

BINDING PRIVATE RULING: BPR 236

DATE: 31 May 2016

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITION OF “CONTRIBUTED TAX CAPITAL”, 10(1)(k)(i), 24J, 41, 45, 55 – DEFINITION OF “DONATION”, 56, 58, 64D, 64E AND 64FA OF THE ACT AND PARAGRAPHS 11, 20, 35 AND 75 OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : SET-OFF OF A LOAN ACCOUNT ARISING FROM AN INTRA-GROUP TRANSACTION TO ACQUIRE EQUITY SHARES

1. Summary

This ruling determines the income tax consequences resulting from the acquisition of equity shares by setting-off a loan account, arising from an intra-group transaction, against the subscription price.

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 and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule thereto applicable as at 14 April 2016. 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) – definition of “contributed tax capital”;
- section 10(1)(k)(i);
- section 24J;
- section 41;
- section 45;
- section 55 – definition of “donation”;
- section 56;
- section 58;
- section 64D;
- section 64E;
- section 64FA;
- paragraph 11;

- paragraph 20;
- paragraph 35; and
- paragraph 75.

3. Parties to the proposed transaction

Holdco:	A company incorporated in and a resident of South Africa
The Applicant:	A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Holdco
African Holdco:	A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Holdco
Foreign Holdco:	A company incorporated outside South Africa and not a resident that is a wholly-owned subsidiary of African Holdco
Company Y:	A company incorporated outside South Africa and not a resident

4. Description of the proposed transaction

Holdco, the Applicant, African Holdco, and Foreign Holdco are part of the same group of companies (the group). African Holdco was formed to be the holding company for the group's investments in Africa. Foreign Holdco and Company Y are residents of the same foreign country.

During 2015 the Applicant acquired 23% of the equity in Company Y. Subsequently Foreign Holdco acquired 37% of the equity in Company Y.

The Applicant intends to sell its 23% shareholding in Company Y to Foreign Holdco at a price equal to the base cost expenditure of the shares in Company Y, on loan account under an intra-group transaction as contemplated in section 45(1). The purchase price will remain outstanding on an interest-bearing loan account on commercial terms to be settled on demand within a maximum period of 30 days. The interest rate will be determined in terms of the group's transfer pricing policy with no provision to be made for the deferral of interest.

The group proposes to capitalise the loan obligation of Foreign Holdco into equity share capital through the following transaction steps:

- a) The Applicant will distribute the loan account to Holdco as a dividend *in specie*.
- b) Holdco will then subscribe for further ordinary shares in the capital of African Holdco for a subscription price equal to the face value of the loan account.
- c) The obligation of Holdco to pay the subscription price to African Holdco in terms of the subscription agreement will be discharged by the transfer of the loan account to African Holdco.

- d) African Holdco will in turn subscribe for further ordinary shares in the capital of Foreign Holdco for a subscription price equal to the face value of the loan account.
- e) The obligation of African Holdco to pay the subscription price to Foreign Holdco in terms of the subscription agreement will be discharged by way of set-off against the loan account, resulting in the loan account being extinguished.

5. Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

6. Ruling

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

- a) In respect of the sale of the shares in Company Y by the Applicant to Foreign Holdco on loan account:
 - i) The transaction will be an “intra-group transaction”, as defined in paragraph (b) of that term in section 45(1).
 - ii) The Applicant will be deemed to have disposed of the shares in Company Y for an amount equal to the base cost of those shares on the date of the disposal, under section 45(2)(a)(i).
 - iii) The Applicant and Foreign Holdco will, for purposes of determining any capital gain or capital loss in respect of the future disposal of the shares in Company Y by Foreign Holdco, be deemed under section 45(2)(a)(ii) to be one and the same person with respect to the date of acquisition of the shares in Company Y by the Applicant and the amount and the date of incurral by the Applicant of any expenditure in respect of the shares allowable in terms of paragraph 20 of the Eighth Schedule.
 - iv) Section 45(6)(d) will not apply to the disposal of shares to be distributed by the Applicant to Foreign Holdco.
 - v) Section 45(3A) will not apply to the loan account.
 - vi) The sale of the shares in Company Y at a base cost value that is less than its market value will not constitute a “donation” as defined in section 55(1), nor will it be deemed to be a donation under section 58.
 - vii) The loan account will, under section 24J(12), not fall within the ambit of section 24J, therefore, none of the parties to the transaction will be required to account for any accrual amount or adjusted gain or loss in respect of the transfer or redemption of the loan account.
- b) The distribution of the loan account by the Applicant to Holdco as a dividend *in specie* will –
 - i) not give rise to any capital gain in the Applicant;
 - ii) be exempt from dividends tax under section 64FA(1)(b); and

- iii) be exempt from normal tax in Holdco under section 10(1)(k)(i).
- c) In respect of the subscription for further shares in African Holdco by Holdco for a subscription price equal to the face value of the loan account:
 - i) The further shares to be acquired by Holdco in African Holdco will be treated, for purposes of paragraph 20 of the Eighth Schedule, as having been acquired by Holdco for an expenditure equal to the subscription price of the shares and will increase African Holdco's contributed tax capital by the same amount.
 - ii) The transfer of the loan account to African Holdco in setting-off against Holdco's obligation to pay the subscription price will not give rise to any capital gain in Holdco.
- d) In respect of the subscription for further shares in Foreign Holdco by African Holdco for a subscription price equal to the face value of the loan account:
 - i) The further shares to be acquired by African Holdco in Foreign Holdco will be treated, for purposes of paragraph 20 of the Eighth Schedule, as having been acquired by African Holdco for an expenditure equal to the subscription price of the shares and will increase Foreign Holdco's contributed tax capital by the same amount.
 - ii) The set-off of the loan account against African Holdco's obligation to pay the subscription price will not give rise to any capital gain in African Holdco.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 3 years from 14 April 2016.