

BINDING PRIVATE RULING: BPR 193

DATE: 15 June 2015

Legislative changes to section 19 and paragraph 12A of the Eighth Schedule should be noted. Policy guidance is provided in IN 91.

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTION 19 SPECIFICALLY INCLUDING THE DEFINITION OF 'REDUCTION AMOUNT' AND PARAGRAPHS 12A AND 20(3)(b) OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : DEBT REDUCTION BY WAY OF SET-OFF

1. Summary

This ruling deals with the repayment of shareholder loans by way of set-off. The loan outstanding from the subscription of a new issue of ordinary shares will be used to set-off against the amount outstanding under the shareholders loans.

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 Act and paragraphs of the Eighth Schedule thereto applicable as at 3 March 2015, and 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 the provisions of –

- section 19; and
- paragraphs 12A and 20(3)(b).

3. Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

Foreign holding company: The holding company of the Applicant which is a resident of a foreign country

4. Description of the proposed transaction

The Foreign holding company provided loan funding to the Applicant which amount includes capital and interest and remains owing to it (the shareholder loan).

The shareholder loan was used to fund the acquisition of fixed property, erect improvements, acquire operating equipment and finance deductible expenditure (in other words, for working capital purposes or to fund the acquisition of assets for which allowances can be claimed).

The Applicant's current cash flow is insufficient to enable it to operate effectively and to pay interest on the loan. Furthermore, it is evident that the loan will fall foul of the South African thin capitalisation provisions and consequently not all interest due and payable will qualify for a tax deduction.

The balance sheet of the Applicant can also impair the company's ability to obtain credit for working capital requirements.

In order for the loan to be repaid or reduced, the following transaction steps are proposed:

Step 1

The Foreign holding company will demand repayment of a portion of the capital of the shareholder loan and payment of arrear interest owed by the Applicant.

Step 2

The Foreign holding company will then subscribe for 1 ordinary share with a par value of ZAR1 to be issued at a premium in terms of a subscription agreement to be entered into with the Applicant. The value of the share will be equal to the portion of the debt (capital and interest) that is due to be settled by the Applicant. The subscription amount will remain outstanding on loan account (subscription loan).

Step 3

Upon the subscription agreement becoming unconditional, the amounts of the corresponding loan accounts (shareholder loan and subscription loan) will be duly set-off.

Step 4

The Applicant will issue the 1 share to the Foreign holding company. The portion of the loan not settled will remain outstanding.

5. Conditions and assumptions

This ruling is subject to the additional condition and assumption that the transaction will be concluded within one year after the effective date of this ruling.

6. Ruling

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

The proposed subscription for 1 share in the Applicant by the Foreign holding company and subsequent settlement of the corresponding loan accounts between the parties will not fall foul of the following provisions of the Act –

- section 19;
- paragraph 12A of the Eighth Schedule; and

- paragraph 20(3)(b) of the Eighth Schedule.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 1 year from 3 March 2015.

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**