TAX & EXCHANGE CONTROL
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CLIFFE DEKKER HOFMEYR

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IN THIS ISSUE

SARS adopts a very lenient approach when dividends are recharacterised as income pursuant to the issuing of preference shares

The South African Revenue Service (SARS) recently issued a draft interpretation note dealing with the circumstances where dividends in respect of preference shares are recharacterised as income in terms of section 8E of the Income Tax Act 58 of 1962. Section 8E is an anti-avoidance provision that targets shares that have substantial debt features. Should the section be applicable, the dividend is deemed to be an amount of income that is accrued by the holder of the preference shares and not exempt from income tax. The issuer of the preference shares can equally not deduct the amount concerned even though it is recharacterised as income in the hands of the holder of the preference shares.

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The South African Revenue Service (SARS) recently issued a draft interpretation note dealing with the circumstances where dividends in respect of preference shares are recharacterised as income in terms of section 8E of the Income Tax Act 58 of 1962. Section 8E is an anti-avoidance provision that targets shares that have substantial debt features. Should the section be applicable, the dividend is deemed to be an amount of income that is accrued by the holder of the preference shares and not exempt from income tax. The issuer of the preference shares can equally not deduct the amount concerned even though it is recharacterised as income in the hands of the holder of the preference shares.

One of the key features of section 8E is that a preference share will be deemed to be a so-called hybrid equity instrument to the extent that the issuer of the preference share is obliged to redeem the preference share within three years from the date of issue.

The date of issue of a share is not only confined to the actual date upon which the share is issued by the company, but it includes the date on which:

- the company that issued the share undertakes the obligation to redeem the share in whole or in part; or
- the holder of the share, at any time after the share has been issued, obtains the right to require that that share been redeemed in whole or in part, other than as a result of its acquisition by the holder thereof.

The effect of this definition is that a date of issue can also arise to the extent that there is subsequently an undertaking by the issuer of the preference share to redeem the preference share within a period of three years.

Apart from the fact that SARS has indicated that additions or changes to the redemption features of a share will not automatically result in it becoming a hybrid equity instrument, a general approach has also been taken that any redemption after the expiry of a period of three years from the original date of issue of a preference share will not result in the share becoming a hybrid equity instrument.

To the extent that the original redemption date of a preference share thus falls outside the three-year period, it is indicated in the interpretation note that no new date of issue will arise to the extent that the redemption date is extended. This is irrespective of the fact that the extended redemption date may fall within a three-year period after the date upon which it was decided to extend the original redemption date. The only instance where one would be dealing with a restricted equity instrument is if the original redemption date is amended to fall within the original three-year period

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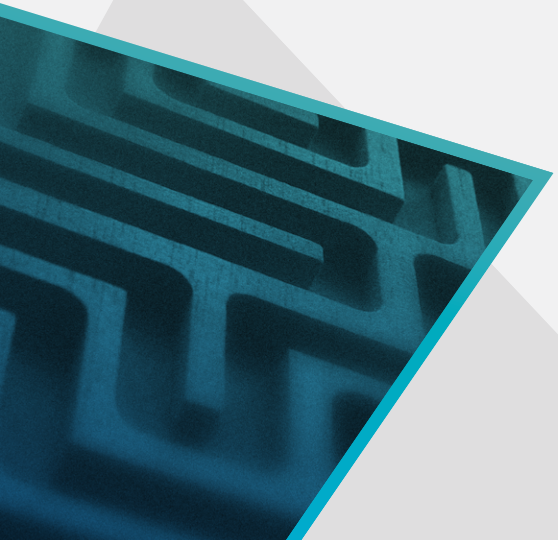
from the date that the preference share was originally issued. It appears that one would also not deal with a recharacterisation to the extent that there is an extension of the original redemption date even before the original three-year period has expired. The test seems to be that, to the extent that the preference shares are redeemed after expiry of a period of three years from their original date of issue, one would not be dealing with a hybrid equity instrument and the dividends would not be recharacterised.

It is not that clear what the position would be to the extent that the issuer of the preference shares defaults and an early redemption date arises in circumstances where this early redemption date still falls outside the initial three-year period. For instance, the preference shares could have been issued for an original period of five years and the default arises in year four. In these circumstances it appears that there will still not be a new date of issue given the fact that the preference shares have already been held for a period of three years.

SARS' views are welcomed as they bring clarity to a much debated topic. One of the arguments was always that, to the extent that the redemption date is amended, it brings about a new date of issue given the fact that the original date of issue has changed. In other words, there is a new right that arises given the fact that the new right relates to a different redemption date as opposed to the original stipulated redemption date. This argument was based on the fact that the date of issue refers to the undertaking of the issuer to redeem the preference share and any extension will result in a new undertaking on the part of the issuer to redeem the preference share.

EMIL BRINCKER



2022 RESULTS

CHAMBERS GLOBAL 2018 - 2021 ranked our Tax & Exchange Control practice in Band 1: Tax.

Emil Brincker ranked by **CHAMBERS GLOBAL 2003 - 2022** in Band 1: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **CHAMBERS GLOBAL 2022** for tax: indirect tax. **CHAMBERS GLOBAL 2009–2021** ranked him in Band 1 for tax: indirect tax.

Mark Linington ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 1: Tax: Consultants.

Ludwig Smith ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 3: Tax.

Stephan Spamer ranked by **Chambers Global 2019-2022** in Band 3: Tax.

TOP RANKED
Chambers
Global
2022
Cliffe Dekker Hofmeyr

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:

Emil Brincker
Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Lance Collop
Director
T +27 (0)21 481 6343
E lance.collop@cdhlegal.com

Mark Linington
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Gerhard Badenhorst
Director
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Jerome Brink
Director
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com

Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Heinrich Louw
Director
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Howmera Parak
Director
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com

Stephan Spamer
Director
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com

Tersia van Schalkwyk
Tax Consultant
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com

Louis Botha
Senior Associate
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

Keshen Govindsamy
Senior Associate
T +27 (0)11 562 1389
E keshen.govindsamy@cdhlegal.com

Varusha Moodaley
Senior Associate
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Louise Kotze
Associate
T +27 (0)11 562 1077
E louise.Kotze@cdhlegal.com

Tsanga Mukumba
Associate
T +27 (0)11 562 1136
E tsanga.mukumba@cdhlegal.com

Ursula Diale-Ali
Associate Designate
T +27 (0)11 562 1614
E ursula.diale-ali@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
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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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

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

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

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

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CLIFFE DEKKER HOFMEYR

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KIETI LAW LLP, KENYA