



South African Revenue Service

BINDING CLASS RULING: BCR 073

DATE: 25 August 2020

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTION 8EA(1) – DEFINITION OF “QUALIFYING PURPOSE”, SECTION 8EA(2) AND (3)
SUBJECT : DIVIDENDS: WHEN THE “QUALIFYING PURPOSE” DEFINITION MUST BE SATISFIED

Preamble

This binding class ruling is published with the consent of the applicant to which it has been issued. It is binding between SARS, the applicant and the class members only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines when the definition of “qualifying purpose” must be satisfied for purposes of section 8EA(3) if third-party backed shares pay dividends.

2. Relevant tax laws

In this ruling references to sections are to sections of the Act applicable as at 26 March 2020. 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) – definition of “qualifying purpose”;
- section 8EA(2); and
- section 8EA(3).

3. Class

The class members to whom this ruling will apply are the preference shareholders referred to in 4.

4. Parties to the proposed transaction

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

Preference shareholders: The investors who will acquire preference shares in the applicant

Company A: A resident company

Company B: A resident of Country X

Company C: A resident of Country Y

5. Description of the proposed transaction

The applicant is wholly-owned by company A.

Company A intends to invest in company C, which will carry on business in country Y. Company A will invest via company B. The applicant will acquire 42.5% of the shares in company B, and the remaining shareholding in company B will be held by non-residents. Company B will acquire 100% of the shares in company C.

- A consortium of financiers will advance a bridge loan to the applicant. The applicant will use the funds advanced to it to subscribe for ordinary shares in company B. Company B will use the proceeds from the ordinary share subscription from the applicant (and the other non-residents) to subscribe for shares in company C.
- The bridge loan advanced to the applicant will be refinanced by the preference shareholders who will subscribe for preference shares in the applicant. The preference shares will be secured by, amongst others, a guarantee issued by company A to the preference shareholders.
- At the time that the preference shares are issued, company C will not be an “operating company” as defined in paragraph (a) of that definition in section 8EA(1) as it will not be a company that carries on business continuously and which, in the course or furtherance of that business, provides goods or services for consideration. Accordingly, company B will not be a controlling group company as contemplated in paragraph (b) of the definition of “operating company” and will therefore also not be an operating company for purposes of section 8EA. It is anticipated that company C will become an operating company at a later stage and company B will then become a controlling group company in relation to an operating company at that stage.
- The preference shareholders will be paid dividends by the applicant. It is anticipated that those preference share dividends, in the case of at least some of the preference shareholders, will be paid in a year of assessment during which company C becomes an operating company, but before it actually does so.

6. Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the preference shares to be issued by the applicant will constitute third-party backed shares for purposes of section 8EA.

7. Ruling

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

- a) Any dividend received by or accruing to a preference shareholder in its year of assessment will not be deemed to be income if at the time that the dividend is received by or accrues to the preference shareholder, company C is an operating company and company B a controlling group company in relation to company C.

b) Any dividend received by or accruing to a preference shareholder in its year of assessment –

- before company C becomes an operating company and company B becomes a controlling group company in relation to company C, will be deemed to be income by section 8EA(2); and
- when company C has ceased to be an operating company and company B is consequently no longer a controlling group company in relation to company C, will be deemed to be income by section 8EA(2).

8. Period for which this ruling is valid

This binding class ruling is valid for a period of five years from 26 March 2020.

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