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PROPOSED TIGHTENING OF THE ANTI-DIVIDEND STRIPPING PROVISIONS

27 August 2019 *5 min read*

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During 2017 and 2018, several changes pertaining to the tax treatment of share buy-backs and so-called "dividend stripping transactions" were introduced to amend the Income Tax Act, No 58 of 1962 ("**Act**"). Primarily these changes were aimed at preventing the avoidance of Capital Gains Tax ("**CGT**"), in instances where companies would undertake subscription and buy-back arrangements, in terms of which CGT was avoided by corporate shareholders.

Prior to the introduction of these provisions, companies ("**Corporate Shareholder/s**") in target companies ("**Target/s**"), were able to dispose of their shares in Targets on a tax-free basis, through the use of one or more of the methods described below:

- where Targets had other shareholders, through the Target's repurchasing of its own shares, that were held by a selling company (i.e. in terms of a share buy-back); and
- in instances where new shareholders were introduced into the Target, by arranging for the new shareholders to subscribe for shares in the Target, after which the Target would utilise the resultant subscription capital to repurchase the shares held by the Corporate Shareholder.

In both the situations described above, the share repurchase proceeds would not be subject to dividends tax, and additionally, the proceeds were also exempt from income tax in the hands of the Corporate Shareholders. For CGT purposes, the share repurchase proceeds were not taken into account by the Corporate Shareholder for purposes of calculating its capital gain or loss resulting from the share repurchase transaction.

The anti-dividend stripping provisions were introduced in order to curb the above described practice. In its current form, these provisions only apply if the Corporate Shareholder actually disposes of its shares in the Target and receives a dividend either as part of the sale (i.e. in terms of a share repurchase transaction) or it received a dividend within an 18 month prior period of the sale. In such situation, the Corporate Shareholder is required, for CGT purposes, to increase its proceeds in respect of the disposal to the extent that the exempt dividends received by or accrued to it within the 18-month period exceeds 15% of the higher of the market value of the Target shares disposed of by it (i) at the beginning of the 18 month period; or (ii) at the date of disposal of such shares.

The dividend stripping provisions only find application if the Corporate Shareholder held a so-called "qualifying interest" in the Target at any time within 18 months prior to the disposal. This would be the case if the Corporate Shareholder, whether alone or together with any connected person in relation to it, held either (i) at least 50% of the equity shares or voting rights in the Target, or (ii) if no person held at least 50% of the equity shares or voting rights in the Target, then the threshold for a qualifying interest is reduced to 20% of the equity shares or voting rights if non-one else held a majority. If the Target is a listed company, the threshold is further reduced to 10%.

Corporate Shareholders sought to avoid these provisions by receiving large dividends, with new shareholders subscribing for shares in the Target, and the Corporate Shareholders being significantly diluted. Then, after the lapsing of 18 months, they would sell the shares for the then value, which would likely be low. In this way the CGT was not payable.

In the Budget Speech 2019, it was proposed that the anti-dividend stripping provisions be expanded to deal with this scenario.

The draft Taxation Laws Amendment Bill, 2019 ("**TLAB**") includes the above proposal by deeming a Corporate Shareholder to have disposed of its shares in a Target, solely for purposes of applying the anti-dividend stripping provisions, to the extent that its effective interest in the Target is diluted as a result of a new share issue to a third party. This deemed disposal takes place immediately after the new shares are issued by the Target to the third party.

Upon this deemed disposal, the Corporate Shareholder will be required to take any extraordinary dividend into account as a capital gain, despite the fact that it has not actually disposed of its shares in the Target.

The TLAB introduces a relief measure to the Corporate Shareholder by effectively providing the extraordinary dividend in respect of this deemed disposal as a credit against any future extraordinary dividends derived by such company from the actual disposal of its shares in the Target.

The TLAB proposes that the new provision be introduced with retrospective effect from 20 February 2019 and that it applies in respect of a reduction in the effective interest in a Target on or after 20 February 2019.

Needless to say, there are numerous problems and difficulties with the proposal, and numerous parties, including Werksmans, have commented to the South African National Treasury and SARS thereon.



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