South African Revenue Service

INTERPRETATION NOTE 123

DATE: 26 September 2022

ACT : INCOME TAX ACT 58 OF 1962

SECTION : SECTION 8E

SUBJECT : EFFECT ON THE DATE OF ISSUE OF A SHARE ARISING FROM A CHANGE IN THE REDEMPTION FEATURES

Preamble

In this Note unless the context indicates otherwise –

- **"section"** means a section of the Act;
- **"share"** means in relation to any company, any unit into which the proprietary interest in that company is divided;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note considers whether adding redemption features or making a change to the existing redemption features of a share constitutes a new date of issue for purposes of section 8E.

2. Background

The Act has a number of anti-avoidance provisions aimed at preventing the use of an instrument with a legal form different from its substance with the aim of achieving a favourable tax position, for example, where shares are used to facilitate what is in substance a loan. Section 8E is one such provision that targets shares and equity instruments[1] with substantial debt features. The treatment of these shares as hybrid financial instruments ensures that debt is not disguised as short-term redeemable preference shares or any other redeemable share containing certain dividend preferences.[2]

Section 8E deems a dividend or foreign dividend on a hybrid equity instrument (see **4.1**) to be an amount of income accrued to the recipient and will not be exempt from normal tax. The payer is also not offered a deduction for the payment of affected dividends or foreign dividends.

[1] See definition in section 8E(1).

[2] Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004.

The date of issue[3] is important to determine whether a share qualifies as a hybrid equity instrument because that is the date from which the three-year period[4] within which the presence of certain redemption rights or obligations for purposes of section 8E must be assessed.

Section 8E covers not only the date of original issue of a share, but also where redemption features are added or changed after the original issue of the share. The potential classification of a share as a hybrid equity instrument must be re-assessed whenever an event occurs that falls within the definition of "date of issue".

The critical question as to when a variation of the redemption features of a share will result in a new date of issue under section 8E is considered in this Note.

3. The law

Section 8E is quoted in the Annexure.

4. Application of the law

The various definitions in section 8E are fundamental to the application of the section. For purposes of this Note the focus is limited to the definition of "hybrid equity instrument" and "date of issue".

4.1 Hybrid equity instrument

The definition of "hybrid equity instrument" is quite wide in order to cover any type of share that could be disguised as debt. The definition identifies five different types of instruments.

The first type of instrument deals with redeemable preference shares with the following criteria:

- any share that is not an equity share[5], if
- the issuer of that share is under an obligation to redeem that share in whole or in part or to distribute an amount constituting a return of the issue price of that share in whole or in part; or
- the holder of that share may exercise an option under which the issuer must redeem that share in whole or in part or distribute an amount constituting a return of the issue price of that share in whole or in part,

within a period of three years from the **date of issue** (see **4.2**).

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[3] See definition in section 8E(1).

[4] See definition of "hybrid equity instrument" in section 8E(1).

[5] The term "equity share" is defined in section 1 as any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in distribution.

The second type of instrument deals with shares other than redeemable shares with the following criteria:

- the issuer of that share is obliged to redeem that share or to distribute an amount constituting a return of the issue price of that share (in whole or in part) within a period of three years from the **date of issue** (see **4.2**);
- the holder of that share may exercise an option in terms of which the issuer must redeem that share or distribute an amount constituting a return of the issue price of that share (in whole or in part) within a period of three years from the date of issue; or
- at any time on the date of issue of that share, the existence of the company issuing that share is to be terminated within a period of three years; or is likely to be terminated within a period of three years upon a reasonable consideration of all the facts at that time; and
- such share does not rank *pari passu* in the participation of dividends or foreign dividends with all other equity shares in the capital of the relevant company or with the equity shares of at least one of such classes; or
- any dividend or foreign dividend payable on such share is to be calculated directly or indirectly with reference to any specified rate of interest or the time value of money.

The third type of instrument deals with any preference share:[6]

- if that share is secured by a financial instrument or is subject to an arrangement in terms of which a financial instrument may not be disposed of;

unless that share was issued for a qualifying purpose.[7]

The fourth type of equity instrument is one the value of which is determined directly or indirectly with reference to:

- a share dealt with in the first and second types above;
- a preference share dealt with in the third type above; or
- an amount derived from these shares or preference shares.

The fifth type is an equity instrument (but not of the fourth type) if:

- that equity instrument is subject to a right or arrangement that would have constituted a right or security arrangement contemplated under the first three types had that right or arrangement applied to the share with reference to which the value of that equity instrument is directly or indirectly determined.

