South Africa

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General

1. What are recent tax developments in your country which are relevant for M&A deals?

Previously, interest incurred on debt acquired to fund acquisitions utilising the tax roll-over provisions of the Income Tax Act No. 58 of 1962 (the Act) was not automatically deductible by a purchaser, which had to apply for a directive from the South African Revenue Service (SARS) in order to obtain approval for such deduction. New interest limitation rules have been inserted into the act which provide for the limitation of the amount of interest which may be deducted by a purchaser. No directive needs to be obtained from the SARS in this regard.

With effect from 1 March 2015, a withholding tax on interest of 15% (may be reduced by the applicable DTA) is imposed on interest paid by a South African resident which is received by or accrues to a non-resident.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

South Africa is a non-member country of the OECD, however, it has a working relationship with the OECD, and collaborates with it on a variety of policy issues. South Africa is also party to various OECD instruments, including most recently, the Declaration on Automatic Exchange of Information in Tax Matters.

The Davis Tax Committee has been tasked with reviewing a number of issues relating to the South African tax system, with its terms of reference being fairly wide and including BEPS among the issues to be considered. With regard to action Plan 6 relating to treaty shopping, the Davis Committee has made the following recommendations in its Interim Report:

- The general anti-avoidance rule (GAAR) contained in sections 80A to 80L of the act should be applied to prevent tax abuse.
- Existing treaties should be renegotiated or protocols signed to clarify that they are not intended to create opportunities for non-taxation through treaty shopping.
- Limitation on benefit provisions should be included in new treaties to limit the benefits to a foreign company which can show that it has a close connection to its country of residence, e.g. a majority of its shareholders are resident in such country of residence.
- The principal purpose of interposed companies should not be to obtain a tax treaty benefit.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

a. Share deal

- The entire corporate history of the entity is assumed by the purchaser, and the purchaser would typically therefore require an in-depth due diligence review and/or comprehensive tax indemnities and warranties.
- The purchaser acquires the tax losses of the target company.
- The supply of shares is an exempt supply for VAT purposes where the purchaser and seller are registered for VAT.
- Securities Transfer Tax (STT) is payable upon the transfer of securities (which includes unlisted shares, shares listed on the JSE, as well as member's interests in close corporations) at a rate of 0.25% on the greater of the consideration given or the market value of the shares in the case of unlisted securities, and the greater of the consideration declared by the acquirer or the closing price in the case of listed shares.

- Interest incurred on debt acquired to finance the acquisition of the assets may be deductible (subject to the interest limitation provisions).

b. Asset deal

- The existing tax liabilities of the target company are not assumed by the purchaser.
- The amount allocated to the various assets would become the base cost of such assets in the purchaser's hands for CGT purposes, which would, where such base cost is high, result in lower capital gains tax implications upon the disposal of such assets (where the purchaser is subject to South African CGT).
- The purchaser may be entitled to certain allowances or deductions on certain assets which are acquired, however, where the purchaser disposes of such assets, a recoupment of allowances or deductions claimed may arise.
- VAT may be payable, thereby increasing the acquisition costs.
- The purchaser may acquire only part of the target company's business.
- Interest incurred on debt acquired to finance the acquisition of the assets may be deductible (subject to the interest limitation provisions which would apply in instances where the purchaser and the target company are connected persons).

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

None. As the purchase price would be allocated to the shares, the purchase price would be used to determine the tax cost of the shares and would have no impact on the value of the underlying assets.

5. What are the particular rules of depreciation of goodwill in your country?

No depreciation may be recognised in respect of goodwill for tax purposes, and the parties should therefore ensure that the purchase price is allocated as much as possible to other asset categories that qualify for tax deductions or allowances.

6. Are there any limitations to the deductibility of interest on borrowings?

Asset deal:

The act provides that interest will be deductible by the taxpayer where such interest is incurred for the purpose of earning taxable income in the course of trade. Where the purchaser is a trading entity and acquires the business/assets of the target company in order to derive taxable income from its operations, the interest would be deductible from its income.

Share deal:

Generally, interest incurred on debt acquired to fund the acquisition of shares would not be deductible as it would not be incurred for purposes of earning taxable income, as the dividend income earned by shareholders is generally exempt income. However, the act provides that the purchaser will be entitled to a deduction on the interest incurred for the acquisition of the shares where the target company is an "operating company" and the purchaser would, at the close of the day of the transaction, be a controlling group company in relation to the target company i.e. will hold more than 70% of the shares in the target company.

The amount of interest which may be deducted by the purchaser would be limited by the interest limitation provisions of the act, in terms of a formula which provides that the taxpayer may not deduct interest exceeding 60% of its so-called "adjusted taxable income" in any year of assessment. Any interest which is not deducted may be carried over and deducted in the following year of assessment. The interest deduction limitation would not affect the purchaser too adversely where the acquiring entity has a high "adjusted taxable income".

