1 JULY 2016

TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

BEWARE OF TAX ON DIVIDEND STRIPPING AND MANIPULATION OF DIVIDEND RIGHTS

Dividends paid by local companies are generally exempt from income tax in the hands of shareholders and, in certain cases, are either exempt from dividends tax or subject to a reduced rate of dividends tax.

CUSTOM AND EXCISE HIGHLIGHTS

We will be providing a brief overview of the Customs and Excise environment in our weekly Tax Alert. This is the third instalment of the series.

CLIFFE DEKKER HOFMEYR

BEWARE OF TAX ON DIVIDEND STRIPPING AND MANIPULATION OF DIVIDEND RIGHTS

Taxpayers may be tempted to enter into transactions where they either do "dividend stripping", or manipulate the right to receive dividends to avoid income tax, capital gains tax (CGT) or dividends tax.

Dividends paid by local companies are generally exempt from income tax in the hands of shareholders and, in certain cases, are either exempt from dividends tax or subject to a reduced rate of dividends tax.

Taxpayers may be tempted to enter into transactions where they either do "dividend stripping", or manipulate the right to receive dividends to avoid income tax, capital gains tax (CGT) or dividends tax.

However, there are a number of rules in our tax law that seek to thwart those kinds of transactions.

First, if a share trader buys shares in a company, and if the purpose of the acquisition is to strip the company of its reserves, then the share trader may not be able to deduct the cost of the shares for income tax purposes. The reason is that, as dividends received from a company are exempt from income tax and accordingly do not constitute "income" for purposes of the Income Tax Act, No 58 of 1962 (Act), the expenditure to acquire the shares is not incurred "in the production of income" as required under s11(a) of the Act: *Commissioner for Inland Revenue v Nemojim (Pty) Ltd* 45 SATC 241.

As dividends received from a company are exempt from income tax and accordingly do not constitute "income" for purposes of the Income Tax Act, No 58 of 1962 (Act), the expenditure to acquire the shares is not incurred "in the production of income.

Second, s22B of the Act applies where a company (BuyerCo) receives a dividend from a company (TargetCo) and disposes of shares in TargetCo within 18 months of receiving the dividend. The provision applies if:

- the dividend is exempt from income tax and dividends tax in the hands of BuyerCo;
- BuyerCo held the shares as trading stock;
- BuyerCo held more than 50% of the equity shares in TargetCo; and
- TargetCo (or its direct or indirect subsidiary), within a period of 18 months before the disposal, by reason of the disposal, has borrowed money from BuyerCo (or a person connected to BuyerCo), or has borrowed money from a third party that is guaranteed by BuyerCo (or a person connected to BuyerCo).

If the requirements of s22B of the Act are met, then the dividend is not exempt from income tax in the hands of BuyerCo. The amount included is limited, however, to the amount of the debt.

Essentially, the provision is aimed at transactions where the person acquiring shares funds the pre-sale dividend in the case where the company paying the dividend has no available cash, and the person then has a loan in the company which it can strip out free of tax.

Third, paragraph 43A of the Eighth Schedule to the Act may apply in the case where BuyerCo held the shares on capital account, and the disposal is subject to CGT. The requirements of that provision are materially similar to those of s22B of the Act. However, the effect in this case is, essentially, that BuyerCo must account for CGT on the dividend as though it were proceeds on the disposal of the shares.

CLIFFE DEKKER HOFMEYR

BEWARE OF TAX ON DIVIDEND STRIPPING AND MANIPULATION OF DIVIDEND RIGHTS

CONTINUED

Under s181 of the Tax Administration Act, No 28 of 2011 a shareholder may become liable for the tax debts of the company if the shareholder receives a dividend (or other distribution of assets) from the company within one year before its winding up and the company had outstanding tax debts at the time of the distribution.

Note that the above provisions may also apply where TargetCo buys back shares from BuyerCo.

Fourth, another 18-month, anti-dividend stripping rule is contained in paragraph 19 of the Eighth Schedule. Under that provision, a shareholder must disregard a capital loss for CGT purposes if, within 18 months before the disposal, or as part of the disposal, the shareholder received "extraordinary exempt dividends". Dividends constitute "extraordinary exempt dividends" if they are exempt from income tax and dividends tax in the hands of the shareholder, and if they exceed 15% of the proceeds on disposal.

Fifth, if the right to receive a dividend (without the underlying share) is transferred to a company, then the dividend is not tax exempt in the hands of the company: proviso *(ee)* to s10(1)*(k)* of the Act. The purpose of the provision is, essentially, to prevent a person from stripping a company of reserves without holding an interest in the underlying share.

There is a similar provision relating to dividends tax. If, in certain cases, a resident company, tax-exempt person or non-resident acquires the right to a dividend by way of cession (without the underlying share), and if the dividend is declared (but not paid) before the acquisition, the person that has ceded the right is deemed to be the beneficial owner of the dividend and, accordingly, must account for dividends tax on the dividend: s64EB(1) of the Act.

Sixth, in certain cases, dividends received by a company are not tax exempt where the company borrows the shares and receives a dividend on the borrowed shares: provisos *(gg)* and *(hh)* to s10(1)*(k)* of the Act. Section 64EB(2) of the Act provides for a similar provision for dividends tax purposes where, in certain cases, a resident company, tax-exempt person or non-resident borrows, or enters into a resale agreement in relation to a listed share.

Finally, under s181 of the Tax Administration Act, No 28 of 2011 a shareholder may become liable for the tax debts of the company if the shareholder receives a dividend (or other distribution of assets) from the company within one year before its winding up and the company had outstanding tax debts at the time of the distribution. The provision is no doubt aimed at shareholders stripping a company of its assets by way of a distribution when they know that the company has outstanding tax obligations. The provision is discussed in greater detail in our Tax Alert of 7 June 2013: Shareholders liable for tax debts of companies on winding up.
Click here to read it.

Ben Strauss

CLIFFE DEKKER HOFMEYR

CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs & Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

We will be providing a brief overview of the Customs and Excise environment in our weekly Tax Alert. This is the third instalment of the series.

Below are this week's selected highlights:

- Increases in rates of duty for bars and rods of certain TH's in headings 72.13, 72.14, 72.15 and 72.28.
- SARS auto merging of tax-payer profiles. Quote from www.sars.gov.za:

  > SARS will match and merge your registered details for tax, customs and excise that we have on our system. The merging of these records will create one consolidated profile. You will then be able to view and manage all your individual or company tax types and registered particulars in one consolidated view.
  >
  > Please note, none of your details will be changed. SARS will simply match and merge your records into one consolidated profile to make it easier for you to view and manage the profile.
  >
  > ....
  >
  > This auto-merge process will affect individuals and companies who have multiple tax and customs registrations and whose profiles were not previously merged. The process will take place in batches over a period of six months.

- UK voted exit from the EU (Brexit). Article 50 of the Lisbon Treaty provides as follow:

  1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
  2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
  3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period" (own emphasis added).

Petr Erasmus

CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Tax and Exchange Control practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Mark Linington
Private Equity Sector Head
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@cdhlegal.com

Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Mareli Treurnicht
Senior Associate
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com

Tessmerica Moodley
Senior Associate
T +27 (0)21 481 6397
E tessmerica.moodley@cdhlegal.com

Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com

Louis Botha
Candidate Attorney
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

CLIFFE DEKKER HOFMEYR