

## **BINDING CLASS RULING: BCR 034**

DATE: 15 May 2012

**ACT** : **INCOME TAX ACT, NO. 58 OF 1962 (the Act)**  
**SECTION** : **SECTIONS 1 – THE DEFINITION OF "GROSS INCOME" AND "TRADING STOCK", 8(4)(a), 11(a), 22, 23(g), 23B, 23H, 24C, 24J, 24L AND 24M**  
**SUBJECT** : **TAXATION OF EXCHANGE TRADED NOTES**

### **1. Summary**

This ruling deals with the tax consequences for taxpayer issuing exchange traded notes (ETNs).

### **2. Relevant tax laws**

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling references to sections are to sections of the Act, applicable as at 16 March 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, definition of "gross income" and "trading stock"
- section 8(4)(a);
- section 11(a);
- section 22;
- section 23(g);
- section 23B;
- section 23H;
- section 24C
- section 24J;
- section 24L; and
- section 24M.

### 3. Class

The class members to whom this ruling will apply are the Issuers as described in point 4 below.

### 4. Parties to the proposed transaction

The Issuers: Any person issuing ETNs listed on the Johannesburg Stock Exchange (JSE) from time to time

The Holders: Any person acquiring ETNs from time to time on the JSE

### 5. Description of the proposed transaction

An ETN is an agreement entered into between a Holder and an Issuer, in terms of which the Holder pays an amount (the acquisition amount) to the Issuer and the Issuer undertakes to pay to the Holder an amount (the redemption amount) calculated with reference to the value of certain specified assets or a benchmark (the reference portfolio) on the maturity date of the ETN. An ETN (for purposes of this ruling application) is a long-term instrument that is traded through the Johannesburg Stock Exchange (JSE) and the maturity date of the ETN will be a minimum of five years after the date of issue.

The reference portfolio may constitute shares, an index, an exchange rate, or a combination of the aforementioned. Examples of ETNs available in the market, include:

- Equity linked notes which provide the Holders with an opportunity to gain exposure to various equity indices. The equity exposures investors can gain access to are –
  - two Africa equity indices;
  - a total return emerging market MSCI index; and
  - the total return China MSCI index.
- Commodity linked ETNs which offer investors exposure to the performance of a single commodity or index or an index that consists of a basket of commodities.

ETNs may be disposed of by the relevant Holder in the market or to a market maker. In terms of the requirements of the JSE in respect of ETNs, a market maker is required. The Issuer may redeem the ETN prior to the maturity date in the event that –

- there is an event that affects the validity of the ETN;
- the reference portfolio that the ETN tracks ceases to exist or does not have a viewable/determinable price available; or
- the Holder wishes to redeem the ETN against the Issuer.

(In all of the above events the ETN redeems at the current value of the reference portfolio it tracks.)

The Issuer may or may not hedge its obligations in terms of the ETN by acquiring the relevant reference portfolio. In terms of the JSE rules it is not required that the Issuer hedges its obligations in terms of the ETN.

## **6. Conditions and assumptions**

This ruling is made subject to the conditions and assumptions that this ruling –

- will only be applicable for issuance of ETN's after the issue date of this ruling;
- is based on the facts as set out in the ETN Programme examples submitted with this ruling application; and
- will not be applicable to ETNs with a Reference Portfolio which comprises any debt instrument.

## **7. Ruling**

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

- The acquisition amount will be included in the gross income of the Issuer in the year of assessment in which the ETN is issued.
- The redemption amount, payable by the Issuer on the maturity date, will be deductible under section 11(a) read with section 23(g) by the Issuer in the year of assessment in which the ETN is issued. The amount of such deduction will be a reasonable estimate of the redemption amount (estimated redemption amount), determined on the date of issue of the ETN.
- If the estimated redemption amount, that is deducted in the year of assessment in which the ETN is issued, exceeds the actual redemption amount payable on the maturity date, the difference will be recouped by the Issuer under section 8(4)(a) during the year of assessment in which the maturity date falls. If the actual redemption amount payable on the maturity date exceeds the estimated redemption amount that is deducted in the year of assessment in

which the ETN is issued, the Issuer will be entitled to a further deduction, under section 11(a) read with section 23(g), during the year of assessment in which the maturity date falls.

- The ETNs which are the subject of this ruling will not constitute “instruments”, as defined in section 24J(1).
- The provisions of sections 23H, 24C, 24L and 24M will not apply to ETNs issued.

**8. Period for which this ruling is valid**

This binding class ruling is valid for a period of five years from March 2012.

Issued by:

**Legal and Policy Division: Advance Tax Rulings  
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