such an inconsistency arises.

It is clear that there are issues arising from the existing conflicts and inconsistencies between the two Acts which, in turn, create uncertainty around the application and interaction between the relevant sections. As an alternative, it appears that parties opt for the more trusted, tried and tested, and broader sections to achieve the same outcome as a merger transaction, even if they do not use the specific merger provisions.

¹⁰⁵⁹ Section 5(4) of the Income Tax Act.

¹⁰⁶⁰ Except to the extent provided otherwise in subsection (5) or s 118(4). Section 118(4) specifically addresses conflicts in terms of the Authority of Panel and Takeover Regulations (Part B), Regulation of affected transactions and offers (Part C) and the takeover regulations.

¹⁰⁶¹ De Koker and Williams *Silke on South African Income Tax* ch 13 para 13.34.

¹⁰⁶² For a discussion of the other direct contradictions identified see para 4.4.3.1.

¹⁰⁶³ Section 44(1)(b) of the Income Tax Act. See discussion in para 4.2.2.

¹⁰⁶⁴ Section 113(1) provides that two or more profit companies may merge or amalgamate. See criticism raised by Davids, Norwitz and Yuill and Cassim in para 4.2.2.

As illustrated in Chapter 4, the use of these alternative provisions means that additional administrative steps may be required – eg, the scheme of arrangement does not occur by operation of law – and there may be additional anti-avoidance provisions to adhere to – eg, sections 42 and 45 of the Income Tax Act.

In my view, the option of using alternative sections serves as a way to bypass the inconsistencies and discrepancies identified in Chapter 4 and may be viewed as a “solution” by many lawyers in practice who may be using these alternative mechanisms on a daily basis in advising their clients. However, from a legislative and academic perspective, these identified issues need to be considered and addressed appropriately by the legislature.

An alignment between the two Acts on certain aspects may address some of these uncertainties, but a holistic view must also be taken and perhaps some degree of reflection: Has the introduction of the statutory merger in South African company law achieved its purpose or has it become redundant to a certain degree in the light of the alternative mechanisms available to restructure a group of companies? Is the rollover relief for amalgamation transactions sufficient for typical mergers, or is it unrealistically narrow resulting in its potential obsolescence?

Therefore, in answer to the research question of whether applying alternative sections in both Acts to merger transactions provides an answer to the misalignment between the two Acts – “no”, from an academic perspective it does not. In practice these uncertainties and inconsistencies may be successfully circumvented by using alternative mechanisms in both Acts. Still, the issues identified have a definite impact on the ease of doing business in South Africa and must be addressed accordingly.

5.2.4 Research question 4:

What is the impact of the Companies Act and Income Tax Act not being aligned as regards merger and amalgamation transactions and how can these disconnects best be addressed?

This research question is an extension of the previous question and has been answered in part. However, as concluded in Chapter 4, I show in the summary below, the differences identified and list the potential impact of each non-alignment/inconsistency/conflict.

NR	INCONSISTENCY/ CONFLICT	SUMMARY	IMPACT
1	Transfer of all the assets	The Income Tax Act allows for some assets to be held back to settle certain outstanding debt and administrative costs. The Companies Act requires all assets and liabilities to be transferred with the merger.	If the transaction is effected by a statutory merger this would be in conflict with the Companies Act as section 116(7) provides that all of the liabilities of the amalgamated company automatically transfer to the resultant company by operation of law. If, however, another Companies Act restructure mechanism is used, there may be administrative costs incurred by the amalgamated company in relation to liquidation or -winding-up of the amalgamated company.
2	Residency of the parties to the merger	The Income Tax Act allows for an amalgamation transaction to take place between foreign companies, while the Companies Act provides that statutory mergers may only take place between “profit companies” (ie, only between South African companies).	The provision of an amalgamation transaction with a foreign party/foreign parties in the Income Tax Act is superfluous as the Companies Act only provides for domestic merger transactions (the Companies Act prevails if there are inconsistencies between the two Acts and there cannot be a fiscal benefit in the form of tax relief if the Companies Act requirements are not met).
3	Confusing definitions and terminology	Basic terminology creates confusion: <u>Income Tax Act:</u>	Confusing terminology leaves room for interpretative differences and uncertainty as to the correct application.

		<p>“Amalgamated company” (Transferor) and “Resultant company” (Transferee)</p> <p><u>Companies Act:</u> “Amalgamated Company” (Transferee) and “Amalgamating Company” (Transferor);</p> <p><u>Income Tax Act:</u> The existence of the amalgamated company will be “terminated” (s 44(13))</p> <p><u>Companies Act:</u> “dissolution” of the amalgamated company.</p>	
4	Type of consideration allowed	Limited consideration is allowed in terms of section 44(4) of the Income Tax Act while the Companies Act does not prescribe specific consideration for a statutory merger.	The limited consideration allowed in terms of the Income Tax Act stifles the flexibility to structure the consideration in the merger agreement provided in the Companies Act. This is however a justified limitation to ensure continued interest post restructure transaction. The impact is however that parties would consider using other tax rollover relief provisions with greater flexibility regarding consideration to action a merger transaction.
5	Type(s) of merger structures allowed	The statutory merger in the Companies Act provides for more than one amalgamating company and more than one	Again, the limitations in the Income Tax Act impact on the flexibility provided in the Companies Act as only

		resultant company, while section 44 allows only for a simple, straightforward merger between an amalgamated company and a resultant company.	straightforward merger structures would qualify for tax rollover relief.
6	Party eligible to receive the consideration	Income Tax Act only allows for bilateral transactions between the amalgamated company and the resultant company. The Companies Act provides greater flexibility to structure the merger per the parties' own requirements.	See impact above under 5.
7	Upstream mergers	Section 44 does not specifically provide for an upstream merger, while section 47 (liquidation distribution) may be used to achieve a similar type of vertical merger. No provision exists in the Companies Act for an upstream merger.	There is a lost opportunity to have a simple, streamlined, cost effective merger in both the Income Tax Act and Companies Act in the form of a short-form merger. See recommendation in paragraph 5.3.2.1 below.
8	Creation of a new company pursuant to the merger agreement	The Companies Act provides for a new company to be created pursuant to a merger agreement (which will be the resultant company). The Income Tax Act only allows for transfers between existing companies.	In addition to a new company merger not qualifying for any tax rollover relief, other practical issues arise. As the new company would not have legal existence at the time of the merger agreement it can, therefore, not be a party to the agreement. In addition, if the company is created pursuant to the merger, eg, delays with VAT registration which may impact

