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TAX ALERT

DIVIDENDS TAX: QUESTIONS AND ANSWERS

The dividends tax, a new form of tax on dividends paid by companies, comes into effect in South Africa soon. Here are some practical questions and answers about the new tax.

When will the new dividends tax take effect?

It's no joke – the dividends tax starts on 1 April 2012 (see Government Notice no 1073 in the Government Gazette no 34873 dated 20 Dec 2011). The tax applies to any dividend declared and paid on or after that date. A dividend declared during March 2012 will still be subject to the Secondary Tax on Companies (STC), but note that the final dividend cycle for companies ends on 31 March 2012. This will accelerate the need to pay the final tranche of STC which may be payable.

Where do I find the dividends tax?

The dividends tax is contained in Part VIII of Chapter II (sections 64D to 64N) of the Income Tax Act 58 of 1962 (the Act). It is very important to know that the legislation creating the tax was introduced in 2008 but has since been changed no less than three times. So, make sure that you are looking at the right text.

You can also find useful information about the mechanics of the tax and payment of the tax on the website of the South African Revenue Service (SARS) at www.sars.gov.za under the heading "Dividends Tax".

What is the rate of tax?

The tax is calculated at the rate of 10% of the amount of any dividend paid by a company. The rate may be lower in the case of shareholders which are not tax residents in South Africa.

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The term “dividend” is defined in section 1 of the Act. Generally, a distribution is only a dividend if it is declared from any account other than so-called “contributed tax capital” (share capital or the old share premium) or if the distribution arises from a general share buyback.

When is the tax levied?

Dividends tax is levied on the date that the dividend is paid or payable. The dividend is deemed to be paid on the earlier of the date on which the dividend is paid or the dividend becomes payable by the company that declared the dividend, in this latter context then the last date to register for the dividend may thus be the “trigger date” for collection of the tax. This payment regime has been legislated to avoid confusion with accruals to the shareholder.

The dividends tax must be paid to SARS by the end of the month following the date that the dividend was paid. It is important to note that this is a single stage tax, ie there are no credits carried forward in this system. The payment must be accompanied by a return in the prescribed format.

Who is liable for the tax?

Legally, the person liable for the tax is the beneficial owner of the dividend, ie the person entitled to the benefit of the dividend attaching to a share, usually the shareholder. However, generally, the tax is withheld by the company paying the dividend (or the shareholders’ central securities depository participant (CSDP), or the managers of the company’s share register) and is paid over to SARS, on behalf of the shareholder.

So, the tax is a charge *on the shareholder* which is withheld by the company. In this respect, the dividends tax is different to STC that is a tax *on the company* paying the dividend.

Do any exemptions apply?

Certain shareholders are exempt from dividends tax. For instance, the following persons are exempt from the dividends tax:

- Companies that are tax resident in South Africa are exempt. For instance, if a South African tax resident company (Company A) pays a dividend to its shareholder which is a company that is tax resident in South Africa (Company B), the dividend is not subject to dividends tax. There will only be dividends tax when Company B pays a dividend to persons who are not exempt from the tax, eg natural persons.
- Public benefit organisations (PBOs) that have been formally exempt from tax by SARS in terms of section 30 of the Act are exempt from dividends tax. This is a very important tax break for PBOs because, under the STC regime, the PBOs would in all cases have received the dividends reduced by STC.
- Pension and provident funds.

To claim the exemption, the entity must submit a written declaration to the relevant company or intermediary in the format prescribed by SARS beforehand.

What about listed companies and collective investment schemes?

In this case, the company does not withhold the dividends tax; it is withheld by the relevant “regulated intermediary” ie the broker, management company or central securities depository participant (CSDP).

And close corporations and private companies?

Close corporations (CCs) and private companies are defined as companies for purposes of the Act.

As such, CCs and private companies must withhold the dividends tax unless an exemption applies.

I am not tax resident in South Africa. Do I pay the dividends tax?

A company that is not tax resident in South Africa must withhold the dividends tax if its shares are listed on a South African securities exchange (eg the JSE or AltX).

A shareholder that is not tax resident in South Africa is liable for the dividends tax that (to recap) is withheld by the local company or regulated intermediary paying the dividend. However, if the shareholder (being either a company or a natural person) is tax resident in a country that has a double taxation treaty (DTA) with South Africa, the rate of the dividends tax may be reduced to 5%, depending on the percentage of shares the non-resident holds and the terms of the relevant treaty. Most of South Africa’s major trading partners have DTAs with South Africa.

How do dividends *in specie* work?

Often companies declare a dividend, but don’t settle the dividend in cash. Instead, the companies settle the dividend *in specie* (Latin for “in kind”) by transferring assets to the shareholders.

