TAX

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EXEMPTION FROM DONATIONS TAX AND THE NET VALUE OF AN ESTATE

On 1 July 2015, the South African Revenue Service (SARS) released Binding Private Ruling 197 (BPR 197) dealing with the donations tax consequences arising from the onward or subsequent donation of funds received by way of a donation from a foreign source. BPR 197 further deals with the estate duty consequences that will apply in the event of the foreign sourced funds being retained or used to acquire property that is located and remains outside South Africa.

By way of background, the applicant, a resident of South Africa as defined in s1(1) of the Income Tax Act, No 58 of 1962 (Act), is one of a number of beneficiaries of a foreign trust (Foreign Trust). The funds held by the Foreign Trust consist solely of funds which have been sourced outside of South Africa. In terms of an agreement reached between the trustees of the Foreign Trust, a certain amount of the trust funds would be awarded to the applicant, whereafter the applicant would be removed as a beneficiary of the Foreign Trust.

Subsequent to the funds being transferred to the applicant's offshore bank account, the applicant intends to donate an amount thereof to certain elected individuals, hereinafter referred to as the donees. The applicant further intends to invest and retain the balance of the awarded funds offshore in order to acquire property, as defined in s3(2) of the Estate Duty Act, No 45 of 1955 (Estate Duty Act), located outside South Africa.

Section 56(1) of the Act deals with certain transactions in respect of which donations tax shall not be payable on the value of property which is disposed of. In particular, s56(1)(g) of the Act provides that donations tax shall not be payable in respect of the value of any property which is disposed of under a donation:

> "(g) if such property consists of any right in property situated outside the Republic and was acquired by the donor –
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> (i) before the donor became a resident of the Republic for the first time; or
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> (ii) by inheritance from a person who at the date of his death was not ordinarily resident in the Republic or by a donation if at the date of the donation the donor was a person (other than a company) not ordinarily resident in the Republic; or
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> (iii) out of funds derived by him from the disposal of any property referred to in sub-paragraph (i) or (ii) or, if the donor disposed of such last-mentioned property and replaced it successively with other properties (all situated outside the Republic and acquired by the donor out of funds derived by him from the disposal of any of the said properties), out of funds derived by him from the disposal of, or from revenue from any of those properties."

Having regard to the background set out above, SARS ruled as follows:

- the awarding of funds by the Foreign Trust to the applicant will not trigger any income tax liability in the hands of the applicant;
- the donations made by the applicant to the donees will be exempt from donations tax under s56(1)(g)(ii) of the Act; and
- the remaining portion of the award received and/or the property acquired using the proceeds of the award from the Foreign Trust will be excluded from the net value of the applicant's estate for estate duty purposes under s4(e)(ii)(aa) or (iii) of the Estate Duty Act.

It is interesting to note that SARS specifically stated that whether or not the proposed transaction is connected with any arrangement implemented or to be implemented for the avoidance of tax falls outside the scope of BPR 197 and shall not be decided on.

BPR 197 is valid until 28 February 2025.

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DEBT REDUCTION BY WAY OF SET-OFF

The South African Revenue Service (SARS) published Binding Private Ruling No. 193 (BPR 193) on 15 June 2015, which deals with the repayment of a shareholder loan by way of set-off with an outstanding loan under a subscription agreement.

The applicable provisions in the Income Tax Act, No 58 of 1962 (Act) are s19 of the Act and paragraphs 12A and 20(3)(b) of the Eighth Schedule to the Act.

The applicant in the transaction to which BPR 193 applies is a company incorporated in and resident of South Africa (Applicant). The second party to the transaction is the holding company of the Applicant and a non-resident for South African tax purposes (Holdco).

The facts are as follows: Holdco, being a shareholder of the Applicant, provided loan funding to the Applicant (Shareholder Loan). The Shareholder Loan was interest-bearing and remained owing to Holdco. The Applicant used the Shareholder Loan to fund the acquisition of fixed property, erect improvements, acquire operating equipment and finance deductible expenditure. In other words, the Shareholder Loan was used for working capital purposes or to fund the acquisition of assets for which allowances can be claimed.

The Applicant faced the following difficulties:

- From a cash-flow perspective, the Applicant found itself unable to operate effectively and to pay off the interest on the Shareholder Loan.
- The Applicant realised that the Shareholder Loan would fall foul of the South African thin capitalisation provisions with the result that not all interest due and payable to Holdco on the Shareholder Loan would qualify for a tax deduction.
- The Applicant further realised that its balance sheet could impair its ability to obtain credit for working capital requirements.

It was therefore decided that the Applicant and Holdco would enter into the following transaction:

- Step 1: Holdco would demand repayment of a portion of the capital of the Shareholder Loan as well as payment of arrear interest owed by the Applicant.
- Step 2: Holdco and the Applicant would enter into a subscription agreement. Holdco would subscribe for 1 ordinary share with a par value of R1 in the Applicant, to be issued at a premium. The value of the share would be equal to the portion of the debt (which would include capital and interest) that is due to be settled by the Applicant. The subscription amount would remain outstanding on loan account (Subscription Loan).
- Step 3: Upon the subscription agreement becoming unconditional, the Shareholder Loan and the Subscription Loan would be set-off.
- Step 4: The Applicant would issue the 1 share to Holdco. The portion of the Shareholder Loan not settled would remain outstanding.

The ruling made in respect of the aforementioned transaction is that the proposed subscription for the 1 share in the Applicant by Holdco and subsequent settlement of the corresponding loan accounts would not fall foul of s19 of the Act, nor paragraphs 12A and 20(3)(b) of the Eighth Schedule to the Act.

BPR 193 is valid for one year from 3 March 2015.

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