

BINDING PRIVATE RULING: BPR 274

DATE: 6 June 2017

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITIONS OF “CONTROLLED GROUP COMPANY” AND “EQUITY SHARE”, 12B, 12D AND 12J
SUBJECT : VENTURE CAPITAL COMPANY INVESTING IN A COMPANY PROVIDING AND EXPANDING PLANTS FOR THE GENERATION OF SOLAR ELECTRICITY

1. Summary

This ruling determines –

- the meaning of “controlled group company” and “equity share” for purposes of the definitions of “qualifying company” and “qualifying share” respectively in section 12J(1) with reference to an operating company that proposes to issue different classes of ordinary shares;
- whether an Operating Company will be regarded as carrying on an “impermissible trade” in immovable property as contemplated in paragraph (a) of the definition of that term in section 12J(1);
- whether rental income derived by the Operating Company will be “investment income” as defined in section 12E(4)(c) and contemplated in paragraph (f) of the definition of “qualifying company” in section 12J(1); and
- whether the Operating Company will be entitled to claim allowances under section 12B(1)(h)(ii)(bb) read with sections 12B(2)(b) and 12D(2).

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 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 17 May 2017. 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 –

- section 1(1), definition of “controlled group company” and “equity share”;
- section 12B;
- section 12D; and
- section 12J.

3. Parties to the proposed transaction

- The Applicant: A company incorporated in and a resident of South Africa that has been approved as a “venture capital company” as defined in section 12J(1)
- Operating Company: A company incorporated in and a resident of South Africa
- Company A: A company incorporated in and a resident of South Africa, and the general partner in an *en commandite* partnership (the Partnership)
- Individuals: Natural persons who are residents of South Africa and limited partners in the *en commandite* partnership with Company A

4. Description of the proposed transaction

Investment in Operating Company

The Applicant intends to invest in Operating Company. The remaining shares are held by the Individuals.

The Individuals subscribed for their shares in Operating Company and paid a nominal amount. These shares are classed as ‘A’ shares.

The Applicant will subscribe for 20% of the equity shares in Operating Company. These shares will be ‘B’ shares. The relevant terms of the ‘B’ shares will be as follows:

- The holders of the ‘B’ shares will be entitled to receive an aggregate amount of distributions that will result in them receiving an aggregate amount equal to the subscription amount, plus a cumulative nominal annual compounded monthly return.
- Dividends in respect of the ‘B’ shares must be paid regularly out of excess or free cash.
- ‘A’ shareholders will not, unless otherwise determined unanimously by the board of directors, be entitled to receive any dividends or distributions until the ‘B’ shareholders have received the total return as described above.
- Once their return has been received by the ‘B’ shareholders, the ‘A’ and ‘B’ shares will rank *pari passu* in all respects.
- For as long as the return has not yet been paid to the ‘B’ shareholders, notwithstanding the relative number of ‘A’ and ‘B’ shares in issue, the ‘B’ shares will carry 50% of the total voting rights. However, once the full amount has been paid to the ‘B’ shareholders, each ‘A’ share and ‘B’ share will carry a single vote.

Trade of the Operating Company

As part of its business operations, Operating Company will acquire an existing Solar Services Agreement (SSA) from the Partnership. The SSA facilitates the provision, maintenance, and expansion of solar electricity at the sites of its customer.

In terms of the sale agreement between the Partnership and Operating Company, it is agreed that Operating Company will acquire, as a going concern, the business of conducting a solar facility at specific sites of its customer. These facilities provide for solar electricity which generates 83 kilowatts and 303 kilowatts at Site 1 and Site 2 respectively.

This sale (Phase 1) will, amongst others, involve the Partnership ceding, assigning and transferring all of its rights and obligations in terms of the SSA to Operating Company.

Phase 2 involves Operating Company entering into an installation development contract with Company A as the developer, for the purpose of extending the existing photovoltaic plants. Upon completion of Phase 2, Site 1 will generate 195 kilowatts and Site 2 will generate 808 kilowatts.

The business operations will therefore be outsourced and as a result continue to be supplied by Company A that built and supplied the solar panels. However, all of the assets relating to the supply of solar electricity (the assets), including solar panels, transmission cables and other related facilities, will be owned by Operating Company and supplied to the customer in terms of an operating lease as stipulated in the SSA.

Neither Company A, nor the Individuals (Seller), are directly or indirectly responsible for the financing needs of Operating Company.

5. Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that the proposed transaction is not part of or connected with any other transaction, operation or scheme, other than as set out herein.

6. Ruling

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

- a) For purposes of the definition of “qualifying company” in section 12J(1), Operating Company will not constitute a “controlled group company” for as long as the number of equity shares which the Applicant holds constitutes less than 70% of the total number of equity shares in issue, irrespective of the fact that the Applicant would have invested more than 70% of the aggregate share capital in monetary terms.
- b) For purposes of the definition of “qualifying share” in section 12J(1), the shares held by the Applicant will be equity shares as defined in section 1(1).

- c) Operating Company will be entitled to claim 100% of the cost to it in the year in which the relevant asset is brought into use by it, both as regards the assets acquired in respect of Phase 1 and those in respect of Phase 2 under section 12B(2)(b).
- d) Operating Company will be entitled to claim the deduction under section 12D of the Act on the basis that any line or cable used for the transmission of electricity is an “affected asset” as defined, but the deduction is applicable to the assets acquired in respect of Phase 2 only.
- e) The solar panels are movable assets and therefore Operating Company will not be carrying on an impermissible trade as contemplated in paragraph (a) of the definition of “impermissible trade” in section 12J(1).
- f) The income derived by Operating Company in terms of its contracts with its customers will not constitute rental derived in respect of immovable property, as contemplated in paragraph (i) of the definition of “investment income” in section 12E(4)(c), so that this amount will not be taken into account in determining the investment income for the purposes of paragraph (f) of the definition of “qualifying company” in section 12J(1).

7. Period for which this ruling is valid

This binding private ruling is valid until 28 February 2022.

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SOUTH AFRICAN REVENUE SERVICE**