DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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BINDING CLASS RULING ON DIVIDENDS DISTRIBUTED BY A FOREIGN COMPANY

The South African Revenue Service (SARS) issued Binding Class Ruling 41 (Ruling) on 24 July 2013 regarding the question of whether a dividend distributed by a foreign company will constitute a 'foreign dividend' as defined in s1 of the Income Tax Act, No 58 of 1962 (Act).

The applicant was a foreign corporate partnership limited by shares (Company X). The structure is essentially a hybrid between a partnership and a limited liability company utilised in European countries such as Germany, Belgium, France, Denmark and Poland. The applicant was listed on the London Stock Exchange (LSE) with depository receipts (DRs) listed on the Johannesburg Stock Exchange (JSE).

DRs are negotiable financial instruments that are issued by a bank and represent a foreign company's shares on a local exchange. DRs make it easier to buy shares in a foreign company, because the company does not have to be listed on the exchange and the shares do not have to leave the foreign country. They are managed through brokers, such as banks, in the local financial sector.

The ruling deals with whether the applicant could be considered to be distributing 'foreign dividends' as defined in s1 of the Act, where it makes distributions to beneficial holders of DRs locally. The class members to which the Ruling applies are these beneficial owners, who would receive foreign dividends associated from time to time with the applicant's shares.

Section 1 of the Act provides that 'foreign dividend' means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated, by that foreign company, as a dividend or similar payment for purposes of the laws relating to:

- income tax on companies in the country in which the foreign company has its place of effective management (POEM); or
- where there are no laws relating to POEM, laws related to companies in the country in which the foreign company has been incorporated, formed or established.

The definition does not include amounts paid or payable which constitute shares in the foreign company.

On the facts, the applicant's shareholders who are resident in Country X, are taxed on dividend income on the basis that it is treated as interest. SARS made it a condition that the shares of the applicant in respect of which dividends are to be declared are not 'hybrid equity instruments' in terms of s8E(1) of the Act. SARS ruled that a dividend declared by the applicant to local beneficial owners of DRs would constitute a foreign dividend.

It appears that despite the fact that the dividends received by foreign shareholders in the applicant are taxed as interest in the foreign country, SARS ruled that distributions received from the applicant by local holders of DRs will qualify as 'foreign dividends' in terms of the definition in s1 of the Act.

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BINDING PRIVATE RULING ON FOREIGN ASSET-FOR-SHARE TRANSACTION

Binding Private Ruling 149 (Ruling) was released by the South African Revenue Service (SARS) on 24 July 2013 and deals with the disposal by a local company of foreign assets (being shares) in exchange for shares in a foreign company.

The applicant was a local company holding 100% of the issued shares in a foreign company A, which held the applicant's various foreign investments.

Foreign company A was incorporated in and a tax resident of the Netherlands.

The applicant wished to interpose another foreign company, being foreign company B, between itself and foreign company A.

Foreign company B was to be established as a co-operative that is also tax resident in the Netherlands.

The transaction entailed that the applicant would dispose of its shares in company A to company B at market value. As consideration, the applicant would be issued 99.99% of the equity in company B.

Company B would record the market value of the shares received in company A as contributed tax capital.

The other 0.01% of the equity in company B would be held by another group company.

SARS ruled that the transaction would fall within the definition of an 'asset-for-share transaction' as defined in s42 of the Income Tax Act, No 58 of 1962 (Act). The transaction would then also be regulated by the latter section and the parties would receive roll-over relief.

In terms of paragraph (b) of the definition of 'asset-for-share transaction', a transaction in terms of which a person (such as the applicant) disposes of an equity share in a foreign company (company A) to another foreign company (company B) in exchange for an equity share in that other foreign company, can also qualify for roll-over relief.

However, immediately before the disposal, the person (such as the applicant) and the other foreign company (company B) must form part of the same group of companies and that other foreign company (company B) must be a 'controlled foreign company' in relation to any resident group company. It is assumed that this requirement was to be met by ensuring that the group company eventually holding the 0.01% stake in company B, initially held all the equity in company B. Also, it must have been ensured that that company would be a 'controlled foreign company'.

In addition, at the close of the day on which the transaction takes place, more than 50% of the equity shares in the foreign company must be held directly or indirectly by a resident, or more than 70% of the equity shares in the other foreign company must be directly or indirectly held by a resident.

It would appear that SARS was satisfied that all these requirements would be met.

SARS further ruled that the definition of 'contributed tax capital' would not apply to company B while it remained a foreign company (a non-resident company).

Also, SARS ruled that the provisions relating to a 'foreign dividends' or 'foreign return of capital' as defined in s1 of the Act would apply without any reference to contributed tax capital.

The ruling was made on the condition that profits distributed by company B would be treated as dividends by the Dutch tax authorities and that company A would not be a 'foreign financial instrument holding company' for purposes of paragraph 64B(5) of the Eighth Schedule to the Act.

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