



SOUTH AFRICAN REVENUE SERVICE

BINDING CLASS RULING: BCR 017

DATE: 05 February 2010

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

SECTION : SECTION 1, DEFINITION OF “GROSS INCOME” AND SECTION 10(1)(h) AND (k)(i) AND PARAGRAPH 2 OF THE EIGHTH SCHEDULE TO THE ACT

SUBJECT : CREATION OF A PERMANENT ESTABLISHMENT IF A FOREIGN PARTNERSHIP CARRIES ON BUSINESS IN SOUTH AFRICA

1. Summary

This ruling deals with the question as to whether the activities to be performed in South Africa by an agent of foreign partnerships (Foreign Funds) will create a permanent establishment (PE) through which such Foreign Funds will be seen as carrying on business in South Africa.

2. Relevant tax laws

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

In this ruling legislative references to sections, paragraphs and Articles are to sections of the Act, paragraphs of the Eighth Schedule to the Act and Articles of the OECD Model Tax Convention on Income and on Capital (OECD Model) applicable as at 8 January 2009 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act and the OECD Model.

This ruling has been requested under the provisions of –

- section 1, definition of “gross income”;
- section 10(1)(h) and (k)(i);
- paragraph 2 of the Eighth Schedule; and
- Articles 5 and 7 of the OECD Model, for a Tax Convention normally entered into between contracting states for the prevention of double taxation (DTA).

3. **Class**

The class members to whom this ruling will apply are foreign investors (investors who are not a “resident” as defined in section 1) who will be the limited partners in the Foreign Funds.

4. **Parties to the proposed transaction**

The Applicant: A company (a “resident” as defined in section 1) that will, on behalf of the class members manage the private equity investments outsourced to it by the Foreign and Local Funds

SA Company: A company (a “resident” as defined in section 1) that wishes to establish a semi-captive private equity fund (the Fund)

ForeignCo: A company (established in the same jurisdiction as the Foreign Funds) that will be responsible to ultimately manage the Foreign Funds and will be owned by a foreign trust and will not be directly or indirectly owned from South Africa in any way

The Fund: A semi-captive South African private equity fund in which the Local Funds and Foreign Funds will each invest on a 70/30 basis respectively

The Foreign Funds: Unincorporated Limited Partnerships constituted under the laws of a foreign country

Foreign LPs: Foreign investors in their capacity as Limited Partners (LPs), who will contribute the capital to the Foreign Funds

Foreign GPLP: An unincorporated limited partnership (which will be the General Partner (GP) of the Foreign Funds) in which SA Company and SA Trust will be the LPs and ForeignCo will be the GP

SA Trust: A trust (a “resident” as defined in section 1) which will be responsible to ultimately manage the Local Funds and will also be a LP to the Foreign GPLP and the GP of the Local GPLP

The Local Funds: Two or more partnerships *en commandite*, constituted under the laws of South Africa

Local LPs: Local investors (SA Company and third party local investors) in their capacity as LPs who are

a “resident” as defined in section 1 and who will contribute capital to the Local Funds

Local GPLP: A partnership *en commandite* (which will be the GP of the Local Funds) in which SA Company or its nominated subsidiary company will be the LP and SA Trust the GP

5. Description of the proposed transaction

In terms of the proposed transaction (see **Annexure A**) SA Company wishes to establish a semi-captive private equity fund (the Fund). The primary objective of the Fund is to ensure an increase in the targeted level of investments in the Fund.

5.1 History and reason for the establishment of the Fund

It is intended that fund capital will be raised from Local LPs and from Foreign LPs in a 70/30 ratio respectively.

Although the Fund will predominantly be marketed and managed as a single private equity fund, in order to accommodate the special requirements of the Foreign LPs, the asset portfolio of the Fund will be held by separate Local Funds and Foreign Funds. Furthermore, the split between the Local Funds and Foreign Funds is necessary in order to ensure compliance with the current Exchange Control Regulations of South Africa. The Fund will ultimately consist of two or more Local Funds and two or more Foreign Funds (that is a Local Investor Fund 1 and a Local Investor Fund 2 and a Foreign Investor Fund 1 and a Foreign Investor Fund 2).

5.2 The structure of the Local and Foreign Funds

The Local Funds will be structured as follows:

- The Local Funds will be constituted as two or more partnerships *en commandite* with Local LPs and the Local GPLP as its partners.
- The Local Funds will be denominated in South African Rands (ZAR).

The Foreign Funds will be structured as follows:

- The Foreign Funds will be constituted as unincorporated limited partnerships with Foreign LPs and Foreign GPLP as its partners.
- The Foreign Funds will be denominated in a foreign currency.

