Theron Le Roux

Accountants / Rekenmeesters

We care about your business

Assosiaat Algemene Rekenmeester (SA • Associate General Accountant (SA)
Professionele Rekenmeester (SA) • Professional Accountant (SA)
Belastingpraktisyn • Tax practitioner

38 Akasia Street George East 6529 • ✉ 4529 George East 6539 • Tel: 044 871 5067 • Fax: 044 871 5082

WITH COMPLIMENTS

e-mail : jgmt@jgmt.co.za

AGA(SA)
ASSOCIATE GENERAL ACCOUNTANTS SOUTH AFRICA

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BUSINESS RESCUE IS BECOMING EFFECTIVE: IGNORE IT AT YOUR PERIL

The new Companies Act ("the Act") became effective on 1 May 2011. One of its focus areas was to enhance protection to ailing businesses – to give them the opportunity to get back on their feet. This had become an internationally accepted practice and the old 1973 Companies Act did not adequately address this.

Owners and managers of businesses need to be aware of the duties imposed on them by the Act and should also know of the potential that the business rescue process offers. Few small and medium sized businesses (SMEs) have taken advantage of business rescue provisions.

Business Rescue – a quick overview

- A business which is already or is becoming financially stressed is obliged to seek business rescue or needs to explain to its stakeholders why it is not opting for business rescue. Alternatively, an affected person (creditor, employee, shareholder or trade union) may approach a court to put a business into business rescue.
  - "Financially stressed" means that within the next six months, liabilities of the business will exceed its assets and/or it will not be able to pay its creditors.
- A notice is filed with the Companies and Intellectual Property Commission (CIPC) advising the business is opting for business rescue and requesting a business rescue practitioner ("BRP") be appointed.
  - If you have a BRP in mind, you may appoint that person, provided they are accredited with the CIPC. This is a critical decision as once appointed, the BRP takes effective control of the business.
- The BRP has 25 business days to consult with all relevant stakeholders and then present a business rescue plan to the stakeholders. The BRP needs to be convinced there is a reasonable chance of successfully turning the business around or obtaining a better deal for affected persons who include creditors, employees and their union representatives and, if their rights are affected, shareholders. If 75% of the stakeholders approve the plan (including at least 50% of independent creditors), the BRP may then execute the plan.
  - Business rescue takes approximately six months and in this time, the rights of creditors are restricted as the BRP may suspend in part or whole their agreement with the business. In this period, creditors may only sue a business with the permission of the court. Employees still enjoy the protections of our labour law – for example, any retrenchments will need to be done in accordance with labour legislation.
  - In addition, the BRP effectively runs the business.
- Once the BRP has completed the rescue plan then business rescue proceedings end. Alternatively, the business may be purchased or go into liquidation.
- Business rescue is designed to be a cost-effective (as it is largely self-regulated) and a speedy way of saving a business.

Owners, directors and managers – your obligations

Decision makers in a business face potential criminal or personal liability if they fail to follow the provisions of the Act's Business Rescue section.

How has Business Rescue fared?

A market has emerged of local and foreign investors who seek to acquire assets at (as they perceive it) good prices. For example, a Chinese business acquired Top TV out of business rescue. This market looks set to grow as investors can purchase assets free of any debt the assets may have had.

In terms of employees 25% have lost their jobs during business rescue – a very creditable statistic as 100% are likely to lose their jobs in the event of liquidation.

Figures released by the CIPC show that in 2012 only 20% of business rescue proceedings were successful. This is set to increase as businesses realise the earlier they begin business rescue proceedings, the more likely the process of business rescue succeeding.

Business rescue is a powerful tool to assist struggling entities. As it is a relatively simple and cost-effective process, it is particularly suitable for SMEs. *If you have any doubts, speak to your accountant and get advice – the earlier the better. Remember the potential liabilities you face by not acting.*

TAKE ADVANTAGE OF THE GENEROUS RESEARCH AND DEVELOPMENT ALLOWANCES

Innovation is seen as one of the key drivers of economic growth and employment, and significant concessions are available to taxpayers that undertake defined research and development ("R&D"). Certain of these businesses are allowed to deduct 150% of specified capital cost ("prototypes or pilot plant" which will be used only in the R&D phase) and expenditures (excluding "administrative, financing, compliance and similar costs"). Other R&D entities are allowed to deduct 100% of all of their expenditure – including capital costs.

This compares to 100% of expenditure and 50% of the capital cost (depending on the industry) enjoyed by businesses not involved in R&D.

What is R&D?

It is "systematic investigative or systematic experimental activities" aimed at creating or developing an invention, functional design or computer program, or the discovery of "non-obvious scientific or technological knowledge", or the discovery of knowledge "essential" to the above criteria. "Significant and innovative" improvements in the above areas also qualify.

The research must be done in South Africa by a taxpayer (or third party commissioned by the taxpayer).

In order to qualify for the additional 50% expenditure, **prior** approval is required from the Minister of Science and Technology ("MST") and it must be incurred on or after the date of the application.

What is excluded?

