



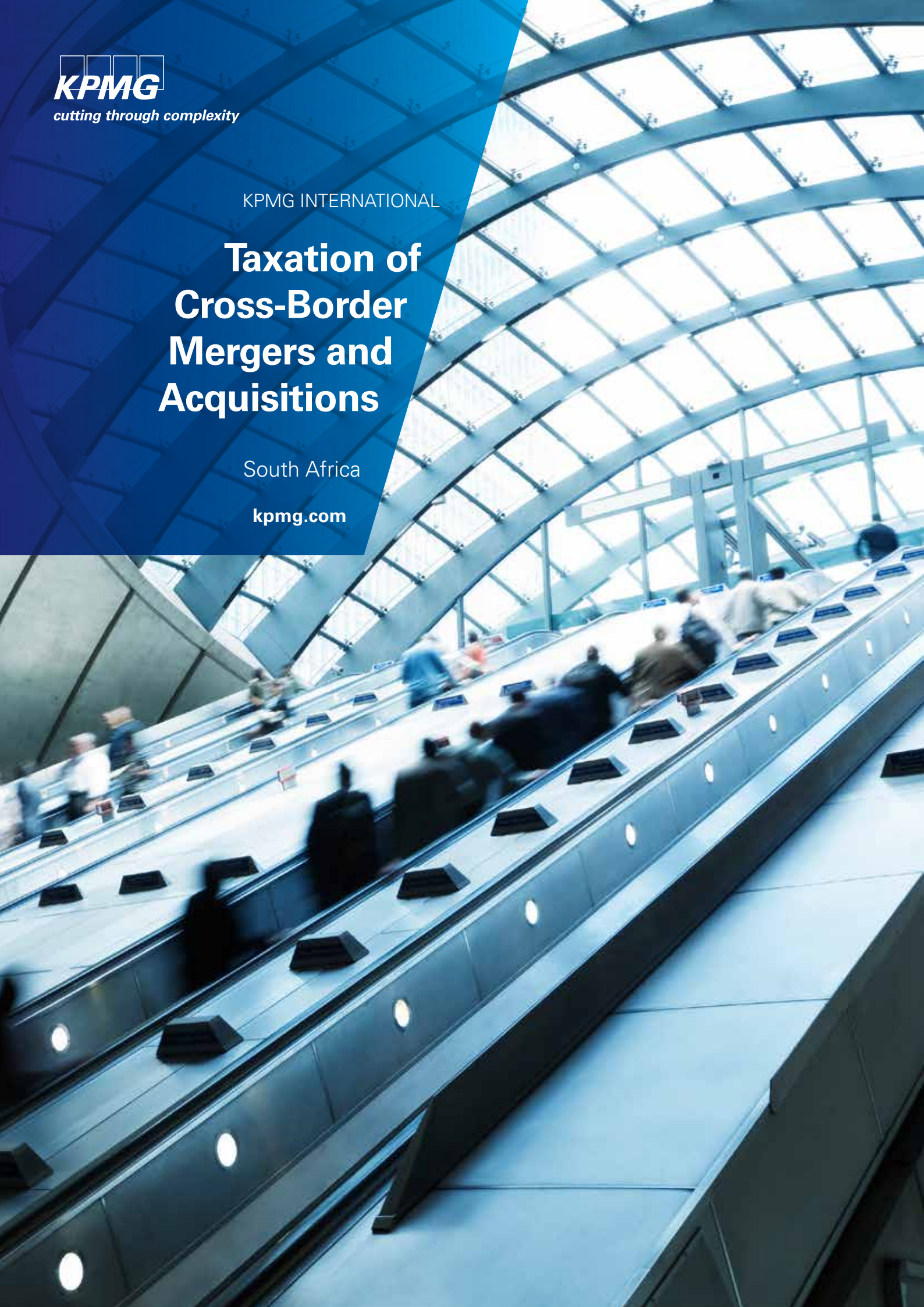
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KPMG INTERNATIONAL

# Taxation of Cross-Border Mergers and Acquisitions

South Africa

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## South Africa

### Introduction

The environment for mergers and acquisitions (M&A) in South Africa is far less clement than in previous years due to the harsh current economic climate and the global credit and liquidity crunches. These constraints have reduced the economy's growth and led to a sharp decrease in M&A activity. The fundraising appetite for domestic financial investments is increasing, however, leading to more opportunities for the growth of small and medium-sized business, which remains relatively active. Larger players are still on the look-out for quality assets with long-term growth potential.

### Recent developments

Recent changes to the South African legislative framework have significantly affected the M&A environment. Historically, there was some uncertainty regarding the appropriate method of dealing with these types of transactions from a tax and legal perspective. Currently, the South African legislator has undertaken to address this uncertainty. While a degree of uncertainty remains, the recent changes are steps in the right direction. Among the recent developments, the most pertinent are the following:

- a permanent restriction on interest deductibility in respect of certain M&A transactions, which replaces the prior pre-approval process in which the tax authorities regulated the deductibility of interest costs in respect of leverage buy-outs
- the introduction of a withholding tax (WHT) on interest and service fees paid to non-residents
- the introduction of limitations on interest deductions in respect of interest paid to, among others, non-residents
- provisions permitting the deduction of interest on debt used to acquire equity shares, where specific requirements are met.

### Withholding taxes

#### *WHT on interest*

As of 1 January 2015, a 15 percent WHT is imposed on interest received by or accrued to a non-resident (that is not a controlled foreign company (CFC)). An exemption applies in respect of any amount of interest received by or accrued to a non-resident in respect of:

- government debt instruments
- listed debt instruments

- debt owed by a bank, the South African Reserve Bank (SARB), the Development Bank of South Africa (DBSA) or the Industrial Development Corporation (IDC)
- debt owed by a foreign person or a headquarter company.

South Africa is expected to renegotiate its existing tax treaties in light of the new 15 percent WHT on interest.

