



DIVIDENDS TAX

PRESENTATION TO BROKERS

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WHERE HAVE WE COME FROM?

Secondary Tax on Companies (STC) is a tax that is levied with reference to the amount of dividends “declared” by a company, reduced by dividends “accrued” to that company. The liability for STC falls on the company distributing the dividend (as opposed to the shareholder receiving the dividend)

WHERE HAVE WE COME FROM? (ctd)

An environment of STC which started at 25%

Company A pays shareholders R1000

Company A pays SARS R250

i.e. the tax is “on top of” the dividend paid

AND THEN?

STC reduced to 12,5% and then, from 1 October 2007, to 10% with “intention to move to a shareholders’ tax on dividends”

AT PRESENT

When a company currently pays a dividend of R1 000,00 it will pay R100 in STC. There are some exemptions/reductions like if the paying company receives a dividend on which STC was paid creating an “STC credit”

The shareholder will pay no tax in addition to the 10% STC as dividends are tax free in terms of Section 10(1)(k) of the Income Tax Act

FOREIGN INVESTOR PROBLEM WITH STC

STC was paid by the company (not the shareholder) so no foreign relief for this payment and STC impacted on earnings per share through increased tax charge

More in a couple of slides time!

SO?

Bowing to foreign pressures, SA decided to abolish STC and reintroduce a tax on dividends

Why re-introduce?

To be introduced on 1 April 2012 per Government Notice No 1073 issued by National Treasury on 20 December 2011

LEGISLATION

National Treasury have applied their minds to the market comments and have come up with some major changes, one of which is the “general” definition of “Dividend” in Section 1 of the IT Act

This is an extremely important definition for all practitioners

SECTION 1 : DIVIDENDS

Definition of “dividend” is now :

“dividend” means any amount transferred or applied by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company, whether-

- (a) by way of a distribution; or
- (b) as consideration for the acquisition of any share in that company, but does not include any amount so transferred or applied by the company to the extent that the amount so transferred or applied-

SECTION 1 : DIVIDENDS (ctd)

- (i) results in a reduction of contributed tax capital;
- (ii) constitutes shares in that company;
- (iii) constitutes an acquisition by a company of its own securities as contemplated in paragraph 5.67 of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with the requirements prescribed by paragraphs 5.67 to 5.84 of section 5 of the JSE Limited Listings Requirements; or
- (iv) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of 'company'”

HOW WOULD A COMPANY INCOME STATEMENT LOOK?

The tax is paid by the Company so the Income Statement would appear:

Net income before taxation		2 000
Taxation		
SA Normal	560	
STC	<u>100</u>	<u>660</u>
Net income after taxation		1 340
Dividend paid		<u>1 000</u>
Retained income - carried forward		<u><u>R 340</u></u>

So, R2 000 net income before tax produces R340 retained income after a dividend of R1 000. If there were 1 000 shares in issue, the EPS would be 134 cents.

MORE REASONS FOR CHANGE FROM COMPANY TAX TO SHAREHOLDER TAX

Internationally, dividends are taxed at shareholder level and STC is unusual

Other problems are :

- STC reduces after tax earnings
- tax treaties are ineffective for foreign holders
- foreign investors unfamiliar with STC resulting in increased cost of equity financing in SA

WHAT IS THE CASE WITH THE PROPOSED DIVIDEND TAX?

Dividends tax is:

- a final tax of 10% - dividends are not added, in any way, to your taxable income for normal tax purposes
- quick collection tax - as it does not form part of your taxable income but is withheld, SARS does not have to wait for provisional/final payment to collect. No quicker than STC though!
- levied on most distributions – not Contributed Tax Capital (CTC) (per definition) and
- levied on most shareholders – exemptions per 64F

HOW DOES INCOME STATEMENT CHANGE?

Same parameters as before :

Net income before taxation	2 000
Taxation	
SA Normal	560
	<hr/>
Net income after taxation	1 440
Dividend paid	1 000
	<hr/>
Retained income	<u>R 440</u>

So, R2 000 net income before tax produces R440 retained income after a dividend of R1 000 and on 1 000 shares, the EPS would be 144 cents

The Retained Income increases by the STC saving

WHAT ABOUT THE SHAREHOLDER?

Local shareholder will be due R1 000 less the withholding tax of R100 which will be withheld (“by whom” depends on holding type) leaving the shareholder with R900 as compared to R1 000 before

Foreign shareholder will also be due R900 (net of Dividend Tax) but could well, depending on a DTA, be entitled to relief both in SA (depending on size of holding and country of residence) and/or the foreign jurisdiction

DOES ONE COMPENSATE?