			on the zero rating of the merger transaction.
9	<i>Causa</i> and the implementation of the merger transaction	In the Companies Act, the <i>causa</i> of a merger transaction is the transfer of all assets and liabilities by operation of law (ie, automatically). In terms of the Income Tax Act, the <i>causa</i> seems to suggest the transfer of the assets and liabilities is “in exchange for consideration”	There seem to be various interpretations in this regard as some scholars suggest that there is no misfit as the transfer takes place by operation of law and the Income Tax Act merely prescribes the consideration for qualification for rollover relief. Another scholar suggests that the wording in section 44 is incorrect as there is no “disposal” if the transfer occurs <i>ex lege</i> . The fact that the term “disposal” in the Eighth Schedule specifically includes “by operation of law” suggests that there is no recommendation required here.
10	Assumption of debt as consideration	The Income Tax Act has certain requirements regarding “qualifying debt”. The Companies Act has no restriction on the debt assumed as consideration, save that creditors may object to the transfer if they are prejudiced by the merger.	There is a clear disparity here which may give rise to practical issues when drafting the merger agreement as the Companies Act requires all obligations to be transferred. For Income Tax purposes only the qualifying debt qualifies for tax rollover relief.
11	Finality of the merger transaction	Timelines are not aligned and certain tax rollover relief anti-avoidance provisions may trigger tax consequences months after the conclusion of the merger agreement.	The relevant transaction parties should note the different timelines and tax clawback provisions, but this does not require a change in legislation.

Table 8: Impact of the inconsistencies and conflicts between the Companies Act and the Income Tax Act

5.3 Recommendations

In conclusion, I set out below my recommendations based upon the conclusions reached in this and the preceding chapters.

I do not offer recommendations for every disparity or inconsistency identified in this thesis. These are two Acts with two different aims, and it would be an impossible task to align them on all fronts.

In addition, as pointed out by Vanistendael, there are benefits to having independent requirements in the Tax Act. In general, where one law refers to another it can be problematic in that if there is a change in company law, there will simultaneously be a change in the conditions for a tax neutral merger.¹⁰⁶⁵ Therefore, any cross references in the two Acts should be approached with caution and only introduced when necessary.

To illustrate the different aims of the Acts, take the limitation to the forms of consideration permitted in an amalgamation transaction in terms of section 44. The whole aim of deferred tax or tax rollover relief is to allow for a tax-neutral transaction where the parties' interests are retained in the group, but in a modified form. Only once such an asset or share is realised outside the group, for example, would the deferred tax liability of the merger be triggered. It would be nonsensical to recommend that the Income Tax Act be broadened to match the wide application of the Companies Act regarding the acceptable forms of consideration. This would result in an unwarranted abuse of the rollover provisions, for example, parties concluding a regular sale of shares in exchange for cash but claiming the tax rollover relief in terms of section 44.

In addition, due to the various restructuring options available to the parties under the Companies Act and the various corporate rollover over relief provisions in the Income Tax Act, parties have various options and combinations available to achieve the effect of a merger. This complicates the matter in that any recommendation must consider not only the interaction between the statutory merger provision or amalgamation transaction, but also all the other restructuring mechanisms and corporate rules in the

¹⁰⁶⁵ Vanistendael "Taxation of Corporate Reorganisations" 14.

two Acts. Were only the statutory merger and only the amalgamation transaction available to effect a merger, an alignment would be far more straightforward.

It stands to reason that, due to the wide application of the Companies Act in structuring the merger transaction and the narrow application of the Income Tax Act to the same transaction, not all statutory merger transactions would qualify for tax rollover relief in terms of section 44 of the Income Tax Act. Parties may attempt to achieve a tax neutral merger by using the other rollover provisions, but again the Income Tax Act must adhere to strict anti-avoidance provisions to address potential abuse of these provisions, making it more difficult to apply broadly to M&A transactions.

The recommendations offered are proposed in the form of either an amendment to current legislation or the introduction of new concepts in the Acts.

5.3.1 Amendments to address some of the uncertainties surrounding the two Acts

5.3.1.1 Transfer of all the assets and liabilities

As highlighted in Table 4 above, there is a conflict between the wording in the definition of an “amalgamation or merger”¹⁰⁶⁶ and the definition of an “amalgamation transaction”.¹⁰⁶⁷ The Income Tax Act provides that certain assets may be retained to settle a debt:

- a) incurred in the ordinary course of its trade;
- b) to satisfy any reasonably anticipated liabilities to a sphere of government of any country; and
- c) administrative costs relating to liquidation and winding-up.

In contrast, in the definition of an “amalgamation or merger” the Companies Act requires that all assets and liabilities be transferred upon merger.

If the merger transaction is achieved by using the statutory merger in the Companies Act, I argue that the retention of assets to settle debt, as provided in the Income Tax Act, is a futile exercise as all the amalgamated company(ies)' obligations become the obligations of the resultant company(ies) by operation

¹⁰⁶⁶ Section 1 of the Companies Act.

¹⁰⁶⁷ Section 44(1) of the Income Tax Act.

of law in terms of section 116(7). Furthermore, the Companies Act does not allow for the contractual exclusion of obligations from the transfer.¹⁰⁶⁸

The Explanatory Memorandum of the Taxation Law Amendment Act 2014 provides that this provision for retention of assets to settle certain debt and costs is aimed at allowing the amalgamated company to retain assets to satisfy certain liabilities and the administration costs associated with liquidating and winding-up the amalgamated company.

Regarding the provision for administrative costs, I indicate in paragraph 4.2.1 that this is redundant as the amalgamated company will be deregistered by operation of law under section 116(5) of the Companies Act. In relation to the settlement of debt, section 116(7)(b) provides that no obligations may be contractually excluded from the transfer, meaning that the retention of assets to settle debt in the Income Tax Act is in conflict with section 116(7) of the Companies Act.

Legitimately, there may be administrative costs arising from the transaction if the statutory merger mechanism is not used to give effect to the transaction. This means that the parties must take the necessary steps to liquidate, deregister, or wind-up the amalgamated company, if required. These costs would have to be negotiated in the light of the transaction purchase price.

I recommend a clarification in the Income Tax Act, specifically in section 44(1)(a)(i), that certain assets may be retained to settle outstanding debt provided that section 116 of the Companies Act does not apply to the transaction. This would ensure that in applying the tax provisions for an amalgamation transaction, parties are conscious not to fall foul of the provisions in the Companies Act regarding the transfer of assets and liabilities in terms of a statutory merger.

5.3.1.2 Residency of the parties to the merger

Once again, there is a conflict between the two Acts. Ironically, in this conflict the provisions in the Income Tax Act are seemingly broader offering flexibility

¹⁰⁶⁸ See discussion on the automatic vesting of the property rights and obligations despite anti-transfer clauses in contracts in para 2.4.2.1 above; Dachs and La Grange 2012 January *The Taxpayer* 5 – 6.

to the parties by allowing for an amalgamation transaction to be concluded between domestic companies,¹⁰⁶⁹ a domestic company and a foreign company,¹⁰⁷⁰ or between two foreign companies.¹⁰⁷¹ In contrast, the Companies Act takes a narrower approach to the application of the statutory merger based upon the residency of the companies in the transaction.

