

BINDING PRIVATE RULING: BPR 361

DATE: 19 March 2021

**ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECURITIES TRANSFER TAX ACT 25 OF 2007 (STT Act)
TRANSFER DUTY ACT 40 OF 1949 (TD Act)
VALUE-ADDED TAX ACT 89 OF 1991 (VAT Act)**

**SECTION : SECTIONS 1(1) – DEFINITION OF “DIVIDEND” AND “TRADING STOCK”, 24BA, 41(1) – DEFINITION OF “GROUP OF COMPANIES”, 42, 46 AND PARAGRAPH 43A OF THE EIGHTH SCHEDULE TO THE ACT
SECTIONS 1(1) – DEFINITION OF “TRANSFER” AND 8(1)(a) OF THE STT ACT
SECTION 9(1)(f) OF THE TD ACT
SECTION 8(25) OF THE VAT ACT**

SUBJECT : ASSET-FOR-SHARE TRANSACTION FOLLOWED BY AN UNBUNDLING TRANSACTION, THE ISSUE OF CAPITALISATION REDEEMABLE PREFERENCE SHARES AND THE SALE OF SHARES TO A THIRD PARTY

Preamble

This binding private ruling is published with the consent of the applicant(s) to which it has been issued. It is binding between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the tax consequences of an internal restructuring involving corporate rules. Cumulative redeemable preference shares are also issued as a capitalisation issue which is followed by the sale of shares to a third party. In particular, the tax relief under corporate rules for the parties involved are examined and whether the dividend stripping rules will apply.

2. Relevant tax laws

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act as at 11 February 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of –

- the Act –
 - section 1(1) – definition of “dividend” and “trading stock”;

- section 24BA;
- section 41(1) – definition of “group of companies”;
- section 42;
- section 46; and
- paragraph 43A.
- the STT Act –
 - section 1 – definition of “transfer”; and
 - section 8(1)(a).
- the TD Act –
 - section 9(1)(f).
 - the VAT Act –
 - section 8(25).

3. Parties to the proposed transaction

The applicant:	A resident company
Company A:	A resident company that is the holding company of the applicant
Company B:	A resident company that will become as subsidiary of company A
Third party buyer:	A resident natural person who is currently the managing director of the applicant

4. Description of the proposed transaction

Company B wishes to reduce its involvement in the applicant to that of a passive limited shareholder, whose interest will be phased out over time, whilst the third party buyer wishes to obtain an equity interest in the applicant. The third party buyer will acquire the ordinary shares of the applicant for purposes of holding them as a long-term investment.

The steps for implementing the proposed transaction are as follows:

Step 1

The applicant owns the property (the Property) from which the applicant carries on its operating activities. The applicant has claimed section 13 allowances on the Property. This Property will be transferred to company B in exchange for the issue of ordinary shares by company B. This transaction will be implemented under section 42 of the Act. The value of the property contributed to company B by the applicant will represent 60% of the overall value of properties held by company B after the acquisition.

The applicant will simultaneously enter into a five year lease with company B in respect of the Property. The lease payments will be at an arm’s length consideration.

Step 2

The applicant will distribute the company B shares it acquired in step 1 to company A in terms of an unbundling transaction as defined in section 46 of the Act.

Step 3

The applicant will issue class A cumulative redeemable preference shares to company A as a capitalisation share issue. The proposed terms of the class A preference shares will be as follows:

- Each preference share will have a specified capital value.
- Each preference share can be redeemed at the discretion of the applicant's board of directors, but a proposed redemption schedule has been prepared and it is envisaged that all the preference shares will be redeemed over the next 12 years.
- The preference shares will bear cumulative preference dividends determined with reference to the published inflation rate.
- If the applicant redeems a specified number of preference shares during each of the first three years after they have been issued, the remaining preference shares will not bear cumulative preference dividends during the next three years (the Dividend Holiday). If it fails to redeem the specified shares, the remaining issued preference shares bear cumulative preference dividends during the Dividend Holiday Period.
- The preference shares can only be redeemed if there are no outstanding cumulative preference dividends.
- The applicant may not make distributions to the ordinary shareholders of the applicant while there are any class A preference shares in issue.
- The preference shares do not have any voting rights, except in respect of protected matters that require the consent of the class A preference Shareholder.

The capitalisation issue will be implemented under section 47 of the Companies Act 71 of 2008 (the Companies Act).

