

BINDING PRIVATE RULING: BPR 398

DATE: 17 November 2023

**ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECURITIES TRANSFER TAX ACT 25 OF 2007 (STT Act)**

**SECTION : SECTIONS 1(1) – DEFINITIONS OF “CONTRIBUTED TAX CAPITAL”,
“GROSS INCOME”, “DIVIDEND” AND “EQUITY SHARE”, 8E, 8EA,
40C AND PARAGRAPH 43A OF THE EIGHTH SCHEDULE TO THE
ACT
SECTIONS 1, 2 AND 6 OF THE STT ACT**

**SUBJECT : DISPOSAL OF SHARES PURSUANT TO A PROPERTY
DEVELOPMENT ARRANGEMENT**

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 and 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 tax consequences of a disposal of ordinary shares in a property company, and the redemption of newly issued capitalisation preference shares in that company at a later stage.

2. Relevant tax laws

In this ruling, references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 12 July 2023. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of –

- the Act –
 - section 1(1) – definitions of “contributed tax capital”, “gross income”, “dividend” and “equity share”;
 - section 8E;
 - section 8EA;
 - section 40C; and
 - paragraph 43A.
- the STT Act –
 - section 1;

- section 2; and
- section 6.

3. Parties to the proposed transaction

The Applicant:	A resident company
PropCo:	A resident company that is a wholly-owned subsidiary of the Applicant
DevelopCo:	A resident company that is not a “connected person” in relation to the Applicant

4. Description of the proposed transaction

PropCo is a property holding company, which owns land. The shares in PropCo, held by the Applicant, were received by the Applicant in terms of an “unbundling transaction” as defined in section 46(1) more than four years ago and are held on capital account.

PropCo and the Applicant are not equipped with the requisite development expertise to further develop the land. Accordingly, the Applicant will partner with a property developer with the relevant experience, expertise and local market knowledge.

The Applicant and DevelopCo intend to work together to unlock the inherent value of the land by means of an incorporated joint venture. This will entail the installation of services across the land and may include the realisation of certain portions of the land to third parties.

Given the underlying uncertainty around the ability to unlock the inherent value in the land through the intended development, a third-party buyer would not be willing to pay for the speculative value of the land. It was, therefore, proposed that capitalisation preference shares be issued to the Applicant giving it a preferential right equal to the speculative value of the land.

The Applicant will divest itself of control over PropCo (subject to certain reserved aspects), in favour of DevelopCo in the hope that the underlying development is a success, and which will over time, generate significant gains for PropCo.

In order to protect the Applicant against this divestiture of control in the shareholding of PropCo, the preference shares will enable the Applicant to have a preferential claim which will be secured by the land, enabling it to have direct access to the land as security in the event that the joint venture is not successful and the preference shares cannot be redeemed.

The parties intend to formalise their shareholding in PropCo and their commercial objectives, by entering into the following proposed transaction:

- a) PropCo will issue preference shares to the Applicant as a capitalisation share issue in terms of section 47 of the Companies Act 71 of 2008 (the Companies Act); and

- b) Thereafter, the Applicant will dispose of 51% of the ordinary shares in PropCo to DevelopCo, but may subsequently dispose of (or reduce its effective interest in PropCo) by an additional 9%.

The proposed steps for implementing the arrangement are as follows:

Step 1

- a) PropCo will issue the preference shares to the Applicant as a capitalisation share issue in terms of section 47 of the Companies Act.
- b) The preference shares will have the following terms:
- i) each preference share will have a specified capital value so that, in aggregate, the preference shares' value equals the speculative market value of the ordinary shares in PropCo;
 - ii) the preference shares shall rank in priority with respect to, amongst others, distributions by PropCo in relation to other shares and the repayment of shareholder loans;
 - iii) each preference share shall be or may be redeemable, as the case may be –
 - (aa) on a scheduled redemption date (which will be five years after the original date of issue); or
 - (bb) at the voluntary and sole discretion of the board of PropCo; or
 - (cc) if a Trigger Event, Illegality Event or a Sanction Event arises;
 - iv) only if a Trigger Event occurs will a dividend rate of 7% be applied to any outstanding payments in respect of the preference shares; and
 - v) the preference shares do not have any voting rights except in respect of –
 - (aa) a resolution which affects –
 - o the rights attaching to the preference shares; or
 - o the interests of the Applicant;
 - (bb) a Potential Trigger Event or Trigger Event that has occurred; or
 - (cc) circumstances in which the Companies Act prescribes that the preference shares shall have a vote.
- c) As security for the timeous redemption of the preference shares, PropCo will enter into the Pledge and Cession Agreement whereby it (i) pledges all shares and other securities it holds or will hold; and (ii) cedes, in *securitatum debiti*, its non-interest-bearing bank accounts and claims against third parties, to the Applicant.

On redemption, the preference shares will be redeemed out of profits and not out of capital (as a return of capital).

Step 2

- a) The Applicant will then dispose of 51% (and up to an additional 9%) of its ordinary shares in PropCo to DevelopCo on the fulfilment of the conditions precedent in the Share Purchase Agreement. The consideration to be paid by the Purchaser to the Seller for the 51% ordinary shares, will be R1.00.
- b) The respective parties will also enter into the following two cession agreements:
 - i) A first ranking pledge and cession agreement, securing the obligations of PropCo in respect of the overdraft facility provided to PropCo; and
 - ii) A second ranking pledge and cession agreement, securing the preference shares and the obligations of PropCo in respect of the preference shares.

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 exchange of rights resulting in the acquisition of the capitalisation shares, must be disregarded for capital gains tax purposes.
- b) Securities Transfer Tax (STT) will be levied under section 2 of the STT Act on the market value of the ordinary shares of PropCo transferred to DevelopCo. PropCo will be liable for the payment of STT (if any) under section 6 of the STT Act which may be recovered under section 7(2) from DevelopCo.
- c) The preference share dividends and / or redemption amounts received by or accrued to the Applicant will be "dividends", as defined in section 1(1) of the Act.
- d) The preference shares are neither –
 - i) "hybrid equity instruments" as defined in section 8E(1) and the dividends are not deemed to be income under section 8E(2) of the Act; nor
 - ii) "third-party backed shares" as defined in section 8EA(1) of the Act and the dividends are not deemed to be income under section 8EA(2) of the Act.
- e) As soon as the Applicant becomes entitled to compel PropCo to redeem the preference shares within three years of the date of issue, the preference shares will constitute "hybrid equity instruments" as contemplated in section 8E(1)(a)(ii) of the Act.

- f) Paragraph 43A will apply to the dividends that will arise in respect of the preference shares, which include the redemption amount.
- g) The Applicant will be required to take the preference share dividends into account in determining if an “extraordinary dividend” arises under paragraph (b) of that definition in paragraph 43A(1) in relation to the ordinary shares disposed of and to the extent there is an extraordinary dividend that must be taken into account as part of proceeds from the disposal of the ordinary shares under paragraph 43A(2).
- h) The Applicant will not also be required to take those preference share dividends into account in determining if an “extraordinary dividend” arises under paragraph (a) of that definition in paragraph 43A(1) in relation to the preference shares.
- i) STT will be payable on the redemption of the preference shares.

The ruling does not express any view on the Companies Act and its application.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 12 July 2023.

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