

# **The rights and obligations of the South African Revenue Service in a business rescue process**

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## DECLARATION

I hereby declare that the mini-dissertation entitled “The Rights and Obligations of the South African Revenue Service in a Business Rescue Process”, which I herewith submit to the North-West University as completion of the requirements set for the MCom (South African and International Taxation) degree, is my own work, has been text edited, and has not already been submitted to any other University.

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## ABSTRACT

Business rescue is a new and very relevant concept in South Africa and therefore there are still a few things which may need clarity and understanding. In this study, the uncertainty of the South African Revenue Service's (SARS) ability to collect tax debt due to them by companies in financial need was investigated, as well as the limitations associated with its status as a concurrent creditor. A conclusion to this uncertainty will make it easier for stakeholders of a company undergoing business rescue to understand what the powers of SARS are with regard to collecting outstanding tax debt. The findings of this study clarified what the rights and obligations of SARS are when a company is filing for business rescue.

Therefore, the first component of this mini-dissertation's primary objective explored why SARS ranks differently in business rescue as opposed to in liquidation. The most important reason behind the ranking of SARS as a concurrent creditor is summarised in Section 7(k) of the Companies Act (71 of 2008), which states that the purpose of business rescue is to efficiently rescue and recover companies experiencing financial distress, "in a manner that balances the rights and interests of all relevant stakeholders".

Judge Fourie ruled in the case of *Commissioner of South African Revenue Services v Beginzel NO and Others* (2012) that SARS will not share the same creditor status as in liquidation. If SARS had the opportunity of enjoying preferent status, it would leave the rest of the company with very little to distribute to concurrent creditors.

The second component of the primary objective is whether business rescue is used as a collection mechanism by SARS. Although SARS is given the lowest position to raise claims, the Tax Administration Act (28 of 2011) clearly states all the powers and rights to collect tax debt due, although it must be carefully read together with the Companies Act (71 of 2008). Business rescue limits the ability of SARS to collect tax, owing to the business rescue plan binding them. Therefore, SARS cannot perform all the procedures to collect tax as it would normally be done. SARS' status as a concurrent creditor limits the dividend that would be received by them.

A comparison between South Africa's business rescue process and Australia's voluntary administration process was performed in order to determine whether there are any shortcomings in the way SARS is entitled to claim taxes due to them. The most important discovery was the fact that the Australian Taxation Office (ATO) is also experiencing a low priority ranking in the voluntary administration process. The main objectives and the aim of business rescue and voluntary administration processes are very much the same, although the ATO have the power to terminate the process if not treated fairly. SARS' position is not protected in the same manner.

**KEYWORDS:**

Business rescue; South Africa; Creditors; Preferent status; Concurrent creditor; Tax debt; Collection mechanisms; Financially distressed; South African Revenue Service; Australia; Australian Taxation Office.

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## LIST OF ABBREVIATIONS

Abbreviation	Meaning
ATO	Australian taxation Office
BEE	Black Economic Empowerment
CGT	Capital Gains Tax
CIPC	Companies and Intellectual Property Commission
DOCA	Deed of Company Arrangements
SARS	The South African Revenue Service
VAT	Value Added Tax

# CHAPTER 1: INTRODUCTION

## 1.1. Background

The economy of any country is directly dependent on companies doing business and therefore it has an enormous impact on the social well-being of a community. Short-term cash flow problems, with no certainty of overcoming it, could only last that long before it is transformed into something more serious: insolvency (Seligson, 2014). Failure of a company will thus affect much more than only the employees and creditors, which is why there was a need for provisions to help rescue a company in financial distress (Seligson, 2014). One of the most important innovations introduced to South Africa's corporate environment was Chapter 6 of the Companies Act (71 of 2008), which took effect on 1 May 2011. This chapter deals with business rescue and how to rehabilitate a company seeking to restore financial health (Seligson, 2014).

This newly introduced chapter captured the attention of business rescue practitioners, accountants, lawyers and academics; and it is a topic which is widely discussed (Levenstein & Barnett, 2013b). 'Business rescue' is defined in Section 128(1)(b) of the Companies Act (71 of 2008) as

*"...proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for–*

- (i) the temporary supervision of the company, and of the management of its affairs, business and property;*
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and*
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the*

*company's creditors or shareholders than would result from the immediate liquidation of the company".*

Business, like life, is full of choices. One of the biggest fears for any business is to become financially distressed; therefore, the early detection thereof is crucial. Non-payment of tax to SARS is the first indication of a possible need for business rescue. South African companies which experience the above-mentioned pass the test for business rescue and now have the opportunity to restructure its affairs, reorganise the business, and provide the business with a breathing space in order to overcome the situation before the '*doom of liquidation*' is faced (Govender, 2013). In a recent case, *Welman v Marcelle Props and Another* (2012), the court held that

*"... business rescue proceedings are not for terminally ill nor chronically ill close corporations, it is for ailing corporations which, given time, will be rescued and become solvent".*

This ruling emphasises that when a company is more than '*financially distressed*', other procedures are recommended for struggling companies, such as winding up or liquidation (Levenstein & Barnett, 2013a).

This is not a process to be taken lightly as it has an enormous effect on all shareholders, creditors and employees (Whittaker & Stubbings, 2015). Creditors will still be obliged to supply goods or services to the company under business rescue as was done prior to the commencement of business rescue proceedings, as the company is said to continue to operate as before, unless an agreement exists between the company and the creditor with regard to actions taken and steps followed in case of insolvency or business rescue (Levenstein & Barnett, 2013a).

Rumney (2011) is of the opinion that there are two certainties in life, death and taxes. The levying of tax is imperative for any government to survive and therefore, no matter what, SARS will always claim its portion (Keulder, 2013:125). This could cause a company to be plunged further into debt as outstanding tax obligations result in penalties and interest, increasing tax debt to enormous amounts in very little time (Keulder, 2013:137).

SARS is regarded as a preferent creditor during an insolvency process, according to Section 99 of the Insolvency Act (24 of 1936). Thus, when a company is liquidated, SARS is considered to be a high-ranking creditor. In the court case *Commissioner of South African Revenue Services v Beginzel NO and Others* (2012), the judge ruled that SARS could not be classified in business rescue in the same way in which it is classified in the ranking of creditors in insolvency where entitled to preferential treatment (Morphet, 2012). The court further held that the Companies Act (71 of 2008) does not set out statutory preferences when compared to the Insolvency Act (24 of 1936). This results in the argument that the legislature should have explicitly stated if it had intended to prefer SARS above the other creditors (Levenstein & Barnett, 2013a). Therefore, the court held that SARS will not rank as a preferent creditor in business rescue.

## **1.2. Literature review of the topic**

In insolvency circles, the word 'success' is definitely a relative term (Cowling, 2010). The importance of a working and successfully feasible business rescue system is of great importance. With this in mind, one could conclude that the main benefit of a successful business rescue is the prevention or limitation of job losses (Cliffe Dekker Hofmeyr Attorneys, 2010). This is even more relevant in a country like South Africa, where the unemployment statistics are constantly above 24% (Loubser, 2010:1). To enable economic growth and stability in this country, an effective business rescue procedure is of immense value. Having a successful business rescue procedure in place will also serve as motivation to foreign investors regarding whether to should invest or not (Loubser, 2010:2).

It is with good reason that SARS argues that a business rescue practitioner is obliged to apply to court immediately in order to discontinue the business rescue process if he/she is of the meaning that a company cannot be rescued (Levenstein & Barnett, 2013a). By 'rescuing the company' is meant the achievement of the goals contemplated by the business rescue plan, which are to restore the company to the point where it could continue on a solvent basis, or to achieve a better outcome for all shareholders than would have been the case in a liquidation process (Levenstein & Barnett, 2013a).

SARS holds a large benefit in a liquidation process as one of the first to receive the debt due as a preferent creditor (just after secured creditors). The concurrent creditors' share is only received thereafter. In some cases, this is only a small fraction of the amount of the outstanding debt due to them, if any at all. SARS will therefore most definitely encourage the initiation of the liquidation process in order to receive its share.

For a company to really benefit from business rescue proceedings, the rescue process needs to be done by a team of qualified persons. In 2012 only eight percent of the companies which applied and filed for business rescue were successful (Terblanche, 2014a). According to the Companies and Intellectual Property Commission (CIPC), this rate increased to between 12% and 15% during 2013. These figures still need to increase drastically to save jobs in an effort to contain South Africa's unemployment rate (Terblanche, 2014a).

According to Terblanche (2014a) it was found in a web survey that business rescue saved 75% of the jobs in successful business rescue processes, which is very good in comparison with what the situation would have been in a liquidation process. The protection of the employees of a company forms part of the main objectives of business rescue proceedings (ACCA, 2015).

To save a company and return it to its former profitable status is not necessarily the purpose of a business rescue regimen of a country. One of the benefits of business rescue proceedings is that, although it does not always result in a company being profitable again, the compensation which the creditors will receive will be much higher than if the business goes into liquidation (Boraine, 2002).

When comparing the Companies Act (71 of 2008) of South Africa and the Corporations Act (2011) of Australia there are a few areas which are relevant with regards to the business rescue process: commencement of the business rescue process, investigation of the company filing for business rescue and development of rescue plans and decision making (Anderson, 2008:112). The first step in both countries' any business rescue or corporate rescue process is the way in which it commences (Carrie & Yan, 2010). Before any proceedings can take place, a

business rescue practitioner or administrator must be appointed (Anderson, 2008:112). The second step, which is the investigation of whether the company under business rescue could continue its operations, takes place as soon as an appointment has been made. Questions arise, for instance, what are the affairs of the company; what sector is this company in; are there any special rules in the legislation relating to the company; and who are all the connected persons? (Carrie & Yan, 2010). As soon as all the relevant information is gathered, the practitioner or administrator can proceed with the last step, the development of a rescue plan (Anderson, 2008:128). This step could take quite a long time. Lastly, but most importantly, when the rescue plan is final, action will need to take place. The practitioner or administrator will need the company to make some drastic decisions. Some may be easy; some not so easy (Anderson, 2008:112). These decisions will need to take place in order for the results to be achieved according to plan.

These three steps are approached differently when the Companies Act (71 of 2008) of South Africa is compared to the Corporations Act 2001 of Australia. Owing to different social conditions and a different commercial environment, the legislation of both countries will operate differently, although it has much in common (Anderson, 2008:104). These social and commercial conditions could include factors which will lead to business or corporate rescue resulting from union strikes for salary increases, bankruptcy of an entity's biggest supplier, or all the new terms and conditions relating to being a Black Economic Empowerment (BEE) company (Anderson, 2008:104).