Section 115(2)(b) of the Companies Act does provide that if the proposed transaction is in respect of the disposal of all or greater part of the assets (in terms of s 112) of a subsidiary, the shareholders of the holding company (in case of a domestic or an external company) must approve the transaction by way of special resolution.¹⁰⁷² No reference is made to an “external company”¹⁰⁷³ in section 114 of the Companies Act, meaning that the section also applies only to arrangements between a “company” as defined in the Act¹⁰⁷⁴ and its holders.

I recommend that this be aligned and either the Income Tax Act be made narrower by including in the section that the amalgamation transactions involving a foreign company must be effected in terms of section 112 of the Companies Act, or in terms of restructuring provisions in the relevant foreign company’s country.

Alternatively, the legislature may consider providing for a cross-border statutory merger under certain circumstances in the Companies Act. For example, a requirement may be included in the provision that the resultant company must be a South African company (remains within the regulation of the Companies Act).¹⁰⁷⁵

5.3.1.3 *Confusing Definitions and Terminology*

The confusion is created first, with regard to the parties as in the Companies Act the transferee is referred to as the “amalgamated company”, while the

¹⁰⁶⁹ Section 44(1)(a) of the Income Tax Act.

¹⁰⁷⁰ Section 44(1)(b) of the Income Tax Act.

¹⁰⁷¹ Section 44(1)(c) of the Income Tax Act.

¹⁰⁷² Delpont *et al Henochsberg (2023)* s 115.

¹⁰⁷³ Section 1 definition of “external company” in the Companies Act: “means a foreign company that is carrying on business, or non-profit activities, as the case may be, within the Republic, subject to section 23(2)”.

¹⁰⁷⁴ See n 831.

¹⁰⁷⁵ See criticism of narrow application of the Companies Act in this regard: Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 354 – 355; Cassim MF (*Part 1*) 2008 1 *SA Merc LJ* 8.

Income Tax Act assigns the same name to the transferor. A simple alignment here would be to use the same terminology in the Income Tax Act as it is used in the Companies Act. An amendment to this effect is recommended to address the confusing terminology used in the two Acts.

Second, regarding the terminology in section 41(4), as discussed in paragraph 4.2.3, the wide terminology in section 44(13) is the most likely reason for amalgamation transactions being effected by other restructuring mechanisms in the Companies Act which may require liquidation, winding-up, or deregistration. I, therefore, make no recommendation to amend this section's terminology of "termination" to "deregistration" to align it with a deregistration under a statutory merger as this would significantly reduce the scope of the provision.

Nevertheless, the legislator provides in section 41(4) that the steps for termination include "liquidate, wind-up or deregister", whilst from a company law perspective, liquidation and winding-up of a company are synonymous terms. I suggest that the current wording of this subsection is confusing as it suggests that there are three methods by which to terminate the company whilst in reality two of the "methods" are synonymous.¹⁰⁷⁶ I, therefore, recommend an amendment to this subsection to address potential confusion in this regard.

Section 41(4) in turn refers specifically to deregistration in terms of section 116 of the Companies Act and in terms of a request for deregistration of the company in terms of section 82(3)(b)(ii) of the Companies Act. Although deregistration generally follows a dissolution, section 41(4) only refers to "deregistration" with reference to section 82(3)(b)(ii), a section governing the dissolution of companies and deregistration. More specifically, section 82(3)(b)(ii) provides for registration where the Companies Commissioner has received a request and has determined that the company has ceased to carry on business and has no or inadequate assets resulting in no reasonable probability of being liquidated.

¹⁰⁷⁶ SARS acknowledges on its website that the two terms are synonymous <https://www.sars.gov.za/businesses-and-employers/liquidations/> (accessed 15 August 2023).

My recommendation is to amend section 41(4) of the Income Tax Act by providing that a company will be deemed to have taken steps to *dissolve and* deregister in terms of section 82(3)(b)(ii) *read with section 83(1) of the Companies Act*. In terms of section 83(1) the date of dissolution will coincide with the removal of the company's name from the register. This would better align the terminology in the Companies Act with that of the Income Tax Act.

5.3.1.4 Creation of a new company pursuant to a merger agreement

A recommendation in this regard would have a far-reaching effect on the current scope of section 44 which may, in my view, not be plausible. For this reason, I make no recommendation on the discrepancy discussed in paragraph 4.2.5 (Types of merger structures allowed).

However, I explore this discussion further here as it was a proposal made by a scholar recognised in paragraph 4.2.8 and with which I agree in principle.

Currently, section 44, and the other corporate rules, do not cater for tax rollover relief for mergers that result in the creation of a new company. This is because as the Act currently reads the parties to the respective transactions must be companies with a legal existence.

In addition, section 44 of the Income Tax Act does not currently allow for a new company merger structure to be tax neutral. This is reserved for a surviving merger structure.

Shama suggests that one extend the principle of “by operation of law” in section 41(4) to apply not only to the deregistration of the amalgamated company(ies) but also to the creation of the new company pursuant to the merger agreement in terms of section 116(5)(a) of the Companies Act.¹⁰⁷⁷

On the face of it, I agree with this suggestion as it would ensure a further alignment between the Companies Act and Income Tax Act regarding mergers. However, if it is to allow for the creation of a company by operation of law, this would require a fundamental addition to the Income Tax Act to provide in the definition of an “amalgamated company” for an amalgamation transaction that

¹⁰⁷⁷ Shama *Statutory mergers* 84.

creates a new company. In other words, to effect such a recommendation the Income Tax Act would first have to introduce a new merger structure for the creation of a new company, and second, the creation would then, per Shama's recommendation, have to come into being by operation of law.

The creation of the company by operation of law in terms of an amalgamation transaction in itself does not, to my mind, hold adverse corporate income tax consequences. That said, the legislator specifically excluded rollover relief in section 44 for a transaction where a new company is created. Therefore, such a fundamental change to section 44 would need to be further explored as regards its reach and potential impact on relevant taxes.

As it stands, when the CIPC registers a new company, information is shared with SARS which allows the Tax Commissioner to register the new company for corporate income tax purposes.¹⁰⁷⁸ This existing practice shows that, from an income tax registration perspective, a creation by operation of law could work. However, this cannot be said of all other tax registrations. For example, would the creation of a new company by operation of law work for the automatic registration for VAT? Currently, SARS requires an application to be made for VAT registration in terms of section 23 of the VAT Act and the Tax Commissioner is then eligible to register that person. Factors SARS considers in this regard include whether the person has a fixed place of business, does he or she keep proper accounting records of the enterprise, and whether he or she has opened a bank account for the enterprise.¹⁰⁷⁹ SARS has a discretion to refuse to register a person as a VAT vendor in terms of section 23(7) of the VAT Act. There is even a pending amendment in the form of section 23(3A) of the VAT Act in terms of which SARS may, under certain circumstances, require a person to submit biometric information to ensure his or her proper identification or to counteract identity theft and fraud.¹⁰⁸⁰

In my view, an automatic registration for VAT based on the creation of a company by operation of law, would not be viable given the current risk SARS

¹⁰⁷⁸ <https://www.sars.gov.za/businesses-and-employers/small-businesses-taxpayers/starting-a-business-and-tax/registering/> (accessed 8 March 2023).

