# A CRITICAL ANALYSIS OF SOUTH AFRICA'S DIVIDEND WITHHOLDING TAX LEGISLATION

by

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# ENGLISH SUMMARY

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The purpose of the study was to perform a critical analysis of the new dividends tax legislation in order to identify possible problem areas and to make recommendations, where appropriate, to address perceived problems in this legislation.

Resulting from this analysis, certain potential problems areas were identified which required further investigation. These included the meaning of "beneficial owner", refund procedures of dividends tax, dividends tax anti-avoidance provisions, the utilisation of secondary tax on companies credits, personal liability of shareholders and directors, and the administrative burden of dividend-paying companies.

The meaning of "beneficial owner" was considered from both a local and international point of view. It was recommended that beneficial ownership with reference to dividends tax be aligned with its international tax meaning in order to avoid discrepancies when assessing beneficial ownership in the context of double tax agreements.

The recognition of secondary tax on companies' credits under dividends tax was also considered together with alternative approaches to the utilisation of such credits. In order to reduce the administrative requirements imposed by the dividends tax legislation and the tracking of these by the South African Revenue Service, it was recommended that the

current dividends tax provisions governing the utilisation of secondary tax on companies' credits be reviewed.

The application of the personal liability of shareholders and directors in the context of other applicable South African law, as well as other jurisdictions, was considered. It was recommended that the dividends tax provision dealing with the personal liability of shareholders and directors be reviewed in order to align these with other relevant domestic law provisions and international practice.

Refund procedures were investigated by comparison with withholding-tax refund procedures in other jurisdictions. Recommendations were made for improving the refund procedures for South Africa's dividends tax.

The specific deemed dividend provisions under the dividends tax legislation were reviewed. It was recommended that guidance be issued to provide a framework or criteria for assessing potential transactions, other than those specifically provided for in the dividends tax legislation, which will be regarded as a dividend by virtue of the extended dividend definition.

The administrative requirements imposed by the dividends tax legislation were reviewed and it was found that an increased administrative burden results from compliance with the dividends tax legislation. The administrative procedures in respect of dividend withholding tax in other jurisdictions were reviewed. It was found that it is necessary for dividend-paying companies and regulated intermediaries to ensure that they have adequate systems and procedures in place to ensure compliance with the dividends tax legislation. Certain recommendations were made to improve the administration of dividends tax.

Key Words**:**
Beneficial owner
Secondary tax on companies credits
Personal liability
Anti-avoidance/ deemed dividends
Administrative burden

# AFRIKAANSE OPSOMMING

## 'N KRITIESE ONTLEDING VAN SUID-AFRIKA SE WETGEWING OOR DIVIDENDTERUGHOUDINGSBELASTING

deur

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Die doel van die studie is om 'n kritiese ontleding van die nuwe wetgewing op dividendebelasting uit te voer, ten einde moontlike probleemareas te identifiseer en om, waar toepaslik, aanbevelings te maak om hierdie probleemareas in die wetgewing aan te spreek.

Voortspruitend uit hierdie ontleding, is sekere potensiële probleemareas geïdentifiseer wat verdere ondersoek vereis. Hierdie sluit in die betekenis van "uiteindelik geregtigde", terugbetalingprosedure van dividendebelasting, teenvermydingsprosedures vir dividendebelasting, die aanwending van sekondêre belasting op maatskappye krediete, persoonlike verpligting van aandeelhouers en direkteure en die administratiewe las van maatskappye wat dividende betaal.

Die betekenis van "uiteindelik geregtigde" is oorweeg in beide 'n plaaslike en internasionale perspektief. Dit word aanbeveel dat "uiteindelik geregtigde" binne die konteks van dividendebelasting met die internasionale betekenis daarvan gelykgestel word ten einde enige teenstrydighede te vermy wanneer "uiteindelik geregtigde" in die konteks van dubbelbelastingooreenkomste beoordeel word.

Die erkenning van sekondêre belasting op maatskappye krediete in dividendebelasting is ook oorweeg tesame met alternatiewe benaderinge met betrekking tot die aanwending daarvan. Ten einde die administratiewe vereistes opgelê deur die dividendebelastingwetgewing, asook die naspoor van hierdie krediete, te verminder, is aanbeveel dat die huidige dividendebelastingbepalings wat sekondêre belasting op maatskappye krediete reguleer, hersien word.

Die toepassing van persoonlike aanspreeklikheid van aandeelhouers en direkteure binne die konteks van ander toepaslike Suid-Afrikaanse wetgewing, asook ander regsgebiede, is oorweeg. Daar word aanbeveel dat die dividendbelastingbepalings wat handel oor die persoonlike aanspreeklikheid van aandeelhouers en direkteure hersien word ten einde dit in lyn te bring met ander plaaslike wetgewing en internasionale praktyk.

Die terugbetalingsprosedure van dividendbelasting is ondersoek deur dit te vergelyk met terugbetalingsprosedures van terughoudingsbelasting in ander regsgebiede. Aanbevelings word gemaak ten einde die terugbetalingsprosedure van Suid-Afrikaanse dividend-belasting te verbeter.

Die spesifieke bepalings rakende geagte dividende kragtens die wetgewing op dividend-belasting is bestudeer. Daar word aanbeveel dat ’n gids uitgereik word ten einde ’n raamwerk te verskaf waarvolgens potensiële transaksies beoordeel kan word, anders as dié waarvoor spesifiek voorsiening gemaak is in die dividendbelastingwetgewing, wat geag sal wees om ’n dividend te verteenwoordig as gevolg van die uitgebreide definisie van dividende.

Die administratiewe vereistes opgelê deur dividendbelastingwetgewing is oorweeg en daar is bevind dat daar ’n toenemende administratiewe las voortspruit uit die nakoming van dié wetgewing. Die administratiewe prosedures met betrekking tot dividende in ander regsgebiede is ondersoek. Daar is bevind dat dit nodig is vir maatskappy wat dividende betaal en gereguleerde tussengangers om te verseker dat hulle voldoende stelsels en prosedures in plek stel ten einde nakoming van die dividendbelastingwetgewing te verseker. Sekere aanbevelings is gemaak ten einde die administrasie van dividendbelasting te verbeter.

Sluitelwoorde:

Uiteindelik geregtigde

Sekondêre belasting op maatskappye krediete

Persoonlike aanspreeklikheid

Teenvermeidingsprosedure/ geagte dividende

Administratiewe las

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# CHAPTER 1

# INTRODUCTION

## 1.1 BACKGROUND

During the Budget Speech of 21 February 2007, the Minister of Finance announced the reform of secondary tax on companies (STC) and its replacement with a dividends tax (DT). “Most countries have a dividends tax at the shareholder level. We have a secondary tax on companies collected directly from a few thousand companies as opposed to millions of shareholders. To further improve the transparency and equity of the tax system, we are proposing that it be phased out and replaced with a dividends tax at shareholder level”. (South Africa, 2007b: 24).

The following is considered the reason for the change to dividends tax: STC is an unfamiliar concept internationally. As it represents an additional tax imposed at company level, it results in an increase in the effective tax rate of companies. It therefore creates the impression that South Africa is a less attractive investment destination (SARS, 2012d:1).

According to Brislon (2009), “The impact of the new laws on an economy like South Africa may be as much as a blessing as a curse and tax is but one of many factors which would effect a decision of this complexity. It has multiple impacts. STC was little understood in the international community, as South Africa is one of only three countries in the world to have such a system. It raises question marks in foreign jurisdictions and does not always allow companies to qualify for credit in the parent company’s home jurisdiction. As the dividends tax is aligned with international norms, it is far more likely to encourage the free flow of funds.”

According to Mazansky (2009), while the new dividends tax may reduce the complexity of tax from the perspective of non-resident investors which may result in attracting capital flows, it introduces a number of complexities. The corporate tax rate for South African

resident companies is now at 28%, which is comparable to international practice, which will create tax certainty for foreigners' as it is familiar to foreign investors.

In terms of a notice in the Government Gazette of 20 December 2011, dividends tax is to replace STC effective from 1 April 2012 which will be governed by sections 64D to 64N of the Income Tax Act no 58 of 1962 (ITA) (South Africa, 2011:b).

DT may be regarded as a simple concept, but the legislation is complex. As noted by Daya (2009:17), while DT is in line with global practice it is of increased complexity.

## 1.2 PROBLEM STATEMENT

The DT legislation is a new and unfamiliar concept to South African taxpayers and is relatively complex. According to Reifarth (2010:6) "…the legislation governing the relatively complex concepts of a withholding tax on dividends, together with the conversion to DT from STC, will most likely result in difficulty being experienced by taxpayers in interpreting, administrating and complying with the new legislation once it becomes effective."

## 1.3 PURPOSE STATEMENT

The purpose of the study will be to critically analyse the new DT legislation in order to identify possible problem areas and to make recommendations, where appropriate, to address perceived problems in the new legislation.

## 1.4 RESEARCH OBJECTIVES

The objectives of the study will be:

- To obtain a good overall understanding of the dividends tax legislation, in order to identify potential problem areas by:
  - analysing the new dividends tax legislation contained in sections 64D to 64N of the ITA,

  - analysing articles and publications by authoritative experts in the field of taxation.
- To investigate if and how potential problem areas identified were addressed in other jurisdictions.
- To make recommendations, where appropriate, to address perceived problems in the new legislation.

## 1.5 IMPORTANCE AND BENEFITS OF THE CURRENTSTUDY

In light of the fact that the DT legislation is new to the South African taxation landscape, there is a knowledge gap as to its implementation and application. The study will assist in identifying potential problem areas to be addressed. In addition, the study may assist taxpayers to gain an understanding of the DT legislation.