There are three collection mechanisms available to SARS where there is tax due to them. These mechanisms are divided into the following areas in the Tax Administration Act (28 of 2011): (1) recovery of tax through civil judgment; (2) recovery of tax through sequestration, liquidation and winding-up proceedings; and (3) recovery of tax debt from third parties (Companies Act (71 of 2008)). Section 169(2) of the Tax Administration Act (28 of 2011) sets a general rule which is applicable to all three collection mechanisms: the collection of outstanding tax is limited to assets under the control of a representative taxpayer (Faber, 2014).

Section 19 and paragraph 12A(1) of the Eighth Schedule of the Income Tax Act (58 of 1962) are focussed on the reduction of debt not being subject to more than

one tax, for instance Capital Gains Tax (CGT) and Income Tax. Due to these provisions which is in effect from 1 January 2013 only income tax consequences will occur by means of a recoupment as set out in Section 8(4)(a) of the Income Tax act (58 of 1962). There are Value Added Tax (VAT) implications with regard to waived or reduced debts in a business rescue which could also give rise to additional tax being payable (Kriel, 2014). The company under business rescue will, in this case, be exchanging one creditor for another, being SARS in this case (Kriel, 2014). As a result of all the tax consequences which are brought to light when debt is dismissed or reduced in a business rescue, SARS does get a portion of the future profit of the company under business rescue. This will be discussed further in Chapter 2.

### **1.3. Motivation of topic actuality**

The study will consider how business rescue is dealt with regarding the rights and obligations of SARS in the legislation (Companies Act (71 of 2008); Tax Administration Act (28 of 2011); Income Tax Act (58 of 1962); and Value Added Tax Act (89 of 1991)) of South Africa in order to determine whether uncertainties exist in the way which the South Africa's above-mentioned legislation affects the rights and obligations of SARS in business rescue. The study will be narrowed down to explore the reason why SARS is rated differently in business rescue, as well as the collection mechanisms SARS could apply. The tax implications caused by business rescue proceedings have resulted in huge debate between SARS and business rescue practitioners (Seligson, 2014). In the past decade, business rescue proceedings have become a very innovative challenge, and play an important role within the corporate environment (Seligson, 2014).

South Africa and Australia share a similar company and tax law regimen with regard to business rescue (Anderson, 2008:112). It could therefore be of great value to compare these two countries' jurisdictions, where the objectives are the same, in order to determine what the circumstances are that lead to the most successful corporate rescue (Anderson, 2008:112). South African business rescue proceedings can be compared to the equivalent in Australia in order to assist the South African legislature with indicators of matters and questions which could be carefully

considered as a result of Australia's voluntary administration process being in place for over 22 years now (Anderson, 2008:113).

Although the Companies Act (71 of 2008) is not being very clear with regard to the ranking of SARS, Judge Fourie gave clarity in the *Commissioner of South African Revenue Services v Beginsel NO and Others (2012)* case as to why SARS is ranked as a concurrent creditor. This will be used in order to determine why SARS is rated differently in business rescue from the way it is in liquidation. Precisely how the treatment of SARS differs from the treatment of the ATO when a company is in business rescue will also be investigated. Therefore, this study will focus on SARS' status as a concurrent creditor in business rescue as well as the views on business rescue as a collection mechanism.

#### **1.4. Problem statement**

Uncertainty exist as to whether the business rescue process give rise to SARS' ability to collect tax debt due to them by companies in financial need, and also what SARS' rights and obligations as a concurrent creditor entails.

#### **1.5. Research objectives**

The primary objective will be to investigate what the rights and obligations of SARS are in a business rescue process.

The primary objective will be addressed by the following secondary objectives:

- (i) to determine the role of the payment rank of SARS in a business rescue process to establish the rights SARS has to claim payment of outstanding tax debt in a business rescue process (Chapter 2);
- (ii) to determine the obligations of SARS in terms of collecting tax in a business rescue process and whether SARS is using business rescue as a collection mechanism (Chapter 3);
- (iii) to identify, by performing an overview comparison, whether there are any weaknesses in South Africa's tax legislation regarding the rights of

SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation (Chapter 4).

## **1.6. Research methodology**

In order to achieve the research objectives mentioned above, a literature review will be necessary to gather information on the payment rank of SARS in a business rescue process (to determine SARS' rights), as well as the collection mechanisms of outstanding tax (to determine SARS' obligations). It will also be necessary to determine the ATO's status in the voluntary administration process, as well as the main differences between these two processes.

Applied research refers to research being done in order to solve practical problems. When this is done through descriptive research, the problem is described systematically (Rajasekar *et al*, 2013:8). The research for this study will consist mainly of descriptive and critical analysis. This type of research forms part of ontology, which usually answers to the question '*what...?*'. Ontology consists of content analysis which indicates how something used to exist: in this case, how did SARS gain status as concurrent creditor; and what are the collection mechanisms used to recover outstanding tax debt?

Descriptive research deals with a problem or scenario that can be studied and which has an impact on the lives of the people dealing with it. This type of research can further be expanded to exploratory research because the researcher seeks to know more about a theoretical idea where not much is known (Rajasekar *et al*, 2013:10). This research method is chosen to answer the specific research question or problems in such a way that a conclusion could be made on what role the payment rank of SARS plays in a business rescue process; whether or not SARS uses business rescue as a collection mechanism; and whether any weakness exist in the rights and obligations of SARS regarding the payment rank and the collection of tax. This research method will also address the differences between the South African and Australian treatment of corporate rescue with regard to SARS and the ATO respectively. The information for this study will be mainly obtained from data such as

the Companies Act (71 of 2008) and the Tax Administration Act (28 of 2011), as well as articles written about disputes between SARS and business rescue practitioners. Court cases will also be used to gather information where the facts are not clear in the Companies Act (71 of 2008).

For the comparison with Australia published articles, theses and reports about the entire business rescue regimen will be consulted, analysed and compared. These resources will provide the necessary information to identify whether there are any weaknesses in South Africa's tax legislation regarding the rights of SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation.

## **1.7. Chapter layout**

A high-level chapter layout is given below to indicate the flow of research and the reasoning processes.

### **Chapter 1**

Background, literature review, motivation of topic actuality, problem statement, objectives, and research methodology.

The objective of this chapter is to determine the problem statement and research objectives which this study has to achieve. In addition, the research methodology (literature review) for the remainder of the study will be established. Background information will be given on the topic of this mini-dissertation.

### **Chapter 2**

In this chapter, the first secondary objective as identified in paragraph 1.5.(i) will be addressed. The aim of this chapter will be to determine the role of the payment rank of SARS in a business rescue process in order to determine what the rights of SARS entails.

### **Chapter 3**

In this chapter, the second secondary objective as identified in paragraph 1.5.(ii) will be addressed. The main focus of this chapter will be determine the obligations of SARS in terms of collecting tax in a business rescue process and whether SARS is using business rescue as a collection mechanism.

### **Chapter 4**

In this chapter, the third secondary objective as identified in paragraph 1.5.(iii) will be addressed by performing an overview comparison between South Africa and Australia to identify whether there are any weaknesses in South Africa's tax legislation regarding the rights of SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation when engaged in a business rescue process.

### **Chapter 5**

Chapter 5 will consist of a summary of the findings, conclusions, suggestions for future research, and limitations.

## CHAPTER 2: ROLE AND THE RANKING OF THE SOUTH AFRICAN REVENUE SERVICE

### 2.1. Introduction

As a result of an increasing growth in the interest in business rescue, it is relevant to determine what exactly SARS' rights is in the business rescue process. Many companies that file for business rescue bring about court cases, and with each judgment, SARS' rights in the process become clearer.

In this chapter the first secondary objective will be addressed, as identified in paragraph 1.5.(i) which will be to determine the role of the payment rank of SARS in a business rescue process to establish the rights SARS has to claim payment of outstanding tax debt in a business rescue process.

### 2.2. Meaning of 'financially distressed'

In order to understand the role of the payment rank of SARS when a company files for business rescue, careful attention must be given to the first element which is necessary for a business rescue process to commence. It is of high importance to understand the meaning of the term '*financially distressed*' in business rescue proceedings. These are clearly set out in Chapter 6 of the Companies Act (71 of 2008), which will be applied when a company is experiencing financial distress. According to the Companies Act (71 of 2008) (Section 128(1)(f)), '*financially distressed*', in reference to a particular company at any particular time

*"... means that it appears to be reasonably unlikely that the company will be able to pay all of its debts as it falls due and payable within the immediately ensuing six months; or it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months".*

The first part of the test is not very complicated. A company will be financially distressed if it is reasonably likely that the company will not be able to pay all of its debt within the following six months and not meet its promises to creditors (Erasmus,

2014). By '*reasonably likely*' is meant that there must be grounds on which to conclude whether it is possible for a company to pay its debt within the following six months. It will therefore be necessary to make an estimate and forecast based on the figures of the company as presented on the statement of financial position (Erasmus, 2014). The second part of the definition deals with factual insolvency versus commercial insolvency (Erasmus, 2014). Many argue that the first part deals with commercial insolvency and the second part with factual insolvency, which is the balance sheet-test that regards a company as insolvent if company's liabilities exceed its assets and the company is are experiencing a tight cash situation (Erasmus, 2014). Thus, for a company to file for business rescue, it will have to comply with the definition of '*financially distressed*'. If a company cannot be relieved from financial distress, this could cause the company to be liquidated.

### **2.3. The role of SARS in the objective of business rescue**

The Companies Act (71 of 2008) which took effect on 1 May 2011, brought about the new business rescue provisions which are now one of the most important and highly discussed topics regarding the financial wellbeing of a company or close corporation (ACCA, 2015). Sections 128 to 154 of the Companies Act (71 of 2008) provide the workings and detail of a business rescue process which are applicable to companies which are financially distressed, in other words, companies which are not yet insolvent or filing for liquidation (ACCA, 2015). The Companies Act (71 of 2008) states the following in Section 7(k):

*"The purpose of this act is to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders".*

This more or less summarises the essence of the purpose of business rescue and the reason it has been provided for in the Companies Act (71 of 2008) (Seligson, 2014).

The more active SARS is in the business rescue process, the better the chances of ensuring the maximum recovery of the debt due (Govender, 2013). Therefore, it is

clear that SARS should actually assist in rescuing the financially distressed company and, together with that, save employees' jobs in order to reduce unemployment, which has an enormous negative effect on South Africa's economy and the viability of new companies (Levenstein & Barnett, 2015). If SARS could realise that such a mind shift could ensure a sustainable business rescue environment and together with that have a positive effect of benefiting the economy, it could result in external investment by companies supporting the financially distressed company (Govender, 2013). From the date of inception of the business rescue proceedings, there have been a significant number of companies which have applied for business rescue. Because of that, the total number of compulsory liquidations have drastically decreased (Levenstein, 2012). According to court decisions recently, it has come to light that the business rescue procedures are far better favoured than the whole liquidation process (Levenstein, 2012).

