

BINDING CLASS RULING: BCR 079

DATE: 24 May 2022

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : PARAGRAPHS 3(c), 4(c), 11(2)(o) and 20(4) OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : CANCELLATION OF SHARE EXCHANGE

Preamble

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

1. Summary

This ruling determines the tax consequences for former investors in one investment vehicle, who exchanged their participating shares for participating shares in another, who now wish to cancel the original share exchange and to be restored to the position they would have been in, had the share exchange not happened.

2. Relevant tax laws

In this ruling references to paragraphs are to paragraphs of the Eighth Schedule applicable as at 17 January 2022. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Eighth Schedule.

This is a ruling on the interpretation and application of –

- paragraph 3(c);
- paragraph 4(c);
- paragraph 11(2)(o); and
- paragraph 20(4).

3. Class

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

4. Parties to the proposed transaction

The applicant: an authorised financial services provider in South Africa and a distribution partner, sub-investment manager and investment advisor of PC that will resume these roles for IC, following the proposed transaction

IC: An incorporated cell of an incorporated cell company that is a non-resident

PC: A protected cell of a protected cell company that is a non-resident

The class members: The South African tax resident investors of IC who participated in the redemption (see below) and who still hold their shares in PC at the time of implementation of the proposed transaction

5. Description of the proposed transaction

The class members, with other investors, held voting, participating redeemable shares (participating shares) in IC.

As an incorporated cell of the incorporated cell company, IC is a company in its own right, under its jurisdiction's company law. However, PC is not a company in its own right under such law, but is a protected cell of the protected cell company. PC was formed anew for purposes of the redemption, described below.

A circular was distributed among the shareholders of IC, which proposed a composite offer for a share exchange, designed to move the investment portfolio from the more expensive incorporated cell platform to the less expensive protected cell platform (the redemption). These transactions were as follows:

- Step 1: IC made an *in specie* subscription for the shares in PC. The subscription price was settled by transferring all the assets of IC to PC. The subscription was on a net asset value basis, valued on the same day.
- Step 2: PC issued shares to IC;
- Step 3: IC redeemed the participating shares held by the shareholders in IC in exchange for the transfer of PC shares to them *pro rata* to their participation percentages.

The shareholders of IC were asked to vote on the offer. On the voting date, 99% of these shareholders supported the offer. The acceptance threshold of 75% having been reached, the redemption was implemented for all shareholders of IC, including the class members.

On the redemption effective date IC transferred the assets to PC in exchange for shares in PC. The value of the PC shares was equal to the value of the transferred assets. The PC shares were transferred by IC to the shareholders of IC *pro rata* to their participation by way of a compulsory *in specie* redemption of the participating shares.

The remaining shareholders (1%) that neither voted, nor redeemed their participating shares before the redemption effective date, also had their shares automatically redeemed for PC shares. All the participating shares in IC were redeemed and cancelled under the company law of the foreign jurisdiction.

Although all the participating shares were redeemed and IC no longer had any assets, IC was not wound up or deregistered, as management shares issued to the management company of IC remained in place.

The purpose of the redemption was to save costs for the shareholders of IC, because an unincorporated protected cell structure was considered to be more cost

efficient than an incorporated cell. However, the capital gains tax consequences of the redemption for the class members were not taken into account. These tax costs far outweighed the expected cost saving, thereby negating the entire business rationale for the redemption. The class members comprise more than 78% of the total shareholders of IC. The parties involved have agreed in principle to cancel the redemption, by way of a reversal of those transaction steps, in the following manner.

- Step 1: PC will make an *in specie* subscription for freshly issued shares in IC, featuring the exact same terms as the redeemed participating shares (referred to as the new participating shares), and settle the subscription price with the assets currently held by PC;
- Step 2: IC will issue the new participating shares to PC; and
- Step 3: PC will redeem the PC shares currently held by the shareholders of IC in exchange for the new participating shares in IC.

The proposed cancellation transaction will take place on the cancellation effective date. Following the cancellation, the shareholders of IC, including the class members, will once more hold voting, participating redeemable shares in IC and IC will once more hold the portfolio of assets. IC, PC and all the shareholders will be in exactly the same economic position as they would have been in, had the redemption not taken place.

6. Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the class members held their participating shares in IC, as well as the PC shares, and will hold the new participating shares on capital account.

7. Ruling

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

a) Since the parties to –

- the redemption are restored to exactly the same position they would have been in, had that transaction not taken place; and
- the proposed cancellation and restitution transaction steps are the same parties that concluded the redemption,

the proposed transaction falls within the ambit of paragraph 11(2)(o) and paragraph 20(4), as the case may be. Accordingly, the following consequences arise:

- i) The class members who continue to hold PC shares on the cancellation effective date will be treated as not having disposed of –
 - their participating shares (in IC) on the redemption effective date; and
 - their PC shares on the cancellation effective date,
 provided that the redemption effective date and the cancellation effective date fall within the same year of assessment.

- ii) The class members whose year of assessment ended between the redemption effective date and the cancellation effective date must account for –
- any capital gain realised in relation to the participating shares in IC on the redemption effective date as a capital loss on the cancellation effective date under paragraph 4(c);
 - any capital loss realised in relation to the participating shares in IC on the redemption effective date as a capital gain on the cancellation effective date under paragraph 3(c); and
 - the base cost of the new participating shares acquired in consequence of the cancellation of the redemption in terms of paragraph 20(4)(b). Thus, the base cost of the new participating shares in IC is deemed to be equal to the base cost of the participating shares in IC immediately before the redemption effective date, with the effect that the return of the PC Shares to IC must be ignored.

8. Period for which this ruling is valid

This binding class ruling is valid for a period of one year from 17 January 2022.

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