

Tax Blow to BEE deals

By Sibonelo Radebe

The sun could set on many future broad-based black economic empowerment (BEE) deals if a proposed amendment to section 45 of the Income Tax Act goes through in its current form.

Designed to flush out tax dodgers who have taken advantage of intragroup transaction tax relief, the proposed amendment threatens to make the leveraging of vendor assets in BEE deals a difficult, if not impossible affair. The leveraging of vendor (seller) assets has become an integral part of funding broad-based BEE deals. This often replaces the special purpose vehicle structure, used historically. But this type of deal requires extensive restructuring of the vendor's corporate structure if it is to benefit the BEE partner. And such a restructuring is currently relieved from tax liability under certain circumstances.



In December, section 38 of the Companies Act - which seeks to promote internally funded BEE deals - was amended. If the proposed Income Tax Act changes go through, they will contradict that amendment.

"We are worried that this amendment will have unintended consequences for BEE transactions and their funding," says Ajay Lalu, a partner at Bravura Economic Empowerment Consulting.

Section 45 of the Income Tax Act was designed to protect corporate restructuring from triggering capital gains tax or income tax where such a restructuring involves the transfer of assets within a group and where a minimum of 70% common ownership exists. National treasury has proposed to limit this tax relief to intra group schemes which transfer assets for no consideration or against the issue of a debt instrument.

The proposal seeks to exclude intra-group transfer of assets against cash consideration. Where a debt instrument is issued, repayment of the loan will trigger an additional tax liability.

"While we appreciate the anti-avoidance concern and fully support the closing of loopholes, the proposal put forward is extremely far-reaching and will have significant detrimental effects on legitimate business transactions, and in particular to BEE transactions," says Lalu.

This relief gave BEE groups access to opportunities at nominal values and is especially useful for broad-based BEE schemes that cannot access commercial funding due to a lack of lending security.

BEE deals under R100m where external funding is particularly hard to obtain will suffer the most, says Lalu. These deals, explains Lalu, are typically structured as follows:

A new entity (for example Newco), is established with nominal capital which is held 75% by the vendor company and 25% by the BEE participants. The vendor company sells its business to Newco on loan account and takes advantage of the existing section 45 relief. If the proposed amendment goes through as is, that advantage will no longer apply to BEE deals and will make such deals more expensive in tax terms. Therefore funding for BEE deals will revert to the typical SPV structures, says Lalu.

Internally funded deals already suffer from a number of disadvantages, says Lalu. These include the loan to Newco failing to meet investment criteria in relation to internal rate of return performance. Where the interest rate on the loan is set so as to ensure the IRR criterion is met, this can lead to the BEE deal being unsustainable as Newco is unable to cover the interest cost. The result is that no wealth will be created for the black participants, he warns.

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