Although it seems easy just to take part in the business rescue process set out in the Companies Act (71 of 2008), it is unfortunately also experiencing opposition, which could derail all the efforts of a business rescue practitioner (Govender, 2013). A good example is when a company has a creditor who owns the majority of the claims and then votes against the implementation of the business rescue plan. All other creditors then suffer the consequences, although it could have been in their favour (Govender, 2013). This could effect in a secured creditor choosing rather to claim to its debt by way of the security held and therefore not supporting or voting in favour of the business rescue plan (Govender, 2013).

The primary objective of the business rescue provisions provided for in the Companies Act (71 of 2008) is to attempt to save the company as a going concern and maximise the company's chances of existence on a solvent basis (ACCA, 2015). If the aforementioned is not entirely feasible, the secondary objective will be to provide the shareholders and creditors with a return which will be much higher in the long run than it would have received if the company had been undergoing liquidation (ACCA, 2015). The implementation of a business rescue plan is supposed to deliver better proceeds for the creditors than would have been the case in a liquidation process (Levenstein & Barnett, 2013b).

The reason for the business rescue proceedings forming part of the new Companies Act (71 of 2008) is to try to avoid liquidation and rather restore companies to a profitable state (ACCA, 2015). Section 135 of the Companies Act (71 of 2008) could be examined in order to determine the hierarchy of preference of all the creditors of a company in business rescue (Seligson, 2014). There is no doubt that SARS could be a creditor of a company during a business rescue process and therefore are entitled to share in the rights as stipulated in Section 145 of the Companies Act (71 of 2008) (Seligson, 2014).

#### **2.4. The ranking of SARS during liquidation**

The ranking of SARS in a liquidation process will be compared to its ranking in a business rescue process because SARS uses its status in the ranking order of the liquidation process in order to enforce where to be ranked in a business rescue process. The Insolvency Act (24 of 1936) considers SARS a preferent creditor during the insolvency or liquidation process, which gives SARS an "*automatic legislative entrance*" to be a creditor whose claim ranks high (Govender, 2013). SARS would like to be ranked the same in business rescue as in a liquidation process owing to the ranking of creditors in a liquidation being set out as follows according to the Insolvency Act (24 of 1936), Sections 96 -103:

- (i) First of all, the costs and expenses of the liquidator must be paid before any other class of creditors (Sections 96-98).
- (ii) Secured creditors hold the benefit of a security interest over some of the assets of a company and are first in line to receive a share of the proceeds after some expenses have been paid (Sections 99-102). If a secured creditor does not receive its claim in full, the remaining balance is considered to be a concurrent claim (Katz, 2008).
- (iii) Preferent creditors are entitled in the event of insolvency to receive a preferential right to payment after the secured creditors (Govender, 2013). These creditors get paid from the proceeds of unencumbered assets in an order which is set out in the Insolvency Act (24 of 1936) (Sections 99-102). This class of creditor includes SARS, and

employees' remuneration up to a certain prescribed amount; a person holding a general notarial bond ranks the lowest (Katz, 2008).

- (iv) If there are any proceeds left, the concurrent creditors are last in line, and are ranked equally. These creditors share in the free residue, and if it is insufficient to cover the claims (which is usually the case), a part by way of a dividend will be received (Section 103). These creditors could even end up paying into the insolvent estate.

Because SARS is a preferent creditor in a liquidation or during winding up, it has often left the rest of the estate with very little to distribute to concurrent creditors (Cliffe Dekker Hofmeyr Attorneys, 2013). It is for exactly this reason that several court cases have emerged to address the '*ranking*' issue since the inception of business rescue. The mere fact that SARS is a preferent creditor during liquidation does not mean that it could be entitled to preferent status in business rescue.

## **2.5. Tax implications of business rescue**

SARS' role in a business rescue process is of cardinal importance; a vote for the business rescue plan is therefore much needed to compensate all creditors within a reasonable time. Because SARS could be a major creditor in the business rescue process it will be necessary to look at the tax implications caused by these proceedings, which will emphasise why SARS would want its position to be as beneficial as possible.

There are several tax implications which arise from business rescue procedures, although there are specifically created provisions in the Companies Act (71 of 2008) to assist companies in financial distress (Terblanche, 2014b). These tax implications could cause less potential for business rescue procedures to be successful and therefore some companies may even experience being in a worse position than before the procedures (Van der Berg, 2013). The business rescue procedures are mainly implemented to provide a solution to financially distressed companies, not to create further tax liabilities (Terblanche, 2014b).

The discharge or waiving of debts goes hand-in-hand with tax consequences for a financially distressed company. A business rescue practitioner will provide for the discharge of debt in the business rescue plan of the company involved (Cliffe Dekker Hofmeyr Attorneys, 2011). When a business rescue process is in progress, claims against the company undergoing business rescue could be suspended for the duration of the proceedings; in other words, the debt is waived until there is a conclusion regarding the proceedings (Cliffe Dekker Hofmeyr Attorneys, 2011). Thus, when the business rescue plan has been approved, no creditor is entitled to force a company under business rescue to pay the outstanding debt which was due before the business rescue process commenced (Cliffe Dekker Hofmeyr Attorneys, 2011). The suspension of the debt of creditors does not lead to negative tax implications because the debt is not completely being waived, as would be the case with the discharging of debt (Cliffe Dekker Hofmeyr Attorneys, 2011).

The different tax implications resulting from business rescue is therefore considered below.

### **2.5.1. Value Added Tax implications (VAT)**

The first tax implication is value added tax (VAT), which arises from waived or reduced debt in the ordinary course of business. If a compromise with creditors results in the reduction of debt, it will trigger VAT if the reduced debt gives rise to input VAT which has previously been deducted (Van der Berg, 2013). The VAT treatment which applies on creditors is straightforward. According to Section 22(1) of the Value Added Tax Act (89 of 1991), if the creditor has already accounted for output VAT on the debts which are now written-off, he input VAT could be claimed. The treatment for the debtor works a bit differently; the debt being written off could in fact give rise to additional VAT, and this can result in the company trading one creditor who has written off his debt for a creditor who needs to be paid (Kriel, 2014). Thus, if the company under business rescue has already claimed input VAT on the reduced debt, it will now become liable to account for output VAT on the reduced debt.

This is not the only VAT liability which arises when debt amounts are reduced. According to Section 22(3)(b) of the Value Added Tax Act (89 of 1991) the debtor (company under business rescue) could also be required to account for and pay output VAT if the debt is not paid within twelve months after it was incurred, but only on debt on which input VAT has already been claimed. Section 22(3A) of the Value Added Tax Act (89 of 1991) results in this twelve-month claw-back rule not applying on debt between companies that form part of the same group. Section 22(6) of the said Act also limits the right a company has to claim bad debt owing by another company in the same group.

The debt which a creditor will write off as a result of a compromise with the company under business rescue, will occur only after the effective date of the business rescue process, and the inclusion of the VAT liability in all the other tax debts owed to SARS arising from the claw-back is not allowed by current legislation (Kriel, 2014). SARS has indicated in the proposal documentation which was issued with the Budget Speech in February 2014 that it is considering amending the legislation regarding VAT as well as other taxation obligations where harsh effects are caused on companies undergoing business rescue proceedings (National Treasury, 2014).

It must be kept in mind that this was only a proposal, and until our legislation is actually changed, companies that file for business rescue will unfortunately be faced with these negative tax consequences. Hopefully SARS will not only amend the legislation very soon, but also provide for the amendments being backdated for additional taxes which arose after companies implemented the business rescue procedures (Kriel, 2014).

### **2.5.2. Income tax implications**

Secondly, for income tax purposes, the tax consequences will be determined only if the amount owed to a creditor by a company under business rescue was used to fund any business expenditure and triggered an allowance or deduction (Seccombe, 2013). This could include buying a depreciable asset or trading stock on which a company receives an allowance that reduces taxable income. Companies undergoing business rescue often have an assessed loss which could absorb some

tax consequences, but such an assessed loss must rather be used when the company starts to generate a profit again while getting back on its feet (Terblanche, 2014b). Sections 19 and 8(4)(a) of the Income Tax Act (58 of 1962) provide that if debt is reduced or waived, the company must first use its assessed loss, if any, and then recoup the rest of the amount (Seccombe, 2013).

### **2.5.3. Capital Gains Tax implications (CGT)**

Lastly, it is set out in paragraph 12A of the Eighth Schedule to the Income Tax Act (58 of 1962) that if a debt owed by a debtor is waived or reduced by a creditor for no consideration or consideration less than the face value of the debt, the company under business rescue will not be obliged to pay CGT on the gain made. When a creditor discharges debt owed to him by a company under business rescue, this debt cannot be claimed on rehabilitation of the company (Cliffe Dekker Hofmeyr Attorneys, 2011). It is with great relief that the CGT rules were amended from 1 January 2013 which prevents the recoupment of the same amount as well as the reduction of the base cost of any asset under more than one provision when debt is reduced. These provisions ensure that no double taxation on the same reduction amount occur (Retief, 2015).

### **2.5.4. Conclusion on tax implications**

All the above tax consequences could take its toll when a company receives debt relief. Due to these tax implications, which are brought about when a company files for business rescue, it can be concluded that SARS will also benefit when voting for the business rescue plan and not only these companies. Although non-declaration or non-payment may sound like a better option when a company is suffering under business rescue, this must not be a route to take because of the harsh penalties and interest which could also be triggered (Van der Berg, 2013). For business rescue to succeed in South Africa and be helpful to businesses experiencing financial distress, it is going to be of utmost importance that some of our tax acts need to reform (Van der Berg, 2013). Although these tax consequences create an obligation to pay tax, SARS must take into account that this will occur only once the financial growth of the company starts to increase. The reason for setting out the tax consequences was to

explain the relevance of SARS in a business rescue process. It is impossible for these provisions to take place without SARS being affected or being part of the process.

## **2.6. The ranking of SARS in business rescue**

Section 135 of the Companies Act (71 of 2008) stipulates the order and ranking of claims of creditors in a business rescue. According to this section, post-commencement financiers (investors which take a risk by investing money in a business rescue company) enjoy preferent status and this finance will form part of the administration costs of the business rescue process. However, Section 135(3)(b) does not clearly distinguish whether secured post-commencement financiers will rank above those who are unsecured. It states only that post-commencement financiers will enjoy preference “in the order in which it was incurred over all unsecured claims” (Levenstein & Barnett, 2013b). A judgment which could be carefully considered together with Section 135 of the Companies Act (71 of 2008) regarding the ranking of creditors was handed down by Kgomo J in the South Gauteng High Court on 10 May 2013, in the case of *Merchant West Working Capital Solutions (Pty) Limited v Advanced Technologies and Engineering Company (Pty) Limited and Another* (2013).

