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CORPORATE & COMMERCIAL **ALERT**

IN THIS ISSUE >

No longer a drop in the ocean: The rise of DRIPs under South African law

It is common market practice for companies who wish to preserve their working capital to provide their shareholders with an alternative to receiving a cash dividend. The cash dividend alternatives available to companies listed on the Johannesburg Securities Exchange (JSE) include the conventional scrip dividend and capitalisation share mechanisms, and in recent years it has become increasingly prevalent for certain listed companies to adopt a dividend re-investment plan (DRIP).

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No longer a drop in the ocean: The rise of DRIPs under South African law.

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It is common market practice for companies who wish to preserve their working capital to provide their shareholders with an alternative to receiving a cash dividend. The cash dividend alternatives available to companies listed on the Johannesburg Securities Exchange (JSE) include the conventional scrip dividend and capitalisation share mechanisms, and in recent years it has become increasingly prevalent for certain listed companies to adopt a dividend re-investment plan (DRIP).

The key difference between a scrip dividend and a DRIP is that whilst under scrip dividends, shareholders may elect to receive scrip (capitalisation shares) *in lieu* of cash, the dividends under a DRIP are declared and settled by the company in cash, and the proceeds are then reinvested by the shareholders who elected to receive shares by subscribing for new shares in the company. Furthermore, while the scrip dividend mechanism is specifically regulated under the JSE Listings Requirements, DRIPs are not.

Rise of DRIPs in South Africa

JSE-listed companies that wish to preserve their working capital when paying out dividends usually do so by using the conventional scrip dividend mechanism, as it is a simple and regulated mechanism.

However, in the case of South African Real Estate Investment Trusts (REITs), South African REITs have a special tax dispensation in terms of section 25BB of the Income Tax Act No 58 of 1962. In terms of the dispensation, all dividends declared and paid by the REIT are subject to income tax (and not dividends tax) in the hands of the South African shareholders and are tax deductible in the hands of the REIT. Therefore, the conventional scrip dividend mechanism used by non-REITs is not tax efficient in a REIT environment, as the dividend is not actually paid or does not accrue to the shareholder – it simply receives a share *in lieu* of a dividend. So the scrip dividend is not regarded as a dividend paid by the REIT and the REIT gets no tax deduction. This has led to REITs increasingly starting to use DRIPs as an alternative to scrip dividends.

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No longer a drop in the ocean: The rise of DRIPs under South African law. *...continued*

As with scrip dividends and rights offers, neither of which require shareholder approval under the JSE Listings Requirements, offers for shares under DRIPs are also made on a *pro rata* basis

Prospectus and Shareholder Approval

As with scrip dividends, DRIPs are according to market practice considered non-renounceable offers under South African law. DRIPs are thereby not considered to be offers to the public, in accordance with section 96(1)(c) of the Companies Act 71 of 2008 and therefore the company is not required to furnish shareholders with a registered prospectus.

Provided that a company's memorandum of incorporation does not impose a requirement for shareholder approval, the conventional scrip dividend mechanism does not require shareholder approval in terms of the JSE Listings Requirements.

As DRIPs are currently not specifically regulated by the JSE Listings Requirements, and because under a DRIP, the dividend is first settled and then reinvested to subscribe for shares, the normal rules regulating issues of shares for cash under the JSE Listings Requirements would seemingly apply to DRIPs. Under the JSE Listings Requirements, issues of shares for cash may be implemented on terms generally approved by shareholders (subject to certain specified limitations on time periods, pricing etc.) or on terms specifically approved by shareholders in respect of that particular issue. Both general and specific authorities to issue shares for cash must be approved by 75% of votes exercised by shareholders on the resolution.

As with scrip dividends and rights offers, neither of which require shareholder approval under the JSE Listings Requirements, offers for shares under DRIPs are also made on a *pro rata* basis. From a policy perspective, it would therefore make sense for the JSE to specifically regulate DRIPs in the same manner as scrip dividends to make it clear that shareholder approval is not required. For the time being, companies who wish to adopt DRIPs are however advised to include a specific issue for cash authority in the company's AGM notice, to specifically authorize the issue of shares under a DRIP on an annual basis.

Johan Green and Marzia Gertse

E-learning Offering

Our Employment practice recently launched an e-learning module:

A better place to work

The module will empower your organisation with a greater appreciation and understanding of what constitutes sexual harassment, how to identify it and what to do it if occurs.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 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.

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