

Income Tax Act: Clarity on distribution of unlisted shares

The South African Revenue Service (Sars) recently released Binding General Ruling 54 (BGR 54), which deals with the unbundling of unlisted shares and the impact on non-qualifying shareholders. In particular, section 46 of the Income Tax Act (ITA), which colloquially refers to this unbundling of shares as an "unbundling transaction", enables a company (the unbundling company) to distribute its shares in a subsidiary (the unbundled company) to its shareholders, in a tax efficient manner. More particularly, the unbundling transaction does not give rise to Capital Gains Tax (CGT), dividends tax or securities transfer tax.

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Distribution of listed shares

In the case of the distribution of listed shares by the unbundling company, other than needing to meet a minimum requirement in terms of shareholding and the distributing all of the shares in the unbundled company to shareholders, qualifying for relief under section 46 is not dependent on a minimum shareholding by the shareholder.

The same cannot be said where a company distributes unlisted shares to its shareholders. In this instance as with the distribution of listed shares, the unbundling company must hold a minimum percentage of shares in the unbundled company and it must distribute all those shares to its shareholders.

When distributing unlisted shares however, the shareholding in the unbundling company must be considered to ascertain whether section 46 will apply. In particular, section 46 notes that the unlisted shares must be distributed to a shareholder that essentially holds at least 70% of the shares in the unbundling company (whether directly or indirectly). This has created substantial debate over the years.

The debate then turns to whether this is an all or nothing scenario. In other words, if you have a shareholder that only holds, for example, 30% of the shares and another shareholder holds the remaining 70%, does it taint the entire unbundling or only part of it? Logic would dictate that section 46 would not make sense if it

required the shares to be distributed to a shareholder that effectively held 100% of the shares in the unbundling company. This would then limit the application of section 46 to instances where unlisted shares are distributed to a corporate shareholder that holds all the shares in the unbundling company. Nonetheless the debate has continued.

Clarifying section 46

Until 22 June 2020, that is, when Sars released BGR 54. In it, Sars has clarified some important aspects of the application of section 46. The first being that, assuming the unbundling company holds the requisite number shares in the unbundled company, that unbundling company must distribute all the shares it holds in the unbundled company, whether listed or not.

Secondly, the note clarifies that in the case of the unbundling of unlisted shares, where the shares are distributed to a number of shareholders, section 46 relief will only be applicable to that portion of unbundled shares distributed to a corporate shareholder that holds at least 70% of the shares in the unbundling company. In other words, it will only be applicable to the shares distributed to a company that forms part of the same group of companies as the unbundling company. That qualifying distribution will result in no liability for CGT, dividends tax or securities transfer tax.

Non-qualifying shareholders

On the other hand, that portion of the shares distributed to the non-qualifying shareholders will then need to be accounted for from a CGT, dividends tax and securities transfer tax perspective. It will, however, not invalidate the entire unbundling transaction. The non-qualifying shareholder would also have to account for own tax position as a result of the "unbundling", which in essence will simply be treated as the receipt of a dividend in specie, with its own facts and specific set of tax consequences.

Ultimately though, BGR 54 is a welcomed publication and provides some much need clarity. Perhaps we may see some further clarification on other particular issues involving the corporate roll-over relief provisions, which have been debated intensely over the years.

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