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Ramathe

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CA(SA)DotNews

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DECEMBER 2014

Thank you for your support in 2014.

Have a Wonderful Festive Season, and a Happy and Prosperous 2015!

Are You A "Prescribed Officer"? If So Be Aware Of Your Onerous Liabilities And Responsibilities

The 2008 Companies Act introduced the

concept of "prescribed officers" three years ago. They are senior employees (not directors) deemed by the Act to have the obligations of directors. **As such they are bound by the duties and responsibilities of directors. They also incur the liabilities imposed by the Act on directors.**

Employees: If you think you may be a "prescribed officer", ask your directors to urgently take action to protect your position as set out below.

Directors: Imagine your senior management make an error which exposes them to civil liabilities. As you have taken out directors' insurance you at least know that directors are not financially exposed. Then you learn that some of your senior managers can be deemed to have the same liabilities as directors. These managers suddenly face litigation without any insurance which could financially ruin them, with potentially devastating consequences for your business.

What are prescribed officers?

The Act defines a prescribed officer as a person who either -

a. "Exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company"; or

b. "Regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company."

This definition applies no matter what title is given to the employee or to his/her functions.

The difficulty with this is that it is not specific and there is no case law to give more concrete meaning to this definition. This is because the Act is still relatively new and the South African definition of "prescribed officer" differs from other countries.

Managing the risks

If you do have staff who potentially could be "prescribed officers" as defined, it is clearly worth doing the exercise to determine whether they are or not. To do this you will need to look at -

- Their job descriptions
- Their levels of authority – to what extent can they authorise budgets, strategy and expenditure?
- Are they included in on key strategic meetings?
- What committees do they sit on? What do these committees do?
- If they are part of a group, do they manage subsidiaries?
- To what extent are they supervised by the directors?

It is worth seeking professional advice especially as you will have no legal precedents to guide you.

Not only is it in your interests to identify prescribed officers but it is clearly very much in their own interests also. They will need to be advised of their duties, responsibilities and liabilities so they can prepare for what the law requires. Most important, they can

be covered with director's insurance.

Finally, as there are differing roles and expectations for directors as opposed to employees, it is important for the proper workings of the business that prescribed officers are identified.

NOTE FOR ACCOUNTANTS: The Companies Act (Act 71 of 2008) is available at ActsOnline (Chapter 2, Part F covers roles, duties and liabilities of directors and prescribed officers).

See also the Companies Regulations 2011, also available at ActsOnline (See bottom of Table of Contents) – Regulation 38(1) covers prescribed officers.

For additional reading, see the following –

- "Who is a Prescribed Officer?" by Ian Cox on the Cox Attorneys website and
- "Prescribed Officers - do you know who they are?" on the Mazars Website.

If You Are Struggling To Get Finance, Consider This Different Solution

Many start-ups and small businesses spend a disproportionate amount of their time managing the tricky problem of cash flow. Instead of focusing on implementing business strategy, management is continually collecting money, stretching creditors or delaying key projects due to a lack of funding.

Enticing an investor

What happens to a business that has no track record or cannot source more funds on its balance sheet? It will be difficult to entice an investor if sustained, growing profits are still some way off.

Consider rather the possibility of acquiring an investor who, instead of requiring dividends or a profit share, gets a share of the business' turnover.

As many of these types of businesses show growing sales but lack of working capital, this solution could potentially work for the business, particularly as new funding from the investor could be channelled into further growing sales.

This creates benefits for both parties as the investor gets the desired return whilst the organisation can focus on key issues.

It could also be part of a flexible strategy whereby the business and investor agree on certain targets which when attained could see the investor switch from having a revenue (i.e. turnover) share to a profit or dividend payout.

Clearly each business has its own unique circumstances and a business considering this would need to ensure they can forgo some turnover. If in doubt, consult your accountant.

NOTE FOR ACCOUNTANTS: See the article "Three ways for investors to profit from SMEs" on the Moneyweb Today website.

Investors: Be Careful When Buying Into A Business With An Assessed Loss

The economic difficulties seen over the past couple of years will certainly have led to many businesses incurring losses. This creates an opportunity for investors to acquire either the whole or part of the equity of a business at a discount.

Many if not most of these businesses will also have run up tax losses.

Investors need to be extra careful as our tax law aggressively tries to prevent tax losses being used in these circumstances. In essence, they should discount getting any benefit from using tax losses in the loss-making entity they buy (or buy a stake in).

What does the anti-avoidance legislation say?

Anti-avoidance tax legislation regarding the use of assessed losses has been around for a long time. The assessed loss avoidance clauses are triggered by a business, which has an assessed loss, either entering into an agreement or acquiring new shareholders whereby new income is injected into the entity which is offset against the assessed loss. This results in no or reduced tax being paid by the loss-making organisation.

