

Business Law & Tax Review

When is a dividend still one?

‘Dividend’ to become a simpler concept, but first the definition is redefined...

PETER DACHS

Edward Nathan Sonnenbergs

THE definition of a “dividend” is contained in section 1 of the Income Tax Act. However, the Revenue Laws Amendment Act, 2008 provides that this definition will be replaced with a far simpler concept. This change will take place only from the date of replacement of secondary tax on companies (STC) with the new dividends tax. It is expected that this will occur in the last quarter of the year.

Until then the existing dividend definition applies. However, this definition has itself been subject to recent amendments.

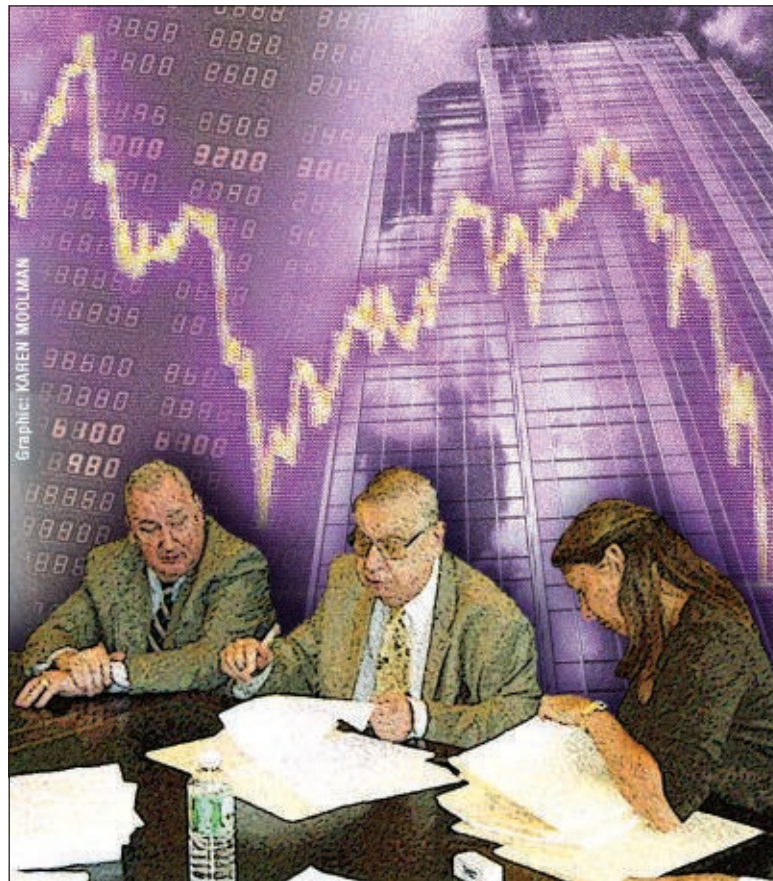
Firstly, in terms of an amendment deemed to have come into operation on October 1 2007, the concept of a dividend excludes “any amount distributed by a company to a shareholder where the company and the shareholder form part of the same group of companies as defined in section 41, to the extent that the shareholder reduces

the cost of the shares held in the company in accordance with Generally Accepted Accounting Practice as a result of the distribution” (paragraph (g) of the dividend definition).

This means that the declaration by a company of its pre-acquisition profits may not constitute a dividend. For example, if a company purchases a target entity and the target entity immediately distributes its reserves to the acquiring company, this distribution may not constitute a dividend.

If it does not constitute a dividend, the next issue is how to characterise such distribution for tax purposes. There is often an assumption that this distribution is capital in nature and therefore subject to the provisions of paragraphs 74–78 of the eighth schedule to the act, ie the capital gains tax provisions dealing with capital distributions by a company. In particular, the provisions of paragraph 76A would treat the recipient company as having disposed of part of the shares of the target entity.

However, dividends are specifically



included in paragraph (k) of the definition of “gross income”. The mere fact that the amount distributed does not qualify as a dividend does not necessarily mean that it qualifies as a capital distribution.

Reference must be made to general principles in order to determine whether such amount is capital in nature. If not, it will merely be included in the shareholder company’s gross income and taxed in its hands.

A further important amendment is contained in paragraph (iiiA) of the first proviso to the dividend definition. This provides that where a company reduces its share capital or share premium account any amount of share capital or share premium distributed

of another class of share. For example, if the total share capital and share premium in respect of, say, class A ordinary shares is ZAR100 and ZAR10 is distributed to the shareholders of the class A ordinary shares from the company’s share capital and share premium account, ZAR10 will be deemed to constitute a dividend in the hands of such shareholders.

A further point of interest is that, in terms of company law, if shares have been issued for say, share capital of ZAR1 and significant share premium, then on the redemption (preference shares) or buy back (ordinary shares) of such shares, the (nominal) share capital may be returned to the shareholder with the balance of the redemption or buy back proceeds coming from the company’s distributable reserve account. This would mean that the entire distribution apart from the nominal share capital returned would constitute a dividend for tax purposes. It is debatable whether paragraph (g) of the dividend definition summarised above would apply in these circumstances as the shareholder would not reduce the cost of the shares as a consequence of the distribution since the shares would be redeemed or bought back.

The nature of the distribution made by a company to its shareholders makes a significant difference from a tax perspective. The distribution may be exempt from tax in the hands of the shareholder (where such amount is a dividend) but may carry an STC cost for the distributing company. Alternatively, the amount distributed may constitute a capital distribution with no STC cost for the distributing company, but carrying a capital gains tax cost for the recipient. Lastly, the amount distributed may simply constitute “gross income” in the hands of the recipient with no deduction for the distributing company. The nature of the distribution depends largely from which account of the distributing company’s balance sheet the distribution is made.

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which exceeds the consideration given in respect of that class of shares will be deemed to constitute a dividend. Under South African company law, it is possible for a company to utilise the share premium created in respect of a particular class of shares to make a distribution to the shareholder in respect