## 1.6 DELIMITATIONS

The current study has the following delimitations:

- The term “contributed tax capital” (CTC) and the provisions related to it are not included in the scope of the study.
- The study will focus on dividends tax within the South African context only. Dividends tax in other jurisdictions will only be covered to the extent that it may provide solutions to potential problem areas identified.
- The study will not focus on the impact of dividends tax on any specific industry.
- The introduction of dividends tax is part of the reform of South Africa’s system for the taxation of dividends, which is not included in the scope of this study.

## 1.7 DEFINITION OF KEY TERMS

This study involves a number of key concepts. The manner in which these key terms are defined for the purpose of this study is considered below.

**"Beneficial owner"** is defined in section 64D of the ITA and "means the person entitled to the benefit of the dividend attaching to a share".

**"Dividend"** in the context of dividend tax as per section 64D of the ITA "means any dividend or foreign dividend as defined in section 1, that is —

(a) paid by a company that is a resident; or
(b) paid by a company that is not a resident —

if the share in respect of which that foreign dividend is paid is a listed share; and

to the extent that that foreign dividend does not consist of a distribution of an asset *in specie*".

**"Dividend"** as defined in section 1 of the ITA "means any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied —

(a) by way of a distribution made by; or
(b) as consideration for the acquisition of any share in that company".

**"Regulated intermediary"** as defined in section 64D of the ITA "means any —

(a) central securities depository participant contemplated in section 34 of the Securities Services Act, 2004 (Act No. 36 of 2004);
(b) authorised user as defined in section 1 of the Securities Services Act, 2004;
(c) approved nominee contemplated in section 36 (2) of the Securities Services Act, 2004;
(d) nominee that holds investments on behalf of clients as contemplated in section 9.1 of Chapter 1 and section 8 of Chapter II of the Codes of Conduct for Administrative and Discretionary Financial Service Providers, 2003 (Board Notice 79 of 2003) published in Government Gazette No. 25299 of 8 August 2003;
(e) portfolio of a collective investment scheme in securities; or

(f) transfer secretary that is a person other than a natural person and that has been approved by the Commissioner subject to such conditions and requirements as may be determined by the Commissioner."

**STC credit** of a company as per section 64J(2) of the ITA "is an amount equal to the sum of —

(a) the amount by which the dividends accrued to that company during the dividend cycle ending on the day immediately before the effective date and the dividends which are deemed in terms of section 64B of the ITA to have accrued to that company during that dividend cycle exceed the dividends declared on that day by that company; and
(b) the dividends accrued to that company on or after the effective date, to the extent that the person paying the dividend submits a written notice to the company prior to paying the dividend of the amount by which the dividend reduces the STC credit of the company paying the dividend,

reduced by the dividends declared and paid by the company to the extent that the dividends are paid by the company on or after the effective date".

## 1.8 ABBREVIATIONS USED

Table 1 below lists the abbreviations used in this document.

**Table 1: Abbreviations used in this document**

| Abbreviation | Meaning |
|---|---|
| ATO | Australian Tax Office |
| CA | Companies Act 71 of 2008 |
| CRA | Canadian Revenue Authority |
| Commissioner | Commissioner of Inland Revenue |
| CTA | Canadian Tax Act — R.S.C, 1985, c.1 |
| CTC | Contributed tax capital |
| DTA | Double tax agreement |
| DT | Dividends tax |
| Excise Tax Act | Excise Tax Act — R.S.C, 1985,c E-15 |

| Abbreviation | Meaning |
|---|---|
| | (Canada) |
| GST | Goods and services tax (Canada) |
| HST | Harmonised sales tax (Canada) |
| ITA | Income Tax Act 58 of 1962 |
| JSE | Johannesburg Stock Exchange |
| National Treasury | National Treasury (Department) of the Republic of South Africa |
| OECD | Organisation for Economic Co-Operation and Development |
| PAYG | Pay as you go |
| RSA | Republic of South Africa |
| SAICA | South African Institute of Chartered Accountants |
| SAIPA | South African Institute of Professional Accountants |
| SARS | South African Revenue Service |
| STC | Secondary tax on companies |
| STT | Securities transfer tax |
| TAA | Tax Administration Act 29 of 2011 |
| USA | United States of America |
| VET | Value extraction tax |

## 1.9 RESEARCH DESIGN

Research refers to a methodical approach during which information is collected, analysed and interpreted in order to obtain an increased understanding of a topic in which we have an interest or concern (Leedy & Ormrod, 2010: 2).

A non-empirical study refer to a study where questions are answered by a researcher related to the explanation of scientific notions, tendencies in scholarships or the nature of current academic viewpoints, without obtaining original data or re-examining current data (Babbie & Mouton, 2001:75).

This research project will be conducted by means of a pure literature review, classified as non-empirical research. The researcher will summarise and critically evaluate the current state of knowledge on DT without collecting and analysing new primary data or re-analysing existing secondary data.

Sections 64D to 64N are new provisions of the ITA, which became effective as from 1 April 2012. A search will be conducted by reviewing the relevant legislation, articles published in the media and journal articles in tax journals, in order to gather information related to the new DT provisions. A detailed analysis will be made of sections 64D to 64N of the ITA by reviewing these provisions and any related commentary gathered.

To the extent that any problem areas are identified, reference is to be made to legislation in other jurisdictions in order to provide guidance as to possible solutions to these problem areas.

It is submitted that the above-mentioned research strategy is the most appropriate — for the following reasons:

- It is submitted that, because articles published in the media and journal articles in tax journals are written by experts in the field, the review of these as well as the current legislation will be adequate to identify potential problem areas.
- DT is not an unfamiliar concept internationally as many countries have a similar tax in place. A review of these may therefore provide guidance on potential problem areas identified.

## 1.10 OVERVIEW OF CHAPTERS

In chapter 2 a summary of the differences between DT and STC will be provided together with a review of the DT legislation and related commentary.

In chapter 3 the meaning of beneficial owner within the context of DT and the utilisation of STC credits post the introduction of DT will be reviewed.

In chapter 4 the personal liability of shareholders and directors, DT refund procedures, anti-avoidance provisions and the administrative burden related to DT will be reviewed.

In chapter 5 the conclusions reached from this study will be summarised.

# CHAPTER 2

# ANALYSIS OF SECTIONS 64D–64N

## 2.1 INTRODUCTION

This chapter will include a summary of the differences between DT and STC as well as a review of the legislation governing dividends tax and related articles.

## 2.2 A COMPARISON BETWEEN DT AND STC

### 2.2.1 Introduction

Since the Minister of Finance announced in 2007 that DT would replace STC, legislation was enacted on an annual basis and the DT legislation contained in sections 64D to 64N of the ITA is now principally finalised and became effective as from 1 April 2012.

The main objectives of the changeover to DT were:

- Aligning South Africa with the international practice of shifting the tax liability attached to a dividend from the dividend paying company to the recipient of the dividend.
- Under STC the perception was created that South Africa had a higher corporate tax rate on the basis that STC is a tax on companies, resulting in a decrease in accounting profit. The changeover will establish South Africa as a more attractive international investment destination (SARS, 2012d:1).

### 2.2.2 Differences between DT and STC

The differences between DT and STC are summarised in table 2 below (SARS, 2012d:1):

**Table 2: Summary of differences between STC and DT**

| Description | STC | DT |
|---|---|---|
| Base and liability | STC is initiated when a dividend is declared. | DT is initiated when a dividend is paid or becomes payable. |
| Base and liability | The liability for STC rests on the company which declared such dividend. | The liability for DT rests upon the recipient (beneficial owner) of the dividend. |
| Base and liability | The liability for STC is additional to the gross amount of such dividend (additional cost to the declaring company). | DT is computed based on the gross amount of such dividend and withheld from the dividend (with no increase in cost to the declaring company). |
| Base and liability | STC is payable to SARS by the declaring company. | DT withheld is payable to SARS by either the company distributing the dividend or certain withholding agents. In the case of a dividend *in specie*, the DT liability remains with the company paying such dividend. In respect of a deemed dividend, the liability for DT will remain with the company which pays the dividend. |
| Rate | The default position is that the rate at which STC is levied is 10%. | The default position is that the rate at which DT is levied is 15%. |
| Exemptions | Dividend declarations made by certain companies were exempt from STC. | Under DT, depending on the nature of shareholders (beneficial owners), dividend payments to these beneficial owners may be exempt from DT, provided that the required notifications are received prior to payment of the dividend. |
| Reduced rates | N/A | The rate at which DT is withheld may be reduced in the case where a double tax agreement exists between South Africa and the beneficial owner's resident country, provided that the required declarations are received prior to payment of the dividend. |
| Calculation | STC is calculated based on the net dividend (dividend declared less qualifying dividends received) during a dividend cycle. | DT is calculated on the gross amount of the dividend payable without regard to a specific period. |

| Description | STC | DT |
|---|---|---|
| Payment of liability | The responsibility for settlement of STC remained with the dividend declaring company which was payable to SARS by the last day of the month subsequent to the month in which the respective dividend was declared. | The liability for DT rests on the party liable for the tax, being the beneficial owner of the dividend, but is withheld by the withholding agent, being the dividend paying company or registered intermediary, and payable to SARS by the last day of the month subsequent to the month in which the respective dividend was paid. In respect of *in specie* distributions and deemed dividends, the liability to pay the DT rests upon the company making the distribution or deemed distribution. |
| Returns | A return had to accompany the payment of STC which was to be submitted to SARS in the format prescribed by SARS. | A return is to accompany the payment of DT which is to be submitted to SARS in the format prescribed by SARS. |
| Refunds | Refunds could be claimed from SARS. | Refunds of DT may be claimed from and paid by the withholding agent, subject to certain requirements being met. |
| Administrative provisions | The administrative provisions, which include the levying of interest, assessments etc., are similar for both STC and DT. | The administrative provisions, which include the levying of interest, assessments etc., are similar for both STC and DT. |
| Dual listed companies | No similar provision applied under STC. | In the case of dual listed companies, any foreign withholding tax paid may be recovered from DT. |

### 2.2.3 Illustrative example: Tax consequences for shareholders — DT versus STC

Summarised in tables 3 and 4 below are the tax consequences in respect of dividends declared prior to 1 April 2012 and after 1 April 2012 in respect of a dividend of R100 (assuming that no STC credits are available):

- Dividend declared prior to 1 April 2012 subject to STC: Dividends are normally paid/declared net of STC.