Step 4

Company A will dispose of all the ordinary shares in the applicant to the third party buyer for a nominal amount which will be the market value of the ordinary shares at that time.

Post step 4

The third party buyer will subscribe for additional ordinary shares in the applicant through which he will provide the company with a cash injection to fund its operations.

The applicant will declare and pay cumulative preference dividends in respect of the class A preference shares. Over time, the applicant will redeem the preference shares.

5. Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions –

- a) the Property will be sold at market value;
- b) the Property does not secure any debt;
- c) the parties to the proposed transaction will not elect that the provisions of section 42 of the Act do not apply;
- d) the public officer of company B will make a sworn affidavit or solemn declaration, as required by the STT Act, that the acquisition of the Property is by way of an asset-for-share transaction under section 42 of the Act;
- e) the applicant and company B will not jointly elect that the provisions of section 46 of the Act do not apply; and
- f) the requirements of section 47 of the Companies Act will be complied with when the applicant makes any payment in respect of the class A preference shares.

6. Ruling

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

Step 1

- a) The applicant will be deemed to have disposed of the Property to company B for an amount equal to its base cost in terms of section 42(2)(a)(i)(aa) of the Act.
- b) The building allowance, previously allowed in respect of the Property, must not be recovered or recouped by the applicant or included in its income in the year of that transfer, as contemplated in section 42(3)(a)(i) of the Act.
- c) The applicant and company B will be deemed to be one and the same person for purposes of determining the amount of any allowance previously deducted, as contemplated in section 42(3)(a)(ii) of the Act.
- d) Company B will not be entitled to any allowances as the Property has been fully claimed for income tax purposes and has a zero tax value. The amount of any allowance or deduction previously claimed by the applicant must be recovered or recouped by company B in the event that company B disposes of the Property in the future.
- e) The transfer of the Property will be deemed not to be a supply made by the applicant for value-added tax purposes under section 8(25)(iii) of the VAT Act.
- f) The transfer of the Property will not be subject to transfer duty under section 9(1)(j)(i) of the TD Act.

Step 2

- g) The applicant must disregard any income tax implication of the distribution of the company B shares to company A under sections 46(2), 46(5) and 46(5A) of the Act.
- h) Company A must allocate a portion of the base cost of the ordinary shares of the applicant to the ordinary shares of company B which the applicant will distribute to it, under section 46(3) of the Act.
- i) The distribution of the ordinary shares of company B by the applicant will be exempt from Securities Transfer Tax in terms of section 8(1)(a)(iv) of the STT Act.

Step 3

- j) The issuing of the class A preference shares of the applicant as capitalisation shares to company A is not a “dividend” or “gross income” as defined in section 1(1) of the Act.
- k) The class A preference shares have a zero base cost for company A, under section 40C of the Act. The contributed tax capital of these shares amounts to Rnil.
- l) No contributed tax capital will be created by the issuing of the class A preference shares.

Step 4

- m) On the disposal of the ordinary shares by company A to the third party buyer, the difference between the proceeds and the base cost of the ordinary shares, after the adjustments have been made in terms of section 46(3) of the Act, will be subject to CGT.
- n) STT will be levied under section 2 of the STT Act on the market value of the ordinary shares of the applicant transferred to the third party buyer. The applicant is liable for the payment of STT under section 6 of the STT Act which may be recovered under section 7(2) from the third party buyer.

Post-Step 4

- o) Paragraph 43A will not apply to the distribution of the company B shares to company A by the applicant, under section 46 of the Act;
- p) The issue of the class A preference shares will not be regarded as a “dividend”, as defined in section 1(1) of the Act and as a result paragraph 43A will not apply;
- q) The class A preference shares are not hybrid equity instruments as defined in section 8E(1) of the Act and the dividends are not deemed to be income under section 8E(2) of the Act; and
- r) To the extent that the class A preference share dividends and redemption amounts are received by or accrued to company A, these amounts will be “dividends”, as defined in section 1(1) of the Act. In the context of the specific facts and circumstances of the transaction, these “dividends” that arise on

the dividend declaration dates and on the redemption dates will be “extraordinary dividends” as defined in paragraph 43A(1) and paragraph 43A(2) of the Eighth Schedule to the Act will apply to these “dividends”.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of three years from 11 February 2021.

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