



# Good news for corporate raiders

If you borrow money to buy shares, preparatory to a take-over of the 'target' company, you will ordinarily be denied a tax deduction for the interest paid on the loans.

This flows from the fact that the income yielded by shares, in the form of dividends, is ordinarily exempt from tax in the hands of the shareholder. You should not be allowed a deduction for interest incurred in deriving exempt – as opposed to taxable – income.

But what if your purpose in buying the shares is, in short order, to strip the assets out of the target company? Can it not then be argued that the purpose behind the loan was not to acquire the shares, but to lay your hands on the income-producing assets of the target? And if the assets of the target will produce taxable income, why should the interest incurred on your borrowings then not be deductible?

There is good news for corporate raiders in the form of a 'Binding Private Ruling' – ruling number BPR 063 – issued by the South African Revenue Service (SARS) in November last year. The ruling serves to confirm that where a purchase of shares is a prelude to an 'asset strip', interest on money borrowed to acquire the shares may indeed be deductible.

However, the ruling must be approached with some caution.

The BPR regime, set out in section 76Q of the Income Tax Act, allows taxpayers to approach SARS for guidance (a ruling) in relation to the tax treatment of a particular transaction contemplated by the taxpayer. The ruling is strictly only 'binding' in relation to the particular transaction, and the taxpayer in whose favour it was issued. SARS is, in principle, not obliged to follow the same approach in relation to other (even similar) transactions and other taxpayers. BPR 063 nonetheless provides useful guidance in regard to SARS's likely response to similar transactions.

We recommend that, where practicable, a preliminary offer should first be made for the assets of the company, with a share purchase to be resorted to only in the event that an offer for the assets is rejected.

If the preliminary offer for the assets is accepted, it will take much of the anxiety and uncertainty out of the deal. If you buy shares, there are almost always concerns about contingent and or hidden liabilities of the company. If you buy the assets, these liabilities need not concern you. If the offer for the assets is rejected, having made the offer will serve as a clear signal that your fundamental intention was to acquire the assets, and not the shares. If, shortly after the take-over, you proceed to strip the assets out of the target company, you will have a clear case for the deductibility of interest.

**Wouter Scholtz, Dirk Kotzé**

# At last a proper gateway into Africa

**I**n February's Budget Speech, the Finance Minister finally responded to requests for much needed relief measures for so-called headquarter companies.

South Africa's location, infrastructure and relative stability has led us to be known as the Gateway to Africa. Despite this title however, since 1994 we have fallen behind many countries as a favourable destination to establish, manage and control headquarter companies. This is due to the fact that no measures have been implemented to encourage companies to base their head offices in SA for the purpose of trade in and around Africa. In addition to this, headquarter companies paid the same taxes as other companies and there have been no relief measures for onerous exchange control regulations. In fact the taxes, rules and regulations made conducting business from South Africa into Africa close to impossible.

One of the countries that overtook SA as a preferred headquarter jurisdiction for trade in and around Africa is Mauritius. Mauritius created an environment whereby foreign persons could set up headquarter companies relatively inexpensively. These companies were easy to administer, they had a low tax base and no exchange controls whatsoever. Mauritius soon became the darling of the Indian Ocean and due to a rush of headquarter companies, the economy benefited hugely from its newly created financial services centre in the market for headquarter jurisdictions.

Many representations were made to the South African Treasury and senior officials at SARS and it is unclear as to why relief measures were not considered at an earlier stage. Instead, SA often threatened to cancel the Double Tax Agreement with Mauritius on the basis that Mauritius was

creating and enjoying an unfair tax benefit from its headquarter company measures. It is however, never easy to unilaterally cancel a Double Tax Agreement in the face of potentially significant international retaliation.

It seems that Treasury has finally seen the light and the announcement in the Budget is to be welcomed. Full details of the relief measures will have to be analysed once the Taxation Laws Amendment Act is promulgated later this year. In the meantime, at least, we can take comfort from the fact that relief from exchange control and taxation for various types of headquarter companies located in South Africa will be considered. This step will certainly make South Africa more competitive in the race for doing business with Africa, especially given China's announcement a while ago that

Africa is considered to be its continent of choice. It is anticipated that there will be a subsequent increase in trade with Africa, but especially so between South Africa and China.