7. What are usual strategies to push-down the debt on acquisitions?

Typically, a South African intermediary holding company is incorporated by a foreign purchaser as a vehicle to purchase the shares in an existing target company, which newly incorporated intermediary holding company may then incorporate a subsidiary which will then acquire debt to acquire the shares of the target company. The business and/or assets of the target company are then acquired (by either the intermediary holding company or the subsidiary of the intermediary holding company) utilising the tax roll-over intra group transaction relief provisions of the act. As the debt will be incurred by the entity which will be conducting the trade, the interest incurred on the debt to acquire the assets of the target company should be deductible, subject to the interest deduction limitations (see 3 above).

8. Are losses of the target company(ies) available after an acquisition is made?

The tax losses of the target company are retained by the purchaser in the case of a share deal, but not where assets are acquired.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

STT is levied upon the transfer of shares in listed and unlisted companies at a rate of 0.25% on the greater of the market value of the share or the consideration given in the case of an unlisted share, and the greater of the consideration declared by the acquirer or the closing price in the case of listed shares. STT is payable by the company which issued the share in the case of an unlisted share or the person who transfers the share in the case of a listed share, but may in both scenarios be recovered from the person to whom the share was transferred.

VAT is not payable upon the transfer of a share as such transfer is an exempt supply.

No transfer duty would be payable as transfer duty is only levied upon the transfer of immovable property.

10. Are there any restrictions on the deductibility of acquisition costs?

Costs incurred to acquire shares/assets

Share deal:

Where the purchaser is a share trader, the shares would likely constitute trading stock and the acquisition cost will be deductible from the purchaser's income. However, the act contains a provision which deems shares to be capital assets where the taxpayer holds the shares for a period of more than three years. Should this deeming provision be applicable, the cost incurred to acquire the shares and deducted will be recouped.

Asset deal:

Where assets are acquired which qualify for deductions or allowances, the purchase price will be allocated to such assets and the purchaser will be entitled to claim such applicable deductions or allowances.

Costs incurred in relation to advisory services

Generally, fees relating to advisory services provided by financial and legal advisors etc. incurred by a purchaser would not be deductible as such fees would generally be regarded as being expenditure of a capital nature. With regard to certain finance charges, depending on the nature of the charge, such charges may be deductible. The deductibility of advisory fees would be dependent on the contractual nature of such fees. Therefore, fees incurred in relation to the funding of the transaction could possibly be structured in a manner which would render same as deductible.

11. Can VAT (if applicable) be recovered on acquisition costs?

Costs incurred to acquire shares/assets

Asset deal:

An input tax credit may be claimed by the purchaser where VAT was charged on a supply of goods or services made to the purchaser and the purchaser utilises the goods or services acquired in the course of furtherance of its VAT enterprise for the purposes of making taxable supplies.

Where the purchaser acquires the business (or part thereof) of the target company as a going concern as envisaged in section 11(1)(e) of the VAT Act, VAT will be payable at a rate of 0%. In order to qualify for the zero-rating, the following requirements must be satisfied: both parties to the transaction must be registered for VAT, and agree in writing that the business is sold as a going concern, the business be disposed of must be capable of separate operation and must be an income-earning activity on the date of transfer, the assets which are necessary for the carrying on of the business must be transferred to the purchaser, and the purchase price is inclusive of VAT at a rate of 0%.

Share deal:

No VAT liability would arise upon the acquisition of shares as the supply of shares is a supply of financial services, which is an exempt supply for VAT purposes.

Costs incurred in relation to advisory services

Asset deal

In respect of an asset deal, an input tax credit may be claimed by the purchaser where VAT was charged on a supply of services made to the purchaser, and the purchaser utilises the goods or services acquired in the course of furtherance of its VAT enterprise for the purposes of making taxable supplies.

Share deal

Generally speaking, VAT incurred on fees for advisory services are not deductible for VAT purposes as the acquisition of shares is not a taxable supply for VAT purposes. It appears as though the current policy of SARS is that they require that there must be a direct and immediate link to a taxable supply for VAT on an expense to qualify as input tax – the ultimate purpose of the expense is disregarded by SARS. However, the phrase “in the course of” in the context of the claiming of input tax, requires that there must be some relationship between the consumption or use of the service and the making of taxable supplies – no direct or immediate link to taxable supplies is necessary.

This issue remains a contentious one for VAT purposes and is guided by domestic and foreign case law.

12. Are there any particular issues to consider in the acquisition by foreign companies? *(for example non-resident taxation rules/substance rules and tax efficient exit routes)*

Foreign purchasers should consider the appropriate acquisition vehicle when structuring the acquisition of a South African target company. In this regard, the purchaser may elect to structure the acquisition through a South African intermediary holding company, a subsidiary or a branch.

The incorporation of a local intermediary holding company offers the purchaser limited liability protection (i.e. the intermediary holding company is a separate legal entity and the liability of the shareholders is limited to the value of their shares). Any dividends received by the local intermediary holding company would be exempt from income tax and dividends tax (levied at a rate of 15%), and interest received from local operating companies would not be subject to interest withholding tax (levied at a rate of 15%). The local intermediary company could therefore be utilised as a vehicle for reinvestment. However, any expenditure incurred by the intermediary holding company would likely not be deductible from its income.

