



SOUTH AFRICAN REVENUE SERVICE

BINDING PRIVATE RULING: BPR 028

DATE: 8 April 2009

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)

SECTION : SECTIONS 11(a), 23(g), and 24J(2)

SUBJECT : DEDUCTION OF RECURRING EXPENDITURE INCURRED IN TERMS OF HYBRID-DEBT INSTRUMENTS WHERE THE PROCEEDS OF SUCH INSTRUMENTS RANK AS PRIMARY SHARE CAPITAL FOR A BANK

1. Summary

This ruling deals with the deduction of certain periodic expenditure payable by a Bank in terms of hybrid-debt instruments issued subject to the conditions outlined in Regulation 38(13) of the Regulations relating to Banks.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling all legislative references to sections are to sections of the Act applicable as at 1 April 2008 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of sections 11(a), 23(g) and 24J(2).

The terms "primary share capital" and "hybrid-debt instrument" shall bear the meanings ascribed to them by the Banks Act, No. 94 of 1990 (the Banks Act).

3. Party to the proposed transaction

The applicant: A public company registered as a bank in terms of the Banks Act and subject to the Regulations relating to Banks

4. Description of the proposed transaction

As of 1 January 2008, the Banks Act was amended and new regulations (the Regulations) relating to Banks were issued under section 90 of the Banks Act. The amended Banks Act and Regulations allow banks to diversify their sources of capital by issuing hybrid-debt instruments, the proceeds of which will qualify as primary share capital. The applicant intends to issue such instruments.

Regulation 38(13) sets out the following conditions for the issue of the said hybrid-debt instruments:

- “(a) the reporting bank or controlling company shall obtain the prior written approval of the Registrar before the instruments are issued;
- (b) the features of the instruments shall be duly disclosed in the annual financial statements and other relevant disclosures to the general public;
- (c) the main features of the instruments shall be such that they are likely to be easily understood by investors and the general public;
- (d) the said instruments –
 - (i) shall not be payable to bearer;
 - (ii) shall be paid in full by the investors on the date of issue and the proceeds of the instruments shall be available to the issuing bank or controlling company without any limitation;
 - (iii) shall be free from any mandatory fixed charges;
 - (iv) shall be non-cumulative, that is, any interest or other servicing cost shall be non-cumulative;
 - (v) may provide the issuer with an option to settle any relevant interest or other servicing cost through the issue of ordinary shares in lieu of cash settlement;
 - (vi) shall enable the bank or controlling company to absorb losses on a going concern basis;
 - (vii) shall be issued without a maturity date;
 - (viii) may make provision for a call option in terms of which the issuing bank or controlling company may redeem the instruments after a minimum initial period of five years, provided that the instruments shall be replaced with instruments of a similar or better quality unless the Registrar determines that the bank is duly capitalised;
 - (ix) may be redeemed only at the option of the bank or controlling company concerned and with the prior written approval of the Registrar;
 - (x) may in addition to any call option make provision for one step-up in the initial rate payable in terms of the instrument but only after a

minimum initial period of ten years provided that the instrument shall not contain any other feature or clause that creates an incentive to redeem the instrument. Normally the call option and step-up feature may be regarded as synthetic redemption features embedded in the instrument. The said step-up in the initial rate shall be restricted to an increase over the initial rate of not more than –

- (A) 100 basis points less the swap spread referred to below; or
- (B) 50 per cent of the initial credit spread, less the swap spread referred to below.

The swap spread shall be determined at the pricing date of the instrument and shall relate to the differential in pricing at that date between the initial reference instrument or rate and the stepped-up reference instrument or rate;

- (xi) shall be subordinated to claims from depositors, general creditors, senior creditors and any subordinated debt issued by the bank the proceeds of which subordinated debt qualify as secondary or tertiary capital of the bank, that is, any claim by a holder of the instrument in respect of the principal amount or any relevant interest or other servicing costs shall be subordinated to any claim from a depositor, general creditor, senior creditor or the holder of any subordinated debt of which the proceeds qualify as secondary or tertiary capital of the bank, provided that the instrument –
 - (A) may rank *pari passu* with the rights of a holder of any non-redeemable non-cumulative preference share of which the proceeds qualify as primary share capital;
 - (B) may rank senior only in respect of the rights of an ordinary shareholder;
- (xii) issued by the bank to investors shall contain the wording "the proceeds obtained through the issue of this instrument qualify as capital for the issuing bank in terms of the provisions of the Banks Act, 1990. Any direct or indirect acquisition of this instrument by a bank or controlling company, as defined in the Banks Act, 1990, or by a non-bank subsidiary of a bank or controlling company, shall be regarded as a deduction against the capital of the acquiring bank or controlling company in question, in an amount equal to the book value of the said investment in the instrument".
- (e) the amount obtained by way of the issue of the instruments and which may rank as primary share capital shall be reduced by any direct or indirect funding provided by the reporting bank, or a bank within the reporting banking group, to the person investing in the said instruments;
- (f) no asset of the bank or controlling company shall be pledged or otherwise encumbered as security for any liability in respect of the instrument;
- (g) the bank's liabilities in respect of the instruments shall not be protected by any guarantee issued by the bank or any related entity of the bank;

- (h) no arrangement shall exist that legally or economically enhances the seniority of the ranking of the instruments;
- (i) the bank or controlling company, as the case may be, may waive any payment in respect of the instruments, subject only to the prior waiver of distributions in respect of any ordinary shares or non-redeemable non-cumulative preference shares the proceeds of which qualify as primary share capital, and the bank shall have full access to the waived payments.”

5. Conditions and assumptions

This ruling is made subject to the following conditions and assumptions –

- 5.1 the funds raised through the issue of the instruments will be used by the applicant as floating capital;
- 5.2 the ruling shall not apply to the extent that the applicant discharges its obligation to pay any expenditure or other servicing cost by issuing shares *in lieu* of cash settlement to the instruments holders;
- 5.3 the ruling is limited to and applies exclusively to the applicant as a company registered as a bank in terms of the Banks Act;
- 5.4 the ruling is limited to and applies exclusively to the issue of the instruments in terms of the first public offering under the specific programme applicable to the ruling application; and
- 5.5 the ruling does not in anyway decide or determine whether any expenditure that may be either incurred, paid or payable by the applicant to any person in terms of the instruments will constitute interest or finance charges or whether the instruments will constitute debt instruments for the purposes of the Act.

6. Ruling

The ruling made in connection with the aforementioned proposed transaction is as follows:

- 6.1 The expenditure that will be incurred by the applicant in terms of these instruments, which expenditure is referred to in Regulation 38(13) and the application by the applicant as ‘interest’ or ‘finance charges’, –
 - (a) shall be allowed as a deduction from the income of the applicant in terms of section 11(a) read with section 23(g);
 - (b) will be deductible for a particular period as an amount determined in accordance with the instruments on the date the obligation to make the payment becomes unconditional;
 - (c) that is not paid as a result of the applicant electing not to pay, or where the applicant is prohibited from paying such expenditure,

will not be actually incurred for the purposes of any part of the Act and will consequently not be deductible for the purposes of determining the taxable income of the applicant; and

- (d) will not be deemed to be incurred upfront during a particular period or on a day to day basis during a particular period and may not be deducted from the income of the applicant in terms of section 24J(2).

6.2 The issue of the instruments will not constitute a disposal of an asset for the purposes of the Eighth Schedule to the Act.

7. Period for which this ruling is valid

This binding private ruling, issued in March 2008, is valid for a period of twelve (12) years reckoned from the date of the first issue of the aforementioned instruments by the applicant in terms of the first public offering under the specific programme applicable to the ruling application.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**