

BINDING PRIVATE RULING: BPR 201

DATE: 13 August 2015

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

SECTION : SECTIONS 1(1) – DEFINITION OF “GROSS INCOME”, PARAGRAPHS (c) and (k); “CONTRIBUTED TAX CAPITAL”; “DIVIDEND” AND “RETURN OF CAPITAL”, 8C, 40C, 42(5) AND (6), AND PARAGRAPH 11 OF THE EIGHTH SCHEDULE TO THE ACT

SUBJECT : ISSUE OF CAPITALISATION SHARES

1. Summary

This ruling deals with the issue of capitalisation shares by a company to its sole shareholder.

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 May 2015 and 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 “gross income”, paragraphs (c) and (k); “contributed tax capital”; “dividend” and “return of capital”;
- section 8C;
- section 40C;
- section 42(5) and (6); and
- paragraph 11 of the Eighth Schedule.

3. Parties to the proposed transaction

The Applicant: A natural person who is a resident of South Africa

The Co-Applicant: A private company incorporated in and a resident of South Africa

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

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

4. Description of the proposed transaction

The Applicant currently holds 100% of the equity shares in the Operating Company. In order for the Operating Company to achieve certain Black Economic Empowerment (BEE) credentials, it is imperative to introduce a minimum of 25.1% direct or indirect BEE shareholding in the Operating Company.

The Applicant proposes to interpose the Co-Applicant (currently dormant and 100% owned by the Operating Company) as the holding company into which the BEE Co will acquire shares which will allow the BEE Co to participate indirectly in the ownership and profits of the Operating Company. The BEE Co is 100% held by a BEE trust.

The following transactions will be implemented:

- **Step 1:** The Operating Company will dispose of its shares in the Co-Applicant to the Applicant for a nominal consideration.
- **Step 2:** The Applicant will dispose of his ordinary shares in the Operating Company to the Co-Applicant in exchange for ordinary shares in the Co-Applicant.
- **Step 3:** The Co-Applicant will issue 10 000 participating, cumulative, redeemable preference shares to the Applicant as capitalisation shares (the capitalisation shares) for no consideration.

The key terms of the capitalisation shares will be as follows:

- The capitalisation shares will be redeemable at the discretion of the Co-Applicant, at a price equal to 100% of the current equity value of the Operating Company (the redemption price).
- The Co-Applicant will have no obligation to redeem the capitalisation shares, other than in the event of default triggered as a result of the Co-Applicant falling into financial distress.
- The Applicant will be entitled to receive the following distributions –
 - cumulative profit distributions equal to the unredeemed balance of the redemption price (plus any arrear distributions) multiplied by 72% of the prime lending rate; and
 - 1% of all distributions made in respect of the ordinary shares.
- **Step 4:** The Co-Applicant will issue 25.1% ordinary shares to the BEE Co for a negligible subscription price.

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:

- The receipt of the capitalisation shares by the Applicant will not result in a “disposal” of the ordinary shares held by the Applicant in the Operating Company, and consequently section 42(5) will not be triggered when the capitalisation shares are issued.
- Upon receipt of the capitalisation shares, section 42(6) will not be triggered as the Applicant will continue to hold a “qualifying interest” as defined in section 42(1).
- The receipt of the capitalisation shares by the Applicant will not constitute “gross income” in the hands of the Applicant.
- The receipt of the capitalisation shares by the Applicant will not constitute a specific inclusion under paragraph (c) of the definition of “gross income” in the hands of the Applicant.
- The receipt of the capitalisation shares by the Applicant will not be subject to section 8C.
- The issue of the capitalisation shares will not qualify as a “dividend” or a “return of capital” as defined in section 1(1).
- Although the Applicant will dispose of an “asset” for capital gains tax (CGT) purposes upon receipt of the capitalisation shares, the exchange of the Applicant’s personal right for the capitalisation shares must be disregarded for CGT purposes.
- Section 40C will deem the expenditure actually incurred by the Applicant in respect of the capitalisation shares to be nil.
- The issue of the capitalisation shares by the Co-Applicant will not create “contributed tax capital” as defined in section 1(1).

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 3 years from 14 May 2015.

8. General Note

The proposed transaction has not been considered from the perspective of the company law, general accepted accounting practice or Black Economic Empowerment accreditation.