Many issuers (especially banks issuing non-redeemable preference shares) have stated they will pay the tax difference to shareholders

How does this work?

Proposed dividend	1 000
STC savings	100
	<hr/>
New proposed dividend	1 100
Dividends Tax	110
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Net receipt in respect of dividend	<u><u>R 990</u></u>

This means a drop of 1% on the net yield unless the issuer contributes more than the STC savings

FOREIGN DIVIDENDS

Comment on conversion of STC to Dividends Tax :

The legislation also creates an equal [level] playing field for both domestic and foreign shares listed on the JSE and hence the 10% charge on dividends will also apply to foreign shares listed on the JSE [less the foreign deduction limited to 10%]

More on this later

WHAT ABOUT FOREIGN DIVIDENDS?

A foreign dividend may well be subject to a withholding tax in the country of domicile (like Switzerland for example) and the receipt in SA will be net of the foreign tax

Strate will pay the net amount to CSDPs for onward transmission to shareholders, net of the Dividends Tax which will be adjusted by the non-recoverable amount of the foreign withholding tax. Anything recoverable must be recovered separately

TAX CREDIT FOR FOREIGN DIVIDENDS?

Section 64N provides for the rebate for foreign taxes :

- (1) Rebate deducted from Dividends Tax payable
- (2) Must be “non-recoverable” foreign tax paid
- (3) Rebate cannot exceed Dividends Tax
- (4) Exchange rate same as dividend conversation rate

RICHEMONT DIVIDEND

Before it gets to SA, it has already been subject to Swiss withholding tax of 35% of which 20/35 can be reclaimed (i.e. 15/35 non-recoverable)

Position in SA would be

SA Dividends Tax	<u>10%</u>
Already deducted overseas	<u>15%</u>

No additional SA Dividends Tax due

RICHEMONT DIVIDEND (ctd)

Dividend to reach SA	65.00
Less : SA Dividends Tax	-
	<hr/>
Paid to SA shareholder	65.00
SA shareholder claims	20.00
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Final dividend receipt	<u><u>R 85.00</u></u>

COLLECTION OF TAX

Who should collect the tax

National Treasury gave two options for us to discuss :

- Issuer
- Nominee

Reasonable consensus was for Nominees

WHAT WAS THE ESSENTIAL DIFFERENCE?

How are dividends paid?

Timing and claims

SARS hate refunds!

CONTRIBUTED TAX CAPITAL : CTC

Generally CTC is a notional amount derived from the value of any contribution made to a company against the issue of shares. CTC is reduced for any capital transfer back to shareholder

Work to be done here to establish opening balance with effect from 1 January 2011 – share capital plus share premium and thereafter, changes

DISCLOSURE BY ISSUER

Status of the dividend needs to be disclosed by the paying company whether for STC credits or an adjustment to Contributed Tax Capital (“CTC”)

Failure to disclose will result in full 10% tax being levied

JSE to include in Listings Requirements for listed securities

Non utilisation of an STC credit by a company results in it being lost

No STC credits after 5 years (revised from 3)

DISTRIBUTIONS

Distributions may be in :

- Shares, or
- Cash

If in shares, what could we have?

DISTRIBUTIONS - Shares

Own shares

Cap issue

NOT a dividend
(per Definition)

Other shares

Specie dividend

Is a dividend but
special treatment.
Company liable and
responsible - difficult
to get shareholder
type exemptions

