

TAX

When is CTC not available as CTC?

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What is contributed tax capital?

CTC – or to give it its full name, contributed tax capital – is an artificial or notional designation created for the purposes of the **Income Tax Act, 1962** (the [Act](#)) and is, roughly speaking, akin to share capital for other legal and accounting purposes.

The definition and notion of CTC, together with the amended definition of "dividend" in section 1 of the Act introduced with effect from 1 April 2012, was occasioned to a large extent by the more modern principles to be found in the Companies Act, 2008.

In the latter legislation, when a company makes a distribution to a shareholder no real distinction is made between a distribution out of current profits, realised reserves, unrealised reserves or share capital – it is merely a distribution, and whether or not one can make the distribution is dependent upon complying with the solvency and liquidity tests.

This is in contrast to the old capital maintenance rule, the effect of which is that there could not be a reduction of share capital save under very specific circumstances.

The distinction in the Act is made between:

- a distribution that is a dividend, and which constitutes a revenue receipt in the hands of a shareholder and which can also be subject to dividends tax; and
- a distribution that constitutes a return of capital, that falls into the CGT regime under the Act.

In short, what makes a distribution a return of capital is that the directors have specifically determined that the distribution represents a reduction of CTC. If they do not so determine, and even if they simply remain silent, it is automatically a dividend.

As stated, CTC is roughly akin to share capital but the amount of CTC need not necessarily equate to the amount of share capital. There can be a number of reasons for this including the fact that a distribution can physically be made out of current year's profits but if it is determined to be a reduction of CTC then it is not a dividend but a return of capital, but the share capital remains intact. Similarly a distribution can physically be made out of share capital, but if it is not stated to be a reduction of CTC the latter remains intact and the receipt is a dividend subject, where relevant, to dividends tax.

The issue: A reduction of CTC

It can readily be seen that there are circumstances where a reduction of CTC is more favourable from a tax perspective than a dividend. Typically this would be the case where dividends tax is payable, eg by an individual or a trust, or by a non-resident shareholder.

A reduction of CTC, not being a dividend, triggers no such tax. Of course a reduction of CTC does have potential CGT consequences but, for example, in the case of a non-resident shareholder generally this would not be a problem as in most cases non-residents are beyond the scope of the CGT rules; and in the case of a resident, if the shareholder has a large base cost in the shares, the reduction of CTC simply reduces the base cost, which has the effect of potentially increasing the CGT at a much later time, but in the meanwhile the receipt is not subject to tax.

Of course, companies often have different shareholders in different categories and it may suit some shareholders to have a dividend while others would prefer a return of capital. To prevent excessive exploitation of the system that has tax avoidance consequences, a proviso was included in the definition of CTC in section 1 of the Act that had two aspects.

The first aspect makes it clear that the CTC of one class of shares is only available to shareholders of that class and cannot be paid as a return of capital to the shareholders of a different class. Secondly, the maximum amount that can be returned as CTC per share is effectively the amount of CTC for that class of shares divided by the number of shares in that class.

So, particularly in the latter case, if the CTC per share is, say, R10, one cannot give shareholder A a return of capital of R12 and, to compensate, give shareholder B a return of capital of R8.

An amendment was made last year, and it is this that caused something of an uproar in the financial and tax community.

The 2021 amendment to CTC

Under last year's amendment, a further proviso was added to the definition of CTC that effectively stated that no CTC could be returned unless all shareholders of that class received the same return of CTC. This might not have been that problematic if it applied only to a general distribution to all shareholders so that it could not be said that where, say, the CTC per share is R5, shareholder A gets a distribution of R1 of CTC while shareholder B receives a distribution of R2 out of CTC.

What really caused a problem is that if shares are being repurchased from certain shareholders and the disposing shareholders would like to receive a reduction of CTC, because it is sheltered by the base cost, rather than to receive a dividend subject to 20% dividends tax, this would not be possible because the non-disposing shareholders would not be receiving anything, let alone a reduction of CTC.

After comments and submissions were made Treasury relented somewhat and made an exception to the rule allowing CTC to be reduced in a case of a share repurchase by a listed company, where the repurchase was done off market. But in all other cases, the utilisation of CTC was effectively not permitted.

After some last-minute lobbying Parliament agreed to extend the effective date of the amendment from 2022 to 2023 to allow time in 2022 for reconsideration. The matter has been duly reconsidered and the proposal changed.

[Click here to read the South African chapter of the 2012/13 PLC Multi-Jurisdictional Guide on Taxation.](#)

The amended proposal

The amendment passed last year is effective to be scrapped and replaced with a different further proviso that now effectively states that there can only be a payment out of CTC if all holders of the shares in that class to which transfers are made within a period of 91 days before or after the date of the payment are actually allocated an amount of CTC based on their proportional shareholding within that class.

Now there can be distributions out of CTC made only to certain shareholders, but in such case, those that do receive returns of CTC within the 91-day period must receive only their proportionate share of CTC.

Accordingly, it is possible that say, a company can repurchase 10% of its shares but then, if there is a repayment of CTC, they must all get collectively 10% of the CTC. So it is still not possible to have a share repurchase and for the repurchase price for some of the disposing shareholders to receive a payment out of CTC and others not to so that the latter will receive a dividend – every shareholder must receive the same amount of CTC or no CTC, and there cannot be a mix and match.

It would appear that the new amendment will still take effect on 1 January 2023



Ernest Mazansky

Director, Werksmans Tax (Proprietary) Limited

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