This case provides for a few ‘*super preferent*’ claims of creditors which exist after business rescue proceedings have commenced and which will enjoy preference over any other claims prior to the commencement of business rescue proceedings. Judge Kgomo clearly stipulates the ranking of creditors in business rescue proceedings as follows:

- (i) payment of the business rescue practitioner’s remuneration and expenses referred to in Section 143 of the Companies Act (71 of 2008), and other claims arising out of the costs/disbursements of (Section 135(3));
- (ii) claims by all employees who have worked since commencement of business rescue for any remuneration, reimbursement for expenses, or other amounts of money relating to employment, which becomes due

and payable by a company to an employee during the company's business rescue proceedings (Section 135(3)(a). This provision is described as unique in South Africa (Du Preez, 2013));

- (iii) claims by **secured** lenders who made finance available to the company **after** business rescue proceedings have commenced in the order it was granted (Sections 135(3)(a)(i) and 135(3)(b));
- (iv) **unsecured** creditors who made finance available **after** business rescue has commenced in the order it was incurred (Section 135(3)(a)(ii));
- (v) **secured** creditors **before** business rescue has commenced;
- (vi) all other **unsecured** creditors including employees' remuneration **before** business rescue has commenced (this is where SARS falls in the rank).

From the list above it could clearly be deduced that claims of secured creditors prior to the commencement of business rescue proceedings do not enjoy preference over the ranking of claims of secured and unsecured post-commencement financiers. The ranking as discussed is not supposed to raise uncertainty and doubt for new investors who want to provide post-commencement finance, as such creditors will be ranked before any secured claims, and therefore the chances of getting back the money invested are higher (Levenstein & Barnett, 2013b). It is thus beneficial for investors to provide post-commencement finance, as it forms part of the pool of creditors being paid first, just after the business rescue practitioner and employees (Levenstein & Barnett, 2013b).

However, the Companies Act (71 of 2008) does not refer to precisely how a company must treat the liability for tax, and there is no preference given for the claims SARS may have (Seligson, 2014). In 2012 there was a judgment which caused a great sensation with regard to SARS and business rescue (Cliffe Dekker Hofmeyr Attorneys, 2013). This was the court case of *Commissioner of South African Revenue Services v Beginzel NO and Others* (2012), where SARS was outvoted by 87 percent of the creditors who had voted in favour of the business rescue plan. In this case, the ranking of SARS as a preferent or a concurrent creditor was the main issue. The judgment in this court case is refreshing and very interesting as it is one of the first and few judgments which provide clarity on some aspects of the whole

business rescue regime. Most judgments have dealt only with the instances where and periods when a court will grant business rescue to a company. This judgment leads to the break-through conclusion which sets out the manner in which concurrent creditors will rank and vote with regard to the business rescue plan (Levenstein & Barnett, 2013c).

In the above-mentioned court case, SARS argued that it accepts that Chapter 6 of the Companies Act (71 of 2008) does not oblige business rescue practitioners to grant SARS a preference on the distribution of free residue. However, while accepting the position with regard to preferent status, SARS was also of the opinion that it cannot be treated as a concurrent creditor, as this chapter does not oblige business rescue practitioners to do so. SARS applied for an order declaring that the decision to treat them as a concurrent creditor was "*unlawful and invalid*". The Companies Act (71 of 2008) was used to argue that all preferent creditors must fall under the "*unsecured creditor*" category, in terms of Section 145(4)(a), and therefore then vote according to the value of the claim. All the other creditors must then be categorised as '*concurrent creditors*' in terms of Section 145(4)(b) of the Companies Act (71 of 2008), who will be subordinated during a liquidation process and will be able to vote at the liquidation value, which in most cases is almost nothing. If SARS could have carried this through, the vote could have been in relation to the claim, and it would then have carried the vote (Levenstein & Barnett, 2013c).

According to the court, the Companies Act (71 of 2008) distinguishes between secured and unsecured creditors, and concurrent creditors form part of the latter. The court then further expounded by saying that concurrent creditors can be divided into two sub-categories, preferent and concurrent unsecured creditors. The court explained that a '*preferent creditor*' is one whose claim is not secured but ranks before the claims of other concurrent creditors. The court held that the words '*unsecured creditor*' cannot directly be interpreted and referred to only '*preferent unsecured creditors*'. Therefore, in business rescue proceedings, the court determined in the case of *Commissioner of South African Revenue Services v Beginsel NO and Others* (2012) that SARS will be treated equally to all other concurrent creditors of the financially distressed company.

The court held that SARS' reference to a 'concurrent creditor', as previously mentioned in Section 145(4)(b), does not refer to all concurrent creditors, but only to those who have subordinated claims against the company in a liquidation in accordance with a formal agreement (Levenstein & Barnett, 2013c). The court then further held that all creditors will vote in relation to its claims, except those who have subordinated claims, who will vote at liquidation value (Levenstein & Barnett, 2013c).

SARS was of the view that all returns being submitted after the commencement of the business rescue proceedings (although relating to periods before the business rescue commencement) need to be treated as post-commencement finance, thereby assigning them (South African Revenue Service) a preference over all unsecured creditors (Seligson, 2014). SARS also stated that it would rather vote for than against the business rescue plan if it had preferent status, as all interests would then remain protected. Therefore, the status has an important effect on the voting for a business rescue plan (Seligson, 2014).

The outcome of the case was that SARS would be treated as a concurrent creditor and was not entitled to be treated as a preferent creditor merely because it enjoys preferential status during liquidation (Soonder Inc, 2013). Judge Fourie made the following very powerful and forceful finding in the case of *Commissioner of South African Revenue Services v Beginzel NO and Others* (2012):

*"However, no statutory preferences are created in Chapter 6 of the Companies Act (71 of 2008) such as are contained in Sections 96–102 of the Insolvency Act (24 of 1936). I would have expected that, if it were the intention of the legislature to confer a preference on SARS in business rescue proceedings, it would have made such intention clear. This could easily have been done, but no trace of such an intention on the part of the legislature is found in the Act. In my view, the language of the aforesaid provisions of the Companies Act (71 of 2008), read in context, and having regard to the purpose of business rescue proceedings, justifies only one conclusion, namely that SARS is not, by virtue of its preferent status conferred by Section 99 of the Insolvency Act (24 of 1936), a preferent creditor for purposes of business rescue proceedings under the Act".*

This judgment puts SARS in a position which is unknown to them, but is also the first step towards a potentially successful business rescue process which emphasises the purposes thereof (Govender, 2013).

The court also came to the conclusion that SARS will not have a greater voting interest than other concurrent creditors, except for creditors who have subordinated claims during liquidation which is mentioned in Section 145(4)(b) (Seligson, 2014). Judge Fourie also held that SARS' claim to be treated as a preferent creditor is not only *"contrary to the ordinary grammatical meaning of the words used in the said Section"* but also leads to an illogical result with regard to what Section 7(k) wants to accomplish, which is *"to balance the rights and interests of all relevant stakeholders"*. In order for a business rescue plan to be approved and performed, SARS' vote is needed because it has a significant role in the business rescue process. Therefore, a conclusion can be drawn which states that all concurrent creditors in a company undergoing a business rescue process will have an equal vote, either for approval of the plan and to help the company find its way to solvency, or for the rejection which leads to liquidation (Levenstein & Barnett, 2013c).

## **2.7. Conclusion**

The fact that a substantial number of companies which file for business rescue proceedings will fail, is unavoidable (Elliott, 2012). Therefore, creditors must take note of the position held in both the business rescue process and the liquidation process. A company undergoing business rescue proceedings is not 100% assured that it will be completely recovered afterwards by way of regaining solvency or to pay all of the creditors in full (ACCA, 2015). Therefore, it is of the utmost importance that SARS shows some patience in this process rather than being destructive with its claims. It can be concluded from the above that SARS' role in business rescue is essential. It is impossible to run business rescue proceedings without SARS forming part of the proceedings, because the claim against such a company could be large.

Govender (2013) is of the opinion that SARS should, due to its demoted status, play a more active role during business rescue proceedings. In order to achieve the maximum recovery of the debt due to them by the company undergoing business

rescue. Although SARS ranks higher in the liquidation process than in business rescue, it does not merely mean it is a better option. The business rescue provisions in the Companies Act (71 of 2008) should result in a decrease in the number of companies that file for liquidation, in the same manner as individuals who are kept from being sequestered by the National Credit Act (34 of 2005) (Levenstein, 2012).

The ranking of SARS as a concurrent creditor was established in the court case *Commissioner of South African Revenue Services v Beginsel NO and Others* (2012) as considered above. Judge Fourie made this ruling because the Companies Act (71 of 2008) does not set out the preferences of the creditors as in the Insolvency Act (24 of 1936). Therefore, it does not mean that SARS is entitled to preferent status. The court also made the following statement with regard to secured, unsecured, and concurrent creditors:

*"The Act distinguishes between secured and unsecured creditors in Section 145(4)(a). Concurrent creditors can further be divided into 'preferent' or 'concurrent' unsecured creditors. The term 'preferent creditor' generally refers to a creditor whose claim is unsecured but which ranks above the claims of concurrent creditors (i.e. unsecured preferent creditors). When assigning the phrase its ordinary meaning, it could not interpret the word 'unsecured creditor' to refer only to 'preferent unsecured creditors' ".*

The court held that SARS is to be treated like any other concurrent creditor of the company in business rescue. SARS is rated differently, that is, not with preference, in business rescue, which gives a financially distressed company a breathing space in order to get back on its feet without having to pay SARS its share first with money the company don't have. If SARS had the opportunity to enjoy preferent status, it would be paid in full, just after secured creditors, and before any other creditors.

This chapter addressed the first secondary objective as identified in par 1.5.(i) by determining the rights of SARS with regards to its payment rank within the business rescue process. It was noted that the rights of SARS are the same as any other concurrent creditor when standing in line for payment of outstanding monies. This

chapter established all the rights regarding the payment rank of SARS in a business rescue process.

## **CHAPTER 3: COLLECTION MECHANISMS OF SARS**

### **3.1. Introduction**

The Tax Administration Act (28 of 2011), which took effect on 1 October 2012, has set out the steps that SARS could follow in order to collect tax debt due. There have always been certain tax collection mechanisms available to SARS, but the Tax Administration Act (28 of 2011) has provided SARS with extraordinary power to enforce payment by taxpayers (Stassen, 2013). The Tax Administration Act (28 of 2011) contains the powers and procedures of SARS to recover tax due to them in Chapter 11 of the said Act in order to meet their obligation to collect tax which is one of the main duties of SARS. SARS will use the recovery processes and procedures available if a company refuses to pay a tax debt or is evasive (National Treasury, 2012). These collection mechanisms can have major effects on companies struggling financially and can also trigger a company to file for business rescue if the company is unlikely to pay its debts within the next six months.