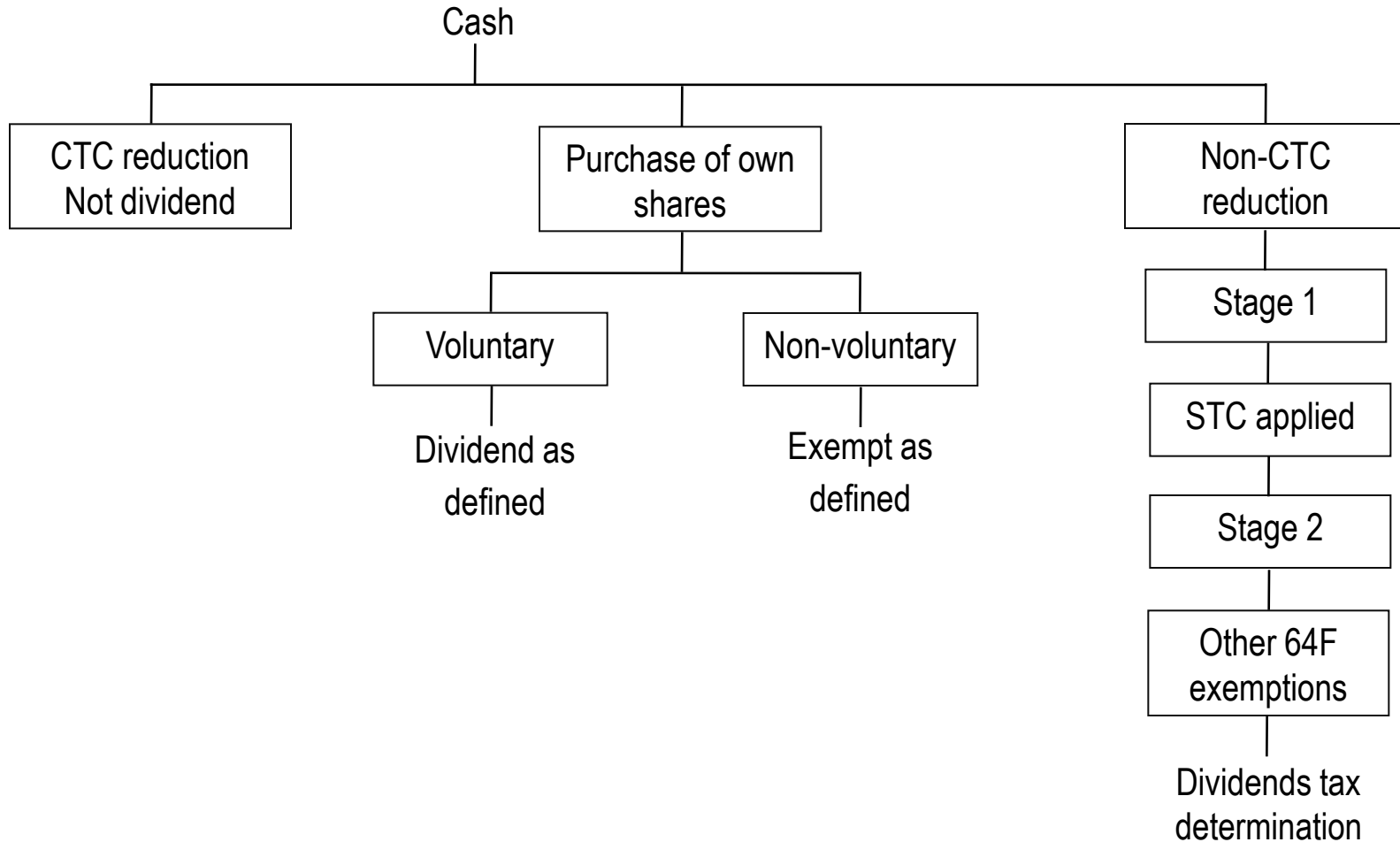
DISTRIBUTIONS – Shares (ctd)

What is a capitalisation issue and the slightly amended SWIFT definition is :

- the Company issues,
- its own, fully paid shares,
- out of its unissued shares,
- to its existing shareholders,
- as a result of a rearrangement of the Company's capital structure, and
- the issue does not result in any new funds for the Company

i.e. a fresh issue of new shares

DISTRIBUTIONS - Cash



STC IN GENERAL

A company's STC credit may increase by incoming dividend including STC credit

STC “LOOK THROUGH”

Let's say ABC Ltd pays R1000 dividend and has R600 STC credit. Of the dividend of R1000, R500 is paid to individuals and R500 to companies

WHAT DO INDIVIDUALS GET?

Gross dividend	500.00
Less : STC element 600/1000	300.00
	<hr/>
Subject to Divi Tax	R 200.00
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Divi Tax @ 10%	R 20.00
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Gross dividend	500.00
Less : Divi Tax	20.00
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Net dividend	R 480.00
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WHAT DO COMPANIES GET?

Gross dividend	500.00
Section 64F exemption	500.00
	<hr/>
Subject to Divi Tax	R -
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Recipient company gets R500.00 and an STC credit of R300.00 to be set off against future Divi Tax liability

Company to keep memorandum account of STC like CGT and CTC

WHAT IF COMPANY DOES NOT ON-PAY?