#### *WHT on service fees*

As of 1 January 2016, a 15 percent WHT will be levied on service fees paid to a foreign person, to the extent paid from a source within South Africa (subject to treaty relief).

This WHT regime will apply to fees for any technical, managerial or consulting services.

#### *WHT on dividends*

A WHT on dividends applies in respect of all dividends declared and paid to non-residents on or after 1 April 2012. The dividend WHT is levied at a rate of 15 percent, subject to treaty relief.

#### *WHT on royalties*

Royalties paid by a South African entity to a non-resident are subject to a WHT of 12 percent (15 percent as of 1 January 2015).

#### *Deductibility of interest on debt used to acquire equity*

As of 1 January 2013, interest incurred on debt to finance the acquisition of the shares is deductible for tax purposes, where a South African company acquires at least a 70 percent equity shareholding in another South African operating company. An 'operating company' includes any company that carries on business continuously by providing goods or services for consideration.

#### *Interest deductibility in respect of M&A transactions*

Previously, interest on debt used to fund certain transactions (discussed below) was not automatically deductible. Approval from the South African Revenue Service (SARS) was needed in order to deduct the interest expenditure in question.

This approval process has been replaced by section 23N, which essentially limits the deductibility of interest where debt is used:

- to fund the acquisition of a business or assets from a related group entity on a tax-neutral basis
- to fund at least a 70 percent equity shareholding in a South African operating company.



In these cases, the amount of interest deductible in the year of the transaction and the following 5 years cannot exceed the sum of:

- interest received
- 40 percent of 'adjusted taxable income' (which is essentially the company's earnings before income taxes, depreciation and amortization (EBITDA)).

These rules apply to transactions entered into on or after 1 April 2014, and also to the refinancing of transactions that were subject to the pre-approval process discussed above.

Where such interest is disallowed, the disallowed portion of interest is lost and cannot be carried forward.

#### Limitations on interest paid to non-residents

As of 1 January 2015, section 23M will impose a general limitation on interest deductions where payments are made to offshore investors (i.e. creditors), or local investors who are not subject to tax in South Africa, that are in a controlling relationship with a South African resident debtor.

The limitations also will apply between a debtor and creditor who are not in a controlling relationship:

- where a creditor advances funding to the debtor and the funding was obtained from a non-resident person in a controlling relationship with the debtor (i.e. back-to-back funding)
- where a creditor advances funding based on a guarantee provided by a non-resident person in a controlling relationship with the debtor.

Essentially, where section 23M applies, the interest deduction by the debtor cannot exceed the total of:

- interest received
- 40 percent of adjusted taxable income (essentially, the company's EBITDA).

Any interest disallowed in terms of section 23M may be carried forward to the following year of assessment, and will be deemed to be interest incurred in that year.

The provisions will not apply where the creditor funded the debt advanced to the debtor with funding granted by an unconnected lending institution and the interest charged on the loan does not exceed a specified rate of interest (currently 7 percent).

## Asset purchase or share purchase

The following sections address those issues that should be considered when contemplating the purchase of either assets or shares.

### Purchase of assets

The decision of whether to acquire the assets of a business or its shares depends on the details of the transaction. The advantages and disadvantages of both purchase mechanisms need to be understood in order to effect the acquisition efficiently while complying with legislative requirements.

Asset purchases may be favored due to the interest deductibility of funding costs and the ability to depreciate the purchase price for tax purposes. However, other considerations may make an asset purchase far less favorable, including, among other things, an increased capital outlay, recently promulgated legislation that may disallow the deduction of interest (discussed above), the inability to use the tax losses of the target company, and the inability to deduct or recover VAT in respect of irrecoverable debts (unless the debts are acquired on a recourse basis).

### Purchase price

Where assets (versus shares) are disposed of, the purchase price must be allocated between the assets acquired in terms of the sale agreement on a reasonable and commercial basis. This allocation is required to determine the tax implications on the disposal of each individual asset.

When assets are purchased at a discount, no statutory rules stipulate how to allocate the purchase price among the assets. Unless the discount can be reasonably attributed to a particular class of asset, it should be allocated among all the assets on some reasonable basis.

### Withholding tax on immovable property disposals

A withholding tax (WHT) is applicable to the disposal of immovable property by a non-resident to any other person insofar as the immovable property or a right or interest therein (i.e. including an interest of at least 20 percent in a company where at least 80 percent of the market value of the company's shares is attributable directly or indirectly to immovable property, other than trading stock), is situated in South Africa, subject to certain exemptions.

In these cases, the purchaser must withhold 5 percent of the purchase price where the seller is a natural person, 7.5 percent if the seller is a company and 10 percent if the seller is a trust.

The purchaser is required to pay the WHT to SARS within 14 days from the date of withholding.

Where the purchaser is not a resident of South Africa, the time period for payment is extended to a period of 28 days. If the amount is withheld from consideration payable in a foreign currency, the amount must be converted into ZAR at the spot rate on the date that the amount is paid to SARS.

### Goodwill

No provision exists for the write-off of goodwill for tax purposes by the purchaser. Accordingly, care should be taken to allocate the purchase price, as much as possible, among the tangible assets, providing such allocations do not result in the over-valuation of any asset.

### Allowances/deductions

Certain allowances or deductions may be allowed on certain assets purchased by the taxpayer. When the assets are re-sold, the potential recoupment of allowances or deductions previously claimed on these assets should be considered. If a recoupment arises, this amount is required to be added back to the taxpayer's taxable income.

### Tax attributes

Tax losses cannot be passed on to the buyer of a business. Recoupments in the company (that is, the difference between proceeds and tax value) are taxable to the seller where the values of certain assets realized exceed their tax values.

### Value added tax

When certain intergroup income tax relief provisions apply to a transaction, the supplier and recipient are deemed to be the same person for value added tax (VAT) purposes. This implies that there is no supply for VAT purposes, provided both the supplier and recipient are registered as vendors for VAT purposes; in certain instances, the supply must be that of a going concern.

