

The corporate debt reduction tax rules as an added impediment to companies in financial distress

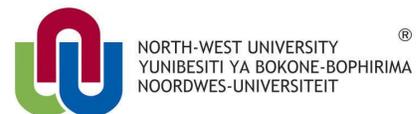
E Ross
13017373

Mini-dissertation submitted in partial fulfilment of the requirements of the degree of Magister Commercii in South African and International Taxation at the Potchefstroom Campus of the North-West University

Supervisor: Prof P van der Zwan

November 2016

It all starts here [™]



ACKNOWLEDGEMENTS

I would like to thank the following people for their contributions to the completion of this mini-dissertation:

- Pieter van der Zwan for his guidance and support throughout the process.
- My husband and daughter who have been patient and kind, allowing me to pursue and inspiring me to reach new heights.

ABSTRACT

Prior to 1 January 2013, the provisions of the Income Tax Act 58 of 1962 (hereinafter referred to as the Act), which dealt with the consequences of a waiver of a debt for less than full consideration, were predominantly section 8(4)(m) and paragraph 12(5) of the Eighth Schedule to the Act (hereinafter referred to as the previous debt reduction rules). The previous debt reduction rules were replaced by section 19 and paragraph 12A of the Eighth Schedule to the Act, which came into operation 1 January 2013 (hereinafter referred to as the new debt reduction rules). The new debt reduction rules were introduced in an attempt to provide additional relief to financially distressed debtors, where a debt was reduced for less than full consideration.

This focus of this research study was to establish whether the design of the new debt reduction rules conceptually facilitate the recovery of financially distressed debtors, where a debt waiver has occurred. This involved a critical analysis of the previous debt reduction rules and the new debt reduction rules to identify the additional relief measures that were introduced, if any. In addition, the new debt reduction rules were compared to the tax rules that apply to a debt waiver in Canada and the United Kingdom.

A literature review was performed to analyse and compare the various pieces of legislation in the Act and the Companies Act (71 of 2008), as well as foreign legislation and literature available in respect of similar legislation in Canada and the United Kingdom. The objective of the literature review was to establish whether the new debt reduction rules provide additional relief, compared to the previous debt reduction rules, to companies in financial distress and whether the relief provided in new debt reduction rules provide adequate relief to financially distressed debtors, compared to countries such as Canada and the United Kingdom.

The research study revealed that the introduction of the new debt reduction rules did not come with any significant amendments to the relief given to financially distressed debtors

in the case of a debt waiver. The research also revealed that the relief provisions that are contained in the new debt reduction rules do not compare favourably to the relief that is given in the case of a debt waiver of a financially distressed debtor in Canada and the United Kingdom. The research study was concluded with suggestions for improvements to the Act, which will provide relief to financially distressed debtors where the new debt reduction rules are currently lacking.

KEYWORDS

Debtor, Debt reduction, Debt forgiveness, Financial distress, Insolvency, Recoupment, Relief

TABLE OF CONTENTS

ABSTRACT	II
LIST OF ABBREVIATIONS	VIII
LIST OF DEFINITIONS	IX
Chapter 1 Introduction	1
1.1 Background	1
1.2 Problem Statement.....	4
1.3 Objectives	4
1.3.1 Main objective	4
1.3.2 Secondary objectives	4
1.4 Purpose/significance of the research study	5
1.5 Research design.....	6
1.5.1 Introduction.....	6
1.5.2 Researcher's ontology and epistemology.....	7
1.5.3 Researcher's research paradigm	7
1.5.4 Research approach	8
1.5.5 Research methods	10
1.6 Chapter outline	11
Chapter 2 What is financial distress?	12
2.1 Introduction	12
2.2 Meaning of the term financial distress	12
2.2.1 Financial distress as defined in the Companies Act (71 of 2008)	12
2.2.2 Financial distress as defined in the United Kingdom	17
2.3 The lifecycle of financial distress	18
2.4 Recovery from financial distress	21

2.4.1	<i>When to initiate recovery proceedings</i>	21
2.4.2	<i>Approach to recovery</i>	22
2.4.2.1	Informal rescue proceedings	22
2.4.2.2	Formal rescue proceedings	23
2.4.2.2.1	Business rescue proceedings.....	23
2.4.2.2.2	Compromise of debts	24
2.4.2.2.3	Liquidation	25
2.5	<i>Conclusion</i>	26
Chapter 3 The development of the debt reduction rules in South Africa		28
3.1	<i>Introduction</i>	28
3.2	<i>The previous debt reduction rules</i>	29
3.2.1	<i>Section 8(4)(m) of the Act</i>	29
3.2.2	<i>Paragraph 12(5) of the Eighth Schedule to the Act</i>	33
3.2.2.1	Background	33
3.2.2.2	Introduction of the group of companies' exemption	35
3.2.2.3	Introduction of the liquidation exemption	36
3.2.2.4	Introduction of anti-avoidance measures.....	36
3.2.3	<i>Summary of the previous debt reduction rules</i>	38
3.3	<i>Donations tax under the previous debt reduction rules</i>	39
3.4	<i>The new debt reduction rules</i>	40
3.4.1	<i>Background to the introduction of the new debt reduction rules</i>	40
3.4.2	<i>Introduction to the new debt reduction rules</i>	42
3.4.3	<i>Paragraph 12A of the Eighth Schedule to the Act</i>	43
3.4.3.1	The debt funded the acquisition of a non- allowance asset	43
3.4.3.2	Debt funded allowance assets.....	46

3.4.3.3	Exclusions from the application of paragraph 12A	47
3.4.4	<i>Development of section 19 of the Act</i>	50
3.4.4.1	Introduction.....	50
3.4.4.2	The debt funded operating expenditure or trading stock still held	51
3.4.4.3	Debt funded operating expenditure or trading stock not held	52
3.4.4.4	Debt funded the acquisition of allowance assets that were still on hand and not disposed	52
3.4.4.5	Exemptions from the application of section 19 of the Act	53
3.4.5	<i>Summary of the new debt reduction rules</i>	54
3.5	<i>Comparison between the previous and the new debt reduction rules</i>	56
3.6	<i>Conclusion</i>	61
Chapter 4	The debt reduction rules in Canada and the United Kingdom	64
4.1	<i>Introduction</i>	64
4.2	<i>Workings of the debt forgiveness rules in Canada</i>	65
4.2.1	<i>General</i>	65
4.2.2	<i>Exemptions</i>	68
4.2.2.1	Transferring the forgiven amount	68
4.2.2.2	Insolvency deduction	68
4.2.2.3	Creating a reserve for certain debtors	70
4.2.3	<i>Summary of the Canadian debt reduction rules</i>	70
4.3	<i>Workings of the debt forgiveness rules in the United Kingdom</i>	71
4.3.1	<i>General</i>	71
4.3.2	<i>Exemptions from the UK debt reduction rules</i>	73
4.3.2.1	Insolvency transactions	74
4.3.2.2	Debt for equity transactions	77

4.3.2.3	Financial distress.....	78
4.3.3	<i>Summary of the UK debt reduction rules.....</i>	79
4.4	<i>Summary and comparisons of the debt reduction rules</i>	80
4.5	<i>Comparison to South Africa.....</i>	82
4.5.1	<i>General.....</i>	82
4.5.2	<i>Canada.....</i>	83
4.5.3	<i>The United Kingdom.....</i>	85
4.6	<i>Conclusion.....</i>	87
Chapter 5 Conclusion.....		89
5.1	<i>Introduction</i>	89
5.2	<i>Achievement of objectives</i>	90
5.3	<i>Recommendations</i>	93
5.4	<i>Suggestions for future study</i>	95
5.5	<i>Conclusion.....</i>	97
BIBLIOGRAPHY		99

LIST OF ABBREVIATIONS

BIA	Bankruptcy and Insolvency Act
CCAA	Companies' Creditors Arrangement Act
CIPC	Companies and Intellectual Property Commission
CTA	Corporation Tax Act
GAAR	General Anti Avoidance Rules
HMRC	Her Majesty's Revenue and Customs (UK)
SARS	South African Revenue Service
UK	The United Kingdom

LIST OF DEFINITIONS

- Allowance asset** As defined in paragraph 12A of the Eighth Schedule to the Income Tax Act (58 of 62) means a capital asset in respect of which a deduction or allowance is allowable in terms of the Act for purposes other than the determination of any capital gains or capital loss
- Assessed capital loss** is defined in paragraph 9 of the Eighth Schedule to the Income Tax Act (58 of 62) and means a person's assessed capital loss for a year of assessment, where that person has—
- a) an aggregate capital gain for that year. This is the amount by which that person's assessed capital loss for the previous year of assessment exceeds the amount of that person's aggregate capital gain for that year;
 - b) an aggregate capital loss for that year. This is the sum of that person's aggregate capital loss for that year and that person's assessed capital loss for the previous year; or
 - c) neither an aggregate capital gain nor an aggregate capital loss for that year. It is the amount of that person's assessed capital loss for the previous year.
- Base cost** the amount determined in terms of paragraph 20 of the Eighth Schedule to the Income Tax Act (58 of 62). This broadly means the expenditure actually incurred in respect of the cost of acquisition or creation of that asset

Canadian Income Tax Act (1985)	Income tax Act, R.S.C. 1985, c1. (5 th sup)
Capital asset	as defined in paragraph 12A of the Eighth Schedule to the Income Tax Act (58 of 62) means an asset that is not trading stock
Capital gain	as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act (58 of 62) means the amount by which the proceeds received or accrued in respect of a disposal exceed the base cost of that asset
Capital loss	as defined in paragraph 1 of the Eighth Schedule to the Act and means the amount by which the base cost of that asset exceeds the proceeds received or accrued in respect of a disposal
Connected person	<p>is defined in section 1 of the Income Tax Act (58 of 62) as:</p> <ul style="list-style-type: none"> a) in relation to a natural person— <ul style="list-style-type: none"> (i) any relative; and (ii) any trust (other than a portfolio of a collective investment scheme) of which such natural person or such relative is a beneficiary; b) in relation to a trust (other than a portfolio of a collective investment scheme)— <ul style="list-style-type: none"> (i) any beneficiary of such trust; and (ii) any connected person in relation to such beneficiary; <p>bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment</p>

scheme), including any person who is a connected person in relation to such trust;

c) in relation to a member of any partnership or foreign partnership—

(i) any other member; and

(ii) any connected person in relation to any member of such partnership or foreign partnership;

d) in relation to a company—

(i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent of the equity shares in” paragraphs (a) and (b) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent of the equity shares or voting rights in”;

(ii)

(iii)

(iv) any person, other than a company as defined in section 1 of the Companies’ Act that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of—

A. the equity shares in the company; or

B. the voting rights in the company;

- (v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;
 - (vi) any other company if such other company is managed or controlled by—
 - A. any person who or which is a connected person in relation to such company; or
 - B. any person who or which is a connected person in relation to a person contemplated in item (aa); and
 - (vii) where such company is a close corporation—
 - A. any member;
 - B. any relative of such member or any trust (other than a portfolio of a collective investment scheme) which is a connected person in relation to such member; and
 - C. any other close corporation or company which is a connected person in relation to—
 - (i) any member contemplated in A; or
 - (ii) the relative or trust contemplated in item B;and
- e) in relation to any person who is a connected person in relation to any other person in terms of the

foregoing provisions of this definition, such other person:

Group of companies	defined in section 41 of the Act as two or more companies in which one company (hereinafter referred to as the “controlling group company”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “controlled group company”), to the extent that— a) at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company.
New debt reduction rules	section 19 and paragraph 12A of the Eighth Schedule to the Income Tax Act, with effect from years of assessment commencing on/ after 1 January 2013
Previous debt reduction rules	section 8(4)(m) and paragraph 12(5) applicable to years of assessment commencing after 1 October 2001 but before 1 January 2013
Reduction amount	the amount by which a debt is reduced less any amount applied as consideration for the reduction
Remaining forgiven amount	the forgiven amount of a Canadian corporation after applying the available tax attributes against such amount

Related corporation

in terms of section 251 of the Canadian Income Tax Act (1985), two corporations will be related –

- i. if they are controlled by the same person or group of persons;
- ii. if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation;
- iii. if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation;
- iv. if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation;
- v. if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation; or
- vi. if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

Specified shareholder defined in terms of section 248 of the Canadian Income Tax Act (1985) as a taxpayer who owns, directly or indirectly, at any time in the year, not less than 10% of the issued shares of any class of the capital stock of the corporation or of any other corporation that is related to this corporation.

The UK insolvency law The Insolvency Act of 1986

LIST OF FIGURES

Figure 2-1: Timeline of financial distress	20
--	----

LIST OF TABLES

Table 3-1:	Comparison of debt reduction rules where debt funded deductible expenditure	Error! Bookmark not defined.
Table 3-2:	Comparison of debt reduction rules where debt funded capital expenditure	Error! Bookmark not defined.
Table 4-1:	Summary and comparison of the debt reduction rules	81

Chapter 1

Introduction

1.1 Background

The tax consequences of a debt waiver were regulated by proviso (ii) to section 8(4)(a) to the Income Tax Act (58 of 1962) (the Act). After these provisions had been deleted by the Taxation Laws Amendment Act (22 of 2012), new rules were introduced by way of paragraph 12A of the Eighth Schedule to the Act read with section 19 of the Act, which came into effect 1 January 2013.

The introduction of the new debt reduction rules were intended to assist financially distressed debtors following the impact of the global financial crisis. The Legislature maintained that the tax system acted as an added impediment to the recovery of companies and other parties that were financially distressed. It further accepted that the potential tax imposed on such companies effectively undermined the economic benefit of the relief on offer (SARS, 2012:44; SARS, 2013:136).

In SARS' Interpretation Note 91 on reduction of debt, the Legislature issued guidance on the interpretation and application of the new debt reduction rules and acknowledged that debt relief was evident in various scenarios such as insolvency, business rescue and other informal workouts such as debt restructuring undertaken by a financially distressed person with creditors, outside of formal insolvency proceedings (SARS, 2015:3-4). This implied that the new debt reduction rules were aimed at addressing the negative tax consequences that could have arisen as a result of debt restructuring transactions.

Previous debt reduction rules that were enacted prior to 2013 resulted in a recoument of the amount of the debt waived in terms of section 8(4)(m) of the Act, where such

debt was used to fund expenditure claimed in terms of section 11 of the Act. In circumstances where the taxpayer had an assessed loss, the amount of the debt waived would first be set-off against such assessed loss in terms of proviso (ii) to section 20(1)(a) of the Act.

In circumstances where debt funded capital expenditure and such debt were discharged for no consideration or for consideration less than the face value of the debt, paragraph 12(5) of the Eighth Schedule to the Act treated such a discharge as a deemed disposal in the hands of the debtor, unless such amount had already been taken into account in terms of section 8(4)(m) or proviso (ii) of section 20(1)(a) of the Act.

With effect from 1 January 2013 section 19 and paragraph 12A of the Act were introduced in an attempt to clarify the tax implications arising from the waiver or reduction of a debt (Rudnicki, 2014:52) and to provide relief to debtors in financial distress (SARS, 2012:44). The only exemption in section 19 which could be applied in a corporate context, occurs where a debt is reduced by way of a donation as defined in section 55 of the Act (Rudnicki, 2014:55). In other words, the exemption from the section 19 recoupment will apply only where the debt is discharged as “a gratuitous disposal of property including any gratuitous waiver or renunciation of a right”, which is unlikely in most corporate debt waiver scenarios (Rudnicki, 2014: 52).

Read with section 19 of the Act, paragraph 12A of the new debt reduction rules will apply where a debt was used to fund the acquisition of non-allowance assets or allowance assets. Therefore, where a debt was used to fund the acquisition of a capital asset, any subsequent waiver of the debt will result in a reduction of the base cost of the asset (if still on hand), with any balance applied toward an available assessed capital loss (Rudnicki, 2014: 54- 55). This will be the case unless the base cost of the allowance asset is reduced to nil, in which case the remainder of the reduction amount

will be treated as a recoupment under section 19 of the Act (limited to the value of allowances that were previously claimed on the asset).

The relief that the Legislature extended by the introduction of the new debt reduction rules applied where the debt specifically funded a non-allowance asset or an allowance asset in terms of paragraph 12A, which relief is focused around the postponement of the realisation of a capital gain in the hands of the debtor (Van Reenen, 2015:30- 31).

In comparing the relief provisions in the Act to other countries, it is interesting to note that some jurisdictions have adopted an approach to exempt profits that result from debt waivers in an attempt to avoid impeding a debtor from reaching a valuable debt restructuring agreement with the creditors (Freshfields Bruckhaus Deringer, 2006: 42). A suggestion has been made that a regulatory framework should be introduced that requires financial institutions to write down the value of distressed debt, suggesting that tax disincentives for debt write-downs or transfer of a distressed loan to a third party, should be removed as was done *inter alia* in Latvia, Romania and Serbia (Lui & Rosenberg, 2013: 13). It has also been recommended that tax and social security administrations should be encouraged to participate in debt restructurings in accordance with clearly defined rules (Lui & Rosenberg, 2013: 13).

Research was conducted to establish whether the relief that was extended by the introduction of the new debt reduction rules, does in fact, address the real economic challenges that are faced by those debtors in financial distress, but with reasonable prospects of recovery. At the outset of the study, the researcher cautioned that the Legislature needed to be mindful of schemes and transactions that were aimed at the avoidance of tax. For this reason the new debt reduction rules are compared to the tax treatment of debt reductions in countries where specific relief is provided to companies that are considered to be in financial distress.

1.2 Problem Statement

As the new debt reduction rules provide relief in very specific circumstances, the aim of this dissertation is to analyze whether the design of the new debt reduction rules conceptually facilitate the recovery of economically viable, but financially distressed companies.

1.3 Objectives

1.3.1 Main objective

The main objective of this dissertation was to establish whether the new debt reduction rules facilitate the recovery of companies that are in financial distress.

1.3.2 Secondary objectives

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

- To explore the meaning of the term financial distress as defined in the Companies Act (71 of 2008). The meaning and application of the term were also investigated from the perspective of the UK tax legislation and work performed by various researchers. This objective is addressed in Chapter 2 of the dissertation;
- To analyze the development and the workings of the debt reduction rules in South Africa, specifically to ascertain whether the new debt reduction rules introduced additional relief to those debtors that were considered to be in financial distress. This objective was achieved through a process of research on the history and the policy rationale behind the previous debt reduction rules and the new debt reduction rules as set out in section 19 and paragraph 12A of

the Eighth Schedule to the Act. This objective forms the basis of the discussion in Chapter 3 of the dissertation; and

- to compare South Africa's debt reduction rules, where the debtor is considered to be in financial distress, to the tax treatment of debt reductions in Canada and the UK. These countries have been chosen as they have in place customised debt reduction rules that may aid companies experiencing financial trouble or financial distress and also because as per Burdette, cited by Pretorius & Rosslyn-Smith (2014:111), these countries have what is regarded as modern rescue regimes which reflect the latest international developments. This objective is addressed in Chapter 4 of the dissertation.

1.4 Purpose/significance of the research study

In the light of the comments that were made by the Legislature in its Explanatory Memorandum to the new debt reduction rules (SARS, 2012), specifically statements that were made regarding financially distressed companies in that "relief for these companies is essential" and that "the tax system unfortunately acts as an added impediment", further research was conducted to establish whether the Legislature effectively addressed those concerns raised in the 2012 Explanatory Memorandum.

In his 2016 budget speech, Mr Pravin Gordhan announced that "the past year has seen a deterioration in the global economy" with an estimated worldwide growth of only 3.1% for 2016. He further alluded to the fact that South Africa's economic prospects are intertwined with global economic developments and this, combined with weaker business confidence, debilitated electricity supply, water shortages coupled with the recent drought and a decline in all major exports in South Africa have culminated in an expected growth rate of just 0.9% for South Africa in 2016. In addition, in its 2016 Budget Summary, National Treasury alluded to the fact that further currency weaknesses could raise inflation and prompt higher interest rates, which would indefinitely lead to lower growth. Furthermore, "weaker-than-forecast improvements in electricity availability and higher electricity prices may also reduce growth". In the

event of a ratings agency downgrade a continued decline in investor confidence will follow leading to higher borrowing costs, further Rand depreciation, and sharper reductions in public and private investment, with knock-on effects for employment and consumption (South Africa, 2016).

This researcher investigated whether the current tax provisions provided adequate relief for debtors that were considered to be in financial distress, and where there was an expectation of economic recovery.

1.5 Research design

1.5.1 Introduction

Research is the systematic process of collecting and analysing information (data) to increase an understanding about the phenomenon about which the researcher is concerned or interested in. The ultimate goal of research itself is to derive conclusions from a body of data and discover what was hitherto unknown. (Leedy & Ormrod, 2001: 3,4; Stack 2011:6).

Research has also been described as a process of discovery, interpretation and communication (Stack, 2011:19).

For this study the researcher collected, analyzed and interpreted information relating to the tax debt reduction rules in South Africa. The researcher's aim was to gain a better understanding of the development of the debt reduction rules over time and to grasp fully the workings in a corporate debt waiver scenario, especially where the debtor was considered to be in financial distress.

1.5.2 Researcher's ontology and epistemology

Ontology is the philosophical study of the nature of being, existence or reality. Ontology focuses on how knowledge can be represented. The researcher aims to determine which entities exist and philosophises about how these entities can be classified and/or relate to one another (Pieterse & Kourie, 2014:223). In other words, ontology is the researcher's view of the world within which the research is conducted.

A researcher who does not perceive reality to exist independently, but rather views reality as being dependent on various circumstances and environmental factors, holds a relativist world view.

A relativist approach to research implies that the researcher respects the opinions and views of different people and different groups. This attitude accommodates a respect for differences in perspectives and a respect for democratic approaches to group opinion and value selection (Johnson & Onwuegbuzie, 2004:16).

In the research that was conducted around the debt reduction rules in South Africa a relativist view was adopted. The researcher who is a tax accountant with a relativist world view appreciates that the interpretation, intention and application of tax legislation are dependent on various factors that exist outside the rule of law.

