

APPENDIX C

Welcome to Bravura

one team,
multiple disciplines,
total integration
leading-edge technical expertise
diverse capital sourcing
(equity & debt)
intelligent solutions

Contents

- 1. Introduction and overall remarks**
- 2. The need for an equitable tax system**
- 3. Selected aspects, sections 45, 8E and 8EA – impact on BEE and other corporate activity**

Introduction and overall remarks

- The dangers of sudden and dramatic announcements (sections 45, 8E and 8EA)
- The need for an internationally competitive tax system (interest deductibility and group taxation)
- Timeframes and process

The need for an equitable tax system

- The good
 - Seeking neutrality
 - Perpetual debt / contingent liabilities / insurance benefits
 - Consistency in GAAR application
- The justified
 - E.g. – bond interest
- The bad
 - Taxation of dividends on income account
 - Sections 8E & 8EA
 - Section 8F
 - Section 9E
 - Section 42
 - Foreign loss offset restriction

Sections 45, 8E and 8EA – impact on BEE and other corporate activity

Why the change?

“Intra-group relief is used to **disguise** indirect purchases of preference shares generating tax-free dividends (that economically replicate otherwise taxable interest).”

“A number of transactions have been identified involving the use of share issues (typically preference shares) to **disguise** otherwise taxable interest as tax-free dividend income.”

Unintended consequences of proposed changes

Will have a significant negative impact on Black Economic Empowerment (“BEE”) Transactions

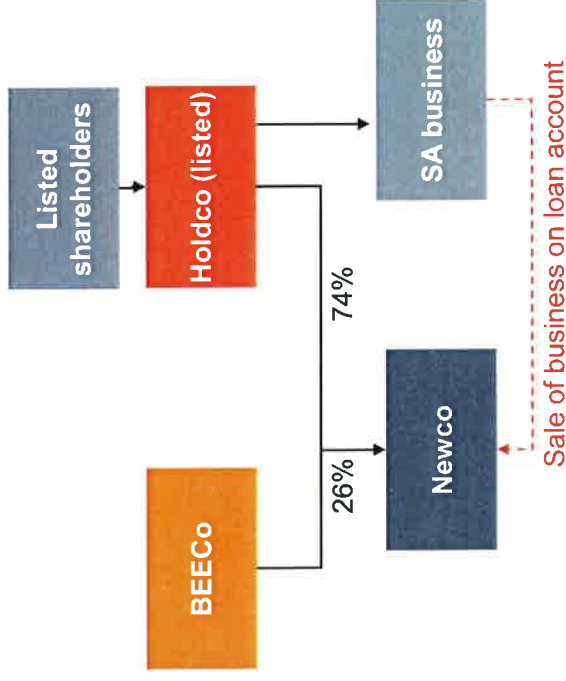
- The model whereby assets are sold to a Newco on loan account has proven to be the **only sustainable model of BEE** ownership.
- This model is in line with the requirements of the Department of Trade and Industry (DTI) on sustainable funding, scores maximum points from the start and is not share price dependant.
- The suspension of the utilisation of section 45 forces entities to use an unsustainable model in BEE transactions (which are now also impacted by sections 8E and 8EA).
- New sections 8E and 8EA will increase the funding cost for BEE parties by 40%.
- Some of the most standard security mechanisms, such as pre-emptive rights, have unintended tax consequences as a result of the proposed changes – this concern equally applies to merger and acquisition (“M&A”) transactions.