**Table 3: Example of dividend declared prior to 1 April 2012**

| | No exemption | Exemption |
|---|---|---|
| Dividend declared — payable to shareholders | R91 | R100 |
| STC | R9 | R nil |
| Net outflow for company | R100 | R100 |

The exemption from STC applies where a dividend is declared to a shareholder that are part of the same "group of companies" as defined in the ITA (i.e. where a 70% shareholding exists).

- Dividend both declared and paid/payable after 1 April 2012 subject to DT (assuming that the required declarations have been received in respect of a reduction in the DT rate to be applied to the dividend):

**Table 4: Example of dividend paid/payable after 1 April 2012**

| | No exemption or reduction of DT | Beneficial owner exempt from DT | Reduction of DT in terms of DTA to 5% |
|---|---|---|---|
| Cash payable to shareholder | R85 | R100 | R95 |
| DT | R15 | R nil | R5 |
| Net cash-flow for company | R100 | R100 | R100 |

From the above illustration it is evident that the net cash payable to shareholders not exempt from DT, or not qualifying for a reduction in the DT rate, would be more favourable if a dividend was declared prior to 1 April 2012. The net cash payable to shareholders exempt from DT, or qualifying for a reduction in the DT rate, would be more favourable if a dividend is declared and payable subsequent to 1 April 2012.

## 2.3 DIVIDENDS TAX LEGISLATION

The DT legislation is contained in sections 64D to 64N of the ITA. These sections are summarised as follows:

- S64D Definitions.
- S64E Levy of tax.
- S64EA Liability for tax.
- S64F Exemption from tax in respect of dividends other than dividends *in specie*.
- S64FA Exemption from and reduction of tax in respect of dividends *in specie*.
- S64G Withholding of dividends tax by companies declaring and paying dividends.
- S64H Withholding of dividends tax by regulated intermediaries.
- S64I Withholding of dividends tax by insurers.
- S64J STC credits.
- S64K Payment and recovery of tax.
- S64L Refund of tax in respect of dividends declared and paid by companies.
- S64M Refund of tax in respect of dividends paid by regulated intermediaries.
- S64N Rebate in respect of foreign tax on dividends.

These sections will be examined together with relevant related commentary.

### 2.3.1 Definitions

The following DT-related definitions are contained in section 64D of the ITA:

**"Beneficial owner"** – Refer 1.7

**"Dividend"** – Refer 1.7

"**Dividend cycle"** "means a dividend cycle as defined in section 64B".

**"Effective date"** "means the date on which this Part comes into operation" [that is, Part VIII of the Act, which governs the dividends tax].

**"Regulated intermediary"** – Refer 1.7

**"STC credit"** "means an amount determined in terms of section 64J(2)".

An understanding of these definitions is important in order to understand the new DT legislation.

**Dividend definition**

DT is based on the dividend definition contained in section 1 of the ITA. Although a dividend for tax purposes will in most cases be identical to the dividend amount as defined by accounting law and company law, the tax definition differs from the accounting/company law definition.

**"distribution"** in terms of the Companies Act (CA) "means a direct or indirect —

(a) transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one or more holders of any of the shares, or to the holder of a beneficial interest in any such shares, of that company or of another company within the same group of companies, whether —

(i) in the form of a dividend;

(ii) as a payment in lieu of a capitalisation share, as contemplated in section 47;

(iii) as consideration for the acquisition —

(aa) by the company of any of its shares, as contemplated in section 48; or

(bb) by any company within the same group of companies, of any shares of a company within that group of companies; or

(iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164 (19);

(b) incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies; or

(c) forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders of any of the shares of that company or of another company within the same group of companies;

but does not include any such action taken upon the final liquidation of the company".

The difference in definitions of dividend for tax and accounting purposes respectively, may result in the following:

- repayment of capital could constitute a dividend for tax purposes and therefore be deemed subject to dividends tax;
- non-declared transfer of value/ extraction of value may be regarded as a dividend for tax purposes;
- dividends declared and payable may be excluded from the ITA definition of "dividend", and may therefore not be subject to DT.

Terms such as "for the benefit of" and "in respect of a share", need to be considered. Where a company makes a distribution to shareholders, it may represent either a return of capital (CTC) or a dividend.

### 2.3.2 Levy of DT (section 64E)

DT replaced STC as from 1 April 2012 and will apply to dividends declared and paid on or after this date. The DT liability is calculated at 15% of a dividend paid by a company other than a headquarter company. It applies to dividends (cash and asset distributions *in specie*) paid by South African residents and cash dividends paid by non-resident companies listed on the JSE.

In terms of section 64E of the ITA, a dividend will be considered paid by the dividend paying company at the earliest of the dividend payment date or when such liability for payment arise. Where the company that declared the dividend is a listed company, this will

be the date on which the dividend is paid. This differs from STC, which is triggered by the declaration date.

In the case where the dividend represents an asset distributed *in specie*, the market value of such asset as at its deemed payment date, will be considered to be the value of such dividend.

Where a dividend is paid/payable in a currency which differ to that of South Africa, such dividend is required to be translated into South Africa's currency at the spot rate which applies as at the dividend payment date.

### 2.3.3 Loans made by a company (deemed dividend) (section 64 E(4))

Section 64E(4) of the ITA provides that where a company has made a loan or advance to a person other than a company, who is a resident and is a connected person in respect of either that company or other connected person in respect of that company, a dividend will be deemed to have been paid by such company, provided that the loan or advance was made as a result of such person being a shareholder of the company.

The value of the dividend is calculated as the difference between a market-related interest (as defined) payable in respect of the loan or advance, less the actual amount of interest payable in respect of the loan or advance for that year of assessment. Where the actual interest payable in respect of the loan or advance exceeds the market-related interest (as defined), the value of the dividend will be nil.

Such dividend is deemed as being paid by the company on the last day of the relevant year of assessment. Where the loan or advance is denominated in a currency which differ to that of South Africa, such loan or advance is required to be translated into South Africa's currency at the spot rate which applies as at the deemed dividend payment date.

"**Connected person"** is defined in section 1 of the ITA and, as far as it is relevant in the context of section 64E(4), means:

(a) "in relation to a company any person, other than a company as defined, who individually or jointly with a connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of —

(i) the equity shares in the company, or

(ii) the voting rights in the company.

(b) "in relation to a close corporation —

(i) any member,

(ii) any relative of such member or any trust (other than a portfolio of a collective investment scheme in securities) which is a connected person in relation to such member."

(c) in relation to a natural person —

(i) any relative

(ii) any trust (other than a portfolio of a collective investment scheme in securities) of which such natural person or such relative is a beneficiary.

The current legislation is silent concerning the liability and administrative rules in respect of this deemed dividend. It is expected that the same rules as applicable to *in specie* distributions will apply, but without specific legislation, it is unclear.

**"Market-related interest"** in relation to any loan or advance provided by a company means "the amount of interest that would be payable to that company on the amount owing to that company in respect of that loan or advance for a period during a year of assessment if the loan or advance had been provided for that period at the official rate of interest as defined in paragraph (1) of the Seventh Schedule" of the ITA.

Currently there is no exemption for loans to employee trusts, which needs to be addressed. From the review of the current legislation it emerges that there is also no

prohibition on the utilisation of STC credits against the DT liability created by this deemed dividend.

The proposed "value-extraction tax" (anti-avoidance measures) was withdrawn from the proposed legislation. As noted by Curr (2012:8), detailed anti-avoidance measures (as is currently the case under STC), will not be introduced under the dividends tax legislation, but the legislature has opted to rely on the general tax definition of dividend (as amended), which will extend beyond formal dividend declarations, to include all transfers of value by a company to a shareholder or related party. Taxpayers are to ensure that loans are properly regulated prior to 1 April 2012 in order to avoid a liability for both STC and DT.

The new dividend definition will cover disguised dividends. One has to rely on the facts and circumstances to determine if value, as withdrawn from a company, will represent a dividend or not. Whether value was extracted from a company and whether it represents a "dividend, salary, payment for the purchase of an asset or use of an asset", is to be established by relying on a similar "legal connection (e.g. 'in respect of' or 'as consideration for')" (SARS, 2011: 31).

Whether the current anti-avoidance measure (deemed dividend) in respect of interest-free loans in section 64E(4) of the ITA is sufficient, remains a question.

### 2.3.4 Liability for tax (section 64EA)

Section 64EA of the ITA provides that, where the dividend represents an asset distributed *in specie*, the company distributing such asset will be liable for the DT related to such dividend. Where a dividend is not represented by an asset distributed *in specie,* the liability for DT related to the dividend rest on the beneficial owner (as defined).

As noted by Passmore (2012), "it is important to note that each of the beneficial owner, the company, or an intermediary are jointly and severally liable for the payment of the tax until the liability is discharged. The company or intermediary will be the first point of call for the tax as a result of their withholding obligations".

### 2.3.5 Exemptions (section 64F)

Section 64F of the ITA provides a list of exemptions from DT, provided the dividend is not a distribution *in specie*. Due to the number of exempt beneficial owners of dividends, companies will be expected to keep detailed records of their shareholders and the nature of their shares to effect the accurate withholding of DT.

