

BINDING PRIVATE RULING: BPR 394

DATE: 15 June 2023

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTIONS 1(1) – DEFINITION OF “GROSS INCOME”, 11(a), 23(g), 24(1), 24J(1) – DEFINITION OF “INTEREST” AND 50A – DEFINITION OF “INTEREST”
SUBJECT : INSTALMENT SALE AGREEMENTS AND THEIR SALE TO A NON-RESIDENT

Preamble

This binding private ruling is published with the consent of the Applicant(s) to which it has been issued. It is binding between SARS, the Applicant and any Co-Applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the income tax treatment of amounts received by the Applicant on instalment sale agreements and on the sale or cession of the receivables to a non-resident at a discount.

2. Relevant tax laws

In this ruling references to sections are to sections of the Act applicable as at 25 April 2023. 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 11(a);
- section 23(g);
- section 24(1);
- section 24J(1) – definition of “interest”; and
- section 50A – definition of “interest”.

3. Parties to the proposed transaction

Applicant: A resident company

Co-Applicant: A non-resident company

4. Description of the proposed transaction

The Applicant sells goods to its customers.

The goods with which this ruling is concerned are sold on instalment and on standard terms. Instalments are paid on a monthly basis over specified periods.

The Applicant sells its goods at a discount to their cost price in order to entice purchasers to become customers.

The Applicant calculates the sale price by applying a discount to the cost price and then adding a cost recovery amount as part of cost of sales to the resulting amount. The purpose of this formula is to ensure that, although the Applicant will sell the goods at a loss, the loss will be mitigated by adding a cost recovery amount to the discounted amount. Those cost of sales items appear in an annexure to the ruling which was issued to the Applicant.

The Applicant raises value-added tax on the sale price.

The Applicant will, from time to time, sell and cede to the Co-Applicant receivables arising from goods sales at a pre-agreed discount to the face value of the accounts receivable. The Applicant and Co-Applicant will enter into two agreements –

- a sale of receivables agreement; and
- a deed of indemnity.

The sale of receivables agreement provides for a 'Dilution Event', which occurs when –

- there is a material change to the terms of the underlying customer contract with the Applicant which affects the collectability of the receivable; or
- the Applicant releases a debtor from payment or waives the right to collect any unpaid balance of a receivable from a debtor.

Upon the occurrence of a 'Dilution Event', the Applicant will be required to accept back any affected receivables. The consideration payable in that event is calculated as the gross amount of the receivables less any amounts already collected and paid over by the Applicant to the Co-Applicant.

In terms of the deed of indemnity the Applicant gives certain undertakings to the Co-Applicant. The Applicant will give a 'Payment Undertaking' to the Co-Applicant against two items –

- any and all losses directly arising as a result of the 'Default Rate' of the receivables exceeding the 'Maximum Default Rate'. In that event, the Applicant must pay a fixed portion of the relevant monthly gross amount to the Co-Applicant; and
- any direct loss, costs or expense suffered or incurred by the Co-Applicant or a transferee arising out of the failure by any customer to pay in full any receivable owed by it where such failure is due to the invalidity or unenforceability of the receivables where there will not be double counting (i.e. there will not be a transfer back of receivables as well as an indemnity payment).

The sale of receivables agreement provides that the Co-Applicant shall pay or procure payment of the purchase amount in respect of account receivables acquired by it from the Applicant no later than the date falling two business days after accepting the sale/cession offer.

The Applicant will act as a collection agent on behalf of the Co-Applicant. It will receive payments from its customers and pay them over to the Co-Applicant.

The proceeds from the sale/cession of the receivables will be used by the Applicant as part of its normal working capital.

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 Applicant must include the sale price of goods sold on instalment in its gross income in accordance with section 24(1).
- b) No portion of the sale price of goods must be excluded from gross income and dealt with as interest under section 24J.
- c) The proceeds that will be received by or will accrue to the Applicant from the subsequent sale/cession to the Co-Applicant of the receivables that arose from the sale of goods on instalment to customers will not be included in the Applicant's "gross income" as defined in section 1(1).
- d) Any loss resulting from the face value of any receivable being discounted in terms of the sale/cession of the abovementioned receivables to the Co-Applicant will be deductible by the Applicant under section 11(a) read with section 23(g).
- e) The difference between the face value of the receivables recoverable by the Co-Applicant and the discounted amount paid by the Co-Applicant will constitute interest as defined in section 24J and for purposes of Part IVB of Chapter II.
- f) The indemnity amounts relating to the 'Default Receivables' breaching the 'Maximum Default Rate' will, if payable by the Applicant, be deductible under section 11(a) read with section 23(g).

No ruling is issued on the tax consequences of the 'Dilution Event' which would entitle the Co-Applicant to re-transfer 'Default Receivables' to the Applicant.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 25 April 2023.