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When is CTC not available as CTC?: Part 2

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In the September 2022 edition of Legal Weks we published an article titled "When is CTC not available as CTC" relating to the proposed amendment of the definition of "contributed tax capital" (CTC) as defined in section 1 of the Income Tax Act, 1962 (the Act). This is a follow-up article on the same topic.

In that article I briefly outlined the characteristics of CTC, including that:

- CTC is a notional concept under the Act that might or might not arithmetically correspond to share capital;
- a distribution by a company to a shareholder is, under the Act, by default a dividend unless the directors specifically determine that the distribution is a reduction of CTC; and
- the maximum amount of CTC that can be reduced per share is the amount of CTC per share attributable to that class of shares.

I also pointed out that, because a reduction of CTC is not a dividend and is treated in the shareholder's hands as a reduction of the latter's base cost of the shares, a distribution out of CTC could be preferable as it avoids dividends tax where it would otherwise be payable. But if the distribution of CTC exceeds the base cost, the excess will be treated as a capital gain in the shareholder's hands. Accordingly it can be seen that different shareholders have different preferences, and under the law as it applied prior to amendment in 2022, it was possible to treat the distribution to some shareholders as a dividend and to others as a reduction of CTC.

As a consequence, the Act was amended in 2021 (effective 2023) to eliminate this practice because of its tax avoidance potential. The amendment caused considerable consternation and in mid-2022 a draft amendment was published for comment, which was the subject of my September article.

The 2021 amendment

The 2021 amendment effectively stated that no CTC could be returned unless all shareholders of that class received the same return of CTC. This was not such a problem when it came to a general distribution to shareholders, but serious problems could arise if shares were repurchased. In such case it would not be possible to treat the purchase price as a reduction of CTC because the non-selling shareholders were not getting anything, and therefore the requirement could not be met.

The 2022 amendment

The draft amendment, dealt with in my September 2022 article, to correct this replaced these provisions with a new proposal that effectively stated that there could only be a payment out of CTC if all holders of the shares in that class to which transfers were made within a period of 91 days before or after the date of payment, were actually allocated an amount of CTC based on their proportional shareholding within that class. This was certainly an improvement, but obviously there could still be difficulties arising given the 182 period during which all distributions had to be treated in the same way.

The Taxation Laws Amendment Bill, 2022, that was tabled in Parliament on 22 October 2022 and duly passed by Parliament, now includes the new rules effective from 2023. Now the restriction is that there can only be a transfer of CTC where, in relation to a particular class of shares:

- where there is a distribution; or
- where there is a share repurchase,

each share receives the same amount of CTC per share and, in addition, the amount of CTC transferred per share cannot exceed the total amount of CTC for that class divided by the number of issued shares in that class.

The effect of this is that whenever there is a single event whereby amounts are distributed to shareholders, whether as a general distribution or by way of share repurchases, all shareholders participating in that event must receive an equal amount per share of CTC, failing which the entire amount will not be considered to be a reduction of CTC. So if, for example, there are several shareholders selling their shares to the company in terms of a single or indivisible transaction, all the shareholders must receive the same amount of CTC per share.

But if there is a specific share repurchase in relation to, say, one shareholder and, say, two months later there is another specific repurchase in relation to another shareholder, each could have different amounts of CTC received by them. Similarly, if the amount of CTC per share is, say, R5 and a general distribution is made where all shareholders receive, say, R2 per share and, say, two months later there is a further general distribution, in the latter case the distribution of CTC could be, say, R2.50 per share, or zero for that matter.

This would appear to deal with Treasury's and SARS's concerns without restricting too much the freedom of companies and their shareholders in their dealings with each other.



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