Assets or liabilities excluded from the income tax relief provisions are considered separately from a VAT perspective to determine the applicable rate of VAT to be levied, if any.

When the income tax and VAT relief provisions are applied, it was previously argued that vendors may not be entitled to recover VAT on the costs incurred on the transaction because the VAT was not incurred for the purpose of making taxable supplies. However, the SARS Draft Interpretation note, issued 31 March 2009, states that even though a transaction may not be regarded as a supply for VAT purposes, the VAT incurred on goods and services acquired for the purpose of making the supply may still qualify as input tax for VAT purposes. The test is whether the vendor would be entitled to an input tax deduction when section 8(25) of the VAT Act does not apply. If the answer is yes, input tax can still be claimed.

Where this provision does not apply and a business, or part of a business that is capable of separate operation, is sold as a going concern, VAT is payable at zero rate (that is, charged with VAT but at 0 percent). To qualify for zero rating, both the seller and the purchaser must be registered for VAT and agree in writing that:

- the business will be sold as a going concern
- the business will be an income-earning activity on the date of transfer
- the assets needed to carry on such enterprise will be sold by the supplier to the recipient
- the price stated is inclusive of zero rate VAT.

The contract can, nevertheless, provide that, should the zero rating for some reason not apply, VAT at the standard rate would be added to the selling price.

### Transfer taxes

Transfer duty is payable by the purchaser on the transfer of immovable property to the extent the sale is not subject to VAT.

A notional VAT input credit is available to a vendor on the purchase of secondhand property from a person not registered for VAT. Where secondhand goods consisting of fixed property are acquired wholly for the purposes of making taxable supplies, the input tax claimable is calculated as the tax fraction of the lesser of any consideration in money given by the vendor or the open market value. The notional input tax is claimable in the tax period that registration of the fixed property was affected in the deeds registry in the name of the vendor.

The transfer duty is payable on the value of the property is determined in the Transfer Duty Act at the following rates (for natural persons and persons other than natural persons):

- on the first 600,000 South African rand (ZAR) – 0 percent
- from ZAR600,001 to ZAR1,000,000 – 3 percent
- from ZAR1,000,001 to ZAR1,500,000 – ZAR12,000 plus 5 percent of the value in excess of ZAR1,000 001
- more than ZAR1,500,001 – ZAR37,000 plus 8 percent of the amounts in excess of ZAR1,500 001.

### Purchase of shares

Share purchases are often favored because of their lower capital outlay and the acquirer's ability to benefit from the acquisition of any tax losses of the target company (subject to the rules governing the carry forward of assessed losses). However, the inability to deduct the funding costs associated with the acquisition (except in limited circumstances as discussed above) is a significant barrier to this method.

### Due diligence reviews

It is not unusual for the vendor in a negotiated acquisition to open the books of the target company for a due diligence review by the prospective purchaser, including an in-depth review of the target's financial, legal and tax affairs by the advisors to the purchaser. The findings of such a due diligence review may result in adjustments to the proposed purchase price and the inclusion of specific warranties negotiated between the purchaser and seller in the sale agreement.

### Tax indemnities/warranties

The purchaser generally requires from the seller warranties regarding any undisclosed taxation liabilities of the company. The extent of the warranties is a matter for negotiation.

### Tax losses

Tax losses may be retained by the purchaser when the shares are purchased, unless any anti-avoidance rules apply.

### Crystallization of tax charges

South African income tax legislation provides for rollover relief on intragroup transfers of assets if certain requirements are

met. For example, the rollover is available where assets are transferred within a 'group of companies', typically comprising a 70 percent shareholding. Each of the intragroup provisions contain its own specific anti-avoidance provisions, which deem the purchaser to have disposed of and immediately reacquire the assets at their market value on the day that certain events occur. Essentially, the purchaser becomes liable for all of the tax that was deferred and effectively rolled over in the intragroup transfer.

Consequently, the purchaser should satisfy itself that it has been made aware of all prior intragroup transfers of the assets that it acquires.

### Securities transfer tax

Securities transfer tax (STT) applies to the transfer of shares in unlisted South African companies, shares listed on the Johannesburg Stock exchange (JSE), members' interests in close corporations, as well as distribution rights. STT is levied at the rate of 0.25 percent of the taxable amount (according to a prescribed formula that differs depending on whether the securities are listed).

The Securities Transfer Tax Act defines 'transfer' to include the transfer, sale, assignment, cession or disposal in any other manner of securities, or the cancellation or redemption of securities; it does not include any issue of securities. Only transfers that result in a change in beneficial ownership attract STT.

### Debt waivers

Where a debt owed by a person is reduced for no or inadequate consideration, the amount by which the debt is reduced less any amount applied as consideration for such reduction ('reduction amount') is added to income and subject to tax at 28 percent to the extent that the debt funded tax-deductible expenditure. To the extent that the debt funded the acquisition of capital assets, the tax cost of the assets is reduced by the reduction amount. If the asset was disposed of before the debt reduction, any capital loss available to the company is reduced by the reduction amount.

### Capital gains tax

Non-residents are subject to capital gains tax (CGT) only on capital gains from the disposal of certain South African property, including immovable property, an interest in such immovable property (i.e. an interest of at least 20 percent in a company where at least 80 percent of the market value of the company's shares is attributable directly or indirectly to immovable property, other than trading stock), and business assets attributable to a permanent establishment situated in South Africa. However, in line with international practice and South African tax treaties, non-residents are not liable to CGT on other assets, such as shares they own in a South African company, unless the value of the assets is attributable to immovable property situated in South Africa (this varies depending on the treaty).

### Value added tax

The supply of shares by the owner of the shares is an exempt supply for VAT purposes. Any VAT incurred on the acquisition of any goods or services for the purposes of the exempt supply is not recoverable as input tax.

