

## DRAFT INTERPRETATION NOTE

DATE:

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 1(1) AND 41(1)**  
**SUBJECT : DETERMINING A “GROUP OF COMPANIES” FOR PURPOSES OF THE CORPORATE RULES CONTAINED IN PART III OF CHAPTER II OF THE ACT**

### *Preamble*

In this Note unless the context indicates otherwise –

- “**section**” means a section of the Act;
- “**the corporate rules**” mean the special rules relating to asset-for-share transactions, substitutive share-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and distributions on liquidation, winding up and deregistration contained in sections 41 to 47 of Part III of Chapter II of the Act;
- “**the definition**” means the definition of a group of companies in the section indicated; and
- any word or expression bears the meaning ascribed to it in the Act.

### **1. Purpose**

This Note provides guidance on the interaction of the definitions of a “group of companies” contained in sections 1(1) and 41(1).

### **2. Background**

The corporate rules contain, amongst other things, special provisions relating to the income tax consequences (including capital gains tax consequences) of transactions between companies forming part of a “group of companies”. Under qualifying circumstances, the corporate rules make it possible for companies in such a group of companies to transfer assets between each other without adverse tax consequences.

The Act contains two definitions of a “group of companies”, namely, a general definition in section 1(1) which generally applies to the Act as a whole and a narrower definition in section 41(1) which applies to the corporate rules and a limited number of other provisions in the Act. The definition in section 41(1) excludes certain companies which might otherwise have qualified for relief under the corporate rules.

### **3. The law**

For ease of reference, the definitions in the Act which are used in this Note are reproduced in the **Annexure**.

#### 4. Application of the law

The interaction between the definition in section 1(1) and the definition in section 41(1) is partly circular in nature.

The first requirement in the definition in section 41(1) is that there must be a “group of companies” as defined in section 1(1). The proviso to the definition in section 41(1) then proceeds to exclude certain companies from consideration (paragraph i) and deems certain equity shares not to be equity shares (paragraph ii). As a result, the definition contained in section 1(1) must be re-applied to assess whether the remaining companies under consideration and the shares, which are still treated as equity shares, meet the requirements of the definition in section 1(1).

When the remaining companies and equity shares no longer meet the requirements of the definition in section 1(1), a group of companies will not exist for purposes of the corporate rules.

##### **Example – Interpretation of the definition of a “group of companies”**

###### *Facts:*

Company A was incorporated in the United States of America and is effectively managed in that country. It directly holds 100% of the equity shares in two companies that are incorporated and effectively managed in South Africa, namely, Companies B and C.

Company C directly holds 100% of the equity shares in Company D which is also incorporated and effectively managed in South Africa.

All of the shares are held on capital account and there are no contractual obligations, rights or options to purchase or sell the shares under particular circumstances.

###### *Result:*

###### *Application of the definition of a “group of companies” in section 1(1) to Companies A, B, C and D*

Companies A, B, C and D meet the requirements of the definition in section 1(1) because Company A directly holds at least 70% of the shares in Companies B and C. As such, Companies B and C are “controlled group companies” as defined. Company A indirectly holds at least 70% of the shares in Company D through another controlled group company, namely, Company C.

Companies C and D meet the definition in section 1(1) because Company C holds at least 70% of the shares in Company D.

###### *Application of the definition of a “group of companies” in section 41(1) to Companies A, B, C and D*

Company A, being a non-resident, is excluded from consideration as part of the group of companies by paragraph (i)(ee) of the proviso to the definition in section 41(1).

None of the exclusions in paragraph (i) or deeming provisions in paragraph (ii) of the proviso to the definition in section 41(1) apply to Company B, C or D.

The definition in section 1(1) must now be re-applied to these companies to determine if there is a group of companies for the purposes of the corporate rules, bearing in mind that Company A has been eliminated as part of the group.

*Application of the definition of a “group of companies” in section 1(1) to Companies B, C and D*

Neither Company B nor Company C is a controlled group company because Company A has been excluded from consideration and as a result there is no company still under consideration which alone or together with other permitted companies hold 70% or more of the shares in Company B or C. In the absence of a controlling group company and a controlled group company there is no “group of companies” as defined.

Companies C and D are a group of companies for purposes of the corporate rules because –

- Company C is a “controlling group company” while Company D is a “controlled group company”; and
- Company C satisfies the requirement that “the controlling group company” directly holds at least 70% of the equity shares in at least one “controlled group company”.

**Annexure – The law****Definition of the term “group of companies” in section 1(1)**

“**group of companies**” means two or more companies in which one company (hereinafter referred to as the “**controlling group company**”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “**controlled group company**”), to the extent that—

- (a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
- (b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;

**Definition of the term “group of companies” in section 41(1)**

“**group of companies**” means a group of companies as defined in section 1: Provided that for the purposes of this definition—

- (i) any company that would, but for the provisions of this definition, form part of a group of companies shall not form part of that group of companies if—
  - (aa) that company is a company contemplated in paragraph (c), (d) or (e) of the definition of “company”;
  - (bb) that company is a non-profit company as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008);
  - (cc) any amount constituting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received by or to accrue to that company;
  - (dd) that company is a public benefit organisation or recreational club that has been approved by the Commissioner in terms of section 30 or 30A; or
  - (ee) that company is a company contemplated in paragraph (b) of the definition of “company”, unless that company has its place of effective management in the Republic; and
- (ii) any share that would, but for the provisions of this definition, be an equity share shall be deemed not to be an equity share if—
  - (aa) that share is held as trading stock; or
  - (bb) any person is under a contractual obligation to sell or purchase that share, or has an option to sell or purchase that share unless that obligation or option provides for the sale or purchase of that share at its market value at the time of that sale or purchase;

**Definition of the term “controlled group company” in section 1(1)**

“**controlled group company**” means a controlled group company contemplated in the definition of “group of companies”;

**Definition of the term “controlling group company” in section 1(1)**

“**controlling group company**” means a controlling group company contemplated in the definition of “group of companies”;