



Tax

Alert

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Let's talk

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Unbundling transactions: Revised proposals presented in Parliament

In brief

On 31 July, 2020, National Treasury released the Draft Taxation Laws Amendment Bill, 2020 ('the DTLAB') for public comment. One of the significant amendments proposed by the DTLAB is to section 46 of the Income Tax Act, 1962, which deals with unbundling transactions.

The proposed amendment would, if enacted as per the DTLAB, have had a significant impact on the viability of unbundling transactions, particularly in a listed context.

On 13 October, following the public comment process during which the proposed amendment was considered and discussed, National Treasury and SARS presented to Parliament's Standing Committee on Finance a Draft Response Document on the DTLAB. As per the Draft Response Document, it appears that the proposal contained in the DTLAB will be watered down somewhat. In addition, the Draft Response Document proposes a revised effective date for the proposed amendment, being the date of introduction of the Taxation Laws Amendment Bill (in this regard the DTLAB proposed an effective date of 31 July 2020).

In detail

The current rule

Currently, in terms of a limiting rule in section 46, the relief afforded by the section will not apply if, immediately after the unbundling distribution, 20% or more of the shares in the unbundled company are held by a 'disqualified person', whether alone or together with any other disqualified person who is a

connected person in relation to that disqualified person. (Generally, a 'disqualified person' is any person who will not be subject to tax on a subsequent disposal of the unbundled shares (such as, for example, non-South African residents, retirement funds, government and public benefit organisations)).



The amendment as proposed in the DTLAB

The amendment to section 46 proposed in the DTLAB removes the reference to 'connected persons' in the limiting rule. The effect is that the relief afforded by section 46 will not apply if more than 20% of the shares in the unbundled company are, immediately after the distribution, held by disqualified persons, irrespective of the level of shareholding of each of these disqualified persons and irrespective of whether or not they are connected persons. The DTLAB proposes an effective date of the date of publication of the DTLAB for public comment (i.e. 31 July 2020).

Effect of and concerns with the proposed amendment

A number of serious concerns with the proposed amendment were raised during the course of the public comment process. We set out below some of these concerns.

South African-listed groups generally have diverse shareholdings, with a significant portion comprising non-resident investors (private and institutional) and other disqualified persons. The 20% threshold would therefore almost always be satisfied for listed companies if the aggregate interest of these disqualified persons is taken into account. The result is that very few, if any, unbundlings by listed companies would, under the proposed amendment, qualify for the tax relief afforded by section 46.

A further concern with the proposal was that, practically, it would be difficult, if not impossible, to implement. This is because it would require a company to identify and determine the tax status of every beneficial owner of shares in the unbundling company (and the unbundled company) at the time of the distribution in order to determine whether an unbundling transaction qualifies for relief from tax. In a listed context, this would be impossible: the shareholding in listed companies generally changes on a regular (often daily) basis, and it is impossible to determine who all the shareholders are (let alone their tax status) on any given day, given that the shareholdings are usually held through intermediaries.

Moreover, the removal of the reference to 'connected persons' in the limiting rule effectively denies relief in respect of the entire unbundling transaction if, immediately after the transaction, an aggregate of 20% or more of the shares in the unbundled company are held by disqualified persons. This is particularly punitive, particularly where, for example,

a single disqualified person holds 21% of the shares in the unbundling company and the other 79% is held by non-disqualified persons.

Another concern is that the test for shareholding is applied to the shareholding in the unbundling company immediately after the unbundling transaction with reference to all of the shares in that company (i.e. including those that may not have been held by the unbundling company and in respect of which no relief is sought). This would have the effect that, where an unbundling company unbundles its entire shareholding (of say 60%) in a listed company, other existing shareholders (holding the remaining 40%) in the unbundled company that have nothing to do with the unbundling transaction will prejudice the relief to the unbundling company.

Finally, regarding the effective date, concerns were raised that the proposed amendment was, as per the DTLAB, to be effective on the date of the publication of the DTLAB for public comment (i.e. 31 July 2020). This would have affected unbundling transactions that are currently underway.

Revised proposals as per the Draft Response Document

In order to address the above concerns, the Draft Response Document proposes the following:

- Instead of the an 'all-or-nothing' rule that disallows tax deferral in its entirety, it is proposed that a 'pro-rata' rule will apply. In terms of this rule, tax deferral will only be disallowed in respect of any equity share that is distributed in terms of an unbundling company to any shareholder that is (1) a disqualified person; and (2) holds at least 5% of the shares in the unbundling company immediately before the unbundling transaction.
- The test for which part of the distribution is denied tax deferral under the unbundling transaction provisions will be limited to the unbundled shares that are distributed to disqualified persons (i.e. no regard will be had to any shareholder holding shares that are not held by the unbundling company and thus not distributed under the unbundling transaction).
- The revised proposals will be effective from the date of introduction of the Taxation Laws Amendment Bill, 2020. Based on the fact that, in prior years, the annual Taxation Laws Amendment Bill is introduced on the date of the Minister's Medium Term Budget Speech, it is expected that introduction will take place on 28 October 2020.

In closing

Although the Draft Response Document addressed some of the concerns raised by commentators during the course of the public comment process, there is still some uncertainty associated with the precise application of the revised proposal, which is a substantial overhaul of the initial proposal as reflected in the DTLAB.

Taxpayers are urged to keep abreast of developments in this regard.



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