## Comparison of asset and share purchases

### Advantages of asset purchases

- The purchase price (or a portion) can be depreciated or amortized for tax purposes.
- No previous liabilities of the company are inherited.
- It is possible to acquire only part of a business.

### Advantages of share purchases

- Lower capital outlay (purchase net assets only).
- Likely to be more attractive to vendor, so price is likely to be lower.
- May benefit from tax losses of target company (subject to general anti-tax avoidance rules).
- Existing contracts normally are unaffected, so the purchaser may gain the benefit of existing supply or technology contracts.
- In certain cases, interest incurred on debt to acquire equity may be deductible where certain provisions of the Income Tax Act are met, as discussed above.

### Disadvantages of share purchases

- Assumption of all liabilities that are in the target company, including tax liabilities.
- STT applicable on the higher of the market value or consideration paid for the shares is payable by purchaser.
- Depending on the transaction, no tax deduction of the funding cost may be permitted.

## Choice of acquisition vehicle

A number of options are available to a foreign purchaser when deciding how to structure the acquisition of a local resident company. The South African Income Tax Act contains special rules for asset-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions and liquidation distributions.

These provisions aim to facilitate mergers, acquisitions and restructurings in a tax-neutral manner. The rules are very specific and generally do not apply when one of the entities in the transaction is not a company.

Often the most crucial element to consider when choosing the vehicle is whether to structure the acquisition through a branch or a subsidiary. While the VAT implications of the branch and a subsidiary structure are the same, the income tax implications do differ.

### Local intermediary holding company

The incorporation of a South African intermediary holding company affords limited liability protection. The intermediary holding company may invest in various joint ventures separately rather than through one single entity. Dividends received by the intermediary company are exempt from dividend WHT, allowing funds to be pooled at the intermediary level for re-investment or distribution.

Additional administrative and regulatory costs incurred by the intermediary holding company may not be tax-deductible because the intermediary earns no taxable income. In certain instances, any expenditure incurred by the intermediary company may have to be apportioned by taking into account the nature of its income streams (if any).

### Foreign parent company

There are generally no legal restrictions on the percentage of foreign shareholding in a South African incorporated company.

Payments of royalties, management fees, dividends or interest on loans are subject to the WHT regimes (as discussed above) and to transfer pricing and thin capitalization rules.

### Non-resident intermediate holding company

The foreign intermediary may separately invest into various African countries and may also be subject to foreign domestic anti-avoidance legislation, such as CFC legislation. The intermediary would need to be established in a jurisdiction that has lower rates of WHT on dividends, interest, management fees and royalties than those stipulated in the relevant tax treaties.

Any dividends declared to the foreign intermediary are subject to WHT (dividend withholding tax), which may be reduced by a tax treaty.

### Local branch

Where a group company purchases the assets of a South African business, it may operate the business in South Africa as a branch of the foreign company (which must be registered as an external company in South Africa) or establish a local subsidiary company in South Africa.

The South African income tax system is based on taxable income. Taxable income is gross income (non-capital) received by or accrued to a resident taxpayer, less any exempt income and less all allowable expenditure actually incurred in the production of that income. Non-residents are taxed on a source basis.

Both a local subsidiary and branch are subject to a 28 percent tax rate. Branch profits are not subject to any WHT on their remittance to the foreign head office.

Resident companies are, however, subject to dividend WHT. As a local branch is not a separate entity, expenditure payable to its foreign head office for royalties, management fees and interest on loans generally is not tax-deductible in South Africa.

The Income Tax Act does provide for the deduction of expenditure and losses actually incurred outside the republic in the production of income, provided they are not of a capital nature. Where the foreign company incurs expenditure outside the republic in the production of the South African branch's income, such amounts normally are tax-deductible by

the branch. The amount of the deduction is the actual amount of expenditure incurred outside South Africa, which may not equate to the market value of the goods or services in South Africa.

The tax rates in the foreign country versus the tax rates in South Africa are an important factor in deciding whether a local subsidiary or a local branch of a foreign company would be more favorable from a tax point of view, especially as branches are not subject to dividend WHT.

An advantage of branches is that, where more than one branch operates in South Africa, the losses of one branch may be offset against the taxable income of another branch in determining the South African income tax payable. This setting-off of losses is not allowed for companies.

### External companies

Companies incorporated in other countries and conducting business in South Africa are referred to as external companies. Such companies are required by the Companies Act to register as external companies, and certain provisions of the Companies Act apply to them.

The test for whether or not a foreign company needs to register as an external company is whether the foreign company has engaged or is engaging in a course of conduct or a pattern of activities in South Africa over a period of 6 months that would lead a person to reasonably conclude that such foreign company intended to continually engage in business in South Africa. A foreign company also needs to register where it is a party to employment contracts in South Africa.

Once registered, the external company must maintain an office in South Africa, register its address with the Company and Intellectual Property Commission and submit annual returns. It is not subject to the audit or review requirements of the Companies Act.

### Domesticated companies

A foreign company may apply to transfer its registration to the South Africa from the foreign jurisdiction in which it is registered. Such a company is referred to as a 'domesticated company'. A domesticated company becomes subject to the South African Companies Act on transfer of its registration.

### Joint ventures

When acquisitions are to be made together with other parties, the choice of an appropriate vehicle is important. Generally, such ventures can be conducted through partnerships, trusts or companies. While partnerships are ideally suited for joint ventures, the lack of limited liability, the joint and several liabilities for debts, and the lack of separate legal existence limit their use. When a partnership is used, its taxable income is first determined and then apportioned between the partners in accordance with their respective interests.

From a VAT perspective, these unincorporated bodies of persons are deemed to be persons separate from their underlying partners/members and can create separate VAT registration liabilities. When using such a vehicle, it is important to set it up properly from a VAT perspective to avoid irrecoverable VAT costs.

