

BINDING PRIVATE RULING: BPR 175

DATE: 30 July 2014

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
VALUE-ADDED TAX ACT, NO 89 OF 1991 (the VAT Act)**

**SECTION : SECTIONS 11(a), 23(g), AND 24J OF THE ACT
SECTIONS 1(1) DEFINITION OF “ENTERPRISE”, 7(1)(a) AND 12(a)
OF THE VAT ACT**

SUBJECT : DEBT PURCHASE TRANSACTIONS

1. Summary

This ruling deals with the purchasing by the Applicant of debtors books from businesses across various industry sectors.

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 No. 28 of 2011.

In this ruling references to sections are to sections of the relevant Acts applicable as at 5 March 2014 and 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 provisions of –

- section 11(a) read with section 23(g) of the Act;
- section 24J(1), (2), (3), (4) and (4A) of the Act; and
- sections 1(1), definition of “enterprise”, 7(1)(a) and 12(a) of the VAT Act.

3. Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa that wishes to acquire debtors books from Sellers

Sellers: Companies incorporated in and residents of South Africa wishing to dispose of their debtors books, with Seller A as the first proposed client

4. Description of the proposed transaction

The Applicant is a close corporation currently providing limited financial consulting services. It intends engaging in the on-going purchase of debtors on the books from numerous Sellers across all industry sectors (debtors). The Applicant is not part of a group of companies.

Individual debtors will be purchased on a monthly basis. The Applicant submitted the estimated number of individual debtor purchase transactions it anticipates to

enter into, within the next three years to SARS. After entering into a contract with a Seller, the Applicant will carry out a risk assessment (by employing credit risk assessors) of the Seller and its debtors to identify whether its book debts would be suitable for the invoice discounting service.

If the Applicant is not satisfied with the risk profile an invoice will be generated by the Applicant for an administration fee in order to cover the costs of this risk assessment process and the contract will be cancelled by agreement. If the Applicant is satisfied with the Seller's risk assessment then no invoice for the administration fee will be generated and the Applicant will engage in the invoice discounting service with that Seller.

Proposed invoice discounting transactions will be carried out as follows:

- The ordering party (the debtor of the Seller) will place an order for goods or services with the Seller. The Seller will supply the goods or service and issue a tax invoice to the debtor. In terms of the supply arrangement between the Seller and the debtor, payment is required to be made by the debtor within a stipulated time frame (i.e. generally 60 or 90 days from the date of statement).
- The Seller will require short term funding to manage its business, therefore, the Seller intends on-selling some of its debtors to the Applicant at a discounted price rather than to wait for the amounts owing by the debtors to become due and payable.
- In order to purchase the debtors from the Seller, an agreement is to be entered into on the following material terms:
 - The Applicant agrees to purchase existing and all future debts of selected debtors.
 - The Applicant undertakes to purchase all right, title and interest to the debts at a discounted price.
 - On purchase of the debtors, the Seller will cede the debtors to the Applicant and will make certain warranties that the debtors can be sold.
 - The Seller will confirm that it is registered for VAT on an invoice basis under section 15(1) of the VAT Act or that it is not registered for VAT.
 - The debtors will be purchased with full recourse in the event –
 - of a dispute by the debtor that the debt is not due;
 - that there is a counter claim; or
 - if the debtor has not paid the Applicant within 10 days after the due payment date.
 - The purchase price of the debtor will be paid by the Applicant to the Seller as agreed to.
 - The debtor will pay the Applicant instead of the Seller on the due payment date in terms of the payment terms agreed between the debtor and the Seller.

- The Applicant has no right to the early redemption of the debt.

Even though the transaction will be 'with-recourse', the Applicant will, at its discretion and where possible, endeavour to take out insurance against non-payment of the debt by the debtor.

The Applicant's gross profit (interest) will be the discount negotiated, which is the difference between the value of the debt purchased and the price paid for that debt.

In order to fund the business operations of the Applicant, the Applicant will receive loans from two related parties. The capital and interest of the loans will have a fixed repayment term repayable monthly. Interest will be charged at a market related interest rate.

5. Conditions and assumptions

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

- Each invoice discounting transaction in relation to a specific debt will be treated as a separate 'instrument' for purposes of section 24J of the Act;
- The requirements of section 24J of the Act will be adhered to.
- Each invoice discounting transaction will be concluded at a discount and will be purchased from an unrelated party.

6. Ruling

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

Income Tax

- The gross profit (interest) earned on each invoice discounting transaction will be included in the Applicant's gross income by virtue of section 24J(3) of the Act in accordance with the "alternative method" as defined in section 24J(1).
- If a debtor defaults and all recovery methods have been exhausted, the Applicant will make an "adjusted loss on transfer or redemption of an instrument", as defined in section 24J(1) of the Act which is then deemed to have been incurred by the Applicant under section 24J(4)(b).
- To the extent that an amount for such instrument has been included in the income of the Applicant under section 24J of the Act, such amount will be allowed as a deduction from the income of the Applicant as holder during such year of assessment under section 24J(4A)(a).
- The remaining loss, not recovered, will be deductible under section 11(a) read with section 23(g) of the Act.
- The interest incurred by the Applicant on the loans to fund its working capital requirements will be deductible under section 24J(2) of the Act.

Value-Added Tax

- The Applicant's activity of purchasing debtors and collecting money from the debtors is not in the furtherance of an enterprise, therefore, no output tax or input tax shall be applicable;
- The supply of services by the Applicant for which it receives payment in the form of a credit assessment fee, will be subject to VAT if the Applicant is a vendor.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of three years from 5 March 2014.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**