1.5.3 Researcher's research paradigm

A researcher's ontology and epistemology affect the philosophical paradigm within which the research is conducted.

The philosophical paradigm which applies to a relativist's view of the world is referred to as an interpretivist or anti-positivist paradigm. In the interpretivist paradigm, research conducted does not attempt to prove a single truth or to seek answers to questions, but rather to gain an understanding of a specific phenomenon.

The researcher, whose philosophical paradigm is best described as interpretivist, can be expected to employ a qualitative methodology which requires inductive reasoning to be employed rather than pure logic (McKercher, M. 2008:6).

Qualitative research is designed to reveal a target audience's range of behaviour and the perceptions that drive it in terms of specific topics or issues. In-depth studies of small groups of people are used to guide and support the construction of an hypothesis. Results of qualitative research are descriptive rather than predictive (Qualitative Research Consultants Association, 2016).

As the researcher's philosophical paradigm is interpretivist, qualitative research methods have been applied to construct an hypothesis that debt reduction rules in South Africa are not likely to provide support for debtors that are considered to be in financial distress.

1.5.4 Research approach

A study was conducted on the tax laws and interpretations governing the implications for a corporate debtor on a debt waiver, specifically where such debtor is considered to be in financial distress. The study focused on the intention of the Legislature with the introduction of the newly released section 19 and paragraph 12A of the Eighth Schedule to the Act to assist a financially distressed debtor and specifically whether

such intention could be achieved using the new debt reduction rules. The researcher also attempted to ascertain whether the South African debt reduction rules would provide adequate relief in circumstances where a financially distressed debtor was subject to a debt reduction, by comparing the new debt reduction rules to the applicable rules in Canada and the UK.

An investigation into the grounded theory methodology reveals that it is a research method that will enable the researcher to develop a theory which offers an explanation of the main concern for the population regarding the selected substantive area and how that concern can be resolved or processed (Grounded Theory Online, 2016).

The application of the grounded theory methodology is further explained by McKercher (2008):

In grounded theory the researcher attempts to derive a general, abstract theory of a process, action or interaction that is "grounded" in the views of participants in a study. Two primary characteristics of this design are the constant comparison of data with emerging categories and theoretical sampling of different groups to maximise the similarities and differences of information.

Strauss and Corbin argue that given the way in which grounded theories are constructed, they are likely to offer insight, enhance understanding and provide a meaningful guide to action. The challenge for the researcher is to be open-minded, to listen to and hear what is being said and to interpret it as honestly as possible, always checking and rechecking for other possible interpretations.

The researcher used the grounded theory methodology to develop a theory, which is based on legislation and available literature, to provide insight into and enhance the understanding of the debt reduction rules for a corporate debtor in financial distress. The researcher also attempted to provide a meaningful guide to action.

1.5.5 Research methods

Grounded theory researchers who enter the field and gather data from interviews, observations, documents and immediately begin to analyse the data (Kuhlmann, 2013:44). Thus, according to Egan, Fendt & Sachs and Glaser & Strauss (as cited in Kuhlmann, 2013) the researcher collects data and immediately begins an iterative process of examining data, comparing, capturing insights and comparing again. At the same time while researchers are coding data, they are also trying to capture their thoughts about emerging theory and concepts (Kuhlmann, 2013:44).

The researcher conducted the research using data gathered in a literature review. The purpose of the literature review was to acquire a detailed knowledge of the previous and the new debt reduction rules and to analyse whether adequate relief was being provided to financially distressed debtors.

The new debt reduction rules were compared to the approach taken by Canada and the UK, specifically relating to debtors in financial distress.

The researcher scrutinised the following sources to answer the research objectives:

- South African legislation;
- International regulations;
- Interpretation notes;
- Explanatory memoranda;
- Guides issued by the SARS;
- Tax articles and journals; and
- Published articles and theses.

1.6 Chapter outline

This document comprises of the following chapters:

Chapter 1 provides the background to the study and spells out the problem statement while formulating the research objectives and the research methodology.

Chapter 2 explores the meaning and definition of the term financial distress, specifically the meaning of financial distress as defined in the South African Companies Act, 2008. This chapter also addresses the first objective as identified in paragraph 1.3.2 of this study.

Chapter 3 traces the history and application of the debt reduction rules from the introduction of section 8(4)(m) and paragraph 12(5) of the Eighth Schedule to the Act as well as the introduction of section 19 and paragraph 12A of the Eighth Schedule to the Act. This chapter addresses the secondary objective as identified in paragraph 1.3.2 of this study.

Chapter 4 cites the debt reduction rules that apply in Canada and the UK and compares the relief given to financially distressed debtors in these countries to the relief given under the new debt reduction rules. This chapter addresses the third objective as identified in paragraph 1.3.2 of this study.

Chapter 5 provides conclusions based on each of the research objectives while listing recommendations and suggestions for future study. This chapter contains conclusions reached on the problem statement as identified in paragraph 1.2 of chapter 1.

Chapter 2

What is financial distress?

2.1 Introduction

Since the global financial crisis in 2008, global debt has risen significantly (McKinsey, 2015). This, coupled with limited economic growth has resulted in tough trading conditions for companies. To further aggravate future economic prospects, high levels of debt in the past have had the effect of limiting growth and raising the risk of financial crises (McKinsey, 2015). The result of the aforementioned is an increasing risk that highly leveraged companies may enter into a state of financial distress.

In its Explanatory Memorandum, released with the introduction of the new debt reduction rules, the Legislature alluded to the term financial distress. It has indicated that the reason for the introduction of the new debt reduction rules was to address the unintended consequences arising from debt relief extended to a distressed debtor (SARS, 2012).

This chapter will interrogate the meaning of the term financial distress by referring to the Companies Act (71 of 2008) and other available studies which trace the lifecycle of financial distress and how a company can recover from it. The aim of this chapter is to provide a backdrop against which the conceptual design of the new debt reduction rules, designed to assist companies that are considered to be in financial distress, can be assessed.

2.2 Meaning of the term financial distress

2.2.1 Financial distress as defined in the Companies Act (71 of 2008)

Although the term financial distress has not been incorporated into the Act, the Legislature has acknowledged that the tax system could act as an added impediment

to companies that are in financial distress (SARS 2012: 44). This is cited as the reason for the introduction of the new debt reduction rules in 2012. Furthermore for this reason the meaning of the term is analyzed in this chapter.

As per section 128(f) of the Companies Act (71 of 2008) the term financially distressed means that:

- (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or
- (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months;

Part (i) of the definition of financial distress refers to a company's ability to pay its debts, which is dependent on the availability of, or access to cash or liquid assets (Wainer, 2015: 510). A company will be in financial distress in terms of the Companies Act (71 of 2008), if there is a strong likelihood that it will be unable to meet its debt obligations within the coming six months. The phrase reasonable likelihood implies that there exists a rational basis for the view that the company may not be able to pay its debts within the coming six months. This conclusion amounts to an educated prediction, based on the current financial position of the company, with consideration of all relevant factors that may impact the company's liquidity in the foreseeable future (Erasmus, 2015).

The ability of a company to pay its debts as they become due is referred to as commercial solvency. A company that is unable to pay its debts as they become due is regarded as being commercially insolvent (Wainer, 2015). As can be seen in *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Limited (936/2012)* a company that is unable to pay its debts is regarded as commercially insolvent, even though it may still be factually solvent because its assets exceed its liabilities. It is an accepted

practice in our courts that commercial insolvency justifies the liquidation of a company (Moosa, 2014). The winding up of an insolvent company is still dealt with in terms of Chapter 14 of the Companies Act (61 of 1973), as if these sections have not been repealed (Boraine & Van Wyk, 2013). Specifically, section 343 of the Companies Act (61 of 1973) states that a company may be wound up voluntarily, by any of the creditors or members of a company, or by order of the Court. In terms of section 344 of the Companies Act (61 of 1973), a company may be wound up by a court in the following circumstances:

- a) the company has by special resolution resolved that it be wound up by the Court;
- b) the company commenced business before the Registrar certified that it was entitled to commence business;
- c) the company has not commenced its business within a year from its incorporation, or has suspended its business for a whole year;
- d) in the case of a public company, the number of members has been reduced below seven;
- e) seventy-five per cent of the issued share capital of the company has been lost or has become useless for the business of the company;
- f) the company is unable to pay its debts as described in section 345;
- g) in the case of an external company, that company is dissolved in the country in which it has been incorporated, or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs;
- h) it appears to the Court that it is just and equitable that the company should be wound up.

Further to subparagraph (f) of section 344 of the Companies Act (61 of 1973), a company will be deemed unable to pay its debts in terms of section 345 of the Companies Act (61 of 1973) when:

- a) a creditor, by cession or otherwise, to whom the company is indebted in a sum not less than one hundred rand then due-

- (i) has served on the company, by leaving the same at its registered office, a demand requiring the company to pay the sum so due; or
 - (ii) in the case of any body corporate not incorporated under this Act, has served such demand by leaving it at its main office or delivering it to the secretary or some director, manager or principal officer of such body corporate or in such other manner as the Court may direct, and the company or body corporate has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or
- b) any process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that he has not found sufficient disposable property to satisfy the judgment, decree or order or that any disposable property found did not upon sale satisfy such process; or
 - c) it is proved to the satisfaction of the Court that the company is unable to pay its debts.

Part (ii) of the definition of financial distress applies where a company is factually insolvent or, in other words, where the company's liabilities exceed its assets, fairly valued (Wainer, 2015). A company that is factually insolvent may still be able to pay its debts, therefore factual insolvency is not, in and of itself, a reason for a company to be placed into liquidation (Moosa, 2014)). Therefore, the test for financial distress in terms of part (ii) of the definition of financial distress should encompass the complete financial position of the company rather than just the factual insolvency aspect (Erasmus, 2014).

From the above it is clear that a company may be regarded as being financially distressed according to the Companies Act (71 of 2008), if there is a reasonable likelihood that it will become commercially insolvent or factually insolvent. A company may be voluntarily liquidated or liquidated by the court in terms of Chapter 14 of the Companies Act (61 of 1973), although a liquidation order may still be set aside in terms of section 131(6) of the Companies Act (71 of 2008) where a company has entered into business rescue proceedings. Furthermore it is important to note that where a company meets the requirements of financial distress as per the Companies Act (71 of 2008), the directors of the company will have a duty in terms of section 129(7) of the Companies Act (71 of 2008) either to adopt a resolution to go into business rescue

or to provide a written notice to stakeholders that it will not go into business rescue proceedings (Erasmus, 2014). Such notice may, in and of itself, not serve the best interests of the interested parties, as the company may be fully able to continue doing business (Erasmus, 2014) and such notice may be tantamount to commercial suicide (Kotze, 2013).

In the light of the duty imposed on the directors of a company to act in accordance with the Companies Act (71 of 2008) to place a company into business rescue proceedings where it meets the requirements of financial distress, it is imperative that the directors should act timeously to address red flags and other early warning signs of financial distress (Smyth, 2012). Warning signs to watch out for include a negative cash flow, customers exceeding their credit terms, an increase in borrowings over a sustained period, strained relationships with bankers and an inexperienced management team (Small, 2016). Financial distress can also be identified by an analysis of financial ratios of a company. Typical ratios that are used to predict financial distress include cash flow ratios, debt-to-total assets ratios, liquid assets to total assets ratios, liquid assets to current debt ratios, turnover ratios and net income ratios (Van der Colff, 2012). Further predictors of financial distress may also occur when a company's Earnings Before Interest, Tax, Depreciation and Amortisation are below the actual interest expense of the company for any two consecutive years or where a company experiences pre-tax losses over at least three consecutive years (Outecheva, 2007).

The use of only financial ratios to predict financial distress have however been criticised due to the fact that the ratios do not capture the future dynamics and prospects of a company (Outecheva, 2007:17). This implies that the term financial distress should be determined by incorporating not only financial variables, but also non-financial variables which track important company characteristics. These include vulnerability, flexibility, efficiency, resources and capability (Van der Colff, 2012:60).

It is clear from the above discussion that financial distress is open to very wide interpretation and, most importantly, financial distress does not imply liquidation or insolvency of a financially distressed debtor. This important distinction will become relevant when the tax implications of a debt reduction are analysed in chapter 3.

2.2.2 Financial distress as defined in the United Kingdom

In the UK, the term financial distress has been included in the introduction to its new tax corporate rescue exemptions which will apply where there is a corporate debt reduction. The purpose of the exemptions is to promote remedial action and to facilitate the restructuring of debts of companies that are in financial distress and in danger of, but not yet in, insolvency (Akin Gump Strauss Hauer & Feld LLP, 2015). In terms of the newly introduced UK debt reduction rules, a company will be subject to relief where it is reasonable to assume that without the release of the debt there will be a material risk that, at some time within the next 12 months the company will be unable to pay its debts (Robinson, 2016). This can be compared to the definition of financial distress in part (i) of section 128 to the Companies Act 2008, whereby a company is regarded as being in financial distress, where it is reasonably unlikely that it will be able to pay all its debts as they become due and payable within the immediately ensuing six months (or in other words, where there is a material risk of commercial insolvency).

Her Majesty's Revenue and Customs have also issued the following situations of where it is reasonable to assume that the debtor may go into insolvency (HMRC, 2015):

- a) likely breaches of financial covenants, negotiations with third party creditors over release or restructuring of debt;
- b) enforcement actions taken by creditors;

- c) adverse trading conditions with no prospect of recovery, failure of a material customer or supplier, redundancies, business disasters, litigation that the company may be unable to meet;
- d) management accounts, reports and forecasts showing material cash flow shortfalls;
- e) an insolvent balance sheet;
- f) qualified audit reports, accounts prepared on a break up basis.

In addition to trying to define financial distress as per the Companies Act (71 of 2008) and the UK debt reduction rules, consideration is also given to the lifecycle of financial distress and how a company can react to financial distress, depending on its position in the cycle of distress. The reason for further analysis is to highlight the fact that the term financial distress is not a static concept, but rather an everchanging concept depending on the company's level of distress. While it serves to highlight that a financially distressed company can recover from financial distress it also serves as evidence that tax debt reduction rules are an important factor in the rehabilitation of a distressed debtor.

2.3 The lifecycle of financial distress

To analyze the lifecycle of financial distress it is imperative to understand the underlying causes thereof. The state of being in financial distress can be described as the result of an incident or a distress point (Outecheva, 2007:16). A distress point is an event which results in a sharp decline in a company's performance and value, which usually begins with a significant decline in profitability, ultimately leading to further distress as revenue is insufficient to cover costs (Outecheva, 2007:17). This includes rising interest expense on increasing levels of debt (Asquith, Gertner & Scharfstein, 1994)). As a result of the aforementioned factors, the distressed company experiences cash flow constraints (Van der Colff, 2012), which in turn will be reflected in poor operating performance relative to other companies operating in the same industry (Asquith, Gertner & Scharfstein, 1994). Ultimately, the company's liabilities will exceed

its assets at which point it will be regarded as factually insolvent and therefore in financial distress as per the Companies Act (71 of 2008).

Various authors have described financial distress as a crucial event, which separates the period of a company's financial health from the period of its financial illness (Outecheva, 2007:14). A company in distress will be compelled to take corrective steps to overcome the troubled situation or event (Outecheva, 2012:14) and to move past the crucial event into recovery if it is to prevent insolvency or liquidation.

Financial distress is also described by some researchers as an occurrence which exists on a distress continuum, where temporary financial distress exists at one end and distress of a more permanent nature at the other end (Van der Colff, 2012: 3). In other words, there is no cut-off point between failed and non-failed companies, as there is usually an overlap or grey area between the two (Muller, Steyn & Hamman 2012). Financial distress is also aptly described as a series of subsequent stages which are characterised by adverse financial events, or put differently, each stage of financial distress is an interval between two distress points (Outecheva, 2007:16). Where there is no intervention between the distress points or stages, a temporarily distressed company will eventually default and liquidate, thereby moving from one end of the continuum to another. For this reason, in the initial phase of the distress cycle, early detection of financial distress is imperative as it could significantly increase the likelihood of a company returning to financial health (Van der Colff, 2012:4).

The timeline of financial distress in the South African context is depicted in the figure below:

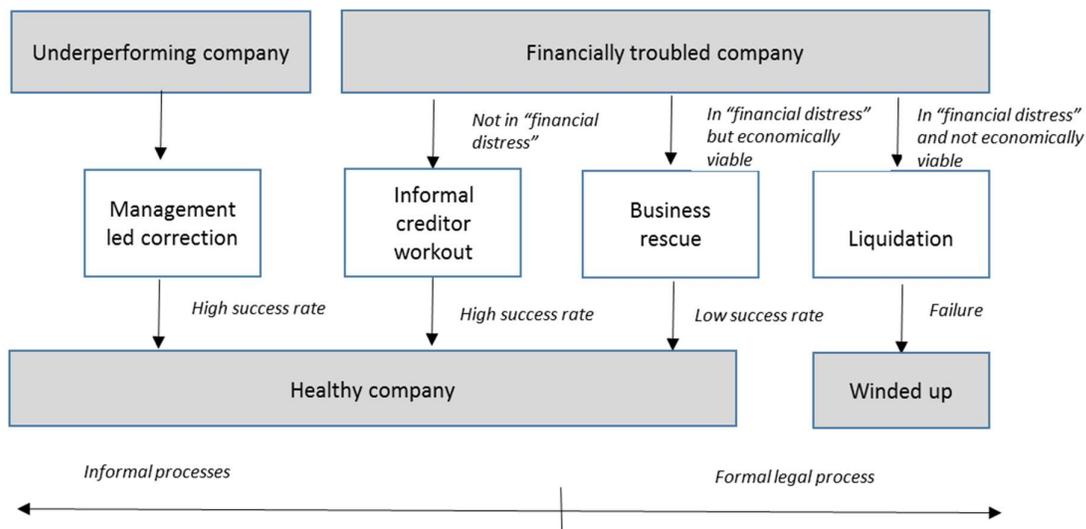


Figure 2-1: Timeline of financial distress

(Source: Corporate Renewal Solutions, 2016)

Based on a review of the definitions of financial distress above, it is clear that even before an economically viable company enters into business rescue or liquidation proceedings it could be regarded as being financially troubled, requiring intervention through informal rescue proceedings (Corporate Renewal Solutions, 2016e). However, early intervention is imperative to prevent financial failure (Van der Colff, 2012:30). This is depicted in Figure 2.1, where there is a high success rate in instances where the financial woes an underperforming company, and even a financially troubled company, are timeously addressed by either management led correction or informal creditor workout proceedings. This position on the timeline of financial distress can be compared to the position where a company becomes "financially distressed", requiring drastic intervention by way of either business rescue or liquidation proceedings, which processes also have a lower rate of success. It is further submitted that where companies are liable for higher tax obligations as a result of a debt reduction (which may be part of any intervention strategy aimed at rescuing a financially distressed company), this may act as an added impediment to foster corporate restructurings (Laryea, 2010:16). This in turn could result in the corporate failure of economically

viable companies (which are depicted as “healthy” companies in Figure 2.1) which still have a high success rate with the appropriate level of intervention).

2.4 Recovery from financial distress

Important to note is that early intervention is key to the survival of a financially troubled or distressed company (Smyth, 2012). For this reason recovery proceedings, as set out below, should be applied in conjunction with tax legislation to ensure the survival of an economically viable business that may be faced with early signs of financial trouble or distress, as set out by the Legislature in its 2012 Explanatory Memorandum.

2.4.1 When to initiate recovery proceedings

Following the view that financial distress is a process orientated event that exists on a distress continuum (as can be seen from Figure 2.1), it suggests that a company that is experiencing financial distress has the ability to shift its position on the distress continuum by implementing strategies to respond to the distress point. Based on a review of Figure 2.1, it is clear that a financially troubled company that is classified as being financially distressed using the criteria of the Companies Act (71 of 2008), has a considerably reduced success rate than a financially troubled company that has not been formally classified as financially distressed (Corporate Renewal Solutions, 2016e). This is aggravated by the fact that in the early stages of financial distress a company typically considers itself to be solvent (Outecheva, 2012:25). This means that it becomes very difficult to recognise and respond to negative processes inside the company as the warning signs are less obvious in a solvent situation. A distressed company will continually shift its position on the continuum until such time as the liabilities of the company exceed its assets and it becomes insolvent, following in a default on its debt. It is imperative that a company identifies the first indicators of financial distress and initiates rescue proceedings (whether formal or informal) as soon as possible to avoid insolvency and bankruptcy.

2.4.2 *Approach to recovery*

A company's approach to financial distress will depend on its position on the distress continuum.

2.4.2.1 Informal rescue proceedings

An informal workout is an out of court negotiation between a distressed company and its principal creditors. A company that responds to financial distress by entering into informal rescue proceedings is more successful after the workout when compared to a company that entered into formal rescue proceedings (Searle, 2013: 10-11; Corporate Renewal Solutions, 2016e). When entering into informal rescue proceedings a company however runs the risk that some of its creditors may choose not to support the process and attach the assets of the distressed company, which will almost certainly lead to liquidation (Searle, 2013: 11). Informal rescue proceedings however do have the benefit that these may be entered into long before a company's insolvency has set in allowing time for the workout to take effect (Corporate Renewal Solutions, 2016d)

Creditors may be reluctant to forgive amounts owing to it, other than for some form of compensation. A creditor (whether it be a connected person in relation to the debtor or not), may be willing to exchange the outstanding debt for the issue of shares in the debtor and this approach is frequently used in practice (SARS, 2015: 8). However, this approach may, in and of itself, provide a challenge where the debtor is still underperforming following the exchange and as such it may not always be an attractive alternative for a lender (Leslie, 2015). Further complications that may arise is where the market value of the shares issued for the exchange of the debt is below the face value of the debt. This may not represent adequate consideration, resulting in the reduction of debt for less than full consideration (SARS, 2015:8). This could lead to a breach of section 40 of the Companies Act (71 of 2008), which requires that shares may only be issued for adequate consideration. Further tax complexities may

also arise in terms of section 24BA where the market value of the shares issued immediately after the issue is lower than the subscription price for such shares resulting in a capital gain for the issuing company (SARS, 2015:9).