The main categories of exclusion are:

- Marketing and sales promotions, including market research
- Ongoing routine costs such as quality control
- The development of internal systems unless these are associated with R&D
- Oil and gas exploration including prospecting but excluding R&D to develop technology in this sphere
- The development or creation of financial instruments
- "The creation or enhancements of trademarks or goodwill".

Please note this is a summary of concessions and exclusions – consult your accountant before making use of these provisions.

The benefits are best illustrated by an example:

1. Assume two companies - company A and company B. Company A undertakes R&D while company B does not.

2. Each company has sales of R2 million.

3. Each company incurs R800,000 in deductible expenditure.

4. Each company spends R500,000 on capital equipment. Company A gets approval for R&D spend from the MST and of its expenditure R400,000 is in MST approved R&D spend.

5. Company B is allowed to deduct 50% of its capital spend for tax purposes.

6. Income tax rate: 28%.

A PRACTICAL EXAMPLE

	Company A		Company B
Sales	2,000,000		2,000,000
Expenses	(800,000)		(800,000)
= Profit before tax	1,200,000		1,200,000
Tax Calculation			
Tax depreciation	(750,000)	*	(250,000)
R&D extra 50%	(200,000)	**	(0)
=Taxable Income	250,000		950,000
Tax charge	70,000		266,000
TAX SAVING	**R196,000**		

Notes:

*
Company A can deduct the full cost of R500,000 on capital equipment plus another 50%

**
Company A may deduct an extra 50% of R&D spend of R400,000

(If the tables above do not display correctly, please see the "online version" – link above the compliments slip)

Although this is purely an illustration it does clearly show the benefits of the R&D concessions.

The R&D incentives are lucrative and the definition of what constitutes R&D spend is not onerous – it does, for example, include improvements. Whilst they are complex, they are well worth considering.

ECONOMICS 101: WHAT WILL 2014 BRING?

The past few years have been tough ones economically. We all know that economies go in cycles – is it time for another economic boom? The answer to the question lies somewhere in between. We are not likely to experience a boom like the one we had from 2003-2008 but 2014 and 2015 look distinctly better than the past few years.

2013 saw a 23% drop in the exchange rate, lower than expected growth (we are unlikely to have achieved 2% GDP growth) and ongoing pressure in terms of unemployment.

The global outlook for 2014 is the best for several years with the USA projected to grow between 3 and 4%. Economies are coming out of recession in Europe (traditionally our strongest trading partner) whilst emerging markets will continue to grow.

This will lead to growth in world trade and South Africa will be well positioned to take advantage of this due to the weaker exchange rate. Exports should lead the way in terms of economic growth. Gross domestic growth is predicted to rise to 2.7% in 2014 and 3.4 % in 2015.

What to look for in an export recovery

If you are exposed to foreign currencies watch the current account deficit (expected at 6.9% for quarter 4 2013). The deficit should ease to 6.5% or lower if the export recovery scenario holds. In turn this should at least stabilise the Rand.

> **Risks:** South Africa, as an emerging economy, is still exposed to any global blow-out. Watch how the new US Federal Reserve Bank Governor settles into her new role, particularly how she handles "tapering" of bond purchases. Also watch for any potential Euro crisis.

Domestic economy

The first issue is the election (to be held in April or May). Expect populist rhetoric but the fact that the National Development Plan (NDP) is part of the ruling party's manifesto is encouraging. Inflation and interest rates should remain broadly constant. The new Employment Incentive Act which provides a wage subsidy to businesses employing young people (beginning January 2014) should create 170,000 new jobs and with improved economic growth, unemployment should decline by one or two percentage points from 25% in 2013.

What to look for in the domestic economy

The embedding of the NDP, less strikes and confrontation in the labour market and (hopefully) more clarity in terms of foreign investment in South Africa. A business as usual budget is presented in February.

> **Risks**: Populist legislation, another Marikana, mixed signals to foreign investors. The budget deficit grows more than forecasted.

It does seem that we are moving away from the fall-out of the global economic crisis of 2008 and have moved to a higher growth path but there are still plenty of risks which can derail this.

BUDGET 2014 – SUBMIT YOUR TIPS AND WATCH THE SPEECH

"The government is like a baby's alimentary canal, with a happy appetite at one end and no responsibility at the other" (Ronald Reagan)

Finance Minister Pravin Gordhan will present the budget speech to Parliament on 26 February 2014 at "around 2 p.m."

Help him sort out government's digestive system issues with your Budget Tips. Submit them online via the National Treasury website at http://tinyurl.com/sabudget2014.

Then watch the speech live online, with real-time commentary and analysis, on CNBC Africa's website at http://www.cnbcafrica.com/abn-pro/.

YOUR TAX DEADLINES FOR FEBRUARY

Provisional income tax payers need to get their second provisional payment in by end February.

Start the process of estimating your tax liability. Remember that if your finally assessed taxable income is less than R1 million, your estimate must be equal to the lesser of the “basic amount” or 90% of your actual taxable income for the year. Over R1 million, your estimate must be 80% accurate.

If you have a car allowance, don’t forget to note your odometer reading on 28 February.

Have a great February – and don’t forget ♥ Valentine’s Day ♥ on the 14th!

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