This is what a “Passive Holding Company” is all about

Divi Tax works if dividends end up in the hands of the ultimate individual beneficial owner as that is where the Divi Tax is paid

Any blockages cause “shrinkage”

WHAT ABOUT AN ELECTIVE CAP ISSUE VS CASH?

The cap issue is not a dividend and is therefore not liable to Dividends Tax

The cash element would be a dividend and subject to Dividends Tax

You therefore have two separate events which are treated differently

WHAT ABOUT A DRIP?

This is exactly what it says it is :

Dividend REINVESTMENT Programme

You get paid the dividend net of Dividends Tax and more shares are bought for you as a NEW investment

AND A DRIP VS A CAP ISSUE?

Liability to Dividends Tax different

Base cost for CGT different

- DRIP @ value of reinvestment,
- Cap issue - no increase in base cost so number of shares increases without base cost increase meaning base cost per share decreases so capital gain would increase

COULD YOU HAVE CASH ELECTIVE SPECIE DIVIDEND?

Never seen one but why not?

Like a DRIP, it would be processed as two corporate actions with the specie being sold and the proceeds paid over

Will have profit or loss vs base cost

AND A REDUCTION OF CTC?

Specifically excluded from the definition of dividend (like a cap issue) so a reduction of CTC is a distribution of capital (with CGT implications) and has no Dividends Tax implications

Issuer will have to keep track of STC credits and CTC as said before

DEFINITIONS : 64 D

"beneficial owner" - person entitled to benefit of dividend attaching to a share

"regulated intermediary" - CSDP, Authorised User, CIS, insurer, approved nominee and approved Transfer Secretary.

"unregulated intermediary" - registered shareholder, other than regulated intermediary, where that shareholder is not entitled to the benefit of a dividend attaching to that share

DEFINITIONS : 64 D (ctd)

“dividend” means any dividend as defined in section 1 that is

- (a) paid by a company that is a resident; or
- (b) a foreign dividend if the share in respect of which that dividend is paid is a listed share to the extent that it is not a distribution of an asset "in specie".

DOUBLE TAX AGREEMENTS (“DTA”)

No DTAs are available in final form yet. Strange approach by SARS to only release when effective so planning difficult.

SARS need name of shareholder and number of shares held. If not provided to regulated intermediary, 10% rate would be applied. Could result in subsequent claims via intermediary. Declaration may be on "per divi" basis!

There are several requirements to disclose large shareholdings like SRP and JSE Listings Requirements so care should be taken

SNEAK PREVIEW - UNOFFICIAL!

UK Protocol - signed but not in force

Must be Company owning at least 10%, then 5% of gross amount of the dividends

Ireland Protocol - signed but not in force

Must be Company owning directly 10% then 5% of the gross amount of the dividends

Malta Protocol - not signed, not in force

Must be a Company which holds at least 10% then 5% of the gross amount of the dividends

LEVY OF TAX : 64 E

There must be levied for the benefit of the National Revenue Fund a tax, to be known as the dividends tax, calculated at the rate of 10% of the amount of any dividend paid by a company

Date on which dividend is paid is deemed to be date on which dividend is paid or made unconditionally available to the shareholder.

Specie dividend the amount is equal to the market value on the day deemed to be paid

LIABILITY FOR TAX: 64 EA

- a. Beneficial owner of a dividend not being a distribution of an asset in specie, or
- b. Company declaring and paying an asset in specie is responsible and liable for the payment of the Dividends Tax

COLLECTIVE INVESTMENT SCHEMES

Exempt on initial distribution – must pay on unitholder payment

LISPS treated in same way

NEW DEFINITION OF HYBRID EQUITY INSTRUMENT

Section 8E deems certain dividend payments to be interest in hands of recipient while the company paying the dividend does not get a deduction

This is to ensure debt is not disguised as equity

HYBRID EQUITY INSTRUMENT (ctd)

- any redeemable preference share :
 - company obliged to redeem within 3 years (now 10);
 - holder has option to redeem whole or part within 3 years;
 - holder has right of disposal within 3 years (third party)

HYBRID EQUITY INSTRUMENT (ctd)

- any other share if :
 - right of disposal within 3 years
 - such share does not rank *pari passu* with other ordinary shares, or
 - dividend calculated with reference to :
 - any specified rate of interest;
 - the amount of capital subscribed for each share; or
 - the amount of any loan made by shareholder or any connected person

HYBRID EQUITY INSTRUMENT (ctd)

TLAB 2011 expanded wef 1 April 2012 to :

- any dividend or foreign dividend payable on such share is to be calculated directly or indirectly with reference to any specified rate of interest or the amount of capital subscribed for such share; and
- such share is directly or indirectly secured by a financial instrument other than an equity share

HYBRIDS – SOME MORE!