Where the debtor and the creditor are connected persons, the creditor may be more likely and willing to forgive amounts owing to the company. A forgiveness of intercompany loans may arise as a result of the need of the group (i) to clean up intercompany loans, and (ii) to facilitate group restructuring. It could also be as a result of a sale or acquisition, or where the loan accounts are the only remaining item on the balance sheet that needs to be cleared to deregister a company (Retief, 2015). As can be seen from paragraph 3.4.4.5 the new debt reduction rules do not provide any relief in respect of the forgiveness of intercompany debt where such debt was used to fund deductible expenditure. This was also the position under the old debt reduction rules.

2.4.2.2 Formal rescue proceedings

The Companies Act (71 of 2008) provides two mechanisms to facilitate the recovery and rescue of financially distressed debtors. These mechanisms are included in Chapter 6 and are aligned to the purpose of the Companies Act (71 of 2008), which is to "provide for the efficient rescue and recovery of financially distressed companies" (Klopper & Bradstreet, 2014:553). These mechanisms are discussed below.

2.4.2.2.1 Business rescue proceedings

With the global financial crisis in recent years, a greater focus has been placed on corporate recovery and insolvency and its effects on the economy (Searle, 2013: 12). Modern insolvency systems in developed nations usually offer financially distressed debtors two alternatives to resolve financial difficulties. These are liquidation or rehabilitation (through business rescue) (Pretorius & Rosslyn-Smith, 2014:111). Modern rehabilitation has become a tool that is devoted to maintaining a company as

a going concern and the modernization of South Africa's insolvency law has enabled features that are consistent with international best practice (Pretorius & Rosslyn-Smith, 2014:111).

On this basis, where the board of a company has reasonable grounds to believe that the company is financially distressed as defined, but where there appears to be a prospect of rescuing the company, it may initiate business rescue proceedings in terms of section 129 of the Companies Act (71 of 2008) (Mackay Davidson & Crystal 2015:19). A business rescue practitioner will be appointed to oversee the operations of the company during this time.

Entering into business rescue proceedings poses various challenges to the business rescue practitioner, which could be as a result of the adverse publicity that is attached to a company that enters into business rescue. Typical examples include loss of credit, loss of sales, loss of customers, loss of suppliers and loss of employees as well as difficulty with entering into new contracts (Corporate Renewal Solutions, 2016b). The stigma that is attached to a company placed into business rescue could also be traced back to the Companies Act (71 of 2008), as a restriction is placed on the action of any third party against the distressed company during the period that it is placed into business rescue (Corporate Renewal Solutions, 2016c). This includes special protection of the property of the distressed company in terms of section 134 of the Companies Act (71 of 2008).

2.4.2.2.2 Compromise of debts

A scheme of compromise, which appears in section 155 of the Companies Act (71 of 2008), applies to any company, irrespective of whether such company is in financial distress or not (Klopper & Bradsheet, 2014: 553). A scheme of compromise typically involves a situation where a company requests its creditors to accept a reduced compromise of their claims based on the premise that the payment that they will receive in respect of their claims under the compromise, is greater than that which they would receive on liquidation (Van Zuylen, 2009). The provisions of section 155 of the Companies Act (71 of 2008), also seeks to achieve the goals of a business rescue,

by strengthening the Companies Act (71 of 2008)'s purpose of encouraging successful rescue of companies (Klopper & Bradsheet, 2014:551).

In terms of section 155 of the Companies Act (71 of 2008), the board of a company is obliged to send a notice, together with a copy of the compromise proposal to all creditors requested to attend the meeting. Where at least 75% of the creditors are present and vote in favour of accepting the proposal, it will be considered as adopted (Mackay-Davidson & Crystal, 2015). It is important to note that where the business rescue regime allows a moratorium on any legal action being taken against the company, a scheme of compromise does not have this proviso. As such the company should have reasonable certainty that its creditors will accept the proposal before it embarks on a scheme of compromise (Klopper & Bradsheet, 2014: 562).

Schemes of compromise can take many forms, such as creditors writing off a portion of their claims or creditors being asked to waive interest on their claims (Van Zuylen, 2009).

2.4.2.2.3 Liquidation

Where informal debt workouts or formal rescue proceedings are unsuccessful, the company may be forced into liquidation which is the last and least desirable alternative (Corporate Renewal Solutions, 2016d).

The winding up of a company is governed by Chapter 14 of the Companies Act (61 of 1973) when such company is considered to be insolvent (Mackay Davidson & Crystal: 2015:18). In terms of section 343 of the Companies Act (61 of 1973) a company can be wound up voluntarily or by the court. Where a company is voluntarily wound up, this may be initiated only by the creditors or by the members of a company. Section 344 of the Companies Act (61 of 1973), further lists the circumstances in which a company may be wound up by the court. One of these reasons is when a company

is unable to pay its debts as described in section 345 of the Companies Act (61 of 1973).

2.5 Conclusion

The term financial distress as defined in the Companies Act (71 of 2008) refers to a company that is either reasonably likely to become commercially insolvent within the coming six months or a company that is likely to become factually insolvent within the following six months (Erasmus, 2014). A company that is commercially insolvent may be liquidated in terms of the Companies Act (61 of 1973). A company may also be voluntarily liquidated or liquidated by the court in circumstances listed in section 344 of the Companies Act (61 of 1973).

In addition to the above, a company that meets the criteria for financial distress as defined in the Companies Act (71 of 2008), is required either to adopt a resolution to commence business rescue proceedings or to issue a notice to the relevant stakeholders informing them of the contrary in terms of section 129 of the Companies Act (71 of 2008) (Kotze, 2013). In other words, where a company meets the criteria for financial distress as defined in the Companies Act (71 of 2008), it is either at risk of being liquidated by its creditors or it is obliged to act in terms of section 129 of the Companies Act (71 of 2008). It is also interesting to note that the definition of financial distress in the Companies Act (71 of 2008) is similar to the definition thereof in the newly introduced UK corporate tax rescue regime, where a company is regarded as being in financial distress when there is a material risk, that without the debt reduction, the company will be unable to pay its debts as they become due, or there will be a material risk that the company's liabilities will exceed its assets within the ensuing 12 months (Akin Gump Strauss Hauer & Feld LLP, 2015).

Further to the above, an investigation into the meaning of the term financial distress has revealed that it is a continuum in which a temporary troubled company can move into liquidation when no corrective steps are taken to address the factors that are

causing distress (Outecheva, 2007). A company can choose to respond to early indicators or warning signs of financial trouble, before it meets the criteria for financial distress as per the Companies Act (71 of 2008) (Smyth, 2012) or before it is liquidated. An early approach to recovery will include initiating informal rescue proceedings which may include reaching a compromise agreement with its creditors. Once a company has been classified as being financially distressed as per section 128 of the Companies Act (71 of 2008), the only response to the distress is to enter into business rescue proceedings or risk facing liquidation proceedings initiated by its creditors.

The exemptions and relief provided by the Legislature through the introduction of the new debt reduction rules need to be analysed carefully to determine whether a company that is regarded as being in financial distress will be eligible for sufficient tax relief on the reduction of its debts, based on the rationale used by National Treasury for the implementation of the new debt reduction rules (SARS, 2012). The analysis of the term financial distress above has revealed that early intervention is imperative to prevent a distressed company from being liquidated. In a situation where the conceptual design of the tax legislation impacts negatively on a debtor upon a reduction of a debt, which may result in an attempt to rescue a distressed company, this may severely impede the recovery proceedings undertaken by the company.

Based on the findings of Chapter 2 that a financially distressed company is not doomed to liquidation or deregistration, a company can, depending on its position on the distress continuum, adopt either informal rescue proceedings or formal rescue proceedings to rescue the business. The following chapters will investigate the design and the workings of the debt reduction rules in South Africa, Canada and the UK to gain an understanding of whether the new debt reduction rules introduced in 2013 can be said to aid a company that is in financial trouble or distress. The issue is whether adequate relief is provided where a company has implemented rescue proceedings in an attempt to rescue the business or whether the new debt reduction rules still act as an added impediment to the recovery of such companies.

Chapter 3

The development of the debt reduction rules in South Africa

3.1 Introduction

The American poet, Ogden Nash once said: “Some debts are fun when you are acquiring them, but none are fun when you set about retiring them”. Nowhere does this observation become more relevant than when a debtor has to deal with the tax consequences arising from a debt forgiveness.

This chapter will analyse the operation of the previous debt reduction rules and the new debt reduction rules and compare the exemptions and relief provisions provided by National Treasury in both sets of legislation. What needs to be established is whether additional relief has been provided to companies in distress with the introduction of the new debt reduction rules. This chapter will contain a summary of the exemptions and relief provisions in both sets of legislation, specifically those exemptions and relief provisions that apply to a debtor that is considered to be in financial distress as alluded to in the 2012 Explanatory Memorandum. This summary will be used in Chapter 4 to establish whether the South African debt reduction rules, when compared to those of Canada and the UK, provide adequate relief to a debtor that is considered to be in financial distress.

As discussed in chapter 2, a debtor is considered to be in financial distress where there is a reasonable likelihood that such a company will become commercially or factually insolvent within the coming 6 months. In other words, where there is a reasonable likelihood that the debtor will not be able to pay the debts as they become due within the ensuing six months, or where there is a reasonable likelihood that the debtor's liabilities will exceed the assets fairly valued, within the next six months. As discussed in Chapter 2, a company that is in financial distress does not necessarily spell liquidation, depending on its position on the distress continuum (see Figure 2.1).

Based on the findings in Chapter 2 of what can be regarded as a financially distressed company, the old and the new debt reduction rules will be evaluated in the conclusion of this chapter to summarise the relief measures that have been introduced to alleviate the burden of a company in financial distress.

3.2 The previous debt reduction rules

In the following paragraphs application of the previous debt reduction rules contained in section 8(4)(m) and paragraph 12(5) of the Eighth Schedule of the Act will be analysed with specific focus on the exemptions and anti-avoidance provisions progressively introduced by National Treasury. The provisions of section 8(4)(m) and paragraph 12(5) of the Eighth Schedule to the Act were deleted by the Taxation Laws Amendment Act (22 of 2012).

3.2.1 Section 8(4)(m) of the Act

Prior to the introduction of section 8(4)(m) of the Act, the rules that applied to debt reductions were governed by section 8(4)(a) and proviso (ii) to section 20(1)(a) of the Act. Application of the earlier versions of these rules were evident in *CIR v Louis Zinn Organisation (Pty) Ltd 1958 (4) SA 478(A)*, where the Commissioner treated the company's gain on a compromise of a debt as a reduction in the balance of assessed loss to be carried forward by the taxpayer. In this instance, the court did not rule on whether the general recoupment provisions apply in relation to a compromise of a debt, but rather that the amount of the compromise should be treated as a reduction in the balance of assessed loss carried forward. On the other hand, in *ITC 1634 60 SATC 235* it was found that the cancellation of a liability, used in the production of the taxpayer's income and which had been allowed as a deduction when calculating the taxable income, should be treated as a recoupment in terms of section 8(4)(a), read with section 8(4)(m) of the Act. This approach was also adopted in *ITC 1704 63 SATC 258* where the court ruled that a cancellation of a liability which had been incurred by

a taxpayer and allowed as a deduction in computing its taxable income, represented a recoupment of such an amount.

Section 8(4)(*m*) of the Act was introduced in 1997 by the Taxation Laws Amendment Act (27 of 1997). In terms of section 8(4)(*m*) of the Act, where:

- (i) as a result of the cancellation, termination or variation of an agreement or due to the prescription, waiver or release of a claim for payment, any person was during any year of assessment relieved or partially relieved from the obligation to make payment of any expenditure actually incurred;
- (ii) such expenditure was at the date on which such person was so relieved or partially relieved not paid; and
- (iii) such expenditure or any allowance in relation to such expenditure was in the current or any previous year of assessment allowed as a deduction from such person's income, such person shall for the purposes of paragraph (*a*) be deemed to have recovered or recouped an amount equal to the amount of the obligation from which the person was so relieved or partially relieved during the year of assessment in which the person was so relieved or partially relieved.

The objective of the introduction of section 8(4)(*m*) of the Act was to eliminate any uncertainty that existed at the time, that amounts that were not actually recovered or recouped could be recouped in terms of section 8(4)(*a*) of the Act where a debt was reduced (SARS, 1997; Olivier, 2006: 303). Therefore, the Legislature made it clear that where a debt that had been used to fund a tax deductible expenditure or an allowance of a debtor, was subsequently reduced or extinguished by either the termination or variation of an agreement or prescription or waiver of a claim, the amount so reduced would be deemed to be a recoupment in terms of section 8(4)(*a*) of the Act (SARS, 1997; Seligson, 2010).

To understand fully the consequences attendant on the application of section 8(4)(*m*) of the Act, the meaning of the term expenditure is analysed. While the term

expenditure is not defined in the Act, reference is made to *CSARS v Labat Africa Ltd (2011) 74 SATC 1* in which Harms AP offered the following on the meaning of expenditure:

The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless the context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent.

The Afrikaans text, in using the term "onkoste", endorses this reading. In the context of the Act it would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended.

The Legislature also provides guidance on the meaning of expenditure in the context of a debt reduction in its Interpretation Note 91 on the reduction of debt (SARS, 2015):

A sufficiently close connection must exist between the debt that is reduced and the particular expenditure incurred in order to conclude that the debt directly or indirectly funded the expenditure. Expenditure is directly funded by an amount of debt if, for example, an asset is purchased on credit from the creditor. Expenditure is indirectly funded by an amount of debt if, for example, a financier advances an amount to a debtor and the debtor uses the amount to finance expenditure incurred in relation to a third person.

The provisions of section 8(4)(m) of the Act were subject to section 20 of the Act (Seligson, 2010). In other words, where the amount waived or reduced had already been applied to reduce the balance of assessed loss of the debtor, then the provisions of section 8(4)(m) of the Act would not have applied (Seligson, 2010:5; Camay, 2011). In terms of proviso (ii) to section 20(1)(a) of the Act this should be offset against the income so derived by such person:

(a) any balance of assessed loss incurred by the taxpayer in any previous year which has been carried forward from the preceding year of assessment:
Provided that-

(i) ...

(ii) the balance of assessed loss shall be reduced by the amount or value of any benefit received by or accruing to a person resulting from a concession granted by or a compromise made with his creditors whereby his liabilities to them have been reduced or extinguished, provided such liabilities arose in the ordinary course of trade;
Provided that

aa) the amount advanced by such creditor was used directly or indirectly, to fund expenditure or an asset; and

bb) a deduction was allowed, in terms of section 11, in respect of such expenditure or asset.

The provisions of section 8(4)(m) of the Act would furthermore not have applied in the case where the creditor ceded the debt owing to him for full consideration. In other words, in circumstances where the debtor was required to make payment on the same terms and the same amount, no debt reduction could arise. Therefore, in any circumstances where the debtor was relieved of paying the full amount of a debt obligation, including scenarios where the debtor had sold the amount owing to a purchaser in terms of a sale of a business, the provisions of section 8(4)(m) of the Act could be found to apply (Olivier, 2006: 303-304).

As alluded to above, section 8(4)(m) of the Act was introduced to remove any uncertainty that existed as to whether a debt that was used to fund a deductible expenditure could be recouped according to the general recoupment rules (Olivier, 2006: 303). Section 8(4)(m) of the Act, and the cases referred to above, contained no guidance on the tax implications arising from a debt reduction where the debt had funded capital expenditure. However, any uncertainty surrounding this matter was addressed by the introduction of paragraph 12(5) of the Eighth Schedule to the Act.

3.2.2 Paragraph 12(5) of the Eighth Schedule to the Act

3.2.2.1 Background

As paragraph 12(5) of the Eighth Schedule to the Act came into existence with the introduction of capital gains tax in South Africa by the Taxation Laws Amendment Act (5 of 2001) it applied solely to debts reduced after 1 October 2001 (Olivier, 2006: 307). Prior to this date, the only rules that governed the tax implications of a debt reduction were section 8(4)(m) of the Act and proviso (ii) to section 20(1)(a) of the Act, which treated a cancellation or reduction of a liability as either a recoupment or a reduction in the balance of assessed loss carried forward by a taxpayer.

Paragraph 12(5) of the Eighth Schedule to the Act dealt with the reduction or discharge of a debt for (i) no consideration; or (ii) for consideration that was deemed to be less than the amount by which the face value of the debt had so been reduced (SARS, 2016:119; Camay, 2011). This would have applied as a residual effect only to the extent that section 8(4)(m) and proviso (ii) to section 20(1)(a) did not apply (Seccombe, 2013).

The meaning of the term consideration was interpreted in the case of *CSARS v Brummeria Renaissance (Pty) Ltd & others* 69 SATC 205 where it was held that a receipt or an accrual in a form other than money, but which could be converted into money, should constitute an amount which has been received or accrued for gross income purposes (SARS, 2016: 139). In other words, to establish whether a debt had been reduced for less than full consideration, attention should be paid to any form of *quid pro quo* given by the debtor, other than money, in settlement of the obligation.

The result of the application of the debt reduction or discharge in terms of paragraph 12(5) of the Eighth Schedule to the Act was that the debtor was treated as having acquired a claim on the portion of the debt so reduced, for no consideration

and thereafter having disposed of such claim for proceeds equal to the amount of the debt so reduced (Seligson, 2010:5). The objective of the Legislature with the introduction of paragraph 12(5) of the Eighth Schedule to the Act was twofold: first to ensure that a debtor who was relieved of a debt would be subject to capital gains tax on the benefit so received (Camay, 2011) and secondly to provide symmetry in the tax system to ensure that there was a matching of capital gains and losses (SARS, 2016:119).

The original version of paragraph 12(5) of the Eighth Schedule to the Act, which was introduced by the Taxation Laws Amendment Act (19 of 2001), did not provide any exemptions or relief provisions. However, National Treasury introduced an amendment to paragraph 12(5) of the Eighth Schedule to the Act in the Second Revenue Laws Amendment Act (60 of 2001) to prevent possible double taxation in circumstances where the amount of the debt waived had already been taken into account as:

- a capital gain in the hands of the debtor in terms of proviso (ii) to paragraph 3(b) of the Eighth Schedule to the Act (Meyerowitz, 2009). Where a debtor purchased an asset on loan account and the debt in respect thereof had been reduced subsequent to the disposal of the relevant asset, the debtor would have been subject to a capital gain on the forgiveness amount in terms of proviso (ii) to paragraph 3(b) of the Eighth Schedule to the Act and, as such, paragraph 12(5) of the Eighth Schedule to the Act would not have applied (SARS, 2016: 69); or
- a reduction in the base cost of an asset in terms of paragraph 20(3) of the Eighth Schedule to the Act (Meyerowitz, 2010). Where a person acquired an asset on a loan account in respect of which the purchase price was subsequently reduced, the base cost of such asset would have been reduced in terms of paragraph 20(3) of the Eighth Schedule to the Act where such an asset was still on hand. In this scenario, the reduction of the debt would not

have resulted in a further capital gain in terms of paragraph 12(5) of the Eighth Schedule to the Act (SARS, 2016: 124).

3.2.2.2 Introduction of the group of companies' exemption

In the Revenue Laws Amendment Act (45 of 2003), which came into operation on 22 December 2003, National Treasury made further amendments to paragraph 12(5) of the Eighth Schedule to the Act by allowing an exemption where:

- in terms of paragraph (B) to proviso (aa) of paragraph 12(5)(a) of the Eighth Schedule to the Act, the amount of the debt waived had already been treated as a recoupment in terms of section 8(4)(m) of the Act or been taken into account in terms of proviso (ii) to section 20(1)(a) of the Act (Meyerowitz, 2009); and
- in terms of proviso (bb) of paragraph 12(5)(a) the debtor and the creditor formed part of the same group of companies (Camay, 2011). The Legislature indicated that the reason for the change was to allow companies, that were indebted to fellow group companies, the opportunity to clean up the group structure and deregister or liquidate without incurring a potential tax liability (KPMG, 2004). The group exemption would however not apply in terms of proviso (bb) to paragraph 12(5)(a) of the Eighth Schedule to the Act where the debt had been directly or indirectly acquired from a person who was not a member of the same group of companies, or where the debtor and the creditor became members of the same group of companies after the debt (or any substituted debt) had arisen. These anti-avoidance rules were introduced to avoid possible abuse (SARS, 2003).

Where the group exemption did not apply and the debtor was subject to tax on the benefit received, the creditor would be entitled to claim a capital loss in terms of paragraph 56(2)(a) of the Eighth Schedule to the Act (Olivier, 2006: 306). The capital

loss would furthermore not have been ring-fenced by virtue of paragraph 39 of the Eighth Schedule to the Act (SARS, 2016:119).

3.2.2.3 Introduction of the liquidation exemption

The Revenue Laws Amendment Act (31 of 2005) which came into operation on 1 February 2006, introduced proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule to the Act which provided that paragraph 12(5) of the Eighth Schedule would not apply where (i) the debtor and the creditor were connected persons (and furthermore that such persons did not become connected persons after the debt or the substituted debt had arisen); and (ii) where the discharge of the debt was as a result of the liquidation, winding-up, deregistration or final termination of the corporate existence of the debtor. This relief would apply only to the extent that the discharge did not exceed the amount of the creditor's allowable expenditure in terms of paragraph 20, on the debt at the time of the reduction (SARS, 2016: 134; Camay, 2011). At the time the Legislature explained that the amendment was introduced in an attempt to eliminate the unintended consequences where a dormant company could not be liquidated as a result of the capital gains tax consequences arising from paragraph 12(5) of the Eighth Schedule to the Act (SARS, 2005). It should be noted that the relief provided in proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule applied only where the debtor had, within 6 months of the debt reduction, taken the necessary steps to liquidate or deregister (SARS, 2005). Therefore, the Legislation did not provide any relief for a distressed company with a prospect of recovery.

