

BINDING PRIVATE RULING: BPR 275

DATE: 23 June 2017

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITION OF “GROSS INCOME”, 24JB AND PARAGRAPH 1 – DEFINITION OF “ASSET”, “DISPOSAL” AND “PROCEEDS” OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : SECURITY ARRANGEMENTS IN RESPECT OF HOME LOANS

1. Summary

This ruling determines certain tax implications arising out of the implementation of security arrangements in respect of home loans.

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 and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 31 May 2017. 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 1(1) – definition of “gross income”;
- section 24JB; and
- paragraph 1 – definition of “asset”, “disposal” and “proceeds”.

3. Parties to the proposed transaction

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

The Trust: A trust established in and a resident of South Africa

Co-Applicant: A company incorporated in and a resident of South Africa which is 100% held by the Trust

Customers: Recipients of home loans advanced by the Applicant

4. Description of the proposed transaction

The Applicant conducts business which includes the advancing of home loans against security by way of a mortgage bond in favour of the Applicant.

It is proposed that, instead of a Customer providing security to the Applicant, the Co-Applicant will provide a guarantee (the Guarantee) to the Applicant for the due fulfilment of the Customer's obligations. The Customer will provide an indemnity to the Co-Applicant and the Customer's obligation to indemnify the Co-Applicant will be secured by a mortgage in the Co-Applicant's favour.

The Trust was settled by the Applicant as the donor, and a separate company appointed as the trustee (Initial Trustee). The Initial Trustee is a resident of South Africa and not a "connected person" as defined in section 1(1) in relation to the Applicant. In terms of the Trust Deed between the Applicant (in its capacity as donor) and the Initial Trustee, the trustee of the Trust shall be entitled to appoint or remove one director to the board of directors of the Co-Applicant from time to time, who shall be independent of the Applicant. In terms of the Trust Deed, the beneficiary of the Trust is the Applicant or any person in favour of whom the Guarantee has been issued. Initially the Applicant will be the only beneficiary of the Trust.

In terms of the loan agreement (Loan Agreement), the Applicant will advance loans to a Customer subject to the Co-Applicant providing security to the Applicant by way of the Guarantee for the repayment of the loan and the Customer concluding a counter indemnity with the Co-Applicant (the Counter Indemnity) to indemnify the Co-Applicant to the extent that there is any default by the customer in terms of the Loan Agreement. The Counter Indemnity will be secured by the registration of a mortgage bond by the Customer in favour of the Co-Applicant.

In addition, the parties will also conclude the following –

- a deed of cession of some of the Customer's rights to derive income in respect of the mortgaged property to and in favour of Co-Applicant which will be effective on date of default only;
- a deed of cession *in securitatem debiti* of insurance proceeds by the Co-Applicant to and in favour of the Applicant (Cession of Insurance Proceeds Agreement); and
- a deed of cession *in securitatem debiti* of Enforcement Proceeds and Rights as Execution Creditor by the Co-Applicant to and in favour of the Applicant (Enforcement Proceeds Agreement).

The Applicant and the Co-Applicant will also conclude an administration agreement in terms of which all the duties of the Co-Applicant will be sub-contracted to the Applicant.

If a default event as defined in the Loan Agreement occurs, the Guarantee becomes exercisable and the Applicant would lodge a claim under the Guarantee Agreement for the Co-Applicant to perform under and in terms of the Guarantee Agreement.

Upon receipt of the Applicant's claim the Co-Applicant will, acting in terms of the Counter Indemnity granted in its favour by the Customer, send a notice in terms of

section 129(1)(a) of the National Credit Act 34 of 2005 to the Customer calling upon the Customer to perform in terms of the Counter Indemnity. If the Customer complies, all sums payable to the Co-Applicant shall be paid into the bank account nominated by the Applicant in reduction of the Customer's Guaranteed Obligations without any set-off, condition or counterclaim whatsoever and free and clear of any deductions or withholdings whatsoever, save as required by law.

If the Customer fails to comply with the notice, the Co-Applicant will be entitled to claim payment of the full amount due, and failing that, levy execution against the property. In terms of the Cession of Insurance Proceeds Agreement and Enforcement Proceeds Agreement, all sums of money which the Co-Applicant collects shall be collected and received by it in its capacity as principal.

The advances in respect of home loans will remain in the books of the Applicant and the only change resulting from the proposed transaction will be the nature of the security for the home loan from secured by mortgage bond to being secured by guarantee.

The Co-Applicant will not recognise any financial assets and financial liabilities in its books of account and no fair value adjustments will be made in its books. Entries in the Co-Applicant's books of account will be limited to share capital and administration expenses.

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) In the event that the Co-Applicant perfects the security by exercising its rights under the mortgage bond (or the additional forms of security mentioned in 4 above), any resulting amounts will not constitute gross income in the hands of the Co-Applicant.
- b) No capital gains tax consequences will arise for the Co-Applicant in enforcing its rights under the Counter Indemnity and the mortgage bond (or the additional forms of security mentioned in 4 above) and discharging its obligations under the Guarantee.
- c) The provisions of section 24JB will not apply to the Co-Applicant.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 31 May 2017.