Save for the contributions made by SA Company as partner of the Local GPLP and the Foreign GPLP, SA Company will make its entire contribution to the Fund as LP of the Local Funds in ZAR.

ForeignCo and all the foreign investors in the Foreign Funds will be resident outside South Africa.

5.3 Operation of the Fund

Management and administration of the Fund

By virtue of the fact that ForeignCo (in respect of the Foreign Funds) and SA Trust (in respect of the Local Funds) will be the GPs of the Foreign GPLP and the Local GPLP respectively, they will be responsible for the management and administration of the Foreign Funds and the Local Funds respectively. They will make the final decisions relating to the acquisition and/or disposal of the investments of these Funds. Both ForeignCo and SA Trust will be entitled to a management fee for their services in this regard. However, in terms of an advisory agreement between the Applicant, ForeignCo and SA Trust, both ForeignCo and SA Trust will receive investment advice from the Applicant in return for which a substantial portion of the management fee earned by ForeignCo will be paid to the Applicant in South Africa in terms of an arm's length arrangement.

Co-investment agreement

A co-investment agreement will be entered into between the Local Funds and the Foreign Funds. To the extent that investments are approved by both the Local Funds and the Foreign Funds, each investment made by such Funds will be made by the Local Funds and the Foreign Funds on the same terms and at the same time on a *pari passu* basis. The co-investment agreement will specify that co-investments will only be made where the investment has been approved by the GPs of the Local Funds and the Foreign Funds.

Investment advisory services

In terms of the advisory agreement, the Applicant will identify all investment opportunities, and will refer such opportunities to ForeignCo and SA Trust for consideration. ForeignCo and SA Trust will have the final authority to approve or decline these investment opportunities and the Applicant will not be at liberty to negotiate the essential elements and details of any agreement in a way that may be binding on ForeignCo or SA Trust in their capacities as GPs of the Foreign Funds and the Local Funds respectively. Furthermore, SA Trust will not have any authority to take decisions or bind its foreign counterpart in any way and the GPs will operate independently.

The services provided by the Applicant will include –

- sourcing, identifying, evaluating and recommending suitable investments;
- advising and assisting with due diligence on prospective investments;
- advising on the merits, structure and financing of any investment, including any additional capital required to satisfy any obligation of the funds;
- advising on the negotiation of various agreements relating to the acquisition of an investment and its financing; and

- monitoring the performance of investments and making divestment recommendations.

Decision-making process

The Applicant will be contracted to develop a proposed portfolio strategy which will be submitted to the GPs for approval. The GPs will consider the proposed portfolio strategy and will, once satisfied with the proposal, jointly approve the overall portfolio strategy.

Investment process

The process to be followed within the Applicant will be as follows:

- The employees of the Applicant will perform economic, sector and corporate research on an ongoing basis and will screen for potential investments.
- Any promising investments will be referred internally to an investment committee who will perform a further screening function.
- Investments that meet the approval of the investment committee will be referred for strategic, financial and legal due diligence screening.
- The Applicant will compile an investment report and, to the extent that the investment committee is satisfied that the proposed investment is appropriate, they will provide the GPs with an investment recommendation.

The process to be followed within the GPs will be as follows:

- On receipt of the investment recommendation made by the Applicant, the GPs (SA Trust and ForeignCo) will consider the information provided by the Applicant and will decide whether to pursue the recommended opportunity.
- The GPs will determine the strategic fit as well as the timing and price parameters in respect of the proposed investment and will provide the necessary negotiation mandates to its transaction advisors (including the Applicant) with a view to execute. It should be noted that none of these advisors will be authorised to bind the GPs or any of the Local LPs or Foreign LPs.
- The execution phase will only commence once both the GPs are satisfied with the proposed investment and transaction parameters.
- The final transaction agreements will be approved and signed by the respective GPs.

The decision-making processes to be followed within ForeignCo will be as follows:

- ForeignCo will have a board of directors which will consist of two individuals resident in the foreign jurisdiction and one permanent alternate director who will also be a foreign resident of that jurisdiction. A

Company, resident in that foreign jurisdiction, will be the company secretary of ForeignCo.

- The board of ForeignCo or the relevant investment committee will consist of a different group of individuals other than the decision-making team in respect of the Local Funds. In the absence of an established investment committee, the board of ForeignCo will function as such.
- All board meetings will be held outside South Africa.
- All investment decisions of the GP of the Foreign GPLS will be made by the board of ForeignCo or by the investment committee.
- The constitution of ForeignCo will detail which investment decisions must be made by the board of ForeignCo. Although the board may delegate certain investment decisions to the investment committee, the board will at all times remain accountable for the decisions made.
- The majority of the members of the board and investment committee are not located in South Africa.
- Members of the board and the investment committee are independent from the investor adviser and its associates.