3.2.2.4 Introduction of anti-avoidance measures

Further changes introduced by the Taxation Laws Amendment Bill, 2008 resulted in the inclusion of anti-avoidance measures in both proviso (bb) of paragraphs 12(5)(a) of the Eighth Schedule and proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule to the Act. In order to utilise the exemption granted in proviso (bb) of paragraph 12(5)(a) and proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule to

the Act, the reduction of the debt in question must not have been part of a scheme to avoid tax (Meyerowitz, 2009).

As the phrase 'scheme to avoid tax' is not defined in the Act, consideration was given to the general anti-avoidance provisions that were contained in the Act. General anti-avoidance provisions were contained in section 103(1) of the Act but this section was deleted from the Revenue Laws Amendment Act (20 of 2006) and replaced with section 80A to section 80L of the Act which applied to all transactions entered into after 2 November 2006 (and hereinafter referred to as the new GAAR). For this reason, the anti-avoidance rules in proviso (bb) of paragraph 12(5)(a) and proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule to the Act will be analysed from the perspective of the new GAAR. The provisions of the new GAAR could be invoked where (i) there was an avoidance arrangement, (ii) the sole or main purpose of the avoidance arrangement was to obtain a tax benefit; and (iii) the avoidance arrangement was abnormal, lacking in commercial substance or abusive of the provisions of the Act, as set out in any one of subsections (a) to (c) of section 80A (De Koker & Williams, 2016: §26.3).

In analyzing the abovementioned requirements, consideration was given to the meaning of the term arrangement. An arrangement as defined in section 80L of the Act means "any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein and parts thereof....". The words 'transaction, operation, scheme' were also used in the case of *Meyerowitz v CIR 1963(3) SA 863(A)* where the appellant argued that the transactions in question were not part of a preconceived plan and that the continuity of operations and connection between the different steps were lacking to such a degree that they did not constitute a scheme. It was however held that the test is whether the different steps, upon examination in retrospect, appear to be so connected with one another that they could ultimately lead to the avoidance of taxation. It was clear that the words "transaction, operation, scheme" should be interpreted very widely to apply to any possible transaction or scheme with the intention to avoid tax (Benn, 2013:21).

Where it has been established that an arrangement exists, it needs to be established whether such arrangement results in a tax benefit. A tax benefit which is defined in section 1 of the Act is "any avoidance, postponement or reduction of any liability for tax". In the case of *Smith v CIR 26 SATC 1*, it was held that the ordinary meaning of avoiding a tax liability was "to get out of the way of, escape or prevent an anticipated liability". Based on a strict reading of the aforementioned case, it is clear that the avoidance should relate only to an anticipated liability and not a current liability (Benn, 2013:13). Furthermore, an avoidance of tax will exist under the new GAAR where (i) an accrual of a stream of income is anticipated with some degree of likelihood; (ii) the income will be subject to tax in the hands of the taxpayer, whether in the immediate or distant future; and (iii) after entering into the arrangement, the tax on the income in the hands of the taxpayer or a third party will be less than it would have been without the arrangement (De Koker & Williams, 2016: §26.3).

Finally, the transaction needs to have an element of abnormality. In other words, the transaction has to be carried out in such a manner that would not generally be used for business purposes other than to obtain a tax benefit (Benn, 2013:29; De Koker & Williams, 2016: §26.3).

3.2.3 Summary of the previous debt reduction rules

In summary, where a debtor had been relieved of a debt, its assessed loss (if any) would first have been utilised to set-off the reduction amount irrespective of whether the debt funded an allowable deduction or a capital expenditure. The remainder of the reduction amount would be subject to a recoupment in terms of section 8(4)(m) of the Act, where a deduction or allowance had been previously granted. Lastly, if there was any amount in excess of the reduction amount following the application of the aforementioned rules, such amount would be a deemed disposal in terms of paragraph 12(5) of the Eighth Schedule to the Act for capital gains tax purposes. It is important to highlight that in terms of the previous debt reduction rules, a reduction

amount would first have been subject to a recoupment in terms of section 8(4)(m) of the Act where the debtor had no assessed loss available. Only the excess of the reduction amount after applying section 8(4)(m) of the Act would have been subject to capital gains tax (Van Reenen, 2015:10). In other words, where the debt funded an allowance asset, the reduction amount would have firstly been subject to a recoupment.

3.3 Donations tax under the previous debt reduction rules

Further to the consideration of section 8(4)(m) and paragraph 12(5) of the Eighth Schedule to the Act, the application of section 54 and section 58 of the Act could have been applicable (Seligson, 2010:6-7) to a debt waiver prior to 2012.

A donation included in section 55 of the Act , is defined as:

any gratuitous disposal of property including any gratuitous waiver or renunciation of a right

In cases where a creditor released a debtor from a debt owing and where such a creditor was motivated by pure liberality or generosity, only then did such a waiver constitute a donation as defined (Olivier, 2006: 305). Therefore, if there was some *quid pro quo* for the disposal in question, it would not qualify as a donation as envisaged in section 54 of the Act . This view was held in the case of *Welch's Estate v CSARS 66 SATC 303*. It is also doubtful whether a creditor in a corporate debt scenario would waive a debt out of pure generosity or liberality (Rudnicki, 2014: 52). Other factors such as the cost to enforce the debt and whether the debtor was a connected person would very likely be taken into consideration by the creditor.

The provisions of section 58 of the Act could also apply. SARS could deem the reduction of a debt to be a donation, where the disposition to which the consideration

was attributable was deemed to be inadequate (Rudnicki, 2014:58), irrespective of the motivation behind the disposal (Seligson, 2010:9). It could be submitted that it was unlikely that the SARS would deem a reduction of a debt as a donation, without having regard to whether there was an element of altruism or an intention to donate, as this would lead to absurd consequences (Rudnicki, 2014:60).

From the discussion above it is clear that under the previous debt reduction rules, a waiver of a debt could therefore have been subject to donations tax in terms of section 54 or section 58 of the Act as well as section 8(4)(m) or paragraph 12(5) of the Eighth Schedule to the Act, which could have resulted in double taxation.

3.4 The new debt reduction rules

3.4.1 Background to the introduction of the new debt reduction rules

In its 2011 National Budget, National Treasury addressed the issue of debt reductions by stating that it would consider exempting otherwise taxable gains or ordinary revenue imposed on a debtor where a debt had been cancelled or reduced. It was further highlighted that relief would be limited to insolvent debtors to ensure that the relief so provided did not give rise to tax avoidance (National Budget, 2011). The meaning of an insolvent debtor was discussed in chapter 2 and it was concluded that a debtor could be either commercially or factually insolvent. As a commercially insolvent debtor is unable to pay the debts, the company may be liquidated in terms of the Companies Act (61 of 1973). A factually insolvent company on the other hand means the debtor's liabilities exceed its assets fairly valued. Factual insolvency is not, in and of itself a reason for a company to be liquidated (Moosa, 2014).

Section 19 and paragraph 12A of the Eighth Schedule to the Act were introduced with effect 1 January 2013 by section 36 and section 108 of the Taxation Laws Amendment Act (22 of 2012). With the introduction of the new debt reduction rules National Treasury conceded that debt relief could occur in a variety of situations, including

insolvency, business rescue, other similar statutory proceedings and informal workouts (SARS, 2016:136) therefore they stated that:

A new uniform system that provides relief to persons under financial distress who are unable to pay their debts was necessary because the pre-existing provisions had adverse consequences for debtors in certain circumstances.

In a scenario where a debt was waived due to the inability of the debtor to repay the amounts due, the Legislature conceded that (SARS, 2012:44):

The tax system unfortunately acts as an added impediment to the recovery of companies and other parties in financial distress. In particular, the potential tax imposed upon parties receiving the benefit of debt relief effectively undermines the economic benefit of the relief....

It is clear from the above that the reason for the introduction of the new debt reduction rules, as per National Treasury, was to assist debtors that were considered to be in financial distress (SARS, 2012; Napier, 2014), or in other words as discussed in Chapter 2, a company that was either commercially or factually insolvent.

In the remainder of this chapter the workings of the new debt reduction rules will be investigated from an income tax and capital gains tax perspective to decide whether the new debt reduction rules provided additional relief to a financially distressed debtor when compared to the previous debt reduction rules. An attempt will be made to establish whether the Legislature has provided additional relief to financially distressed debtors as alluded to in the 2011 National Budget and the 2012 Explanatory Memorandum.

3.4.2 Introduction to the new debt reduction rules

The new debt reduction rules were introduced with a view to eliminating the negative consequences that could arise on the reduction of a debt where the debtor was considered to be in financial distress (SARS, 2012:44). As can be seen from the analysis of section 8(4)(m) and paragraph 12(5) of the Eighth Schedule to the Act, the previous debt reduction rules would have resulted in double taxation as the reduction amount could have been subject to (i) donations tax; (ii) estate duty; (iii) income tax on fringe benefits; and (iv) income tax on income or capital gains tax. The new rules aimed to eliminate this possibility (SARS, 2016:137).

The new debt reduction rules introduced the concept of a reduction amount, which is defined in section 19 and paragraph 12A of the Eighth Schedule to the Act as –

the amount by which a debt is reduced less any amount applied as consideration for the reduction

As can be seen in the case of *CSARS v Brummeria Renaissance (Pty) Ltd & others* 69 SATC 205, consideration included not only an amount that was expended in cash, but also consideration given in a form other than cash, but which can be converted into cash. Therefore, the new debt reduction rules would apply only where this consideration is given in respect of a debt that is less than the face value of the debt (SARS, 2016:139).

In understanding the implications attendant on the new debt reduction rules, it is important to highlight that section 19 and paragraph 12A of the Eighth Schedule to the Act should be read together due to the interaction between these provisions (SARS, 2016:137). In broad terms, section 19 of the Act deals with the income tax implications of a debt reduction where the debt funded expenditure in terms of which a deduction or an allowance was granted (Rudnicki, 2014:54), whereas paragraph 12A of the Eighth Schedule to the Act deals with the capital gains tax consequences of a debt

reduction (Dachs, 2015:31). In other words, paragraph 12A of the Eighth Schedule to the Act will apply where the debt funded expenditure other than expenditure in terms of which a deduction or allowance was granted and will also apply where debt funded expenditure incurred in respect of an allowance asset (Rudnicki, 2014:54).

3.4.3 Paragraph 12A of the Eighth Schedule to the Act

The provisions of paragraph 12A(2) of the Eighth Schedule to the Act would apply where:

- a debt that is owed by a person is reduced by any amount and –
 - a) the amount of the debt was used, directly or indirectly, to fund any expenditure –
 - (i) other than expenditure in respect of which a deduction or allowance was granted in terms of this Act; or
 - (ii) incurred in respect of an allowance asset; and
 - b) the amount of that reduction exceeds any amount applied by that person as consideration for that reduction.

Therefore, where a debt was used to fund the acquisition of capital assets, paragraph 12A of the Eighth Schedule to the Act would apply to the reduction amount when the debt is subsequently reduced for less than full consideration (Napier, 2014). The following paragraphs will provide an explanation of the specific rules that will apply depending on the nature of the capital assets acquired in respect of the reduced debt.

3.4.3.1 The debt funded the acquisition of a non- allowance asset

Where the non-allowance asset in question is still on hand, paragraph 12A(3) of the Eighth Schedule to the Act , states that:

where –

- a) a debt owed by a person is reduced as contemplated in subparagraph (2);
and
- b) the amount of the debt was used as contemplated in item (a) of that subparagraph to fund expenditure incurred in respect of an asset that is held by that person at the time of the reduction of the debt,

the amount of the expenditure so incurred in respect of that asset must, for the purposes of paragraph 20, be reduced by the reduction amount in respect of that debt.

Where the debt funded the acquisition of a non-allowance asset that was still held at the time when the debt was reduced, the debtor would be required to reduce the base cost of the non-allowance asset in question (SARS, 2015: 24). This will result in delaying the taxing event to the date on which the asset is subsequently disposed of by the debtor.

Where the reduction amount exceeds the base cost of the non-allowance asset that was funded by the reduced debt, paragraph 12A(4) of the Eighth Schedule to the Act states that where –

- a) a debt owed by a person is reduced as contemplated in subparagraph (2);
and
- b) the amount of that debt was used as contemplated in item (a) of that subparagraph to fund expenditure incurred in respect of an asset (other than an allowance asset) that is –
 - (i) held by that person at the time of the reduction of the debt, and subparagraph (3) has been applied to reduce any expenditure in respect of that asset to the full extent of that expenditure; or
 - (ii) no longer held by that person at the time of the reduction of that debt,

the reduction amount in respect of that debt, less any amount that has been applied to reduce any amount of expenditure as contemplated in subparagraph (3), must be applied to reduce any assessed capital loss

of that person for the year of assessment in which the reduction takes place.

In other words, where the reduction amount exceeded the base cost of the asset, paragraph 12A(4)(b)(i) of the Eighth Schedule to the Act would treat the excess as a reduction of any assessed capital loss of the debtor (Rudnicki, 2014; SARS, 2015:25), which would also delay the taxing event resulting from the reduction of the debt.

In the case where the debt funded the acquisition of a non-allowance asset that was no longer on hand, paragraph 12A(4)(b)(ii) of the Eighth Schedule to the Act would apply to reduce the assessed capital loss in relation to such debtor with the reduction amount in the year of assessment in which the debt was reduced (limited to the balance of assessed capital loss) (SARS, 2015:25; De Koker & Williams, § 24.34E). Where a debtor's assessed capital loss was reduced by the reduction amount in the case of a debt waiver, the debtor's taxing event would be delayed to a time in the future when the debtor disposes of a capital asset on which a capital gain could be realised. In the event that the debt was reduced after the disposal of the asset, but in the same year of assessment as the disposal, and where the debtor acquired the asset directly from the creditor, paragraph 20(3)(b) of the Eighth Schedule would apply to reduce the base cost of the asset (De Koker & Williams, § 24.34E). Under the previous debt reduction rules the debtor would have been subject to a deemed disposal in terms of paragraph 12(5) of the Eighth Schedule to the Act .

Where the debtor does not have a balance of assessed capital loss available at the time when the debt is reduced, there will be no further consequences for the debtor in relation to the reduction of the debt (Napier, 2014, De Koker & Williams, § 24.34E).

3.4.3.2 Debt funded allowance assets

Where the debt funded the acquisition of an allowance asset that was held by the debtor at the time of the debt reduction, the base cost of the asset in question would be reduced by the reduction amount to the full extent of the expenditure in terms of paragraph 12A(3) of the Eighth Schedule to the Act. The result of the above would be a postponement of the taxing event (Van Reenen, 2015:28), to the year of assessment in which the allowance asset was disposed of by the debtor (SARS, 2015:20). This would not have been the case under the previous debt reduction rules where section 8(4)(m) would have firstly applied to any previous allowances granted.

Where the reduction amount exceeded the base cost of the allowance asset still on hand, the excess would be brought into consideration under section 19(6) of the Act, and treated as a recoupment in terms of section 8(4)(a) of the Act (De Koker & Williams, § 24.34E). The recoupment would be limited to the allowances that had previously been granted on the asset (SARS, 2015: 20).

It should be noted that in accordance with section 19(7) of the Act, the allowances that could be claimed on the asset after the debt reduction, would be limited to the reduced base cost of the asset following the application of paragraph 12A(3) of the Eighth Schedule to the Act (SARS, 2015:26). Furthermore, the proceeds that were realised on the subsequent disposal of the allowance asset could not be reduced by the recoupment realised in terms of section 19(6) of the Act, irrespective of the provisions of paragraph 35(3)(a) of the Eighth Schedule to the Act which states that proceeds on the disposal of an asset must be reduced by any amount that "must be or was included in the gross income of that person" (SARS, 2015:21). The proceeds received upon the subsequent disposal of the asset, and that relates to the portion of the debt that was reduced, would not be subject to a further recoupment in terms of proviso (iii) to section 8(4)(a) of the Act other than the recoupment already brought into account in terms of section 19(6) of the Act (SARS, 2015:23).

Where the allowance asset was no longer on hand, the reduction amount would be brought into account under section 19(6) of the Act and treated as a recoupment in terms of section 8(4)(a) of the Act, to the extent of the allowances that were granted in the past.

3.4.3.3 Exclusions from the application of paragraph 12A

A debtor would be exempted from applying the rules contained in paragraph 12A of the Eighth Schedule to the Act in the following circumstances:

- The debtor and the creditor formed part of the same group of companies

In terms of paragraph 12A(6)(d) of the Eighth Schedule to the Act, where the debtor and the creditor formed part of the same group of companies as defined in section 41 of the Act, the debtor would be absolved from reducing the base cost of the asset still on hand and/or the balance of the assessed capital loss in terms of paragraph 12A(3) and paragraph 12A(4) of the Eighth Schedule to the Act. In such event however, the creditor would also be denied a capital loss in respect of the debt claim in terms of paragraph 56 of the Eighth Schedule to the Act (SARS, 2015: 38; De Koker & Williams, §24.34E).

Relief given to a debtor in terms of paragraph 12A(6)(d), would not apply where (i) the debt was acquired directly or indirectly from a person who did not form part of the same group of companies; or (ii) where the debtor and the creditor became part of the same group of companies after the debt had arisen. The relief would be denied only as aforementioned, if the debt was forgiven as part of "any transaction, operation or scheme entered into to avoid any tax imposed." An analysis of the meaning of a "scheme to avoid tax" in terms of the now deleted paragraph 12(5) of the Eighth Schedule to the Act is contained in

paragraph 3.2.2.4 of this chapter and will also be applicable to paragraph 12A of the Eighth Schedule to the Act (De Koker & Williams, 2016: §24.34E).

It should be noted that where the companies elected that the group exemption should apply in respect of a reduced debt that was used to purchase an allowance asset that is still on hand, the full reduction amount could be subject to a recoupment in terms of section 19 of the Act (Rudnicki, 2014).

- The debtor company was in liquidation

In terms of paragraph 12A(6)(e) of the Eighth Schedule to the Act where a debt owed by a debtor to a person that was a connected person in relation to such debtor and the debt was reduced in the course of, or in anticipation of the liquidation or deregistration of the debtor, the provisions of paragraph 12A(3) or paragraph 12A(4) of the Eighth Schedule to the Act would not apply to the debt reduction. The relief extended by paragraph 12A(6)(e) would not apply to the extent that the reduction amount did not, at the time of the debt reduction, exceed the expenditure contemplated in paragraph 20 incurred in respect of such debt by the connected creditor (De Koker & Williams, §24.34E). This situation would typically arise where a creditor acquired the debt from a third party at an expenditure that was less than the face value of the debt (SARS, 2015: 40).

Furthermore, the exclusion in paragraph 12A(6)(e) of the Eighth Schedule to the Act would not apply where:

- the debtor and the creditor became connected persons after the debt had arisen as part of a transaction, operation or scheme to avoid tax in terms of proviso (aa) to paragraph 12A(6)(e); or

- where the debtor had not taken steps to liquidate, wind-up, deregister or terminate the corporate existence within 36 months from the date of the debt reduction in terms of proviso (bb) to paragraph 12A(6)(e).

The liquidation exemption could be compared to the exemption allowed under the previous debt reduction rules. It also became clear from an analysis of paragraph 12A(6)(e) of the Eighth Schedule to the Act, that the Legislature did not introduce any additional relief to insolvent debtors, with a prospect of recovery.

In terms of section 41(4)(a) of the Act, a company would be deemed to have taken steps to liquidate or wind-up its corporate existence where (i) it had lodged a resolution in terms of section 80(2) of the Companies Act (71 of 2008) authorising the voluntary winding up; and (ii) the company had disposed of all its assets and settled all its liabilities. Furthermore, in terms of section 41(4)(b) of the Act a company would be deemed to have taken steps to deregister in terms of the Act, where the company had lodged a request for deregistration with the CIPC in terms of proviso (ii) of section 82(3)(b) of the Companies Act (71 of 2008), which section prescribes the circumstances in which the Commissioner could remove a company from the companies register. In terms of proviso (ii) to section 82(3)(b) of the Companies Act the CIPC would be entitled to remove a company from the companies register where it:

has received a request in the prescribed manner and form and has determined that the company—

(aa) has ceased to carry on business; and

(bb) has no assets or, because of the inadequacy of its assets, there is no reasonable probability of the company being liquidated.

The following additional exemptions to the application of the debt reduction rules were introduced in paragraph 12A of the Eighth Schedule to the Act:

- where a debt was owed by an heir or legatee of a deceased estate to the extent that the debt was owed to, and reduced by, the deceased estate and the amount by which the debt was reduced formed part of the property of the deceased estate;
- where the debt was reduced by way of a donation as defined in section 55 of the Act or any transaction to which section 58 of the Act applied; and
- where the debt was owed to an employer and such debt was reduced in circumstances contemplated in paragraph 2(*h*) of the Seventh Schedule of the Act where the fringe benefit tax provisions would apply (SARS, 2015: 12).

3.4.4 Development of section 19 of the Act

3.4.4.1 Introduction

Section 19(2) of the Act would apply where:

a debt that is owed by a person is reduced by any amount and –

- a) the amount of that debt was used, directly or indirectly, to fund any expenditure in respect of which a deduction or an allowance was granted in terms of this Act; and
- b) the amount of that reduction exceeds any amount applied by that person as consideration for the reduction.

To conclude that the provisions of section 19 of the Act would apply to an amount of expenditure, there needed to be a sufficiently close connection between the debt so reduced and the expenditure in question (SARS, 2015: 12). The meaning of the term

expenditure and the rules laid down by the courts, as discussed under section 8(4)(m) of the Act, would continue to apply under section 19 of the Act.

