

# Companies, tax acts mismatch

**Many Income Tax Act provisions refer to laws which will change or disappear**

**PETER DACHS  
ENS**

**T**HE new Companies Act introduces changes to existing company law principles. However, what is not widely understood is the effect these changes will have on existing income tax principles.

For years the existing Companies Act has been critical in understanding the tax consequences of, amongst other things, company distributions. For example, in understanding whether a distribution made by a company is a dividend and therefore tax exempt or a

distribution of capital and therefore subject to capital gains tax in the hands of the shareholder.

However, once the new Companies Act has been introduced there will be provision made for no par value shares, which will mean these shares do not have a share premium account. It may therefore no longer be possible to identify whether a distribution which a company makes to its shareholders arises from its share premium account or, for example, from profits. It will simply be classified as a distribution from a company law perspective.

However, there is a critical tax difference between a distribution from profits (tax exempt dividends for the shareholder and secondary tax on companies for the declaring entity) and a distribution from the company's share premium account (taxable capital gain for the shareholder).

Many other provisions of the Income Tax Act also refer to company law principles which will be amended or abolished under the new Companies

Act. These include the provisions of section 8E of the Income Tax Act which recharacterises tax exempt dividends as taxable interest in respect of dividends declared on certain types of redeemable preference shares. These provisions are triggered by the declaration of a dividend. However, this reference is to the existing company law concept as opposed to the new concept of "distribution" to be introduced by the new Companies Act.

The secondary tax on company provisions also contain certain references to a company making a formal declaration of a dividend, which will fall

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away under the new Companies Act.

In addition the new Companies Act will introduce the concept of merging companies. This is not properly dealt with in terms of the Income Tax Act. When a company merges with another, for example, it is not clear from an income tax perspective whether and to what extent any party receives "proceeds". This is a critical point in determining the capital gains tax consequences of such a transaction.

There are transitional measures in the new Companies Act which provide for the retention of a share premium account. Further, the 2010 Budget mentioned that work is being done on transitional amendments to the Income Tax Act in order to deal with the new concepts introduced by the Companies Act.

However, time is running out in respect of the introduction of such amendments. It will also be difficult for the South African Revenue Service (SARS) to predict and deal with all the potential implications of the new Com-

panies Act on the Income Tax Act.

To further muddy the waters, the Income Tax Act is also undergoing major surgery in terms of the much anticipated replacement of secondary tax on companies with dividends tax. The 2010 budget did not provide a date on which this replacement will become effective. It is therefore likely that companies will have to deal with a three-stage process, namely, the current status quo with the existing Companies Act and Income Tax Act followed by the introduction of the new legislation and finally by the amendments to the Income Tax Act.

When the Companies Act is amended there will be significant mismatches between company law and tax law concepts. Companies should therefore be careful in terms of analysing the tax implications of any company distributions as well as merger and acquisition activity after the introduction of the new Companies Act and before the amendments to the Income Tax Act introducing dividends tax.