

BINDING PRIVATE RULING: BPR 228

DATE:13 April 2016

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTION 8EA(1) – DEFINITION OF “OPERATING COMPANY” AND “QUALIFYING PURPOSE”
SUBJECT : WHETHER AN INVESTMENT OF PREFERENCE SHARE FUNDING IN A NEWLY ESTABLISHED BUSINESS IS FOR A “QUALIFYING PURPOSE”

1. Summary

This ruling determines whether –

- a newly established company will be regarded as an “operating company”;
and
- an indirect investment into such company will be for a “qualifying purpose”.

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 31 October 2015. 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 8EA(1) – definition of “operating company” and “qualifying purpose”.

3. Parties to the proposed transaction

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

The Co-Applicant: A finance provider

The Project company: A newly established company that is incorporated in and a resident of South Africa

4. Description of the proposed transaction

The Project company will undertake a business project as it intends to produce goods and services and to sell these goods and services for consideration. The Project company will fund the business project costs necessary by means of 80% debt and 20% equity.

The Applicant will hold 25% of the ordinary shares in the Project company as a BEE partner. The shares in the Applicant are held 100% by its holding company.

The Applicant will fund the subscription price of the ordinary shares in the Project company out of the proceeds of –

- issuing ordinary shares to its holding company; and
- issuing preference shares to the Co-Applicant.

The Co-Applicant requires that the Applicant's holding company provides the Co-Applicant with –

- a guarantee for any amount which the Applicant has contracted to pay to the Co-Applicant, but fails to pay in respect of the preference shares; and
- a cession and pledge by the Applicant's holding company of its shares in the Applicant.

At the time of the investment in the Project company, the Project company will not be operating and will not be providing the goods or services it intends to provide for consideration. The Project company is expected to be operational within eighteen months from the commencement of the construction of its plant.

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 use of funds derived from the issue of the preference shares to subscribe for the ordinary shares in the Project company will not be applied for a "qualifying purpose" as defined in section 8EA(1), as the Project company will not be an "operating company" as defined.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 3 years from 31 October 2015.