In this chapter the second secondary objective will be addressed, as identified in paragraph 1.5.(ii) which will be to determine the obligations of SARS in terms of collecting tax in a business rescue process and whether SARS is using business rescue as a collection mechanism.

### **3.2. Collection of tax debt**



Section 169 of the Tax Administration Act (28 of 2011) refers to debt due to SARS as

*"... an amount of tax due or payable in terms of a tax Act is a debt due to SARS for the benefit of the National Revenue Fund".*

SARS follows a broad spectrum of processes and procedures to collect tax debt if it is not paid on or before the due date.

When a company files for business rescue there are two main results regarding the voting of SARS as a creditor. These two results (as set out in the Tax Administration Act (28 of 2011) and the Companies Act (71 of 2008)) can be better illustrated for the purposes of this study by distinguishing it by means of a table:

Table 3.1 SARS' vote in business rescue

<p>1. SARS could either be a creditor with a small voting interest and therefore all the other creditors vote for the business rescue plan, or it could be a large creditor and also vote for the business rescue plan.</p>		<p>The consequences of this result are that SARS is bound by the business rescue plan and that its rights regarding the collection of tax debt in terms of the Tax Administration Act (28 of 2011) are limited by the Companies Act (71 of 2008). (This result will be discussed further below).</p>
<p>2. SARS could be a large creditor and vote against the business rescue plan, which will either result in the company having a second chance to adjust the business rescue plan, or SARS will apply to court in order to put the company into liquidation owing to its claim being higher than those of other creditors.</p>		<p>The consequences of this result are that SARS will not be bound by the business rescue plan and could therefore use its powers as set out in the Tax Administration Act (28 of 2011) in order to collect tax debt.</p>

SARS can recover an amount of tax due to them through a few channels described in Sections 163 to 179 of the Tax Administration Act (28 of 2011). These channels or provisions must be read together with Section 133 of the Companies Act (71 of 2008), which imposes a general moratorium on legal proceedings against the company in business rescue. This means that when a company is engaged in business rescue proceedings, any party is prohibited from taking legal action,

including enforcement action, against the company or assets belonging to the company. Section 133(1)(f) of the Companies Act (71 of 2008) includes the exception that a regulatory authority can proceed in the execution of its duties only by notifying the business rescue practitioner.

This could create the possibility that SARS will see itself as a regulatory authority and thus enforce its power to collect tax debt due (Ritchie, 2014). The definition of 'regulatory authority' in Section 1 of the Companies Act (71 of 2008) is

*"... an entity established in terms of national or provincial legislation responsible for regulating an industry or sector of an industry".*

In addition to that, "SARS" is referred to in Section 2 of SARS Act (34 of 1997) as

*"... an established organ of state within the public administration, but ... an institution outside the public service".*

Therefore, SARS is not limited to a specific industry, and this directly influences the right of SARS to collect tax, because it is bound by the business rescue plan and cannot take any legal steps (Ritchie, 2014).

Although SARS' status as a concurrent creditor places a limit on its collection ability, the mere fact that a company owing SARS money in business rescue is the true obstacle, an obstacle due not only to tax acts and other legislation being applicable, but SARS is now also bound by the business rescue plan and the restrictions imposed by the Companies Act (71 of 2008). SARS cannot just sweep a company's accounts in order to collect tax. However, it must be kept in mind that business rescue cannot interfere with the contractual rights of any creditor of the company (Koen & Fuhrmann, 2015).

The Tax Administration Act (28 of 2011) makes the following four procedures available which, together with the Companies Act (71 of 2008), must be considered by SARS in order to collect overdue taxes. The following table was compiled during the course of this study in order to show the working of the Tax Administration Act

(28 of 2011) during the collection procedures versus the possible limitation of the Companies Act (71 of 2008) during business rescue:

Table 3.2 Working and limitations of the procedures to collect tax debt.

<b><u>Procedure</u></b>	<b><u>Tax Administration Act (28 of 2011)</u></b>	<b><u>Companies Act (71 of 2008)</u></b>
(i) Apply for a preservation order which will prohibit the taxpayer from doing business with certain of his assets (e.g. when a taxpayer plans to dispose his assets without settling taxes owed to SARS) (Stiglingh <i>et al</i> , 2014:1219).	Section 163(1) of the Tax Administration Act (28 of 2011) provides that a senior official of SARS may authorise an application of an order to the High Court for the preservation of assets and to prohibit any person from dealing with it.	Because this procedure involves the court, it cannot be initiated. If legal steps have already commenced by the time business rescue commences, it must be frozen until the business rescue practitioner gives written consent to proceed, or with the leave of the court (Koen & Fuhrmann, 2015). Legal action relates to steps taken within a forum, i.e. a court or tribunal (Koen & Fuhrmann, 2015).
(ii) Apply for civil judgment for the recovery of tax against the taxpayer, irrespective of whether the assessment is subject to any objection or appeal (Stiglingh <i>et al</i> , 2014:1219).	Section 172 of the Tax Administration Act (28 of 2011) states that SARS can file a certified statement with any competent court after giving a taxpayer ten business days' notice.	This is the same as the above with regard to legal proceedings during business rescue.

<u>Procedure</u>	<u>Tax Administration Act (28 of 2011)</u>	<u>Companies Act (71 of 2008)</u>
(iii) Put in place sequestration, liquidation or deregistration steps against the taxpayer (Stiglingh <i>et al</i> , 2014:1219).	Section 177(1) of the Tax Administration Act (28 of 2011) provides SARS with the power to enforce liquidation rather than business rescue provided that no objection is pending, otherwise the court first needs to give consent.	In terms of Section 130 of the Companies Act (71 of 2008) any affected person (SARS) can, after the adoption of a resolution to file for business rescue but before the business rescue plan is actually implemented, apply to court for an order to set aside the resolution on good grounds and overturn it to a liquidation.
(iv) Recover the amount from certain third parties (Stiglingh <i>et al</i> , 2014:1219).	<p>The most substantial impact which the Tax Administration Act (28 of 2011) brought about is SARS' ability to collect tax due to them from the following third parties:</p> <p>(i) <i>Representative taxpayers:</i></p> <p>Apart from such a person's usual duties, it is possible to be held personally liable for outstanding taxes of a company, if other creditors or dividends</p>	No restriction to collection of tax debt from third parties exists in the Companies Act (71 of 2008).

<u>Procedure</u>	<u>Tax Administration Act (28 of 2011)</u>	<u>Companies Act (71 of 2008)</u>
	<p>are paid instead of paying SARS (Stassen, 2013). In the case of business rescue, SARS could argue that the business rescue practitioner is the representative taxpayer dealing with the submitting and payment of returns.</p> <p>(ii) <i>Withholding agents:</i></p> <p>These persons are responsible to withhold and will be personally liable if they either withhold the tax and do not pay it over, or fail to withhold it (Stassen, 2013).</p> <p>(iii) <i>Third parties (including banks, debtors and employees):</i></p> <p>This refers to any person who holds or owes money to the</p>	

<u>Procedure</u>	<u>Tax Administration Act (28 of 2011)</u>	<u>Companies Act (71 of 2008)</u>
	company. These persons will be required to pay this money directly over to SARS instead of to the company (Stassen, 2013).	

With reference to *table 3.2*, it is clear that the Companies Act (71 of 2008) places a limit on some of the collection procedures of SARS which are set out in the Tax Administration Act (28 of 2011). According to the court case *Murray NO & another v FirstRand Bank Ltd t/a Wesbank* (2015), the general moratorium is applicable only to creditors who lodge a claim against a company in business rescue, rather than limiting a creditor's rights. Therefore, it can be concluded that SARS will be limited only by Section 133(1) of the Companies Act (71 of 2008) when first claiming from the company in business rescue, but this will not limit its rights and procedures to collect tax (Koen & Fuhrmann, 2015).

Prinsloo (2015) is of the opinion that it is very important to keep in mind that SARS does not hold some sort of magical power just because it is 'SARS', but however, it has the legislation on its side as well as powers other creditors don't have. The best is to make arrangements with SARS even though it is not possible to pay immediately, because no matter what happens, to ignore SARS will not solve the problem (Prinsloo, 2015). The fact that all companies which take part in a business rescue process experience being financially distressed and owing a lot of money to SARS could lead to the possibility that SARS consider business rescue to be a mechanism to collect tax although SARS has not yet released an interpretation note for guidance with regards to the taxation (Du Toit, 2012).

### **3.3. Write-off or compromise of tax debt**

The Tax Administration Act (28 of 2011) consists of different ways to deal with the deferral of a company's tax liability. Although it is the duty of SARS to collect taxes due by any taxpayer, the choice rests solely on the Commissioner to determine whether he wants to deviate from the tax acts and not collect tax debt or part of it, if it is in its own interest or '*uneconomic*' to collect the outstanding tax (Viljoen, 2014). The purpose of these provisions is to give the Commissioner flexibility in his approach to collect tax from companies which are in arrears (Mali, 2011). There are certain conditions which could be seen as mechanisms to help a taxpayer pay the tax due to SARS, whether it is a partial payment, postponement of a payment, or payment of a reduced amount.

If a company realises its financial predicament in time, it is necessary to rather apply for the write-off of tax debt or arrange a compromise with SARS before filing for business rescue. This way, SARS could possibly get a part of its tax debt sooner than when the company is in business rescue as a result of SARS' status as a concurrent creditor. The following three conditions are available in Chapter 14 of the Tax Administration Act (28 of 2011) when dealing with the collection of tax debt due to SARS:

- (i) temporary write-off;
- (ii) permanent write-off; and
- (iii) compromise.

These conditions must be provided for by the business rescue practitioner in the business rescue plan, as the creditors cannot create own terms and conditions and follow them later on. SARS' power to follow through with these provisions are completely independent of its status as a concurrent creditor.

### **3.3.1. Temporary write-off**

Section 195 of the Tax Administration Act (28 of 2011) provides that SARS, and more specifically, a senior South African Revenue Service official, has the power to write off tax debt due to them by a company undergoing business rescue proceedings as referred to in Section 132 of the Companies Act (71 of 2008). There are five main factors SARS will consider before tax debt will be temporarily written off. These include:

- (i) the tax amount;
- (ii) the period outstanding;
- (iii) steps taken to recover the outstanding tax;
- (iv) the determination by the Commissioner as to whether the costs incurred to recover the tax debt will exceed the actual value of the tax debt; and lastly
- (v) the determination of future financial position and income streams of the company, which will be its motivation to write the debt off temporarily rather than permanently (Mali, 2011).

This does not mean a company is totally acquitted from paying the debt; SARS could still claim outstanding tax debt for up to fifteen years according to Section 171 of the Tax Administration Act (28 of 2011), and will charge interest from the date on which the debt is written off up to the date the company starts to pay back all debt (FSP Business, 2013). SARS could also withdraw this decision as soon as it is clear that the company is no longer under business rescue or that it is worthwhile to proceed with action in order to collect the tax debt. This is therefore a mere postponement of a company's obligation to pay its tax debt and a courtesy provided by SARS as a concurrent creditor in a business rescue process (FSP Business, 2013).