A "dividend is exempt from dividend tax provided it is not a dividend *in specie*, and the beneficial owner is:

- a company or close corporation which is a resident,
- the Government, a provincial administration, or a municipality,
- a public benefit organisation (PBO) approved by the Commissioner for the South African Revenue Service in terms of section 30(3),
- a trust contemplated in section 37A,
- an institution, board or body contemplated in section 10(1)(cA),
- a pension, provident or retirement annuity fund contemplated in section 10(1)(d)(i)) or (ii),
- a person contemplated in section 10(1)(t),
- a shareholder in a registered micro business, as defined in the Sixth Schedule, paying that dividend, to the extent that the aggregate amount of dividends paid by that registered micro business to its shareholders during the year of assessment in which that dividend is paid does not exceed R200 000,
- a person that is not a resident and the dividend is a dividend contemplated in paragraph (b) of the definition of "dividend" in section 64D".

### 2.3.6 Exemption — Dividend *in specie* (section 64FA)

Per section 64FA(1) of the ITA a dividend that constitutes a distribution of an asset *in specie*, is exempt from DT if:

- the recipient of the dividend has by the dividend payment date provided the company with—
  - a declaration from the beneficial owner in the format prescribed by the Commissioner that to the extent that such dividend represents an asset distributed *in specie* it would be exempt from DT in terms of section 64F of the ITA, should it not have represented an asset distributed *in specie*; and
  - a undertaking in writing and in the format prescribed by the Commissioner that the company will be notified in writing when it is no longer the beneficial owner of dividends declared by the company;
- the dividend paying company and the beneficial owner of the dividend are part of the same group of companies (as defined in section 41of the ITA); or
- such dividend represents a disposal of a residence as intended in paragraph 51A of the Eighth Schedule of the ITA (the transfer is exempt from transfer duty and capital gains tax).

Per section 64FA(2) of the ITA a dividend that constitutes an asset distributed *in specie*, is subject to DT at a reduced rate where the recipient of the dividend has by the dividend payment date provided the company with —

- a declaration from the beneficial owner in the format prescribed by the Commissioner that to the extent that such dividend represents an asset distributed *in specie,* it would be subject to a reduced rate of DT should it not have represented an asset distributed *in specie*; and
- a undertaking in writing and in the format prescribed by the Commissioner that the company will be notified in writing when it is no longer the beneficial owner of dividends declared by the company;

In respect of the exemptions, the payee of dividends may only rely on these exemptions if the beneficiary has provided a declaration in writing, which specifies its exemption from DT, together with an undertaking that it will notify the payee once it is no longer the beneficial owner of that share. If the beneficial owner and the payee of the dividend are part of the same group of companies as defined, a written declaration is not required. Where the payment is affected to a regulated intermediary, a written declaration is also not required (SAIPA Tax Committee, 2011:45).

The DT liability will qualify for DTA relief if applicable provided that, where the non-resident recipient wishes to rely on a reduced rate under a DTA, it must provide the payee of the dividend with a declaration to this effect.

### 2.3.7 Withholding tax (section 64G)

Per section 64G of the ITA the obligation of withholding and paying over dividends tax to SARS remain with the dividend paying company (where it is not represented by an *in specie* distribution). No dividends tax is required to be withheld where:

- the recipient of the dividend has, by the date as specified by the dividend paying company or, where no such date was specified, by the dividend payment date, provided the company with —
  - a declaration from the beneficial owner in the format prescribed by the Commissioner, that such dividend would be exempt from DT in terms of section 64F of the ITA; and
  - a undertaking in writing and in the format prescribed by the Commissioner, that the company will be notified in writing, when it is no longer the beneficial owner of dividends declared by the company;
- the dividend paying company and the beneficial owner of the dividend are part of the same group of companies (as defined in section 41of the ITA); or
- the dividend payment is receivable by a regulated intermediary.

A dividend paying company is obliged to withhold DT from a dividend payment at a reduced rate where the recipient of such dividend has —

- by the date as specified by the dividend paying company or, where no such date was specified, by the dividend payment date, provided the company with —
  - a declaration from the beneficial owner in the format prescribed by the Commissioner, that such dividend would be subject to a reduced rate of DT resulting from a DTA applying in respect of such dividend; and
  - a undertaking in writing and in the format prescribed by the Commissioner, that the company will be notified in writing, when it is no longer the beneficial owner of dividends declared by the company.

The potential for liability or exemption from DT is established as regards to the "beneficial owner" of such dividend. This concept gives rise to interpretational issues such as:

- the beneficial owner must be distinguished from the registered ownership; and
- where the various rights attached to a share might vest in different people, it is only the person that has the dividend entitlement that is to be regarded.

### 2.3.8 Withholding of dividends tax by regulated intermediaries (section 64H)

Per section 64H of the ITA the obligation of withholding and paying over dividends tax to SARS remain with the regulated intermediary (where it is not represented by an *in specie* distribution). No dividends tax is required to be withheld where:

- the recipient of the dividend has, by the date as specified by the regulated intermediary or, where no such date was specified, by the dividend payment date, provided the regulated intermediary with —
  - a declaration from the beneficial owner in the format prescribed by the Commissioner, that such dividend would be exempt from DT in terms of section 64F of the ITA; and
  - a undertaking in writing and in the format prescribed by the Commissioner, that the company will be notified in writing, when it is no longer the beneficial owner of dividends declared by the company;

- the dividend payment is receivable by another regulated intermediary.

A regulated intermediary is obliged to withhold DT from a dividend payment at a reduced rate where the recipient of such dividend has —

- by the date as specified by the regulated intermediary or, where no such date was specified, by the dividend payment date, provided the regulated intermediary with —
  - a declaration from the beneficial owner in the format prescribed by the Commissioner, that such dividend would be subject to a reduced rate of DT resulting from a DTA applying in respect of such dividend; and
  - a undertaking in writing and in the format prescribed by the Commissioner, that the company will be notified in writing, when it is no longer the beneficial owner of dividends declared by the company.

As noted by Daya (2009:16) there are two sets of rules, one for certified (paper) and one for uncertified (electronic) shares. In respect of certified shares the withholding obligation rests on the dividend paying company while, where uncertified shares is concerned, the withholding obligation rests on the regulated intermediary. Beneficial owners seeking to claim an exemption from DT or a reduced rate of DT due to a DTA applying need to do so directly, as intermediaries will generally have no role concerning certified shares.

### 2.3.9 Withholding of dividends tax by insurers (section 64I)

In terms of section 64I of the ITA, where a dividend is payable to an insurer (as defined in section 29A of the ITA), and it is not represented by an asset distributed *in specie*, such insurer will be regarded as a regulated intermediary. Where such dividend is allocated to a fund referred to in section 29A(4)(b) of the ITA, such dividend is regarded as being paid by the regulated intermediary to a natural person which is a resident on the date on which such dividend was receivable by the insurer.

### 2.3.10 STC credit (section 64J)

In terms of section 64B of the ITA, STC is calculated on the net amount of any dividend declared by any resident company. The net amount of a dividend is calculated as the value of the dividend declared by a company less the sum of all dividends which have accrued to such company during the respective dividend cycle. Where the dividend received in a dividend cycle exceeds the amount of the dividend declared, it results in an STC credit.

An STC credit of a company is defined in section 64J (2) of the ITA (Refer 1.7).

In terms of section 64J of the ITA, no DT obligation exists where the value of STC credits exceeds the value of a dividend paid by such company, provided that such company has by the dividend payment date informed the recipient of the dividend as to the value of the company's STC credit being reduced by such dividend paid to it.

Section 64B of the ITA provides that any dividend cycle which commenced but did not end prior to the effective date of DT, is deemed to end on the day prior to such effective date, and is regarded as the last dividend cycle for STC purposes. This will assist companies in determining their STC credits available for future use under DT. A final STC cycle must therefore be determined as at 31 March 2012.

As noted by Ellary (2011b:10) there will be an obligation placed on a company to notify its shareholders on payment of a dividend as to the value of an STC credit utilised with regard to such dividend declaration. A company's STC credit increases with the STC credit as informed, in respect of dividends received and will reduce with the value of STC credits applied during dividend declarations.

In the event that a company has STC credits, these apply automatically to reduce DT obligations when a company pays a dividend. Companies receiving dividends will also "receive" STC credits, but only where the paying company provides the recipient company with a declaration confirming that the paying company has reduced the DT obligation with

STC credits, (in order to transfer the STC credits to the shareholder company, the notification must occur even if the dividend is exempt from DT).

STC credits will apply to reduce DT until 31 March 2015, at which time all remaining STC credits will be forfeited. It makes sense to give recognition for STC credits as those dividends already bore STC. It is, however, debatable whether the three-year utilisation period is sufficient (Temkin, 2008:28).

STC credits are assigned proportionally among every shareholder that is entitled to the dividend. This takes place regardless of any shareholders being exempt from DT (PKF, 2012).

“Credits will be allocated automatically and pro-rata to the total dividend and not as previously, only to the portion of the dividend that is not exempt from the tax” (PwC, 2009b:8).

STC credits represent a potential DT saving for shareholders and are only available to the company in respect of *in specie* dividends.

### 2.3.11 Payment and recovery of tax (section 64K)

The beneficial owner, and not the person paying the dividend, is liable for DT. The DT is payable to SARS by the last day of the month subsequent to the month in which the respective dividend was paid unless another person paid the DT.

Where a company is liable for DT in terms of section 64EA of the ITA (*in specie* dividends), such company is required to settle the DT by the last day of the month subsequent to the month in which the respective dividend was paid.

