

Binding Ruling – BPR 143 – Headquarter company

Binding Private Ruling 143, dated 2 May 2013, issued in terms of section 76Q of the Income Tax Act No. 58 of 1962 (the Act), deals with whether certain preference shares held by the applicant (a public company incorporated and resident in South Africa) qualify as equity shares in the context of the definition of headquarter company in section 1 of the Act.

The applicant holds preference shares in a foreign company and those shares confer on the holder the right to participate in a return of capital only to the extent of the subscription price of the shares plus any arrear dividends.

The right to participate in dividends, although expressed in the company's articles of association as a rate on the subscription price, is effectively unlimited and unrestricted, since the rate is within the discretion of the directors and is thus not restricted to a predetermined amount or coupon. The directors are thus free, if they so wish, to declare the same dividend on preference shares as on ordinary shares.

The applicant intends to list a certain percentage of its shares on an international stock exchange, should it qualify as a headquarter company as defined in section 1 read with section 9I(1) and 9I(2).

The Binding Private Ruling is that the preference shares in question, held by the applicant in the foreign company, will be regarded as equity shares for the purpose of applying the definition of headquarter company. The ruling is valid for five years from 25 November 2011.

The significance of the ruling

The term headquarter company is defined in section 1 of the Act as a company envisaged in section 9I(1) (in other words, a

resident company that fulfils the requirements set out in section 9I(2)) that has made an election, in terms of that section and in the form and manner prescribed by SARS, to be a headquarter company for a particular year of assessment of that company.

An equity share is defined in section 1 as –

“any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution”

This definition thus disqualifies a share from being categorised as an equity share if the right of the holder, both as regards dividends and as regards a return on capital, is limited to a specified amount.

The preference shares held by the applicant in the foreign company in question were limited in respect of the right to participate in a return of capital to a specified amount, namely, the subscription price plus arrear dividends. The second of the disqualifying criteria in the definition of equity share, quoted above, was thus present.

The first disqualifying factor, namely, the restriction of dividends to a specified amount seemed, at first blush, also to be present in that the right of the shares in question to participate in dividends was, in terms of the company's articles, limited to a rate (specified in the articles) on the subscription price.

Typically, preference shares embody a right to receive a specified yield or return which is expressed as a percentage of the nominal value or issue price (this yield is often referred to as the “coupon”).

It would appear that a straight forward limitation as to coupon would have caused the share to fall foul of the second disqualifying criterion, given that the amount can be readily

determined by reference to either the par value or the issue value of the preference share and would not vary over the term of the preference share.

In the case of this applicant, however, the coupon in respect of the preference shares in question was not fixed, but was in the discretion of the directors. Once this factor was taken into account, the right to participate in a dividend distribution was not subject to a limitation either as to coupon or as to amount.

The way in which the foreign company's articles of association expressed the rights of the holders of the preference shares in question was thus ingenious, in that the specified rights, attaching to the shares in question, were held not to fall foul of the exclusionary criteria set out in the definition of equity share, even though the directors could, in practice, limit the right to participate in dividends by way of a discretionary determination, year by year, of the coupon.

The broader perspective



SARS did not take the view, as it could have done, that in substance, if not in form, the preference shares in question fell foul of the exclusionary criteria in the definition of equity share in that the right to participate in dividends was indeed limited, or at least, was not unlimited.

However, SARS's expansive attitude in this regard is not surprising, given that National Treasury had announced in the 2010 Budget Review that South Africa is to be promoted as a gateway to investment in Africa, and given that legislative amendments have already been made and exchange control regulations eased to encourage the establishment of headquarter companies in South Africa.

PwC

ITA: Sections 1 (definition of equity share and headquarter company); 9I(1); 9I(2) and 76Q

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