

# TAX ALERT

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### THE DEFINITION OF 'CONTROLLED GROUP COMPANY' AND 'EQUITY SHARE'

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# DISPOSAL BY SHARE BLOCK COMPANY OF SECTIONAL TITLE UNITS TO ITS SHAREHOLDERS

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*SARS ruled that, to the extent that the disposal by the Share Block Company of the sectional title units constitutes a dividend in specie, it would be exempt from dividends tax.*

**The South African Revenue Service (SARS) released Binding Private Ruling, No 206 (Ruling) on 14 September 2015. The Ruling dealt with the disposal by a share block company of sectional title units to its share block holders.**

A resident company (Applicant), and a resident trust (Trust), held shares in a resident share block company (Share Block Company).

The Share Block Company owned three sectional title units.

It was proposed that the Share Block Company would dispose of the sectional title units to the Applicant and the Trust. The Applicant and the Trust would then surrender their share block certificates and rights of use to the Share Block Company. These would then be cancelled.

Effectively, after the completion of the transaction, the Applicant and the Trust would directly hold the sectional title units, and would no longer hold shares in the Share Block Company.

On the assumption that the Applicant and the Trust held their shares as capital assets, SARS ruled that paragraph 67B of the Eighth Schedule of Income Tax Act, No 58 of 1962 (Act) would apply to the disposal of the sectional title units by the Share Block Company.

Paragraph 67B of the Eighth Schedule to the Act effectively provides that, where a person has a right of use of a part of the property of a share block company, conferred by reason of that

person holding a share in that share block company, and that person subsequently acquires ownership of that part of the property upon disposal by the share block company:

- The share block company must disregard any capital gain or loss resulting from the disposal; and
- The person must disregard any capital gain or loss resulting from the disposal of its shares in the share block company.

In addition SARS ruled that, to the extent that the disposal by the Share Block Company of the sectional title units constitutes a dividend *in specie*, it would be exempt from dividends tax in terms of s64FA(1)(d) of the Act. Presumably this would only be relevant to the Trust.

For purposes of Value-added Tax (VAT), SARS ruled that the supply of the sectional title units by the Share Block Company would be deemed to have been made in the course and furtherance of an enterprise, as contemplated in s8(19) of the Value-added Tax Act, No 89 of 1991 (VAT Act). The value of the supply would also be deemed to be nil in terms of s10(27) of the VAT Act. Accordingly, the output VAT would be zero.



# DISPOSAL BY SHARE BLOCK COMPANY OF SECTIONAL TITLE UNITS TO ITS SHAREHOLDERS

CONTINUED

*The provisions apply to undivided interests in sectional title units owned by share block companies.*

In terms of s9(19) of the Transfer Duty Act, No 40 of 1949, the transfer of the sectional title units would also be exempt from transfer duty.

Effectively, the provisions referred to above provide for roll-over relief where a share block company disposes of its property or parts thereof to a shareholder who has rights in respect of that property or part.

The Ruling illustrates the application of these provisions rather well, and also makes it clear that the provisions apply to undivided interests in sectional title units owned by share block companies.

*Heinrich Louw*

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# THE DEFINITION OF 'CONTROLLED GROUP COMPANY' AND 'EQUITY SHARE'

*SARS ruled that the class A ordinary shares would constitute 'equity shares' for purposes of the definition of 'qualifying share'.*

*SARS therefore ruled that the rental income received by the company into which the VCC will invest would not constitute 'investment income'.*

**The South African Revenue Service (SARS) released Binding Private Ruling No, 205 (Ruling) on 11 September 2015. The Ruling considers the meaning of 'controlled group company' and 'equity share'.**

An approved venture capital company (VCC) in terms of s12J of the Income Tax Act, No 58 of 1962 (Act), resident company A (Company A), and resident company B (Company B), proposed to incorporate a new company (RentalCo).

RentalCo would lease certain movable goods under operating leases to existing clients of Company A.

The VCC would subscribe for 20% of the issued shares in RentalCo, but at a disproportionate subscription price of 75% of the issued share capital of RentalCo. The VCC would be issued with class A ordinary shares.

Company A and Company B would subscribe for class B and class C ordinary shares respectively, totalling 80% of the issued shares in RentalCo.

The class A ordinary shares would entitle the VCC to a first distribution of profits or capital equal to the capital invested and a return of prime plus 2%.

Once the distributions in respect of the class A shares have been settled, the holders of the class B and C shares would be entitled to a second distribution of profits or capital equal to prime plus 2% in proportion to their respective shareholding.

Thereafter all ordinary shares would rank *pari passu*.

All ordinary shares would at all times carry equal voting rights.

The VCC intends to enter into similar transactions in future with partners whereby companies would be incorporated for

purposes of leasing goods to clients. The VCC will always hold less than 70% of the shares in issue because a 'qualifying company' for purposes of s12J of the Act may not be a controlled group company in relation to the VCC. The VCC will always subscribe for cash.

SARS ruled that the class A ordinary shares would constitute 'equity shares' for purposes of the definition of 'qualifying share' in s12J(1) of the Act. In other words, they are not shares that "neither as respects dividends nor as respects returns of capital, carr[y] any right to participate beyond a specified amount in a distribution".

SARS also ruled that the company into which the VCC will invest (such as RentalCo), would not constitute a 'controlled group company' for purposes of the definition of 'qualifying company' in s12J(1) of the Act to the extent that the VCC holds less than 70% of the number of equity shares in issue. This is so despite the fact that the VCC might invest more than 70% of the share capital.

The company into which VCC will invest would not be a 'qualifying company' as defined if the sum of the 'investment income' derived during any year of assessment exceeds 20% of gross income. 'Investment income' includes rental from immovable property, but not movable goods. SARS therefore ruled that the rental income received by the company into which the VCC will invest would not constitute 'investment income' as defined in s 12E(4)(c) of the Act.

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