Post-deal value creation

The Applicant will be mandated contractually to communicate the portfolio strategy to portfolio companies as applicable and to monitor strategy implementation by attending management meetings and reviewing reports prepared by portfolio companies. The Applicant will also be mandated to take appropriate steps to ensure that portfolio companies are governed in line with the overall strategy of the Fund.

Divestment process

The Applicant will also be mandated contractually to develop exit options on investments and will thereafter review investment performance and the market environment on an ongoing basis. Divestment recommendations will be made internally to the investment committee who will decide whether or not to refer such proposal to the GPs.

The process to be followed within the GPs will be as follows:

- On receipt of the divestment recommendation made by the Applicant, the GPs will consider the information provided by the Applicant and will decide whether to divest.
- Again the GPs will determine the timing and price parameters in respect of the proposed divestment and will provide the necessary negotiation mandates to its transaction advisors (including the Applicant) with a view to execute. Note that none of these advisors will be authorised to bind the GPs or any LPs.
- The execution phase will only commence once both GPs are satisfied with the proposed divestment and transaction parameters.

- The final transaction agreements will be approved and signed by the respective GPs.

5.4 Business of the Applicant

The business of the Applicant will be conducted in the following manner:

- The Applicant will be a wholly-owned subsidiary of SA Company, conducting investment advisory services both in respect of the Local Funds and the Foreign Funds and will operate as an independent profit-driven service provider. This service will be provided to a variety of funds and the survival of the business of the Applicant, therefore, not just dependent on one fund.
- The premises to be occupied by the staff of the Applicant will not be subject to any control on the part of ForeignCo or any of the foreign investors.
- No expenditure incurred by the Applicant will be paid for by ForeignCo or any of the foreign investors.
- All equipment at the office of the Applicant will be owned or leased by the Applicant.
- Management decisions of the Applicant will be made without the involvement or influence of ForeignCo or any of the foreign investors and conversely, the Applicant will not be involved in any management decisions made by ForeignCo or the foreign investors.
- No executive, managerial or operational decisions in respect of the business of ForeignCo or any of the foreign investors will be made in the offices of the Applicant.
- Neither ForeignCo nor any of the foreign investors will have any employees working out of the offices of the Applicant's offices.
- The Applicant will assume all risks for its own operations.
- The Applicant will not be able to conclude agreements on behalf of ForeignCo or any of the foreign investors.

6. Conditions and assumptions

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

- all income of the Foreign Funds will be from a source or deemed source situated within South Africa; and
- all transactions with connected persons will take place at arm's length.

7. Ruling

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

7.1 Foreign Funds

Each Unincorporated Limited Partnership will not be regarded as a “company” as defined in section 1.

7.2 Permanent establishment (PE)

A PE will not be created in South Africa on the part of the foreign investors by the activities to be performed within South Africa in respect of the Fund.

7.3 Foreign investors not subject to a DTA

Interest-income on shareholder loans will be exempt from income tax in the hands of the foreign investor under the provisions of section 10(1)(h), provided the foreign investor does not have a PE in South Africa.

Dividends received in respect of equity shares held in a company that is a “resident” as defined in section 1 will be exempt from income tax in the hands of the foreign investor under the provisions of section 10(1)(k)(i).

Trade income on the disposal of equity shares held will form part of the “gross income”, as defined in section 1, of the foreign investor and will be taxed at the applicable rate.

Capital gains on the disposal of equity shares held, which are not considered to be an interest in South African movable property, will not be subjected to income tax in the hands of the foreign investor.

7.4 Foreign investors subject to a DTA

Interest income on shareholder loans will be exempt from income tax in the hands of the foreign investor under the provisions of section 10(1)(h), provided the foreign investor does not have a PE in South Africa.

Dividends received in respect of equity shares held in a company that is a “resident” as defined in section 1 will be exempt from income tax in the hands of the foreign investor under the provisions of section 10(1)(k)(i).

Trade income on the disposal of equity shares held will not be subjected to income tax in the hands of the foreign investor as a result of the application of the terms of any applicable DTA if such DTA incorporates the wording contained in Article 7 of the OECD Model. Capital gains on the disposal of equity shares held, which are not considered to be an interest in South African movable property, will not be subjected to income tax in the hands of the foreign investor.

8. Other issues considered

Although the following issues do not form part of the ruling issued, they are specifically noted (in view of the facts provided by the Applicant):

- Based on SARS’ interpretation of “place of effective management” the view is held that ForeignCo will be effectively managed and controlled

in South Africa and accordingly ForeignCo will be a “resident”, as defined in section 1.

9. Period for which this ruling is valid

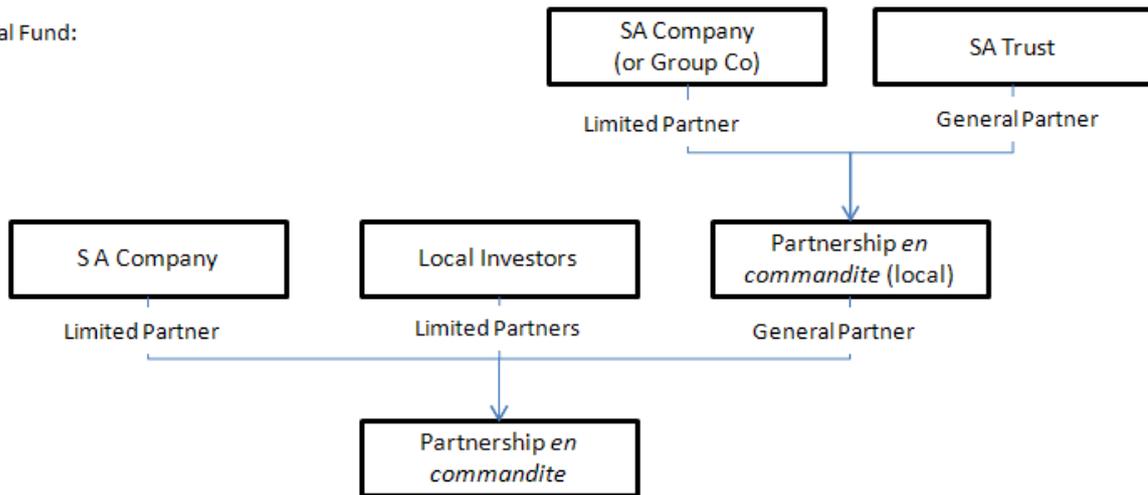
This binding class ruling is valid for a period of three (3) years as from 1 April 2009.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**

Annexure A

Local Fund:



Foreign Fund:

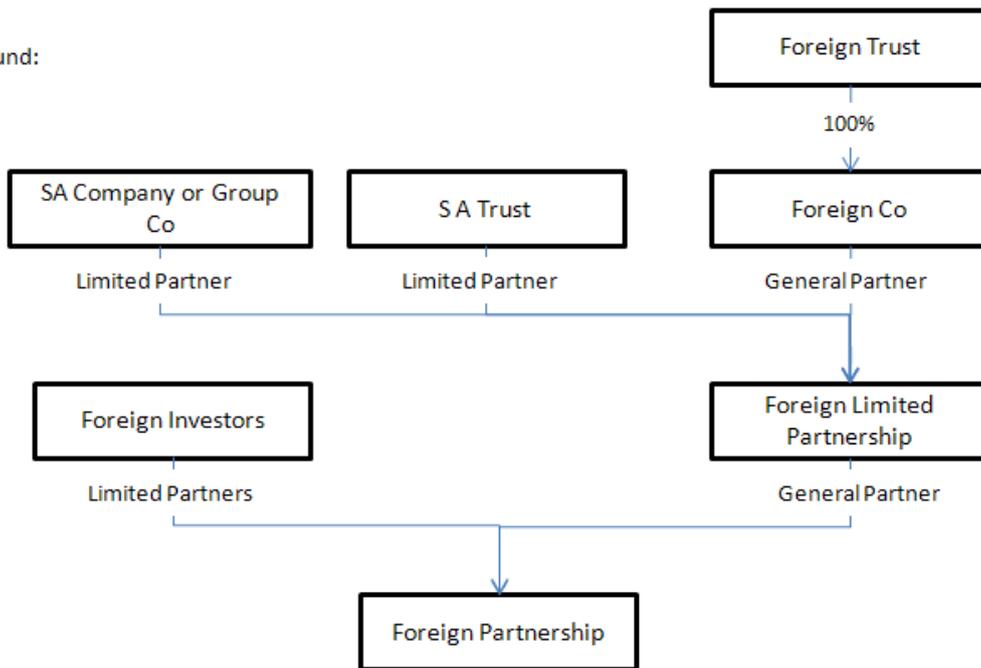


Illustration of pari-passu investment by local fund and foreign fund in SA asset

