SOUTH AFRICAN REVENUE SERVICE

BINDING PRIVATE RULING: BPR 002

DATE	:	3 September 2007
ACT	**:**	**INCOME TAX ACT, NO 58 OF 1962 (“the Act”)**
SECTION	**:**	**SECTION 24J**
SUBJECT	**:**	**METHOD FOR DETERMINATION OF THE INTEREST AMOUNT THAT ACCRUES ON THE COLLECTION OF A DISTRESSED DEBTORS BOOK**

1. Summary

The issues considered in this ruling are –

- How to calculate the interest amount to be included in gross income over the collection term of the distressed debtors book;
- How to treat any unrealised interest income, already included in gross income over the term of the distressed debtors book when the debt collecting efforts have been ceased; and
- How to treat the debt collected after it has been written off.

2. Relevant tax laws

This ruling 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 31 July 2007 and unless the context otherwise indicates, any word or expression in this ruling bears the meaning ascribed to them in the Act.

The specific ruling has been requested in terms of section 24J.

3. Parties to the transaction

The Applicant: A South African company that is in the business of debt collecting.

4. Description of the proposed transaction

This transaction concerns the acquisition of a 'distressed' (for example, overdue) retail debtors' book at a discount. The Applicant intends to profit from the collection of the debts.

5. Specific conditions and assumptions

This binding private ruling is made subject to the following conditions and assumptions:

- The tax and accounting treatment of the instrument will be determined using the same facts and assumptions (for example, initial purchase consideration, actual and expected annual cash collections, and expected collection period).
- Only the debtors acquired on the acquisition date of the debtors' book in terms of the proposed transaction should form part of the instrument.
- The same methodology to determine timing and amount of accrual should be applied throughout the term of the instrument.
- A description of the methodology used to determine the yield to maturity of the instrument should accompany the annual tax returns submitted by the Applicant throughout the duration of the proposed transaction.

6. Specific ruling

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

- The acquisition of the 'distressed' debt portfolio, and the subsequent collection thereof, is an 'instrument' as defined and may be treated as a single interest-bearing arrangement for purposes of section 24J ('the instrument');

- The 'term' of the instrument will, for purposes of section 24J, be the expected period from the date of acquisition of the instrument until the date that recovery efforts cease by the Applicant, bearing in mind that the term will be reassessed at each financial year end taking into account the levels of gross collections and cost of collection;
- Each financial year of the Applicant will be treated as a separate 'accrual period' in relation to the instrument;
- The 'accrual amount' which accrues to the Applicant in each accrual period in terms of section 24J in relation to the instrument will be calculated with reference to –

  (a) the adjusted initial amount at the beginning of each accrual period, and

  (b) the actual cash receipts received during such accrual period; and

  (c) the estimated future cash receipts that the Applicant anticipates collecting over the remaining term of the instrument.

  In other words, the 'yield to maturity' will be redetermined in terms of par (d) of the definition of 'yield to maturity' for purposes of section 24J in respect of each accrual period whenever the future estimated collection amount(s) and term differ from the estimated collection amount(s) and term used for the previous accrual period provided that –

  (i) where the calculated rate of compound interest per accrual period results in a negative rate of interest, the rate of compound interest per accrual period must be treated to be zero;

  (ii) fluctuations in the actual cash receipts received during each accrual period and the estimated future cash receipts that the Applicant anticipates collecting over the remaining term of the instrument, will be treated as variations and/or alterations of the Applicant's rights and/or interests in relation to the instrument, as contemplated in par (d) of the definition of 'yield to maturity' in section 24J;

- Any amount of interest included in the Applicant's gross income in terms of section 24J(3)(*a*) over the term of the instrument that is not actually collected will, in turn, be treated as an adjusted loss on redemption in terms of section 24J(4)(*b*). This amount of unrealised accrued interest will be deductible in the last year of the 'term' in respect of the instrument in terms of section 24J(4A), provided that it has not already been accounted for on an annual basis by adjusting the 'yield to maturity' in calculating the accrual amount for each accrual period;
- Any adjusted loss as envisaged in terms of section 24J(4)(*b*) that has not otherwise been taken into account in terms of section 24J(4A)(*a*), will be allowed as a deduction in terms of section 11(a) in the year of assessment during which the 'term' of the instrument ends, on the basis that the instrument is regarded as being held by the Applicant on revenue account; and
- All amounts allowed to be deducted in terms of section 11(*a*) read with section 24J(4)(*b*) and (4A)(*a*), which have been recovered or recouped after redemption of the instrument, will be included in the Applicant's gross income in terms of section 8(4)(*a*).

7. Period for which this ruling letter is valid

This binding private ruling, issued in March 2007, is valid from the year of assessment in which the instrument is acquired by the Applicant up to and including the year of assessment in which all collection efforts in respect of the proposed transaction finally cease.

Issued by:

Legal and Policy Division: Advance Tax Rulings
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