South African Revenue Service

BINDING PRIVATE RULING: BPR 360

DATE: 17 March 2021

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECURITIES TRANSFER TAX ACT 25 OF 2007 (STT Act)

SECTION : SECTIONS 1(1) – DEFINITION OF "CONTRIBUTED TAX CAPITAL" AND "GROSS INCOME", AND DEFINITION OF "GROUP OF COMPANIES" TOGETHER WITH THE DEFINITION OF THE SAME TERM IN SECTIONS 41(1), 24BA, 40CA, 42, 45, 55, 58 AND PARAGRAPHS 12A, 13(1)(*a*)(i), 20(1)(*a*), 32(3)(*a*), 35(1) AND 39 OF THE EIGHTH SCHEDULE TO THE ACT
SECTION 8(1)(*a*) OF THE STT ACT

SUBJECT : INTERNAL RESTRUCTURE FOLLOWED BY A DISPOSAL OF SHARES TO A BBBEE INVESTOR

Preamble

This binding private ruling is published with the consent of the applicant(s) to which it has been issued. It is binding between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the tax consequences of an internal restructure aimed at consolidating the operating entities involved in a particular type of business (the target business) under a single intermediate holding company (company G) (the internal restructuring), as well as the sale of a 25% interest in company G by the ultimate holding company (the applicant) to a third party B-BBEE investor (the investor) (the BEE transaction).

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 27 November 2020. 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 1(1) – definitions of "contributed tax capital", "gross income" and the definition of "group of companies" together with the definition of the same term in section 41(1);
  - section 24BA;
  - section 40CA;

- section 42;
- section 45;
- section 55;
- section 58;
- paragraph 12A;
- paragraph 13(1)(*a*)(i);
- paragraph 20(1)(*a*);
- paragraph 32(3)(*a*);
- paragraph 35(1); and
- paragraph 39.

- the STT Act –
  - section 8(1)(*a*)(i) read with section 8(1)(*a*)(iv)(*B*) and 8(1)(*a*)(iii).

3. Parties to the proposed transaction

The applicant:	A listed resident company
Company A:	A resident company that is a wholly-owned subsidiary of the applicant
Company B:	A resident company that is a wholly-owned subsidiary of Company A
Company C:	A resident company that is a wholly-owned subsidiary of the applicant before the proposed transaction
Company D:	A resident company that is a wholly-owned subsidiary of the applicant
Company E:	A resident company that is a wholly-owned subsidiary of the applicant
Company F:	A resident company that is a wholly-owned subsidiary of Company E
Company G:	A resident company that is a wholly-owned subsidiary of the applicant, formed to be the new intermediate holding company of the target business

4. Description of the proposed transaction

The applicant and all the co-applicants are South African resident companies. The applicant is listed on, amongst others, the JSE Limited and is the ultimate holding company of, amongst others, the co-applicants (collectively the group). The applicant directly holds the entire issued share capital of company A, company C, company D, company E and company G. Company A holds the entire issued share capital of company B, and company E holds the entire issued share capital of company F.

As part of its B-BBEE initiative, and to contribute to the realisation of its strategy to protect and enhance its commercial position, the applicant will sell a 25% interest in company G to the investor under the BEE transaction.

As a precursor to the BEE transaction the group will implement an internal restructuring (internal restructuring) to consolidate its target business under company C, an intermediate holding company, and under an ultimate intermediate holding company (company G).

Unrelated to the internal restructuring, the applicant will subscribe for additional shares in company C to enable the repayment of outstanding funding used for strategic acquisitions by company C (the C subscription). The C subscription will take place prior to the asset-for-share transaction (AFS transaction).

The internal restructuring is implemented in two phases. Phase I comprised various intra-group transactions, as envisaged in paragraph (*a*) of that definition in section 45(1), in terms of which wholly-owned subsidiaries (directly or indirectly) of the applicant sold and transferred equity shares held in subsidiary companies to wholly-owned subsidiaries (directly or indirectly) of the applicant at their market values.