Reduced M&A transactions – loss of economic growth and job creation

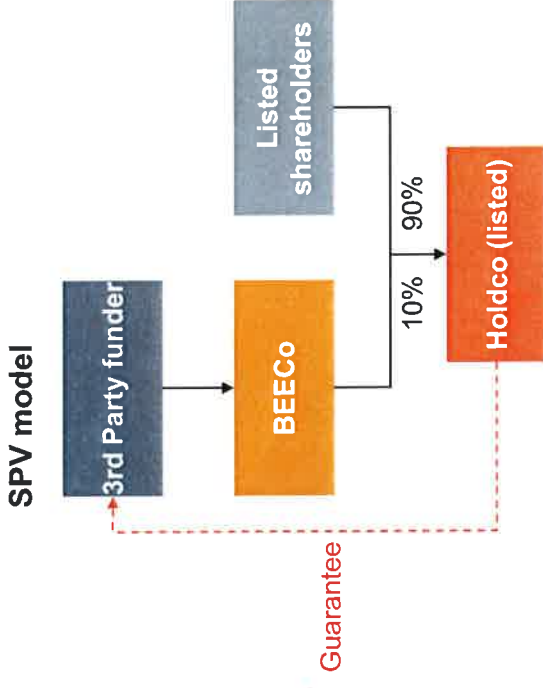
- The proposed changes results in decreasing the ability of buyers (who want to buy assets) and sellers (who want to sell shares) to come to an agreement in M&A transactions.
- The proposed changes result in an inability for companies to introduce gearing (debt or preference shares) into their acquisitive transactions.
- The lack of gearing results in a higher cost of funding for the transaction (i.e. cost of equity vs cost of debt).
- Higher funding costs reduces the number of feasible M&A transactions.
- Reduced M&A transactions decreases the ability for companies to achieve acquisitive growth (thereby decreasing the possibility of increased profits (benefit to the Fiscus), job creation and growth to the South African economy).
- Far reaching implications of section 8EA will effectively result in dividends on all ordinary shares subject to shareholders agreements being taxable.

Impact of suspension of section 45 on BEE transactions

Leveraged model (acquisition of business)



MOVING BACKWARDS



The suspension of section 45 eliminates the ability of using the leveraged model, the SPV model results in transactions:

- whose sustainability is dependent on share price and dividend performance
- with typically substantially reduced BEE % upon unwinding – BEE sell shares to pay funding
- normally utilise preference share funding of 5-7 years: expensive, short term empowerment (now also subject to section 8E and 8EA)
- where Funders typically require at least a 70% debt, 30% equity ratio from BEE - limits to partners with sufficient cash or access to cash or funding to invest
- where Holdco has to provide support / guarantees which may also impact on day to day business
- where cost to shareholders remains high

Was there a need for this change?

	Existing legislation	Proposed legislation
Leveraged model	<ul style="list-style-type: none"> Base cost of assets sold rolled over 	<ul style="list-style-type: none"> Neutral to Fiscus
	<ul style="list-style-type: none"> Interest deduction claimed in operating company 	<ul style="list-style-type: none"> Neutral to Fiscus, income taxed at funder level (may be benefit in timing regarding start-up or mining companies)
	<ul style="list-style-type: none"> Interest income included in Funder or Holdco's taxable income 	<ul style="list-style-type: none"> Neutral to Fiscus
	<ul style="list-style-type: none"> STC payable on ordinary dividends paid to BEECo 	<ul style="list-style-type: none"> BEE parties taxed on dividend income – erosion of value
	<ul style="list-style-type: none"> STC credit for BEECo 	
SPV model	<ul style="list-style-type: none"> Funder receives tax exempt preference dividends 	<ul style="list-style-type: none"> Bank now also taxed on preference dividends received – increased cost of funding for BEE parties
	<ul style="list-style-type: none"> BEECo not entitled to deduction on interest/dividend paid on preference shares held by the Bank 	
	<ul style="list-style-type: none"> STC treatment on dividends declared by Holdco to BEECo – same as leveraged model 	<ul style="list-style-type: none"> As per leveraged model
	<ul style="list-style-type: none"> BEECo has any form of security over its shares in Holdco 	<ul style="list-style-type: none"> BEECo taxed on dividend income received from Holdco

Whilst there are some 'bad' transactions that have been implemented, which Treasury should address either by way of applying the GAAR or by fresh targeted legislation, the proposed changes will mean the end of sustainable BEE transactions with limited or no real expectation of creating value to the BEE parties.....

Increased unsustainability due to double taxation

Grossed up funding cost due to proposed changes

Fund cost 12%
Div yield 4%

Year	Loan and		Closing balance	Market value
	Div Yield	Interest		
0	100.00		100.00	100.00
1	-5.20	12.00	106.80	129.97
2	-6.76	12.82	112.86	168.93
3	-8.78	13.54	117.62	219.57
4	-11.42	14.11	120.32	285.39
5	-14.84	14.44	119.92	370.93
6	-19.28	14.39	115.03	482.11
7	-25.06	13.80	103.76	626.62
8	-32.58	12.45	83.64	814.45
9	-42.34	10.04	51.33	1 058.58
10	-55.04	6.16	2.46	1 375.89

Growth rate required over 10 year period to achieve:

- > 100% of original shareholding
- > 50% of original shareholding
- > 0% of original shareholding