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For instance, a company may declare a dividend to be settled by the transfer of shares in the amount of R100 to the shareholder. In this case, the amount of the dividend is deemed to be equal to the market value of the asset distributed. So, if a company declares a dividend of R100 but settles the dividend by distributing an asset worth R150 to the shareholder, the dividends tax is determined on R150 (and not on R100).

Where a company that is tax resident in South Africa declares and settles a dividend in specie, the company – and not the shareholder – is liable for the tax; in other words, the tax is a charge on the company in this case, and not the shareholder.

What about secondary tax on companies?

STC falls away but until 31 March 2017 a company may set off the liability of withholding of dividends tax against any so-called STC credits it may hold. It is important to note that where a company uses its STC credit like this, it is attributed to the full dividend; not just the portion which needs to be withheld for the relevant shareholders. The company must in these circumstances notify the shareholders of the amount by which the dividend has reduced the company's STC credit, and such reduction is pro rata to all shareholders. If the dividend paid exceeds the STC credit, then dividend withholding applies to such excess.

Okay. But what does all this mean for me practically?

Generally, if you are a natural person you don't need to do anything if you are a shareholder of a company or an investor in a collective investment scheme (eg unit trusts). You will simply receive your dividends net of 10% dividends tax in the same way as you would have received your dividends net of STC at a rate of 10% in the past. If you are not tax resident in South Africa you must claim your treaty benefits, if applicable. And if you are exempt from the dividends tax (eg a PBO) make sure that you inform the company, your CSDP and/or collective investment schemes of your exempt status on the prescribed form.

If you are responsible for the financial management of a private company or CC, you must ensure that you understand how the dividends tax works and that the company or CC withholds the tax when it makes distributions to shareholders or members.

Ben Strauss & Alastair Morphet

WHEN CAN SARS RE-CHARACTERISE CONTRACTUAL ARRANGEMENTS FOR TAXATION PURPOSES?

Tax planning structures normally involve multiple parties. Sometimes the individuals and/or legal entities involved are inter-connected. The tax benefits generated through such structures, almost without exception, annoy revenue authorities.

SARS, in setting out to extract the tax it believes to be owing, occasionally runs into a "little problem". The individual or entity in the structure that should really be the "target taxpayer":

- might not have any assets (eg it is a tax-neutral once-off Special Purpose Vehicle);
- might be inconveniently situated (eg it is located off-shore or in a tax haven);
- might have a tax-exempt tax profile (eg a long-term insurer's policyholder fund); or
- might have an assessed loss.

The attack on the structure will therefore be completely futile, alternatively, yield no cash payment. Then the temptation arises "to follow the money". That is, SARS might try and pin the tax consequences on the individual or entity in the structure that does have a substantial balance sheet.

The question is to what extent SARS can shove aside contractual relationships between parties, thereby determining the tax liabilities on the basis of what SARS perceives to be the "real transaction"?

Legal precedent indicates that SARS's ability to simply pursue the taxpayer who happens to have the money to meet the alleged tax liability might be rather limited.

In *Rane Investment Trust v CSARS [2003] 3 All SA 39 (SCA)*, the Supreme Court of Appeal (the SCA) dealt with the tax consequences of a so-called "film scheme". The SCA pointed out: "*... we are not concerned in this matter with a dispute between the parties. It is a third person – the Commissioner – who seeks to place a different interpretation on the agreements.*"

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The SCA held that "... *when a third party is questioning the meaning of a contract, regard may be had to the parties' conduct in executing their obligations.*" Despite certain "obscure" clauses in the parties' contract, the SCA gave effect to same since the parties' subsequent conduct was aligned with what they really intended to achieve.

There you have it: it is not that easy for SARS to gate-crash the taxpayers' (contractual) party. SARS must first jump certain hurdles before it can re-characterise a transaction for taxation purposes.

In *Zandberg v Van Zyl 1910 AD 302* it was that held: "*The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be.*" (emphasis added)

In *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* a "disguised transaction" was explained as follows:

"*In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, inter partes, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax.*" (emphasis added)

[Many more recent cases like Conhage, Ladysmith, Relier, and NWK are in the same vein. The older cases are specifically cited to show just how far back these principles go in South African law.]

SARS can therefore only re-characterise a transaction where, among others:

- there exists a "definitely ascertainable" intention at odds with the wording of the contract;
- an element of "dishonesty" or "deceit" is present in so far as parties intended to conceal their real agreement;
- the parties' subsequent actions were out of sync with the terms of their contract.

[*ITC 1816 69 SATC 62* gives a comprehensive list of *indiciae* that a court will consider in determining the true substance of a contract.]