### **3.3.2. Permanent write-off**

Section 197 of the Tax Administration Act (28 of 2011) contains the conditions under which SARS will permanently write-off tax debt. If SARS is of the opinion that the tax debt due to them is totally irrecoverable by law and it is due by a company undergoing business rescue proceedings, a senior South African Revenue Service official could authorise the permanent write-off of the tax debt provided that Sections 200 to 203 are taken into account. *'Irrecoverable'* means that the tax debt cannot be recovered by a judgment of court and no dividend is available for distribution after liquidation or, in this case, business rescue (Mzizi, 2014). Mzizi (2014) is of the opinion that this is not something which happens often.

### **3.3.3. Compromise**

A senior South African Revenue Service official will authorise an application to compromise a tax debt according to Section 200 of the Tax Administration Act (28 of 2011) only if it is clear that

*"... the purpose of such a compromise is to secure the highest net return from the recovery of the tax debt" and is consistent with considerations of good management of the tax system and administrative efficiency".*

SARS will take into consideration the amount of tax which it would receive if it compromises with the debtor (company under business rescue) as well as the fact that the tax would be received earlier. This provision also aims to save a company from closing its doors by assisting a debtor and relieve it from the harsh effects the South African tax law could have (Mali, 2011). If a company enters into a compromise with SARS the company should be aware that SARS will only agree to a repayment period of not more than 12 months (Palmer, 2013). The company should note that SARS will not provide relief in terms of Chapter 14 if the tax debt is already being disputed (SAIT Technical, 2015).

### 3.4. Binding offers

Up to this point, it is quite clear that SARS is a major creditor in most business rescue proceedings, which could cause a problematic situation. SARS could vote against the business rescue plan, which could result in getting less than 75% of the votes to implement the business rescue plan (Ritchie, 2014). This negative situation could potentially be resolved by the provision in Section 153(1)(b)(ii) of the Companies Act (71 of 2008), which gives any affected person of the financially distressed company the opportunity to make a binding offer and purchase the voting interest from the party who votes against the plan. The value of such a binding offer must be independently determined as well as being in line with what the person/party would have received in case of liquidation (Ritchie, 2014). It could be argued that this also provides SARS with a mechanism to collect a portion of the debt due even though it may not take any further part in the proceedings of the business rescue plan.

In the court case *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* (2012), the judge, Kathree-Sitloane J, stated that a 'binding offer' is not an 'option' or 'agreement' but rather "a set of statutory rights and obligations from which both the parties may resile". The court held that the opposing party's claim will be equally to what he would have received under liquidation; thus the offeree will be protected but will lose his right to vote (Ritchie, 2014). In the court case *DH Brothers Industries (Pty) Ltd. v Gribnitz NO and Others* (2013), it was held that every creditor has the right to vote either for or against the business rescue plan, and that the opposing creditors cannot be involuntarily deprived of a voting interest.

Therefore, if SARS votes against the business rescue plan, a binding offer could be made by any affected person to purchase the claim from SARS for a return which would be equal to what it would have been had the company been in liquidation (Ritchie, 2014). This could result in SARS being in a much better position because of its preferent status in the liquidation process, but it also has a choice as to whether or not to accept the binding offer.

### 3.5. Collection of tax debt from directors

If the board of directors fails to comply with the duty as set out in Section 129(7) of the Companies Act (71 of 2008), it could have adverse consequences for the directors of the board, especially if some of the creditors suffer great losses which could have been lower or could have been avoided had the directors not made themselves guilty of reckless trading (Smith, 2012). Section 22 of the Companies Act (71 of 2008), which deals with reckless trading, sets out what happens to directors who do not '*play*' according to the Act. If a company carries on business with gross negligence and the Commissioner has reasonable grounds to believe that the company is unable to pay tax, the company will be issued with a notice which must be adhered to within 20 days. In the case of failure, the Commissioner will issue a notice requiring the company to cease carrying on its business. The business rescue process does not protect directors from any liability.

Together with the above, the following must be kept in mind: Section 218(2) of the Companies Act (71 of 2008) makes it clear that

*"... any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention".*

For example, if a shareholder who invests money in the financially distressed company or a creditor who sells goods worth thousands to such a distressed company, finds out and had been unaware all along of the true situation, these losses could be claimed from the directors if the company liquidates (Kotzé, 2013). A reasonable step the board of directors could take is to file for business rescue in order to prevent losses that shareholders and creditors could suffer (Kotzé, 2013).

According to Section 129(3), when a company chooses to carry on with business, an obligation rests on the directors to publish a notice to all '*affected persons*' with reasons how to still carry on with business activities (MD Accountants & Auditors, 2014). '*Affected persons*' refer to banks, employees, shareholders and creditors, including most importantly SARS (MD Accountants & Auditors, 2014). Because SARS is an affected person, it has more than enough power to approach the court in

order to seek answers as to why a company did not file for business rescue with the realisation of being financially distressed, as well as why the directors failed to send out a notice stating why they are not filling for business rescue. The consequences for the company of such a notice to all affected persons is quite uncertain and could cause a financially distressed company to feel as if it is undergoing 'commercial suicide' (Kotzé, 2013). Creditors will no longer feel safe providing the company with goods and services on credit; banks will not provide loans anymore; and worst of all, SARS could probably try to recover all taxes due to them (MD Accountants & Auditors, 2014).

The reason directors will mostly withhold on giving out such a notice is because a company which is financially distressed will need access to finance in order to escape liquidity problems, but will also start to find it more and more difficult to obtain finance to pay monthly obligations (MD Accountants & Auditors, 2014). This notice could therefore result in no creditor wanting to provide the company in distress with extra finance, while the intended consequence should rather have been to assure all affected persons that the company is going to be rescued and that soon the debt will be settled (MD Accountants & Auditors, 2014). The sooner the financial 'crisis' of a company is communicated to SARS, the sooner positive action could be taken (MD Accountants & Auditors, 2014).

Section 129(7) of the Companies Act (71 of 2008) states:

*"If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this Section, the board must deliver a written notice to each affected person, setting out the criteria referred to in Section 128(1)(e) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this Section".*

This action by directors is essential, because if the directors continue business knowing that it is actually in financial need and do not notify the company's creditors (specifically SARS), the directors could be held personally liable for all the debt as well as the company's obligation towards SARS (Smith, 2012). The action against directors is exactly what SARS will use in order to support its case and make sure it

collects the tax owed to them, regardless of who needs to provide the funds to settle the debt. Section 77(2) of the Companies Act (71 of 2008) states that directors will be held personally liable for all losses, damages and costs if the directors breach any of their duties as set out in the Companies Act (71 of 2008) or the company's Memorandum of Incorporation.

The early detection of a company's financial need and the non-compliance therewith punishes directors and is a mechanism of SARS to get companies into business rescue as early as possible. The message for directors of all companies which suffer financially is made very clear by the steps taken by SARS. When your company is experiencing financial distress of whatever manner, apply for business rescue. Do not delay the process and take the risk of being held personally liable. Most importantly, communicate with your creditors (Smith, 2012). SARS should set out a clear penalty in the Tax Administration Act (28 of 2011) for directors who do not comply with Section 129(7), as well as a specified time limit within which the compliance must be adhered to (Kotzé, 2013).

This leads to an indirect tax collection mechanism being available to SARS in order to collect tax debt due to them. It is the right of SARS to make use of the above-mentioned in order to collect the tax debt. SARS can and will make use of all procedures available to collect tax. Even though the company cannot pay the outstanding tax, it does not mean that the directors are unable to pay it. Although SARS cannot use its status as a concurrent creditor to enforce being paid first in a business rescue process, there is a few procedures available in order to collect what is due to them.

### **3.6. Preservation order**

According to Section 163(1) of the Tax Administration Act (28 of 2011), SARS can apply to the High Court for the preservation of any assets of a taxpayer. SARS can seize the assets of a company, but it must apply to court for a preservation order within 24 hours. Section 163(3) further states that a preservation order may be made if it is required by SARS to secure the collection of outstanding tax debt. During

business rescue, the general moratorium in Section 133 of the Companies Act (71 of 2008) protects the company from creditors taking any legal steps against it. Thus SARS will not be able to seize the assets of a company under business rescue. SARS must rather follow a long-term view with regard to business rescue, which is to have a taxpayer in the future, rather than a short-term view which is to seize all the assets of the company and lose a taxpayer for future collections.

### **3.7. Conclusion**

From the above it could be concluded that there are various ways in which SARS is able to collect tax debt due to them while a company is in business rescue. According to the Tax Administration Act (28 of 2011) a company must pay the outstanding tax debt within a specified period given by SARS after receiving a notice to do so or else the company will face huge penalties as well as having to pay interest at the official rate. For the companies experiencing financial distress, certain prescribed circumstances are made available in the Tax Administration Act (28 of 2011). For instance, the taxpayer will either have the option to pay his tax debt in instalments over a fixed period of time, or SARS will compromise a tax debt or write off the tax debt as a whole (National Treasury, 2012). Not all companies will qualify for the procedures to minimise or eliminate tax debt; a company needs to meet the requirements set out by SARS in order to qualify to have tax written off or to arrange a compromise.

The economic crisis in South Africa could be one of the circumstances which relates to companies struggling to keep its head above water and therefore neglecting the statutory obligation it has towards SARS (Ritchie, 2014). It must not be assumed, if a company is not in the position to pay its tax debt, that SARS can be forgotten. As previously stated, SARS will always claim its portion (Keulder, 2013:125). Although SARS is a concurrent creditor in a business rescue process, it does not mean at all that SARS will not follow the normal procedures in order to collect the debt due to them. Aside from the fact that SARS ranks after secured and preferent creditors, it does not mean that business rescue cannot be used as a collection mechanism. Despite the status of SARS, it will continue to take steps to collect taxes due to them except in cases where it is uneconomical to do so.

Business rescue limits the ability of SARS to collect outstanding tax debt by way of the business rescue plan being binding on SARS once it is adopted. When the business rescue process commences, SARS has a choice whether to vote for or against the business rescue plan. SARS is not obliged to accept the plan except in cases where the other creditors hold the majority of the voting interest. limit SARS' ability to collect 100% of the tax debt due to them from every company which files for business rescue. Therefore, the collection mechanisms of SARS are dependent on its ranking status in a business rescue process. SARS' status as a concurrent creditor limits the dividend it will receive, even where a company recovers fully from the business rescue process.

This chapter addressed the second secondary objective by determining the obligations of SARS in terms of collecting tax in a business rescue process and whether SARS is using business rescue as a collection mechanism. From the above it could be seen that business rescue does form part of the collection mechanisms of SARS and this establish what the obligations of SARS is in a business rescue process regarding the collection of outstanding tax debt.

