

BINDING PRIVATE RULING: BPR 150

DATE: 24 July 2013

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
VALUE-ADDED TAX ACT NO. 89 OF 1991 (the VAT Act)**

**SECTION : SECTIONS 1(1) DEFINITION OF “GROSS INCOME”, 11(a) READ
WITH 23(g), 24C, AND 24J OF THE ACT
SECTION 7(1) OF THE VAT ACT**

SUBJECT : TAX TREATMENT RELATING TO A CREDIT LINKED DEPOSIT

1. Summary

This ruling deals with the income tax consequences arising from a credit linked deposit agreement entered into with a Bank in order to raise funding.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the relevant Act applicable as at 23 June 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in that Act.

This is a ruling on the interpretation and application of the provisions of –

- section 1(1) of the definition of “gross income” of the Act;
- section 11(a) read with section 23(g) of the Act;
- section 24J of the Act; and
- section 7(1) of the VAT Act

3. Parties to the proposed transaction

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

The Bank: A public company registered as a bank in terms of the Banks Act No. 94 of 1990

4. Description of the proposed transaction

Part of the Applicant’s business operations is to sell its products to its clients on credit. As a result, the Applicant enters into instalment sale agreements from time to time in terms of which its clients have to pay amounts to the Applicant over a certain period. These transactions are capital intensive and have a substantial impact upon the cash flow exposure of the Applicant. The Applicant intends to enter into a Credit Linked Deposit Agreement (CLD Agreement) with the Bank, on the basis that –

- the Bank will make a deposit with the Applicant;
- the Applicant will agree to repay such deposit amount together with interest thereon only from payments it receives from its clients in respect of their so-called obligations. The concept of these obligations is defined in the CLD Agreement as the amount owing by each client to the Applicant in terms of the relevant instalment sale agreement;
- the outstanding deposit amount will bear interest at a fixed deposit rate. This rate will be calculated as the internal rate of return or fixed rate based on the difference between the discounted amount (the deposit amount) and the amount of future expected cash flows to be paid by the Applicant to the Bank. Cash received from the Applicant will first be applied in settlement of the interest amount due, and thereafter, to repayment of the deposit amount;
- all monies that the Applicant receives from its clients in respect of their obligations, will be deposited into a collection account, the proceeds of which will be paid by the Applicant to the Bank on a monthly basis;
- the sole source of the repayment of the deposit amount and the payment of interest thereon will be the amounts received by the Applicant in respect of its clients' obligations. Should the Applicant receive insufficient payments in respect of these obligations, the Applicant will have no further repayment or payment obligations to the Bank in respect of the outstanding deposit amount and/or any accrued but unpaid interest;
- in terms of the proposed CLD Agreement the Applicant is to discharge its remaining obligations to the Bank only on the termination date, by ceding its rights in relation to any debt unpaid as at the termination date against the instalment sale debtors in favour of the Bank on an out-and-out basis. The cession will result in the Applicant being deemed to have paid the outstanding deposit amount and any interest payable thereon and the Applicant will have no further obligations in terms of the deposit towards the Bank. The initial deposit amount will thus be repaid through means of either cash received from the instalment sale debtors prior to the termination date, or on the termination date by cession of the remaining rights against the instalment sale debtors. It is thus agreed upfront that the deposit amount will be repaid through the cession of the remaining instalment sale debtors, whether or not they have defaulted. The Bank thus effectively takes the risk on the repayment by the instalment sale debtors of these amounts.

In the same agreement, the Applicant and the Bank will agree (a Service Undertaking) that the Applicant undertakes to pursue its remedies under the instalment sale agreements entered into with its clients and to collect any and all amounts owing by or on behalf of the clients to the Applicant. The Applicant will be paid an annual fee (Undertaking Fee). in respect of the Service Undertaking.

5. Conditions and assumptions

This ruling is not subject to any additional conditions and assumptions.

6. Ruling

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

- The CLD Agreement will be an 'instrument' for purposes of section 24J of the Act;
- The interest will be incurred by the Applicant on a 'yield to maturity' basis in terms of section 24J of the Act;
- Any gain or loss realised at the end of the CLD Agreement which is not treated under section 24J will be a gain or loss on revenue account;
- Any Undertaking Fee payable in terms of the CDL Agreement will, however, be subject to VAT in terms of section 7(1)(a) of the VAT Act.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 5 years from 23 June 2013

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**