- 1366%
- 353%
- 209%

Fund cost 17%
Div yield 4%

Year	Loan and		Closing balance	Market value
	Div Yield	Interest		
0	100.00		100.00	100.00
1	-5.42	16.67	111.25	135.47
2	-7.34	18.54	122.45	183.53
3	-9.95	20.41	132.91	248.63
4	-13.47	22.15	141.59	336.83
5	-18.25	23.60	146.93	456.31
6	-24.73	24.49	146.70	618.18
7	-33.50	24.45	137.65	837.47
8	-45.38	22.94	115.21	1 134.54
9	-61.48	19.20	72.93	1 537.00
10	-83.29	12.15	1.79	2 082.22

Growth rate required over 10 year period to achieve:

- > 100% of original shareholding
- > 50% of original shareholding
- > 0% of original shareholding

- 2081%
- 529%
- 315%

HIGH FUNDING COST RATES = UNSUSTAINABLE EMPOWERMENT

Far reaching impacts on BEE

After the release of The Draft Taxation Laws Amendment Bill, 2011 (“the Bill”) Bravura did a high level overview of some previous and proposed announced BEE transactions. The following was discovered:

- Certain previously announced BEE transactions may no longer be implemented; and
- There are a number of current BEE transactions in place that will be negatively impacted by the proposed changes.

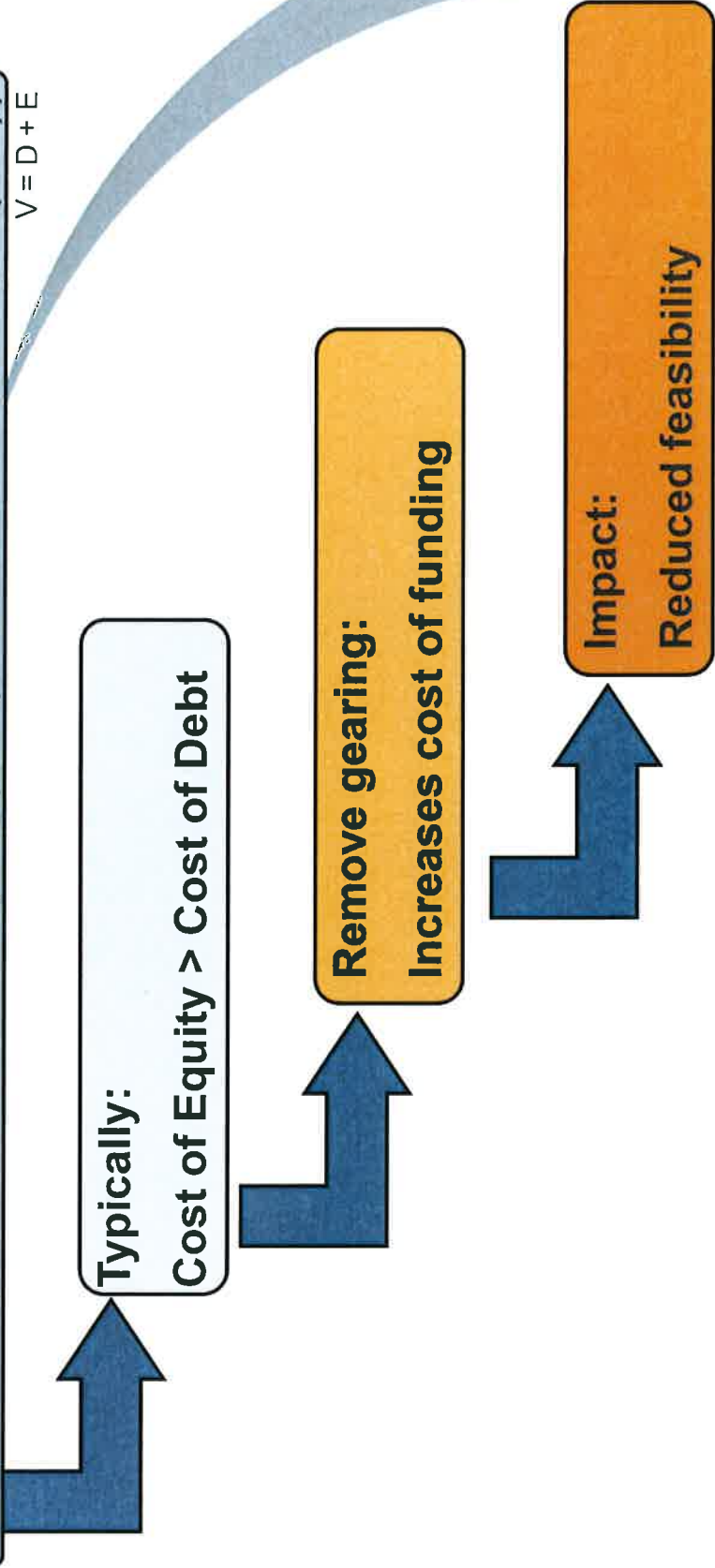
The following BEE transactions are classic examples of how BEE deals may be impacted:

Company	Potential impact
Aveng	Preference share funding has a term shorter than 10 years – section 8E. Embedded security mechanisms in the form options – section 8EA.
African Bank	Preference share funding has a term shorter than 10 years – section 8E.
Altech	Announcements regarding BEE transactions on 9 March 2011 and 18 April 2011 that potentially involved the utilisation of section 45. If the sale of business has not been concluded before 3 June 2011 the transaction may require complete revision.
PMC	Section 11 approval from the Department of Minerals and Resources is still pending. The transaction involved the disposal of the business to a new shelf company. The utilisation of section 45 for this disposal is no longer permissible in terms of the proposed changes.
MTN	Preference share funding has a term shorter than 10 years – section 8E Embedded security mechanisms in the form of options, pledges and cessions – section 8EA
Sasol	Preference share funding to public BEE vehicle has a term shorter than 10 years – section 8E Embedded security mechanisms in the form of options – section 8EA

Mergers and Acquisitions – Cost of funding

$$WACC = \left(\frac{E}{V} \times \text{Cost of Equity} \right) + \left(\frac{D}{V} \times \text{Cost of Debt} \times (1-t) \right)$$

$V = D + E$



WACC is impacted by the combination of the cost of equity, preference shares or loan funding

Far reaching impact on M&A activity

- For acquisitions to succeed, efficient funding is essential.
- Tax policy to **promote economic growth and new jobs** – long term positive impact on Fiscus.
- Tax policy which results in a **material increase in the cost of funding due to double taxation** should be avoided at all cost.
- Redeemable preference shares are a fundamental financing tool filling the gap between equity and debt.
- The abolishment of section 45 leaves **redeemable preference shares as the only other term funding alternative** to corporates.
- Due to the 10 year extension of section 8E and the broad principles in section 8EA which captures normal security arrangements, **preference share funding will now become approximately 40% more expensive.**
- Currently no interest deduction is allowed on the acquisition of shares (unlike in many most modern economies).
- Section 45 is the only real viable alternative to **bridge the gap** between sellers (wanting to sell shares) and buyers (wanting to buy assets) whilst still being able to obtain a deduction for the interest expense incurred, therefore **reducing the cost of funding.**

Far reaching impact on M&A activity

- Prior to the amendments, in by far the majority of cases, these transactions resulted in no tax leakage to the fiscus and created economic growth which in turn leads to increased taxable profits over time.

- *Preference shares*

Existing legislation	Proposed legislation
<ul style="list-style-type: none"> ▪ Profits taxed at company level ▪ No deduction for preference shares claimed in operating company ▪ Preference dividend income not included in Funder's taxable income ▪ STC payable on preference dividends paid to Funder ▪ STC credit for Funder 	<ul style="list-style-type: none"> ▪ Neutral to Fiscus, taxed once at company level ▪ Dividend income received by Funder now taxed as well

- *Loan funding*

Existing legislation	Proposed legislation
<ul style="list-style-type: none"> ▪ Interest deduction claimed in operating company ▪ Interest income included in Funder's taxable income 	<ul style="list-style-type: none"> ▪ Neutral to Fiscus, taxed once at funder level ▪ Additional tax on transfer of assets without economic profits

- Leads to double taxation and an increase to the cost of doing business in South Africa - **uncompetitive environment.**
- This is not conducive to economic growth and job creation.

Other far reaching impacts

- Proposed Section 8EA extremely broad.
- Targetted for transactions akin to debt.
- Does however also include any shares subject to pre-emptive rights even at market value.
- Same applies to put and/or call options over shares even if at market value.
- Dividends received on almost all ordinary shares subject to shareholders agreements will now be taxable.

Conclusion

Proposed amendments aimed at targeting transactions that **disguise** the nature of income earned.....

.....proposed changes negatively impacts innocent transactions.....

.....existing legislation (through anti-avoidance provisions) already provides the ability to address the intended target of the proposed changes.....

....if still required, proposed changes should be targeted at mischief and not broad brushed

Thank You

