

BINDING PRIVATE RULING: BPR 205

DATE: 11 September 2015

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1), DEFINITIONS OF “CONTROLLED GROUP COMPANY” AND “EQUITY SHARE”, 12E(4)(c) AND 12J
SUBJECT : MEANING OF “CONTROLLED GROUP COMPANY” AND “EQUITY SHARE”

1. Summary

This ruling determines the meaning of “equity share” and “controlled group company” with reference to a company that proposes to issue different classes of ordinary shares. It further determines the meaning of “investment income”, as defined in section 12E(4)(c).

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 22 June 2015. Unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of –

- section 1(1) – definitions of “controlled group company” and “equity share”;
- section 12E(4)(c); and
- section 12J.

3. Parties to the proposed transaction

The Applicant: A private company incorporated in and a resident of South Africa which is an approved “venture capital company” as defined in section 12J(1) and licensed in terms of section 7 of the Financial Advisory and Intermediary Services Act No. 37 of 2002

Company A: A private company incorporated in and a resident of South Africa

Investor B: A company incorporated in and a resident of South Africa

RentalCo: A private company to be incorporated in and which will be a resident of South Africa and will be a “qualifying company” as defined in section 12J pursuant to the proposed transaction (the leasing company)

4. Description of the proposed transaction

Company A’s main business is the marketing and sale of certain goods that are movable property. It wishes to expand its business by leasing some of the same goods under operating leases as defined by International Financial Reporting Standards.

Material terms of the proposed transaction are as follows:

- The Applicant, Investor B and Company A propose to incorporate RentalCo which will lease product A to Company A’s clients on a medium term basis under operating leases.
- The Applicant will subscribe for 20% of the issued shares (Class A ordinary shares) at a subscription price equalling 75% of the entire issued share capital. Company A and Investor B will subscribe for Class B and C ordinary shares respectively.
- All the ordinary shares will carry the same votes.
- As the Applicant has contributed a disproportionate amount of share capital, the Class A ordinary shares will be entitled to a first distribution of profits or capital equal to the capital invested and a return to the equivalent of prime plus 2%.
- Upon settlement of the Class A ordinary shares, the Class B and Class C ordinary shares subscribed for by the Company A and Investor B respectively will be entitled to a second distribution of profits or capital equal to a return to the equivalent of prime plus 2%, paid in proportion to their respective shareholding.
- Thereafter, the Class A, B and C ordinary shares will rank *pari passu* in all respects.

The Applicant also proposes to enter into similar transactions with companies which are suppliers of goods that are movable assets, establishing a leasing company that will be a qualifying company in collaboration with the supplier. The actual shareholding proportions in the leasing company will be negotiated, but the Applicant will always hold less than 70% of the shares in issue, given that a qualifying company may not be a controlled group company in relation to the Applicant. The supplier will pay the subscription price in cash and / or by the transfer of its trading stock, to be leased out under operating leases by the leasing company, while the Applicant will subscribe for cash only.

5. Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that all the investments to be made by the Applicant must substantially be in the form as described above.

6. Ruling

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

- For purposes of the definition of “qualifying share” in section 12J(1), the Class A shares to be held by the Applicant in RentalCo will constitute “equity shares”, as defined in section 1(1).
- For purposes of the definition of “qualifying company”, as defined in section 12J(1), the qualifying company (such as RentalCo) into which the Applicant invests will not constitute a “controlled group company” for so long as the number of equity shares held by the Applicant constitutes less than 70% of the total number of equity shares in issue, notwithstanding that the Applicant invests more than 70% of the aggregate share capital.
- The receipt of rental income under operating leases in respect of movable assets by the qualifying company into which the Applicant invests, will not constitute “investment income”, as defined in section 12E(4)(c).

7. General Note

No consideration has been given to whether RentalCo will be carrying on an “impermissible trade”, as defined in section 12J(1).

8. Period for which this ruling is valid

This binding private ruling is valid for a period of 5 years from 22 June 2015.