DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

IN THIS ISSUE

Tax anomalies with odd-lot offers

Give that judge a Bell's!

Tax Clearance Certificates

TAX ANOMALIES WITH ODD-LOT OFFERS

An odd-lot offer is defined in the listing requirements of the Johannesburg Stock Exchange as an offer where a listed company intends reducing administrative costs resulting from a large number of "odd-lot" holders. An odd-lot is interpreted as a total holding of:

- Less than 100 securities; or
- 100 or more securities provided that it can be illustrated that the cost associated with a holder disposing of such number of shares is equal to or exceeds the total value of such number of securities.

To the extent that a company embarks on an odd-lot offer on the basis that it repurchases the relevant securities, the question arises how to deal with the proceeds associated with the odd-lot offer. A dividend is defined in s1 of the Income Tax Act, No 58 1962 as any amount that is transferred or applied by a company for the benefit or on behalf of a person in respect of a share in that company. It includes an amount transferred as consideration for the acquisition of any share in the company. The only instance where one is not dealing with a dividend is if the purchase price results in a reduction of contributed tax capital of the company or constitutes an acquisition by a company of its own securities by way of a general repurchase of securities. In other words, should one be dealing with a general repurchase of securities by a company, one would not be dealing with a dividend.

In the context of an odd-lot offer, however, one is not dealing with a general repurchase of securities, but the offer is made to targeted shareholders, that is if for instance holding less than 100 securities. Therefore, one cannot argue that the purchase price, if funded out of reserves and not contributed tax capital, does not constitute a dividend.

The problem faced with companies that embark on odd-lot offers and in circumstances where the purchase price is funded out of reserves is that the purchase price then constitutes a dividend. The purchase consideration may thus be exempt in the hands of the sellers. However, the consequence is that the dividend may be subject to dividends tax, especially to the extent that the shareholders do not constitute companies. If an individual holds shares that are sold in terms of the odd-lot offer, a dividend is in fact received by such shareholder and dividends tax must be accounted for. Even in the case of a company, dividends tax will have to be deducted unless the company that is a

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shareholder provides the listed company embarking on the odd-lot offer with an undertaking and a declaration that it is in fact exempt from a dividends tax perspective.

Unfortunately, it appears that it is not practically possible to implement the tax consequences of this type of transaction to the extent that an odd-lot offer is embarked on. This is especially relevant in the context of the sellers having to receive certificates pertaining to the fact that they have received dividends. The systems do not seem to have been set up for that purpose and an administrative nightmare may well ensue.

It is suggested that the definition of a dividend be amended on the basis that a purchase price paid in respect of an odd-lot offer should also not constitute a dividend. This should be similar to the scenario where a company embarks upon a general repurchase of securities as opposed to a specific repurchase of securities. The way in which the legislation is currently drafted, implies that the proceeds from the sale of the shares will be deemed to be a dividend, with the resultant consequences. It makes logical sense that the proceeds from an odd-lot offer should not constitute a dividend and an amendment to the legislation is urgently required given the anomaly that has currently arisen.

Emil Brincker

GIVE THAT JUDGE A BELL'S!

In our Tax Alert of 18 March 2011 we reported on the Western Cape Tax Court (Tax Court) case involving Stellenbosch Farmers' Winery Limited (Farmers) and the Commissioner for the South African Revenue Service (SARS). (Click here to read that report.)

The parties in the meantime appealed to the Supreme Court of Appeal (SCA). The SCA handed down its judgment on 25 May 2012 (*Stellenbosch Farmers' Winery v Commissioner for SA Revenue Service (511/2011 and 504/2011) [2012] ZASCA 72 (25 May 2012.*)

To recap, in 1991 United Distillers plc (Distillers), a United Kingdom company, and Farmers, a local company, signed a distribution agreement in terms of which Farmers was appointed as the exclusive distributor for resale in Southern Africa of the Bell's, Haig and Dimple whiskies for a period of 10 years.

In 1997, the group Distillers formed part of was restructured. As a result Distillers approached Farmers to end the distribution agreement about 41 months early. In 1998 the parties concluded a dissolution agreement to this effect.

Distillers agreed to pay Farmers compensation of R67 million.

Two questions arose: first, was the compensation amount of R67 million subject to income tax because it was of a revenue nature (and not of a capital nature)? Second, was the amount subject to VAT at the rate of 14%, or at the rate of 0% because Farmers had made a supply of services to a non-resident?

