TAX

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RULING ON SHARE REPURCHASE AND TRANSFER FOR NO CONSIDERATION

The South African Revenue Service (SARS) published Binding Private Ruling 194 (Ruling) on 15 June 2015. The ruling dealt with the disposal of shares by way of a share repurchase by a resident company from a non-resident shareholder for no consideration, and a subsequent donation by the non-resident of shares to a resident company.

The Applicant was a resident private company, whose shareholders were HoldCo (68.2%), Company B (17.8%) and Company C (14%). The Applicant's shareholders were also resident private companies. Company B was a broad-based black economic empowerment company.

A certain Investor A was a non-resident who held 5.16% of the ordinary shares in HoldCo.

The Applicant, HoldCo, and Investor A, for benevolent purposes, proposed the following transaction:

- the Applicant would donate 4% of its annual profits to charitable causes;
- to compensate the shareholders of the Applicant, HoldCo would repurchase (and cancel) a portion of Investor A's shares in HoldCo for no consideration; and
- investor A would transfer the balance of its shares in HoldCo to Company B for no consideration, in order to ensure that Company B remains in the same economic position.

SARS ruled that:

- The share repurchase would not result in any inclusion in HoldCo's gross income, nor would it constitute a disposal by HoldCo for capital gains tax purposes.
- Securities transfer tax would be payable in respect of the share repurchase as well as the share transfer to Company B at 0.25 % of the market value of the shares, and HoldCo would be responsible for payment.
- The share repurchase and share transfer would not result in any inclusion in Investor A's gross income (from a South African tax perspective), nor would there be any capital gains tax consequences for Investor A because the assets do not fall within the ambit of paragraph 2(1)(b) of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act).
- The repurchase would not result in a dividend for purposes of dividends tax (presumably because the repurchase is for no consideration).
- Investor A would not be liable for donations tax in respect of the share repurchase and the share transfer because he is a non-resident.
- The annual donations to be made by the Applicant would be deductible by the Applicant to the extent that such donations comply with s18A of the Act, and would also be exempt from donations tax.

The Ruling appears to be correct in respect of the application of the various provisions of the Act, but it is noted that no mention is made as to whether any transfer pricing adjustments would be made in terms of s31 of the Act.

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PROPOSED AMENDMENT TO ANTI-AVOIDANCE RULE IN RESPECT OF ASSET-FOR-SHARE TRANSACTIONS

Section 42 of the Income Tax Act, No 58 of 1962 (Act) provides for tax roll-over relief in respect of asset-for-share transactions as defined. Such a transaction generally entails the disposal by a person of an asset to a company, and the issue by that company of new shares to the person as consideration.

One of the requirements is that the nature of the asset must be retained. In other words, if the person held the asset as trading stock, the company must acquire it as trading stock, and if the person held it as a capital asset, the company must acquire it as a capital asset. If the person held the assets as a capital asset, the company may acquire it as a capital asset if the person (where the person is a company) and the company do not form part of the same group of companies.

However, asset-for-share transactions can create an opportunity for a person holding assets as trading stock, to dispose of such assets to a company by way of an asset-for-share transaction, and subsequently sell the shares as capital assets.

To prevent such an abuse of asset-for-share transactions, s42(5) of the Act contains an anti-avoidance provision. If a person disposes of any share received in terms of an asset-for-share transaction within 18 months after the date of acquisition, and immediately prior to such disposal more than 50% of the market value of all the assets disposed of by that person to the company is attributable to allowance assets or trading stock, that person will be deemed to have disposed of the relevant shares as trading stock.

The deeming provision only operates to the extent that the amount received by the person for the disposal of the shares is less than or equal to the market value of the shares at the beginning of the 18 month period. In other words, the person disposing of the shares will be deemed to have disposed of the shares on revenue account, but only up to the amount of the market value of the shares at the beginning of the 18 month period. If the person receives more than that as consideration for the disposal of the shares, the normal rules will apply in respect of determining whether the disposal is on revenue or capital account.

The restriction does not apply to the disposal of a share by means of:

- an intra-group transaction in terms of s45 of the Act;
- an unbundling transaction in terms of s46 of the Act;
- a liquidation distribution in terms of s47 of the Act;
- an involuntary disposal in terms of paragraph 65 of the Eighth Schedule to the Act; or
- the death of the person.

An amalgamation transaction in terms of s44 is not excluded. However, see Binding Private Ruling No 159, in which the South African Revenue Service ruled that, based on the particular facts at hand, shares acquired in terms of a s42 transaction could be disposed of by way of a s44 amalgamation transaction and would not be deemed to be on revenue account but on capital account.

National Treasury recently released the draft Taxation Laws Amendment Bill 2015. One of the proposed amendments concerns the clarification of s42(5) of the Act. There appears to be a concern that the current wording "creates unintended anomalies and potentially converts the nature of the equity shares to assets held as trading stock".

It is proposed that, instead of formulating the anti-avoidance provisions as a deeming provision, whereby the person is deemed to dispose of shares as trading stock, the person must rather be directly obliged to include the relevant consideration in income. The inclusion in income will therefore not be as a result of the shares being deemed to be trading stock, which could have caused confusion considering accompanying transactions.

It is important to appreciate that the restriction contained in s42(5) should be read together with the requirement that the person must retain a "qualifying interest", as defined, in the company for a period of at least 18 months. The consequences for not doing so are described in s42(6) of the Act. Even though it is possible for the person to dispose of the shares received within 18 months of the implementation of the transaction without s42(5) necessarily applying (for example, if less than 50% of the value of the assets is attributable to trading stock), the person should take care not to dispose of so many shares as would cause the person to no longer hold a qualifying interest in the company.

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