

## RULING ON NOTIONAL FUNDING ARRANGEMENT

**The degree to which black people participate in the ownership of an entity is an important measure of an entity's compliance with the black economic empowerment (BEE) legislation and the amended codes. The difficulty with many BEE transactions is that the participants do not have the funding available to acquire ownership (shares) in the measured entity. Historically, where the participants have used third party funding (eg preference shares) to finance the acquisition of shares in the measured entity, the funding has proved too costly, leaving the participants with no meaningful ownership in the measured entity.**

Notional vendor funding (NVF) has therefore become a popular means of implementing BEE transactions (and other transactions where the participants do not have available funding) as no capital is required to implement the transaction and, as a result of the arrangement, the participants can be left with a greater number of shares in the measured entity compared to other funding alternatives.

There has often been much debate as to the tax consequences that may arise from the NVF arrangement. The NVF arrangement has also been implemented in a number of different ways and has evolved over the years. The tax consequences arising from a NVF arrangement can therefore differ depending on the way in which the arrangement has been implemented.

The applicants in Binding Private Ruling No 190 (BPR 190), released by the South African Revenue Service (SARS) on 9 March 2015, sought clarity on the tax consequences arising from their particular NVF arrangement. BPR 190 does not discuss all of the particular issues that form part of the debate in relation to NVF arrangements. Taxpayers should therefore be aware that BPR 190 will not necessarily apply to their particular arrangement.

The basic mechanics of the NVF arrangement contemplated in BPR 190 involve the participant (BEECo) subscribing for an appropriate number of ordinary shares (shares) in the measured entity (SACo) to comply with the BEE requirements. These shares rank *pari passu* with the other ordinary shares in SACo. However, it is contractually agreed between SACo and BEECo, in terms of the subscription and repurchase agreement, that:

- The Shares are issued for a subscription price of R1 per share on day one and SACo has the right to repurchase a determinable number of shares at the original subscription price (R1) (repurchase right) on a future repurchase date (maturity date).

- BEECo is not entitled to dispose of the shares until after the maturity date.
- The maturity date on which the repurchase right will be exercised is the 5th anniversary of the subscription date.
- The number of shares to be repurchased by SACo will be determined in accordance with a pre-determined notional vendor funding formula which takes into account the following:
  - the initial market value of an ordinary share in SACo not subject to the repurchase right;
  - market value of an ordinary share in SACo not subject to the repurchase right, on the maturity date;
  - a notional escalation factor; and
  - the period of time that elapsed since the subscription date and the maturity date.

The effect of the NVF arrangement is therefore that SACo issues a number of shares to BEECo on the basis that, depending on the formula, it is entitled to repurchase a determined number of those shares at the same issue price. The shares are thus issued at nominal value and acquired at nominal value. The tax consequences arising from this arrangement may appear to be relatively straight forward, but this is not necessarily the case and careful consideration must be given to various provisions in the Income Tax Act, No 58 of 1962 (Act), having regard to the specific mechanics of the NVF arrangement contemplated in BPR 190.

Without discussing the issues in detail, BPR 190 confirmed that:

- Section 24J of the Act (governing the taxation of interest) will not be applicable to the proposed transaction.

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- The issue and the repurchase of a portion of the shares from BEECo will not give rise to a capital gain or loss in the hands of BEECo for purposes of the Eighth Schedule to the Act.
- No securities transfer tax will be levied in respect of the remaining ordinary shares released to the BEECo following the repurchase transaction.

As with all binding private rulings, BPR 190 may not be cited in any proceedings between SARS and taxpayers other than the applicants to the ruling. If parties wish to make use of an NVF arrangement, it is recommended that they apply for their own advance tax ruling in respect of their particular transaction.

*Andrew Lewis*

## THE VAT TREATMENT OF JOINT VENTURE INTERESTS

**Substantial uncertainty has arisen over the last few months pursuant to the Value-added Tax (VAT) treatment of interests in unincorporated joint ventures. This has especially become relevant in the context of property owners owning an undivided interest in property and forming a joint venture so as to lease the property to third parties. From a strict legal perspective, the joint venture may have had to register as a separate vendor in terms of s51 of the Value-Added Tax Act, No 89 of 1991 (VAT Act), it being a body of persons. In this context the requirement is to register as a separate VAT vendor irrespective of the question whether a partnership is formed between the property owners.**

A specific problem arose pursuant to the disposal of the undivided interest in these properties by one of the owners. In itself this may not necessarily result in a sale of a going concern as it is not possible to lease the undivided interest in the property without the co-operation of the remaining owner of the undivided interest. It was thus not possible to make use of the corporate reorganisation rules in these circumstances. It was proposed as part of the 2015 Budget

tax proposals to extend the relevant provisions of the VAT Act so as to recognise reorganisation in these circumstances. In other words, it may be possible to enter into reorganisation transactions in these circumstances without any additional VAT liability that will arise.

*Emil Brincker*

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