To understand fully the implications attendant upon the reduction of a debt that funded deductible expenditure of the debtor, it is imperative to establish exactly what the debt funded, as specific rules apply for each scenario (Napier, 2014). The following scenarios were further analysed:

3.4.4.2 The debt funded trading stock still held

In terms of section 19(3) of the Act where the amount of the debt funded the acquisition of trading stock held and not disposed of, which either funded the cost price of the trading stock in terms of section 11(a) or the trading stock value in terms of section 22(1) (closing stock) or section 22(2) (opening stock) of the Act, the reduction amount had to be applied against the amounts so taken into account (SARS, 2015:13; De Koker & Williams, §24.34D). The result of the application of section 19(3) of the Act would be a reduction in the deduction claimable upon the disposal of the trading stock (Van Reenen, 2015:20).

In terms of section 19(4) of the Act, where the reduction amount was applied to the full extent of the amounts taken into account in terms of section 11(a), section 22(1) or section 22(2) of the Act, for the year of assessment in which the debt is reduced (SARS, 2015:14), any excess would be treated as a recoupment for purposes of section 8(4)(a) of the Act in the year of assessment in which the debt is reduced (De Koker & Williams, §24.34D) to the extent that a deduction was previously granted in terms of the Act (Van Reenen, 2015:20).

3.4.4.3 Debt funded operating expenditure or trading stock not held

In terms of section 19(5) of the Act, where a debt that was reduced funded expenditure in terms of which a deduction or an allowance was previously granted under the Act (SARS, 2015:18), or where it funded the acquisition of trading stock that was no longer on hand at the time of the debt reduction (SARS, 2015:15), the reduction amount would be treated as an immediate recoupment in terms of section 8(4)(a) of the Act to the extent of the allowances or deductions claimed in the past (Rudnicki, 2014:54).

3.4.4.4 Debt funded the acquisition of allowance assets that were still on hand and not disposed

Where the debt funded the acquisition of allowance assets that were still on hand at the time of the debt reduction, consideration had to be given to paragraph 12A(3) of the Eighth Schedule to the Act (SARS, 2015:19). In terms of paragraph 12A(3) of the Eighth Schedule to the Act, the reduction amount would be applied to reduce the base cost of the asset to the full extent thereof in terms of paragraph 20 of the Eighth Schedule to the Act, if such asset was still held at the time of the debt reduction (SARS, 2015:19). Any excess remaining of the reduction amount would be deemed by section 19(6) of the Act to be a recoupment (Rudnicki, 2014:54) in terms of section 8(4)(a) of the Act, but only to the extent that a deduction or an allowance was previously granted under the Act (SARS, 2015:20).

The reduction in the base cost of the allowance asset in terms of paragraph 12A(3) of the Eighth Schedule to the Act would reduce future allowances that could be claimed for tax in respect of such assets in the subsequent years of assessment (Seccombe, 2013) in terms of section 19(7) of the Act, thereby increasing the future taxable income of the debtor.

3.4.4.5 Exemptions from the application of section 19 of the Act

As is the case with paragraph 12A of the Eighth Schedule to the Act, the new debt reduction rules, including section 19 of the Act, were aimed at eliminating the possibility of double taxation where a reduction amount could be subject to donations tax, estate duty, income tax on fringe benefits as well as income tax on income or capital gains tax.

The following exemptions are available for a reduction amount that is subject to a section 19 recoupment.

- Deceased estate

In terms of section 19(8)(a) of the Act the provisions of section 19 of the Act would not apply to any debt that was owed by an heir or a legatee of a deceased estate where such debt was owed to and reduced by the deceased estate.

- Donations tax

Where a debt was reduced by way of a donation which met the requirements of section 55 of the Act, or which was deemed a donation in terms of section 58 of the Act, section 19(8)(b) provided that such debt reduction would not be subject to the provisions of section 19 of the Act.

The following exemptions were not available for a reduction amount that was subject to a section 19 recoupment.

- Same group of companies

Unlike paragraph 12A(6)(d) of the Eighth Schedule to the Act, section 19 of the Act did not allow an exemption for a debt that was reduced between a group of companies. This could be due to the fact that the tax benefit or deduction had historically been granted by the SARS to the debtor based on the purpose for which the loan was used either as an allowance or as a deductible expenditure (Rudnicki, 2014:56).

- Liquidation exemption

Section 19 of the Act did not allow an exemption where the debt was reduced in the course, or in anticipation of a liquidation or deregistration of the debtor.

A discussion on the meaning of a donation in terms of section 55 of the Act and a deemed donation under section 58 of the Act was given under paragraph 3.3 to be applied equally to an exemption of a donation in terms of section 19 of the Act .

- Fringe benefits

The provisions of section 19 of the Act would not apply where a debt was reduced by an employer in circumstances described in paragraph 2(h) of the Seventh Schedule to the Act.

3.4.5 Summary of the new debt reduction rules

Where the debt funded the acquisition of a capital asset, the new debt reduction rules would apply to reduce the base cost of such assets in terms of paragraph 12A(3) of the Eighth Schedule to the Act, resulting in the reduction amount being subject to a

lower effective tax rate which would be realised in the year of assessment in which the asset was disposed of. Any allowances previously claimed on such assets would be subject to a recoupment in terms of section 19(6) of the Act (only where the reduction amount exceeded the base cost of the asset or where the asset was no longer on hand), and in such scenario, an immediate taxing event would arise. Where the debt funded deductible expenditure, there would be an immediate recoupment event in terms of section 19(5) of the Act which would result in an increase in the debtor's taxable income in the year of assessment in which the debt was reduced. In the event that the debt funded the acquisition of trading stock, the allowable deduction in respect of such trading stock would be reduced in terms of section 19(3) of the Act if the trading stock was still held. Where the trading stock was no longer held, and a deduction in respect thereof had been claimed in previous years of assessment, section 19(5) of the Act would result in a recoupment of the amounts previously claimed against the taxable income of the debtor.

The new debt reduction rules also eliminated the possibility of double taxation where a debt reduction, in a corporate context, was subject to donations tax as well as section 19 or paragraph 12A of the Act.

In summary, the new debt reduction rules did not provide any additional relief measures, compared to the previous debt reduction rules, to a company in financial distress, other than the relief of double taxation, and additional relief in respect of allowance assets still on hand.

3.5 Comparison between the previous and the new debt reduction rules

Table 3.1: Comparison of the debt reduction rules where debt funded deductible expenditure

Relief provision	Previous debt reduction rules	New debt reduction rules
Utilization of assessed loss	<p>Where available, the balance of assessed loss was utilised in terms of the now deleted section 20(1)(a)(ii) of the Act.</p> <p>Where the debtor did not have a balance of assessed loss available, the result of the debt reduction would have been an immediate recoupment in terms of the now deleted section 8(4)(m) for income tax purposes, to the extent of any deduction allowed in the past.</p>	<p>Where available, a balance of assessed loss will indirectly be utilized through a reduction in future allowable deductions (where an allowance asset is still on hand) or a recoupment of deductions previously allowed in the following circumstances:</p> <ul style="list-style-type: none"> • where a debt is reduced in relation to trading stock still held and not disposed of by the debtor, section 19(3) of the Act will apply to reduce the allowable deductions available under section 11(a), section 22(1) or section 22(2) of the Act; • where a debt is reduced in relation to trading stock no longer on hand, section 19(4) of the Act will result in an immediate recoupment of the amounts previously allowed as a deduction; • where the debt funded a deductible expenditure, section 19(5) of the Act will result in a recoupment of the amount previously allowed as a deduction; or • where the debt funded allowances claimed in respect of an allowance asset in

		<p>respect of which the full extent of its base cost has already been utilised or where such asset is no longer on hand, section 19(6) of the Act will result in an immediate recoupment of the allowances previously granted (limited to the reduction amount of the debt).</p> <p>hand; (ii) any deductible expenditure; or (iii) allowance assets in respect of which the base cost has already been utilized to the full extent thereof (or where the asset is no longer on hand).</p>
Exemptions	None	None, other than that the exemptions that are aimed at preventing double taxation.
Deferment of taxing event	<p>Where the debtor had a balance of assessed loss available, the application of the previous debt reduction rules would have resulted in a deferment of the tax liability to a year of assessment in which the tax loss could be fully utilised.</p> <p>Where the debtor did not have a balance of assessed loss available, there would be no deferment available.</p>	<p>Where the debtor has a balance of assessed loss available, the application of section 19 of the Act will result in a reduction of the balance of assessed loss, which will defer the taxing event to a year of assessment in which the tax loss is fully utilized.</p> <p>Where the debtor does not have a balance of assessed loss available, the application of section 19 of the Act will result in an immediate taxing event, unless the debt funded the acquisition of trading stock still held and not disposed of.</p>
Possibility of double taxation	Yes, the reduction amount could have been subject to donations tax in terms of section 55(1) and section 58 of the Act. In addition, the reduced debt could also have	No, a reduction amount can either be subject to donations tax (see section 55(1) and section 58),

	been subject to estate duty and income tax on fringe benefits.	estate duty, income tax on fringe benefits or section 19.
--	--	---

Table 3.2: Comparison of the debt reduction rules where debt funded capital expenditure

Relief provision	Previous debt reduction rules	New debt reduction rules
Utilisation of assessed losses	Where the debtor had a balance of assessed loss available, and the reduction amount had been applied against such assessed loss in terms of the now deleted section 20(1)(a)(ii) of the Act, paragraph 12(5) of the Eighth Schedule to the Act would not have applied to the reduction amount to the extent of the assessed loss so utilized.	Where the debtor has a balance of assessed loss available, the reduction amount will indirectly be set-off against the balance of assessed loss in the year of assessment in which the asset, that is subject to a reduction of its base cost, has been disposed of.
Utilisation of assessed capital loss	Yes, where the reduction amount was subject to a deemed disposal in terms of paragraph 12(5) of the Eighth Schedule to the Act the debtor's assessed capital loss (if any) would have been utilized against the capital gain.	Yes, only with respect to a non-allowance asset and only to the extent that such asset's base cost has been reduced to nil by the reduction amount. Where the debt has funded the acquisition of an allowance asset, any balance of assessed capital loss will be utilised against the capital gain in the year of assessment in which the asset is disposed of.
Exemptions	In terms of proviso (aa) to paragraph 12(5)(a) of the Eighth Schedule to the Act where the debt reduction had already been taken into account in terms of the now deleted section 8(4)(m), paragraph 3(b)(ii) or paragraph 20(3) of the Act. In terms of proviso (bb) of paragraph 12(5)(a) of the Eighth Schedule to the Act where the debtor and the creditor formed part	In terms of paragraph 12A(6)(d) of the Eighth Schedule to the Act where the debt is reduced between companies that form part of the same group of companies and where there is no scheme to avoid tax. In terms of paragraph 12A(6)(e) of the Eighth Schedule to the Act where the debt is reduced between connected persons in anticipation

	<p>of the same group of companies as defined in section 41 of the Act and there was no scheme to avoid tax.</p> <p>In terms of proviso (cc) of paragraph 12(5)(a) of the Eighth Schedule to the Act where the debt had been reduced between connected parties in anticipation of liquidation and there was no scheme to avoid tax.</p>	<p>of liquidation and where there is no scheme to avoid tax.</p>
Deferment of taxing event	<p>Where the debtor had a balance of assessed loss available to offset the increase in taxable income resulting from the capital gain arising from the deemed disposal as a result of paragraph 12(5) of the Eighth Schedule to the Act (and included in taxable income by way of section 26A of the Act), in which event the tax liability would have been deferred to the year of assessment in which the assessed loss was fully utilised.</p> <p>Where the debtor did not have a balance of assessed loss available, the application of paragraph 12(5) of the Eighth Schedule to the Act would have resulted in an immediate tax liability arising from the inclusion of the capital gain in taxable income by virtue of section 26A of the Act.</p>	<p>The taxing event will automatically be deferred to the year of assessment in which the asset, which is subject to a base cost reduction in terms of paragraph 12A of the Eighth Schedule to the Act, is disposed of (unless section 19(6) of the Act is applied to any excess of the reduction amount).</p> <p>Furthermore, where the debtor has a balance of assessed loss available to offset the increase in the taxable income resulting from the increased capital gain realised by the debtor on disposal of the asset (as a result of the rules in paragraph 12A of the Eighth Schedule to the Act), this will automatically result in a further deferment of the tax liability to the year of assessment in which the assessed loss is fully utilized.</p>
Possibility of double taxation	<p>Yes, the reduced debt could be subject to donations tax (in terms of section 54 and section 58 of the Act), estate duty tax and income tax on fringe benefits.</p>	<p>No, a debt reduction can be subject to donations tax (see section 55(1) and section 58), estate duty tax, income tax on fringe benefits or paragraph 12A of the Eighth Schedule of the Act.</p>

3.6 Conclusion

As previously alluded to, the Legislature's intention with the introduction of the new debt reduction rules was to provide relief to companies that were considered to be in financial distress. This chapter analyzed the application and development of the previous and the new debt reduction rules over time. A comparison of the relief provisions contained in both sets of rules was provided in paragraph 3.5 of this chapter.

Where the debt funded the acquisition of allowance assets, the taxpayer benefited from the new debt reduction rules where the allowance assets were still on hand and where such allowance assets had a sufficient base cost to offset the reduction amount. If this were not the case, the remaining reduction amount will be subject to a recoupment for income tax purposes. Unless the debtor has a sufficient balance of assessed loss available to absorb the increase in taxable income resulting from the recoupment, the debtor will have an immediate tax liability. This can be compared to the previous debt reduction rules where the full reduction amount was subject to an immediate recoupment if allowances had been granted in the past, irrespective of whether the allowance asset was still on hand or not. It is therefore submitted that the new debt reduction provides additional relief when compared to the previous debt reduction rules, where the debt funded the acquisition of allowance assets. Furthermore, where the debt funded the acquisition of a non-allowance asset, the new debt reduction rules provide additional relief in that the consequences of the debt reduction will be realised only once the asset has been disposed. This can be compared to an immediate deemed disposal for capital gains tax purposes (unless the debtor had a balance of assessed capital loss available) under the previous debt reduction rules.

If the debt funded either the acquisition of trading stock no longer on hand or any other deductible expenditure, the reduction amount would still be subject to a taxing event, by way of a recoupment, in the year of assessment in which the debt was so reduced. It could be argued that in a situation where the debt funded the acquisition of trading stock no longer on hand or any other deductible expenditure in terms of which a

deduction had been previously allowed, the Legislature has not introduced any additional relief measures in the new debt reduction rules, other than the elimination of the possibility of double taxation. In the situation where the debt funded the acquisition of trading stock still on hand, the reduction amount would reduce the allowable deduction or the cost of the trading stock (depending on when the trading stock was acquired), with the reduction amount. This would result in a possible postponement of the taxing event to the year of assessment in which the trading stock is disposed of and could indicate a benefit to the debtor where the trading stock was disposed of in a subsequent year of assessment to that of debt reduction. Under the old debt reduction rules, the reduction amount would have been subject to an immediate recoupment, equal to the amount previously claimed as a deduction (unless the debtor had a balance of assessed loss), irrespective of whether the trading stock was still on hand (unless the debtor had a balance of assessed loss available).

In the case where the debtor had a balance of assessed loss available, the previous and the new debt reduction rules became analogous where the debt funded the acquisition of trading stock or deductible expenditure. Under both sets of rules the balance of assessed would absorb the reduction amount or the increase in taxable income resulting from the recoupment, therefore the tax liability would be postponed to the year of assessment in which the assessed loss was fully utilised.

In summary, a debtor that is considered to be in financial distress, as discussed in Chapter 2, may benefit from the introduction of the new debt reduction rules only where the reduction amount could have been subject to double taxation or where the debt funded an allowance asset or a non-allowance asset. Where the debt funded the acquisition of trading stock or any other allowable deduction, the impact of the previous debt reduction rules and the new debt reduction rules are considered to be equal in all material respects. The Legislature did not provide any additional relief, specifically aimed at debtors in financial distress, other than the postponement of tax where the base cost of the asset is reduced. It is therefore doubtful whether the debt reduction

rules in South Africa will assist a company in financial distress to recovery, or whether it may rather be said to act as an added impediment to a financially distressed debtor.

It was established that, despite the intention of the Legislature to provide additional relief to companies in financial distress, no significant changes have been introduced in the new debt reduction rules to suggest that this outcome has been achieved. Despite this finding that the Legislature has not introduced significant changes to the new debt reduction rules to assist financially ailing companies, the following chapter will investigate the debt reduction rules in Canada and the UK to ascertain whether the new debt reduction rules provide adequate relief to a distressed company compared to the tax debt reduction rules in these countries.

Chapter 4

The debt reduction rules in Canada and the United Kingdom

4.1 Introduction

Global markets are currently experiencing fear of global debt contagion as the global debt load is currently three times the size of the entire global economy (Phillips, 2016). To illustrate the phenomenon of rising global debt levels, corporate borrowers across the world have defaulted on \$50 billion of debt up to April 2016, with an increase in the number of delinquent companies since 2009 (Platt, 2016). Based on the aforementioned phenomena, it is anticipated that the topic of debt restructuring will become increasingly relevant for financially distressed corporations globally, specifically as it relates to the tax implications resulting from debt reductions.

Based on the analysis of financial distress carried out in Chapter 2, a debtor is generally considered to be in financial distress where there is a reasonable chance of (i) an inability to pay its debts as they become due; or (ii) its liabilities exceeding its assets fairly valued. A company may also be in financial trouble if it experiences cash flow constraints or trading conditions that are less than favourable, leading to increased borrowing and reduced profitability. As noted in Chapter 2, where a company does not respond to early warning signs of financial trouble, by entering into informal workouts or a compromise with creditors, the company in question may become financially distressed and ultimately face insolvency and liquidation. In a staff position note released by the International Monetary Fund in 2010, the economic case for moderate government intervention in debt restructuring in the corporate sector was analyzed (Laryea, 2010). In this report, the assistance of governments to facilitate out of court debt restructurings was suggested as a method to support the corporate sector, part of which should consist of amendments to tax laws that act as an impediment to corporate debt restructurings by treating the forgiveness of debt as taxable income (Laryea, 2010: 13).

As per Burdette, cited by Pretorius & Rosslyn-Smith (2014:111), the UK and Canada (and also the US and Australia) are regarded as modern rescue regimes which reflect the latest international developments. Furthermore, according to Du Preez, cited by Pretorius & Rosslyn-Smith (2014:111), current legislation is “predominantly modelled on the best practices in these countries”, it is for this reason (as well as for the reasons listed in paragraph 1.3.2) that the rules of the UK and Canada have been selected to compare with the South African debt reduction rules.

The following paragraphs will investigate the manner in which the selected countries have provided tax relief to debtors that may be regarded as being in financial trouble or financially distress and conclude with a summary of how these rules compare to the debt reduction rules in South Africa.

4.2 Workings of the debt forgiveness rules in Canada

4.2.1 General

In general, the debt forgiveness rules will apply when a commercial debt is settled and where there is a forgiven amount. In terms of section 80(1) of the Canadian Income Tax Act (1985, c. 1), hereafter referred to as the Canadian Tax Act (1985), a commercial debt obligation broadly means an obligation on which interest is, or if chargeable, would be deductible in computing income (Durand, 2011: 10). A forgiven amount is defined in section 80 of the Canadian Tax Act (1985) and broadly means (i) the lesser of the amount for which the obligation was issued or the principal amount less; (ii) the amount, if any, paid at that time in satisfaction of the principal amount of the obligation, including other amounts such as amounts that have already been taken into account in the debtor’s taxable income (Bernstein & Choudhury, 2008:859).

When a debtor's commercial obligation has been settled, the forgiven amount is applied to reduce the tax attributes of the debtor resulting in what is hereinafter referred to as the remaining amount. The tax attributes of the debtor will be reduced in the following order (Bernstein & Choudhury 2008:859; Durand, 2011: 15).

- a. non-capital loss carry forwards in terms of section 80(3) of the Canadian Tax Act (1985) which is a mandatory set off. A non-capital loss represents the excess of allowable expenditure for the year over revenue for the year (Suarez, 2012);
- b. capital loss carry forwards in terms of section 80(4) of the Canadian Tax Act (1985) which is a mandatory set off. A capital loss arises from a disposition of a capital property, where the costs of the property exceed the sale proceeds (Suarez, 2012);
- c. depreciable properties in terms of section 80(5) of the Canadian Tax Act (1985). However, the set-off is only to the extent designated by the debtor and only to the extent of the undepreciated capital cost of the asset, or the pool of assets to which the asset belongs;
- d. cumulative eligible capital in terms of section 80(7) of the Canadian Tax Act (1985), in terms of which the set-off is determined by the debtor. Eligible capital expenditure means the capital expenditure of a business that does not come within any of the capital cost allowances, but rather goes into an eligible capital property pool of which a percentage of such pool may be claimed as a deduction for that year (Canada Revenue Agency, 2015b);
- e. resource pools in terms of section 80(8) of the Canadian Tax Act (1985), but only to the extent designated by the debtor. A resource pool broadly means the expenditure incurred in respect of depreciable property used in mining operations and which are subject to an annual capital cost allowance (Mining Tax Canada, 2016);
- f. non-depreciable capital properties in terms of section 80(9) of the Canadian Tax Act (1985). The base costs of non-depreciable properties may be reduced in the

following order, only where amounts have been designated to the maximum extent under section 80(5), section 80(7) and section 80(8) of the Canadian Tax Act (1985) (Durand, 2011: 18) –

- (i) in terms of section 80(9) of the Canadian Tax Act (1985), the adjusted base cost of capital properties other than shares or debts in which the debtor is a specified shareholder, ie where the debtor holds 10% of the shares of any class;
- (ii) in terms of section 80(10) of the Canadian Tax Act (1985), the adjusted base cost of certain shares and debt in corporations where the debtor is a specified shareholder; and
- (iii) in terms of section 80(11) of the Canadian Tax Act (1985), the adjusted base cost of certain shares or debt in related corporations.