Phase II will comprise an AFS transaction and an intra-group transaction (the B sale) at market value, with the consideration for the B sale remaining outstanding on loan account.

In terms of the AFS transaction the applicant will transfer its entire holding of shares in company C (the C disposal shares) to company G, in exchange for shares issued by company G, on a 1:1 basis, as envisaged in section 42. The C disposal shares will comprise existing shares in issue (C existing Shares) and new shares issued in consequence of the C subscription (new C shares). The effective date of the AFS transaction will occur after all approvals are obtained for the internal restructuring (the AFS effective date).

The market value of all but 1 of the C existing shares will be equal to or exceed their base costs on the AFS effective date. It is assumed for purposes of this ruling (see **5**) that the market values of the new C shares will be equal to or exceed their base costs on the AFS effective date. These shares are referred to as the qualifying C disposal shares.

The remaining C existing shares has a base cost which is expected to exceed the market value of this share on the AFS effective date. This share is referred to as the disqualified C existing share.

The shares to be issued by company G in exchange for the receipt of the qualifying C disposal shares are referred to as the qualifying G consideration shares. The single share to be issued by company G in exchange for the receipt of the disqualified C existing share is referred to as the disqualified G consideration share.

Following the implementation of the AFS transaction company A will sell all the issued shares in company B to company C at market value (the B sale). The purchase consideration will remain outstanding on loan account in favour of company A (the B consideration loan).

Under a set-off agreement to be entered into between company A and company C (set-off agreement), the B consideration loan in favour of company A will be set off against an existing loan owing by company C to company A in part settlement of the B consideration loan.

Following the implementation of the internal restructuring the applicant will sell 25% of the issued shares (the G disposal shares) in company G on a specific identification basis as envisaged in paragraph 32(3) to the investor. For purposes of the BEE transaction and the determination of the purchase price payable by the investor, a minority and liquidity discount was applied to the value of the target business. The BEE transaction will be subject to a number of conditions precedent, including the obtaining of regulatory approvals.

5. Conditions and assumptions

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

a) The intra-group transactions under phase I meet the requirements for the application of section 45.

b) The transaction steps occur in the order they were stated above.

c) On the AFS effective date the market value of each of the qualifying C disposal shares equals or exceeds its base cost.

d) On the AFS effective date the market value of the disqualified C existing share does not exceed its base cost.

6. Ruling

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

a) The applicant and the co-applicants form part of the same group of companies as defined in section 1(1) and section 41(1).

b) The applicant's subscription for the new C shares will not have any immediate tax consequences for the applicant or company C. These shares will have contributed tax capital as defined in section 1(1) attributable to them equal to the subscription price. The subscription price paid by the applicant for these shares will constitute expenditure actually incurred by the applicant for purposes of paragraph 20(1)(*a*).

c) The disposal of the qualifying C disposal shares in exchange for the issue of the qualifying G consideration shares on a 1:1 basis will constitute an AFS transaction as defined in paragraph (*a*) of that definition in section 42(1).

d) Under section 42(2) the applicant –

- will be deemed to have disposed of the qualifying C disposal shares for an amount equal to the base cost of these shares on the AFS effective date in accordance with section 42(2)(*a*)(i)(*aa*);
- will be deemed to have acquired the qualifying G consideration shares for a cost equal to the expenditure in respect of the qualifying C disposal shares actually incurred by the applicant that is allowable

under paragraph 20 and on the date on which the expenditure will be incurred. These costs must be treated as expenditure actually incurred and paid by the applicant in respect of the qualifying G consideration shares for purposes of paragraph 20, in accordance with sections 42(2)(*a*)(ii)(*aa*) and 42(2)(*a*)(ii)(*A*); and

- the applicant and company G, in accordance with section 42(2)(*b*)(ii), must for the purposes of determining any capital gain or capital loss in respect of the disposal of the qualifying C disposal shares be deemed to be one and the same person with respect to:
  - the date of acquisition of the qualifying C disposal shares by the applicant and the amount and date of incurral by the applicant of any expenditure in respect of these shares allowable under paragraph 20; and
  - the market value determined by the applicant in respect of the qualifying C disposal shares as contemplated in paragraph 29(4).