Arrangements that would have qualified as hybrid equity instruments had the prescribed period under section 8E been 10 years are listed as reportable arrangements in the public notice[8] issued under section 35(2) of the Tax Administration Act 28 of 2011.

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[6] The term “preference share” means a preference share as defined in section 8EA(1).
[7] The term “qualifying purpose” means a qualifying purpose as defined in section 8EA(1).
[8] Government Notice 140 in *Government Gazette* 39650 of 3 February 2016.

4.2 Date of issue

The "date of issue" of a share in a company is important to determine whether it qualifies as a hybrid equity instrument (see **4.1**). The date upon which the right of acquisition of the share arises is irrelevant. The "date of issue" as defined is the date from which the three-year period within which the presence of certain redemption rights or obligations is determined.

The "date of issue" in relation to a share in a company means the date on which –

- the share is issued by the company;
- the company at any time after the share has been issued, undertakes the obligation to redeem that share in whole or in part; or
- the holder of the share at any time after the share has been issued, obtains the right to require that share to be redeemed in whole or in part, otherwise than as a result of its acquisition by that holder.

The board of a company may resolve to issue shares of the company at any time under section 38 of the Companies Act[9], but only within the classes and to the extent that the shares have been authorised by or in terms of the company's memorandum of incorporation in accordance with section 36 of the Companies Act. A company issues a share only once. After that a shareholder may sell the share to another person on the secondary market. The original date of issue is thus fixed.

The "date of issue" of a hybrid equity instrument includes not only the actual date of issue, but also the date a holder acquires the right to require the instrument to be redeemed, or the date that the issuer undertakes an obligation to redeem the instrument. Section 8E thus covers those shares that do not initially provide for redemption by the issuer or the holder at issue but after their issue by the subsequent undertaking by the issuer to redeem or acquisition by the holder to require redemption within a period of three years.

The classification of a share as a hybrid equity instrument must be considered whenever an event occurs that establishes a date of issue.

4.3 Change in redemption features

The terms of issue and redemption of a share determine whether the company is under an unconditional obligation to redeem the share in whole or in part or whether the holder of the share has acquired the right to claim redemption of the share in whole or in part as envisaged under section 8E.

Any redemption after three years from the date of issue, for example three years and one day, will result in the share not being regarded as a hybrid equity instrument. Although a share may not be regarded as a hybrid equity instrument at the date of issue, it may become such after redemption features have been added or changed. It is important to note that not all additions or changes to the redemption features of a share subsequent to the original issue of the share will result in it becoming a hybrid equity instrument. The date and terms of the agreement relating to the redemption features and the redemption date are critical in determining whether a share becomes a hybrid equity instrument.

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[9] The Companies Act 71 of 2008.

In a case where the obligation to redeem the share or right to claim redemption did not exist at the original issue of the share, the share will not be a hybrid equity instrument. If the obligation to redeem or right to claim redemption of the share is subsequently introduced, but the redemption date falls outside the period of three years as envisaged under section 8E, the share will still not become a hybrid equity instrument.

Example 1 – Non-redeemable shares become redeemable shares

Facts:

A preference share is issued on 1 January Year 1 without the obligation or right to redeem it. The obligation or right to redeem is introduced on 1 January Year 3 with a redemption date of 30 June Year 6.

Result:

The share became redeemable on 1 January Year 3. Under the definition of "date of issue" the date of issue of the shares is the date on which the company issuing the share undertakes the obligation to redeem it. The "date of issue" is therefore 1 January Year 3. The share is not subject to section 8E because the redemption date of 30 June Year 6 is outside the three-year period from the date of issue.

The above situation can be distinguished from the scenario where the obligation to redeem or right to redemption of the share did not exist at the original issue of the share, but the obligation or right to redeem the share within a period of three years is introduced subsequently. In such a case the share will become a hybrid equity instrument.

Example 2 – Non-redeemable shares become redeemable shares within 3 years

Facts:

A preference share is issued on 1 January Year 1 without the obligation or right to redeem it. The obligation or right to redeem is introduced on 1 January Year 2 with a redemption date of 31 December Year 3.

Result:

The share became redeemable on 1 January Year 2. Under the definition of "date of issue" the date of issue of the shares is the date on which the company issuing the share undertakes the obligation to redeem it. The "date of issue" is therefore 1 January Year 2. The share will become subject to section 8E from that date because the redemption date is within the three-year period from the new date of issue.