Note it is wider than equity changing hands – an agreement between two parties can also invoke the legislation. For example, company A has an assessed loss and manufactures toys. Company B does a deal with company A whereby Company B's toys are manufactured by Company A.

Company A cannot realistically expect that the additional sales from manufacturing Company B's toys can be set-off against its tax loss.

What would trigger SARS invoking these anti-avoidance clauses?

Businesses affected are trusts, close corporations and companies.

Should a business as above enter into an agreement or have a change of shareholding and both -

1. As a "direct or indirect result of" the agreement or change of shareholding, income is received or accrued by the entity, and

2. The "sole or main purpose" of the receipt of injected income (trading or capital) is to reduce the tax liability of the entity; then

SARS will disallow the set-off of the income against the organisation's assessed loss.

The onus lies with the assessed loss entity to prove that the "sole or main purpose" was not to use the assessed loss.

The Bottom line

It is foolhardy to enter into a deal and expect to be able to use an assessed loss. It only makes sense if there is a compelling business rationale for the deal.

No one wants to enter into an argument with SARS which you are not likely to win. Seek expert advice.

NOTE FOR ACCOUNTANTS: See the Income Tax Act on ActsOnline - see Section 103.

Other Reading –

- P.Haupt: “Notes on South African Income Tax” (Chapter 17) and
- “South Africa: Section 103(2) Of the Income Tax Act – Use of Assessed Losses on the Mondaq website.

Finance 101: The Medium Term Budget – There’s Hope But There Will Also Be Pain

The new Minister of Finance, Nhlanhla Nene, delivered his maiden budget speech in late October. It was the Medium Term Budget speech which looks at government finances over the next three years.

Setting the scene – a difficult task

The Minister faced a difficult task with gloom over our disappointing economic performance (forecasted GDP growth has been cut from 2.7% in February to 1.4% now), industrial unrest, electricity shortages, growing government debt and ratings downgrades on South Africa’s ability to repay its debt.

Just five years ago as the first world entered a severe recession, emerging markets like South Africa were in a strong position – low debt and good economic growth. We responded to the global recession by stimulating economic activity via rapidly increasing government expenditure.

This policy is clearly no longer affordable. 56% of government expenditure is on social welfare and salaries and if the country continued on its spending path, these costs would consume 100% of state spend in the next ten years.

Ratings agencies have downgraded our debt and we are now just above junk status – if South Africa’s debt rating falls to this level it could potentially add 1.5% cost to our debt.

In essence we are at a tipping point.

The Budget

Minister Nene has recognised the difficulties the economy is facing and has unveiled measures to improve government finances. These include -

- Freezing the government headcount – new posts will have to come from current staffing
- In addition, unfilled government posts have been abolished
- A reduction in spend on entertainment, travel, communications, catering and consultants
- Government salaries can rise by no more than 6.6%
- Funding to State Owned Entities such as Eskom, SAA and SABC will be viewed differently. Stricter controls will be placed on them and any funding required by them will be debt neutral as it will come from the sale of government assets

- There will be tax increases. These will be announced in the February budget. These will come from recommendations from the Davis Committee on taxation

- Social spend on grants, health care and education will stay as is.

The effect of these actions will be to reduce government expenditure by R25 billion and increase revenue (tax increases) by R27 billion. This will reduce the budget deficit to below 3% of the budget by 2017. Economic growth will rise to 3% in this timeframe.

Hope amidst difficulties

- The fact that the bond market improved and the Rand remained stable indicates that global markets approved of the budget

- The Minister stressed that the budget was drawn up within the framework of the National Development Plan. This is accepted as a credible long term plan to improve investment, economic growth and jobs in South Africa

- The consumption spend economic stimulus programme is being replaced by one that emphasises investment – in the medium to long term this will enhance economic growth

- It has been a long time since government mentioned privatisation and it will be interesting to see what flows from government's commitment to sell assets to fund parastatal entities like Eskom

- The budget is "collectively owned", so the Minister has government consensus which gives more credibility to the budget

- The first big test will be government salaries next year. Unions are pushing for a 15% increase but the Minister clearly stated that salaries cannot go up by more than 6.6%.

Although no one likes tax increases, this budget was a strong statement based on common sense and reality.

NOTE FOR ACCOUNTANTS: The Medium Term Budget Policy Statement Speech by the Minister of Finance, Nhlanhla Nene can be read on the National Treasury Website .

Other articles –

- "Nene administers tough love" on Business Day Live and

- "Medium-Term Budget: Taking the bull by the horns" on the Financial Mail website.

Your Tax Deadlines For December

There are no major deadlines for December.

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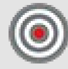 A Client Connection Service by DotNews

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