¹⁰⁷⁹ Section 23(7) of the VAT Act.

¹⁰⁸⁰ The effective date of the amendment has yet to be determined by the Minister of Finance by notice in the *Government Gazette*.

has with false vendor registrations aimed at benefitting from false input VAT claims.¹⁰⁸¹ An automatic VAT registration would remove the much-needed discretion and defence accorded SARS to accept or deny a VAT vendor application.

5.3.2 Proposal to introduce new concepts in the Acts

5.3.2.1 Introducing a short-form merger

The South African statutory merger has the potential of being a convenient mechanism for cleaning up a group structure, by, for example, merging subsidiaries and erasing unnecessary divisions in a company group structure rapidly and economically.¹⁰⁸² This can be achieved by way of a short-form merger which is currently not addressed in the Companies Act.

To recapitulate, a short-form merger can occur between two sister companies (wholly owned by the same holding company) as a horizontal short-form merger, or as a vertical short-form merger between a wholly-owned subsidiary and its holding company.¹⁰⁸³

There are many procedural steps required in statutory merger in terms of section 113 which may be redundant in the case of an internal short-form merger.¹⁰⁸⁴ For example, the notice of the merger to all known creditors, if there is no change in the ultimate control following the statutory merger, or obtaining the shareholder approval of the merging companies if both parties are part of the same group of companies.

It has been pointed out by various writers that it is disappointing that the Companies Act does not cater for a short-form merger,¹⁰⁸⁵ which could, in my view, boost the use of the statutory merger mechanism, especially in terms of South African intra-group restructuring.

¹⁰⁸¹ Commissioner Kieswetter: "There are companies that are created for the sole purpose of defrauding SARS. This sentence of direct imprisonment must communicate a clear message that SARS has the capacity to detect fraud and make it costly for the perpetrators." <https://www.sars.gov.za/media-release/businessman-gets-5-year-jail-term-for-vat-fraud/> (accessed 21 February 2023). Also see <https://www.npa.gov.za/media/sars-tax-fraudster-sentenced-jail-time> (accessed 21 February 2023).

¹⁰⁸² Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 80.

¹⁰⁸³ See para 1.2.6 for a discussion on short-form mergers.

¹⁰⁸⁴ See the steps required for a statutory merger in para 2.4.1.

¹⁰⁸⁵ Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 80.

Cameron highlights that section 112(1)(c) provides a carve-out in respect of disposals between wholly owned group companies and their parent or sister companies¹⁰⁸⁶ so allowing for a sale of business to take place in certain circumstances between sister companies and parent companies. Davids, Norwitz and Yuill have commented that a similar carve-out could have been provided for statutory mergers¹⁰⁸⁷ to effectively allow for short-form and triangular mergers.

I suggest that if such a proposed carve-out is introduced in the statutory merger provisions of the Companies Act then, upon meeting certain carve-out requirements specific to a short-form merger, the group companies should be allowed to apply the statutory merger provisions.¹⁰⁸⁸ The carve-out requirements would, for example, still require a solvency and liquidity test to avoid shifting of losses and also require relevant board approval.¹⁰⁸⁹ It is advanced that the general requirements of section 113 read with sections 115 and 116 – ie, the notification of all known creditors and securing shareholder approval are redundant in a short-form merger.¹⁰⁹⁰

Currently, however, despite the broad wording of section 113 which allows for various merger structures (including short-form mergers), section 115(4) provides that the voting rights of an acquiring company or person related to the acquiring company must not be included in calculating the percentage of voting rights required for a quorum or for the votes required in support of a resolution. As a result, short-form mergers are not permitted under the Companies Act as the voting rights of relevant parties to a short-form merger must be disregarded. I believe that if the legislature is serious about introducing special requirements for a short-form merger in section 113, it must also introduce an exception for the application of section 115(4) – eg, where a short-form merger is effected in terms of section 113.

¹⁰⁸⁶ *ibid* 81; s 112(1)(c) of the Companies Act.

¹⁰⁸⁷ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 357.

¹⁰⁸⁸ Cassim MF (*Part 2*) 2008 20 *SA Merc LJ* 147 156; Cameron 2016 2/2 *Journal of Corporate and Commercial Law & Practice* 80 – 81.

¹⁰⁸⁹ Davids, Norwitz and Yuill 2010 *Acta Juridica* 337 357.

¹⁰⁹⁰ *ibid*.

I turn now to legislation from foreign jurisdictions, such as the UK, New Zealand, Delaware in the USA, Hong Kong, and Canada. Judge Kriegler warns in *Bernstein v Bester NO*,¹⁰⁹¹ that the use of foreign legislation should not be considered in a facile manner by the courts. There must be a similarity between the bases of jurisdiction and the provisions being compared.¹⁰⁹² Therefore, the countries discussed have been selected based upon common bases, for example, the majority of the above countries were former British colonies and consequently show a strong English law influence. As the concept of a merger was adopted from American law it is also useful to consider relevant legislation in the USA.

As stated in Chapter 1, paragraph 1.11, this is not a comparative study of foreign jurisdictions as such; but rather a search for a solution to the need for the successful implementation of the short-form merger in South Africa.

As regards foreign legislation, South African company law has historically followed UK company law. This means that in principle South African and UK company law share similar bases.

However, a significant difference emerged as regards restructuring transactions with the enactment of the Companies Act. First, the UK maintains a court-sanctioned scheme of arrangement, while South Africa now provides for a court-free scheme of arrangement.¹⁰⁹³ Second, while a statutory merger was adapted from American company law in South African company law, the UK Companies Act 2006 (UK Companies Act) still does not cater for a statutory merger between UK private companies. The UK Companies Act does, however, facilitate company restructuring in the following ways:

- a) arrangements and reconstructions (Parts 26 and 26A of the UK Companies Act);

¹⁰⁹¹ In *Bernstein and Others v Bester NO and Others* (CCT23/95) 1996 ZACC 2; 1996 4 BCLR 449; 1996 2 SA 751 (27 March 1996) para 133, Kriegler J stated: "The second reason is that I wish to discourage the frequent - and, I suspect, often facile - resort to foreign 'authorities'. Far too often one sees citation by counsel of, for instance, an American judgment in support of a proposition relating to our Constitution, without any attempt to explain why it is said to be in point. Comparative study is always useful, particularly where courts in exemplary jurisdictions have grappled with universal issues confronting us."

