

BINDING PRIVATE RULING: BPR 323

DATE: 18 July 2019

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTION 19 AND PARAGRAPH 12A OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : DEBT REDUCTION BY MEANS OF SET-OFF

Preamble

This binding private ruling is published by consent of the applicants to which it has been issued. It is binding as between SARS and the applicants only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the tax consequences for the applicant of a proposed settlement of a shareholder's debt and the subsequent issue of ordinary shares.

2. Relevant tax laws

In this ruling a reference to a section is to a section of the Act and to a paragraph is to a paragraph of the Eighth Schedule to the Act applicable as at 10 April 2019. 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; and
- paragraph 12A.

3. Parties to the proposed transaction

The applicant: A resident company

Co-applicant: A resident company which holds 100% of the shares in the applicant

4. Description of the proposed transaction

The applicant is indebted to the co-applicant. The major portion was incurred before 1 January 2011.

The applicant's liabilities which are material to the proposed transaction are interest-free and arose under the following circumstances:

- The co-applicant advanced the proceeds of a rights issue to the applicant on loan account (Liability 1).

- The co-applicant disposed of a going concern to the applicant on loan account (Liability 2).
- The applicant declared dividends to the co-applicant during the 2008 and 2009 financial years which were left outstanding on loan account. The applicant will settle a portion of this amount under the proposed transaction (Liability 3).

Under the proposed transaction, the applicant will reduce its total balance sheet liabilities by settling the specified liabilities by way of set-off, as follows:

- The applicant will issue shares to the co-applicant for an amount equal to the market value of those shares and will leave the liability for the share subscription outstanding on loan account.
- The liability to be owed by the co-applicant to the applicant for the share subscription will be set-off against the specified liabilities owed by the applicant to the co-applicant.

5. Conditions and assumptions

This binding private ruling is made subject to the following additional conditions and assumptions:

- The market value of the effective interest held by the co-applicant in the shares of the applicant after the set-off of the liabilities will exceed the market value of the effective interest of the shares before the set-off, and the difference between the two market values will be less than the cumulative face value of Liabilities 1 and 2 prior to the set-off.
- The amounts in respect of Liabilities 1 and 2 were used, either directly or indirectly, to fund expenditure for which deductions or allowances were granted in terms of the Act.

6. Ruling

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

- a) Section 19 and paragraph 12A will not apply to the proposed set-off of Liabilities 1 and 2 owed to the co-applicant, against the share subscription liability owed by the co-applicant in the same amount, because of section 19(8)(e) and (f) and paragraph 12A(6)(f) and (g) respectively.
- b) Liability 3 does not constitute “debt” as defined in section 19(1) and paragraph 12A(1). Section 19 and paragraph 12A will therefore not apply to the set-off in respect of this liability.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of three years from 10 April 2019.