The application of the forgiven amount against tax losses and capital losses in terms of section 80(3) and section 80(4) are mandatory. Although the reductions under section 80(5) to section 80(11) are optional, a debtor may only utilize certain tax attributes, such as the base cost of certain property under section 80(9) to section 80(11), if the maximum possible designations have been made against the forgiven amount in terms of section 80(5) to section 80(8) (Bateman & Strawson, 2015: 7). This also applies to the rule in section 80(12) whereby the forgiven amount may only be treated as a capital gain (to the extent of the current year capital losses), if the maximum designations have been made as listed in sections 80(5) to 80(8) (Bateman & Strawson, 2015:7).

Following the application of the forgiven amount against the tax attributes of the debtor, only half of the remaining amount will be included in taxable income of the debtor in terms of section 80(13) (Jung, 2005). The result of the income inclusion equal to half of the remaining amount, is that the income inclusion mimics, but is not, a capital gain (Bateman & Strawson, 2015:7).

4.2.2 Exemptions

4.2.2.1 Transferring the forgiven amount

A debtor may be permitted to minimize the tax consequences resulting from a debt forgiveness in terms of section 80.04 of the Canadian Tax Act (1985), by transferring any remaining amount to an eligible transferee (only where such debtor has already reduced all of its tax attributes, excluding sections 80(9) to 80(11) of the Canadian Tax Act (1985)) (Durand, 2011: 21). Such an eligible transferee may apply the remaining amount against its tax attributes, subject to certain limitations (Jung, 2005). An eligible transferee is defined in section 80.04 of the Canadian Tax Act (1985) as:

a directed person at that time in respect of the debtor or a taxable Canadian corporation or eligible Canadian partnership

A directed person broadly means a taxable Canadian corporation (Durand, 2011: 20).

4.2.2.2 Insolvency deduction

The Canada Revenue Agency allows a deduction against the income inclusion for insolvent debtors in terms of section 61.3 of the Canadian Tax Act (1985). In terms of section 61.3 a corporation is allowed a deduction, which has the effect of reducing the income inclusion under section 80(13) to twice the fair market value of the corporation's net assets (Bernstein & Choudhury, 2008:861; Durand, 2011: 25). This deduction is aimed at ensuring that the corporation's tax liability resulting from the income inclusion does not exceed the fair market value of its net assets (Ehinger, 2013), which in turn should also not result in the corporation becoming insolvent because of the income inclusion (Durand, 2011: 25). The deduction under section 61.3 is subject to an anti-avoidance rule in section 61.3(3) which restricts the deduction where any property transfers were made in the preceding 12 months with such property being transferred

with the intention of increasing the available deduction under section 61.3 (Ehinger, 2013).

Where the debtor claims an insolvency deduction in terms of section 61.3 and where such debtor has not voluntarily elected to designate the forgiven amount against the tax attributes listed in section 80(5) to section 80(8), the Canada Revenue Agency may designate the forgiven amount on behalf of the debtor first to certain tax attributes before allowing the deduction (Bateman & Strawson, 2015:8).

To understand fully the intention behind section 61.3 to reduce the risk of a corporation becoming insolvent, the definition of an insolvent person in Canada was researched. An insolvent person in Canada broadly means a person who carries on business or has property in Canada, whose liabilities to creditors amount to \$1 000, and who is for any reason unable to meet his obligations as they generally become due, or one who has ceased to meet his current obligations in the ordinary course of business as they generally become due, or the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process would not be sufficient to enable payment of all his obligations, due and accruing (Krüger, 2010). An insolvent person in Canada may avoid bankruptcy by resorting to restructuring processes created by statute which further means that insolvency does not necessarily spell bankruptcy (Krüger, 2010). This can be compared to the meaning of insolvency in South Africa, where a company is regarded as insolvent if it cannot meet its debt obligations or where its liabilities exceed its assets fairly valued.

In Canada, there are two primary pieces of insolvency legislation which are the Companies' Creditors Arrangement Act, hereafter referred to as the CCAA, or the Bankruptcy and Insolvency Act, hereafter referred to as the BIA (Casgrain, 2011) both of which allow a debtor to restructure the operations rather than being liquidated (Mann, 2007:3). The BIA contains the principal legislation which deals with voluntary and involuntary liquidations, as well as debtor reorganisations (Casgrain, 2011). The

CCAA, on the other hand, is designed to facilitate the reorganisation of larger corporations (Casgrain, 2011) with a prerequisite that over CDN\$ 5 million owed to creditors (Pretorius & Rosslyn-Smith, 2014:121). In terms of the rescue proceedings under the CCAA, a corporation that is insolvent may request an order that will allow a stay of proceedings, preventing creditors and other third parties from enforcing their claims. This grants the corporation time to negotiate a compromise with such creditors (Mann, 2007: 8). The aim of the BIA and the CCAA is to assist a financially distressed company to avoid bankruptcy, while maximising returns for its creditors while retaining jobs and the company's value as a going concern (Pretorius & Rosslyn-Smith, 2014:121).

4.2.2.3 Creating a reserve for certain debtors

A debtor may also claim a reserve in terms of section 61.4 of the Canadian Tax Act (1985) to spread the remaining amount (following the section 61.3 deduction, if any) over five years (Bernstein & Choudhury, 2008: 861; Ehringer, 2013). This reserve is discretionary and there are no eligibility criteria for a debtor to claim a section 61.4 reserve (Bateman & Strawson, 2015:8).

4.2.3 *Summary of the Canadian debt reduction rules*

The Canadian debt reduction rules will apply equally where the debt has been used to fund deductible expenditure or the acquisition of capital assets. Where a debt is forgiven, the Canadian tax rules will apply to first reduce the tax attributes of a debtor, as listed in paragraph 4.2.1 which includes tax and capital losses as well as future allowable allowances on depreciable property.

The most notable relief given in respect of a forgiven debt, is the ability to reduce the income inclusion to twice the fair market value of the debtor's net assets in terms of

section 61.3 or spread the income inclusion over five years in terms of section 61.4 of the Canadian Tax Act (1985).

4.3 Workings of the debt forgiveness rules in the United Kingdom

4.3.1 General

In the UK, companies are generally taxed on the debits and credits that are recognised in their statutory accounts in respect of their loan relationships (Corporate Finance Manual 2016b). In terms of section 302 of the Corporation Tax Act (2009, c. 4), hereafter referred to as the CTA, a company will have a loan relationship if:

- a) the company stands in the position of a creditor or debtor as respects any money debt (whether by reference to a security or otherwise), and
- b) the debt arises from a transaction for the lending of money.

Loan relationships are further classified as either trading loan relationships or non-trading loan relationships. A company will enter into a trading loan relationship if it has entered into a loan because of its trade. On the other hand, a company will enter into a non-trading loan relationship where it is not party to the loan for purposes of trade i.e. loans held for investment or other non-trading purposes (Corporate Finance Manual, 2016c).

As a general rule, profits arising from a company's loan relationships are taxed as income in accordance with section 295 of the CTA (Mainwaring, 2015). Furthermore, in terms of section 307(2) of the CTA, the credits and debits to be taken into account are those recognised in accordance with generally accepted accounting practice. The debits and credits that may be taken into account for purposes of calculating the profit on a loan relationship, are listed in section 307(3) and 307(4) of the CTA. In terms of section 307(3) of the CTA these amounts must fairly represent :

- (i) all profits or losses from its loan relationships;
- (ii) interest arising from its loan relationships;
- (iii) expenses incurred by the company for purposes of its loan relationships (ie expenses that are directly incurred in bringing the loan into existence, incurred in making of payments under any loan relationship, or collecting amounts due in respect of loan relationships).

Section 297 of the CTA states that any debit and credit in respect of a trading loan relationship is treated as a receipt and expense or allowance for trade purposes, therefore they are accordingly brought into account for tax purposes. On the other hand, any debits and credits arising from non-trading loan relationships are pooled together, resulting in either a net credit or a net deficit. A net credit is brought into account in the company's total taxable profit (Mainwaring, 2015). A net trading deficit may be carried forward to any subsequent period, or be surrendered as group relief (Corporate Finance Manual, 2016a).

Specific rules apply in determining the debits and credits in a loan relationship where such loan relationship exists between connected parties. For purposes of Part 5 of the CTA, section 466 of the CTA deems there to be a connection between a company ("A") and another company ("B") for an accounting period if there is a time in the period when (i) A controls B, (ii) B controls A, or (iii) A and B are both controlled by the same person. Where a connected party relationship exists between the debtor and the creditor, section 349 of the CTA determines that the amortised cost basis must be used to determine the cost basis in respect of each loan, in other words such loans need to be recognised at cost (Blundell, 2015). Furthermore, section 354 of the CTA dictates that no impairment losses or any loss on the writing off of a loan, may be claimed as a debit where a connected party relationship exists (Howard, 2014). On the other hand, the corresponding credit on the release of the connected party debt must be ignored

in terms of section 358 of the CTA (Mainwaring, 2015). The term release has to take on its formal legal meaning, i.e. in order to secure the applicability of the relief provided in section 358 of the CTA, it may be necessary to draw up a formal release deed between the debtor and the creditor (Mainwaring, 2015).

The connected person exemption is subject to certain exclusions which may be triggered where parties that are in a loan relationship become connected. Broadly, the connected party exemptions will not apply where there is (i) an acquisition of the creditor's rights by an unconnected party at a value that is under the value determined in terms of section 361 of the CTA and immediately after the acquisition of the debt, the debtor and such other person become connected; and (ii) where parties become connected when the creditor's rights are subject to an impairment adjustment in terms of section 362 of the CTA (Howard, 2014).

4.3.2 Exemptions from the UK debt reduction rules

In terms of section 322 (3) to (5) of the CTA, a credit in respect of a release of a debt will not have to be brought into account where condition A, B or C referred to below, is met:

- (3) Condition A is that the release is part of a statutory insolvency arrangement.
- (4) Condition B is that the release is—
 - A. in consideration of shares forming part of the ordinary share capital of the debtor company, or
 - B. in consideration of any entitlement to such shares.
- (5) Condition C is that—
 - A. the debtor company meets one of the insolvency conditions (see subsection (6)), and
 - B. the debtor relationship is not a connected companies' relationship (see section 348).

4.3.2.1 Insolvency transactions

In terms of the exemption contained under condition A of section 322(3) of the CTA, a statutory insolvency arrangement is defined in section 1319 of the CTA as:

- a) a voluntary arrangement that has taken effect under, or as a result of, the Insolvency Act 1986, Schedule 4 or 5 to the Bankruptcy (Scotland) Act 1985 or the Insolvency (Northern Ireland) Order, 1989;
- b) a compromise or arrangement that has taken effect under Part 26 of the Companies Act 2006; or
- c) an arrangement or compromise of a kind corresponding to any of those mentioned in paragraph (a) or (b) that has taken effect under, or as a result of, the law of a country or territory outside the United Kingdom,

A voluntary arrangement, as referred to in subparagraph (a) of section 322(3) of the CTA, is a renegotiation by a company of the payments due to all its creditors, which often involves debt write offs; creditors accepting less than the full amount due to them; or some other form of financial restructuring which is subject to creditors' meeting and vote. Unlike a scheme of arrangement (or a compromise) a voluntary arrangement requires the acceptance of at least 75% of all the creditors and it does not apply to preferential creditors without their individual consent (Linklaters, 2008). A voluntary arrangement is aimed at assisting a company that is in some form of distress but which does have a sound underlying business (PWC, 2009: 13).

A compromise in subparagraph (b) of section 322(3) of the CTA is also referred to as a scheme of arrangement under Part 26 of the Companies Act 2006, which is a formal agreement or compromise between a company and its creditors (PWC, 2009: 24). A compromise that could include an extension of payment terms, may be used by either a solvent or an insolvent company (Robertson, 2015).

A debtor will also be relieved from including any credits arising from a debt release in its taxable income, under condition C of section 322(5) of the CTA if it meets the insolvency conditions listed in section 322(6) of the CTA, which are:

- a) it is in insolvent liquidation,
- b) it is in insolvent administration,
- c) it is in insolvent administrative receivership,
- d) an appointment of a provisional liquidator is in force in relation to the company under section 135 of the Insolvency Act 1986 (c. 45) or Article 115 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)), or
- e) under the law of a country or territory outside the United Kingdom circumstances corresponding to those mentioned in paragraph (a), (b), (c) or (d) exist.

A company will be regarded as being insolvent where its debts exceed its assets or where it is unable to pay its debts as and when they fall due (PWC, 2009: 32). This definition of an insolvent company can be compared to the definition of financial distress as contained in the Companies Act (71 of 2008) as discussed in Chapter 2. An insolvent company in the UK can either (i) enter into administration; (ii) enter into a voluntary arrangement; (iii) enter into administrative receivership; or (iv) enter into compulsory or a voluntary liquidation (PWC, 2009: 9; Linklaters, 2008). The procedures listed under (i) to (iii) allow for the potential rescue of the company, whereas compulsory or voluntary liquidation does not (PWC, 2009: 9).

Regarding the exemption contained in section 322(6)(a), liquidation means turning of a company's assets into cash and then distributing the cash among the creditors. Liquidation can be voluntary, in other words, the company is still able to pay its debts, but the shareholders may wish to realise their investments. However, when liquidation

is compulsory, it will occur where the company is insolvent and the court has received a petition from an unpaid creditor to wind up the company (PWC, 2009: 18)

Insolvent administration, as referred to in subparagraph (b) of section 322(6) of the CTA, is a process whereby an administrator is appointed by the company, the creditors or the court to hold the business together while plans are made to either rescue the company or implement financial restructuring (PWC, 2009: 10). As administration proceedings are aimed at rescuing a company that is likely to become insolvent (Linklaters, 2008) the administrator is obliged to present a proposal to reveal the mechanisms that will be implemented to restore the business to financial health (Pretorius & Rosslyn-Smith, 2014:118).

Under administrative receivership, as referred to in subparagraph (c) of section 322(6) of the CTA, an administrative receiver is appointed by a lender that holds a floating charge security such as a debenture. Such person is appointed to take temporary charge of the company's property which is subject to the secured debt and to realise proceeds on such property up to the value of the secured debt (Linklaters, 2008).

As can be seen from the above, the UK insolvency law offers distressed companies a variety of procedures, including administration, administration receivership, company voluntary arrangement and scheme of arrangement to assist such companies to return to financial health (Pretorius & Rosslyn-Smith, 2014:116). This approach is particularly evident as the UK Insolvency Act (1986) that sets out a particular set of objectives to be achieved by an administrator including rescuing the company as a going concern (Pretorius & Rosslyn-Smith, 2014:116). This objective becomes obvious in the light of the exemptions provided by the HMRC in section 322 of the CTA. These exemptions are aimed at providing relief, not only to debtors that are in the process of liquidation, but also to debtors that are in the midst of initiating formal recovery proceedings.

4.3.2.2 Debt for equity transactions

In a corporate rescue transaction, the debt for equity exemption contained in section 322(4) of the CTA may be of great benefit where the creditor has the desire and the ability to take an equity stake in the debtor (Davies, 2015). This type of transaction has, however, created significant difficulty in the past as it was typically applied where a debt worth less than the full value became a connected party debt (Leslie, 2016). Furthermore, a debt release between connected persons is exempt in terms of section 354 and section 358 of the CTA (Mehta, 2016) but not if such a debt release is a 'deemed release' in terms of section 361 and section 362 of the CTA (Leslie, 2016; Metha, 2016:4). A deemed release is covered under section 361 where there is an acquisition of creditor rights by connected companies at a discount, or in terms of section 362 of the CTA where parties become connected where the creditor's rights are subject to an impairment.

The deeming provisions in section 361 of the CTA are aimed at avoidance transactions whereby the connected creditor purchases the debt from the original lender at a discount after which such debt is released to avail of the connected party exemption in section 354 and section 358 of the CTA (Metha, 2016). To prevent the unintended consequences of the anti-avoidance provisions, which have resulted where the debt and shares of the debtor were acquired as part of a rescue transaction (Leslie, 2016), the HMRC introduced section 361-C which applies where the debt was acquired at a discount and where it was paid for by the issue of shares (Southern, 2012). In most cases, taxpayers request a clearance certificate from the HMRC to obtain certainty that their transactions have not fallen foul of the requirements in section 361-C (Leslie, 2016). Relief provided in terms of section 322(4) of the CTA has become a costly and a time-consuming exercise for the HMRC following the global economic downturn in 2008 as the number of applications has increased. This necessitated the introduction of the targeted relief provisions applicable to companies that are in financial distress (Leslie, 2016).

To add complications to the application of section 322(4) of the CTA, the debt for equity transaction must be concluded at arm's length (HMRC, 2013). However, the HMRC has indicated that it will not argue that section 322(4) does not apply merely because of a huge disparity between the nominal amounts of the debt released and the market value of the shares issued (Corporate Finance Manual, 2016d). Rather, the HMRC will look at the surrounding circumstances at the time of the debt release to ascertain whether there is a real commercial desire at the time of the debt release for the shares to be held indefinitely and not sold to a connected person of the debtor straight after the release. In other words, the transaction needs to be a real transaction and not merely a device to be granted the exemption (Metha, 2016).

4.3.2.3 Financial distress

Additional exemptions were introduced by the Finance (No 2) Act 2015 which became effective on 1 January 2015, which allow additional relief for companies that are considered to be in financial distress (Robinson, 2016). With reference to the existing exemption in section 322 of the CTA, in some cases, a lender may have no interest in owning the equity of the distressed debtor (Robinson, 2016) while in other cases it may not be appropriate for the debtor to enter into insolvency proceedings (Stones, 2015). To address these shortcomings the HMRC introduced new rules to allow the credits arising from a cancellation of a debt to be exempt. In terms of section 323A of the CTA (i) there have been significant modifications to the terms of a loan relationship; or (ii) in terms of section 322(5A) of the CTA it is reasonable to assume that without the release of the debt, there will be a material risk that at some point within the next 12 months that the company will be unable to pay its debts (Robinson, 2016). In terms of section 323(A1) of the CTA, a company will be considered to be unable to pay its debts where (i) it cannot pay as they fall due; and (ii) the value of the company's assets is less than the value of its liabilities (Mullen, 2016; Akin Gump Strauss Hauer & Feld LLP. 2015). In other words, where no remedial action is taken to address the distress situation of the debtor there is a realistic likelihood or material risk that the company will go into insolvency within 12 months after the date of the release (Stones, 2015).

The new rules will be accompanied by a new general anti avoidance rule that will counter arrangements with the main purpose of obtaining a tax benefit (HMRC, 2015).

4.3.3 Summary of the UK debt reduction rules

As a general rule, the tax treatment of a loan relationship follows the accounting treatment. In other words, a creditor receives a tax deduction for any provision or write off while the debtor receives a tax inclusion for any amount that is written off (Howard, 2014). There are a number of exemptions that apply to the general rule such as where the debtor and the creditor are connected persons. In terms of section 358 of the CTA, where there is a release of a debt between a connected debtor and creditor the corresponding credit and debit are generally neutral for corporation tax purposes (Howard, 2014).

Other exemptions will also apply where (i) the release of the debt is part of a statutory insolvency arrangement in terms of section 322(3) of the CTA; (ii) a debt is released in consideration for the issue of ordinary shares by the debtor in terms of section 322(4) of the CTA; or (iii) where the debtor meets the insolvency conditions and the debtor and creditor are not connected in terms of section 322(5) of the CTA.

Additional exemptions were introduced with effect 1 January 2015 to provide relief for companies that are considered to be in financial distress, but for whom a debt/ equity swap or a formal insolvency process is inappropriate (Stones, 2015). The new exemptions will apply where there have been significant modifications to the terms of a loan relationship or where there is a material risk that the debtor will be unable to pay the debts within the next 12 months (Mullen, 2016).

The tax exemptions that are available to a financially distressed debtor can be aligned to the aim of the UK insolvency law, which is to rehabilitate and preserve a viable

business, as well to offer the ailing company an opportunity for survival (Conradie & Lamprecht, 2015: 15).

4.4 Summary and comparisons of the debt reduction rules

From a tax perspective, the tax relief provisions in Canada and the UK that are summarised in the table below, are limited to the exemptions and relief provisions aimed at assistance to insolvent companies or companies in financial distress.

Table 4.1: Summary and comparison of the debt reduction rules

Category of relief	Canada	United Kingdom
Insolvency relief	<p>In terms of legislation, an insolvent company in Canada is not necessarily doomed to bankruptcy because the business may be rescued if it enters restructuring arrangements. Therefore, the following relief measures, which are not limited to insolvent corporations, could provide valuable relief where a debtor is struggling to avoid bankruptcy.</p> <ul style="list-style-type: none"> • The debtor can transfer the forgiven amount to an eligible transferee, after all its tax attributes have been utilized. • The income inclusion resulting from a forgiven amount (after reducing tax attributes) is limited to half of the forgiven amount, mimicking a capital gain inclusion. • The income inclusion resulting from the debt forgiveness may be spread over a period of 5 years in terms of section 61.4 of the Canadian Tax Act. <p>Specific relief is also provided to insolvent companies in terms of section 61.3 of the Canadian Tax Act, whereby the income inclusion is limited to twice the fair market value of the net assets of the debtor.</p>	<p>In the UK, the following targeted relief measures can be applied to assist an insolvent company not necessarily on the verge of liquidation; where</p> <ul style="list-style-type: none"> • the release of a debt is part of a voluntary arrangement or a compromise between the debtor and the creditors in terms of section 322(3) of the CTA, the debt so relieved will be exempt from income tax. • a company has entered liquidation proceedings, or where it has entered into insolvent administration or insolvent receivership in terms of section 322(5) of the CTA, any debt release that forms part of these procedures will be exempt from income tax. • the debt is exchanged for the issue of shares in the debtor's company in terms of section 322(4) of the CTA.
Financial distress	<p>There are no express relief provisions for a company that is in financial distress. However, the relief provisions that are summarised above can also be said to aid a debtor in financial distress as it may serve to aid to prevent a debtor from bankruptcy or liquidation.</p>	<p>The UK provides specific relief where a debtor is considered to be in financial distress, or in other words where there is a material risk that a debtor will become insolvent within 12 months. Debt reduction is undertaken in an attempt to avoid the insolvency of the debtor. The relief so provided will result in the forgiven amount being exempt from income tax.</p>

4.5 Comparison to South Africa

4.5.1 General

In an attempt to compare the tax implications of a debt reduction of a financially distressed debtor in South Africa to a financially distressed debtor in Canada and the UK, it is necessary to set out certain limitations and similarities. First, definitions of a financially distressed debtor in South Africa (as defined in Chapter 2), an insolvent company or a financially distressed company in Canada and the UK (as discussed in Chapter 4) are considered to be sufficiently similar so that the terms can be used interchangeably for the purposes of this comparison. Furthermore, the comparison following below will be based on the assumption that (i) the debtor and the creditor are not connected persons; and (ii) the debtor has no available assessed tax losses or assessed capital losses (or any other tax attributes). This assumption is necessary as there are country specific rules that apply in relation to connected parties as well as assessed losses, the analysis of which is outside the scope of this paper.