Where a company or regulated intermediary withholds DT, it is required to pay the DT, less amounts refundable by virtue of section 64L or section 64M of the ITA, to SARS by the last day of the month subsequent to the month in which the respective dividend was paid. The DT payment is to be accompanied by a DT return.

To the extent that a person fails to withhold DT as required, or withholds DT without paying it over to the Commissioner, such person will be liable for the DT as if it were due by such person by virtue of the ITA. Where a person withheld DT at a reduced rate (by the application of a DTA) such person is required to submit the relevant declaration received from or on behalf of a beneficial owner by the date and, in the way as dictated by the Commissioner.

Where the Commissioner is convinced that DT was not settled, an estimate may be made of the outstanding DT liability, followed by an assessment being issued in respect of the outstanding DT Liability.

Late payment of the DT liability will result in interest being levied at the prescribed interest rate. The provisions of the ITA dealing with assessment and the collection of outstanding tax as well as administrative penalties resulting from default or omission applies to DT.

### 2.3.12 Personal liability

Section 64K (8) of the ITA provides that each shareholder or director which is concerned with or exercise control in respect of the financial management of an unlisted company (as defined in section 41 of the ITA) which is responsible for withholding DT, will be liable in their personal capacity for the DT and any related additional tax, penalty and interest payable by such company or intermediary.

As noted by Haupt (2012:412) this liability is a personal one which exists whether the shareholder or director is responsible for the default to pay the DT or not. As stated by Croome (2008:31), “The liability does not require intent to evade the tax. There is no requirement by SARS to consider the circumstances at all”.

As Mazansky (2009) comments, “this is nothing new, but continues the disturbing trend of eroding the concept of limited liability for companies”.

### 2.3.13 Refund (section 64L & section 64M)

Should the required declarations for exemption from DT or a reduced DT rate not be received on time, the payee of the dividend is to withhold DT. The DT will become refundable where the respective declarations are received within three years after the dividend payment.

In terms of section 64L of the ITA, in respect of dividends qualifying for a reduced rate (application of a DTA) or being exempt from DT, to the extent that a company withheld DT as a result of the required declarations not being received within the prescribed period, such DT withheld will be refundable to the person if such declarations are received by that company within three years after the dividend payment. Such refund is to be recovered from any DT which the company withholds during the year following the receipt of such declaration. Where the amount to be refunded exceeds the amount of DT withheld within the aforementioned period, the excess is recoverable from the Commissioner, provided that this claim is submitted to the Commissioner within four years after the dividend payment date.

In terms of section 64M of the ITA, to the extent that a regulated intermediary withheld DT as a result of the required declarations not being received within the prescribed period, in respect of dividends qualifying for a reduced rate (application of a DTA) or being exempt from DT, and such declarations are received by that regulated intermediary within three years after the dividend payment date, such DT withheld will be refundable to the person. Such refund is to be recovered from any DT which the regulated intermediary withholds subsequent to the declaration being received by it.

It is important for taxpayers to gain an understanding of the refund procedures in order to ensure that their systems comply with the DT requirements. As noted by Reifarth (2010:7), systems that do not comply with the DT legislation may result in DT being incorrectly withheld resulting in taxpayers needing to rely on the refund provisions.

According to Reifarth (2010:7) no formal provision is made for instances where the DT was incorrectly withheld from payments to regulated intermediaries or where the beneficial owner and the payee of the dividend are part of the same group of companies (as defined).

Where the beneficial owner of an *in specie* dividend is late in submitting the required declarations, the declaring company is not able to claim a dividends tax refund subsequently from SARS.

As noted by Reifarth (2010:7) contrary to refunds made by a company related to dividends it declares and pays, the refunds can only be claimed by a regulated intermediary from withholding tax withheld in respect of future dividends paid, as these refunds may not be claimed from SARS.

According to Reifarth (2010:7), refunds will only be processed by SARS where the required declaration has not been submitted to the company or the regulated intermediary who has made payments of dividends.

As noted by Reifarth (2010:7), “It is evident that the refund procedures may lead to time delays as well as further administrative complications being experienced for entities paying dividends”.

### 2.3.14 Rebate in respect of foreign taxes on dividends (section 64N)

In terms of section 64N of the ITA, in cases where tax is paid to another country related to a dividend envisaged in paragraph (b) of the dividend definition in section 64D of the ITA, which is not recoverable, such tax paid may be claimed as a rebate against the South African DT liability. The amount of the rebate may not exceed the DT payable. The amount of foreign tax paid is required to be translated into South Africa’s currency at the same spot rate which applied for purposes of conversion of the dividend into South Africa’s currency.

## 2.4 CONCLUSION

From the review of the current DT legislation, the following potential problems areas have been identified that require further investigation:

- Meaning of beneficial owner
- STC credits
- Personal liability
- Refunds of dividends tax
- Anti-avoidance/ deemed dividends
- Administrative burden/ systems in place

The above-mentioned items will be discussed and addressed in chapters 3 and 4.

# CHAPTER 3

# BENEFICIAL OWNER/ STC CREDITS

## 3.1 INTRODUCTION

In this chapter the following items will be considered:

- The meaning of "beneficial owner" as it relates to DT, as it is a new concept in South African domestic law, and with the purpose of establishing whether any discrepancies exist between its meaning under South African domestic law when compared to its "international tax" meaning,
- The utilisation of STC credits post 1 April 2012, for purposes of assessing the appropriateness of the current DT provisions applicable to such credits.

## 3.2 BENEFICIAL OWNER

### 3.2.1 Introduction

"Beneficial owner" is defined in section 64D of the ITA (refer 1.7). The term beneficial owner is vital in the context of DT, as it is such beneficial owner of a dividend which would be liable for DT.

### 3.2.2 The meaning of beneficial owner

The definition of beneficial owner as contained in section 64D of the ITA, is not explained in the *Explanatory Memorandum* issued on the introduction of this legislation, nor is the reason provided for incorporating the concept of beneficial ownership into the DT legislation (De Koker & Brincker, 2011:9.11).

If one attempts to interpret the definition of “beneficial owner” as provided in section 64D of the ITA, by applying terms as defined in the ITA, together with the ordinary (dictionary) meanings of undefined terms, the following are noted:

- *Person* as defined in section 1 of the ITA “includes an insolvent estate, the estate of a deceased person, any trust and any portfolio of a collective investment scheme other than a portfolio of a collective investment scheme in property but does not include a foreign partnership (as defined)”.
- The term *entitled* is defined in the Oxford Dictionary as “a legal right or a just claim to receive or do something”(Oxforddictionaries.com, Not dated c).
- The term *benefit* is defined in the Oxford Dictionary as “an advantage or profit gained from something or to receive an advantage” (Oxforddictionaries.com, Not dated b).
- *Dividend* is defined in section 1 of the ITA (refer 1.7).
- The word *attach* is defined in the Oxford Dictionary as “include (a condition) as part of an agreement/ assign/ connected/ have as a result/ associated with/ be linked with” (Oxforddictionaries.com, Not dated a).
- *Share* as defined in section 1 of the ITA means, “in relation to a company, any share or similar equity interest in that company”.

The words “entitled to the benefit” may open a debate around possibilities on when a person would benefit from a dividend or not. It is further not clear whether the reference to “entitled” suggests that a “contractual nexus” comes into existence. In current South African tax law, other than DT, the term “beneficial owner” is only used in securities transfer tax (STT) legislation, but the term is not defined in this legislation (De Koker & Brincker, 2011:9.11).

South African DT is a withholding tax in nature, but it is applied differently from other countries in that this withholding tax is not applied only to foreign residents. It may thus be for this reason that the legislature opted to use the term “beneficial owner” in the DT legislation.

As stated in section 233 of the South African Constitution (1996):

"Application of international law — When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law".

The question that arises is whether the international tax meaning of a term — such as "beneficial owner" in relation to STT — is to be applied in South African domestic tax law where such term is undefined. A further question arises as to the position in a case where an international meaning is contradictory to South African domestic law. In defining the term beneficial owner as it relates to a DTA in respect of dividends, based on section 233 of the Constitution, the international tax meaning would be preferred (De Koker & Brincker, 2011:9.13).

### 3.2.3 Dividends tax and DTAs

DT is normally reduced in terms of DTAs concluded by South Africa. These DTAs provide that where the dividend paying company and the recipient of such dividend (in its capacity as the beneficial owner of such dividend) are residents of the two contracting states, such dividend is taxable in the resident country of the payee of that dividend. As noted by De Koker & Brincker (2011:9.2), the term "beneficial ownership" was introduced into the OECD Model in 1977 but was not defined.

As noted by Ger (2008), the term "beneficial owner" is relevant in relation to DTAs concluded by South Africa. Although the term is widely used, it is not defined in South African domestic law, in South African DTAs or international jurisprudence.

According to PricewaterhouseCoopers (PwC, 2009a:8), the reason for introducing the concept of "beneficial owner" in international tax treaties is to deny benefits afforded under such tax treaties to intermediaries (agents and nominees).

As noted by Peters (2012), where the dividend paying company and the recipient of such dividend are residents of the two contracting states, such recipient will be regarded as the beneficial owner of such dividend in terms of the OECD Model and its related commentary— provided that such recipient did not act in the capacity of an "agent, nominee, fiduciary or administrator on behalf of a person resident in another country".

Limited guidance exists as to the meaning or interpretation of the term “beneficial owner”. Most tax treaties require terms which are not defined, to be interpreted with reference to its meaning as provided in terms of the appropriate domestic law of the state applying such DTA.

It should also be noted that currently there is no domestic case law in South Africa which deals with the meaning of the term “beneficial owner” (PwC, 2009a:7).