Redeemable preference shares that are issued with a redemption date which falls outside the three-year period, that is, redemption occurs after three years, are not subject to section 8E. The original redemption date falling outside the three-year period may, subsequent to the original date of issue of the share and before the scheduled redemption date, be extended. Although the new extended redemption date may fall within a three-year period after the date on which it was decided to extend the original redemption date, it does not change the share to a hybrid equity instrument because the extended redemption date is more than three years from the original date of issue.

The extended redemption date simply moves the original redemption date that is already outside the three-year period further into the future.

Example 3 – Change in redemption date of a redeemable preference share

Facts:

A redeemable preference share is issued on 1 January Year 1 with a redemption date of 30 June Year 4. This share is not subject to section 8E because the redemption date is outside the three-year period after the date of issue. Due to the company's financial position, the redemption date is extended on 31 January Year 4 to 31 December Year 4.

Result:

The extension of the original redemption date will, despite the new redemption date being within three years from the original redemption date, not make the share subject to section 8E because the extended redemption date is more than three years from the original date of issue. The original redemption date that is already outside the three-year period is simply moved further into the future.

Redeemable preference shares that are issued with a redemption date which falls outside the three-year period and subsequently altered to fall within the three-year period would result in those shares qualifying as a hybrid-equity share under section 8E as it becomes redeemable within a period of three years from the original date of issue. Contrary to the case where the redemption date is extended further into the future, bringing the new redemption date forward within a three-year period from the original date of issue will result in the share becoming a hybrid-equity share subject to section 8E.

Example 4 – Change in redemption dates of a redeemable preference share from outside the 3-year period to within the 3-year period

Facts:

A redeemable preference share is issued on 1 January Year 1 with a redemption date of 30 June Year 4. This share is not subject to section 8E because the redemption date is outside the three-year period after issue of the share. On 31 January Year 3 the redemption date is brought forward to 31 December Year 3.

Result:

On the original date of issue the share is not subject to section 8E because the redemption date falls outside the three-year period. However, upon changing the redemption date to 31 December Year 3, the new redemption date is brought within the three years from the original date of issue. The new redemption date will result in the share being subject to section 8E as it falls within the three-year period from the original date of issue.

5. Conclusion

Section 8E is an anti-avoidance provision preventing the use of shares to facilitate what is in substance a loan. The section applies to hybrid equity instruments as defined.

Section 8E also covers shares where redemption features are added or changed after the original date of issue of the share. A share which does not originally qualify as a hybrid equity instrument on date of issue will qualify as such when a change in the redemption feature is effected which brings it into the ambit of the definition. The "date of issue" of a share in a company is important in determining whether it qualifies as a hybrid equity instrument.

Not all additions or changes to the redemption features of a share will result in it becoming a hybrid equity instrument. The date and terms of the agreement and date of redemption are critical in this regard.

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Annexure – The Law

Section 8E

8E. Dividends derived from certain shares and equity instruments deemed to be income in relation to recipients thereof.—(1) For the purposes of this section—

"date of issue", in relation to a share in a company, means the date on which—

(*a*) the share is issued by the company;

(*b*) the company at any time after the share has been issued undertakes the obligation to redeem that share in whole or in part; or

(*c*) the holder of the share at any time after the share has been issued obtains the right to require that share to be redeemed in whole or in part, otherwise than as a result of the acquisition of that share by that holder;

"equity instrument" means any right or interest the value of which is determined directly or indirectly with reference to—

(*a*) a share; or

(*b*) an amount derived from a share;

"financial instrument" means any—

(*a*) interest-bearing arrangement; or

(*b*) financial arrangement based on or determined with reference to a specified rate of interest or the time value of money;

"hybrid equity instrument" means—

(*a*) any share, other than an equity share, if—

(i) the issuer of that share is obliged to redeem that share or to distribute an amount constituting a return of the issue price of that share (in whole or in part); or

(ii) the holder of that share may exercise an option in terms of which the issuer must redeem that share or distribute an amount constituting a return of the issue price of that share (in whole or in part),

within a period of three years from the date of issue of that share;

(*b*) any share, other than a share contemplated in paragraph (*a*), if—

(i) (*aa*) the issuer of that share is obliged to redeem that share or to distribute an amount constituting a return of the issue price of that share (in whole or in part) within a period of three years from the date of issue of that share;

(*bb*) the holder of that share may exercise an option in terms of which the issuer must redeem that share or distribute an amount constituting a return of the issue price of that share (in whole or in part) within a period of three years from the date of issue of that share; or

(*cc*) at any time on the date of issue of that share, the existence of the company issuing that share—

(A) is to be terminated within a period of three years; or

(B) is likely to be terminated within a period of three years upon a reasonable consideration of all the facts at that time; and

