

BINDING PRIVATE RULING: BPR 248

DATE: 15 September 2016

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 8FA AND 24J(2)
SUBJECT : DEDUCTION OF INTEREST ON ASSET BACKED NOTES

1. Summary

This ruling determines the deductibility of interest to be incurred in respect of notes issued by a special purpose vehicle. The capital receipts for the notes are to be invested in commercial debt.

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 23 August 2016. 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 8FA; and
- section 24J(2).

3. Parties to the proposed transaction

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

The Investees: Companies incorporated in and residents of South Africa that will issue debt instruments to the Applicant

The Note Holders: Tax exempt pension funds and/or untaxed policyholder funds of South African life insurers, incorporated in and residents of South Africa

4. Description of the proposed transaction

The Applicant was incorporated as a special purpose vehicle to issue asset backed notes (notes) to the Note Holders.

The Applicant will utilise the proceeds received from the issuance of the notes to invest in debt instruments (underlying investments) issued by the Investees.

Interest on the underlying investments will be calculated with reference to a base lending rate linked to the consumer price index plus a fixed interest rate. Interest

will be paid by the Investees to the Applicant in quarterly or bi-annual instalments together with the return of the principal debt amortised over the period of the investment.

In terms of the notes, interest will accrue to the Note Holders, calculated at the same interest rate as that at which interest accrues to the Applicant from the underlying investments. All interest that accrues to the Applicant from the underlying investments is to be distributed to the Note Holders.

The Applicant will receive management, advisory and administration services over the life of the underlying investments from its holding company. As consideration for these services, the holding company will be entitled to a management fee from the Note Holders, that the Applicant will be authorised to withhold from monies due by the Applicant to the Note Holders.

The notes will embody obligations of the Applicant and will be redeemed as and when the underlying investments are redeemed.

In the event that the Applicant is unable to recover amounts in respect of an underlying investment, the Note Holders will suffer a loss in respect of the notes concerned.

5. Conditions and assumptions

This binding private ruling is not subject to any additional conditions or assumptions.

6. Ruling

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

- a) The underlying investments will constitute interest bearing arrangements for purposes of section 24J. Consequently, section 24J(3) will apply to the interest to be received by or accruing to the Applicant.
- b) Each note will constitute an instrument for purposes of section 24J. On this basis, the amounts payable in excess of the original subscription price will constitute interest for purposes of section 24J.
- c) The Applicant will be entitled to deduct interest incurred in respect of the notes, limited to the amount of the interest included in its income.
- d) Interest to be received by or accruing to the Applicant in respect of the underlying investments will not constitute "hybrid interest", as defined in section 8FA(1).
- e) Interest payable by the Applicant in respect of the notes will not constitute "hybrid interest" as defined in section 8FA(1).
- f) Interest to be received by or accrued to the Applicant in respect of the underlying investments will not be deemed to be a dividend *in specie* for the Applicant in terms of section 8FA and will not prohibit the Applicant from deducting the interest payable in respect of the notes from its income under section 24J(2).

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 23 August 2016.

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