One of the most authoritative judgements in international case law on beneficial ownership was the case of Royal Dutch Petroleum handed down by the Netherlands Supreme Court. It is an important case as the court focused exclusively on the meaning of beneficial ownership without applying other tests (Du Toit, 2010:503).

The term “beneficial owner” was also considered in two judgements handed down by the Canadian Tax Court, namely the Prévost Car case in 2008 and the Velcro case in 2012.

As noted by Ger (2008), the so-called Prévost case was the primary case in which the term “beneficial owner” was considered in detail. It is therefore likely to be relevant to other countries outside North America. In the case where a payment is made and received by residents of contracting states and is then transferred to a resident in another jurisdiction, the question arises who the beneficial owner of such payment is. Should the beneficial owner not be the person in the other contracting state, then a reduction in the withholding tax rate afforded by such DTA may not be relevant.

The Prévost case is the most significant as it provides the most comprehensive examination of the term “beneficial owner” by a high court. Due to both common and civil law as well as both the official languages of the OECD, being English and French, apply makes Canada a favourable country in which the meaning of beneficial owner can be determined (Du Toit, 2010:506).

Given the relevance of these three court cases in the context of the term “beneficial owner”, these will be discussed in more detail.

### 3.2.4 Royal Dutch Petroleum case

**Background**

This court case as summarised by Du Toit (2010:503): A United Kingdom resident stockbroker purchased dividend coupons in respect of Royal Dutch Petroleum shares without acquiring ownership of the relevant shares. When the coupons were acquired, dividends had been declared but were not yet payable. On payment of the dividends, the stockbroker claimed a reduction in the rate of withholding tax afforded in terms of the Netherlands–United Kingdom Tax Treaty. The question before the court was to determine whether the stockbroker represented the beneficial owner of such related shares.

**Finding**

The stockbroker was found by the court to be the beneficial owner of the dividend. An extract of the court finding as translated by Van Weeghel (1998): “The taxpayer became the owner of the dividend coupons as a result of purchase thereof. It can further be assumed that subsequent to the purchase the taxpayer could freely avail of those coupons and, subsequent to the cashing thereof, could freely avail of the distribution, and in cashing the coupons the taxpayer did not act as voluntary agent or for the account of the principal. Under those circumstances the taxpayer is the beneficial owner of the dividend. The tax treaty does not contain the condition that the beneficial owner of the dividend must also be the owner of the shares and further it is irrelevant that the taxpayer purchased the coupons at the time the dividend had already been announced, because the question who is the beneficial owner must not be answered at the time the dividend is announced, but at the time the dividend is made payable” (De Koker & Brincker, 2011:9.6.1).

As noted by Du Toit (2010:503), the following vital principles were determined by the court:

- There was no requirement of the ownership of the underlying shares.
- The stockbroker could without restraint administer both the coupons and related payment.
- Beneficial ownership is to be determined at payment date.

### 3.2.5 Prévost Car case (Prévost Car Inc. v The Queen, 2008 TCC 231 (CanLII)

**Background**

Prévost Car Inc ("Prévost Car") which was a Canadian resident company manufactured buses and associated products in the province of Quebec. It operated various services and parts facilities within North America. During 1995 the shareholders of Prévost Car at the time opted to dispose of its shareholding in Prévost Car to Volvo Bus Corporation ("Volvo"), which was a Swedish resident, and Henlys Group PLC ("Henlys"), which was a United Kingdom resident. In terms of the "shareholders and subscription agreement" entered into between Volvo and Henlys, its shareholding in Prévost would be held via a newly formed company resident in the Netherlands, to be named Prévost Holding BV ("Prévost Holding"). Prévost Car would be a full subsidiary of Prévost Holding. Volvo and Henlys' shareholding in Prevost Holdings were 51 per cent and 49 per cent respectively.

Neither party wished that the holding company be incorporated in the resident country of its co-shareholder, and accordingly wished for the holding company to be incorporated in Europe. Although one of the factors in selecting the Netherlands as place of incorporation was tax this was not the main reason.

Per the shareholders agreement concluded amongst Volvo and Henlys, at least 80 per cent of all profits realised by Prévost Car and Prévost Holding were distributable to its shareholders, subject to adequate funds being available for their current and forecasted requirements in respect of working capital.

When Prévost Car paid dividends during 1996 to 1999 and 2001, it applied the reduced withholding tax of 5 per cent, as applicable under the tax treaty concluded by Canada with the Netherlands. Assessments were issued on the assumption that the shareholders of Prévost Holding and not the company (Prévost Holding) itself were the beneficial owners of such dividend declared by Prévost Car. Accordingly, on assessment the 25 per cent withholding tax on dividends payable to foreign residents was reduced to a withholding tax of 15 per cent and 10 per cent based on the tax treaties concluded by Canada with Sweden and the United Kingdom separately.

No persons were employed by Prévost Holding within the Netherlands neither did it have any additional investments within the relevant years under appeal. The Canadian Revenue Authority (CRA) contended that Prévost Holdings acted as a "conduit" for the benefit of Volvo and Henlys.

The court had to determine who the beneficial owner of the relevant dividend payments was.

**Finding**

The court found that the "beneficial owner" of a dividend "is the person who receives the dividends for his own use and enjoyment and assumes the risk and control of the dividend he or she receives. The person who is the beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income. Where an agency or mandate exists or the property is in the name of a nominee, one looks to find on whose behalf the agent or mandatory is acting or for whom the nominee has lent his or her name. When corporate entities are concerned, one does nor pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it".

It was concluded by the court that Prévost Holdings did not act as a "conduit" or agent for Volvo and Henlys and, accordingly, Volvo and Henlys could not be regarded as beneficial owners of such dividend declared by Prévost Car. Support for its finding included the following:

- Volvo and Henlys could not demand performance from Prévost Holdings should it not comply with the policy contained within the shareholders agreement with regard to dividends.

- No obligation is placed on Prévost Car in terms of the Deed of Incorporation to pay any dividends.
- On the basis detailed in the shareholders agreement, no obligation exists in law on Prévost Holding to pay dividends to its shareholders.
- Prévost Holding owned the shares in Prévost Car as registered owners.
- Prévost Holding owned the dividends it received and they represented an asset of Prévost Holding, which was at the disposal of the company's creditors. The company is entitled to utilise such amounts received as it wished.
- An entitlement to dividends by Volvo and Henlys only exists in respect of dividends which Prévost Holding declares and pays.

### 3.2.6 Velcro case (Velcro Canada Inc v The Queen, 2012 TCC 57)

**Background**

Velcro Canada Inc ("VCI") business operations included the manufacturing and selling of fastening products in the auto industry. Royalties was paid by VCI to Velcro Industries BV ("Velcro Industries"), which was a previous resident of the Netherlands, in terms of a licensing agreement for the use of "Velcro Brands Technology", which was concluded in 1987. During 1995, following a reorganisation of the Velcro Group, Velcro Industries obtained a residency in the Netherlands Antilles and assigned the licensing agreement to Velcro Holdings BV ('Velcro Holdings"), a subsidiary which residency is based in Netherland.

During the period 1996 to 2004, VCI paid royalties to Velcro Holdings and 90 per cent of these were subsequently paid over by Velcro Holdings to Velcro Industries. In Canada, royalty payments to non-residents are subject to a 25 per cent withholding tax. Canada has no tax treaty with Netherlands Antilles, thus any royalties paid by VCI to Velcro Industries would be subject to withholding tax of 25 per cent. In terms of the Canada – Netherlands Tax Treaty, withholding tax on royalties paid to non-residents are reduced to a 10 per cent withholding tax in respect of royalty payments up to 1998, and nil thereafter.

Assessments were issued based on Velcro Industries being the beneficial owner of such royalties received. Accordingly, on assessment the 25 per cent withholding tax was applied in respect of the 1995 to 2004 years of assessment.

The question before the court was to determine whether Velcro Holdings or Velcro Industries was the beneficial owner of the royalty payments made by VCI.

**Finding**

It was held that in considering whether a recipient is a conduit one has to consider where the entitlement of use and assumption of related "risk and control" of such royalty payments are situated. The following is the crux of the judgement in the Prévost Car case: "there are four elements in considering the attribution of beneficial ownership and those are (a) possession, (b) use, (c) risk, and (d) control." The court reaffirmed the words of Chief Justice Rip in the Prévost Car case that the court is "not likely to pierce the corporate veil unless the corporation has no discretion with regard to the use or application of the funds. The court will look at whether the party in question exercised or held the attributes of beneficial ownership in regards to the royalty payments. The person who is the beneficial owner is the person who enjoys and assumes all the attributes of ownership. Only if the interest in the item in question gives that party the right to control the item without question (e.g. they are not accountable to anyone for how he or she deals with the item), will it meet the threshold set in Prévost".

The court found that Velcro Holdings was regarded to be the beneficial owner of such royalties and not Velcro Industries. Support for its finding included the following:

- The royalties were an asset of Velcro Holdings which was at the disposal of the company's creditors and reflected as such in its financial statements. Velcro Industries had no priority claim as creditor, thus Velcro Holdings carried the risk associated with the royalty payment by VCI.
- The royalties did not pass through Velcro Holdings and, as these royalty payments were mixed with other funds, they were subject to claims of creditors together with the company's other assets. Velcro Holdings exercised control over these funds due

to the funds earning interest or decreasing in value owing to currency fluctuations. These funds were available for payment of the company's financial obligations, therefore control over the funds remained with Velcro Holdings.

