

BINDING PRIVATE RULING: BPR 251

DATE: 6 October 2016

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECURITIES TRANSFER TAX ACT NO. 25 OF 2007 (STT Act)**

**SECTION : SECTIONS 1(1) – DEFINITION OF “PERSON” AND “COMPANY”,
24BA, 41(1) – DEFINITION OF “EQUITY SHARE” AND 42 OF THE
ACT, AND PARAGRAPHS 10(b)(ii), 20, 31(1) AND 35 OF THE
EIGHTH SCHEDULE TO THE ACT
SECTIONS 1(1) – DEFINITION OF “SECURITY”, 2 AND 8(1)(a)(vi) OF
THE STT ACT**

SUBJECT : CANCELLATION OF REINSURANCE AGREEMENT

1. Summary

This ruling determines the tax consequences resulting from the disposal of assets by a long-term insurer to a collective investment scheme (CIS) in securities in exchange for the issue of participation units in the CIS and the *in specie* transfer of such units, pursuant to the cancellation of a reinsurance agreement.

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 relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 8 September 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

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

- the Act –
 - section 1(1) – definition of “person” and “company”;
 - section 24BA;
 - section 41(1) – definition of “equity share”;
 - section 42;
 - paragraph 10(b)(ii);
 - paragraph 20;
 - paragraph 31(1); and
 - paragraph 35.

- the STT Act –
 - section 1(1) – definition of “security”;
 - section 2; and
 - section 8(1)(a)(vi).

3. Parties to the proposed transaction

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|----------------|---|
| The Applicant: | A CIS “manager” as defined in section 1 of the Collective Investment Schemes Control Act No. 45 of 2002 |
| Company A: | A company incorporated in and resident of South Africa |
| Company B: | A company incorporated in and resident of South Africa |
| Fund X: | A “portfolio of a collective investment scheme in securities” as defined in section 1(1) of the Act |

4. Description of the proposed transaction

Company A and Company B are both long term insurers.

Company A offered policies (linked plans) to selected retirement fund policyholders. The premiums of these linked plans in whole or in part fund its obligations to its members. The assets held by Company A under these linked plans are allocated to its untaxed policyholder fund (UPF). The benefits of these linked plans are linked to investments in a portfolio managed by a specific third party investment manager (investment manager) and financial services provider.

Company A reinsured its obligations to pay policy benefits under these linked plans. Company A pays reinsurance premiums to Company B in terms of a reinsurance agreement. Company B invested these premiums in a pooled investment portfolio (portfolio B) held by it, which enables Company B to meet its obligations in terms of the reinsurance agreement.

Company A wishes to terminate the reinsurance agreement by following these steps:

- The Applicant has already established Fund X.
- An investment manager will be appointed for Fund X.
- Company B will dispose of the underlying investments comprising portfolio B to Fund X at market value in exchange for units in Fund X (X units).
- Company A will terminate the reinsurance agreement and Company B will transfer the X units to Company A in settlement of its liability under the reinsurance agreement.
- Company A will own the X units as assets supporting its liability under the linked plans.

5. Conditions and assumptions

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

6. Ruling

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

- a) Section 42 will not apply to the disposal of the assets underlying portfolio B in exchange for the issue of the X units.
- b) Any capital gain that may arise as a result of the disposal of the assets underlying portfolio B attributable to the UPF of Company B to Fund X will be subject to an inclusion rate of 0% in accordance with the provisions of paragraph 10(b)(ii).
- c) The X units will constitute proceeds from the disposal of the assets underlying portfolio B according to paragraph 35, the market value of which will have to be determined according to paragraph 31(1)(c).
- d) The value of the assets underlying portfolio B will constitute expenditure actually incurred by Company B to acquire the X units from Fund X for purposes of paragraph 20, the market value of which will have to be determined according to paragraph 31.
- e) The issue of the X units that represents the liability of Fund X to Company B will constitute the expenditure incurred by Fund X to acquire the assets underlying portfolio B for purposes of paragraph 20, the market value of which will have to be determined according to paragraph 31.
- f) Section 24BA will not apply to the disposal of the assets underlying portfolio B.
- g) All assets underlying portfolio B, comprising of securities falling within the ambit of the STT Act, to be disposed of by Company B to Fund X, will qualify for the exemption under section 8(1)(a)(vi) of the STT Act.
- h) On the basis that the X units will be allocated to the UPF of Company B, any capital gain that may arise in Company B upon the disposal of the X units to Company A will be subject to an inclusion rate of 0% in accordance with the provisions of paragraph 10(b)(ii).
- i) Company B will dispose of the X units to Company A for proceeds equal to Company B's liability in terms of the reinsurance agreement according to paragraph 35.
- j) Company A will acquire the X units for a cost or expense equal to the amount of its claims in terms of the reinsurance agreement as determined in paragraph 20.
- k) No STT will be payable on the transfer of the X units by Company B to Company A in settlement of Company B's liability in terms of the reinsurance agreement.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 8 September 2016.

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