### Choice of acquisition funding

The tax treatment of interest and dividends plays an important role in the choice between debt and equity funding. A hybrid instrument, which combines the characteristics of both debt and equity, may also be used to finance the purchase.

#### Debt

An important advantage of debt over equity is the greater flexibility it provides. Debt can be introduced from any company within a group, a financial institution or any other third party. In addition, debt can be varied as a group's funding requirements change, whereas any change in equity, particularly a decrease, can be a complex procedure.

Further, subject to the interest limitation provisions noted above and South African transfer pricing and thin capitalization provisions, the use of debt may increase an investor's return and thus be preferable to an equity contribution.

#### Deductibility of interest – foreign company

When funds in South Africa are loaned to a borrower, the interest earned by the lender, being from a South African source, is usually tax-exempt, provided certain requirements are met. The interest is subject to a WHT of 15 percent as of

1 January 2015, subject to relief under a tax treaty. Interest on foreign loan funding can be remitted abroad, provided the SARB has previously approved the loan facility, the repayment terms and the interest rate charged.

Approval from the SARB or the authorized Dealer (as the case may be) must be obtained by the South African exchange control resident before any foreign financial assistance may be accepted. This is to ensure that the repayment and servicing of loans do not disrupt the balance of payments. For loans, this entails providing full details of the loan to be received, the purpose of the loan, the repayment profile, details of all finance charges, and the denomination of the loan and the rate of interest to be charged. The loan itself does not need to be approved by the SARB for the funds to flow into South Africa, but, as already noted, the non-approval of the loan may result in restrictions on the repayment of the loan and any disinvestment from South Africa.

The SARB usually accepts an interest rate that does not exceed the prime lending rate plus two basis points in South Africa when the loan is denominated in ZAR. Where the loan is denominated in foreign currency, the SARB accepts a rate that does not exceed the relevant interbank rate plus two basis points.

The South African transfer pricing provisions should be considered where loan proceeds are provided by a non-resident creditor (as discussed above). Additionally, under legislative proposals having effect from 1 January 2016, where a debtor incurs interest on a debt provided by a creditor that is not taxable in South Africa and these parties are connected with each other, then the interest incurred by the debtor may be limited in relation to that debt. This limitation is determined with reference to the debtor's adjusted taxable income. Any portion of the non-deductible interest may be carried over to the following year of assessment.

#### Checklist for debt funding

- Transfer pricing for the interest rates charged and the level of debt introduced.
- The possibility of higher rates applying to tax deductions in other territories.



## Equity

A purchaser may use equity to fund its acquisition, possibly by issuing shares to the seller as consideration or by raising funds through a seller placing.

New share issues are not subject to STT. However, dividends paid by a South African company are not deductible for South African tax purposes.

Previously, the South African thin capitalization provisions applied where financial assistance granted by a connected person that was a non-resident or a non-resident that held at least 25 percent of the equity shares capital/voting rights in a South African company, exceeded a 3:1 debt to fixed capital ratio (calculated with reference to the proportion of equity held). If so, the excessive portion of interest was disallowed as a deduction from the taxable income of that South African company.

As of 1 April 2012, thin capitalization is now treated as part of the general transfer pricing provisions. This test no longer applies a debt-to-fixed capital ratio. Rather it is necessary to undertake an analysis to determine whether the financial assistance granted is excessive in relation to financial assistance that would have been granted had the investor and the connected person been independent persons' dealing at arm's length. These changes are intended to be compatible with the rules as set forth by the Organisation for Economic Co-operation and Development (OECD).

Non-tax reasons may exist for preferring equity, for example, where a low debt-to-equity ratio is favored. This factor is often the reason for companies choosing hybrid funding.

## Hybrids

Dividends declared from hybrid equity instruments are deemed to be interest and taxable as such. Where dividends or capital returns on the shares are hedged by a third party, the dividends declared on these shares may be deemed to be taxable (subject to certain exemptions). Otherwise, the normal tax principles relating to debt and equity apply. The provisions of the Banks Act, which regulates the issue of commercial paper, and the Companies Act, which regulates offers to the public, may need to be considered.

In certain circumstances, interest on hybrid debt instruments (i.e. debt with equity-like characteristics) may be deemed to be dividends paid (and thus not deductible in the hands of the payor).

## Discounted securities

The tax treatment of securities issued at a discount normally follows the accounting treatment. As a result, the issuer should be able to obtain a tax deduction for the discount accruing over the life of the security, provided the discount amounts to 'interest' for tax purposes. Similarly, the holder of the instrument may be subject to tax on the discount received over the life of the security.

## Deferred settlement

The period or method of payment generally does not influence the tax nature of the proceeds. The payment for a capital asset can be deferred without altering the capital nature of the proceeds. However, where the full selling price is not clearly stipulated and payment is based on a proportion of profits, an inherently capital transaction may be treated as revenue and taxed in the vendor's hands. Likewise, care should be taken not to have the sale proceeds characterized as an annuity, which is specifically taxable in South Africa.

## Share swaps

Approval from the exchange control authorities is required for the exchange of shares in cross-border mergers and amalgamations and for issues of shares on acquisition of assets. To obtain this approval, the assets and shares must be valued.

When shares are issued in exchange for an asset, South African legislation deems the value of the shares issued to equal the market value of the asset acquired. Moreover, the issuing company is deemed to acquire the asset at the market value of the shares immediately after the acquisition.

## Other considerations

### Concerns of the seller

The concerns for a seller may vary depending on whether the acquisition took place via shares or via a purchase of assets. When the assets are acquired by the purchaser, for example, capital gains tax may be levied on the capital gain realized on the disposal of the assets. Further, to the extent that any deductions were claimed against the original cost of the assets and the amount realized from the sale of the assets exceeds the tax values thereof, the seller may experience clawbacks, which it would have to include in its gross income (as defined) and would be subject to income tax at the normal rate of 28 percent.