In the analysis of the new debt reduction rules applicable in South Africa in Chapter 3, the tax consequences that arise where the debt funded (i) the acquisition of allowance assets; (ii) the acquisition of non-allowances; (iii) the acquisition of trading stock; or (iv) the funding of deductible expenditure is covered. For ease of reference the South African tax implications in respect of each application of the debt will be discussed below briefly.

Where the debt has funded the acquisition of allowance assets still on hand, the reduction amount will be applied against the remaining base cost of the asset at the time of the debt reduction and the excess will be recouped under section 8(4)(a) of the Act. Where a significant portion of the cost of the asset has been claimed against taxable income as wear and tear, the tax implications arising from a debt reduction may be a higher recoupment in the year of the debt reduction. The same principle will apply where the allowance asset is no longer on hand, and where a significant amount

of the cost of the asset has been claimed as wear and tear in the years prior to assessment where such allowance has not already been recouped in terms of section 8(4)(a) of the Act upon the disposal of the asset.

Where the debt has funded the acquisition of a non-allowance asset that is still on hand at the time of the debt reduction, the reduction amount will reduce the base cost of the asset which will result in an increase in the capital gain that may be realised upon the subsequent disposal of the asset. Where the asset is no longer on hand, there will be no further tax implications resulting from the debt reduction, other than the reduction of an available assessed capital loss.

Where the debt has funded the acquisition of trading stock or any other deductible expenditure, the result of a debt reduction will be an immediate recoupment of the amounts previously allowed as a deduction.

The South African debt reduction rules offer relief from double taxation, or in the case where the debt has funded the acquisition of capital assets, the reduction amount may be exempt where, in terms of paragraph 12A(6)(e) of the Eighth Schedule to the Act, the debt was forgiven by a connected person in anticipation of the liquidation of the debtor, or where the debt is forgiven between a group of companies in terms of paragraph 12A(6)(d) of the Eighth Schedule to the Act.

4.5.2 Canada

In a paper that is aimed at setting out tax opportunities that are available to a Canadian corporation in times of economic slowdown, the following relief provisions are specifically identified as being available to a debtor where a debt has been forgiven (Bateman & Strawson, 2015: 8):

- only 50% of a forgiven amount (after applying the mandatory and optional tax attributes) will be included in the income of the debtor;
- application of the insolvency deduction available in section 61.3 of the Canadian Tax Act (1985), has the effect of reducing the income inclusion to twice the fair market value of the debtor's net asset value;
- application of the reserve in section 61.4 of the Canadian tax Act (1985) allows the debtor to spread the income inclusion over 5 years; and
- the forgiven amount can be assigned to an eligible transferee in terms of section 80.04 of the Canadian Tax Act (1985).

In comparison to the debt reduction rules in South Africa, specifically where a debtor who has been relieved of a debt may be subject to a full recoupment under section 8(4)(a) of the Act of the reduction amount in the year of assessment during which the debt has been reduced in terms of section 19 of the Act, a forgiven amount of a Canadian corporation will be included only in its taxable income at half of the remaining forgiven amount, to mimic a capital gain (Bateman & Strawson, 2015:7). Furthermore, additional relief measures allow a deduction against the income inclusion thereby preventing the corporation from becoming insolvent as a result of the tax liability (Ehringer, 2013). The relief is extended to the possibility of claiming a reserve under section 61.4 of the Canadian tax Act (1985), where there is still an income inclusion following the insolvency deduction in section 61.3 of the Canadian tax Act (1985), to spread the income inclusion over a period of five years.

It is clear from the above analysis that the South African debt reduction rules fall far short of the Canadian debt reduction rules where specific, targeted relief is given to a debtor whose debts have been forgiven. It is also clear that the Canadian tax rules

work in conjunction with the CCAA and the BIA, in their intention to assist companies that are in financial distress, to avoid bankruptcy (Pretorius & Rosslyn-Smith, 2014:121). As the South African business rescue regime is modelled on best practice in countries such as Canada and the UK (Pretorius & Rosslyn-Smith, 2014:111), it is recommended that the Legislature revisit the new debt reduction rules in respect of the relief that is given to companies that find themselves in financial distress.

The tax relief measures in the Canadian Tax Act (1985) that are aimed at alleviating the tax burden arising from a debt reduction of an insolvent debtor, are based on the actual financial position of the debtor i.e. twice the fair market value of the net asset value. In addition, to prevent abuse the Canadian debt reduction rules also include anti-avoidance measures in section 61.3(3) which disregard the section 61.3 deduction with the value of the property transferred within the 12-month period preceding the end of the year if it is reasonable to assume that the reason for the transfer is to increase the section 61.3 deduction (Ehringer, 2013). It is suggested that the Legislature should consider the rules adopted in Canada, where the preference is to limit the income inclusion arising from a debt reduction, rather than to exempt fully such amounts as is the case in the UK, where the debtor is an insolvent company with a net asset value of nil.

4.5.3 The United Kingdom

In the UK it has been recognised that the taxation of profits arising from a debt forgiveness could force a distressed company into insolvency because a transaction to relieve its debts is not viable due to the unaffordable tax liability arising from this (Robinson, 2016). The HMRC allows various exemptions from the credits arising from a debt waiver (as discussed in paragraph 4.3.2) to ensure that UK companies in financial difficulty do not get exposed to additional tax liabilities in their efforts to reduce their tax obligations (Akin Gump Strauss Hauer & Feld LLP, 2015). These exemptions are limited in circumstances where the debtor is not engaged in formal insolvency

proceedings, or where the creditor is not willing to accept shares in exchange for debt (Robinson, 2016).

The newly introduced tax exemptions in the UK, which will apply to debts reduced after 1 January 2015 (Akin Gump Strauss Hauer & Feld LLP, 2015), address the shortcomings of the existing exemptions by allowing further exemption from the credit resulting from a debt reduction where the debtor is financially distressed, or where there is a material risk that the debtor will be unable to pay its debts as they become due. This applies where there is a material risk that the debtor's liabilities will exceed the assets in the next 12 months. The newly introduced tax exemptions supplement the existing exemptions while reflecting the policy objective of the HMRC that a company in financial difficulty should not be subject to further tax charges that may hinder its ability to stay in business (Akin Gump Strauss Hauer & Feld LLP, 2015). This objective is aligned to the UK insolvency regime where the aim is "rescuing the company as a going concern" (Pretorius & Rosslyn-Smith, 2014:116).

In contrast to the debt reduction rules in Canada, where the income inclusion is based on the actual financial position of the debtor, the eligibility criteria for the exemption of the credit arising from a debt reduction in the UK are that the debtor must be financially distressed. It is submitted that this may present a risk for the Legislature, as the interpretation of what is regarded as being in financial distress may become a subjective exercise that could be open to abuse and avoidance schemes. In implementing a similar approach, a regime wide anti-avoidance provision may be introduced in conjunction with the exemption. This will aim at disregarding any transaction or any scheme that is entered into with the main purpose of avoiding or postponing tax. The abuse of such a relief provision will be further discouraged by the existence of the understatement penalties which are contained in section 223 of the Tax Administration Act 2011. In particular, the understatement is as a result of intentional tax evasion, this could result in a maximum penalty of 200 per cent being imposed.

4.6 Conclusion

It is clear from the analysis conducted above that Canada and the UK offer targeted relief measures to companies that are either at risk of becoming insolvent or companies that are insolvent. In the case of Canada, this takes the form of a deduction allowed in section 61.3 of the Canadian Tax Act (1985). This entails that the income inclusion resulting from a debt reduction is subject to the debtor's net asset position, resulting in a nil inclusion for an already insolvent debtor, or a reduced inclusion for a company that is in danger of becoming insolvent. The UK on the other hand specifically defines the term financial distress and specific relief is given to companies that meet the criteria. This is in addition to existing UK tax rules that allow exemptions where companies have entered into compromise agreements with their debtors, or where companies have initiated insolvency proceedings.

It is suggested that the Legislature defines the meaning of the term financial distress and provides targeted relief measures that are specifically aimed at companies that meet the criteria. Financial distress should include entities that have entered into informal rescue proceedings to rescue the underlying business or companies that have entered into formal rescue proceedings such as business rescue proceedings or a scheme of compromise with their creditors. It is also suggested that the relief given to debtors that meet these criteria should be based on specific and determinable criteria, as is the case in Canada where the income inclusion is calculated according to the net asset value of the debtor, subject to an analysis of property transferred in the preceding 12 months. It is also suggested that the relief should be subject to anti-avoidance provisions that nullify the relief given in circumstances where the aim of the transaction is to avoid tax.

It is also deemed necessary that the Legislature provide relief to companies that have entered formal liquidation proceedings, as is done in the UK in terms of section 322(5) of the CTA. As can be seen from paragraph 3.4.3.3, the Legislature provides such relief only where the debtor and the creditor are connected persons and where the debt was initially incurred to acquire capital assets.

Chapter 5

Conclusion

5.1 Introduction

It has been speculated that the lacklustre economy and plight of taxpayers wishing to restructure their debt obligations have inspired National Treasury to revisit the previous debt reduction rules that were replaced with the new debt reduction rules with effect 1 January 2013 (Garven, 2012).

The main objective of this study was to establish whether the new debt reduction rules facilitated the recovery of companies that were economically viable but considered to be in financial distress. To address the main objective, the meaning of the term financially distressed was investigated in Chapter 2 with reference to the definition of financial distress as contained in the Companies Act (71 of 2008) and also by taking into consideration the meaning of the term in the recently amended UK tax rules relating to debt forgiveness. The meaning of financial distress was further investigated in Chapter 2 citing the findings of various researchers who studied the lifecycle of financial distress and how companies could recover therefrom. The workings of the debt reduction rules were explained in Chapter 3 to address the second research objective in paragraph 1.3.2. This chapter contained a discussion on whether the new debt reduction rules introduced by the Taxation Laws Amendment Act 22 of 2012 brought additional relief measures in to assist a company that was in financial distress, based on the findings of what constituted financial distress in Chapter 2. In a further attempt to provide a backdrop against which the debt reduction rules in South Africa could be analyzed, specifically with regard to assistance given to a financially distressed debtor, the tax implications arising from a debt reduction were compared to the tax rules in Canada and the UK in Chapter 4.

5.2 Achievement of objectives

The objectives of this study, which are set out in paragraph 1.3.2, were addressed by conducting a literature review, which included an analysis and a study of the South African and foreign laws and legislation specifically related to the tax implications arising for a debtor on a debt reduction, as well as the meaning of the term financial distress. The findings of the literature review were applied to each of the research objectives in an attempt to address the research problem as set out in paragraph 1.2. Each of the secondary research objectives is discussed below.

- (i) To explore the meaning of the term financial distress as defined in the Companies Act (71 of 2008). The meaning and application of the term were also investigated from the perspective of the UK tax legislation and work performed by various researchers.

The study of the meaning of financial distress was conducted to establish whether the relief measures provided in the new debt reduction rules could be said to aid a company that was regarded as being in financial distress.

The investigation into the term financial distress in Chapter 2, revealed that where it was reasonably likely that a company would be unable to pay its debts as they fall due, or where it was reasonably likely that a company's liabilities would exceed its assets within the following six months, such company would be regarded as being in financial distress. Chapter 2 further revealed that a financially distressed company was not necessarily a company on the verge of liquidation or deregistration, but rather a company that was still able to react to warning signs to prevent insolvency and ultimately liquidation (Outecheva, 2012:16). This is especially important as insolvency systems around the world have recognised that a business will offer greater value when it is a going concern than when it is in liquidation (Pretorius & Rosslyn-Smith, 2014: 109), and particularly as South

Africa's insolvency law is modelled on international best practice. It is also for this reason that the Legislature introduced the business rescue regime in Chapter 6 of the Companies Act (71 of 2008), which was introduced to assist financially ailing companies that met the formal criteria for financial distress, with an alternative to liquidation (Pretorius & Rosslyn-Smith, 2014: 109). It is on the basis that a financially distressed company can implement recovery proceedings to prevent deregistration or liquidation, that the debt reduction rules were analysed in Chapter 3.

- (ii) To analyze the development and the workings of the debt reduction rules in South Africa specifically to ascertain whether the new debt reduction rules introduced additional relief to those debtors that were considered to be in financial distress.

In analyzing the tax implications attendant on a debt waiver, it would seem counterintuitive that provisions such as the compromise of a debt, (in terms of section 155 of the Companies Act (71 of 2008)) and the business rescue regime (in terms of section 128 of the Companies Act (71 of 2008)) were catered for to assist financially troubled and distressed companies, whereas these proceedings, if implemented could be subject to significant and adverse tax consequences in terms of the Act (Seccombe, 2013). In an ideal world, the tax laws should work in conjunction with the corporate laws to prevent a company from becoming insolvent and entering into liquidation. This was highlighted in Chapter 4 in the analyses of the debt reduction rules in Canada and the UK.

To establish whether the South African tax laws worked in conjunction with the Companies Act (71 of 2008) to rescue financially distressed companies, Chapter 3 detailed the workings of the previous and the new debt reduction rules and highlighted the significant exemptions and relief provisions allowed by the Act. A further analysis of the additional relief provisions that were introduced in 2013 revealed that the Legislature provided additional relief where the underlying debt

was used to fund capital assets still on hand. This could result in a deferment of the taxing event resulting from the reduction of the debt in certain circumstances. Where the debt funded either deductible expenditure or trading stock not held, the additional relief provided by the new debt reduction rules were geared to prevent double taxation.

Both the previous and the new debt reduction rules provided relief where the underlying debt was used to fund capital expenditure and where the debt was subsequently forgiven between companies that formed part of the same group of companies (paragraph 12A(6)(d) of the Eighth Schedule to the Act), or in circumstances where the debt was reduced by a connected person in anticipation of the liquidation of the debtor (paragraph 12A(6)(e) of the Eighth Schedule to the Act). These exemptions were not extended to section 19 of the Act where the debt funded deductible expenditure, trading stock or allowances on assets. Furthermore, the Legislature did not provide specific relief to a financially distressed debtor by the introduction of the new debt reduction rules other than the deferment of tax, in certain circumstances, or the elimination of the possibility of double taxation.

(iii) to compare South Africa's debt reduction rules where the debtor is considered to be in financial distress, to the tax treatment of debt reduction in Canada and the UK.

As discussed in Chapter 3, a South African company that was experiencing financial trouble or financial distress could be absolved from repaying a portion of its debts. It is questionable whether the debt reduction rules in their current form would actually assist the company to recover from the financial set-back. This is especially questionable in circumstances where the underlying debt was used to fund deductible expenditure or trading stock or allowances on assets that were either not on hand at the time of the forgiveness or that had insufficient base costs to absorb the reduction amount. In these circumstances, it could appear that the

debt reduction rules acted as an added impediment to companies that were in financial distress.

This observation was confirmed in Chapter 4 where research results were reported on the tax implications of a debt reduction in Canada and the UK where relief measures extended to all forgiven amounts, irrespective of whether the underlying debt funded capital expenditure or revenue expenditure. Furthermore, the debt reduction rules in Canada and the UK included relief measures that were specifically aimed at preventing the insolvency of a financially troubled or distressed debtor because of the tax implications arising from a debt reduction.

5.3 Recommendations

Based on a reading of the 2011 National Budget and the 2012 Explanatory Memorandum, it was clear apparent that it was indeed the intention of the Legislature to assist companies that were in financial distress. However, upon performing an analysis on the new debt reduction rules it became clear that the Legislature did not expressly provide any relief to financially distressed debtors, as was the case in Canada and UK. Following an analysis of the meaning of financial distress in Chapter 2 it can be concluded that the tax legislation should work in conjunction with the Companies Act (71 of 2008), where specific measures were introduced in the business rescue regime of which the main objective was to help a company to continue as a going concern (Conradie & Lamprecht, 2015:22). For these reasons the following recommendations are put forward.

- (i) From an analysis of the workings of the debt reduction rules in Chapter 3 it is evident that the Legislature did not extend any worthwhile relief provisions to reduction amounts where a debtor was in financial distress. It is recommended that the debt reduction rules that are included in section 19 and paragraph 12A of the Eighth Schedule to the Act , be aligned to the objectives of the business rescue

regime in Chapter 6 of the Companies Act (71 of 2008) to provide relief to companies experiencing financial distress and that have entered into business rescue. In addition, it is recommended that the Legislature introduce a definition of financial distress in the Act .

(ii) The Legislature should consider introducing additional relief measures to companies in financial distress that have entered into a scheme of compromise agreement in line with section 155 of the Companies Act (71 of 2008) in an attempt to rescue its business. The Companies Act (71 of 2008) has included the provisions of a scheme of compromise in Chapter 6, which serves as a mechanism whereby a financially distressed company could react to rescue the company as a going concern. It is suggested that the tax rules be amended to include this mechanism.

(iii) The Legislature should also address the limited relief that is given in section 19 of the Act , specifically in circumstances where a financially distressed debtor is not eligible for business rescue or a scheme of compromise. Currently, where a debtor is relieved of a debt which funded deductible expenditure or the acquisition of trading stock, such debtor could be subject to an immediate recoupment in the year of assessment in which the debt is reduced, which could reduce the benefit of the debt reduction granted to the debtor.

(iv) The Legislature should extend the relief to companies that are being liquidated, where there is no prospect of rescuing the business. Currently the only relief given to a company that is being liquidated can be found in paragraph 12A(6)(e) of the Eighth Schedule to the Act, where a debt that is forgiven by a connected person, in anticipation of the liquidation of the debtor, is relieved from the tax implication arising as a result thereof, but only in circumstances where the debt funded the acquisition of a capital asset. Where the debt funded the acquisition of trading stock or any deductible expenditure or allowances (where the base cost of the asset was insufficient to absorb the reduction amount), section 19 of the Act does not provide

any exemptions where the debtor is being liquidated. Such a debtor will be subject to an immediate recoupment.

5.4 Suggestions for future study

Potential topics for further research have been identified:

- (i) As was done in the UK, targeted relief measures were given to debtors where the debt was reduced as part of a statutory insolvency arrangement (such as a compromise agreement with creditors) or where the debtor met any of the insolvency conditions, which included being placed in administration.

Currently, the Companies Act (71 of 2008) allows a scheme of compromise between a debtor and a creditor in section 155 and a business rescue regime in section 129, both of which are aimed at the rescue and rehabilitation of a distressed company. The current debt reduction rules do not directly address any of the aforementioned proceedings therefore it is suggested that research should be conducted to establish how the tax rules could be amended to facilitate the objective of the Companies Act (71 of 2008) without leading to tax abuse and how specific rules should be formulated to target abuse without disallowing legitimate relief.

- (ii) It is suggested that further research be conducted on whether targeted tax relief should be given to financially distressed debtors that have initiated informal rescue proceedings and what such relief measures should entail. As discussed in Chapter 2, a company could be in a financially distressed situation, but not eligible to enter into business rescue, or it might not be in a position to suggest a compromise with its creditors. In such circumstances, where the debtor did not take the necessary steps to address the financial distress, there could be a continual shift its position on the distress continuum and ultimately the probabilities of rescuing the business, as discussed in Chapter 2 would be reduced. However, the tax implications resulting from the debt reduction could eliminate the benefits of such proceedings.

Countries such as Canada have introduced not only specific relief measures that are targeted at eliminating the possibility of insolvency of the debtor, but have also allowed various other relief mechanisms that could benefit a financially distressed debtor, as discussed in paragraph 4.5.2. In this regard it is interesting to note that, irrespective of whether the debtor is considered to be in financial distress, the income inclusion resulting from the debt reduction will be included only in taxable income at half of the remaining forgiven amount. In other words, a forgiven amount is treated as a capital gain, providing relief in all debt relief scenarios.

Although a similar approach has not been followed in the UK, transactions such as a debt for equity swap are exempt in certain circumstances. Such transactions have however given rise to various problems in the UK, specifically since the creditor may not always have the desire to hold shares in the debtor, particularly where the debtor is underperforming. Further complications may present themselves where the market value of the shares issued in exchange for the debt is less than the reduction amount. In the UK, the HMRC has specifically stated that regard will be given to the real intention behind the transaction, further suggesting that sham transactions that are merely entered into to reduce the debt, will not be acceptable.

Further research needs to be conducted on alternative relief mechanisms that could be introduced for financially distressed companies that have not reached the extreme end of the distress continuum, as depicted in Table 2.1 of Chapter 2.

5.5 Conclusion

In terms of section 7(k) of the Companies Act (71 of 2008), the purpose of the Companies Act (71 of 2008) is "providing for the efficient rescue and recovery of financially distressed companies" (Klopper & Bradsheet, 2014). This goal is legislated in Chapter 6 of the Companies Act (71 of 2008), entitled "business rescue and compromise with creditors".

The Companies Act (71 of 2008) introduced the business rescue regime to facilitate the rehabilitation of a company in financial distress (Rushworth, 2010: 375). The business rescue regime has been developed from similar concepts, in particularly the United States and Great Britain. It is considered to be a modern approach as it allows a company the opportunity to put itself onto a sound financial footing, thereby saving the underlying business, the rights of the employees and society in general (Rushworth, 2010: 376). The South African business rescue regime is in line with international insolvency law (Conradie & Lamprecht, 2015).

