

BINDING PRIVATE RULING: BPR 057

DATE: 26 October 2009

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTION 24J
SUBJECT : INTEREST INCURRED ON A LOAN OBTAINED TO ACQUIRE THE BUSINESS OF A COMPANY AS A GOING CONCERN THROUGH THE ACQUISITION OF THE SHARES OF THE COMPANY

1. Summary

This ruling deals with the deductibility of interest incurred on a loan to be obtained by a company to be funded by a local bank and utilised for the purpose of acquiring the business of another company as a going concern through the acquisition of the shares of that other company with the intention that the business so acquired will form part of its own current operations.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling legislative references to sections are to sections of the Act applicable as at 29 February 2008 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 24J.

3. Parties to the proposed transaction

The Applicant: A limited liability company which is a “resident” as defined in section 1 that will acquire the shares in Company A, thereby acquiring Company A’s entire business operations

Company A: A limited liability company which is a “resident” as defined in section 1 whose shares will be acquired by the Applicant

4. Description of the proposed transaction

The Applicant's intention was to purchase 100% of the assets and liabilities of the business of Company A as a going concern with the primary objective of obtaining the business operations of Company A and to integrate such operations with the rest of its own operations.

During its negotiation with Company A, the Applicant sent a letter of intent with an offer to purchase 100% of the assets and liabilities of the business of Company A as a going concern.

In terms of the letter of intent, the business of Company A would have been operated as part of the business of the Applicant. The Applicant's intention was to continue the business of Company A in certain towns/cities as representative offices of the Applicant and to merge the other offices of Company A over time with the Applicant's existing offices in other towns/cities.

The Applicant would have continued to use Company A's brand for marketing and identification purposes and the shareholders of Company A and other employees (as mutually agreed) of Company A would have continued to be employed by the Applicant.

After considering the initial offer as set out in the letter of intent made by the Applicant, the shareholders of Company A decided against the selling of the assets and liabilities of Company A to the Applicant. The shareholders in Company A stated in a letter to the Applicant that although they were interested in the proposed merger between the two companies, they would only enter into an agreement with the Applicant on the basis that the Applicant acquires their shares in Company A.

The Applicant now intends to acquire the business of Company A by way of purchasing all the shares in Company A on the basis substantially outlined in the Applicant's letter of intent.

The Applicant wants the business operations of Company A to form an integral part of its current operations. To achieve this, the Applicant indicated that it intends to liquidate Company A within two to three weeks after receiving Company A's tax assessment for the 2007/2008 financial year. The Applicant furthermore indicated that the entire business operations of Company A will be transferred to the Applicant on a specified date. The business operations of Company A will thus form part of the Applicant's existing business from that specified date and Company A will become dormant from that specified date until it is liquidated.

The Applicant is not a “connected person” as defined in section 1 in relation to any of the shareholders of Company A and the purchase price will be based on arm’s length commercial negotiations to allow the shareholders of Company A, who will no longer share in the growth of Company A’s business, to unlock the value of their investment in Company A.

The acquisition of the shares of Company A will be funded by the Applicant through an interest bearing loan raised from a local bank.

Both the shape and character of the proposed transaction are inspired entirely by commercial reasons. The Applicant’s intention is to expand its trade by becoming more accessible to their clients and thereby produce more income. Equally it is certain that the availability to the Applicant of the technical skills within Company A will substantially increase its competitiveness in the market and thereby increase the income of the Applicant.

5. Conditions and assumptions

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

- no dividend will be declared to any shareholder of the Applicant as a result of, or as part of the acquisition process of Company A; and
- the business of Company A will be transferred to the Applicant on the specified date and the necessary steps to liquidate, wind up or deregister Company A, as envisaged in section 41, will take place within a period of six (6) months after the business of Company A is transferred to the Applicant.

6. Ruling

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

- The interest to be incurred by the Applicant on a local bank funded loan, obtained to acquire the business of Company A as a going concern to form an integral part of its current operations through the acquisition of the shares in Company A, will be an expense incurred in the production of income as envisaged by section 24J and therefore deductible in determining the taxable income of the Applicant.

7. General note

This ruling represents the very limited circumstances under which the interest expense on a loan obtained to acquire the shares of a company and thereafter the business of that company as a going concern, will be

allowed. In this instance the Applicant will satisfy the onus of proof under section 82 that the sole or main purpose of the acquisition of shares will be to preserve and enhance its own income-producing activities. There will further be a clear or close causal connection between the interest expense to be incurred and the income against which it is sought to be deducted.

With the introduction of section 23K, a transaction of this nature will have to be disclosed and approval obtained from the Commissioner that the provisions of section 23K will not prohibit the deduction of the interest otherwise allowable.

8. Period for which this ruling is valid

This binding private ruling is only in respect of interest incurred to acquire the shares of Company A and is valid for a period of three (3) years as from the date of this ruling.

Issued by:

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