

# Hybrid Equity Instruments: Redemption versus repurchase



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Section 8E of the Income Tax Act, 1962 (the Act) applies to *inter alia* deem a share to be a hybrid equity instrument if certain requirements are met, with the result that otherwise exempt dividends paid in respect of that share are deemed to be fully taxable income.

One of the requirements that must be met for purposes of section 8E to apply is that the issuer of the share must be obliged to redeem the share in whole or in part, or the share may at the option of the holder be redeemed in whole or in part, within three years from the date of issue of the share. Section 8E therefore requires a “redemption” of the relevant shares.

As the Act does not define a “redemption” and a “repurchase”, the question arises whether SARS will seek to apply the provisions of section 8E where shares are repurchased as opposed to redeemed.

In the case of *A (Pty) Ltd v Commissioner for SARS (Case No*

12644), 2012 SARS argued that, in essence, a redemption is a kind of “buy-back” and that there is no difference between the redemption of shares and a share buy-back. As the case on hand was decided on a different point, the court did not think it necessary to decide on the difference between a redemption of shares and a buy-back or a repurchase of shares.

Practically, however, there is a difference in the meaning of these terms. The redemption of shares results in the extinction of rights whereas a repurchase of shares results in a transfer of the rights embodied in the shares. It is, accordingly, arguable that where shares are repurchased as opposed to redeemed the provisions of section 8E cannot apply as a repurchase is a separate and distinct event from a redemption.

In SARS Binding Class Ruling: BCR 044 (2014), the applicant was a public company listed on the Johannesburg Stock Exchange (JSE) that issued non-redeemable and non-participating preference shares to certain persons (the Class Members). The applicant subsequently decided to repurchase the preference shares from Class Members at their current market value as traded on the JSE. SARS made various rulings in respect of the transaction, but in particular, ruled that the preference shares would not be recharacterised as hybrid equity instruments for purposes of section 8E merely by reason of their repurchase by the applicant, and that dividends paid by the applicant during the relevant financial year of assessment would therefore not be recharacterised as income in the hands of the Class Members.

Based on BCR 044, it would seem that SARS agrees that there is a difference between a redemption and a repurchase, but

unfortunately, binding class rulings are only binding on the particular Class Members and cannot be relied upon by other taxpayers. Consequently, taxpayers must take care when drafting the terms of a redemption or repurchase of shares and rather take the more conservative approach and assume that SARS may seek to apply the provisions of section 8E broadly, so that a repurchase (although different from a redemption in practice) will be treated akin to a redemption for purposes of section 8E.