

BINDING PRIVATE RULING: BPR 405

DATE: 30 July 2024

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 8EA(1),(2) AND (3), 8FA(1) AND (2), 10(1)(k), 24J(1) DEFINITION OF "INTEREST" AND 64F
SUBJECT : THIRD-PARTY BACKED SHARES AND HYBRID INTEREST

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 whether cumulative redeemable preference shares (preference shares) will be issued for a qualifying purpose and whether they will constitute third-party back shares. The funds raised from the issue of the preference shares will be advanced as a loan and the ruling determines whether the return received in respect of the loan will be regarded as hybrid interest.

2. Relevant tax laws

In this ruling references to sections are to sections of the Act applicable as at 20 March 2024. 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 8EA(1), (2) and (3);
- section 8FA(1) and (2);
- section 10(1)(k);
- section 24J(1) - definition of "interest"; and
- section 64F.

3. Parties to the proposed transaction

The Applicant: A listed resident company

The Co-Applicant: A resident company that is a wholly-owned subsidiary of the Applicant and the issuer of the preference shares

The Target: A non-resident operating company

4. Description of the proposed transaction

The Applicant purchased equity shares (the Target Shares) in an operating company. The purchase price together with additional fees relating to their acquisition was funded with debt.

In order to settle the debt incurred to acquire the Target Shares, the Co-Applicant will issue preference shares to the preference shareholders. The preference shareholders will be entitled to preferred dividends calculated at an agreed rate, on the respective issue prices of the preference shares and will be payable at agreed intervals. The preference shares will be redeemable more than three years after their issue date. The Applicant or a wholly-owned subsidiary will guarantee the Co-Applicant's obligations (both actual and contingent) under the preference shares.

The Co-Applicant will lend the funds derived from the issue of the preference shares to the Applicant who will, in turn, apply the funds to settle the debt incurred by it to acquire the Target Shares.

The loan made by the Co-Applicant to the Applicant will accrue interest from time to time in an amount equal to the dividends actually paid to the Applicant by the Target in respect of the Target Shares.

The Applicant will be expected to make capital repayments on the loan equal to the redemption price of the preference shares which would be required to be redeemed by the Co-Applicant on the respective redemption dates of the preference shares.

5. Conditions and assumptions

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

- a) Dividends paid by the Target are not determined with reference to an interest rate or the time value of money.
- b) The debt incurred by the Applicant was used solely for the purpose of acquiring the Target shares (which includes the additional fees relating to their acquisition).

6. Ruling

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

- a) The interest payable by the Applicant to the Co-Applicant will constitute "hybrid interest" as defined in section 8FA(1).
- b) In terms of section 8FA(2), the interest will be deemed to be a dividend *in specie* and must be treated as a dividend *in specie* for normal and dividends tax purposes.
- c) Since the proceeds of the issue of the preference shares will be applied by the Applicant to settle debt incurred by it to acquire the Target Shares, the preference shares will be issued (by the Co-Applicant) for a "qualifying purpose" as defined in section 8EA, provided that the Target is an operating company at the time of the receipt or accrual of any dividend in respect of those preference shares.

- d) Although the preference shares will be subject to an enforcement right in the form of a guarantee issued by the Applicant or a wholly owned subsidiary, section 8EA(3) will apply and the enforcement right exercisable against the Applicant must accordingly be disregarded in determining whether the preference shares are third party backed shares.
- e) On the issue date of this ruling, the preference shares will not constitute third-party backed shares, as defined in section 8EA.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of seven years.

**Leveraged Legal Products: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**