South African Revenue Service

BINDING PRIVATE RULING: BPR 300

DATE: 23 March 2018

ACT : INCOME TAX ACT 58 OF 1962 (the Act)

SECTION : SECTIONS 1(1) – DEFINITION OF "GROUP OF COMPANIES", "FOREIGN COMPANY", "FOREIGN DIVIDEND" AND "CONTRIBUTED TAX CAPITAL", 10B(2)(*a*), 44(5), 45 AND PARAGRAPHS 1 – DEFINITION OF "BASE COST", 12A, 20(1)(*a*) AND 75 OF THE EIGHTH SCHEDULE.

SUBJECT : INTRA-GROUP TRANSACTION AND CONVERSION OF DEBT TO EQUITY

1. Summary

This ruling determines the tax consequences of an "intra-group transaction" contemplated in paragraph (*b*) of that definition in section 45(1) and a conversion of debt to equity.

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 and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 1 January 2018. 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) – definitions of "group of companies", "foreign company", "foreign dividend and "contributed tax capital";
- section 10B(2)(*a*);
- section 44(5);
- section 45;
- paragraph 1 – definition of "base cost";
- paragraph 12A;
- paragraph 20(1)(*a*); and
- paragraph 75.

3. Parties to the proposed transaction

The applicant:	A listed company, which is a resident
Co-applicant 1:	A resident company that is a wholly-owned subsidiary of the applicant
Co-applicant 2:	A company that is not a resident that is a wholly-owned subsidiary of the applicant

4. Description of the proposed transaction

Co-applicant 2 is the holding company of some of the applicant's strategic foreign investments and all of the equity investments held by co-applicant 2 are held as long-term capital investments.

More than 18 months ago, co-applicant 2 entered into a cross-border merger by way of absorption. For South African tax purposes, the merger was implemented in terms of an amalgamation transaction as contemplated in section 44 and co-applicant 2 participated as the 'resultant company' in that merger.

Co-applicant 2 proposes to dispose of its equity investments in a number of its foreign held companies (target companies) to co-applicant 1.

The proposed steps to implement the transaction will be as follows:

a) Step 1: Co-applicant 1 and co-applicant 2 will enter into a purchase and sale agreement (the sale) in terms of which co-applicant 2 will dispose of its shares held in the target companies (target companies' shares) at market value to co-applicant 1 in terms of an "intra-group transaction" as defined in paragraph (*b*) of that definition in section 45(1). The consideration will remain outstanding on loan account (consideration loan).

b) Step 2: Co-applicant 2 will distribute out of its distributable reserves by way of an *in specie* distribution, all of its rights in the consideration loan to the applicant (*in specie* distribution).

c) Step 3: The applicant will subscribe for additional ordinary shares in co-applicant 1 for a subscription consideration equal to the consideration loan (subscription price).

d) Step 4: The applicant will demand repayment of the consideration loan from co-applicant 1.

e) Step 5: The applicant and co-applicant 1 will agree that the applicant's obligation to pay the subscription price will be set off against co-applicant 1's obligation to pay the consideration loan.

The salient terms of the sale will be as follows:

a) The effective date will be the last business day of the month in which all conditions precedent are fulfilled (effective date).

b) The consideration loan will be repayable on demand and carry interest at a market related rate.

c) Co-applicant 1 will acquire the target companies' shares as capital assets.

With respect to transaction steps 2 to 5 above, the following will apply:

a) The *in specie* distribution will be implemented immediately following the implementation of the agreement on the effective date (distribution date).

b) The *in specie* distribution will be implemented by way of a cession and assignment of rights arising out of the consideration loan by co-applicant 2 to the applicant. Co-Applicant 1 will owe the consideration loan to the applicant pursuant to the cession and assignment.

5. Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

a) Each of the ordinary shares of the applicant, co-applicant 1 and co-applicant 2 constitutes an "equity share" as defined in section 1(1).

b) Each of the ordinary shares of the target companies constitutes an "equity share" as defined in section 1(1) and the equity shares are held as capital assets by co-applicant 2.

c) The market values of the target companies' shares will exceed the base costs of those shares as at the effective date of the agreement.

d) The *in specie* distribution will be treated as a dividend for purposes of the tax and company laws of the jurisdiction of co-applicant 2 and the amount will not be deductible from taxable income by co-applicant 2.

6. Ruling

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

a) The disposal of the target companies' shares will constitute an "intra-group transaction" as envisaged in paragraph (*b*) of that definition in section 45(1) and co-applicant 1 and co-applicant 2 will qualify for the relief contemplated in section 45(2) because, amongst others, co-applicant 1 and co-applicant 2 form part of the same "group of companies" as contemplated in section 1(1).

b) Section 45(3A) will not apply to deem the consideration loan to have a base cost of Rnil in the hands of co-applicant 2 because co-applicant 2 does not form part of the same "group of companies" as co-applicant 1 as contemplated in section 41(1). The consideration loan will have a base cost equal to its face value on the effective date.

c) Section 44(5) will not apply to the disposal of the target companies' shares by co-applicant 2.

d) The distribution of the consideration loan by co-applicant 2 to the applicant will, under paragraph 75, result in co-applicant 2 being deemed to have disposed of the consideration loan to the applicant for expenditure equal to the market value of the loan and the applicant will be deemed to have

acquired the consideration loan for proceeds equal to the market value of the loan on the distribution date.

e) The *in specie* distribution will constitute a "foreign dividend" as defined in section 1(1), which will be exempt from tax in the applicant in terms of section 10B(2)(*a*).

f) The *in specie* distribution will not result in the application of section 45(4B) as the applicant and co-applicant 2 do not form part of the same "group of companies" as contemplated in section 41(1).

g) The subscription price payable by the applicant to co-applicant 1 for the issue of additional shares in co-applicant 1 will constitute "contributed tax capital" as defined in section 1(1) in co-applicant 1.

h) The subscription price payable by the applicant to co-applicant 1 will constitute expenditure actually incurred by the applicant for purposes of paragraph 20(1)(*a*).

i) Paragraph 12A will not apply to co-applicant 1 in relation to the set-off of the consideration loan against the subscription price as both companies are part of the same "group of companies" as contemplated in paragraph 12A(6)(*f*) and defined in paragraph 12A(1) read with section 41(1).

7. Period for which this ruling is valid

This binding private ruling is valid from 1 January 2018 for a period of three years.

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SOUTH AFRICAN REVENUE SERVICE