“This step will certainly make South Africa more competitive in the race for doing business with Africa.”

**Johan Troskie**



# A new wave of VAT deregistrations

**B**usinesses whose turnovers don't meet the new minimum threshold of R50 000 per annum may find themselves being summarily deregistered as VAT vendors by SARS. But in its drive to clear its books of VAT vendors that are simply clogging the system and wasting resources, it is also deregistering legitimate businesses such as some property developers and farmers that typically only breach the minimum threshold over time. This could cause significant inconvenience to these enterprises and worse, a potentially substantial VAT liability without the funds to cover it.

Take the example of a property developer who has spent significant capital developing a new residential estate. During the course of developing the property, VAT inputs have been claimed; but because the property has not yet been finished and not a single apartment has been sold, no VAT outputs have been declared. Further, if the property developer is then deregistered for VAT purposes, it is deemed to supply the assets it holds at that date. In this example, the assets would be the land and any unfinished buildings or structures. It's easy to appreciate that the VAT owing to SARS could amount to a substantial sum, at a time when the business has no

cash flow from turnover. For most developers, this is an impossible situation.

The same would hold true for farmers. Consider the wine farmer who develops a new vineyard. It takes several years before vines are ready to produce the right quality of grapes. In the interim the farmer has ploughed significant financial resources into his vineyard and paid over a great deal of VAT, which would have been claimed as inputs. But until he makes the first sale of his new wine, his turnover probably won't breach the R50 000 mark. If his enterprise is deregistered, he will be in the same situation as the property developer of having to find substantial funds to pay the deemed supply of his vineyard.

“...the VAT owing to SARS could amount to a substantial sum at a time when the business has no cash flow from turnover.”

It's important to note that some vendors have received a letter from SARS notifying them of its intention to suspend their VAT registration. But on closer reading it becomes apparent that, in fact, they have already been suspended, and have been granted three months in which to challenge the suspension before their VAT registration is

permanently cancelled. Despite the fact that the legislation caters for an extended period of time to breach the minimum turnover threshold, SARS has been issuing these letters on the grounds that turnover for the previous 12 months was less than R50 000.

**Bernard Sacks**

**IMPORTANT SARS NOTICE • IMPORTANT SARS NOTICE • IMPORTANT SARS NOTICE**

From 1 April 2010, the South African Revenue Service will **NO LONGER** accept cheque payments made out to the abbreviation 'SARS'. All cheques must be made out in full to 'South African Revenue Service'.

# SARS serious about collecting outstanding taxes

**T**he South African Revenue Service (SARS) is no longer merely threatening legal action to recover outstanding taxes; it has recently begun accessing taxpayers' bank accounts to recover its funds.

It's not yet clear just how aggressive SARS will become in applying this form of collection in the future, but current Commissioner Oupa Magashula recently indicated that it may become common practice for SARS to take drastic action against defaulting taxpayers who delay their payments to SARS.

As revealed in the recent Budget Speech, due to the current economic climate, SARS has not been able to replenish its coffers with the same vigour as in the past resulting in the revenue deficit being greater than originally anticipated. It appears that, where taxpayers default on their tax payments to SARS, SARS is now starting to approach taxpayers' bankers directly to pay over surplus funds from their clients' accounts.

In terms of section 99 of South African income tax legislation, SARS has the authority to do so.

The Commissioner has the power to declare any person to be the agent of another. This agent may be required to make payment of any taxes, interest or penalty due to the Commissioner from any of the taxpayer's funds held by the agent, or due to the taxpayer by the agent (including salary, pension or any other remuneration).

In the past, SARS practiced this primarily at the time of

issuing tax directives to employers or pension funds for the payment of lump sums. If any taxes were owed to SARS at the time of the directive being issued, SARS would withhold the outstanding tax from the lump sum amount to be paid to the taxpayer.

Whether Section 99 infringes on a person's basic human rights was addressed in the High Court in *Hindry v Nedcor Bank Limited and Another* in 1999, where Hindry contended that section 99 of the Act violated the constitution in that it infringed the taxpayer's right of privacy and the right to just administrative action.

The court held that such a course of action was reasonable and justifiable in an open and democratic society, and was, accordingly, not unconstitutional. The court further stated that the limitation of a taxpayer's rights was legitimate as collecting taxes should be seen as a benefit to South African society as a whole.

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