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# CORPORATE & COMMERCIAL ALERT

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### 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*

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## OUR TEAM

For more information about our Corporate & Commercial practice and services, please contact:



**Willem Jacobs**  
National Practice Head  
Director  
Corporate & Commercial  
T +27 (0)11 562 1555  
M +27 (0)83 326 8971  
E willem.jacobs@cdhlegal.com



**David Thompson**  
Regional Practice Head  
Director  
Corporate & Commercial  
T +27 (0)21 481 6335  
M +27 (0)82 882 5655  
E david.thompson@cdhlegal.com

**Mmatiki Aphiri**  
Director  
T +27 (0)11 562 1087  
M +27 (0)83 497 3718  
E mmatiki.aphiri@cdhlegal.com

**Roelof Bonnet**  
Director  
T +27 (0)11 562 1226  
M +27 (0)83 325 2185  
E roelof.bonnet@cdhlegal.com

**Tessa Brewis**  
Director  
T +27 (0)21 481 6324  
M +27 (0)83 717 9360  
E tessa.brewis@cdhlegal.com

**Etta Chang**  
Director  
T +27 (0)11 562 1432  
M +27 (0)72 879 1281  
E etta.chang@cdhlegal.com

**Clem Daniel**  
Director  
T +27 (0)11 562 1073  
M +27 (0)82 418 5924  
E clem.daniel@cdhlegal.com

**Jenni Darling**  
Director  
T +27 (0)11 562 1878  
M +27 (0)82 826 9055  
E jenni.darling@cdhlegal.com

**André de Lange**  
Director  
T +27 (0)21 405 6165  
M +27 (0)82 781 5858  
E andre.delange@cdhlegal.com

**Werner de Waal**  
Director  
T +27 (0)21 481 6435  
M +27 (0)82 466 4443  
E werner.dewaal@cdhlegal.com

**Emma Dempster**  
Projects & Energy  
Director  
T +27 (0)11 562 1194  
M +27 (0)79 491 7683  
E emma.dempster@cdhlegal.com

**Lilia Franca**  
Director  
T +27 (0)11 562 1148  
M +27 (0)82 564 1407  
E lilia.franca@cdhlegal.com

**John Gillmer**  
Director  
T +27 (0)21 405 6004  
M +27 (0)82 330 4902  
E john.gillmer@cdhlegal.com

**Jay Govender**  
Projects & Energy Sector Head  
Director  
T +27 (0)11 562 1387  
M +27 (0)82 467 7981  
E jay.govender@cdhlegal.com

**Johan Green**  
Director  
T +27 (0)21 405 6200  
M +27 (0)73 304 6663  
E johan.green@cdhlegal.com

**Allan Hannie**  
Director  
T +27 (0)21 405 6010  
M +27 (0)82 373 2895  
E allan.hannie@cdhlegal.com

**Peter Hesseling**  
Director  
T +27 (0)21 405 6009  
M +27 (0)82 883 3131  
E peter.hesseling@cdhlegal.com

**Quintin Honey**  
Director  
T +27 (0)11 562 1166  
M +27 (0)83 652 0151  
E quintin.honey@cdhlegal.com

**Roelf Horn**  
Director  
T +27 (0)21 405 6036  
M +27 (0)82 458 3293  
E roelf.horn@cdhlegal.com

**Kendall Keanly**  
Director  
T +27 (0)21 481 6411  
M +27 (0)83 645 5044  
E kendall.keanly@cdhlegal.com

**Yaniv Kleitman**  
Director  
T +27 (0)11 562 1219  
M +27 (0)72 279 1260  
E yaniv.kleitman@cdhlegal.com

**Justine Krige**  
Director  
T +27 (0)21 481 6379  
M +27 (0)82 479 8552  
E justine.krige@cdhlegal.com

**Johan Latsky**  
Executive Consultant  
T +27 (0)11 562 1149  
M +27 (0)82 554 1003  
E johan.latsky@cdhlegal.com

**Giada Masina**  
Director  
T +27 (0)11 562 1221  
M +27 (0)72 573 1909  
E giada.masina@cdhlegal.com

## OUR TEAM

For more information about our Corporate & Commercial practice and services, please contact:

### Nkcubeko Mbambisa

Director  
T +27 (0)21 481 6352  
M +27 (0)82 058 4268  
E [nkcubeko.mbambisa@cdhlegal.com](mailto:nkcubeko.mbambisa@cdhlegal.com)

### Anita Moolman

Director  
T +27 (0)11 562 1376  
M +27 (0)72 252 1079  
E [anita.moolman@cdhlegal.com](mailto:anita.moolman@cdhlegal.com)

### David Pinnock

Director  
T +27 (0)11 562 1400  
M +27 (0)83 675 2110  
E [david.pinnock@cdhlegal.com](mailto:david.pinnock@cdhlegal.com)

### Tamarin Tosen

Director  
T +27 (0)11 562 1310  
M +27 (0)72 026 3806  
E [tamarin.tosen@cdhlegal.com](mailto:tamarin.tosen@cdhlegal.com)

### Nonhla Mchunu

Director  
T +27 (0)11 562 1228  
M +27 (0)82 314 4297  
E [nonhla.mchunu@cdhlegal.com](mailto:nonhla.mchunu@cdhlegal.com)

### Jo Neser

Director  
T +27 (0)21 481 6329  
M +27 (0)82 577 3199  
E [jo.neser@cdhlegal.com](mailto:jo.neser@cdhlegal.com)

### Allan Reid

Director  
T +27 (0)11 562 1222  
M +27 (0)82 854 9687  
E [allan.reid@cdhlegal.com](mailto:allan.reid@cdhlegal.com)

### Roxanna Valayathum

Director  
T +27 (0)11 562 1122  
M +27 (0)72 464 0515  
E [roxanna.valayathum@cdhlegal.com](mailto:roxanna.valayathum@cdhlegal.com)

### Ayanda Mhlongo

Director  
T +27 (0)21 481 6436  
M +27 (0)82 787 9543  
E [ayanda.mhlongo@cdhlegal.com](mailto:ayanda.mhlongo@cdhlegal.com)

### Francis Newham

Director  
T +27 (0)21 481 6326  
M +27 (0)82 458 7728  
E [francis.newham@cdhlegal.com](mailto:francis.newham@cdhlegal.com)

### Megan Rodgers

Oil & Gas Sector Head  
Director  
T +27 (0)21 481 6429  
M +27 (0)79 877 8870  
E [megan.rodgers@cdhlegal.com](mailto:megan.rodgers@cdhlegal.com)

### Roux van der Merwe

Director  
T +27 (0)11 562 1199  
M +27 (0)82 559 6406  
E [roux.vandermerwe@cdhlegal.com](mailto:roux.vandermerwe@cdhlegal.com)

### William Midgley

Director  
T +27 (0)11 562 1390  
M +27 (0)82 904 1772  
E [william.midgley@cdhlegal.com](mailto:william.midgley@cdhlegal.com)

### Gasant Orrie

Cape Managing Partner  
Director  
T +27 (0)21 405 6044  
M +27 (0)83 282 4550  
E [gasant.orrie@cdhlegal.com](mailto:gasant.orrie@cdhlegal.com)

### Ludwig Smith

Director  
T +27 (0)11 562 1500  
M +27 (0)79 877 2891  
E [ludwig.smith@cdhlegal.com](mailto:ludwig.smith@cdhlegal.com)

### Charl Williams

Director  
T +27 (0)21 405 6037  
M +27 (0)82 829 4175  
E [charl.williams@cdhlegal.com](mailto:charl.williams@cdhlegal.com)

### Tessmerica Moodley

Director  
T +27 (0)21 481 6397  
M +27 (0)73 401 2488  
E [tessmerica.moodley@cdhlegal.com](mailto:tessmerica.moodley@cdhlegal.com)

### Verushca Pillay

Director  
T +27 (0)11 562 1800  
M +27 (0)82 579 5678  
E [verushca.pillay@cdhlegal.com](mailto:verushca.pillay@cdhlegal.com)

### Ben Strauss

Director  
T +27 (0)21 405 6063  
M +27 (0)72 190 9071  
E [ben.strauss@cdhlegal.com](mailto:ben.strauss@cdhlegal.com)

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### 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](mailto: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](mailto:ctn@cdhlegal.com)

### STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.  
T +27 (0)21 481 6400 E [cdhstellenbosch@cdhlegal.com](mailto:cdhstellenbosch@cdhlegal.com)

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