When the seller does not receive adequate consideration for the disposal of its assets, the transaction may be subject to donations tax at the rate of 20 percent on the difference between the consideration actually given and the market value consideration.

The sale of shares also may be subject to CGT, assuming the shares were held by the seller on capital account. To the extent that the seller disposed of the shares in a profit-making scheme, the proceeds may be taxed on revenue account at a rate higher than the rate of CGT. However, the three-year holding rule in the South African Income Tax Act would deem the proceeds received on the sale of shares held for a continuous period of 3 years to be capital in nature and hence, taxed at the effective capital gains tax rate of 18.6 percent (assuming the seller is a company).

### Concerns of the purchaser

To the extent that the assets are disposed of, the assessed tax losses of the seller cannot be carried forward into the new company, so the losses would be ring-fenced in the seller and thus lost.

When the seller decides to dispose of shares, the tax losses in the company remain in the company, available for future set-off. However, when SARS is satisfied that the sale was entered into for the purpose of using the assessed loss and that, as a result of the sale, income has been introduced into the company to use the loss, the set-off of the loss may be disallowed.

### Company law

In South Africa, the operations of a company can be acquired by purchasing the business from the company as a going concern or by purchasing the company's shares. In addition, the Companies Act recognizes the following means by which mergers and takeovers of corporate entities can be effected:

- sale of a greater part of a company's assets
- scheme of arrangement (restructuring either the debt or share capital of the company)
- amalgamation or merger.

These transactions are jointly referred to as 'fundamental transactions'.

A special resolution is required to authorize a fundamental transaction. In addition, notwithstanding the approval by special resolution, the company may not implement the approval by special resolution without the approval of a court if:

- the resolution was opposed by at least 15 percent of the voting rights exercised on that resolution
- any shareholder who voted against the resolution requires the company to seek court approval
- any shareholder who has opposed the resolution has been given consent by a court to have the transaction reviewed by the court.

The court is only required to review the resolution (and not the terms of the overall transaction) and may only set aside a resolution where it is manifestly unfair to any class of shareholder, the vote was materially tainted by conflict of interest, inadequate disclosure, failure to comply with the Companies Act or the memorandum of incorporation (MOI), or there was any other significant and material procedural irregularity.

In addition to the above requirements, the acquisition of a business in South Africa, is affected by the 'takeovers and offers' provisions of the Companies Act. Takeovers are overseen by the Takeover Regulation Panel (TRP) and monitored in accordance with takeover regulations.

The TRP and takeover regulations apply to regulated companies, which include a public company, a state-owned company and a private company if its MOI provides for its application or if 10 percent or more of its shares of such private company were transferred within the previous 24 months. The takeover regulations could apply to private companies irrespective of their size, because the test depends not on the number of shareholders or the size of shareholder equity but rather on the percentage of shares transferred over a period. The Companies Act also includes provisions relating to required disclosure of share transactions, mandatory offers, comparable and partial offers, restrictions on frustrating action and prohibited dealings before and during an offer.

### Appraisal rights

The Companies Act has introduced a new concept called appraisal rights for shareholders. The appraisal rights apply where the company has:

- amended its MOI to change the rights attaching to any class of shares in a manner materially adverse to the rights of a particular shareholder
- entered into a fundamental transaction.

However, the appraisal rights do not apply where the transaction is pursuant to a business rescue plan that has been approved by the shareholders. If a shareholder (the dissenting shareholder) has notified the company that it intends to oppose any resolution for a matter referred to earlier and thereafter votes against the particular resolution, the dissenting shareholder can require the company to repurchase their shares at fair value. This right is afforded to the dissenting shareholder irrespective of the majority percentage approval obtained by the company.

The Companies Act sets out certain formal requirements that the dissenting shareholder must follow to enforce their appraisal rights.

### Financial assistance for secondary trading in company's shares

The Companies Act restricts a company from providing financial assistance for the subscription or purchase of its own shares or shares in a related or inter-related company. This restriction is wider than section 38 of the old Companies Act, which only applies to financial assistance by a company for its own shares or shares in its holding company. The Companies Act effectively applies to financial assistance for buying or subscribing for shares in the company or any other company within the group of companies of which the company is a part.

### Group relief/consolidation

South Africa's tax law does not recognize the concept of group relief, where losses made by some group companies are offset against profits made by other group companies. Rather, companies are assessed as separate entities. However, intragroup transactions may take place in a tax-neutral manner in certain circumstances, mostly relating to situations in which companies form part of the same South African group of companies (unless the foreign company has a place of effective management in South Africa). To be a group requires the companies to have a common shareholding of at least 70 percent of their equity share capital.

### Transfer pricing

The overriding principle of the transfer pricing legislation is that cross-border transactions between connected persons should be conducted at arm's-length.

Under the Income Tax Act, where connected persons conclude a cross-border agreement for the supply of goods or services (such as the granting or assignment of any right such as a royalty agreement, the provision of technical, financial or administrative services, the granting of financial assistance such as a loan), and such goods and services are not supplied on an arm's length basis, the Commissioner of SARS may adjust the price to reflect an arm's length price in determining the taxable income of any of the persons involved.

Essentially there is a focus on the overall arrangements and the profits derived from such activities. If terms or conditions made or imposed in transactions, operations, schemes, arrangements or understandings differ from the terms and conditions that would have existed between independent persons acting at arm's length and the difference confers a South African tax benefit on one of the parties, the taxable income of the parties that have benefited must be calculated as if the terms and conditions had been at arm's length. In addition, the difference being calculated is deemed to be a loan.

The transfer pricing provisions now also cover any financial assistance (i.e. debt, security or guarantee) granted between connected persons. As such, the previous legislation pertaining to thin capitalization is replaced with this arm's length test.

### Foreign investments of a local target company

South Africa's CFC legislation is designed to prevent South African companies from accumulating profits offshore in low-tax countries.