¹⁰⁹² *ibid* paras 28 – 29; Delpont *et al Henochsberg* (2023) s 5.

¹⁰⁹³ Section 900 of the UK Companies Act 2006.

- b) take-over offers (Part 28 of the UK Companies Act); and
- c) acceptance of shares as consideration for the sale of company property (s 110 of the Insolvency Act 1986).

Section 904 of the UK Companies Act (Part 27) governs mergers and merging of public companies and is akin to section 311 read with section 314 of the 1973 Companies Act in that the merger is effected by way of a scheme of arrangement¹⁰⁹⁴ which is a court-sanctioned process.¹⁰⁹⁵ As it currently reads, section 904 allows for public companies to merge by absorption and by formation of a new company to be effected under the scheme of arrangement.¹⁰⁹⁶

In 1999, a UK Company Law Review Steering Group launched a study entitled *Modern Company Law for a Competitive Economy*¹⁰⁹⁷ as a lead-up to the enactment of a new UK Companies Act. In their consultative document, “Completing the Structure” the group asked whether a non-court-based statutory merger should be introduced to supplement existing restructuring procedures. Many of those consulted found that the absence of a court-free statutory merger represented a weakness,¹⁰⁹⁸ but also considered that a full-scale statutory merger should not be introduced in the UK.¹⁰⁹⁹ Rather, it was proposed that only a statutory merger within a wholly owned group of companies be considered.¹¹⁰⁰ Such a statutory merger would constitute a short-form merger which means that it would offer a simple, streamlined process with minimum formalities and could be made entirely tax neutral.¹¹⁰¹

The document further provides that:

¹⁰⁹⁴ Section 902 read with s 904 of the UK Companies Act.

¹⁰⁹⁵ Section 899 (court sanction for compromise or arrangement) of the UK Companies Act.

¹⁰⁹⁶ Section 904 of the Companies Act 2006.

¹⁰⁹⁷ https://webarchive.nationalarchives.gov.uk/ukgwa/20070603164510/http://www.dti.gov.uk/cld/final_report/prelims.pdf (accessed 1 February 2023).

¹⁰⁹⁸ Para 11.44 of Chapter 11: “Reconstruction, Mergers and Jurisdictional Migration” <https://webarchive.nationalarchives.gov.uk/ukgwa/20090609044142/http://www.berr.gov.uk/whatwedo/businesslaw/co-act-2006/clr-review/page25080.html> (accessed 1 February 2023).

¹⁰⁹⁹ *ibid* para 11.50.

¹¹⁰⁰ *ibid*.

¹¹⁰¹ *ibid*.

“Many groups of companies include subsidiaries which are kept alive for no good reason *other than to avoid the expense and problems associated with getting rid of them*”¹¹⁰² (emphasis added).

This comment illustrates the need for a transfer mechanism that can be used within a group of companies rapidly and effectively to “clean-up” a group structure in a cost effective and streamlined manner.

Based upon the feedback received from consultees, the Final Report of the Company Law Review Steering Committee proposed two options regarding the proposal to introduce a statutory merger in the UK:¹¹⁰³

- a) where a company forms a wholly owned subsidiary to acquire the assets and liabilities of another company with the latter being dissolved and its shareholders receiving shares in the wholly owned subsidiary as payment;¹¹⁰⁴ and
- b) a non-court-supervised procedure where a merger occurs between a wholly owned subsidiary and its parent company or a fellow wholly owned subsidiary (a sister company) based upon a decision by the directors of the companies involved, a certificate of solvency from the directors, notice to creditors, and advertisement of the proposed merger, with a right for dissenting creditors to apply to court for appropriate relief.¹¹⁰⁵

Nevertheless, neither of these proposals was included in the UK Companies Act.¹¹⁰⁶

It appears that the schemes of arrangement for the reconstruction or amalgamation of companies in terms of the Part 26 of the Companies Act 206

¹¹⁰² Clark *Corporate Law* 435 – 436.

¹¹⁰³ Para 13.14 of The Company Law Review Steering Group “Modern Company Law For a Competitive Economy, Final Report Volume I” 2001 https://webarchive.nationalarchives.gov.uk/ukgwa/20070603164510/http://www.dti.gov.uk/cld/final_report/prelims.pdf (accessed 1 February 2023).

¹¹⁰⁴ *ibid.*

¹¹⁰⁵ *ibid.*

¹¹⁰⁶ Davies, Worthington, Micheler *et al Gower and Davies' principles (2012)* 29-12. Interestingly, UK companies could have a cross-border merger between private companies under European Union Directive 2017/1132/EU provided the merger was between a UK company and a company in one of the other European Economic Area (EEA). However, following Brexit, the UK no longer has access to this European Union Merger Directive. Additionally, the UK does not have its own domestic private company merger regime.

is rarely used in the UK.¹¹⁰⁷ Bailey suggests that in practice a much simpler mechanism by which to effect a merger or demerger is a reconstruction in terms of section 110 of the Insolvency Act 1986.¹¹⁰⁸ This mechanism does not involve court approval and requires that the transferor be put into a voluntary winding-up following the transfer of its business to the transferee company.¹¹⁰⁹ It is deemed to be the most cost effective and expeditious mechanism by which to effect a private company merger in the UK.¹¹¹⁰

From a UK tax perspective, such a reconstruction would be tax neutral for both the company and its shareholders.¹¹¹¹

It appears that the UK has a similar issue to South Africa in that alternative mechanisms are used to effect a merger, such as a scheme of arrangement, reconstruction, or take-over. The UK considered the introduction of a statutory merger before the enactment of the current Companies Act, specifically a short-form merger, but there was no uptake of the concept in the Companies Act 2006. The reason for this omission is unclear. It was nevertheless clear from the study conducted that the UK is in need of some form of cost effective and expeditious mechanism that would allow companies to rid themselves of unwanted subsidiaries.¹¹¹²

New Zealand's company law provisions are also relevant in that it shares South Africa's common-law background to company law by having been a British colony and part of the Commonwealth. New Zealand was also a party to the consultations with foreign jurisdictions when the Companies Act was being drafted in South Africa.¹¹¹³

The New Zealand Companies Act 1993 makes provision for a short-form amalgamation in section 222. The requirements are that a company and one or

¹¹⁰⁷ Bailey *Mergers* 10. Also see *TSB Nuclear Energy Investment UK Ltd, Re* 2014 EWHC 1272 (Ch), 2014 BCC 531 for a rare example of such a scheme of arrangement sanctioned by the court. Bailey points out that the process in Part 26 of the Companies Act is, in the main, used for the composition of debt of companies that are insolvent or close to becoming insolvent, to avoid the company going through the formal insolvency process as governed in the Insolvency Act 1986.

¹¹⁰⁸ *ibid* 14.