Often the *Zandberg* and *Randles Bros* criteria would be insurmountable for SARS, or it might not be able to procure the necessary evidence. SARS might then seek to invoke the "piercing the corporate veil" doctrine in order to tax the party SARS feels should actually be the target taxpayer (and who incidentally happens to have deep pockets).

That doctrine also has limitations. In *ITC 1611 59 SATC 126*, Wunsch J held that there was no established principle of law that justified the "radical step" of piercing the corporate veil:

"*... a court can lift the veil only if that is legitimate by application of established doctrines, such as the plus valet rule or the fraus legis rule (or in other cases of fraud or dishonesty) or, possibly, the actio pauliana, that is if the requirements for such application are present, or a finding of a true relationship of principal and agent. There is, we consider, no self-standing doctrine of piercing the veil.*" (own emphasis)

Where does that leave SARS?

SARS could always turn to section 80B(1) of the Income Tax Act, 58 of 1962 (the Act). Under that section, the Commissioner may determine the tax consequences of any impermissible avoidance arrangement for any party by:

- disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
- disregarding any accommodating or tax-indifferent party;
- deeming connected persons to be one and the same person for taxation purposes;
- re-characterising any gross income of a capital nature;
- treating the impermissible avoidance arrangements as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate to eliminate the offending tax benefit.

This gives SARS extensive powers to re-characterise the whole transaction, or a step or part thereof (refer to section 80H of the Act). But first SARS would have to properly navigate the complexity of Part IIA of the Act. Furthermore there are certain notice requirements (section 80J of the Act). Consequently, in practice, attempts by SARS to re-characterise a transaction in terms of sections 80A-L have, so far, been few and far between.

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Taxpayers are often made to sleep in the beds they make. In *CIR v Sunnyside Centre (Pty) Ltd 1997(1) SA 68 (A)* it was held:

"*When a scheme works, no tears are shed for the Commissioner. That is because a taxpayer is entitled to order his affairs so as to pay the minimum of tax. When he arranges them so as to attract more than the minimum he has to grin and bear it.*"

Surely, what is good for the goose is good for the gander?

SARS' determination to "follow the money" by simply re-characterising taxpayers' contractual arrangements could in certain instances result from the drive for revenue collections.

Taxpayers should be aware that SARS' powers to re-characterise taxpayers' contractual arrangements are by no means unfettered.

Should SARS attempt to willy-nilly re-characterise the rights and/or obligations flowing from a transaction because the true target taxpayer is a man of straw or inaccessible, such attempt should be resisted strenuously. SARS should first be put through its paces to show that re-characterisation of the transaction is warranted either:

- in terms of the principles laid down in South African case law; or
- under sections 80A-L of the Act.

Re-characterisation as a short-cut to the pot of gold at the end of the rainbow is not on.

Johan van der Walt

THE INDIAN CASE OF VODAFONE

On 20 January 2012, the Supreme Court of India (Civil Appellate Jurisdiction) decided the appeal in *Vodafone International Holdings B.V. v Union of India & Anr*.

This matter involved a complicated transaction in which Vodafone's Netherland subsidiary (Vodafone International Holdings B.V.) had acquired all the shares in CGP Investment Holdings Limited (a company incorporated in the Cayman Islands) from a Hong Kong group. CGP Investment Holdings Limited had a 67% stake in Hutchison Essar Limited (an Indian resident company). Therefore, Vodafone had indirectly acquired a 67% stake in Hutchison Essar.

The Indian tax authorities had decided that since the company indirectly acquired (being Hutchison Essar) was based in India and had its assets in India, the seller of the CGP Investment Holdings Limited shares was liable for capital gains tax, and Vodafone, being the buyer, had a duty to withhold such tax. This despite the fact that the asset sold was the shares in a foreign company. Effectively the tax authorities had looked through the corporate shareholding structure to levy tax on the transaction. Vodafone lost in the Indian High Court in 2010, but was victorious in the Supreme Court.

The Supreme Court came to the conclusion that the buyer and the seller were foreign companies. The shares sold were also shares in a foreign company. The Indian tax authorities therefore had no jurisdiction to tax the transaction.

The Supreme Court also summarised its view as follows:

"*Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner. Legal doctrines like "Limitation of Benefits" and "look through" are matters of policy. It is for the Government of the day to have them incorporated in the Treaties and in the laws so as to avoid conflicting views. Investors should know where they stand.*"

It highlights two critical aspects for India:

- it affirms the rule of law in India; and
- it indicates that India is a safe place for a foreign investor to do business.

It is speculated that the tax authorities may seek to change the tax laws to the effect that, where an acquired company has more than half of its assets in India, the disposal of the shares in that company will be subject to capital gains tax in India.

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