When a South African resident directly or indirectly holds shares or voting rights in a foreign company, the net income of that company is attributed to the South African resident if that foreign company is a CFC and does not qualify for any of the available exclusions. The net income of a CFC attributable to the South African resident is the taxable income of the CFC, calculated as if that CFC were a South African taxpayer and a resident for specific sections of the Income Tax Act. Consequently, both income and capital gains are attributed.

The main exemptions to these rules are the Foreign Business establishment (FBE) exemption and the so-called high-tax jurisdiction exemption (i.e. where the CFC would be subject to tax in that foreign jurisdiction at a rate of at least 21 percent). If a CFC's income and gains are attributable to an FBE (including gains from the disposal or deemed disposal of any assets forming part of that FBE), they will generally not be attributed to the South African-resident parent, subject to the application of the diversionary rules and the mobile passive income tests.

## Other regulatory authorities

### JSE listing requirements

The JSE listing requirements apply to all companies listed on the JSE and to applicants for listings. The requirements

were introduced in 1995 and have since been subject to many amendments. The requirements aimed to raise the levels of certain market practices to international standards and account for situations unique to the South African economy and culture.

Integral functions of the JSE are to provide facilities for the listing of the securities of companies (domestic or foreign), to provide users with an orderly marketplace for trading in such securities, and to regulate accordingly.

The listing requirements reflect, among other things, the rules and procedures governing new applications, proposed marketing of securities, and the continuing obligations of issuers. The requirements are intended to ensure that the business of the JSE is carried on with due regard to the public interest.

With respect to M&A, the JSE listing requirements regulate transactions of listed companies by rules and regulations to ensure full, equal and timely public disclosure to all holders of securities and to afford them adequate opportunity to consider in advance, and vote on, substantial changes in the company's business operations and matters affecting shareholders' rights.

The JSE listing requirements are numerous and may be onerous. To comply, a listed company considering a transaction with another party should assess the proposed transaction on the basis of its size, relative to that of the listed company, to determine the full extent of these requirements and the degree of compliance and disclosure needed.

### Exchange controls

No cross-border merger or acquisition should be contemplated without due consideration being given to the likely impact of the strictly enforced South African Exchange Control Regulations.

The exchange control authorities allow investments abroad by South African companies, although a case would have to be made proving, among other things, the benefits to the South African balance of payments, the strategic importance of the proposed investment, and the potential for increased employment and export opportunities. A minimum 10 percent shareholding is generally required. Under a new dispensation, JSE-listed entities may establish one subsidiary to hold African and offshore operations that is not be subject to any exchange control restrictions (various conditions must be met, including that the subsidiary be a South African tax resident.



## Remittance of income

Income derived from investments in South Africa is generally transferable to foreign investors, subject to the following restrictions:

- Interest is freely remittable abroad, provided the authorities have approved the loan facility and the interest rate is related to the currency of the loan, such as the Great British Pound Sterling at the London Interbank offered rate (LIBOR).
- Payment of management fees by a South African company to a non-South African exchange control resident company or beneficiary is subject to exchange control approval. The amount paid must be reasonable in relation to the services provided. Payments of such fees by wholly owned subsidiaries of overseas companies are not readily approved. Authorized dealers may approve, against the production of documentary evidence confirming the amount involved, applications by South African residents to effect payments for services rendered by non-residents, provided that the fees payable are not calculated on the basis of a percentage of turnover, income, sales or purchases.
- Agreements for the payment of royalties and similar payments for the use of technical know-how, patents, and copyrights require the prior approval of the exchange control authorities.
- All license agreements relating to the use of technology in manufacture are first vetted by the Department of Trade and Industry. Other license agreements are submitted directly to the exchange control authorities.
- Dividend distributions, whether from capital or revenue profits, are freely remittable abroad, provided the shares to which the dividends relate have been endorsed 'non-resident'. The non-resident endorsement can be achieved by submitting to an authorized dealer proof that funds have flowed to South Africa from abroad for the original purchase of the shares are at market value.

## Structuring the transaction

### Mergers and amalgamations

A merger or amalgamation is a transaction in which the assets of two or more companies become vested in or come under the control of one company, the shareholders of which then

consist of the shareholders (or most of the shareholders) of the merged companies. The single company that owns or controls the combined assets of the merged companies may be either:

- one of the merged companies whose share capital was reorganized to enable it to be the vehicle of the merger
- a new company formed for the purpose of the merger.

The Companies Act has introduced the concept of amalgamations or mergers, prescribing a statutory procedure for effecting mergers and amalgamations. Note, however, that the definition of 'amalgamation or merger' in the Companies Act is not aligned with the concepts of amalgamation and merger as contemplated in the Income Tax Act.

### Acquisitions

An acquisition or takeover is a transaction in which control over a company's assets is obtained by the acquisition of sufficient shares in the company to control it. The continued existence of the acquired company is not affected by the introduction of the new majority shareholder.

### Structuring and South African tax relief

The South African Income Tax Act contains special rules relating to asset-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions and liquidation distributions. The purpose of these provisions is to facilitate mergers, acquisitions and restructurings in a tax-neutral manner. The rules are very specific and generally do not apply cross-border or when one of the entities in the transaction is a trust or natural person.

- Profitable operations can be absorbed by loss companies in the acquirer's group, thereby effectively gaining the ability to use the losses (subject to general anti-tax avoidance rules).
- Interest incurred to finance an asset purchase may be deductible, subject to the interest limitation provisions and transfer pricing rules.
- Assets may be encumbered to assist in financing the acquisition.

### Disadvantages of asset purchases

- Possible need to renegotiate supply, technology and other key agreements.