The purchaser may also elect to operate through a local subsidiary or a branch of the foreign purchaser which is registered in South Africa. A South African resident company is taxed on its worldwide income at a rate of 28% (subject to the applicable DTA which may reduce the rate), while a branch, which is a non-resident, will be taxed on the income sourced in South Africa at a rate of 33% (save for where the entity constitutes a permanent establishment, in which case it will be considered a resident).

Upon the repatriation of funds to the foreign parent company, dividends declared by a subsidiary will be subject to dividends withholding tax at a rate of 15% (subject to the applicable DTA which may reduce the rate), and any interest paid to the parent company will be subject to interest withholding tax at a rate of 15% (subject to the applicable DTA which may reduce the rate). In addition, any profits repatriated to the foreign parent company by way of management and other fees will be subject to transfer pricing rules.

The repatriation of funds by a branch to its foreign parent company will not be subject to any withholding taxes.

Much like a subsidiary, the branch is entitled to a deduction of its expenditure incurred in the production of its income, however, where a foreign parent company operates more than one South African branch, the losses of one branch may be set off against the taxable income of another branch in the determination of the South African tax payable.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

Yes. Various special rules are provided for in the act to allow for tax neutral mergers, acquisitions, and restructuring. The act specifically provides for asset-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions and liquidation distributions (tax roll-over provisions), each with specific requirements which must be met by the parties to the transactions before they will be applicable.

South African has no "group tax provisions".

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

The act contains provisions relating to the taxation of Real Estate Investment Trusts (REITs). A REIT is a resident company the shares of which are listed on a recognised exchange. Essentially, the act allows for a "qualifying distribution" to be made by a REIT or a controlled company (a company that is a subsidiary of a REIT) for which the REIT or controlled company that is a resident gets a deduction from its income for the year of assessment to which that qualifying distribution relates. A "qualifying distribution" means dividends paid or payable by the REIT or a controlled company or interest incurred in respect of debentures that form part of a linked unit in that company where 75% of the gross income of that company consists of "rental income".

Amounts distributed by a REIT are fully taxable in the recipient's hands. Where such distribution is in the form of a dividend, the dividend is not exempt from income tax in the recipient's hands. This exclusion from the dividend exemption also applies in respect of dividends distributed by a controlled company.

There are a number of further specific provisions dealing with the taxation of REITs and controlled companies, including, inter alia, provisions dealing with the receipt or accruals by a REIT or a controlled company in respect of a financial instrument, the disallowance of deductions in respect of immovable property and specific rules in respect of the receipt or accrual of amounts of interest in respect of debentures forming part of a linked unit.

Sell-side

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

CGT is payable by residents upon the capital gains arising from the disposal of capital assets.

Non-residents will only be subject to CGT upon capital gains arising from the disposal of:

- immovable property situated in South Africa;
- any interest in or right to immovable property situated in South Africa, where more than 80% of the market value of the interest at the date of the disposal relates directly or indirectly to South Africa immovable property which is not trading stock ("South African property rich company"). An interest would include equity shares in a company where more than 20% is held (together with connected persons) in the company being disposed of, or a right of ownership, or a vested interest.; and
- Any asset effectively connected with a permanent establishment of the non-resident in South Africa.

Therefore, where a non-resident acquires an interest in a South African property-rich company, whether South African or foreign, such non-resident will be liable for CGT upon the disposal of such equity shares, subject to treaty relief.

Only a portion of capital gains are taxable, and at the tax rate applicable to the particular taxpayer – for example:

- 33.3% inclusion in the case of a natural person or special trust; and
- 66.6% in the case of a company.

A foreign company will thus suffer an effective tax rate of 18.64% on capital gains (66.6% x 28% corporate tax rate.

Where a non-resident disposes of immovable property in South Africa or an interest in a South African property rich company, the transaction may be subject to withholdings tax. The purchaser will have a duty to withhold a portion of the purchase consideration where tax is due on the transaction, and remit this to SARS. The amounts to be withheld amount to 5% of the purchase price where the seller is a natural person and 7.5% if the seller is a company and 10% if the seller is a trust. This amount will be allocated towards settling the CGT liability of the non-resident seller, who will be obligated to register as a taxpayer with SARS for purposes of making payment of its CGT liability

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

No.

17. Are there any local substance requirements for holding/finance companies?

There are no specific substance requirements for obtaining/maintaining South African tax residency.

Foreign incorporated companies will be tax resident in South Africa when they are effectively managed in South Africa. South African incorporated companies will automatically be South African tax resident, unless they are exclusively resident in another country by way of a DTA. It is thus important that, where the holding/finance company wants to apply South Africa treaties and that the company's place of effective management remains in South Africa. Place of effective management is not defined in the act, and is open to interpretation, but the current SARS view appear to be 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. This approach is consistent with the OECD's commentary on the term "place of effective management".

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