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TAX & EXCHANGE CONTROL ALERT

IN THIS ISSUE

THE PROPOSED AMENDMENTS REGARDING DIVIDEND STRIPPING RULES IN THE 2019 BUDGET: SOME FURTHER REFLECTION

In our Special Edition Budget Speech Alert 2019, we discussed, among other things, National Treasury's (NT) proposal to address abusive arrangements aimed at avoiding the anti-dividend stripping provisions in the Income Tax Act, No 58 of 1962 (Act). The purpose of this article is to delve into this issue in a little bit more detail.

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In our Special Edition Budget Speech Alert 2019, we discussed, among other things, National Treasury's (NT) proposal to address abusive arrangements aimed at avoiding the anti-dividend stripping provisions in the Income Tax Act, No 58 of 1962 (Act). The purpose of this article is to delve into this issue in a little bit more detail.

We firstly deal with the history of the amendments to the anti-dividend stripping provisions and thereafter briefly discuss NT's proposal in the 2019 Budget.

The 2017 amendments

In 2017, NT amended s22B of the Act and paragraph 43A of the Eighth Schedule to the Act (Eighth Schedule), by replacing the old s22B and paragraph 43A completely, in an attempt to address the abuse whereby share buy-back transactions were concluded by companies wishing to dispose of their shares in another company. Prior to the introduction of paragraph 43A and s22B, companies could dispose of their shares in another company (Target), by having their shares bought back by the Target, followed by the Target issuing shares to the new shareholder. This would result in no dividends tax or capital gains tax (CGT) being payable on the disposal.

In some instances, companies would arrange for the Target to declare a tax-exempt dividend to it, which would reduce the value of the selling company's shares, so that when the shares are disposed of, the seller's CGT liability would also be reduced.

Pursuant to the 2017 amendments, if a company sold its shares in one of the ways set out above, the portion of the dividend that exceeds 15% of the market value of the share, ie the extraordinary dividend, would be added to the proceeds from the share sale, which would likely increase the seller's CGT liability. The only way to avoid this in terms of s22B and paragraph 43A was if the seller holds the shares for at least 18 months after the dividend is declared.

At the time, s22B and paragraph 43A were also made to trump the corporate rollover relief provisions in s41 to s47 of the Act.

The 2018 amendments

In 2018, NT amended s22B and paragraph 43A to address the unintended consequences that arose from the 2017 amendments. In particular where shares were disposed of in terms of the corporate rollover relief provisions after a dividend was declared to a company, the corporate rollover relief would not assist the company disposing of the shares as intended, but would instead trigger a capital gain in the hands of the company disposing of shares in terms of a corporate rollover relief provision.

NT then decided to amend s22B and paragraph 43A to address this unintended consequence so that parties could benefit from the corporate rollover relief provisions when disposing of shares after receiving a dividend by virtue of their shareholding. However, NT also inserted provisions in s22B and paragraph 43A that would prevent tax avoidance, so that companies making use of the corporate rollover relief provisions, could not avoid the application of s22B or paragraph 43A. Within the context of s22B and paragraph

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In the 2019 Budget, NT notes that some taxpayers are trying to avoid the adjusted rules in s22B and paragraph 43A.

43A, transactions concluded in terms of the corporate rollover relief provisions are referred to as "deferral transactions". One of the ways in which NT tried to prevent avoidance of s22B and paragraph 43A through a deferral transaction was by inserting a provision stating that:

- where a company disposes of shares in terms of a deferral transaction (disposing company), after having acquired those shares in terms of a deferral transaction, other than an unbundling transaction in terms of s46 of the Act; and
- within 18 months prior to the disposal, an exempt dividend in respect of those shares accrued to or was received by a person that disposed of the shares in terms of a deferral transaction, who was also a connected person in relation to the disposing company within that period; then
- that dividend must for purposes of s22B or paragraph 43A be treated as a dividend that accrued to or was received by the disposing company in respect of those shares within the period during which the disposing company held those shares.

Therefore, where the disposing company acquired shares in terms of a deferral transaction, it could only avoid the application of s22B or paragraph 43A, if it held the shares for at least 18 months after acquiring the shares, or if the disposing company and the company from which it acquired the shares in terms of a deferral transaction, were not connected persons during the 18-month period.

The proposal in the 2019 Budget

In the 2019 Budget, NT notes that some taxpayers are trying to avoid the adjusted rules in s22B and paragraph 43A. According to NT, some taxpayers are now putting arrangements in place whereby the the target company, being the company in which the shares are held, distributes a substantial dividend to its current company shareholder and thereafter issues shares to a third party. As a result, the value of the current company shareholder's holding in the shares of the target company is diluted and these shares are not immediately disposed of. According to NT, this differs from the previous avoidance arrangements that involved disposing of the same shares in return for a tax-exempt dividend.

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NT intends to further amend the rules governing share buy-backs and dividend stripping to address this new form of abuse. According to NT, the amendments will take effect on 20 February 2019.

It appears that this scheme may be similar to some of the avoidance schemes that were implemented prior to the 2017 amendments coming into effect, with the difference being that the target company does not buy back the shares from its current shareholder, followed by a share issue to a new shareholder, as this would likely trigger the application of s22B or paragraph 43A. Instead, the current company shareholder receives a substantial dividend that is exempt from dividends tax, following which the new shareholder subscribes for shares in the target company, which dilutes the current company shareholder's interest in the target company significantly. When the current company shareholder disposes of its remaining interest in the target company more than 18 months after receiving the dividend, its CGT liability will be less than it would have been, had it simply sold the shares to the new shareholder. Where the transaction is implemented in this manner, paragraph 43A and s22B will not apply.

Therefore, NT intends to further amend the rules governing share buy-backs and dividend stripping to address this new form of abuse. According to NT, the amendments will take effect on 20 February 2019.

Comments

It is clear that NT is intent on preventing tax avoidance from occurring through any type of scheme involving share buy-backs and dividend stripping. It will be interesting to see how the proposed amendment reads. As the proposed amendments will apply from 20 January 2019, any taxpayer implementing the schemes that NT will try to address through the proposed amendments, after this date, will be caught by this provision. The provision will apply to taxpayers from 20 January 2019 even if the legislation is only passed by Parliament later in 2019.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 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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