

**BINDING PRIVATE RULING: BPR 163**

DATE: 12 March 2014

**ACTS : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 1(1) DEFINITION OF ‘DIVIDEND’ AND ‘CONTRIBUTED TAX CAPITAL’, 10(1)(k)(i), 22B, 24J(2) AND 64F(1)(a) AND PARAGRAPHS 35 AND 43A OF THE EIGHTH SCHEDULE**  
**SUBJECT : INTEREST ON REPLACEMENT LOANS AND PROCEEDS ARISING FROM A SHARE REPURCHASE**

**1. Summary**

This ruling deals with interest incurred on replacement loans and whether the loans will retain their initial business purpose for the interest on those loans to qualify for a deduction under section 24J(2). The ruling also deals with a share repurchase consideration received by a selling company and whether such consideration constitutes a dividend and consequently exempt from dividends tax and income tax.

**2. Relevant tax laws**

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 11 February 2014 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of: –

- section 1(1) definition of “dividend” and “contributed tax capital”;
- section 10(1)(k)(i);
- section 22B;
- section 24J(2);
- section 64F(1)(a); and
- paragraphs 35 and 43A of the Eighth Schedule.

**3. Parties to the proposed transaction**

The Applicant: A public company incorporated in and a resident of South Africa

The Co-Applicant: A private company incorporated in and a resident of South Africa

The Subsidiaries: Private companies incorporated in and residents of South Africa and directly held subsidiaries of the Applicant

#### 4. Description of the proposed transaction

The Co-Applicant owns 49.3% of the shares in the Applicant. Various professional individuals own 50.57% of the shares in the Applicant, either individually or through trusts, companies or the executors of their deceased estates. The employees of the Applicant own the remaining 0.13% of the shares.

The Applicant proposes to repurchase the entire shareholding which the Co-Applicant holds in the Applicant.

The steps comprising the proposed transaction are as follows:

- The Applicant will acquire all the shares in a company (NewCo) for a nominal value.
- NewCo will acquire all the shares in the Subsidiaries from the Applicant in exchange for issuing new shares in itself to the Applicant.
- The Subsidiaries will refinance four existing interest-free intra-group loans (group loans) through interest-bearing third party bank loans (replacement loans). The cash arising from the replacement loans will be applied in repaying the group loans. The group loans arose from time to time as a consequence of companies, with available surplus cash (creditor companies), advancing interest-free loans to fellow group companies which had certain funding requirements (debtor companies).
- The Subsidiaries will distribute their refinanced cash and excess cash to NewCo as a dividend.
- NewCo will source loan funding from a third party bank in order to partly raise funding for the share repurchase consideration payable by the Applicant to the Co-Applicant. The loan will represent a large portion of the share repurchase consideration payable by the Applicant to the Co-Applicant.
- NewCo will distribute the cash arising from the aforementioned third party bank loan together with the cash distributions it will receive from the Subsidiaries to the Applicant as a dividend. The Applicant will apply these funds towards the settlement of the repurchase consideration.
- The professionals will purchase specified numbers of the Applicant's shares directly from the Co-Applicant.
- The Applicant will repurchase all of the remaining shares held by the Co-Applicant in accordance with section 48(2)(a) of the Companies Act, No. 71 of 2008, subsequent to the professionals acquiring the shares from the Co-Applicant.

The first three group loans were applied by the respective debtor companies to finance working capital, various building projects or for the purchase of capital equipment necessary to continue to conduct their businesses. Since the replacement loans will be interest bearing funding, the debtor companies will incur interest and will seek to deduct such interest for income tax purposes.

The original purpose of a fourth loan was that it would be applied by the debtor company for a future capital expenditure programme. Projects were budgeted for but the implementation of these projects was dependent on approval of the necessary licenses. Had the applications for the licenses been granted, surplus cash resources would have been utilised to fund such an expansion project. Prior to this happening and in anticipation of the forthcoming capital expenditure, the group loan was advanced by the creditor company and the proceeds of the group loan were placed by the debtor company in a fixed interest-earning deposit. The result is that the debtor company will retain only an interest bearing bank loan and have no funds available for the initially intended project. The debtor company will have to borrow these funds again when the group decides to proceed with the initially intended project.

**5. Conditions and assumptions**

This ruling is not subject to any additional conditions and assumptions.

**6. Ruling**

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

- Interest incurred on the first three replacement loans will be deductible by the respective Subsidiaries under the provisions of section 24J(2).
- Interest incurred on the fourth loan will not be deductible by the relevant Subsidiary under the provisions of section 24J(2).
- The repurchase consideration to be paid by the Applicant to the Co-Applicant will constitute a “dividend”, as defined in section 1(1), and will be exempt from dividends tax under the provisions of section 64F(1)(a). In addition, it will also be exempt from income tax in the hands of the Co-Applicant under the provisions of section 10(1)(k)(i).

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

This binding private ruling is valid for the implementation of the transaction and will be valid from the effective date of the transaction for a period of 5 years.

Issued by:

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