DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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RECHARACTERISATION OF DIVIDENDS AS INCOME

The 2013 draft Taxation Laws Amendment Bill has introduced significant changes insofar as the taxation of dividends are concerned, specifically dividends paid in respect of unvested shares held via employee share schemes.

By way of background, the Income Tax Act, No 58 of 1962 (Act) currently contains certain anti-avoidance rules to prevent taxpayers from converting high-taxed salary into low taxed dividends. In particular, s10(1)(k)(dd) of the Act provides that a dividend derived from a restricted employee share scheme shall be taxable as normal income unless that dividend falls into one of the following three exceptions:

- the share constitutes an equity share that lacks hybrid equity share features (without having regard to the three-year carve-back);
- the dividend constitutes an equity instrument; or
- the dividend arises from a trust solely containing equity shares that lack hybrid equity share features (without having regard to the three-year carve-back).

Although these anti-avoidance rules are aimed at preventing taxpayers from converting their high-taxed salary into low-taxed dividends, it is clear that these anti-avoidance rules are targeted solely at dividends derived from restricted employee share schemes, where the underlying share does not have pure equity features. Accordingly, the current anti-avoidance rules draws a distinction between equity shares and non-equity shares in respect of restricted employee shares, with the resultant effect that only dividends derived from restricted employee share schemes, where the underlying shares do not consist of pure equity features (preference shares), are taxable as normal income.

In order to remove the distinction that exists in respect of restricted employee shares, it is proposed in paragraph 32(1)(n) of the Taxation Laws Amendment Bill that the proviso to s10(1)(k)(dd) be deleted, with the effect that dividends (restricted and unrestricted) from employee shares and share schemes essentially operate as income without regard to whether the underlying shares have a pure equity or preference-like yield.

The effect of the proposed amendment is that:

- the recipient of the dividend derived from the equity instrument will be taxed on the dividend as ordinary income, unless the equity instrument has vested (as contemplated in section 8C(3) of the Act); and
- the company declaring the dividend, in respect of the equity instrument, will be entitled to an income tax deduction equal to the amount of the inclusion (in terms of the newly proposed section 11(t) of the Act).

Accordingly, higher income earners who receive dividends from employee shares and share schemes will be subject to income tax at the marginal rate of 40% and the company declaring the dividend will effectively offset a 28% rate of tax. Similarly, lower income earners will be subject to tax at the marginal rate of between 18 to 25% and the company declaring the dividend will effectively offset a 28% rate of tax.

It is important to note that the proposed amendments seek to apply equally to senior management incentive plans as well as to broad-based Black Economic Empowerment schemes.

It is proposed that the amendments be effective as from 1 March 2014 and will be applicable in respect of dividends declared on or after that date.

Nicole Paulsen

VAT REGISTRATION OF FOREIGN BUSINESSES

The draft Taxation Laws Amendment Bill 2013 (TLAB) was released for public comment on 5 July 2013. Among other things, the TLAB proposes that, in order to curtail foreign businesses that supply goods and services in 'cyber space' from escaping the VAT net, all foreign businesses supplying digital goods and services will be required to register as VAT vendors in South Africa.

This line of thinking follows the current trend adopted by the European Union, which requires such suppliers to register for VAT in the country where the consumer resides. The question of whether non residents need to register as vendors in South Africa has been the subject matter of muchdebate over the years. Generally, a person would not be regarded as carrying on a business or other activity in a country unless that person either has a physical presence in that country or the person provides goods or performs services in that country personally or through an agent.

The proposed amendment in the TLAB considers the place of supply rules and the impact of these rules on imported services.

In terms of the proposal, new place of supply rules will be introduced, in terms of which the actual or deemed location of the supplier will determine whether a foreign supplier would need to charge VAT on the supply made. The introduction of place of supply rules is in line with current OECD principles. In terms of these rules, foreign suppliers will be required to charge VAT on supplies made to South African customers by using a customer proxy. It is proposed, in order to determine the proxy of the customer location, that either the payment from a South African bank or the residency of the customer will be used. Apparently other proxies such as place of performance, the customer IP address and the customer's billing address on the invoice were rejected as alternative means of determining a customer's location. Further, the proposal contemplates a compulsory VAT registration category which applies to all foreign suppliers of e-commerce services to South African customers and a special compulsory category in terms of which no monetary thresholds are applicable.

The other practical issue the proposal deals with is placing reliance on the reverse charge mechanism for imported services, however this was deemed impractical as a result of lack of compliance on the part of the customer.

As a safeguard measure, all foreign suppliers of e-commerce can only claim VAT refunds to the extent that cash payments exceed total outputs.

The proposed amendment will be applicable in respect of all supplies made on or after 1 January 2014.

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