Just when you thought it was safe to go back into the water!!

Anti-avoidance – Debt without set Maturity
Dates

THREE TYPES OF INSTRUMENT

1. Debt without maturity date (known as perpetual debt);
2. Debt with uncertain maturity dates; and
3. Demand instruments

PERPETUAL DEBT – “QUOTE” FROM MEMORANDUM

Perpetual debt is essentially equivalent to shares

Payments in respect of perpetual debt will accordingly be treated as dividends for both the payor and payee

As a result, payments in respect of perpetual debt will no longer be deductible with the payment instead being potentially subject to the new Dividends Tax in the hands of the recipient

THIRD PARTY BACKED SHARES

Dividends in respect of shares will be deemed to be interest if instruments labeled as shares contain certain debt features

Conversely, interest will not be deductible if instruments labeled as debt contains certain share features

For non-equity shares Puts, Calls or similar rights will trigger interest treatment

EQUITY SHARES

Equity shares will be classed as debt if :

1. the Puts, Calls or similar rights are exercisable within 3 years, and
2. the shares contain at least 1 key debt feature (such as specified interest rate)

Same types of concerns for SARS as Dividend
Cessions

EXEMPTION FROM TAX : 64 F

A dividend is exempt from dividends tax if the beneficial owner (means the person entitled to the benefit of the dividend attaching to a share) is:

- a. the Government, provincial administration or municipality
- b. 30(3) PBO
- c. 37A Environmental rehabilitation trust
- d. 10(1)(cA) exempt institutions (Research etc)
- e. 10(1)(d)(i) or (ii) fund (pension, provident & RAF)
- f. 10(1) (t) exempt person (CSIR etc per list)
- g. a shareholder in a registered micro business not exceeding R200 000 p.a.
- h. disposal of a residence & liquidation of company

EXEMPTION FROM TAX : 64 F (ctd)

- (2)(a) a company which is a resident; or
 - (b) a portfolio of a collective investment scheme in securities
-
- (3) if the foreign company dividend is paid to a beneficial owner who is a non-resident

IN SPECIE DIVIDENDS: 64FA

Company is totally in control and responsible!

Declaration *by the beneficial owner* of exemption has to be made *to the company*.

Other exemptions if same group of companies as defined in section 41 of the Income Tax Act or para 51A of the Eighth Schedule

IN SPECIE DIVIDENDS (ctd)

Important to remember that a cap issue is NOT a specie dividend. It falls outside of definition of dividend

Don't ever confuse the two

WITHHOLDING OF TAX BY COMPANY : 64 G

Company that declares & pays dividend must withhold dividends tax

No withholding of tax if :

- in certificated form and beneficial owner has given written declaration of exemption
- forms part of same group of companies per section 41 (Inter group transactions)
- if uncertificated and paid to a Regulated Intermediary

WITHHOLDING OF TAX BY COMPANY : 64 G (ctd)

Company must deduct the reduced rate in terms of Double Tax Agreement

- declaration made in prescribed form, and
- written undertaking to inform of sale

Declaration for none or reduced rate lasts until

- beneficial owner ceasing to be beneficial owner
- registered holder ceasing to be registered holder

DISCLOSURE BY SHAREHOLDER

Tried to use FICA to reduce declarations as you need to remember the 5 year retention of records and applies to each dividend

Section 64H applies to Regulated Intermediaries and same declaration applies

DIVIDENDS TAX BY INSURERS: 64I

Treat as Regulated Intermediary

STC CREDIT : 64J

Valid for 5 years from effective date (was 3)

Free of withholding tax if within STC credits and given notice to payee of the reduction or non-payment

Benefit passes from Company to beneficial owner, being recipient of the dividend

TRANSITIONAL EXEMPTION : 64 J

Any dividend declared before the effective date is exempt from the dividends tax

RECOVERY OF TAX : 64 K

Beneficial owner is liable for the tax if not paid by any other person

Withholding party must pay SARS by last day of month following payment of dividend

Any person who fails to withhold or who withholds and fails to pay is liable as if it was tax due by that person in terms of this Act