¹¹⁰⁹ Section 110 of the Insolvency Act 1986.

¹¹¹⁰ Bailey *Mergers* 16.

¹¹¹¹ Sections 136 and 139 of the Taxation of Chargeable Gains Act 1992.

¹¹¹² Clark *Corporate Law* 435 – 436.

¹¹¹³ See para 2.3.1 above,

more other companies which are directly or indirectly wholly owned by it may amalgamate and continue as a single company if the following requirements are met:¹¹¹⁴

- a) “The amalgamation is approved by a resolution of the board of each amalgamating company; and
- b) Each resolution provides that:
 - i. the shares of each amalgamating company, other than the amalgamated company, will be cancelled without payment or other consideration; and
 - ii. the constitution of the amalgamated company, if it has one, will be the same as the constitution of the company first referred to, it if has one; and
 - iii. the board is satisfied on reasonable grounds that the amalgamated company will, immediately after the amalgamation transaction becomes effective, satisfy the solvency test; and
 - iv. The person or persons named in the resolution will be the director or directors of the amalgamated company.”

In addition, written notice must be given to every secured creditor of the company not less than 20 days prior to the amalgamation is proposed to take effect.¹¹¹⁵ The resolutions approving an amalgamation in terms of section 222, shall be deemed to constitute an amalgamation proposal that has been approved.¹¹¹⁶

In terms of section 222(5) of the New Zealand Companies Act 1993, the directors who vote in favour of a resolution must sign a certificate stating that, in their opinion, the company will meet the solvency test after the amalgamation is finalised and must also set out the grounds for that opinion. A director who fails to comply with the above commits an offence and is liable upon conviction to a penalty.¹¹¹⁷

Several of the above requirements are similar to those set in section 113 of the Companies Act. For example, in both Acts it is required that the board of directors must be satisfied that a solvency test will be met (a liquidity test is also required in the Companies Act). Both Acts require written notice of the

¹¹¹⁴ Part 13 of the New Zealand Companies Act 1993 and Subpart FO “Amalgamation of companies” of the Income Tax Act 2007.

¹¹¹⁵ Section 222(3) of the Companies Act 1993.

¹¹¹⁶ Section 222(4) of the Companies Act 1993.

¹¹¹⁷ Section 222(6) of the Companies Act 1993.

amalgamation to be provided to each known creditor after the amalgamation resolution has been adopted. The Companies Act additionally requires certain other steps, such as notice of the merger agreement to be given to the shareholders of the merging companies and also a special resolution to support the merger.

From a tax perspective, New Zealand has a group tax regime in terms of which if certain requirements are met the group of companies is treated as a consolidated group (ie, as a single taxpayer) and therefore any transfers between companies within the group are disregarded for tax purposes.¹¹¹⁸ This means that short-form mergers would automatically be tax neutral as they take place between companies within the same group. Due to this significant difference in the tax regimes in this regard, this will not be pursued further.

As the merger concept introduced in South African company law is based on an American concept, it is fitting to see how the USA, specifically Delaware, deals with short-form mergers. Clark discusses a short-form merger under Delaware General Corporation Law. He indicates that it can be achieved by resolution of the board of directors of the parent company (in a vertical short-form merger) after which a subsidiary can be merged into its parent company (given that the parent holds a prescribed percentage of the shares in the subsidiary).¹¹¹⁹ Clark opines that the short-form merger encourages groups of companies to eliminate partially owned subsidiaries and the conflict of interest problems they create.¹¹²⁰ For example, in terms of the Delaware General Corporation Law, section 253 allows for a short-form merger when a parent company is merged with a 90 per cent held subsidiary (a short-form, freeze-out merger).¹¹²¹

Clark further points out that minority shareholders are still protected against abuse of power in a short-form merger as the dissenting shareholders have appraisal rights and, in appropriate circumstances, may attack the short-form

¹¹¹⁸ CV 1 – CV 4 of the Income Tax Act 97 of 2007.

¹¹¹⁹ Clark *Corporate Law* 435 – 436.

¹¹²⁰ *ibid.*

¹¹²¹ Section 253 of the Delaware General Corporation Law <https://delcode.delaware.gov/title8/c001/sc09/index.html> (accessed 9 March 2023).

merger in a lawsuit.¹¹²² However, as seen in the case of *Glassman v Unocal Exploration Corp*,¹¹²³ a Delaware short-form merger involves a unilateral act by the parent company terminating the existence of its 90 per cent owned company:

“The minority stockholders receive no advance notice of the merger; their directors do not consider or approve it; and there is no vote. Those who object are given the right to obtain fair value for their shares through appraisal.”

In my view, a short-form, freeze-out merger would not be in the spirit of the South African Companies Act given its focus on the protection of the rights of minority shareholders. In wholly owned subsidiaries there are no dissenting minority shareholders, the merging parties all want the merger to take place, and no special shareholder resolution would, therefore, be required.

From a company law perspective, I, therefore, propose that section 115(4) of the Companies Act be amended to include a carve-out provision which would allow for short-form mergers amongst wholly owned companies to be excluded from the application of section 115(4). With the introduction of such a carve-out specifically limited to wholly owned companies, there are no dissenting shareholders, and one could consider removing certain of the requirements under the statutory merger process, for example requiring a special resolution to effect the short-form merger.

However, some additional requirements for a short-form merger may have to be added to the Companies Act in this regard. These would need to stipulate the specific requirements which should be less onerous than those for a regular statutory merger.

From a tax perspective, steps for a vertical short-form merger would be similar to a liquidation distribution in section 47. There is currently no corporate rule that allows for a horizontal short-form merger between two sister companies. If

¹¹²² Clark *Corporate Law* 435 – 436. Also see *Glassman v Unocal Exploration Corp* 777 A 2d 242 (Del 2001) 248 where the court held: “By enacting a statute that authorizes the elimination of the minority without notice, vote, or other traditional indicia of procedural fairness, the General Assembly effectively circumscribed the parent corporation’s obligations to the minority in a short-form merger. The parent corporation does not have to establish entire fairness, and, absent fraud or illegality, the only recourse for a minority stockholder who is dissatisfied with the merger consideration is appraisal.”

¹¹²³ *Glassman v Unocal Exploration Corp* 777 A 2d 242 (Del 2001). Also see Steinberg 2002 27 *DEL J Corp L* 489 – 492.

the government in future decides that specific regulations are to be introduced in the Income Tax Act, additional requirements may be necessary in both the Income Tax Act and the Companies Act in order to qualify for a short-form merger.

