South African Revenue Service

BINDING PRIVATE RULING: BPR 317

DATE: 11 February 2019

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
VALUE-ADDED TAX ACT 89 OF 1991 (the VAT Act)

SECTION : SECTIONS 7B, 11(*a*) READ WITH 23(*g*) AND 42 OF THE ACT
SECTIONS 1(1) – DEFINITION OF "VENDOR", 8(25) AND 16(3) OF THE VAT ACT

SUBJECT : DISPOSAL OF BUSINESS BY WAY OF ASSET-FOR-SHARE TRANSACTION

Preamble

This binding private ruling is published by consent of the applicants to which it has been issued. It is binding as between SARS and the applicants only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the income tax and value-added tax (VAT) consequences of the disposal of a business by way of an "asset-for-share transaction" as envisaged in paragraph (*a*) of that definition in section 42(1).

2. Relevant tax laws

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 6 December 2018. 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 Act –
  - section 7B;
  - section 11(*a*) read with section 23(g); and
  - section 42.
- the VAT Act –
  - section 1(1) – definition of "vendor";
  - section 8(25); and
  - section 16(3).

3. Parties to the proposed transaction

The applicant:	A resident company that is a wholly-owned subsidiary of Company A
The co-applicant:	A resident company that is a wholly-owned subsidiary of the applicant
Company A:	A company that is not a resident

4. Description of the proposed transaction

The applicant's business involves the manufacturing, sales and marketing of products and its business can be divided into two categories namely business A and business B. The co-applicant is a newly incorporated company. Both the applicant and co-applicant are registered vendors.

The applicant proposes to dispose of business A to the co-applicant and business B will remain the property of the Applicant. The proposed steps for implementing the transaction are as follows:

- The applicant will dispose of assets and liabilities associated with business A at book value to the co-applicant as a going concern by way of an asset-for-share transaction as contemplated in section 42 of the Act. The liabilities that will be transferred will include contingent liabilities. The employees of the applicant employed in business A will be transferred to the co-applicant in accordance with section 197 of the Labour Relations Act 66 of 1995 and contracts and licences of the applicant will be assigned and ceded to the co-applicant.
- As consideration, the co-applicant will therefore assume liabilities associated with business A and issue equity shares to the applicant to the value of the net asset value of the business transferred.
- On the effective date of the transaction, the applicant and co-applicant will enter into a loan agreement in terms of which the applicant will lend money to the co-applicant which it will use for the commencement of its operations.
- Pursuant to the co-applicant issuing new shares to the applicant as part of the asset-for-share transaction, the co-applicant will remain a wholly-owned subsidiary of the applicant.

5. Conditions and assumptions

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

a) The requirements of section 11(*a*) read with section 23(*g*) and 7B of the Act (where applicable) must be met at the time when the contingent liabilities materialise.

b) For purposes of section 42(8)(*b*) of the Act, the liabilities that the applicant will transfer to the co-applicant are attributable to and arose in the ordinary course of the applicant's business undertaking.

6. Ruling

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

a) The disposal of business A by the applicant to the co-applicant in exchange for the assumption of liabilities of business A by the co-applicant and the issue of equity shares in the co-applicant will constitute an "asset-for-share transaction" as envisaged in paragraph (*a*) of that definition in section 42(1) of the Act.

b) The applicant and the co-applicant will qualify for the relief contemplated in sections 42(2), 42(3) and 42(3A) of the Act in respect of the assets of business A that will be disposed of as follows:

i) The applicant will, under section 42(2)(*a*)(i)(*aa*) of the Act, be deemed to have disposed of the –

aa) capital assets at their respective base costs determined under paragraph 20 on the date of disposal; and

bb) trading stock at the amount taken into account in respect of that trading stock as determined under section 11(*a*) or section 22(1) or (2) of the Act.