## **CHAPTER 4: A COMPARISON OF AUSTRALIA'S VOLUNTARY ADMINISTRATION PROCESS TO SOUTH AFRICA'S BUSINESS RESCUE PROCESS**

### **4.1. Introduction**

The reason for choosing Australia's legislation regarding voluntary administration to compare with South Africa's business rescue proceedings was to identify whether the ATO's rights and obligations differ from these of SARS. Where differences are found it can be considered whether a weakness exist in the way either SARS treats companies in business rescue according to the Tax Administration Act (28 of 2011) or the provisions binding on SARS according to the Companies Act (71 of 2008). Although the content of the respective legislation may differ, the main objectives and aim of the legislation in the two countries is almost identical (Anderson, 2008:132). The purpose of corporate rescue is also almost identical in both countries.

In this chapter the third secondary objective will be addressed, as identified in paragraph 1.5.(iii) by performing only an overview comparison between South Africa and Australia to identify whether there are any weaknesses in South Africa's tax legislation regarding the rights of SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation when engaged in a business rescue process.

### **4.2. Background**

The most common formal corporate rescue process in Australia is the voluntary administration process. Cook (2012) is of the opinion that the reason a company should preferably choose voluntary administration rather than following the liquidation route, is that voluntary administration offers an approach which could be used to rescue a company from all its debt, as in South Africa. This procedure could help companies overcome its short-term cash flow problems as well as restructuring its business into a more profitable and healthier position (Cook, 2012). The voluntary administration process can commence by way of an appointment document applied

for by the directors, a liquidator or a secured creditor. Voluntary administration could result in two possible outcomes, implementing a Deed of Company Arrangement, or liquidation. The administrator's role in this procedure is to take control of the company's affairs in order to be able to channel the company into becoming more profitable (Cook, 2012).

Part 5.3A of the Corporations Act 2001 contains the provision which deals with rehabilitation which came into operation on 23 June 1993. The number of Australian companies that have since been placed under external administration is a clear result of the significance of an effective corporate rescue framework (Blazic, 2010). The figures in respect of companies applying for voluntary administration increased by 118% in the ten-year period between 1999 and 2009 (Blazic, 2010).

The voluntary administration process sets out how a company in financial need could restructure its affairs by providing sufficient protection to save as much of the company as possible in order to give the creditors and shareholders a better return than would have been the case had the company followed the liquidation route (Australian Debt Solvers, 2015). In other words, voluntary administration was designed to help a company determine the direction of its future as quickly as possible. The Australian Debt Solvers (2015) is of the opinion that it is clear that the voluntary administration process was provided for in the Corporations Act 2001 in order to provide directors with a mechanism to face the company's financial distress and to take early action in preventing a total breakdown and obtaining a 'breathing space', as well as protecting themselves from personally being liable for corporate debts. During voluntary administration, unsecured creditors are not able to enforce its claims without the administrator or court's permission; parties which own property used by or leased to the company cannot recover its property; secured creditors cannot enforce its claims over property of the company; and the company cannot file for liquidation after voluntary administration has begun (ASIC, 2015b).

A Deed of Company Arrangement, or DOCA, as it is often referred to, is similar to South Africa's business rescue plan and could best be described as a contract between the company and its creditors to allow the company to restructure and trade itself out of its financial problems (O'Flynn & Mainsbridge, 2008). The ATO had a few

comments on the voluntary administration regime and believe that there are a number of DOCA's being compiled to wind up the company and that it doesn't provide for the claims as set out in the plan (O'Flynn & Mainsbridge, 2008). The ATO is concerned about the provisions in the Corporations Act 2001 being misused as a mechanism for companies to avoid paying its tax debt as well as sufficient dividends to other creditors (O'Flynn & Mainsbridge, 2008).

It is possible to use this corporate rehabilitation process without having the intention of actually saving the company, although the courts in Australia concluded that a company cannot appoint an administrator if it appears that there is an ulterior purpose behind this act (Anderson, 2008:110). Section 435A in part 5.3A of the Corporations Act 2001 states that the objectives of the voluntary administration regime are

*"... to provide for the business, property and affairs of an insolvent company to be administered in a way that:*

- (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or*
- (b) if it is not possible for the company or its business to continue in existence, results in a better return for the company's creditors and members than would result from an immediate winding up of the company".*

The first objective is important for the preservation of employment because employees are of great assistance in turning the distressed company around (Anderson, 2008:111). The second objective aims to maximise the overall return to companies even though it is not always necessarily possible to save all companies from liquidation (Anderson, 2008:111). From the above, it can be said that both Australian and South African company law have the same aim with voluntary administration and business rescue respectively, and both recognise the desire for a company in financial distress to continue in existence (Anderson, 2008:111).

Although the ATO supports voluntary administration it seems to believe that the success rate of voluntary administration should not be measured by the DOCA being

proposed to creditors but rather by the number of orders which are complied with (O'Flynn & Mainsbridge, 2008). To conclude the above, the ATO agrees that voluntary administration has changed the insolvency provisions in Australia for the good, but it is not yet clear whether it will result "*in a better return for the company's creditors*" as stated in Section 435A(b) or merely delay an inevitable liquidation (O'Flynn & Mainsbridge, 2008).

#### **4.3. Tax implications**

Although the ATO is a creditor in the voluntary administration process, it is different from other creditors because it is a powerful creditor which can demand tax from any party owing them money (Rescue Restore & Rebuild, 2011). The ATO can also insist on the tax debt being paid by the directors of the company undergoing voluntary administration. Upon application, the Ato will allow negotiations in order to arrange for tax debt being paid over a period of time in smaller amounts (Rescue Restore & Rebuild, 2011).

The Australian voluntary administration process also brings various inevitable tax implications to light when a company is in financial distress. When a company sells its assets, the proceeds which is receivable will give rise to either income or capital gain (Taxpayers Australia, 2015). Although it could be the case that such a company will sell its trading stock or assets at a value lower than the amount or which it would normally sell them, the tax law could treat the transaction as being incurred at market value, which will result in either CGT or donations tax (Taxpayers Australia, 2015).

Even if you are only a sole trader and winding up your company or selling your shares in another company, you will need to pay tax on the proceeds received, although there are various tax exemptions available under the small business CGT rules (Taxpayers Australia, 2015). If a creditor waives or forgives a part of the debt owed to them, the amount will be subject to the '*commercial debt forgiveness*' rules, although this would only cause the company to reduce the tax and capital losses (Taxpayers Australia, 2015). If a shareholder receives any distribution according to its claim, it will be tax free to the extent that it meets the original investment amount; thereafter the amount will be taxed as a dividend (Taxpayers Australia, 2015).

#### **4.4. Ranking of the Australian Taxation Office in a voluntary administration process**

Outstanding tax debts due to the ATO are treated in the same way as other creditors since the priority of tax liabilities was revoked in 1993 (180 Group, 2012). The ATO has no other choice than to accept the terms set out in the DOCA if it is accepted by more than 50% of the creditors (180 Group, 2012). Because of this, the directors sometimes misuse a DOCA, but the ATO will nevertheless resist the application thereof in some cases (180 Group, 2012). Section 555 of the Corporations Act 2001 states the following:

*"Except as otherwise provided by this Corporations Act 2001 all debts and claims proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, it must be paid proportionately".*

The ATO enjoyed preference until 1993, but now the only claim of the ATO which has a preferential status is unpaid superannuation guarantee charges (Batten Sacks Harvey Bruce Lawyers, 2014). Since 1993, the ATO has ranked equally with the other unsecured creditors in a voluntary administration process (O'Flynn & Mainsbridge, 2008).

#### **4.5. Collection mechanism regarding voluntary administration**

Even if a company is unable to meet its obligation to pay the ATO, it does not mean the company is free from paying tax. The ATO does have other mechanisms in place in order to meet their obligation in terms of collecting outstanding tax. It is the duty of any director to make sure that the company is not trading while being insolvent by considering the company's solvency before each big transaction where debt plays a role (ASIC, 2015a). This does not include only being aware of the financial position of your company when you sign your annual financial statements, but being constantly aware of your financial position (ASIC, 2015a).

Due to the ATO being an unsecured creditor, a moratorium is imposed on the actions, which means it is not entitled to enforce any legal action while the company

is under voluntary administration. Together with that, no liquidator can be appointed, which means that liquidation could take place only after a DOCA has been declined. All of the company's property is also protected by placing any legal action on hold during the voluntary administration process.

The Commissioner of the ATO has the power to write-off certain tax debts if he enters into an agreement with the company under voluntary administration as set out in Section 44 of the Financial Management and Accountability Act 1997 (Ritchie, 2014). In Australia the compromise of tax debt owed to the ATO is a very strict process, much more so than in South Africa, because the ATO takes all of the assets of the company under voluntary administration (Ritchie, 2014). When the ATO considers a compromise with a company under voluntary administration, it does not have any concern with or compassion with regard to the company's ability to trade again (Ritchie, 2014). SARS could possibly consider a compromise by means of Section 200 in the Tax Administration Act (28 of 2011) in a way that could give a company in financial distress a little more time to pay back any tax debt if it results in the highest net return.

Section 588G of the Corporations Act 2001 mentions what the law requires of a director and also sets out one of the most important responsibilities or duties as being their obligation to *"prevent insolvent trading by a company"* (Herat, 2015). The contrary directly leads to a director being personally liable to pay the creditor claims, banned from the position of director for any company for up to ten years, and even imprisonment for up to five years if he is aware that the company is facing insolvency and doing nothing about it (Herat, 2015). Directors must get assistance from an administrator and lawyer as soon as possible, because the main reason for being unable to save a company is due to professional advice which has been sought too late (ASIC, 2015a).

#### **4.6. Similarities and differences between Australian and South African legislation**

Through the research performed in this mini-dissertation, it was discovered that more similarities than differences exist between the legislation regarding corporate rescue in Australia and South Africa. Both the ATO and SARS enjoy concurrent creditor status with regard to outstanding tax debt. In both countries, the corporate rescue regimen causes tax implications, as discussed in paragraphs 2.5 and 4.3, which have enormous effects on a company already suffering financially. In both countries' legislation, the Receiver of Revenue/Income will need to reform the effect of the tax acts on financially distressed companies in order for corporate rescue to achieve its purpose.

More or less the same collection mechanisms are also used with regard to outstanding tax debt by means of negotiation or compromise as discussed in paragraph 3.3. Directors also share the same responsibilities and dangers when not filing for business rescue on time as discussed in paragraph 3.5. The effect of the concurrent status in both countries is the same: it causes a situation where the Receiver of Revenue/Income does not receive the outstanding tax in full, even though a company may recover as a result of the corporate rescue process.

