

BINDING CLASS RULING: BCR 029

DATE: 10 May 2011

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 11(a), 23(g) AND 23E
SUBJECT : DEDUCTIBILITY OF CONTINGENT LIABILITIES TAKEN OVER WHEN BUYING THE ASSETS AND LIABILITIES OF ANOTHER COMPANY WITHIN THE SAME GROUP OF COMPANIES

1. Summary

This ruling deal with the question as to whether the buyer, when buying the assets and liabilities of another company within the same group of companies under section 44 of the Act, will be entitled to deduct the contingent liabilities taken over from the seller, when actually incurred.

2. Relevant tax laws

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling references to sections are to sections of the Act applicable as at 23 December 2010 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of section 11(a) read with sections 23(g) and 23E.

3. Parties to the transaction

The class members to whom this ruling will apply are the parties as described in point 4 below.

4. Parties to the proposed transaction

The Applicant: A company incorporated in South Africa and a subsidiary in a group of companies

Company A: A company incorporated in South Africa and a fellow subsidiary within the same group of companies as the Applicant

5. Description of the proposed transaction

The parties to the proposed transaction are part of the same group of companies (the Group). As the client base of both parties is largely similar, and for various additional commercial and administrative reasons, it is planned that the two companies will be amalgamated under section 44.

The amalgamation is expected to give rise to a host of efficiencies and synergies such as; the optimization, streamlining, improvement and simplification of business processes, the improved use of capacity of all resources (people, equipment, information technology and systems), savings in statutory and administrative costs, simplifying branding and improving marketability, the facilitation of the Group's vision to become a "one-stop shop", and the centralization of support functions such as the human resource and administrative functions. Furthermore, the proposed transaction is expected to improve the Group's BEE rating.

As part of the amalgamation process Company A will transfer, as a going concern, all its assets and liabilities to the Applicant, except the assets it elects to use to settle liabilities which have already become due and payable. In exchange for the transfer of the business of Company A to the Applicant, the Applicant will issue shares to Company A, equal to the net asset value of the said transfer for accounting purposes.

The contingent liabilities forming the subject of this ruling are reflected as provisions by Company A for accounting purposes, include employment-related obligations such as leave pay and bonuses as well as sales related obligations such as warranty obligations and contract cost overruns. Provisions for future costs, eligible for allowances under section 24C, are specifically excluded from the scope of the transfer.

These contingent liabilities, when and if they materialize, would have ordinarily been deductible when incurred by Company A were the two companies not to amalgamate.

Transaction steps

- In terms of the transfer agreement, Company A will transfer its assets and liabilities to the Applicant (apart from the excluded assets and liabilities mentioned above) as a going concern, with reference to the net asset value of the Applicant as per the audited annual financial statements as at 31 December 2010.
- Upon transfer of the assets and liabilities the Applicant will issue to Company A 1 000 ordinary shares of R1 each, issued at a premium per share, equal to the net asset value of Company A minus the par value of the new shares (R1 000) divided by 1 000 shares.

- The employees of Company A will be transferred to the Applicant. The Applicant shall employ the employees of Company A on terms which, on the whole, shall not be less favourable than their employment terms prior to the transfer. The Applicant shall only be liable for employee costs which become due and payable after the amalgamation, arising in the ordinary course of business.
- Company A will distribute the shares to be issued by the Applicant to their holding company and the BEE Shareholder, under section 44, in proportion to their shareholdings.
- Reasonable steps will be taken to wind up, liquidate or deregister Company A, as envisaged by section 44(13), within 18 months after the transfer transaction.

6. Conditions and assumptions

This ruling is made subject to the conditions that –

- no ruling is made in respect of the market value of any of the shares to be issued or any assets or liabilities;
- no ruling is made in respect of the applicability of section 103(2) to the proposed transaction; and
- this ruling does not in any way prescribe how any assessed losses are going to be dealt with.

7. Ruling

The ruling made in connection with the proposed transaction is as follows:

- The Applicant will be entitled to deduct expenditure actually incurred which relates to contingent obligations under section 11(a) read with section 23(g), provided that section 23E is complied with in respect of leave pay.
- Company A will not be entitled to a deduction of the contingent obligations transferred to the Applicant, notwithstanding any reduction of the purchase price of the business, arising from the Applicant assuming such contingent obligations.

8. Period for which this ruling is valid

This binding class ruling is valid for a period of five (5) years as from 24 December 2010.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
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