RECOVERY OF TAX : 64 K (ctd)

Commissioner may estimate unpaid amount and interest must be paid

Every shareholder and director of unlisted company or unregulated intermediary is personally liable for dividends tax, additional tax, penalties and interest

Currently states declarations must be submitted to Commissioner at time and in manner prescribed

REFUND OF TAX CERTIFICATED SHARES : 64 L

If exemption claimed within one year after payment of dividend, recovery against subsequent[#] dividend within that year

After 12 months, claim against SARS

No amount claimable after three years

REFUND OF TAX UNCERTIFICATED SHARES : 64 M

Refund up to 3 years with wide set-off

OTHER ISSUES

Unclaimed dividends : can claim after 3 years as it is only then that you establish that it should not have been paid in the first place

Submission form : will consult with market like they did for STT

OTHER ISSUES (ctd)

Refund mechanisms : some need to be worked through like 64 L(3) when someone wakes up that they are exempt after payment date

Deemed dividends : 10% at date of “payment” per 64E

OTHER ISSUES (ctd)

Entities that qualify as “regulated intermediaries”:

- broker nominee
- CSDP nominee or nominee approved by CSD
- nominee approved by registrar
- CIS
- Insurer
- approved Transfer Secretary

OTHER ISSUES (ctd)

Be careful to use the correct terminology at all times and stick to the definitions of the Act and explanations of the Explanatory Notes

Don't refer to "dual"; "dual primary"; "multiple"; "secondary" listings. The definition refers to "if the share in respect of which that foreign dividend is paid is a listed share"

This means "domicile" is important and "listing" is important. If the JSE listing is the sole listing of a foreign company, so what?

PAYMENT

Payment to be made by last day of month following payment by company declaring the dividend per section 64 K

PASSIVE HOLDING COMPANIES

In tandem with the coming into force of the “new” dividends tax is the introduction of a tax on the passive income and the dividend income of Passive Holding Companies (PHC)

This is intended to eliminate the arbitrage benefit for individuals arranging their affairs so that passive income derived by company and not themselves

PASSIVE HOLDING COMPANIES (ctd)

Tax rate on passive companies passive income to be 40% (maximum marginal for individuals) and 10% for dividends

Other income taxed at ordinary corporate rate

Once subject to 10%, dividends can be paid on free of dividends tax

ANTI-AVOIDANCE CLAUSES : DIVIDEND CESSIONS

Meaningful underlying stake

Mainly eliminate the tax-free nature of dividends obtained by way of cession and in respect of dividends held only momentarily

ANTI-AVOIDANCE CLAUSES : BORROWED SHARES

Proposal is for long position dividends to be treated as taxable to the extent of Manufactured Dividends paid

	<u>Shares</u>	<u>Dividend</u>
Bull position	1 000	R500
Short position	600	R300

So R200 of R500 received treated as Dividend and R300 as taxable ordinary revenue

ANTI-AVOIDANCE CLAUSES : PERPETUAL DEBT

Perpetual debt is essentially equivalent to shares

Payments in respect of perpetual debt will accordingly be treated as dividends for both the payor and payee

As a result, payments in respect of perpetual debt will no longer be deductible with the payment instead being potentially subject to the new Dividends Tax in the hands of the recipient

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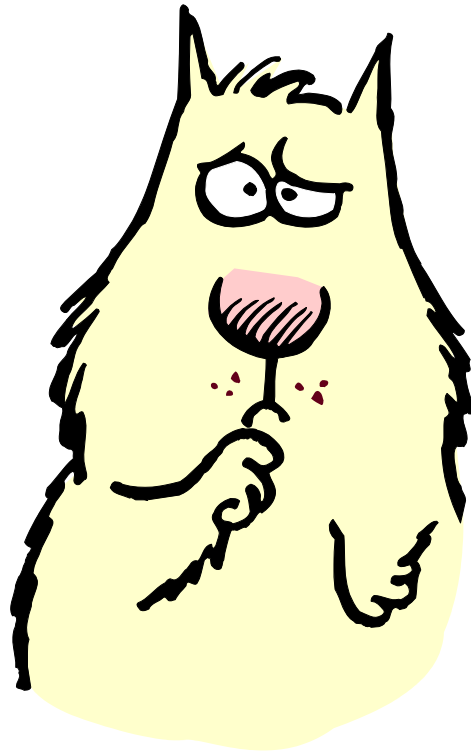
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QUESTIONS



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