Consecutive asset-for-share transactions

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Section 42 of the Income Tax Act, No 58 of 1962 (Act) allows taxpayers to transfer assets to a company free of immediate tax consequences, provided certain requirements are met; there is a roll-over for tax purposes. However, certain anti-avoidance provisions may be triggered if the company that acquired the assets, disposes of the assets within 18 months of acquisition.

A question that has often been posed is whether the anti-avoidance provisions will apply if the company that acquired the asset, within 18 months of the acquisition, disposes of those assets to another company in terms of an asset-for-share transaction under s42 of the Act.
The South African Revenue Service (SARS) has provided some guidance in Binding Private Ruling 288 (BPR 288).

In BPR 288 the taxpayer sought a ruling from SARS on the following proposed transactions.

Company A is a local company. The shares in Company A are held (i) as to 89.8% by Company B, a foreign company, and (ii) as to 10.2% by the managing director (MD) of Company A.

A new shareholder (X) will buy 6.5% of the shares in Company A from Company B and the MD in proportion to their shareholding in Company A. The price will be market-related.

X will then transfer the shares it acquired in Company A to Company Q, a local company, in exchange for shares in Company Q.

Company B and the MD will then dispose of 19.5% of their shares in Company A to Company R in exchange for shares in Company R in quantities proportionate to their respective shareholding in Company A. Company B will transfer those shares as an asset-for-share transaction under s42 of the Act. Company R intends holding the shares in Company A on capital account.

The subsequent transaction is the tricky one: Company R will promptly transfer its shares in Company A to Company Q in exchange for shares in Company Q. Company R will transfer those shares in terms of an asset-for-share transaction under s42 of the Act. Company R will then hold 75% of the shares in Company Q. The remaining shares in Company Q will be held by X.

The rulings of SARS that are notable are the following:

- First, in the circumstances of the matter, Company R will be seen to hold the shares in Company A on capital account even though it will dispose of the shares in Company A to Company Q shortly after it acquired the shares.
- Second, in principle, the 18-month anti-avoidance rule will apply to the disposal by Company R of its shares in Company A to Company Q. However, practically, no gain or loss will arise as the shares in Company A will be transferred at the cost at which they have been acquired.
- Third, the second asset-for-share transaction, that is, the transfer by Company R of its shares in Company A to Company Q, will qualify as an asset-for-share transaction under s42 of the Act.

What the ruling essentially says is this: if a taxpayer transfers a capital asset to a company in exchange for shares in that company and the requirements of s42 of the Act are met; and if the company then promptly disposes of that capital asset to another company in exchange for shares in that other company and the requirements of s42 of the Act are met then both transactions may qualify for tax roll-over relief.

A word of warning though: SARS made it very clear that the ruling in BPR 288 was specific to the facts in the matter. BPR 288 accordingly is not a licence for taxpayers to do successive asset-for-share transactions under s42 of the Act in all cases. Taxpayers would still in each case need to take specific advice from tax professionals before implementing such transactions.

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