SOUTH AFRICA

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

The dividend-stripping provisions, aimed at preventing taxpayers from extracting the value from a company by way of tax-free dividends before disposing of the shares, have been amended with effect from 19 July 2017. In this regard, any tax-exempt dividends in excess of 15% of the market value of the shares disposed of by a shareholder, received either as part of the disposal of the shares or within 18 months prior to such disposal, shall be treated as proceeds (where the shares are held as capital assets) and taxable at an effective Capital Gains Tax (CGT) rate of 22.4%, or included in income (where the shares are held as trading stock) and subject to income tax at a rate of 28%.

Therefore, upon the sale of a company, adverse tax implications may arise for the seller where the seller's shares are repurchased by the company by way of a tax exempt dividend (i.e. a share buyback). Any dividends paid by the company to the seller within a period of 18 months prior to the disposal of the shares plus the dividends paid to the seller as part of the disposal may be taxable to the extent that such dividends exceed 15% of the market value of the shares.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

OECD BEPS actions

South Africa signed the Multilateral Instrument on 7 June 2017. South Africa has opted to include the principle purpose test, as set out in Article 7, within their Covered Tax Agreements. Additionally, South Africa will determine dual residency of a person other than an individual through a procedure of mutual agreement with the other Contracting State, as set out in Article 4, on the assumption that such other Contracting State has reserved the right for the entirety of Article 4 not to apply to its Covered Tax Agreements.

EU Parent-Subsidiary Directive and Anti-Tax Avoidance Directives

These directives are not applicable to South Africa, since it does not form part of the EU.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

Share deal

In respect the acquisition of shares, 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. In addition, the purchaser also acquires the tax losses of the target company.

No Value-Added Tax would be levied upon the sale of shares as 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, listed shares, as well as members' 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).

There is no step-up in the tax base of the assets held by the acquired company.

Asset deal

Where a purchaser acquires assets from a seller, the existing tax liabilities of the seller 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 Capital Gains Tax (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.

In addition, VAT may be payable, thereby increasing the acquisition costs.

Any 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 AMORTISATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS 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. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Asset deal:

The Income Tax Act No. 58 of 1962 (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 a taxpayer's 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 (or a company that is a controlling company in relation to the operating company).

A company will be an "operating company" where such company continuously carries on business in the course of providing goods or rendering services, and 80% of its receipts and accruals constitute "income" in its hands.

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 COMMON STRATEGIES TO PUSH-DOWN 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 6 above).

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Where financing is provided to a company by way of an equity injection, the amount will constitute the Contributed Tax Capital (CTC) of the shares. Dividends tax will not be levied on the return of such CTC to shareholders. Additionally, such return of CTC (in the absence of a repurchase of shares) will not result in a taxable capital gain for the shareholder, unless the CTC returned exceeds the tax carrying value of the shares in the hands of the investor. The amounts invested may therefore be extracted by the shareholder without adverse tax implications.

Venture Capital Companies' investors enjoy an immediate tax deduction equal to 100% of the amount invested, through an equity subscription, with no annual limit or lifetime limit. Such deduction results in a reduction of the tax carrying value of the investment in the hands of the investor. Certain provisions apply in obtaining the relief.

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?

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.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

There are no specific items to be included in the scope of a due diligence in South Africa.

11. 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.

Transfer duty is payable upon the transfer of shares in a residential property company, which is a company (other than a REIT) which holds property which constitutes residential property.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX 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 any expenditure incurred in respect of an equity share to be of a capital nature if that equity share had at the time of that expenditure been held for a period of at least 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 the 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.

13. 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 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 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 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 attributable to a taxable supply for VAT purposes as no taxable income will generally be generated from the shares acquired. 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.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

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 from the SA operating company would be exempt from income tax and dividends tax (levied at a rate of 20%), 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 as it arguably would not be incurred in the production of its income or in the course of its trade.

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 28%. Where the branch constitutes a permanent establishment, 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 20% (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.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL MANNER THROUGH MERGERS OR A TAX GROUPING?

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 relief 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".

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

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 as defined in the JSE Limited Listing Requirements. 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 prior 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.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

No.

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

No.

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

The seller of the intangible assets would be subject to CGT upon the disposal of the intangible assets.

Additionally, where such ownership of intangibles is transferred by the resident to a non-resident which is a connected person (20% or more voting rights / equity share connection) and going forward a fee (royalty) is paid by the resident, or a resident connected persons to the first resident, to the non-resident connected person, a deduction will not be allowed for such fee.

SELL-SIDE

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

CGT is payable by South African tax residents on 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 (i.e. a "property rich company"); or
- Any asset effectively connected with a permanent establishment of the non-resident in South Africa

An "interest in immovable property" would include equity shares in a company where more than 20% is held (together with connected persons) in the company being disposed of. Therefore, where a non-resident acquires an interest in a South African property-rich company, such non-resident will be liable for CGT upon the disposal of such equity shares, subject to treaty relief

Only the proceeds received upon the disposal of assets in excess of the base cost of the assets will be included in the taxpayer's income and be taxable at the CGT rate applicable to the particular taxpayer. In this regard, the following rates are applicable:

- 40% inclusion in the case of a natural person
- 80% special trust; and
- 80% in the case of a company

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 withholding 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 7.5% of the purchase price where the seller is a natural person, 10% if the seller is a company and 15% 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.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS ARE REINVESTED?

No.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING 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.

23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

No.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

The tax considerations will be dependent on the type of incentives provided to the employees. Where the employees are paid a bonus upon the successful conclusion of the transaction, such bonus would constitute "remuneration" and be included in the income of employees and taxable at their respective rates.

Should the employees be incentivized by way of being awarded shares in the company, the tax implications for the employees would be dependent on whether the employees are entitled to freely dispose of the shares for a consideration equal to the market value thereof (i.e. whether the instruments are "restricted" or "unrestricted"). In the event that the shares can be freely disposed of by the employees at market value (i.e. unrestricted), the market value of the shares on the date that the shares are awarded to the employee, less any consideration paid by the employee for the shares, would be included in the employee's income. Where the shares cannot be freely disposed of by the employee, no tax implications would arise at the time that the shares are awarded. Upon the lifting of the restrictions on the disposal of the shares, the market value of the shares on that date, less any consideration paid by the employee for the shares, would be included in the employee's income.

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