(ii) (*aa*) that share does not rank *pari passu* as regards its participation in dividends or foreign dividends with all other equity shares in the capital of the relevant company or, where the equity shares in such company are divided into two or more classes, with the shares of at least one of such classes; or

(*bb*) any dividend or foreign dividend payable on such share is to be calculated directly or indirectly with reference to any specified rate of interest or the time value of money;

(*c*) any preference share if that share is—

(i) secured by a financial instrument; or

(ii) subject to an arrangement in terms of which a financial instrument may not be disposed of,

unless that share was issued for a qualifying purpose;

(*d*) any equity instrument the value of which is determined directly or indirectly with reference to—

(i) a share contemplated in paragraph (*a*) or (*b*) or a preference share contemplated in paragraph (*c*); or

(ii) an amount derived from a share or preference share contemplated in subparagraph (i); or

(*e*) any equity instrument, other than an equity instrument contemplated in paragraph (*d*), if that equity instrument is subject to a right or arrangement that would have constituted a right or security arrangement contemplated in paragraph (*a*), (*b*) or (*c*) had that right or arrangement applied in respect of the share with reference to which the value of that equity instrument is directly or indirectly determined;

"issue price" in relation to a share in a company means the amount that was received by or that accrued to that company in respect of the issue of that share;

"preference share" means a preference share as defined in section 8EA (1);

"qualifying purpose" means a qualifying purpose as defined in section 8EA (1).

(2) Any dividend or foreign dividend received by or accrued to a person during any year of assessment in respect of a share or equity instrument must be deemed in relation to that person to be an amount of income accrued to that person if that share or equity instrument constitutes a hybrid equity instrument at any time during that year of assessment.

(2A) Where any share or preference share that was issued in terms of an agreement, all the terms of which were finally agreed to before 1 April 2012 by all the parties to that agreement, constitutes a hybrid equity instrument solely by reason of a right of redemption or a security arrangement acquired in accordance with the terms of that agreement and that right or arrangement is cancelled on or after 26 October 2016 and on or before 31 December 2017—

(*a*) the provisions of subsection (2) will not apply in respect of any dividend or foreign dividend that accrues in respect of that share after the date of cancellation of that right or arrangement; and

(*b*) the cancellation of that right or arrangement must not be treated as a disposal of that share if no consideration is payable in respect of that cancellation.

Section 8EA(1)

8EA. Dividends on third-party backed shares deemed to be income in relation to recipients thereof.—(1) For the purposes of this section—

"preference share" means any share—

(*a*) other than an equity share; or

(*b*) that is an equity share, if an amount of any dividend or foreign dividend in respect of that share is based on or determined with reference to a specified rate of interest or the time value of money;

"qualifying purpose", in relation to the application of the funds derived from the issue of a preference share, means one or more of the following purposes:

(*a*) The direct or indirect acquisition of an equity share by any person in a company that is an operating company at the time of the receipt or accrual of any dividend or foreign dividend in respect of that preference share, other than a direct or indirect acquisition of an equity share from a company that, immediately before that acquisition, formed part of the same group of companies as the person acquiring that equity share;

(*b*) the partial or full settlement by any person of any—

(i) debt incurred for one or more of the following purposes:

(*aa*) The direct or indirect acquisition of an equity share by any person in a company that is an operating company at the time of the receipt or accrual of any dividend or foreign dividend in respect of that preference share, other than a direct or indirect acquisition of an equity share from a company that, immediately before that acquisition, formed part of the same group of companies as the person acquiring that equity share;

(*bb*) a direct or indirect acquisition or a redemption contemplated in paragraph (*c*);

(*cc*) the payment of any dividend or foreign dividend as contemplated in paragraph (*d*); or

(*dd*) the partial or full settlement, directly or indirectly, of any debt incurred as contemplated in item (aa), (bb) or (cc); or

(ii) interest accrued on any debt contemplated in subparagraph (i);

(*c*) the direct or indirect acquisition by any person or a redemption by any person of any other preference share if—

(i) that other preference share was issued for any purpose contemplated in this definition; and

(ii) the amount received by or accrued to the issuer of that preference share as consideration for the issue of that preference share does not exceed the amount outstanding in respect of that other preference share being acquired or redeemed, being the sum of—

(*aa*) that amount; and

(*bb*) any amount of dividends, foreign dividends or interest accrued in respect of that other preference share; or

(*d*) the payment by any person of any dividend or foreign dividend in respect of the other preference share contemplated in paragraph (*c*);