

BINDING PRIVATE RULING: BPR 191

DATE: 26 March 2015

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 8E, 8EA, 19 AND PARAGRAPH 12A OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : REFINANCING OF DEBT THROUGH PREFERENCE SHARE FUNDING

1. Summary

This ruling deals with the refinancing of current debt through preference share funding.

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 and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule thereto applicable as at 12 November 2014 and 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 the provisions of –

- section 8E;
- section 8EA;
- section 19; and
- paragraph 12A.

3. Parties to the proposed transaction

The Applicant: A listed company incorporated in and a resident of South Africa

The Co-Applicant: A private company incorporated in and a resident of South Africa

Operating Company: A private company incorporated in and a resident of South Africa

4. Description of the proposed transaction

The Applicant historically held 100% of the equity shares in the Operating Company, which was diluted to 74% when the Co-Applicant subscribed for 26% of the equity shares. The Operating Company provided financial assistance to the Co-Applicant to obtain the shares, as contemplated in section 44 of the Companies Act No. 71 of 2008, resulting in an interest bearing loan (the subscription loan) owing by the Co-Applicant to the Operating Company.

As compensation for the dilution of the Applicant's shareholding, the Operating Company declared a dividend equal to the subscription loan to the Applicant (the subscription dividend) which remained outstanding on loan account.

The Applicant and Co-Applicant wish to refinance the respective loans as follows –

- the Applicant will utilise cash (equal to the current outstanding balance of the subscription loan) to subscribe for preference shares in the Co-Applicant;
- the Co-Applicant will utilise the proceeds received from the preference share subscription to fully settle the subscription loan owing to the Operating Company; and
- the Operating Company will utilise the funds received from the Co-Applicant to fully settle the outstanding balance of the subscription dividend.

The salient features of the preference share subscription agreement will be as follows:

- The preference share dividends shall be paid by the Operating Company to the Applicant for and on behalf of the Co-Applicant as a first charge against any dividends receivable by the Co-Applicant.
- Any dividends which remain after the payment of the preference share dividends will be allocated as follows –
 - a) 6% thereof will be paid directly to the Co-Applicant; and
 - b) the remaining 94% must be paid into an escrow account for the benefit of the Co-Applicant on which the Co-Applicant will earn interest at a competitive interest rate. The funds in the escrow account may not be used for any purpose other than to redeem the preference shares.
- The Co-Applicant may redeem the preference shares in part or in full at any time after the date of issue.
- The exercise by the Co-Applicant of its option to redeem the preference shares (or a part thereof) will not create an obligation on the Co-Applicant to do so, nor will it give the Applicant the right to call on the Co-Applicant for the redemption. The exercise of the option to partially redeem will furthermore not alter any of the remaining preference share terms.
- There is no fixed date on which the Co-Applicant must redeem all of the preference shares, although it is expected that they will all be redeemed after a period of approximately three years from the date of issue.

- The Co-Applicant will not be obliged to utilise any other funds except the funds in the escrow account to redeem the preference shares.

5. Conditions and assumptions

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

6. Ruling

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

- The preference shares to be issued by the Co-Applicant to the Applicant will not be –
 - a) Hybrid equity instruments as defined in section 8E(1); or
 - b) Third party backed shares as defined in section 8EA(1).
- The issue of the preference shares will fall within the definition of “qualifying purpose” as defined in section 8EA(1), read with section 8E;
- The voluntary redemption of the preference shares by the Co-Applicant, whether partially or in full, will not create a new “date of issue” as defined in section 8E(1).
- The provisions of section 19 and paragraph 12A will not be applicable to the repayment of the subscription loan and subscription dividend loan.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 3 years from 12 November 2014.

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