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Tax Developments on one page

The finer details of asset-for-share transactions

The Income Tax Act allows for roll-over relief in certain circumstances where assets are contributed to a company in exchange for shares in that company. Binding Private Ruling 287 is a good illustration that the provisions of this roll-over relief measure requires detailed consideration before it can be concluded that it applies to a transaction.

The Income Tax Act (Act) allows for roll-over relief in certain circumstances where assets are contributed to a company in exchange for shares in the company. These transactions are referred to as asset-for-share transactions and the relief afforded is contained in section 42 of the Act. The requirements of this roll-over provision are however quite complex and require detailed consideration before it can be concluded that it applies to a transaction. Some of the intricacies of this provision are well illustrated in a recent ruling, binding private ruling 287 (BPR 287).

Proposed transaction

The applicant, a company that owns undeveloped vacant land, will dispose of some of its land to another company (co-applicant). The co-applicant will issue 250 shares to the applicant.

The parties intend that the co-applicant will sell the undeveloped property with a comprehensive building package to a development company after it has been rezoned for development.

The development efforts will be managed by Company A. Company A will contribute to the development by, amongst others, using its expertise, executing certain critical steps in the development and facilitating the disposal of the property. In exchange for its expertise and services, the co-applicant will issue 125 shares to Company A when the property is transferred by the applicant to the co-applicant and 125 shares when the property is transferred to a development company that will undertake the development.

Ruling

The transaction qualifies as an asset-for-share transaction, provided that the property was a capital asset in the hands of the applicant and there has been no change of intention that will result in a disposal for capital gains tax purposes. Of particular relevance is the ruling that the base cost of the property, or its market value on valuation date, for the applicant must be treated as an amount to be taken into account by the co-applicant for purposes of sections 11*(a)*, 22(1) or 22(2), all of which deal with trading stock. If the co-applicant disposes of the property within 18 months from the transaction, an amount received in respect of trading stock must be ring-fenced from any assessed losses or balances of assessed losses.

Analysis and other considerations

One of the requirements of section 42 that is relevant in this instance, based on the reference to trading stock in the hands of the co-applicant, is:

> '…[the] company acquires that asset from that person —… as trading stock, where that person holds it as a capital asset and that company and that person do not form part of the same group of companies…"

If the the nature of the property in the hands of the co-applicant was not in doubt, it would appear that the uncertainty that required a ruling may have related to the timing of the application of the group of companies requirement. Immediately after the transfer of the property, prior to the issuing of shares to Company A, the applicant and co-applicant may have formed part of the same group of companies. It would appear as if SARS agreed to a pragmatic reading of the requirement in this particular context, taking into account the fact that sufficient shares would be issued to Company A following completion of transfer of the property to result in the applicant and co-applicant eventually not being part of the same group of companies after completion of the first set of steps. This is a good example of the detailed requirements to be considered before one can conclude a transactions qualifies for section 42 relief. *(February 2018)*

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