Tax Alert

22 January 2008

Corporate reorganisations

The 2007 Revenue Laws Amendment Act includes several changes to the corporate reorganisation provisions of the Income Tax Act. These amendments are likely to have implications for groups of companies that have undertaken or are contemplating undertaking reorganisations using the corporate reorganisation relief provisions.

Company formation and share-for-share transactions – Changes effective 1 January 2007

- Company formation and share-for-share transactions have been 'merged' into a new transaction –the "asset-for-share" transaction. Whereas company formations previously excluded financial instruments, and on the other hand share-for-share transactions applied only to financial instruments, the new asset-for-share transaction covers financial instruments and other assets in a single provision.

- Technically, the company formation transaction (s42) has been replaced by the new asset-for-share transactions (i.e. s42) and the share-for-share transaction (s43) has been deleted.

- The retroactive effective date of 1 January 2007 might be problematic for share-for-share transactions. S42 can only apply if the parties jointly elect its application – which means that the old 'company formation' and the new 'asset-for-share' are identical in this respect – whereas the s43 share-for-share transaction provisions were peremptory unless an election (only available to 'groups') was made to dis-apply them. In other words, some transactions in early 2007 might have been assumed to automatically fall into s43, whereas there is now a retroactive requirement that a specific election should have been made in order to apply the relief.

- Financial instrument holding companies – Changes effective 1 January 2007

- Relief will now be available where the transferor is a domestic or foreign financial instrument holding company (FIHC) in the case of amalgamation transactions, unbundling transactions and liquidation transactions.

- Financial instruments transferred under an intra-group transaction are no longer excluded from rollover relief.

The Tax Alert is designed to keep you abreast of developments and is not intended to be a comprehensive statement of the law. It should not be relied upon as a substitute for specific advice in considering the tax effects of particular transactions. No liability is accepted for errors or opinions contained herein.

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Deemed capital shares – Changes effective 1 October 2007

- In relation to the 3-year rule in terms of which shares are deemed to be capital under the new s9C, the holding period of the transferor is carried through to the transferee in the case of amalgamation (s44), intra-group (s45) and liquidation (s47) transactions. However, in the case of asset-for-share (s42) and unbundling (s46) transactions, the shares are treated as being acquired on transaction date for the purposes of the s9C 3-year rule.

Amalgamations – Changes effective 30 October 2007

- Rollover relief will no longer be available under s44 where the 'resultant' company (transferee) is one of the listed disqualified entities. The disqualification list refers to (for example) non-resident companies, exempt companies, public benefit organisations, and a few others.

Intra-group – Changes effective 30 October 2007

- Transactions that potentially qualify as asset-for-share transactions, unbundling transactions or liquidation transactions can no longer claim relief under the intra-group transaction provisions.

Intra-group – Changes effective 1 January 2009

- In determining what comprises a "group of companies" for the purposes of the group relief, there will now be restrictions on
  - what types of entities may form part of the group, and
  - equity shares that count toward the prescribed 70% holding requirement.

- As regards the entities that may form part of the 'group', certain entities have been specifically disqualified, like foreign incorporated companies, exempt companies, public benefit organisations, and a few others.

- As regards the 70% "equity share capital" holding requirement for the group determination, shares held as trading stock and certain shares subject to a contractual obligation or purchase or sale options, are not taken into account.

  There is therefore a window opportunity to reorganise groups that will no longer qualify for relief after 1 January 2009 (i.e. to ensure that s45 can be successfully applied to future transactions). Furthermore – in respect of past transactions – the new 'group' definition might also technically trigger 'break-up' of group, thereby crystallising a claw-back or so-called 'de-grouping' charge. Hence, the current window may be used to address future and past applications of s45.

- If a company ceases to form part of a group of companies more than 6 years after claiming relief in terms of an intra-group transaction, claw-back of the relief will not apply.

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