

TAX

SARS Binding Private Ruling 399: Replacing an asset shortly after its acquisition under an asset-for-share transaction

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A recent ruling published by SARS deals with the anti-avoidance implications of the disposal of an asset by a company shortly after its acquisition in terms of an asset-for-share transaction, where the asset disposed of was replaced in terms of the special relief available for replacement assets.

The applicant requesting the ruling is a South African company wholly owned by a natural person who operated a business as a sole proprietor. One of his business assets was an aircraft, which he was in the process of selling, to replace it with a new aircraft.

Prior to the sale and replacement of the aircraft, the sole proprietor wanted to transfer his entire business to his company in exchange for more shares in terms of the tax rollover relief applicable to asset for share transactions as contemplated in section 42 of the Income Tax Act. The rollover relief, if available, allows an asset to be transferred to a company in exchange for equity shares of equivalent value without any immediate tax consequences. The company, essentially, steps into the shoes of the transferor and inherits the tax profile of the transferor with respect to the asset acquired.

The aircraft which the company acquired from the sole proprietor was treated for tax purposes as a capital asset which qualified for tax-deductible capital allowances, so that the company inherited the tax value of the aircraft acquired.

The rollover relief rules contain specific anti-avoidance provisions. One of the anti-avoidance provisions applicable to asset-for-share transactions determines that a company disposing of a capital asset that qualified for tax-deductible allowances within 18 months of its acquisition in terms of an asset-for-share transaction must ring-fence (and be subject to tax without setting off against losses):

- so much of a capital gain determined in respect of the disposal of the asset as does not exceed the amount that would have been determined had the asset been disposed of at market value at the time of the asset-for-share transaction; and
- so much of any allowance in respect of that asset that is recovered or recouped as a result of the disposal as does not exceed the amount that would have been recovered or recouped had the asset been disposed of at the time of the asset-for-share transaction.

Due to the need to replace the aircraft, the company disposed of the aircraft acquired in terms of the asset-for-share transaction within the 18-month period which triggered the anti-avoidance rule referred to above.

The aircraft was, however, replaced by a new aircraft. The replacement asset relief claimed by the company allows for the capital gain arising from the disposal of an asset, as well as the recoupments arising from such disposal, to be deferred where the asset disposed of is replaced within a certain time by another qualifying asset and the other requirements of the relief are met. In this case, absent the 18-month complication, the company qualified for the replacement relief so that no capital gain or taxable recoupment would have resulted from the disposal of the aircraft.

The ruling therefore dealt with the complication added by virtue of the fact that the aircraft that is being replaced was acquired by the company in terms of an asset-for-share transaction entered into less than 18 months prior to the disposal of the asset.

If the company did not elect the relief available concerning replacement assets, the company would have –

- realised a capital gain on the disposal of the aircraft, and so much of that capital gain as would not have exceeded the capital gain that would have arisen had the aircraft been disposed of at market value on the date of the asset-for-share transaction would be ring-fenced and taxed without the benefit of setting it off against any losses; and
- recouped previously claimed capital allowances, and so much of that recoupment as would not have exceeded the recoupment arising on a disposal at market value on the date of the asset-for-share transaction, would similarly be ring-fenced and taxed.

The ruling clarifies that, as a result of the disposal benefiting from the replacement asset relief, there is no capital gain or recoupment on the disposal within the 18-month period which could (to an extent) be ringfenced and taxed in terms of the anti-avoidance rule. This is an important indication of how SARS views the interpretation of the anti-avoidance rule applicable to the rollover relief provisions that deal with the disposal of assets acquired in terms of the relief, within the 18-month window.

We agree with the approach adopted by SARS in that the anti-avoidance rule can only potentially apply if the disposal within the 18-month period gives rise to an actual capital gain or recoupment. If, for some reason, the actual disposal would not give rise to a capital gain or recoupment (for example, because rollover relief applies to the actual disposal, or replacement asset relief applies, or because there is no gain or recoupment due to the amount of disposal proceeds received), the anti-avoidance provision cannot be interpreted to mean that if there would have been a gain or recoupment at the time when the asset-for-share transaction was entered into based on the market value of the asset at that time, such (deemed) gain or recoupment must be recognised, ring-fenced and taxed purely because the disposal occurred within 18 months of the asset-for-share transaction.

The takeaway from Binding Private Ruling 399 is that:

- Although the ruling and other rulings are non-binding concerning anyone other than the party identified in the ruling and may not be cited as authority in any proceeding other than proceedings involving the applicant for that specific binding private ruling, the views expressed by SARS are consistent with the purpose of the corporate rules and the rollover relief provided therein.
- The absence of an actual capital gain or recoupment on disposal of an asset within 18 months of its acquisition under the rollover relief provisions, constitutes an absolute bar to the application of the anti-avoidance provision aimed at disposals within the 18-month window. The anti-avoidance provisions were not intended to levy tax on gains and recoupments which would otherwise not exist. Put differently, if no capital gain or recoupment actually arises on the disposal within 18 months, there is nothing to ring-fence and no tax liability.



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