DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

DIVIDENDS TAX AND THE BENEFICIAL OWNER - SHOULD A DIVIDEND BE PAID TO A TRUST?

The issue pertaining to whether a trust is liable for dividends tax should a company pay a dividend to the trust as the registered owner of the shares has recently been clarified by SARS. By way of background, dividends tax must be paid by the beneficial owner, the concept being defined as the person that is entitled to the benefit of the dividend attaching to a share.

SARS has now indicated that, should one be dealing with a vesting trust where the beneficiary has a vested right to the underlying shares and the dividends, the beneficiary will be deemed to be the beneficial owner. A company that is a vested beneficiary of such a trust will be deemed to have a vested right to the underlying dividend. In the case of a so-called bewind trust, the beneficiary is in fact the beneficial owner of the shares and the dividend. In such an instance, it is possible to claim exemption from dividends tax to the extent that the beneficiary is a company.

In the case of a discretionary trust, the trust is deemed to be the beneficial owner of a dividend given the fact that the trustees would not have exercised their discretion in favour of the beneficiaries at any given point in time. Should the trustees have vested the dividend in a beneficiary by the date on which the dividend is paid or becomes payable by the company declaring it, the beneficiary is deemed to be the beneficial owner of the dividend. This will also be the case if the trustees have vested the dividend in a beneficiary after the date that the dividend is paid or payable, but before the end of the year of assessment of the trust. Should the trustees fail to vest the dividend during the same year of assessment in which it is received by or accrues to the trust, the trust will be deemed to be the beneficial owner of the dividend. The dividend will in such case form part of the trust capital and will lose its character as a dividend if it is vested in a beneficiary in a subsequent year of assessment.

Should a beneficiary be exempt from dividends tax in circumstances where the trustees have vested the dividend in such beneficiary after the date on which it has been paid by the company, the beneficiary would still be entitled to apply for a refund if the dividends tax has been withheld. However, the vesting of the dividend must occur during the same year of assessment in which the dividend has been received by or has accrued to the trust.

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It has also been indicated that dividends tax does not become payable when the trustees of a trust vest a dividend in a beneficiary as dividends tax is only levied when a company declares and pays a dividend and not when a trust passes such dividend on to its beneficiaries.

Emil Brincker

THE WIDE APPLICATION OF SECTION 23K

The general purpose of s23K of the Income Tax Act, No 58 of 1962 (Act) is to disallow interest deductions in respect of debt used in certain reorganisation transactions. One of the targeted transactions is where a taxpayer has indirectly obtained interest deductions in respect of debt used to purchase shares. Generally, interest paid on debt used to purchase shares is not deductible because shares produce exempt dividend income.

The classic example of how a taxpayer could obtain such an indirect interest deduction in respect of the purchase of shares is known as the debt push-down structure.

To illustrate, holding company A wishes to purchase the business of company B. It does not wish to purchase the shares in company B because it would not be able to get an interest deduction if it buys the shares with borrowed money. However, the shareholders of company B would prefer to sell their shares to company A. In order to purchase the shares in company B and to get an interest deduction, company A makes use of the debt push-down technique. Company A buys the shares in company B and obtains bridging finance from a third party in order to settle the purchase price of the shares. Company A then forms a subsidiary, company C. Since company B and company C now form part of the same group of companies, company C purchases the assets from company B in terms a s45 intra-group transaction, without triggering any tax. Company C obtains a long-term loan from a bank in order to settle the purchase price of the assets. Company B distributes the cash up to company A, and company A uses it to settle the bridging finance. In the result, shares have been bought into the group, and the group has obtained interest deductions through the long-term loan to company C.

Such transactions are problematic to the state, especially in cases where the interest is paid to foreign lenders, in which case the taxpayer gets a deduction, but the state cannot tax the interest as income in the hands of the lender because the income is exempt (s10(1)(h) of the Act).

Section 23K(2) of the Act reads: "...no deduction is allowed in respect of any amount of interest incurred by an acquiring company in terms of a debt instrument if that debt instrument was issued or used directly or indirectly - (a) for the purpose of procuring, enabling, facilitating, or funding the acquisition by that acquiring company of any asset in terms of a reorganisation transaction..."

A reorganisation transaction is defined in s23K(1) of the Act as including an intra-group transaction in terms of s45 of the Act.

Interest deductions on such debt instruments used in respect of reorganisation transactions will only be allowed if special application is made to the South African Revenue Service (SARS) for a directive allowing such interest deductions (s23K(3)), or if a specific prescribed exclusion applies (s23K(9)).

Consider the following scenario: Company A, and its subsidiaries company B and company C are pre-existing companies. Company C has a long-term loan from a bank, which loan it has had for many years and in respect of which it claims interest deductions. Company C purchases all the assets of company B, its fellow subsidiary. Company C settles the purchase price by making use of the funds from the long-term loan.

In terms of s23K(2) of the Act, company C will no longer be entitled to claim interest deductions on the loan because it has used the debt to fund the acquisition of assets in terms of a s45 intra-group transaction (assuming that no specific prescribed exclusion applies). Company C will have to apply for a directive from SARS in order to continue claiming interest deductions in respect of the loan.

It is therefore irrelevant whether the loan was specifically obtained for the purposes of acquiring assets in terms of a s45 intra-group transaction. The mere fact that the loan funds were used in respect of the s45 intra-group transaction is sufficient to trigger the provisions of s23K of the Act.

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