- Need to change stationery and other company documentation.
- A higher capital outlay is usually involved (unless debts of business are also assumed).
- May be unattractive to the vendor, thereby increasing the price.
- Accounting profits are affected if acquisition goodwill is written-off.
- The benefit of any tax losses incurred by the target company remains with the vendor.
- Tax disallowance of trade receivables purchased without recourse when proven uncollectible.
- Registration of registerable assets and consents required for transfer of agreements and licenses.
- When the acquirer will not use the assets to make taxable supplies, VAT or transfer duty become an additional cost.
- If debts are also assumed, no tax deduction or VAT claim can be made on irrecoverable debts.
- Interest on debt funding may not be deductible.

## Comparison of asset and share purchases

### Advantages of asset purchases

- The purchase price (or a portion) can be depreciated or amortized for tax purposes.
- No previous liabilities of the company are inherited.
- It is possible to acquire only part of a business.

### Advantages of share purchases

- Lower capital outlay (purchase net assets only).
- Likely to be more attractive to vendor, so price is likely to be lower.
- May benefit from tax losses of target company (subject to general anti-tax avoidance rules).
- Existing contracts normally are unaffected, so the purchaser may gain the benefit of existing supply or technology contracts.
- In certain cases, interest incurred on debt to acquire equity may be deductible where certain provisions of the Income Tax Act are met, as discussed above.

### Disadvantages of share purchases

- Assumption of all liabilities that are in the target company, including tax liabilities.
- STT applicable on the higher of the market value or consideration paid for the shares is payable by purchaser.
- Depending on the transaction, no tax deduction of the funding cost may be permitted.

## South Africa – Withholding tax rates

This table sets out reduced withholding tax rates that may be available for various types of payments to non-residents under South Africa's tax treaties. This table is based on information available up to 31 January 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
<b>Domestic rates</b>				
<i>Companies:</i>	15	0	0 <sup>2</sup>	12
<i>Individuals:</i>	15	N/A	0	12
<b>Treaty rates</b>				
<i>Treaty with:</i>				
Algeria	15	10	10	10
Australia	15	5 <sup>3</sup>	10	10
Austria	15	5	0	0
Belarus	15	5	5/10 <sup>4</sup>	5/10 <sup>5</sup>
Belgium	15	5	10	0
Botswana	15	10	10	10
Brazil	15	10	15	10/15
Bulgaria	15	5	5	5/10
Canada	15	5	10	6/10
China (People's rep.)	5	5	10	7/10
Congo (Democratic republic)	15	5	10	10
Croatia	10	5	0	5
Cyprus	0	0	0	0
Czech Republic	15	5	0	10
Denmark	15	5	0	0
Egypt	15	15	12	15
Ethiopia	10	10	8	20
Finland	15	5	0	0
France	15	5	0	0
Germany	15	7.5	10	0
Ghana	15	5	5/10 <sup>6</sup>	10
Greece	15	5	8	5/7
Grenada	–	–	–	–
Hungary	15	5	0	0
India	10	10	10	10

	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
Indonesia	15	10	10	10
Iran	10	10	5	10
Ireland	10	5	0	0
Israel	25	25	25	0/15
Italy	15	5	10	6
Japan	15	5	10	10
Korea (rep.)	15	5	10	10
Kuwait	0	0	0	10
Lesotho	15	15	10	10
Luxembourg	15	5	0	0
Malawi	– <sup>7</sup>	–	–	0 <sup>8</sup>
Malaysia	10	5	10	5
Malta	5	5	10	10
Mauritius	15	5	0	0
Mexico	10	5	10	10
Mozambique	15	8	8	5
Namibia	15	5	10	10
Netherlands	10	5	0	0
New Zealand	15	5/15 <sup>9</sup>	10	10
Nigeria	10	7.5	7.5	7.5
Norway	15	5	0	0
Oman	0	0	0	0
Pakistan	15	10	10	10
Poland	15	5	10	10
Portugal	15	10	10	10
Romania	15	15	15	15
Russia	15	10	10	0
Rwanda	20	10	10	10
Saudi Arabia	10	5	5	10
Seychelles	10	5	0	0
Sierra Leone	–	–	–	–
Singapore	15	5	0	5



	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
Slovak Republic	15	5	0	10
Spain	15	5	5	5
Swaziland	15	10	10	10
Sweden	15	7.5	0	0
Switzerland	15	5 <sup>10</sup>	5	0
Taiwan	15	5	10	10
Tanzania	20	10	10	10
Thailand	15	10	10/15	15
Tunisia	10	10	5/12	10
Turkey	15	10	10	10
Uganda	15	10	10	10
Ukraine	15	5	10	10
United Kingdom	10/15	5	0	0
United States	15	5	0	0
Zambia	–	–	0	–
Zimbabwe	–	–	–	–

**Notes:**

- Some treaties provide for an exemption for certain types of interest, e.g. interest paid to public bodies and institutions. Such exemptions are not considered in this column.
- Effective from 1 January 2015, the rate is 15 percent.
- Provided the beneficial owner holds at least 10 percent of the capital of the company paying the dividends and the dividends are paid out of profits that have been subject to the normal rate of company tax.
- The lower rate applies to interest derived by a bank or any other financial institution and the higher rate applies in all other cases.
- The lower rate applies depending on the type of royalty.
- The applicable rate is 5 percent if the recipient is a bank.
- The treaty does not deal with the taxation of these items of income.
- Provided the royalty is actually subject to tax in the residence state.
- The 15 percent rate applies to dividends paid by New Zealand resident companies. The 5 percent rate applies to dividends paid by South African resident companies where the beneficial owner is a company holding at least 25 percent of the capital of the company paying the dividends.
- A minimum holding of 20 percent is required.

## KPMG in South Africa

### Michael Rudnicki

KPMG Services (Proprietary) Limited  
Crescent 85 Empire Road  
Parktown Johannesburg  
2193  
South Africa

**T:** +27 (11) 647-5725

**E:** michael.rudnicki@kpmg.co.za

[kpmg.com](http://kpmg.com)

[kpmg.com/socialmedia](http://kpmg.com/socialmedia)



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