For example, in Canada¹¹²⁴ there are specific provisions for both vertical and horizontal short-form amalgamations in their Companies Act.¹¹²⁵ In addition, the Canadian Income Tax Act provides specific regulations for the tax consequences of a vertical or horizontal amalgamation.¹¹²⁶ There is a distinction between qualifying amalgamations and non-qualifying amalgamations. Qualifying amalgamations are eligible for certain tax deferrals if the requirements in section 87 of the Income Tax Act are met. In the Supreme Court judgment of *Envision Credit Union v Canada*¹¹²⁷ the court found with regard to “non-qualifying amalgamations”:

“All other amalgamations, which are sometimes called ‘statutory amalgamations’ or ‘non-qualifying amalgamations’, are outside the scope of s. 87. The tax consequences of non-qualifying amalgamations are not specified in the ITA and therefore must be determined using the other provisions of the ITA where relevant, other relevant statutes and the common law.”

Section 87 of the Canadian Income Tax Act provides that an amalgamation is a merger of two or more corporations each of which was, immediately before the merger, a taxable Canadian corporation, to form one corporate entity. A qualifying amalgamation must meet the following requirements:

- “(a) all of the property (except amounts receivable from any predecessor corporation or shares of the capital stock of any predecessor corporation) of the predecessor corporations immediately before the merger becomes property of the new corporation by virtue of the merger,
- (b) all of the liabilities (except amounts payable to any predecessor corporation) of the predecessor corporations immediately before the merger become liabilities of the new corporation by virtue of the merger, and
- (c) all of the shareholders (except any predecessor corporation), who owned shares of the capital stock of any predecessor corporation immediately before the

¹¹²⁴ Canada is specifically considered here as it is also a member of the Commonwealth and was previously a British colony. Canadian corporate law is based on the English model.

¹¹²⁵ Section 184 of the Business Corporation Act.

¹¹²⁶ Section 184 of the Business Corporation Act and s 87 of the Income Tax Act.

¹¹²⁷ *Envision Credit Union v Canada* 2013 SCC 48, 2013 3 SCR 191.

merger, receive shares of the capital stock of the new corporation because of the merger.”

As highlighted above, if an amalgamation meets the above requirements, it will be deemed a qualifying amalgamation and the transaction will qualify for tax deferrals (tax rollover relief).

In 2014, Hong Kong¹¹²⁸ introduced a court-free intragroup amalgamation in their Companies Ordinance.¹¹²⁹ Before the introduction, companies wishing to amalgamate could do so by way of a take-over, a transfer of assets, or a court-sanctioned mechanism (akin to a scheme of arrangement).¹¹³⁰ According to Lee, companies would rarely use the court sanctioned mechanisms and rather opted for the alternative options which would invariably trigger various tax implications.¹¹³¹ Following in the footsteps of the company law reforms in Singapore and New Zealand, Hong Kong introduced a court-free intragroup amalgamation under sections 678 – 686 of the Companies Ordinance.¹¹³²

The Hong Kong intragroup amalgamation only applies to wholly owned intragroup amalgamations in order to protect the interests of minority shareholders.¹¹³³ This amalgamation mechanism includes vertical and horizontal short-form amalgamations. In 2021 Hong Kong also introduced specific taxing provisions for intragroup amalgamations which allow for succession (rollover of tax consequences) if this special tax treatment was chosen by the amalgamated company.¹¹³⁴

In considering the above foreign legislation which provides tax rollover relief for both horizontal and vertical short-form mergers, it is clear that foreign jurisdictions are modernising their company law by providing a cost effective and streamlined mechanism by which companies can streamline their group

¹¹²⁸ Hong Kong was a former British colony and English law has impacted its laws. It is considered in this study as many South African companies are dual listed on both the South African and Hong Kong stock exchanges. Hong Kong was formally part of the Commonwealth.

¹¹²⁹ Hong Kong Companies Ordinance ER 1 of 2013 <https://www.elegislation.gov.hk/hk/cap622> (accessed 17 August 2023).

¹¹³⁰ Lee 2017 43/1 *International Tax Journal* 37.

¹¹³¹ *ibid* 38.

¹¹³² *ibid*.

¹¹³³ *ibid*.

¹¹³⁴ Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021; The Hong Kong Internal Revenue Department – Court-free Company Amalgamations https://www.ird.gov.hk/eng/tax/bus_cfa.htm (accessed 17 August 2023).

structures to improve operational efficiency and to reduce costs using a court-free short-form amalgamation.¹¹³⁵ Jurisdictions, such as Hong Kong and Canada also have specific tax rollover provisions which allow these short-form mergers to be tax neutral.

I should advise that if specific tax relevant requirements are necessary for a proposed short-form merger in South Africa, that a new subsection be added to section 44 of the Income Tax Act.

But before introducing a new concept in our law, it is imperative that the legislature consider examples of existing foreign legislation with these mechanisms in place – eg, New Zealand,¹¹³⁶ Canada,¹¹³⁷ Hong Kong,¹¹³⁸ and Singapore.¹¹³⁹ This should, in my view, be considered from both a company law and a tax law perspective as the idea is to create an attractive option, such as a short-form merger, in the Companies Act and appropriate tax relief in the Income Tax Act. This would allow groups of companies to use the merger mechanism in both Acts to “clean up” their group structures and rid themselves of unused (wholly owned) subsidiaries with the potential benefit of:

- a) a simpler and quicker merger process than that currently prescribed in section 113 of the Companies Act; and
- b) a tax neutral short-form merger with minimal tax-avoidance regulations.

5.3.2.2 Introducing a triangular merger

As discussed in Chapter 1, the wording of the Companies Act allows for various types of mergers, including triangular and reverse-triangular mergers.¹¹⁴⁰ These types of merger involve three companies: a target company; and on the

¹¹³⁵ Lee 2017 43/1 *International Tax Journal* 38.

¹¹³⁶ Part 13 of the New Zealand Companies Act 1993 and Sub-part FO “Amalgamation of companies” of the Income Tax Act 2007.

¹¹³⁷ Section 184 of the Business Corporation Act RSC 1985 c C-44 and s 87 of the Income Tax Act RSC 1985 c 1 (5th Supp).

¹¹³⁸ Hong Kong Companies Ordinance ER 1 of 2013 ch 622 and The Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021.

¹¹³⁹ Section 215D of the Singapore Companies Act 1967; s 34C of the Income Tax Act, 1961. In 2005 Singapore introduced a fast-track merger or short-form merger based on the New Zealand model in their Companies Act.

¹¹⁴⁰ See *Figure 1-3* and *Figure 1-4* depicting a typical triangular and reverse-triangular merger.

acquisition side, two companies: a holding company and a wholly owned subsidiary.

The advantages of having a triangular merger includes that on completion of the transaction neither the holding company nor the target company must “disappear” and the structure allows for the newly acquired business of the target company to be held in a separate legal entity.¹¹⁴¹ This is beneficial as the newly acquired company’s liabilities are ringfenced in a separate legal entity and where the businesses of the acquiring and acquired companies differ, they can be kept separate and distinct from one another.¹¹⁴²

A reverse-triangular merger has a similar structure to that of a triangular merger but sees the target company as the surviving company and the subsidiary company as the disappearing company. The reverse-triangular merger is a beneficial process if the target company has an indispensable corporate personality (goodwill, contracts, licences, et cetera.).¹¹⁴³

The broad wording of section 113(2) of the Companies Act appears to suggest that a triangular merger is permitted in company law, but this idea is limited by the wording of section 115(4) of the Companies Act as discussed in paragraphs 2.7.2 and 1.2.5 above.

