

BINDING PRIVATE RULING: BPR 109

DATE: 01 March 2012

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1, DEFINITION OF “GROSS INCOME”, 22 AND 24J AND PARAGRAPHS 18, 20(1)(a), 20(c)(ix), 35, 43 AND 58 OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : LOAN GRANTED WITH EMBEDDED OPTION

1. Summary

This ruling deals with the income tax consequences for a taxpayer who grants a loan with an embedded option to subscribe for shares in the borrower.

2. Relevant tax laws

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

In this ruling legislative references to sections are to sections of the Act applicable as at 1 February 2012 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 1, the definition of “gross income”;
- section 22(2) read with 22(4);
- section 24J; and
- paragraphs 18, 20(1)(a), 20(c)(ix), 35, 43 and 58 of the Eighth Schedule.

3. Parties to the proposed transaction

The Applicant: A company that is incorporated in and a resident of South Africa

The Co-Applicant: The Holding company of the Applicant, that is incorporated in and a resident of South Africa

The Borrower: An unconnected third party

4. Description of the proposed transaction

The proposed transaction will entail a loan agreement and a subscription agreement, which will be interdependent.

The Applicant will raise funds to be advanced as a loan to the Borrower. The interest chargeable on the funding will be less than the interest that will be charged on the loan to be granted.

In terms of the proposed loan agreement the full amount so advanced will be repayable in three years time.

In terms of the proposed subscription agreement, the Applicant will have the right but will not be obliged to subscribe for a fixed number of shares in the Borrower at a future date and at an agreed price. The subscription agreement will indicate that no premium will be payable for the option rights receivable on day one.

The subscription rights will be sold by the Applicant to the Co-Applicant after the agreements are entered into, but before the Applicant's financial year end.

5. Conditions and assumptions

This ruling is made subject to the assumption that the subscription rights will be sold by the Applicant at market value to the Co-Applicant. In the event that the said rights are sold for less than market value a portion of the interest allowed as a deduction under section 24J(2) will be disallowed as that portion will be deemed to have not been incurred for the Applicant's trade but for that of the Co-Applicant.

6. Ruling

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

- The Applicant will be entitled to claim all interest incurred by it, in order to raise the funds to be advanced as a loan to the Borrower, under section 24J.
- The subscription rights received on day one will constitute an amount received and will, in terms of the definition of "yield to maturity" as contained in section 24J(1), be regarded as part of the amounts receivable under the loan agreement. Consequently, the deemed accrual to the Applicant from an interest perspective will be greater than the interest receivable as set out in the loan agreement.

- The amount received from the sale of the subscription rights will be included in the gross income of the Applicant. The Applicant will be entitled to claim opening stock in respect of subscription rights, calculated at the market value of the subscription rights, under section 22(2) read with section 22(4).
- If the subscription rights are acquired on capital account then the payment made by the Co-Applicant in relation to the acquisition of the said subscription rights will result in either –
 - a capital loss if the entitlement to subscribe for the shares is not exercised; or
 - be added to the base cost of the shares if the entitlement to subscribe for shares is exercised.
- No additional amount will be included in the gross income of the Applicant or the Co-Applicant should the entitlement to subscribe for the shares be exercised notwithstanding the fact that the value of the shares may exceed the subscription price at that point in time.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five (5) years from February 2012.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**