- While there is a contractual obligation on Velcro Holdings to pay Velcro Industries a portion of the royalties received, there was no automatic flow of these receipts to Velcro Industries because Velcro Holdings had the right to exercise judgement in respect of the utilisation of these amounts obtained.
- There was no agency relationship between Velcro Holdings and Velcro Industries because Velcro Holdings did not have the authority to influence the "legal position" of Velcro Industries.
- Velcro Holdings was not designated to act on behalf of Velcro Industries in a restricted manner and Velcro Holdings at all times operated independently in compliance with the "assignment agreements".
- For a court to conclude that Velcro Holdings was a "conduit", Velcro Holdings needed to have no discretion as to the royalties received by it, as indicated in the Prévost case. "It is only when there is absolutely no discretion that the Court take[s] the draconian step of piercing the corporate veil".
- There is no legal control by Velcro Industries in respect of royalty payments made by VCI. In addition, Velcro Holdings may only enforce the right of payment.
- As the assignment agreement does not automatically forward the royalty payments to Velcro Industries without any discretion afforded to Velcro Holdings, it cannot be concluded that beneficial ownership of the royalties paid is transferred from Velcro Holdings to Velcro Industries.

## 3.3 STC CREDITS

### 3.3.1 Introduction

The issue around STC credits and its treatment at the time of the introduction of DT has resulted in many discussions and submissions to the National Treasury. The priority of this matter is evidenced through SAICA issuing a letter to National Treasury in which this topic is individually addressed (SAICA: 2009). Initially taxpayers feared that STC credits would

be forfeited with the introduction of DT, which would effectively result in double taxation of these distributions, but some relief is provided in respect of these STC credits.

Although the retention of these credits has been widely welcomed, concerns were raised around these credits only being available for offset against DT obligations. As noted by Temkin (2008), “Mazansky said that one of the more controversial announcements in this year’s budget was a decision permitting STC credits to be offset against future withholdings tax payments”.

SAICA (2009) points out that, while the retention of these STC credits is preferred to forfeiting them, the STC credits would not be available for offset against tax previously borne by companies. The utilisation of these credits also requires companies to make distributions, thus penalising those companies that retain income to fund future investments, which are needed in the current economic climate.

### 3.3.2 Recognition of STC credits under DT

In essence STC credits are represented by the excess of dividends which accrue within a dividend cycle to a company, on which STC was payable by the company from which these dividends were received, together with any STC credits carried forward from the previous dividend cycle, over dividends declared which were not subject to an exemption from STC.

Under the STC legislation the final dividend cycle will be deemed as ending on 31 March 2012 in the case where a dividend is not declared on this date. The DT legislation makes provision to carry forward these STC credits to be utilised as a credit against the DT liability in the hands of shareholders receiving dividends after 1 April 2012. As explained by the 2008 *Explanatory Memorandum* (SARS, 2008:26), “this exemption ensures that profits previously subject to STC are not subject to another tax (i.e. dividends tax) when subsequently passing through resident companies”. As noted by Ellary (2011a) “… an STC credit is not a credit against taxes as used in international tax terminology, but is an amount which can be deducted from the outgoing dividends when calculating the Dividends Tax”.

Despite the fact that the last dividend cycle will be deemed as ending on 31 March 2012 where no dividend is declared on this date, as notified by SARS, taxpayers are not required to submit an STC return (IT56) in respect of this dividend cycle. SARS's STC system will close all open/active dividend cycles, thus the final STC credits will be reflected on SARS's system (SARS, 2012a: 4).

In the case of a South African group of companies, it may be that certain subsidiaries and associates within these groups may have STC credits available as at 31 March 2012. On the basis that South African resident companies are exempt from DT in terms of section 64F of the ITA, the question arises whether these STC credits will be forfeited or whether the possibility exists for them to be transferred to the ultimate holding company, to be utilised in reducing the DT obligations of its shareholders.

To the extent that such a company pays a dividend after 1 April 2012, provided that it issues the recipient of such dividend with a written notice prior to the dividend being paid, stating the extent to which the value of its STC credit is being reduced, this portion of the STC credit is transferred to the recipient of the dividend.

As explained by the 2008 *Explanatory Memorandum* (SARS, 2008:26), "the transfer of STC credits will only be possible if the company paying the dividend has provided the recipient shareholder of the dividend prior written notice of the amount by which its STC credit has been allocated to the dividend which accrued to that shareholder".

As further explained by the 2008 *Explanatory Memorandum* (SARS, 2008:26), the "… notification of the STC credit transferred will only be required if the recipient of the dividend is a resident company".

As explained by the 2008 *Explanatory Memorandum* (SARS, 2008:26), "STC credits must be allocated on a pro rata basis amongst all shareholders within the same class entitled to the dividends, irrespective of whether those shareholders are exempt from the Dividends Tax".

As noted by Ellary (2011a), should a reduced withholding tax rate apply due to the application of a DTA, the utilisation of STC credits is not be affected in respect of such a dividend declaration.

The basis of allocating STC credits mentioned above may be regarded by some as unfair on the basis that the portion relating to beneficial owners, which are exempt, is effectively forfeited. Also taxpayers are not compensated for the reduction in DT rate due to the application of a DTA. There is, however, partial relief due to the differential in tax rates between STC and DT.

A company's STC credit is thus calculated as follows:

- Balance of STC credits as at 31 March 2012.
- Plus: Dividends accrued after 1 April 2012 to the extent that it decreased the payer company's STC credit (subject to the required notification being received).
- Less: Dividend paid subsequent to 1 April 2012 by that company.

As noted in the 2008 *Explanatory Memorandum* (SARS, 2008:26), "… dividends paid on or after the effective date of the Dividends Tax by companies with STC credits will reduce the balance of their STC credits. For purposes of administrative convenience, STC credits will be exhausted first (i.e. a company will not be entitled to pay a dividend which does not reduce STC credits)".

According to Reifarth (2012), a discrepancy exists among section 64J(1) and section 64J(2) of the ITA, in that the amount of dividends as paid after 1 April 2012 will decrease the company's STC credits, irrespective of whether this company has notified its shareholders of the reduction of its STC credit, while the recipient will not be able to increase its STC credit if no notification is received. Suggested wording for such notification is not provided by SARS.

As noted by Ellary (2011a), an increased administrative burden is placed on both companies and shareholders. Provided that they keep up to date with this increase in

administration, they will be able to effectively utilise these credits within the afforded three-year period.

Aggressive tax planning was encountered in practice where, due to shortcomings in the legislation, STC credits were being generated while these dividends were not subject to STC. An amendment was proposed to this legislation in order to clarify that STC credits will not be generated by dividends which were not subject to STC. This amendment is included in the 2012 Draft Taxation Laws Amendment Bill. This draft legislation will be amended in order to insert the provision that a company which pays a dividend which is subject to STC credits which is overstated, will be accountable in respect of the additional DT liability resulting from this overstatement, on the basis that it has control over the STC credit calculations. No liability will be incurred by regulated intermediaries or shareholders because they rely on the STC credit as notified to them by the dividend payer company. These changes will be effective as from 1 April 2012 (South Africa, 2012a:3).

### 3.3.3 Alternative approaches to the utilisation of STC credits

In its submission to the National Treasury, SAICA (2009), has suggested three options for utilising STC credits against the respective companies to which the STC credit relates, own income tax liability, which includes a total dividend approach, a taxable dividend approach, and a cash credit approach. These three options are summarised in table 5 below:

**Table 5: The alternative options in utilisation of STC credits post 1 April 2012**

| | **Total dividend approach:** | **Taxable dividend approach:** | **Cash credit approach:** |
|---|---|---|---|
| Basis | Credit is calculated with reference to the total dividend distribution. | Credit is calculated with reference to taxable dividend distribution. | Credit is computed based on an amortised amount over a fixed term and is offset against corporate tax. |

| | Total dividend approach: | Taxable dividend approach: | Cash credit approach: |
|---|---|---|---|
| Basis | Credit is calculated with reference to the total dividend distribution. | Credit is calculated with reference to taxable dividend distribution. | Credit is computed based on an amortised amount over a fixed term and is offset against corporate tax. |
| Advantages | Simple | No prejudice to SARS in respect of cash flow. | Simple<br><br>No prejudice to SARS in respect of cash flow.<br><br>A dividend is not required to be paid.<br><br>Complex record keeping is not required. |
| Disadvantages | Where major portions of shareholders are exempt or where a reduced DT rate applies, SARS would be prejudiced.<br><br>A dividend is required to be paid.<br><br>Ineffective if no taxable income. | More complex.<br><br>A dividend is required to be paid.<br><br>Ineffective if no taxable income.<br><br>Requires record keeping related to dividends paid to companies. | None. |

Table 6 below summarises the tax consequences of STC credits under the three options (assuming an STC credit of R500):

**Table 6: Tax consequences under the alternative options in utilisation of STC credits post 1 April 2012**

| | Total dividend approach: | Taxable dividend approach: | Cash credit approach: |
|---|---|---|---|
| STC credit | R500 | R500 | R500 |
| Gross dividend | R1000 | R1000 | - |
| Gross DT | R150 | R150 | - |
| Ratio of taxable to total shareholders | 50% | 50% | 50% |

| | Total dividend approach: | Taxable dividend approach: | Cash credit approach: |
|---|---|---|---|
| Net DT (after adjusting for exempt and reduced rate) | R75 | R75 | - |
| Credit available against corporate tax liability in year of dividend payable | R150 | R75 | - |
| Gross credit to amortise against corporate tax over a fixed period. | - | - | R250 |

On the basis of complexity, SAICA lobbied for the cash credit approach (SAICA: 2009).

## 3.4 CONCLUSION

The conclusions reached in this chapter are summarised below:

### 3.4.1 Beneficial owner

While South Africa is not bound by foreign case law, it may be of persuasive value. What follows from the Prévost case is that, if an overseas holding company is correctly set up, it is to be considered the beneficial owner related to a receipt from a South African resident, despite its ultimate shareholders residing in another country. In the context of DT, the shareholder will be the beneficial owner unless it has no discretion as to its use with an obligation to distribute such dividend to its shareholders (Ger, 2008).