Kershoff argues that, regrettably, given the current wording of section 115(4) read with section 113(2) the Companies Act itself prevents parties from engaging in triangular mergers.¹¹⁴⁴ He proposes an amendment to section 115(4) to create a carve out which will allow for triangular mergers.¹¹⁴⁵

If a recommendation is made to introduce such a carve-out measures would have to be put in place to address potential abuse and adequate shareholder protection. For example, in a triangular merger the holding company is not a direct party to the transaction – the merger is concluded between the target company and the subsidiary.¹¹⁴⁶ However, the subsidiary acts as the acquisition

¹¹⁴¹ Cassim MF (*Part 1*) 2008 1 SA Merc LJ 27 – 31.

¹¹⁴² *ibid.*

¹¹⁴³ Cassim MF (*Part 2*) 2008 20 SA Merc LJ 147 155.

¹¹⁴⁴ Kershoff 2015 SA Merc LJ 325 326.

¹¹⁴⁵ *ibid* 337.

¹¹⁴⁶ *ibid* 328 – 330.

vehicle in the merger and is generally a “shell company” formed purely for the purpose of the merger with the target company. Since the holding company is not a direct party to the transaction, its shareholders are excluded from the voting process and can, therefore, not rely on the inherent shareholder protection measures.

In reference to sources on American law regulating triangular mergers, Cassim argues that denying the holding company (the true acquirer) voting rights and appraisal rights is inappropriate and unsatisfactory.¹¹⁴⁷

But, the introduction of a carve-out can be considered from a company law perspective potentially to increase the use of the statutory merger mechanism in the Companies Act. Yet, as highlighted above, this would require thorough consideration of how this type of merger can be regulated, including as regards shareholder protection.

From a tax law perspective, section 44 specifically requires that the transaction take place between two companies – the amalgamated company, and the resultant company.¹¹⁴⁸ This means that in a typical triangular merger the parent company (the true acquirer) would most likely not be able to be party to the transaction for tax purposes as the actual transfer would be between the subsidiary and the target company. Depending on whether a forward-triangular merger or reverse-triangular merger is being implemented, one of these parties would be the amalgamated company and the other the resultant company.

The next issue that arises is that of consideration. In a typical triangular or reverse-triangular merger transaction, the consideration for the target company’s property constitutes either shares in the parent company or cash.¹¹⁴⁹ Clearly if the consideration consists of cash, the corporate rollover relief cannot apply, and one can focus the discussion of the consideration constituting shares in the parent company (which is not physically a party to this transaction). Due to the consideration taking the form of shares in the parent company, following the merger the shareholders of the target company will become shareholders

¹¹⁴⁷ Cassim MF (*Part 1*) 2008 1 SA Merc LJ 30.

¹¹⁴⁸ Section 44(1) of the Income Tax Act.

¹¹⁴⁹ Ravazzini 1996 26 *Golden Gate University Law Review* 568 – 571.

of the parent company. Section 44 would typically not apply in this scenario as it only allows for consideration to take the form of equity shares in the resultant company¹¹⁵⁰ or the assumption by the resultant company of a debt of the amalgamated company.¹¹⁵¹

The same problem exists under the other current corporate rules as the parties are not permitted to use shares in a third company as consideration. For example, in section 42 the asset-for-share transaction is defined as a transaction where a person disposes of an asset to a resident company in exchange for an equity share in *that* company.¹¹⁵² In addition, section 42 requires that at close of the day of the section 42 transaction the person must hold a qualifying interest in the company in which it acquired the shares.¹¹⁵³

This may be an important consideration for the company law legislator. Will the administrative burden of introducing a carve-out for triangular mergers in the Companies Act see sufficient uptake of this new transfer mechanism if it cannot be tax neutral?

If a triangular merger is in fact introduced in the Companies Act, it would be worth considering the corporate rollover relief provisions that other countries such as the USA¹¹⁵⁴ and Japan¹¹⁵⁵ allow for triangular mergers.

5.4 Concluding remarks

This thesis has shown that there are issues within both the Companies Act and the Income Tax Act regarding merger transactions. These issues make the sections unattractive options for effecting merger transactions.

To add to these issues, are the disconnects that arise when comparing the Income Tax Act and Companies Act as regards their provisions for mergers or amalgamation transactions.

¹¹⁵⁰ Section 44(4)(a) of the Income Tax Act.

¹¹⁵¹ Section 44(4)(b) of the Income Tax Act.

¹¹⁵² Section 42(1)(a)(i) of the Income Tax Act.

¹¹⁵³ Section 42(1)(a)(bb)(A) of the Income Tax Act.

¹¹⁵⁴ Section 368(a)(2)(D) (forward triangular mergers) and s 368(a)(2)(E) of the Internal Revenue Code.

¹¹⁵⁵ Article 2(xii) – 8 of the Corporation Tax Act 34 of 1965.

Cumulatively, this has the effect of alternative provisions in both the Companies Act and Income Tax Act being used to achieve the same outcome as a merger transaction, whilst avoiding identified risks and uncertainties associated with the merger provisions.

When reflecting on the recommendations above, it is clear that there are certain clarifications required in both Acts to address these issues. Going forward, I should encourage the legislator to include law experts in both these fields of law to consider proposed changes to the Companies Act or the Income Tax Act relating to these restructuring mechanisms. Vanistendael points out that drafters of company law are often not tax experts so changes to company law could lead to unexpected tax law consequences and *vice versa*.¹¹⁵⁶ Collaboration with experts from both fields may avoid future disconnects between these two Acts where mergers are concerned.

In addition, in order to make the merger provisions in both Acts more engaging, I recommend, amongst other things, the introduction of a short-form merger in both the Companies Act and the Income Tax Act.

This recommendation is aimed at allowing parties to clean up their group structures in a streamlined, simple, cost-effective manner, free from the requirements of a regular statutory merger or amalgamation transaction.

I further recommend the introduction of a triangular merger and reverse-triangular merger in the Companies Act. This may be influenced, however, by whether or not corporate rollover relief can be expanded to allow for tax neutral triangular and reverse-triangular mergers.

The introduction of these recommendations can also serve as an opportunity for legislators to ensure future alignment between the Companies Act and Income Tax Act and in so doing optimise the interest in the use of these sections to effect a merger.

¹¹⁵⁶ Vanistendael “Taxation of Corporate Reorganisations” based on the New Zealand model 14.

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