

BINDING PRIVATE RULING: BPR 263

DATE: 1 February 2017

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 8FA, 10(1)(k)(i) READ WITH PARAGRAPH (hh) OF THE PROVISIO THERETO, 24J(1) – DEFINITION OF “INTEREST”, 24JB(2)(b), 64D, 64E, 64EA, 64F AND 64FA
SUBJECT : HYBRID INTEREST

1. Summary

This ruling determines the income tax consequences of the entitlement to and the payment of a share in the profit of the Co-Applicant to the Applicant in the context of a funding arrangement, as well as the re-characterisation rules contained in section 8FA.

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 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 6 December 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 –

- section 8FA;
- section 10(1)(k)(i), read with paragraph (hh) of the proviso thereto;
- section 24J(1) – definition of “interest”;
- section 24JB(2)(b);
- section 64D;
- section 64E;
- section 64EA;
- section 64F; and
- section 64FA.

3. Parties to the proposed transaction

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

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

4. Description of the proposed transaction

The Applicant conducts business as an investment bank. As part of the Applicant's normal business operations, it grants credit facilities and advances loans to its clients. The Co-Applicant is a client of the Applicant and the owner-developer of a shopping centre.

The Applicant concluded two interest-bearing loan agreements with the Co-Applicant; a senior loan facility and a mezzanine loan facility. As consideration for making available the funding in terms of these loan agreements, the Applicant, the Co-Applicant and the Co-Applicant's shareholder concluded a profit sharing agreement.

In terms of the profit sharing agreement the Applicant will be paid a share of the profit that is to be realised in the event of, amongst other things, the sale of the immovable property or the sale of the shares in the Co-Applicant (expressed in the profit sharing agreement as a specific rand amount).

The proposed transaction is the imminent sale of all of the shares in the Co-Applicant to a REIT.

The amount of the profit share, to which the Applicant will become entitled to upon the execution of the proposed transaction, is the result of negotiation between the parties at the time of the conclusion of the profit sharing agreement and is influenced by the expected future fair value of the property as well as the Applicant's expected return on the funding provided.

5. Conditions and assumptions

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

6. Ruling

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

- a) The profit share constitutes "interest" as defined in section 24J(1) for the Applicant and the Co-Applicant.
- b) The profit share constitutes "hybrid interest" for purposes of section 8FA, with the following consequences under section 8FA(2):
 - i) For purposes of the Act, this amount is deemed to be a dividend *in specie* that is declared and paid by the Co-Applicant to the Applicant on the last day of the year of assessment of the Co-Applicant, during which this amount is incurred by the Co-Applicant.
 - ii) This deemed dividend *in specie* is not deductible by the Co-Applicant under the Act.
 - iii) For purposes of the Act, this amount is deemed to be a dividend *in specie* that is declared and paid to the Applicant on the last date of the year of assessment of the Co-Applicant, during which this amount accrues to the Applicant.
- c) The profit share will constitute a "dividend" for purposes of section 24JB and will be excluded, as a result, under section 24JB(2)(b).

- d) Paragraph (*hh*) of the proviso to section 10(1)(k)(i) will not apply to the profit share that is deemed to be a dividend *in specie*, received by the Applicant and will be exempt from normal tax under section 10(1)(k)(i).
- e) The dividend *in specie* will be exempt from dividends tax under section 64F, read with section 64FA, if the necessary declaration and undertaking are submitted to the Co-Applicant.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of three years from 6 December 2016.

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