e) Section 24BA would not find application in the context of the AFS transaction.

f) Under section 40CA company G will be deemed to have acquired the disqualified C existing share for expenditure equal to the market value of the disqualified G consideration share immediately after the implementation of the AFS transaction. The applicant will be treated as having:
   - disposed of the disqualified C existing share for proceeds equal to the value of the consideration received by the applicant, being the market value of the disqualified G consideration share received by the applicant, which will result in a ring-fenced capital loss for the applicant in accordance with paragraph 39; and
   - acquired the disqualified G consideration share for expenditure equal to the market value of the disqualified C existing share, being the value by which the applicant's assets diminished. That value will be expenditure incurred by the applicant for purposes of paragraph 20(1)(*a*).

g) The transfer of the C disposal shares (which includes the disqualified C existing share) pursuant to the AFS transaction will be exempt from securities transfer tax in accordance with section 8(1)(*a*)(i) read with section 8(1)(*a*)(iv)(*B*) of the STT Act and provided that the required sworn affidavit or solemn declaration is made by the public officer of company G.

h) The B sale will constitute an intra-group transaction as envisaged in section 45(1)(*a*) and section 45(2) will apply, so that:
   - company A will be deemed to have disposed of the shares in company B (B sale shares) for an amount equal to the base cost thereof as at the B sale date; and
   - for purposes of the determination of any capital gain or capital loss resulting from the disposal of the B sale shares by company C,

company A and company C must be deemed to be one and the same person with respect to:

- the date of acquisition of the B sale shares, the amount and date of incurral of any expenditure allowable under paragraph 20 by company A; and
- any valuation of the B sale shares effected by company A as contemplated in paragraph 29(4).

i) Company A will be deemed to have acquired the B consideration loan for expenditure of nil pursuant to section 45(3A)(*b*)(i).

j) Section 45(6) will not apply to the B sale.

k) The transfer of the B sale shares pursuant to the B sale will be exempt from securities transfer tax by virtue of the provisions of section 8(1)(*a*)(iii) of the STT Act, provided that the required sworn affidavit or solemn declaration is made by the public officer of company C.

l) Paragraph 12A will not find application pursuant to the implementation of the set-off agreement.

m) Section 45(3A)(*c*) will find application and the amounts accrued to company A and company C pursuant to the set-off agreement will be disregarded and will not result in any capital gain or other taxable income in the hands of company A or company C.

n) The proceeds from the sale of the G disposal shares by the applicant to the investor will not be of a revenue nature and will not fall within the applicant's "gross income".

o) The base cost of the G disposal shares will be determined in accordance with the specific identification method as envisaged in paragraph 32(3)(*a*) and will comprise the expenditure actually incurred by the applicant for the acquisition of these specific shares. The first-in-first-out mandatory method as envisaged in section 9C(6) is merely for the purpose of applying section 9C and does not affect the identification method adopted by the applicant for determining the base cost of the G disposal shares.

p) The purchase price payable by the investor will constitute "proceeds" in the hands of the applicant, as envisaged in paragraph 35(1).

q) The applicant will be treated as having disposed of the G disposal shares on the date on which all the suspensive conditions for the disposal transaction are fulfilled as per the provisions of paragraph 13(1)(*a*)(i).

r) The discount applied for purposes of the determination of the pricing of the BEE transaction will not constitute a "donation" as envisaged in section 55.

s) It would not be an appropriate case for the Commissioner to exercise the discretion under section 58 to conclude that the pricing of the BEE transaction does not constitute adequate consideration under the circumstances.

t) Section 45(4)(*b*) will not find application pursuant to the BEE transaction, the AFS transaction or the B sale.

7. Period for which this ruling is valid

This binding private ruling is valid in respect of the year of assessment ending 31 December 2020.

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