

BINDING PRIVATE RULING: BPR 292

DATE: 24 January 2018

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 19, 42, AND PARAGRAPHS 12A AND 38 OF THE EIGHTH SCHEDULE
SUBJECT : TAX CONSEQUENCES OF A DEBT RESTRUCTURING

1. Summary

This ruling determines the income tax consequences of a discharge of debt by set-off, the waiver of a right to the payment of a dividend, and the acquisition and immediate disposal of associate company shares.

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 and paragraphs to paragraphs of the Eighth Schedule to the Act applicable as at 9 November 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 19;
- section 42;
- paragraph 12A; and
- paragraph 38.

3. Parties to the proposed transaction

The applicant:	A private company incorporated in and a resident of South Africa
Co-applicant 1:	A public company incorporated in and resident of South Africa
Co-applicant 2:	A public company incorporated in and resident of South Africa
Co-applicant 3:	A public company incorporated in and resident of South Africa

4. Description of the proposed transaction

The applicant is a wholly-owned subsidiary of co-applicant 2. Co-applicant 1 holds 20% of the ordinary share capital of co-applicant 2. Co-applicant 1 also holds 100% of the ordinary shares in a group company which in turn holds 100% of the ordinary shares in co-applicant 3. In addition, co-applicant 1 holds preference shares in the applicant.

While the applicant remains a viable business, its operating cash flow has been less than debt service obligations due to the economic downturn in the sector in which it operates. Accordingly, the applicant's debt has reached a highly burdensome level and this is creating acute liquidity pressures.

To alleviate the financial pressure, the applicant, its creditors, as well as other invested stakeholders have agreed to enter into the proposed transaction as a financial and debt restructuring of the applicant.

The following debts are owed by the applicant to the co-applicants prior to the proposed transaction –

- a mezzanine loan to co-applicant 3 (First Mezzanine Loan);
- a mezzanine loan to co-applicant 1 (Second Mezzanine Loan); and
- an inter-company loan to co-applicant 2.

Immediately before the proposed transaction, co-applicant 1 held all of the preference shares in the applicant. Co-applicant 1 had subscribed for them in the previous year. They are cumulative redeemable non-participating no par value preference shares.

The transaction steps will be as follows:

Step 1 – the first mezzanine loan delegation

- The applicant will delegate a portion of the first mezzanine loan owing to co-applicant 3 to co-applicant 1 and co-applicant 1 will consequently become indebted to co-applicant 3 for the delegated amount, including the outstanding balance on that loan from time to time. The applicant will remain indebted to co-applicant 3 for the amount not delegated. This debt will be interest-free and subordinated.

Step 2 – redemption of Applicant preference shares

- The applicant will elect to redeem the preference shares held by co-applicant 1 in the applicant.
- Under the Preference Share Terms:
 - The applicant is obliged to declare and pay all accrued and / or accumulated preference dividends immediately prior to redemption of the preference shares.
 - If any preference dividend is not declared and or paid on any applicable dividend date the amount of the undeclared or unpaid preference dividend will be accumulated until declared and paid in full or until the redemption date of the last preference share, whichever is the earlier.

- No dividends have been declared or paid in respect of the preference shares. To the extent that any dividends may over this period have accrued or been accumulated, they will be waived by co-applicant 1 in terms of the proposed transaction.
- The applicant will finance the redemption through an intraday bridge loan from a bank. The applicant will pay the redemption amount to co-applicant 1 in cash and at the same time delegate to co-applicant 1 its liabilities to the bank arising out of the loan. Upon receipt of the redemption amount, co-applicant 1 will immediately pay over to the bank, as a repayment of the intraday bridge loan delegated, an amount equal to the loan balance. As a consequence of the delegation, a loan claim will exist against the applicant and in favour of co-applicant 1 for the amount which co-applicant 1 will pay to the bank (the redemption loan).

Step 3 – Inter-company loan and set-off

- The applicant is indebted in terms of an inter-company loan account to co-applicant 2. Co-applicant 2 will subscribe for additional ordinary shares in the applicant for an amount equal to the outstanding inter-company loan amount (Applicant subscription shares) which will be a debt which is due, owing and payable to the applicant on the closing date. The applicant will issue the applicant subscription shares to co-applicant 2 and credit them as fully paid up by setting-off the outstanding subscription price against the outstanding inter-company loan amount. Co-applicant 2 will thereafter have no further claims on inter-company loan account against the applicant.

Step 4 – Applicant share subscription and set-off

- The applicant is indebted to co-applicant 1 in terms of the second mezzanine loan.
- Co-applicant 1 will subscribe for additional ordinary shares in the applicant (applicant designated shares) for a subscription price equal to all the debt owing to co-applicant 1 by the applicant. The total debt owing to co-applicant 1 by the applicant comprises the applicant's claim arising out of the first mezzanine loan less the excluded amount, the second mezzanine loan and the redemption loan (the designated debt).
- The amount owing in respect of the subscription price will be set-off against the designated debt thereby constituting full discharge of the designated debt.

Step 5 - Asset for share exchange

- Co-applicant 1 will exchange the applicant designated shares in consideration for the issue of ordinary shares in co-applicant 2 and the parties will agree that section 42 will apply to the transaction.
- Co-applicant 3 will sell the ordinary shares which it holds in co-applicant 2 to co-applicant 1 on loan account.

Step 6 – Unbundling

- Co-applicant 1 will unbundle all of the equity shares held in co-applicant 2 (which include the equity shares it held prior to the proposed transaction)

to all its shareholders by distributing the co-applicant 2 shares to its shareholders as a dividend *in specie*, as contemplated in section 46.

5. Conditions and assumptions

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

6. Ruling

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

- a) Section 19 and paragraph 12A of the Eighth Schedule will not apply to the settlement of the inter-company loan and designated debt by set-off against the share subscription obligations in steps 3 and 4 of the proposed transaction.
- b) The applicant designated shares that will be acquired by co-applicant 1 in step 4 and disposed of in step 5 will be regarded as having been acquired and held by co-applicant 1 as capital assets for purposes of paragraph (a)(ii)(bb) of the definition of “asset-for-share transaction” in section 42(1).
- c) Paragraph 38 of the Eighth Schedule will not apply to the waiver of any accumulated dividends in step 2 of the proposed transaction.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of one year from 9 November 2017.