ii) For purposes of determining any capital gain or capital loss in respect of the disposal of the capital assets by the co-applicant, the applicant and the co-applicant will, under section 42(2)(*b*)(ii)(*aa*) of the Act, be deemed to be one and the same person with respect to –

aa) the dates of acquisition of the assets and the amounts and dates of incurral by the applicant of any expenditure in respect of the assets allowable under paragraph 20; and

bb) the valuation of the capital assets effected by the applicant within the period contemplated in paragraph 29(4).

iii) For purposes of determining any taxable income derived by the co-applicant from a trade carried on by it, the applicant and the co-applicant will be deemed to be one and the same person, under section 42(2)(*b*)(i)(*bb*) of the Act, with respect to the dates of acquisition of trading stock and the amounts and dates of incurral by the applicant of any cost or expenditure incurred in respect of the trading stock as contemplated in section 11(*a*) or 22(1) or (2) of the Act.

iv) Under section 42(3)(*a*)(i) of the Act, no allowance allowed to the applicant in respect of allowance assets must be recovered or recouped by the applicant or included in the applicant's income for the year of the transfer.

v) Under section 42(3)(*a*)(ii) of the Act, the applicant and the co-applicant will be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction –

aa) to which the co-applicant may be entitled in respect of the allowance assets; or

bb) that is to be recovered or recouped by or included in the income of the co-applicant.

vi) The applicant will, under section 42(2)(*a*)(ii) of the Act, be deemed to have acquired the equity shares in the co-applicant on the date that the applicant acquired –

aa) the capital assets and for a cost equal to any expenditure incurred by the applicant that is allowable under paragraph 20 and to have incurred such cost at the date of incurral by the applicant of such expenditure; and

bb) the trading stock and for a cost equal to the amount taken into account in respect of the trading stock under section 11(a) or 22(1) or (2) of the Act,

which cost will be treated as expenditure actually incurred and paid by the applicant in respect of the equity shares issued by the co-applicant for purposes of paragraph 20.

vii) Under section 42(2)(*c*) of the Act, any valuation of the capital assets effected by the applicant within the period contemplated in paragraph 29(4) will be deemed to have been effected in respect of the equity shares in the co-applicant acquired by way of the proposed asset-for-share transaction.

viii) Under section 42(3A) of the Act, the contributed tax capital amount received by or accrued to the co-applicant for the issue of shares to the applicant will be deemed to be equal to the –

aa) amount taken into account by the applicant in respect of the trading stock under section 11(*a*) or 22(1) or (2) of the Act; and

bb) base costs of the capital assets determined at the time of disposal in relation to the applicant.

No ruling is made on the allocation method to be used in determining the dates of acquisition or dates of incurral of expenditure in respect of the assets that will be transferred by the applicant to the co-applicant and no ruling is made on the allocation method to be used in determining the base costs of capital assets and costs in respect of trading stock in relation to equity shares to be issued by the co-applicant to the applicant as contemplated in section 42(2) of the Act.

c) Expenditure incurred in relation to the contingent liabilities transferred to the co-applicant will be deductible by the co-applicant when those liabilities materialise.

d) Subject to compliance with the provisions of section 42 of the Act, the applicant and co-applicant are, under section 8(25) of the VAT Act, deemed to be one and the same person in respect of the disposal of business A based on the fact that –

i) each of the applicant and co-applicant is a “vendor” as defined in section 1(1) of the VAT Act;

ii) business B is distinct with its own identifiable assets, employees, contracts, licences, etc, and is therefore capable of separate operation; and

iii) the applicant and the co-applicant have agreed in writing that business A is disposed of as a going concern for VAT purposes.

e) Notwithstanding that the applicant and the co-applicant may be deemed to be one and the same person under section 8(25) of the VAT Act (refer paragraph d) above), the applicant may, in terms of section 16(3), deduct any VAT incurred on goods or services acquired for purposes of the disposal of business A which qualify as “input tax” as defined under section 1(1) of the VAT Act. The deduction of “input tax” is subject to sections 16(2), 17(1), 17(2) and 20 of the VAT Act.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 6 December 2018.

Legal Counsel: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE