

## **BINDING GENERAL RULING (INCOME TAX) 54**

DATE: 22 June 2020

**ACT: INCOME TAX ACT 58 OF 1962**

**SECTION: SECTION 46**

**SUBJECT: UNBUNDLING OF UNLISTED COMPANY: IMPACT OF NON-QUALIFYING SHAREHOLDERS**

### ***Preamble***

For the purposes of this BGR –

- “**BGR**” means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- “**non-qualifying shareholder**” means a shareholder of the unbundling company that does not form part of the same group of companies as the unbundling company;
- “**paragraph**” means a paragraph of the Eighth Schedule to the Act;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act 58 of 1962;
- “**unbundled company**” means the company whose equity shares are distributed to the shareholders of an unbundling company;
- “**unbundling company**” means the company that distributes all the equity shares it holds in an unbundled company to its shareholders;
- “**unbundling transaction**” means an unbundling transaction as defined in section 46(1); and
- any other word or expression bears the meaning ascribed to it in the Act.

### **1. Purpose**

This BGR provides clarity on what constitutes an unbundling transaction when an unbundling company having non-qualifying shareholders unbundles shares in an unlisted unbundled company.

### **2. Background**

Section 46 provides roll-over relief when an unbundling company distributes all of its equity shares in an unbundled company to its shareholders under an unbundling transaction. The definition of “unbundling transaction” contains requirements relating to the unbundling company, unbundled company and shareholders of the unbundling company. This BGR examines the qualifying shareholders requirement in paragraph (a)(i)(bb) of the definition of “unbundling transaction” in the context of a

resident unbundling company holding shares in a resident unlisted unbundled company. The applicable part of the definition reads as follows:

**“46. Unbundling transactions.**—(1) For the purposes of this section, ‘unbundling transaction’ means any transaction—

- (a) (i) in terms of which the equity shares in a company (hereinafter referred to as the “unbundled company”), which is a resident that are held by a company (hereinafter referred to as the “unbundling company”), which is a resident, are all distributed by that unbundling company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company, and if—
  - (aa) all of the equity shares of the unbundled company are listed shares or will become listed shares within 12 months after that distribution;
  - (bb) that shareholder to which that distribution is made by that unbundling company forms part of the same group of companies as that unbundling company; or
  - (cc) that distribution is made pursuant to an order in terms of the Competition Act, 1998 (Act No. 89 of 1998), made by the Competition Tribunal or the Competition Appeal Court; and”

Subitems (aa) and (cc) of the definition do not stipulate any shareholder requirements for the unbundling company when the shares in the unbundled company are listed or will be listed within 12 months after the distribution or when they are distributed pursuant to an order under the Competition Act. However, under subitem (bb) when the unbundled company is unlisted, the shareholder must be part of the same group of companies as defined in section 41<sup>1</sup> as the unbundling company.

The issue arises as to what effect the wording of subitem (bb) has on an unbundling transaction when the unbundling company has non-qualifying shareholders. More specifically, does the presence of non-qualifying shareholders mean the whole transaction or only part of it does not meet the definition of “unbundling transaction”.

### 3. Discussion

The words in paragraph (a)(i) require the unbundling company to distribute all the shares it holds in the unbundled company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company. These words make it clear that the unbundling company may not retain any shares in the unbundled company and also contemplate that all holders of shares in the unbundling company must participate in the distribution in accordance with their effective interests. Such shareholders include all shareholders holding equity shares in the unbundling company regardless of the size of their holdings. The further requirement in subitem (bb) is that “that shareholder” to which “that distribution” is made must be part of the same group of companies as the unbundling company. This wording may create some uncertainty because the opening words contemplate all shareholders of the unbundling company while subitem (bb)

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<sup>1</sup> Interpretation Note 75 “Exclusion of certain companies and shares from a ‘group of companies’ as defined in section 41(1)”.

contemplates only shareholders of the unbundling company that form part of the same group of companies as the unbundling company.

