

BINDING PRIVATE RULING: BPR 410

DATE: 11 September 2024

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTION 9H(3)(b) AND (5) AND PARAGRAPH 64B OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : DISPOSAL BY A CONTROLLED FOREIGN COMPANY OF EQUITY SHARES IN A FOREIGN COMPANY

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 income tax and capital gains tax consequences on the disposal by a controlled foreign company (CFC) of an investment in a foreign company.

2. Relevant tax laws

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 12 June 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 9H(3)(b) and (5); and
- paragraph 64B.

3. Parties to the proposed transaction

The Applicant: A company incorporated outside South Africa (SA) but a resident of South Africa

Company A: A CFC (as defined in section 9D(1)) of the Applicant

Company B: A foreign company

4. Description of the proposed transaction

Company A holds 50.1% of the issued shares in Company B, a widely held corporation. The other shareholders of Company B are all third parties in relation to Company A. The participation of Company A in the shares in Company B is not

limited to a specified amount in respect of dividends or capital. In consequence the shares held by Company A in Company B are regarded as “equity shares” as defined in section 1(1). No value of any assets of Company B is attributable to assets directly or indirectly located, issued or registered in SA. Consequently, the shares held by Company A in Company B also do not constitute an interest contemplated in paragraph 2(2).

The Applicant’s group will dispose of its interest in Company B. It is envisaged that Company A (and the third-party shareholders) will dispose of their shares in Company B to a third-party purchaser (the Purchaser) in return for a combination of cash and shares.

The Purchaser holds 100% of the shares in Merger Sub 1 and Merger Sub 2. These entities are incorporated to facilitate the proposed transaction. The Purchaser, Merger Sub 1 and Merger Sub 2 are not SA residents. They are also not CFCs or “connected persons” in relation to Company A or any other entity in the Applicant’s group. Neither the Purchaser, nor Merger Sub 1, nor Merger Sub 2 formed part of the same group of companies as Company A at any time during a period of 18 months prior to the proposed transaction.

The proposed transaction will be structured as a merger governed by the foreign law applicable in the jurisdiction of the Purchaser. In this regard, even though the disposal of shares in a private company may in principle also be structured as a simple sale and purchase of shares, it is the norm in that jurisdiction to use the merger construct when the target company has many dispersed shareholders, as is the case of Company B.

In particular, structuring the transaction as a merger provides the buyer with certainty that the buyer is acquiring 100% of the issued shares in the target company. A sale-and-purchase structure does not provide this certainty, as the buyer will never know whether or not all of the outstanding shares of the target company would actually be acquired. In the foreign jurisdiction the merger may be completed with just the approval of a majority of the shareholders of Company B, much like a scheme of arrangement in South Africa. In contrast, a share purchase requires each and every shareholder to agree to the terms of the transaction and sign a purchase agreement. Therefore, unlike a merger, a single shareholder of Company B could functionally block the entire transaction by refusing to sell its shares. Further, even if all shareholders wanted to participate in the sale transaction, the logistics required to identify and contact everyone (and the risk that some will inadvertently be missed) make simple share purchases functionally impossible if there are a large number of shareholders, as is the case with Company B. In these circumstances, a merger is the only realistic option.

Company B has more than 50 shareholders, which may be grouped into 18 distinct corporate groups. Negotiating a share purchase agreement with 18 different parties would impose significantly greater transaction costs as compared to a merger, and even render it impossible if one of the 18 parties opposed the transaction. Of the 18 shareholder groups, Company A holds 50.1% of the voting power. An additional 38.5% of the total voting power is held by five groups, all of whom have signed voting and support agreements committing to support the transaction with the Purchaser. Thus, these six parties are able to approve the merger, acting alone. This is a significant advantage, as the Purchaser can acquire 100% of Company B without the risk of minority shareholders blocking the transaction.

Under the merger construct, the mechanics of the transaction are broken down into separate sub-steps and are set out below. Note that all the steps happen sequentially on the same day and are interdependent.

- **Step 1 – The First Merger:** Merger Sub 1 will merge with Company B. Company B will be the surviving company and Merger Sub 1's existence will be terminated automatically. The Company B shares held by Company A and the third parties will be cancelled by Company B following their conversion in the hands of Company A to the right to receive the per share merger consideration (being a combination of cash and shares to be issued by The Purchaser to Company A and the third parties). Consequently, Company B will become a wholly-owned subsidiary of the Purchaser.
- **Step 2 – The Second Merger:** Company B will merge with Merger Sub 2, with Merger Sub 2 being the surviving company and Company B's existence automatically terminated.
- **Step 3 – Payment of Consideration:** The Purchaser will pay the per share merger consideration to Company A and the third parties (in the form of cash and shares in the Purchaser).

The result is that the Purchaser will hold all the shares in Merger Sub 2, which is the surviving entity encompassing the Company B business. In addition to the cash consideration, Company A will hold less than 10% of the issued shares in the Purchaser, with the third party investors in Company B and the original shareholders of the Purchaser holding the balance. Company B (and its subsidiaries) will therefore cease to be CFCs in relation to the Applicant. The rights held by the Purchaser comprising the Merger Sub 2 shares after the implementation of the proposed transaction will be identical to the rights held by Company A comprising the Company B shares prior to the proposed transaction.

5. Conditions and assumptions

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

- a) Company A's portion of the per share merger consideration will equal or exceed the market value of Company A's 50.1% shareholding in Company B; and
- b) Company A has held at least 10% of the shares and voting rights in Company B for a period of 18 months or longer and will continue to do so until the proposed transaction is implemented.

6. Ruling

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

- a) Company A will be regarded as having disposed of its shares in Company B "to" the Purchaser for purposes of paragraph 64B(1)(b);
- b) Immediately after the proposed transaction, the shareholders of the Purchaser and any company in Company A's group of companies are not "substantially the same" for purposes of paragraph 64B(1)(b)(iii);

- c) The participation exemption in paragraph 64B(1) will apply to the Company A's envisaged disposal of its shares held in Company B to the Purchaser, resulting in any capital gain (or capital loss) arising from the disposal to the Purchaser being disregarded; and
- d) As a result, section 9H(5) will apply to the proposed transaction and will have the effect that the section 9H(3)(b) deemed disposal of all Company B's assets (including those held by any CFC held directly or indirectly by Company B) is not applicable when Company B (and any such CFC of Company B) ceases to be a CFC as a result of the proposed transaction.

7. Period for which this ruling is valid

This binding private ruling is valid in respect of the 2024 and 2025 years of assessment of the Applicant and Company A.

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