The Tax Court answered the first question in the affirmative. It held that the amount paid by Distillers to Farmers was of a revenue nature, and not of a capital nature as Farmers had contended.

The Tax Court's answer was no in relation to the second question. It held that the supply made by Farmers was zero-rated as Distillers was not resident in South Africa.

The SCA did not agree with the Tax Court on the first issue. The SCA found in favour of the taxpayer holding that, on the facts of the case, the amount of the compensation was of a capital nature and, accordingly, was not subject to income tax.

The SCA found that the Tax Court had erroneously focused on only physical assets and should have focussed instead on the much more valuable incorporeal assets constituted by the exclusive distribution rights that were lost. The Court held that the 'compensation for the impairment of the taxpayer's business constituted by that loss is properly to be viewed as a receipt of a capital nature'.

I think the following are the important principles that can be distilled from the case:

- If, in the valuation of the right to receive compensation for giving up a right, a taxpayer has regard to the profits anticipated from the use of the right, it does not necessarily mean that the compensation for giving up the right is of a revenue nature.
- The way that a receipt is subsequently dealt with for accounting purposes does not determine the nature of the receipt (revenue or capital) for income tax purposes.
- The way that a receipt is subsequently dealt with by the taxpayer (eg by paying a dividend), does not determine the nature of the receipt for income tax purposes.
- The SCA emphasised that the dissolution agreement referred to payment of full compensation for the closure of Farmers' business relating to the exercise of the distribution rights; the agreement made no reference to a payment for loss of profits. Taxpayers should accordingly know that, particularly where uncertainty may arise as to the treatment of amounts for tax purposes, the words they use in agreements (provided of course that the words accord with their intentions) are of great importance. Taxpayers should get advice from tax professionals when drafting agreements.

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The SCA agreed with the reasoning and finding of the Tax Court in relation to the second issue, relating to VAT, and again held in favour of the taxpayer.

However, the SCA also said *obiter* (in passing) that it agreed with the finding of the Tax Court that the exclusive distribution right, which was incorporeal property, was not situated in South Africa but was situated where the debtor resides (in this case, in the United Kingdom).

This is an important (albeit, non-binding) finding because – by analogy – it implies that persons who are not resident in South Africa and who make available incorporeal property in South Africa against, say, payment of a royalty need not register for VAT in South Africa for that reason alone.

The taxpayer was successful in the SCA on all fronts. No doubt the taxpayer said: "Give that judge a Bell's!".

Ben Strauss

TAX CLEARANCE CERTIFICATES

A taxpayer can apply to SARS for a tax clearance certificate in respect of:

- Good standing and tenders;
- emigration; and
- Foreign Investment Allowances.

One of the most frequently applied for tax clearance certificates in the commercial sphere is the one relating to good standing and tenders. It is invariably a requirement when contracts are put out to tender that bidders must submit such tax clearance certificates with their bids. These certificates usually only vouch for the fact that a taxpayer's returns are up to date and that there are no amounts outstanding on the taxpayer's account. They are also usually only valid for a limited period.

Even though tax clearance certificates are quite common in the commercial world, they are a rather peculiar phenomenon from a tax law perspective. This is so because tax clearance certificates are not issued in terms of any particular section of the Income Tax Act No 58 of 1962, or any other act administered by SARS for that matter, but are wholly issued in terms of internal policy at SARS.

On 30 May 2012 a significant ruling was handed down by Wright J in the North Gauteng High Court in motion proceedings brought by a taxpayer (a close corporation) whose tax clearance certificate was revoked by SARS in light of allegations of tax fraud involving the taxpayer and a member of the taxpayer.

Essentially the court said that the revocation was unlawful because the taxpayer was not afforded an opportunity to make representation to SARS before the decision was taken to revoke the certificate. The court alluded to a fundamental rule of administrative justice, being that parties whose rights could be negatively affected by an administrative decision have the right to be heard. Of course, this also entails that reasonable notice must be given to the affected party.

When bidding for contracts, the sudden revocation by SARS of a tax clearance certificate can have devastating effects on a business.

This ruling sends a clear message to SARS that taxpayers need to be dealt with in a fair manner that accords with the tenets of administrative law. It is anticipated that this ruling will prompt an overhaul of SARS's policy in respect of tax clearance certificates.

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