

**BINDING PRIVATE RULING: BPR 087**

DATE: 14 June 2010

**ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)**  
**SECTION : PARAGRAPH 80(1) AND (2) OF THE EIGHTH SCHEDULE TO THE ACT**  
**SUBJECT : CAPITAL GAINS TAX CONSEQUENCES ARISING FROM RESTRUCTURING ACTIVITIES INVOLVING TRUSTS**

**1. Summary**

This ruling deals with the capital gains tax (CGT) consequences for a company that will undertake certain restructuring activities to mitigate its post retirement medical aid (PRMA) obligations where such restructuring activities will involve the use of trusts.

**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 and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act, 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.

This ruling has been requested under the provisions of paragraph 80(1) and (2) of the Eighth Schedule.

**3. Parties to the proposed transaction**

The Applicant: A company incorporated in South Africa

The Medical Benefit Fund (MBF): A trust established in South Africa by the Applicant and registered as a benefit fund

The H Medical Benefit Trust (Trust A): A trust established in South Africa by the Applicant to be the successor to the MBF

The New Trust (Trust B): A new trust to be established in South Africa by the Applicant with a purpose substantially identical to that of Trust A

#### 4. Description of the proposed transaction

The Applicant intends to perform certain restructuring activities in order to mitigate its obligation to its current and retired employees to make PRMA contributions on their behalf to a medical scheme. The Applicant initially established the MBF, which was approved by SARS as a benefit fund as contemplated in paragraph (c) of the definition of “benefit fund” in section 1 in order to fulfil the obligation.

The assets, rights and obligations of the MBF were subsequently transferred to Trust A, the successor to the MBF some years later. The purpose for which Trust A has been established was and remained to ensure adequate funding to finance compliance by the Applicant with those obligations. Trust A applied some of the funds so transferred to acquire an annuity policy from a long-term insurance company.

Those PRMA obligations of the Applicant however expose the Applicant to a number of significant financial risks arising from uncertainty regarding future medical scheme inflation and future investment returns, as well as the increasing longevity of retired employees.

The value of investments in Trust A exceeds the Applicant’s existing PRMA obligations.

Trust A intends to surrender the annuity policy and to receive the proceeds *in specie* rather than in cash. The assets so received will form part of Trust A’s capital.

The Applicant intends to mitigate its PRMA obligations by offering current and retired employees the opportunity to relinquish their entitlements to PRMA contributions for their benefit or to continue with the *status quo*. Those who opt to relinquish their entitlements will have the following options –

- lump sum contributions will be made on their behalf to the Applicant’s Retirement Fund; or
- current employees who are not members of the Applicant’s Retirement Fund will receive cash payments for waiving their entitlements.

An amount will be set aside for the benefit of retired employees who are entitled to PRMA contributions in order to purchase compulsory life annuity policies from a life insurer to satisfy those obligations in the future. The

retired employee will be the owner of the policy. He or she will be entitled to resign from the medical scheme and become entitled to the benefits arising out of the annuity.

An amount will be retained in Trust A to satisfy obligations to employees who elect not to relinquish their rights.

The surplus amount, after providing for the above, will be utilised in the Applicant's operations.

The manner in which the above will be achieved is as follows:

- The trustees of Trust A will authorise a capital distribution to the Applicant as capital beneficiary. However, a clause of the trust deed prohibits the distribution of funds from Trust A to the Applicant unless such funds are distributed to an entity, fund or trust with objectives substantially identical to that of Trust A.
- In order to overcome this legal impediment on the distribution of funds, the Applicant will set up Trust B, with a purpose substantially identical to that of Trust A, however, without a limitation clause.
- The capital distribution once made by Trust A to the Applicant will immediately be transferred by the Applicant to Trust B to comply with the limitation clause.
- The amount so received by Trust B will, in turn, be distributed to the Applicant as capital beneficiary of Trust B.
- The Applicant will apply the capital distribution received from Trust B for the purpose and in the manner described above.

## **5. Conditions and assumptions**

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

- Trust A and Trust B are discretionary trusts; and
- the amount distributed to the Applicant by Trust A and to the Applicant by Trust B constitute a capital distribution which each trust is authorised to make under its trust deed.

## **6. Ruling**

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

- Paragraph 80(1) or (2) does not apply when the trustees of Trust A exercise their discretion to surrender the annuity policy referred to above.
- Paragraph 80(1) applies when the trustees exercise their discretion to distribute the capital held in Trust A to the Applicant.

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

This binding private ruling, issued in January 2009, is valid for the year of assessment in which the transaction takes place.

Issued by:

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