The intention of subitem (*bb*) is to make the distribution to shareholders forming part of the same group of companies as the unbundling company an unbundling transaction, while excluding from an unbundling transaction distributions to shareholders not forming part of that group of companies. In other words, the presence of non-qualifying shareholders does not invalidate the entire unbundling transaction but only that portion relating to the non-qualifying shareholders. Consequently, the part of the distribution to the non-qualifying shareholders must be dealt with outside section 46 under general principles, while the part of the distribution to shareholders forming part of the same group of companies as the unbundling company must be dealt with under section 46, assuming the other requirements of that section are met.

The exact tax treatment for the unbundling company and its non-qualifying shareholders, for the part of the distribution to the non-qualifying shareholders, will depend on the facts of the particular case but is generally likely to be as follows for a resident unbundling company and its resident non-qualifying shareholders:

- If the unbundling company holds the shares on capital account, or as trading stock but the shares have been held for at least three years and section 9C(2) applies, it must determine a capital gain or loss under paragraph 75(1)(a) on the portion of the unbundled company shares disposed of to the non-qualifying shareholders, with the proceeds being equal to the market value of the unbundled company shares on the date of distribution. Alternatively, if the shares in the unbundled company are held as trading stock falling outside section 9C(2), the market value of the equity shares distributed to the non-qualifying shareholders must be included in the income of the unbundling company under section 22(8), with the cost price of the unbundled company shares being deducted under section 11(a) (if acquired in the same year of assessment as the disposal) or section 22(2) (opening stock). In addition, a distribution taking the form of a dividend *in specie* will potentially result in the imposition of dividends tax on the unbundling company, subject to any applicable exemptions in section 64FA.
- Resident non-qualifying shareholders holding their unbundling company shares as capital assets or as trading stock but the shares have been held for at least three years and section 9C(2) applies, must include the distribution in gross income if it takes the form of a dividend and consider whether it qualifies for exemption under section 10(1)(k). If in the form of a return of capital, the distribution must be dealt with under paragraph 76B by reducing the base cost of the unbundling company shares and treating any excess as a capital gain. The base cost of the unbundled company shares will be established under paragraph 75(1)(b), being equal to their market value on the date of distribution.
- Resident non-qualifying shareholders holding their unbundling company shares as trading stock falling outside section 9C(2) must include the distribution in their gross income, regardless of whether the distribution takes the form of a dividend or a return of capital. If the distribution takes the form of a dividend, it may be exempt from normal tax under section 10(1)(k). If the unbundled company shares are acquired as trading stock, they will have a cost price under section 22(4) equal to the current market price on the date of acquisition. For purposes of paragraph 20(1) the unbundled shares will have an expenditure determined under paragraph 75(1)(b) equal to their market

value on the date of distribution. Resident non-qualifying shareholders that have included a return of capital in gross income will not be required to reduce the expenditure incurred in respect of their shares in the unbundling company under paragraph 76B.

- The distribution to non-qualifying shareholders will not qualify for the exemption from securities transfer tax available for an unbundling transaction referred to in section 46 which is provided for in section 8(1)(a)(iv) of the Securities Transfer Tax Act 25 of 2007.

Paragraph (a)(i) of the definition of “unbundling transaction” does not require other holders of shares in the unbundled company, that is, shareholders other than the unbundling company, to distribute their shares.

#### **4. Ruling**

When an unbundling company distributes unlisted unbundled company equity shares to a company forming part of the same group of companies as the unbundling company as well as to non-qualifying shareholders, the distribution to shareholders forming part of the same group of companies as the unbundled company will comprise an unbundling transaction, while the distribution to the non-qualifying shareholders will not comprise an unbundling transaction.

This ruling constitutes a BGR under section 89 of the Tax Administration Act 28 of 2011.

#### **5. Period for which this ruling is valid**

This BGR applies from date of issue until it is withdrawn, amended or the relevant legislation is amended.

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