Although a moratorium, as explained in paragraph 3.2, protects companies in both countries from taking legal action against them, the ATO has enough power to still apply to court when not treated fairly. During the voluntary administration process, the ATO could be voted out by other creditors during a meeting. The Commissioner of the ATO still has enough power to terminate the voluntary administration process by applying to court if the Commonwealth is deprived of any rights or benefits; thus the ATO is protected by Section 600A of the Corporations Act (2001). This is in direct contrast with South Africa's Companies Act (71 of 2008) where there is no provision protecting the position of or giving special treatment to SARS (Ritchie, 2014). Although SARS may not consider a business rescue plan, if it is disadvantaged compared to other creditors, it is not enough proof to end all business rescue proceedings.

SARS allows a business rescue practitioner to adjust the business rescue plan with regard to the dividend of SARS if not satisfied (Anderson, 2008:132). The ATO does not attempt a revised plan; the company go straight into liquidation as an alternative (Anderson, 2008:132). The Australian legislation regarding voluntary administration to help a company show growth is in direct contrast with the insolvency law which forces a company to close its doors (Carrie & Yan, 2010). This process can be speedy and relatively inexpensive, and by applying for it timeously, a company can increase the chances of being saved (Carrie & Yan, 2010). Unnecessary engagement and participation of the court could be eliminated, which will in turn reduce administration costs. Since there is no prescribed manner in the Corporations Act 2001 for how the DOCA must be compiled, the administrators can implement any creative solution they could think of (Carrie & Yan, 2010). In Part D of the Companies Act (71 of 2008), a specific layout is provided for how a business rescue plan must be proposed and compiled in South Africa.

#### **4.7. Conclusion**

The aim of this chapter was to identify whether there exist any weaknesses in the rights of SARS by comparing it to the ATO. One would expect that there would be many differences, but that is not the case in respect of the factors considered in this study although an in depth comparison was not done. Only a few small differences were discovered regarding the treatment of the respective tax bodies. In South Africa there are some provisions which contradict each other as set out in table 3.2 in Chapter 3. The Tax Administration Act (28 of 2011) is aimed at gaining the maximum financial benefit for the State when a company applies for a compromise, while the Companies Act (71 of 2008) provides for rescuing financially distressed companies (Ritchie, 2014). In Australia there is only one Act which deals with voluntary administration. Australia's company legislation focuses much more on benefiting state officials, compliance with rules and regulations, and the protection of the Commonwealth, as compared to company legislation in South Africa (Ritchie, 2014).

It must be kept in mind that regardless of the timing, for certain companies which enter into voluntary disclosure, the results will not be what is expected it to be (Carrie & Yan, 2010). The companies referred to are those experiencing financial difficulty as

a result of economic recession, which involves external factors over which the company has no control, and there is therefore actually much less action which could be taken against it. Therefore, in this case, the voluntary administration process only cause postponement of the liquidation process. SARS would provide time for adjustment of the business rescue plan by the business rescue practitioner as set out in Section 152 of the Companies Act (71 of 2008).

In Australia, the objectives of the voluntary administration regimen according to Section 435A in Part 5.3A of the Corporations Act (2001) are to maximise the chances of the business to continue in existence and, if this is not possible, to result in a better return for creditors and shareholders rather than a winding up of the company. In South Africa, the objectives according to Section 128(1)(b) of the Companies Act (71 of 2008) are to restructure a company which maximises the likelihood of continuing existence and, if this is not possible, to create a better return for creditors and shareholders than the liquidation process would. Due to the ATO's laws being much more rigorous than South Africa's, it promotes respect towards the state officials as well as the rules of the regulating authority (Ritchie, 2014). When a company is being rescued by either of the two processes, it will generate a taxpayer for the Receiver of Revenue/Income in the future.

This chapter addressed the third secondary objective by performing an overview comparison between South Africa and Australia to identify whether there are any weaknesses in South Africa's tax legislation regarding the rights of SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation when engaged in a business rescue process. From the above it could be concluded that no remarkable weaknesses exist in South Africa's legislation regarding the rights and obligations of SARS in a business rescue process. Despite the few differences between these two processes with regard to the factors as considered, the similarities are far more visible when comparing the respective countries' corporate rescue processes. Therefore, the experience of a company which participated in such a process in both these countries would be very much the same (Anderson, 2008:133).

## **CHAPTER 5: CONCLUSION**

### **5.1. Introduction**

The primary objective was to investigate what the rights and obligations of SARS entails as a concurrent creditor in a business rescue process and whether this process can give rise to SARS' ability to collect tax debt due to them by companies in financial need.

The primary objective will be addressed by the following secondary objectives:

- (i) to determine the role of the payment rank of SARS in business rescue proceedings to establish the rights SARS has to claim payment of outstanding tax debt in a business rescue process (Chapter 2);
- (ii) to determine the obligations of SARS in terms of collecting tax in a business rescue process and whether SARS is using business rescue as a collection mechanism (Chapter 3);
- (iii) to identify, by performing an overview comparison, whether there are any weaknesses in South Africa's tax legislation regarding the rights of SARS to claim payment of outstanding tax as well as the obligations regarding the collection of outstanding tax by comparing it with Australia's tax legislation (Chapter 4).

This chapter will provide a summary of the findings on the above objectives.

### **5.2. Summary of findings**

This study's primary objective was to determine the rights and obligations of SARS when a company is filing for business rescue, and more specifically, its ranking as concurrent creditor. In order to get a proper understanding of all the factors that will lead to the answer, a discussion including the relevant court judgments was provided in Chapter 2. The difference between SARS' ranking in the liquidation process and its ranking in the business rescue process was also broadly discussed. It was noted in the case *Commissioner of South African Revenue Services v Beginsel NO and*

*Others* (2012) that SARS has done everything in its ability to get the same status as in liquidation, but that has been to no avail. Judge Fourie ruled that SARS is a concurrent creditor in business rescue proceedings. SARS will have to make peace with a place at the bottom of the priority list together with all other concurrent creditors. The provisions in the Companies Act (71 of 2008) with regard to business rescue most definitely boost our economy indirectly due to fewer businesses closing its doors and discharging employees as well as SARS saving a taxpayer for the future. Despite the fact that SARS could be one of the largest creditors in a business rescue, it is considered similar to any other unsecured or concurrent creditor and will have to consider that a positive vote will get the share so long as they are willing to wait.

In Chapter 3, the collection mechanisms were considered as the obligations of SARS in a business rescue process. The Tax Administration Act (28 of 2011) provides for different channels in order to collect outstanding tax debt. These channels include the application for the write-off of a company's outstanding tax debt as well as to compromise with SARS for either a longer payback period or a decreased amount. As identified in Chapter 3, business rescue could most probably be seen as a collection mechanism of SARS because it collects the tax in any possible way. Directors of companies in financial distress could also suffer under the heavy hand of SARS when not giving notice of the financial position of the company on a timely manner. There are only small limitations on the procedures of SARS to collect tax during business rescue. The only drawback of being a concurrent creditor is that it may not be possible to collect all outstanding tax in full.

In Chapter 4, a brief overview was done between the corporate rescue procedures of both South Africa and Australia in order to identify whether any weaknesses exist regarding the rights and obligations of SARS when comparing it to Australia's corporate rescue legislation. Secondary data about these two countries' company legislation and judgments were used to determine what the differences are regarding the rights and obligations of the Receiver of Revenue/Income. The most important finding is the fact that the ATO also suffers from a low priority ranking in the voluntary administration process. In South Africa, the business rescue plan is accepted if the business rescue plan gets more than 75% of the votes, in Australia the voting

interest has to be only 50% in order to accept the rescue plan. The Australian Taxation Office is an unsecured creditor and a moratorium is also imposed on its actions, which means that it is not entitled to enforce any legal action while the company is under voluntary administration. All of the company's property is also protected by placing any legal action on hold during the voluntary administration process. When the Australian Taxation Office considers a compromise, it does not have any concern with or compassion for the company's ability to trade again (Ritchie, 2014). SARS will compromise in a way which gives a company in financial distress a little more time to pay its tax debt.

Although the process has been running for more than 22 years in Australia, there are still some people who believe that this process does not entirely meet its primary objective, which is to rescue a company in financial need. This is due to the legislation providing for liquidation rather than an advised plan should the first option not be accepted (Anderson, 2008:132). In other words, Australia's legislation gives up much more easily on companies in financial distress than the South African legislation, which really strives to save the company.

### **5.3. Conclusion on findings**

The overall conclusion from this study is that the role of SARS is of the utmost importance owing to its influence on the success of the business rescue regimen. SARS, with its rights and obligations encapsulated in the Tax Administration Act (28 of 2011), has the ability to help save companies in financial distress as going concerns. SARS uses business rescue in order to collect tax debt due to them, although not always as soon as it would like to. All companies in financial need should inform SARS in time of its position, in order to minimise additional penalties and interest on outstanding tax debt.

With this study it was discovered that there are far more similarities than differences between Australia and South Africa's corporate rescue procedures. The major difference between the corporate rescue legislation of these two countries is that the Australian Taxation Office may, despite the moratorium placing a limit on legal

action, still apply to court if not treated properly and fairly. Furthermore, the aims and objectives of these processes in both countries are very much alike.

#### **5.4. Problem statement**

The problem statement for this study was to address the uncertainties which exist as to whether the business rescue process limits SARS' ability to collect tax debt due to them by companies in financial need, and also what SARS' role as a concurrent creditor entails.

The answer in short is that the main limitation is found in Section 133 of the Companies Act (71 of 2008), which prohibits any party from commencing legal action during the business rescue process. SARS will be limited only by Section 133(1) of the Companies Act (71 of 2008) when it first claims from the company in business rescue, but this will not limit the rights and procedures to collect tax (Koen & Fuhrmann, 2015). The concurrent status does place a limit on SARS' ability to collect tax debt which is due through not being able to collect 100% of the debt, but only a percentage dividend if a company recovers from the business rescue process.

#### **5.5. Suggestions for future research**

A more detailed analysis could be done regarding the treatment of the Receiver of Revenue/Income in a business rescue process of South Africa and Australia respectively, as this study focused on only some areas. This could be extended further to a comparative study which includes England and Germany as well. It would be interesting to see whether better mechanisms exist in order to treat SARS, in its opinion, more fairly.

#### **5.6. Research limitations**

Due to this study being only a mini-dissertation, the only comparison done was between South Africa and Australia which was merely on a high level. To achieve more precise results as to whether there are any shortcomings in the treatment of SARS during a business rescue process, it has to be compared to more countries'

legislation regarding the rescuing of a financially distressed company and in greater detail.

The legislation of both South Africa and Australia relating to corporate rescue is very similar. This makes it more difficult to address shortcomings in the legislation of South Africa and suggest solutions to these shortcomings.

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