The success of the business rescue regime in South Africa is of particular importance, due to high levels of unemployment in South Africa. It has been argued that Chapter 6 of the Companies Act (71 of 2008) supports goals for South Africa to reduce business liquidations and to preserve the country's level of employment (Conradie & Lamprecht, 2015).

Considering the abovementioned goals of the Companies Act (71 of 2008) to rescue and recover financially distressed companies, it seems to be counterproductive that

the Act does not operate in conjunction with the Companies Act (71 of 2008) to achieve this goal (Seccombe, 2013). This disparity becomes particularly evident when the tax rules governing the implications of a debt reduction in Canada and the UK are analysed (particularly as the business rescue regime in South Africa is predominantly modelled on best practice in these countries) (Pretorius & Rosslyn-Smith, 2014). The tax rules in these countries have specifically introduced relief provisions that aid insolvent companies, or in other words, companies in financial distress, as was reported in Chapter 4.

The focus of this study was to establish whether the debt reduction rules in South Africa were able to facilitate the recovery of financially distressed companies that were still economically viable by preventing such companies from going insolvent. This study found that the relief provided by the debt reduction rules in South Africa was limited when compared to that in Canada and the UK. Of particular relevance in this regard was the inability of the debt reduction rules to support the goals of the Companies Act (71 of 2008) to rescue financially distressed companies. This researcher concludes that the Legislature should revisit the debt reduction rules included in the Act, and should align the tax rules to the goals which are set out by the Companies Act (71 of 2008), which aim is to facilitate the rescue and rehabilitation of a company in financial distress. This is a matter of urgency as the debt reduction rules currently applicable in South Africa could act as an added impediment to the solution of a financially distressed company in certain circumstances.

BIBLIOGRAPHY

Acts **see** Canada

Acts **see** South Africa

Acts **see** UK

Akin Gump Strauss Hauer & Feld LLP. 2015. Proposed new UK tax rules for debt restructuring. Available from <http://www.lexology.com/library/detail.aspx?g=ab2cef04-1a0b-462e-b118-2784b75e31f1> Date of access: 15 August 2016.

Asquith, P., Gertner, R. & Scharfstein, D. 1994. Anatomy of financial distress: an examination of junk bond issuers. *Quarterly journal of economics*, 109(3).

Bateman, A. & Strawson, A. 2015. Tax planning during an economic slowdown. Paper presented at the 2015 Prairie Provinces Tax Conference, Calgary, Alberta, 2 June.

Benn, D.J. 2013. Tax avoidance in South Africa: an analysis of general anti-avoidance rules in terms of the Income Tax Act 58 of 1962, as amended. Cape Town: UCT. (Dissertation – Post Graduate Diploma).

Bernstein, J & Choudhury, R. 2008. Tax consequences of debt restructuring and workouts in Canada. *Tax notes international*: 859-868, June 9.

Blundell, R. 2015. HMRC issue draft guidance on treatment of interest free and other non-market loans under new UK GAAP. Available from:

<http://blogs.mazars.com/letstalktax/2015/11/hmrc-issue-draft-guidance-on-the-treatment-of-interest-free-and-other-non-market-loans-under-new-uk-gaap/>

Date of access: 20 September 2016.

Boraine, A. & Van Wyk, J. 2013. Application of "repealed" sections of the Companies Act 61 of 1973 to liquidation proceedings of insolvent companies. *DeJure*, 46(3): 644.

Camay, A. 2011. Proposed tax relief for debtors in the event of debt cancellations.

Available from: <https://www.ensafrica.com/news/proposed-tax-relief-for-debtors-in-the-event-of-debt-cancellations?Id=200&STitle=tax%20ENSight>

Date of access: 9 October 2016.

Canada. 1985. Income Tax Act R.S.C. (Revised Statutes of Canada), 1985, c. 1 (5th Supp.)

Canada Revenue Agency. 2015a. Business and professional income. Available

from: <http://www.cra-arc.gc.ca/E/pub/tg/t4002/t4002-15e.pdf>

Date of access: 15 August 2016.

Canada Revenue Agency. 2015b. Meaning of eligible capital expenditure. Income

Tax Bulletin 143-R3. Available from: [http://www.cra-](http://www.cra-arc.gc.ca/E/pub/tp/it143r3/it143r3-e.pdf)

[arc.gc.ca/E/pub/tp/it143r3/it143r3-e.pdf](http://www.cra-arc.gc.ca/E/pub/tp/it143r3/it143r3-e.pdf) Date of access: 29 September 2016.

Casgrain, F.M. 2011. A general overview of Canadian bankruptcy, Insolvency and Restructuring Law. Available from:
<http://www.acc.com/legalresources/quickcounsel/agoocbiarl.cfm> Date of access: 11 October 2016.

Conradie, S. & Lamprecht, C. 2015. Business rescue: how can success be evaluated at company level. Available from:
http://www.unisa.ac.za/contents/faculties/service_dept/docs/Sabview_19_3_chap1.pdf Date of access: 20 October. 2016.

Corporate Finance Manual. 2016a. CFM 30180: Loan relationships: a short guide - how are taxable amounts brought into account. Available from:
<https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm30180>.
Date of access: 15 August 2016.

Corporate Finance Manual. 2016b. CFM 32010: Loan relationships: taxing and relieving provisions - overview. Available from: <https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm32010>. Date of access 15 August 2016.

Corporate Finance Manual. 2016c. CFM 32020: Loan relationships: trading credits and debits. Available from: <https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm32020> Date of access 15 August 2016.

Corporate Finance Manual. 2016d. CFM 33201: Loan relationships: computational rules – credits not brought into account – releases of debt. Available from:
<https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm33201> Date of access: 12 October 2016.

Corporate Renewal Solutions. 2016a. Timeline of Financial Distress. Available from: <http://www.turnaround-sa.com/timeline%20of%20financial%20distress/insolvency.php> Date of access: 22 September 2016.

Corporate Renewal Solutions. 2016b. Business rescue vs workout. Available from: http://www.business-rescue.co.za/business-rescue/business-rescue-versus-workout.php#.V_oDh-B942w Date of access: 9 October 2016.

Corporate Renewal Solutions. 2016c. Section 133: moratorium on legal proceedings against company. Available from: http://www.business-rescue.co.za/legislation/Section-133-General-moratorium-on-legal-proceedings-against-company.php#.V_oFzuB942w Date of access: 9 October 2016.

Corporate Renewal Solutions. 2016d. Informal creditor workout. Available from: <http://www.turnaround-sa.com/timeline%20of%20financial%20distress/informal%20creditor%20workout.php> Date of access: 9 October 2016.

Corporate Renewal Solutions. 2016e. Business rescue vs workout. Available from: <http://www.business-rescue.co.za/business-rescue/business-rescue-versus-workout.php#.WAW-dORJmM8> Date of access: 18 October 2016.

Dachs, P. 2015. Tax consequences arising from the writing off of loan. *Tax professional*, 27-29.

Davies, P. 2015. The new corporate exemption. Available from:
<https://www.cch.co.uk/content/new-corporate-rescue-exemption> Date of access: 29
September 2016.

De Koker, A.P. & Williams, R.C. 2016. Silke on South African income tax. Available
from:
<https://www.mylexisnexis.co.za/Index.aspx> Date of access: 1 September 2016.

Durand, R. 2011. Overview of section 80. Available from:
http://www.cba.org/cba/cle/PDF/TAX11_Durand_Paper_Section80.pdf
Date of access: 15 August 2016.

Ehinger, M. 2013. Relief from debt forgiveness inclusions: the basics. Available
from:
https://www.ctf.ca/ctfweb/EN/Newsletters/Canadian_Tax_Focus/2013/3/130308.aspx
Date of access: 26 September 2016.

Erasmus, J. 2014. The Companies Act: when is a company financially distressed
and what does it mean. 2014. Available from:
[http://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-
compliance/ZA_FinancialDistress_15052014.pdf](http://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_FinancialDistress_15052014.pdf) Date of access 17 July 2016.

Freshfields Bruckhaus Deringer. 2006. The tax consequences of restructuring
indebtedness. Available from:
<http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/The%20tax%20conse>

[quences%20of%20restructuring%20of%20indebtedness%20\(debt%20work-outs\).pdf](#)

Date of access: 7 April 2016.

Garvin, B. 2012. Debt waivers – New Developments. Available from:

http://www.bowmanslaw.com/insights/debt_waivers/ Date of access: 16 Sep. 2016.

Grounded Theory Online. 2016. Available from:

<http://www.groundedtheoryonline.com/what-is-grounded-theory/> Date of access: 17

April 2016.

HMRC. 2013. Modernising the taxation of corporate debt and derivative contracts.

Available from:

<https://www.gov.uk/government/publications/modernising-the-taxation-of-corporate-debt-and-derivative-contracts-draft-guidance> date of access 30 September 2016.

HMRC. 2015. Policy Paper: modernisation of the taxation of corporate debt and derivative contracts. Available from:

<https://www.gov.uk/government/publications/corporation-tax-modernisation-of-the-taxation-of-corporate-debt-and-derivative-contracts/corporation-tax-modernisation-of-the-taxation-of-corporate-debt-and-derivative-contracts> Date of access: 30

September 2016.

HMRC (Her Majesty's Revenue & Customs). 2016. Corporate Finance Manual

32010. Accessible from <https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm32010> Date of access: 22 June 2016.

Howard, P. 2014. Back to basics: loan relationships impairment losses and releases.

Available from:

<http://www.gabelletax.com/media/Loan-relationships-impairment-losses-and-releases.pdf> Date of access: 15 Aug. 2015.

Johnson, R.B., & Onwuegbuzie, A.J. 2004. Mixed methods research: a research paradigm whose time has come. Available from:

<http://edr.sagepub.com.nwulib.nwu.ac.za/content/33/7/14.full.pdf+html> Date of access: 16 April 2016.

Jung, J.E. 2005. A Selection of income tax issues in the downsizing and restructuring of an insolvent company. Available from:

<http://www.mindengross.com/docs/publications/a-selection-of-income-tax-issues-in-the-downsizing-and-restructuring-of-an-insolvent-company> Date of access: 18 September 2016.

Klopper, H. & Bradsheet, R.S. 2014. Averting liquidations with business rescue: does a section 155 compromise place the bar too high. *Stellenbosch law review*. 25(3).

Kotze, D. 2013. Catch 22: Director's duties under 129(7) of the Companies Act – financial distress: feature. *DeRebus*: 42-43.

KPMG. 2004. Consequences on the waiver of a loan. Available from:

https://www.saica.co.za/integritax/2004/1242_Consequences_on_the_waiver_of_loans.htm Date of access: 9 October 2016.

Krüger, JGA. 2010. Restructuring of insolvent corporations in Canada. Potchefstroom Electronic Law Journal.

Kuhlmann, D.O. 2013. How do tax accountants develop technical tax expertise: a Grounded Theory study. Minneapolis, MN: University of Minnesota. (Thesis – PhD).

Laryea, T. 2010. Approaches to corporate debt restructuring in the wake of financial crises. Available from: <https://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf>
Date of access: 6 September 2016.

Leedy, P.D., & Ormrod, J.E. 2001. Practical Research: Planning and design. Upper Saddle River, New Jersey: Merrill Prentice Hall.

Leslie, S. 2016. Distressed companies and the corporate rescue exemption – the Finance (No2) Act 2015. Available from:
<http://blogs.lexisnexis.co.uk/randi/distressed-companies-and-the-corporate-rescue-exemption-the-finance-no-2-act-2015/> Date of access: 29 Sep. 2016.

Linklaters. 2008. Brief Guide to English Corporate Insolvency Law. Available from: <http://www.linklaters.com/pdfs/Insights/banking/Guidetoinsolvency.pdf> Date of Access: 12 October 2016.

Lui, Y., Rosenberg, C. 2013. Dealing with private debt distress in the wake of the European financial crisis. A review of the economics and legal toolbox. Available from: <https://www.imf.org/external/pubs/ft/wp/2013/wp1344.pdf>. Date of access 27 April 2016.

Mackay-Davidson, S. & Crystal, M. 2015. Saving Graces: Liquidation, Compromise or Business Rescue. *Without prejudice*, 15(8): 18-19.

Mainwaring, S. 2015. Taxation of loan relationships. Available from: <https://www.icaew.com/~media/corporate/files/join%20us/join%20a%20faculty/0315035%20taxation%20loan%20relationships.ashx> Date of access: 12 October 2016.

Mann, D. 2007. An overview of Canadian bankruptcy and insolvency law. Available from: <https://www.acc.com/education/webcasts/upload/An-Overview-of-Canadian-Insolvency-Law.pdf> Date of access: 14 October 2016.

McKercher, M. 2008. Philosophical Paraparadigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation. *eJournal of Tax Research*. Available from: <http://www.austlii.edu.au/au/journals/eJITaxR/2008/1.html> Date of access: 7 October 2016.

McKinsey & Company. 2015. Debt and (not much) deleveraging. Available from: <http://www.mckinsey.com/global-themes/employment-and-growth/debt-and-not-much-deleveraging> Date of access 16 August 2016.

Metha, N. 2016. Debt releases: taxing times for corporate debtors. Available from: http://taxbar.com/wp-content/uploads/2016/01/Debt_Releases_Taxing_Times_for_a_Corporate_Debtor_Nikhil_Mehta.pdf.pdf Date of access: 30 September 2016.

Meyerowitz, D. 2009. Capital Gains Tax: Beware of paragraph 12(5) of the Eighth Schedule. *The Taxpayer*, 163-168.

Mining Tax Canada. 2016. Treatment of expenditures in Canada. Available from: <http://miningtaxcanada.com/treatment-of-expenditures/> Date of access: 27 September 2016.

Moosa, R. 2014. Solvent and insolvent winding up of companies – what is “solvent”. Available from: <http://www.financialinstitutionslegalsnapshot.com/2014/05/solvent-and-insolvent-winding-up-of-companies-what-is-solvent-2/> Date of access: 17 July 2016.

Muller, G., Steyn-Bruwer, B. & Hamman, W. 2012. What is the best way to predict financial distress of companies. Available from: <http://scholar.sun.ac.za/handle/10019.1/85389> Date of access: 17 July 2016.

Mullen, C. 2016. July 2016 – Corporate Rescue Exemption. Available from: <http://www.frenchduncan.co.uk/blog/july-2016-corporate-rescue-exemption/> Date of access: 15 August 2016.

Napier, N. 2014. Debt Restructuring: Practical Considerations. Available from: <https://www.ensafrica.com/news/debt-restructuring-practical-considerations?id=1529&> Date of access: 31 August 2016.

National Budget. 2011. Chapter 5: Revenue Trends and Tax Proposals. Available from:

<http://www.treasury.gov.za/documents/national%20budget/2011/review/default.aspx>

Date of access: 25 August 2016.

Olivier, L. 2006. Reduction or discharge of debt: the hidden tax dangers. *Stellenbosch Law Review*, 17(2).

Outecheva, N. 2007. Corporate Financial Distress: An empirical analysis of distress risk. University of St Gallen. (Thesis – PhD).

Phillips. M. 2016. The world's debt is alarmingly high but is it contagious. Available from: <http://www.bloomberg.com/news/articles/2016-02-22/the-world-s-debt-is-alarmingly-high-but-is-it-contagious> Date of access: 6 September 2016.

Platt, E. 2016. Corporate borrowers defaults on \$50 billion debt so far this year. Available from: <http://www.ft.com/cms/s/0/a0ea3972-0356-11e6-99cb-83242733f755.html#axzz4JSBWyhM8> Date of access: 6 Sep. 2016.

Pieterse, V., & Kourie, D.G. 2014. Lists, Taxonomies, Lattices, Thesauri and Ontologies: paving a pathway through a terminological jungle. Available from: <http://content.ebscohost.com/ContentServer.asp?T=P&P=AN&K=101115523&S=R&D=aci&EbscoContent=dGJyMMTo50SeprU4zdneyOLCmr06ep7BSr6y4S7eWxWXS&ContentCustomer=dGJyMPGusUu0rq5JuePfgex44Dt6fIA> Date of access 17 April 2016.

Pretorius, M. & Rosslyn-Smith, W. 2014. Expectations of a business rescue plan: international directives for Chapter 6 implementation. Available from: http://www.unisa.ac.za/contents/faculties/service_dept/docs/Sabview_18_2_Chap%2005.pdf Date of access: 9 October 2016.

PWC. 2009. Insolvency in brief – a guide to insolvency terminology and procedure. Available from: <https://www.pwc.co.uk/assets/pdf/insolvency-in-brief.pdf> Date of access: 7 September 2016.

Qualitative Research Consultants Association. 2016. What is qualitative research. Available from: <http://www.qrca.org/?page=whatisqualresearch> Date of access: 17 April 2016.

Retief, E. 2015. Write off or waiver of loan: Tax Technical. *Tax professional*, 18-19.

Robertson, S. 2015. What are schemes of arrangements and how do they work. Available from: <http://www.gtlaw-restructuringreview.com/2015/07/what-are-schemes-of-arrangement-and-how-do-they-work/> Date of access: 7 September 2016.

Robinson, G. 2016. Distressed companies and the corporate rescue exemption – the Finance (No 2) Act 2015. Available from: <http://blogs.lexisnexis.co.uk/randi/distressed-companies-and-the-corporate-rescue-exemption-the-finance-no-2-act-2015/>. Date of access: 25 July 2016.

Rudnicki, M., & Bird, N. 2014. The debt waiver rules and their exemptions. *Business tax and Company Law Quaterly*, 5(4). Available from:

<http://reference.sabinet.co.za.nwulib.nwu.ac.za/document/EJC173375> Date of

access: 7 April 2016.

Rushworth, J. 2010. A critical analysis of the business rescue regime in the Companies Act 71 of 2008 : business rescue. *Acta Juridica: Modern company law for a competitive South African economy*, 375 – 408.

SARS. 1997. Explanatory Memorandum on the Income Tax Bill, 1997.

SARS. 2003. Explanatory Memorandum to the Revenue Laws Amendment Bill.

SARS. 2012. Explanatory Memorandum on the taxation law amendment bill.

Available from: www.sars.gov.za Date of access: 18 April 2016.

SARS. 2013. Comprehensive Guide to Capital Gains Tax, Issue 5, 2013. Available from: www.sars.gov.za Date of access: 18 April 2016.

SARS. 2015. Draft Interpretation Note. Reduction of Debt. Available from:

www.sars.gov.za Date of access: 18 April 2016.

SARS. 2016. Comprehensive Guide to Capital Gains Tax Issue 5. Available from:

www.sars.gov.za. Date of access: 27 July 2016.

Searle, R. 2013. Will there be a need for informal loan workouts? A question from Chapter 6 of the New Companies Act. University of the Witwatersrand. Masters of Management in Finance and Investment.

Secombe, D. 2013. Proposed Tax Amendments will assist Business Rescue. *TaxTalk*: 40-41.

Seligson, M. 2010. The fiscal price of forgiveness. *Business Tax and Company Law Quarterly*, 1(1): 1-13.

Small, R., Smidt, L. & Joseph, A. 2016. Financial Distress: The responsibility of the professional accountant. *Professional Accountant*, 20-21.

Smyth, S. 2012. Detecting 'red flags' early can help a business avoid severe financial distress. *Tax Professional*. Quarter 4. P26-27. Available from: <http://reference.sabinet.co.za/nwulib.nwu.ac.za/document/EJC130157> Date of access: 18 April 2016

South Africa. 1962. Income Tax Act 58 of 1962. Available at: www.sars.gov.za
Date of access: 18 April 2016.

South Africa. 1997. Taxation Laws Amendment Act 27 of 1997.

South Africa. 2001. Taxation Laws Amendment Act 5 of 2001.

South Africa. 2005. Revenue Laws Amendment Act 31 of 2005.

South Africa. 2006. Revenue Laws Amendment Act 20 of 2006.

South Africa. 2008. Companies Act 71 of 2008.

South Africa. 2012. Taxation Laws Amendment Act 22 of 2012. Available from: www.treasury.gov.za Date of access: 18 April 2016.

South Africa. 2016. Budget Summary. Available from: www.treasury.gov.za Date of access: 18 April 2016.

Southern, D. 2012. Finance Bill 2012: debt buy back legislation. Available from: <http://www.taxjournal.com/articles/finance-bill-2012-debt-buy-back-legislation-44341> Date of access: 30 September 2016.

Stack, E.M. 2011. Writing a research proposal. UNISA.

Stones, K. 2015. Unpicking the Finance Bill 2015: the new 'corporate rescue' tax relief. Available from: <http://blogs.lexisnexis.co.uk/randi/unpicking-the-finance-bill-2015-the-new-corporate-rescue-tax-relief/>. Date of access: 15 August 2016.

Suarez, S. 2012. Using tax losses within a corporate group. Available from: <http://www.mondaq.com/canada/x/167978/Capital+Gains+Tax/Using+Tax+Losses+Within+A+Corporate+Group> Date of access: 15 August 2016.

UK. 1986. Insolvency Act 1986 c. 45

UK. 2009. Corporation Tax Act 2009 c. 4

Van der Colff, F. 2012. Company Financial Failure and Distress: A Perspective. University of Pretoria. (Mini Dissertation – Masters of Commerce).

Van Reenen, J. 2015. Debt reduction: new legislation, new challenges. Johannesburg: University of the Witwatersrand. (Mini Dissertation – Masters of Commerce).

Van Zuylen, C. 2009. There be dragons: compromises with creditors under the new Companies Act. Available from: <http://www.bowman.co.za/News-Blog/Blog/There-be-dragons-compromises-with-creditors-under-the-new-Companies-Act>. Date of access: 17 August 2016.

Wainer, H.E. 2015. The insolvency conundrum in the Companies Act. *South African Law Journal*. 132(3): 509-517