

SOUTH AFRICAN REVENUE SERVICE

BINDING PRIVATE RULING: BPR 025

DATE : 19 February 2009

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)

SECTION : SECTION 42

SUBJECT : THE REPLACEMENT OF DEBT AND THE SUBSEQUENT
TRANSFER THEREOF TOGETHER WITH THE ASSETS IN AN
ASSET-FOR-SHARE TRANSACTION

1. Summary

This ruling gives guidance on whether the total amount of debt which relates to a division to be replaced with debt from third party banks (“replacement debt”), and thereafter such division is to be disposed to a controlled group company, can be regarded as “an amount of debt that is attributable to, and arose in the normal course of that division’s business undertaking”.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

All legislative references are to sections of the Act applicable as at 11 April 2008 and unless the context otherwise indicates, any word or expression in this ruling bears the meaning ascribed to them in the Act.

This ruling has been requested in relation to the provisions of section 42(4) and (8).

3. Parties to the proposed transaction

The Applicant: A South African resident company which intends to dispose of one of its divisions to a newly formed company (“Company A”) to form a group of companies

Company A: A newly formed company incorporated in accordance with the laws of South Africa which is a wholly owned subsidiary of the Applicant

4. Description of the proposed transaction

- 4.1 The Applicant has various separate identifiable business undertakings organised as “divisions”. One of these divisions (the division) will be transferred to Company A.
- 4.2 The Applicant is financed by various bank loans, bonds, commercial paper, etc (existing debt). The Applicant’s existing debt requirement is determined with reference to the funding requirements of the various divisions on a daily and ongoing basis.
- 4.3 The existing debt is borrowed generally, and upon a large scale, for utilisation in the operations of the various divisions.
- 4.4 The Applicant allocates an internal divisional operating loan (operating loan) to each division which represents the funding of each division. The operating loans bear interest at an average rate which is representative of the interest rate of the existing debt.
- 4.5 The operating loan represents money borrowed by the Applicant externally and does not include equity, cash, preference shares, finance leases or provisions. The operating loan is just a representation of the amount of the existing debt that is attributable to the division.
- 4.6 The Applicant intends to dispose of the division to Company A in terms of an asset-for-share transaction and wishes to make use of the provisions of section 42. The following conditions will be met –
 - (a) the market values of the assets (comprising the division) to be disposed of by the Applicant to Company A will be equal to or exceed –
 - (i) in the case of assets held as capital assets, the base cost of those assets on the date of that disposal; or

- (ii) in the case of assets held as trading stock, the amount taken into account in respect of those assets in terms of section 11(a) or 22(1) or (2);
- (b) the Applicant will, at the close of the day of this transaction, hold a **“qualifying interest”**, as defined in section 42, in Company A;
- (c) Company A will acquire the assets from the Applicant –
 - (i) as capital assets or as trading stock, where the Applicant holds them as capital assets; or
 - (ii) as trading stock, where the Applicant holds them as trading stock; and
- (d) the Applicant and Company A will jointly elect that section 42 applies to this proposed transaction.

Transaction steps

- Step 1: To ease the implementation of the proposed transaction and to allow for the efficient transfer to the division, the existing debt attributable to the division in terms of the asset-for-share transaction, the operating loan (referred to above) of the division is refinanced with replacement debt. The face value of the replacement debt will be equal to the operating loan that has been allocated to the division (for example, R100 before, R100 after).
- Step 2: The Applicant disposes the division as a going concern (that is, assets and liabilities) to Company A in exchange for equity shares to be issued by Company A. In this regard, the following ancillary steps are also relevant –
 - (a) the Applicant and Company A elect that the provisions of section 42 will apply to the transfer of all assets of the division; and

- (b) as part consideration for the disposal of the division, Company A will assume the replacement debt from the Applicant.

5. Conditions and assumptions

This ruling is made subject to the following conditions and assumptions –

- the amount of the replacement debt to be transferred to Company A in terms of section 42(8) will be limited to the extent that the operating loan between the division and the Treasury division represented true debt in the hands of the Applicant with third parties;
- the amount of the replacement debt will be limited to the amount of debt attributable to the division's business undertaking; and
- the replacement debt will not replace finance leases, preference shares or provisions.

6. Ruling

The ruling made in connection with the proposed transaction is as follows –

- the quantum of the existing debt that was attributable to, and arose in the normal course of the division's business that will be replaced with replacement debt will be regarded as an amount of debt that is attributable to and arose in the normal course of the business undertaking of the division as contemplated in section 42(8)(b); and
- the assumption of the replacement debt by Company A does, therefore, not constitute consideration in addition to any equity share issued by Company A as contemplated in section 42(4)(b).

7. Period for which this ruling is valid

This binding private ruling is valid for a period of three (3) years as from 11 April 2008.

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