

SARS ruling on payment of shareholder's loan from proceeds of a new share issue



By [Graeme Palmer](#)

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It is common for shareholders to have loan accounts in a company. For example, loan accounts could arise when a shareholder provides funding to the company for working capital. In the recent Binding Private Ruling 208, the South African Revenue Service (SARS) considered the tax consequences of a repayment of a shareholder's loan from the proceeds of a new share issue by a company.

The SARS ruling considered the 'debt reduction provisions' in section 19 and para 12A to the 8th schedule of the Income Tax Act, 1962. Section 19 deals with the income tax consequences of a loan waiver, while paragraph 12A deals with the capital gains tax implications. Generally these provisions apply when a debt that is owed by a person is reduced or written-off, and that debt was used to acquire an asset which was held on capital account (in the case of para 12A) or to fund deductible expenditure, acquire allowance assets or trading stock (in the case of section 19). The application of these provisions sometimes has adverse tax consequences for the taxpayer.

In the SARS ruling, two shareholders each owned 50% of the shares in a company. The one shareholder intended to acquire the other shareholders 50% shareholding in the company. The seller had a loan account in the company, which consisted of capital and accrued interest. It was the purchaser's intention to only acquire the seller's shares, and not the loan account, which would be settled prior to transfer. The seller's loan account was to be reduced to nil through the following steps:

- The seller and the purchaser would each subscribe for one share in the company;
 - The purchaser would subscribe for one share at a nominal value of R1.00, while the seller would subscribe for one share at a premium equal to the face value of the seller's loan;
 - The company would use the cash proceeds of the capital contribution to repay and discharge the seller's loan in full.
- The value of the shareholder's loan would thus be reduced to nil before the sale of shares to the purchaser.

SARS considered the application of the debt reduction provisions in section 19 and para 12A, and ruled that they would not apply; however, the ruling did not cover the application of any general anti-avoidance provision to the proposed transaction.

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