

**BINDING PRIVATE RULING: BPR 167**

DATE: 2 April 2014

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 1(1), DEFINITION OF “GROSS INCOME” AND PARAGRAPH (a) OF THE DEFINITION OF “TRADING STOCK”, 11(a) READ WITH 23(g) AND 22(1)(a)**  
**SUBJECT : DEBENTURES TRACKING THE VALUE OF A REFERENCE ASSET**

**1. Summary**

This ruling deals with the income tax consequences for a company that issues debentures to investors, the value of which tracks the price of specified quantities of a precious metal as reference assets.

**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 Act applicable as at 2 December 2013 and 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 the provisions of –

- section 1(1), definition of “gross income” and paragraph (a) of the definition of “trading stock”;
- section 11(a) read with section 23(g); and
- section 22(1)(a).

**3. Parties to the proposed transaction**

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

Debenture Holders: Holders of debentures to be issued by the Applicant

**4. Description of the proposed transaction**

The Applicant is “ring-fenced” and “insolvency remote” in that its Memorandum of Incorporation limits its legal capacity to conduct any business or to incur any liability other than that permitted without the prior consent of the JSE and that of its Debenture Holders by special resolution.

The Applicant conducts the business of establishing and operating exchange traded funds (ETFs) listed on the JSE and by way of one or more secondary or dual listings on such other exchanges as the Applicant may select from time to

time, in relation to the debt instruments issued by it, the values of which track the prices of specified quantities of given reference assets.

The Applicant has no employees and is managed in terms of a management agreement by a manager appointed by it from time to time. The manager manages and administers the business and affairs of the Applicant and advises the Applicant in relation to the conduct of its business. The Applicant is a wholly-owned subsidiary of a trust which was established with the sole purpose of beneficially holding its entire issued share capital.

In a JSE approved "Offering Circular and Pre-Listing Statement" the Applicant proposes to notify the terms under which it will issue and redeem the debentures by listing them on the main board of the JSE on the JSE's ETF sub-sector in the expectation that investors will buy and sell them primarily in the secondary market.

The debenture based method of investment is used to enable the Debenture Holders to invest in the reference asset concerned without acquiring the ownership of a quantity of the asset itself, because doing so is extensively regulated.

The subscription price for a debenture may be settled in cash or *in specie* and will be the price of a specified initial quantity of the reference asset on the issue date.

The Applicant will use any cash proceeds from the issuing of the debentures to buy quantities of the reference asset. The reference asset will be kept on deposit and in a segregated account with a custodian.

Each debenture entitles its holder to receive a cash amount on redemption equal to the value of the specified quantity of the reference asset at the redemption date. The specified quantity is to be determined by a formula which reduces it over time because the Applicant must from time to time sell appropriate quantities of the reference asset to defray its monthly costs.

A Debenture Holder may on notice redeem the debenture at any time. The Applicant has no right of voluntary redemption except in certain narrowly defined circumstances relating, in the main, to performance being or becoming impossible. A Debenture Holder will have the right, upon redemption, to require the Applicant to sell to the Debenture Holder the specified quantity of the reference asset associated with the debentures as at the redemption date, provided that the Debenture Holder must have opened a nominated account with the custodian into which the Applicant can transfer the acquired reference asset on the delivery date.

In that event the obligation of the Applicant to pay the redemption value of the debentures to the Debenture Holder on the redemption date will be off-set against the obligation of the Debenture Holder to pay the purchase price of the reference asset on the redemption date to the Applicant. Although the specified quantity reduces over time, the unit price of the reference asset may rise. This entails that the Applicant may be obliged, on redemption, to pay either less or more than the subscription price as at the date of issue, depending on the prevailing price of the reference asset (in the ruling referred to as the "shortfall" or the "excess", respectively).

The debentures are unsecured senior obligations of the Applicant and rank equally with one another. They evidence the final indebtedness of the Applicant to the Debenture Holders.

## **5. Conditions and assumptions**

This ruling is subject to the additional condition and assumption that it is based on the terms of the “Offering Circular and Pre-Listing Statement”, together with the documents it incorporates by reference.

## **6. Ruling**

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

- Amounts received by the Applicant in respect of debenture subscriptions do not form part of the Applicant’s “gross income” as defined in section 1(1).
- On the redemption of a debenture –
  - the Applicant must include the shortfall that results from a decline in the reference asset’s price between the debenture’s issue date and redemption date in its gross income; and
  - the Applicant may deduct the excess that results from a rise in the reference asset’s price between the debenture’s issue date and redemption date from its income.
- Expenditure incurred to acquire appropriate quantities of the reference asset will be expenditure contemplated in section 11(a) read with section 23(g).
- The proceeds from the sale of quantities of the reference asset for purposes of the redemption of debentures will form part of the Applicant’s gross income in the year of sale.

## **7. Period for which this ruling is valid**

This binding private ruling is valid for a period of 5 years from 2 December 2013.

Issued by:

**Legal and Policy Division: Advance Tax Rulings  
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