The approach followed in the Velcro case is relevant in the context of South Africa due to the initiation of DT. The fact that a dividend are on distributed by its recipient may not necessarily lead to such recipient not representing the beneficial owner thereof if it is found that such recipient is not a mere conduit of such dividend but that both the risk and related control of the dividend received is acquired by the recipient (Cliffe Dekker Hofmeyr, 2012).

The Velcro decision provides a framework for both courts and taxpayers to assess if the beneficial owner of such amount received is the recipient of such dividend (Hassam, 2012).

As noted by Du Toit (2010:507), the definition of beneficial owner as provided in the Prévost case, can be regarded as its international tax meaning.

Disagreement may arise if South Africa seeks to apply its DT definition of "beneficial owner" to assess beneficial ownership of a dividend in the context of a DTA. In the Prévost case the court rejected a definition of "beneficial owner" based on benefits, while this is essentially its definition in terms of South Africa's DT legislation (De Koker & Brincker, 2011:9.13).

It is recommended that, in applying the meaning of beneficial owner for DT purposes, it should be aligned with its international tax meaning. This would ensure that no discrepancies arise should the domestic law definition be applied in the context of DTAs. It would further ensure that the definition of "beneficial owner" applied in DTAs related to dividends tax is similar in determining the beneficial owner of other income, such as interest and royalties.

### 3.4.2 STC credits

While there is some relief provided in respect of STC credits, it will only be available for use by dividend recipients and not to the dividend declaring companies. It is agreed with the contention that this relief should have been afforded to the companies on the basis that it relates to STC, which in essence was a tax at company level. It is submitted that an equitable solution would have been to allow taxpayers to claim the STC credit as a credit against their income tax liability at 10 per cent of its value (which may be subject to it being spread over a period if required). This would resolve the disparity in the utilisation of these credits, resulting from the difference in tax rates between STC and DT and the allocation thereof to exempt parties. In addition, this would eliminate the increased administrative burden placed on companies resulting from the treatment of STC credits under the current DT legislation. This would also eliminate the difficulty to SARS of tracking STC credits. It is

appreciated that the legislation contained in section 64J of the ITA, which governs the utilisation of STC credits, is already enacted, resulting in STC credits being partially utilised. However, it may be worthwhile to consider this alternative in respect of the balance of STC credits at a date in future as decided on by SARS.

In the next chapter the remaining potential problem areas, as identified in chapter 2, namely the personal liability of directors and shareholders, the DT refund procedure, the DT anti-avoidance provisions (deemed dividends), and the administrative burden of dividend payer companies under DT will be considered.

# CHAPTER 4

# PERSONAL LIABILITY/ REFUND PROCEDURE/ DEEMED DIVIDEND / ADMINISTRATIVE BURDEN

## 4.1 INTRODUCTION

In this chapter the following items will be considered:

- Personal liability of shareholders and directors in order to assess the reasonableness of this onerous DT provision.
- DT refund procedures compared to those in other jurisdictions.
- Assessment of the adequacy of the anti-avoidance (deemed dividend) provisions in the context of DT.
- The administrative burden placed on dividend-paying companies/ regulated intermediaries in terms of the DT legislation.

## 4.2 PERSONAL LIABILITY

### 4.2.1 Introduction

As previously noted, section 64K(8) of the ITA provides that each director or shareholder which is concerned with or exercise control in respect of the financial management of an unlisted company (as defined in section 41 of the ITA) which is responsible for withholding DT, will be liable in their personal capacity for the DT and any related additional tax, penalty and interest payable by such company or intermediary .

The concept of personal liability is not a new concept in the ITA. A similar provision related to employees tax is contained in paragraph 16(2C) of the Fourth Schedule to the ITA. It provides that each director or shareholder who is concerned with or exercise control in

respect of the financial management of a company in its capacity as an employer, will be liable in their personal capacity for the employee tax and any related additional tax, penalty and interest payable by such company.

This personal liability extends to both shareholders and directors. While the personal liability of shareholders and directors under the DT provision only extends to unlisted companies, with regards to employment tax it applies to both listed and unlisted companies. As noted previously the concerns raised are that the application of this personal liability does not require an intention to evade the respective taxes and that there are no requirement that the particular circumstances of a case be considered. A further concern is that the period to which such liability extends is not limited.

A consideration when opting to utilise a company for purposes of conducting business is the limited liability afforded to shareholders. However, this provision of the ITA disregards this limitation of liability afforded to shareholders.

In order to investigate this matter further it may be useful to investigate the application of personal liability in the context of other applicable South African law as well as other jurisdictions.

### 4.2.2 The meaning of unlisted company

For purposes of section 41 of the ITA, “unlisted company” refers to any company that is not a listed company as defined in paragraph (a) of section 1 of the ITA.

A listed company as defined in paragraph (a) of section 1 of the ITA, “means a company where its shares or depository receipts in respect of its shares are listed on an exchange as defined in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004), and licensed under section 10 of that Act”.

### 4.2.3 Personal liability of directors in the context of the Companies Act

Section 77 of the Companies Act (CA) deals with the liability of directors and specifies the conditions under which a director may be liable for losses and damages suffered by a company. The following provisions contained in section 77 are important to note:

- There is a time limit for instituting a claim against a director of three years after the "act or omission" occurred which resulted in the liability.
- Should the liability not relate to intentional misbehaviour or violation of trust, such director may partially, or totally, be relieved from liability if it is found that the director performed its duties with honesty and reasonableness or, if based on the specific circumstances, it is found that it was reasonable for such director to have acted in such a manner.

It is submitted that the provision on directors' liability in the CA is more equitable on the basis that a time limit is placed on the liability, that there is a requirement of intentional misbehaviour or violation of trust or that the circumstances of a particular case be evaluated.

### 4.2.4 Personal liability of directors in other countries

South Africa is not unique in enforcing personal liability on directors. Some of the countries that have similar provisions include Canada, Australia and the USA. In most of these countries, the personal liability is, however, only relevant in the context of employee-related tax.

As per section 227.1 of the Canadian Income Tax Act (CTA), the Canadian Revenue Agency (CRA), is allowed to recover uncollected or unpaid payroll and withholding tax. A similar provision is also provided under section 323 (1) of the Canadian Excise Tax Act related to GST/HST. This has resulted in an increase in the number of assessments issued to directors subsequent to GST/HST being introduced. This may, however, only be done when the CRA is unsuccessful in recovering these taxes from the taxpayer company or when its claim is unsuccessful in the case of a dissolution or bankruptcy proceeding.

These provisions extend to both “de facto” and deemed directors. In the case where a person acts in a manner similar to a director or proceed in acting similar to a director subsequent to vacating from this role, such person could be regarded to be a “de facto” director in terms of “common law”, or may be deemed a director under the applicable provincial business corporations’ legislation. A number of court cases have resulted from these provisions. In the Canadian case, Bremmer v R., the court ruled that Mr Bremmer, by virtue of his activities, was “a de facto director” subsequent to the latest director resigning, and accordingly ruled that he was personally liable for unpaid GST/HST (Woodward, 2008).

It is further noted by Woodward (2008) that two of the defences to an assessment under these provisions include:

- Due diligence — Should it be found that a director acted with the “degree of care, diligence and skill that a reasonably prudent person would have in similar circumstances” in order to avoid such neglect to pay over the tax, he would not be held liable. Due diligence refers to actions taken to “safeguard amounts owed to the CRA”. The ideal way to prove this is through supporting documentation, such as board meeting minutes confirming that tax payments were made on a timely basis etc.
- Two-year limitation period — Assessment under these provisions needs to be issued within a period of two years after such directorship ended.

It is submitted that the provision of the CTA are more equitable than the DT provision in respect of personal liability.

### 4.2.5 Personal liability in the context of the Tax Administration Act

Personal liability of representative taxpayers, withholding agents, third parties, shareholders and directors (management) is also contained in the newly promulgated Tax Administration Act, 2011, Act No.29 of 2011 (TAA).

The definition of “taxpayer” in section 1 of the ITA (“any person chargeable with any tax leviable under this Act and includes every person required by this Act to furnish any return”) is expanded in section 151 of the TAA, and “means:

(a) a person chargeable to tax (as defined in section 152 of the TAA);
(b) a representative taxpayer (as defined in section 153 of the TAA);
(c) a withholding agent (as defined in section 156 of the TAA);
(d) a responsible third party (as defined in section 158 of the TAA); or
(e) a person who is the subject of a request to provide assistance under an international tax agreement.”

Section 155 of the TAA provides for personal liability of a representative taxpayer related to tax payable in its capacity as a representative taxpayer in the case where it “alienates, charges or disposes of amounts” subject to tax or parts with funds in its possession or received by it after such tax is due, from which such tax could have been funded.

Section 157 of the TAA provides for personal liability of a withholding agent related to tax payable by a taxpayer where such tax was withheld and not paid over to SARS or was not withheld while an obligation to withhold existed. This would be relevant in the context of DT.

Section 180 of the TAA provides for personal liability of a person in respect of any tax debt due by a taxpayer, if such person is concerned with or exercise control in respect of the financial management of the taxpayer’s financial affairs and such person acted with negligence or fraudulently in respect of settling the tax liability of the taxpayer.

Section 181 of the TAA provides that in the case of a voluntary liquidation of a company (other than a listed company) where tax debts have not been settled, any shareholder who received assets during the last year before the liquidation, may incur liability for the company’s tax debt.

From the review of the personal liability provisions contained in the TAA, these appear to be reasonable. Unlike the DT provision, there is a requirement of negligent or fraudulent acts by directors in relation to the payment of tax debt. Shareholders are only liable for

outstanding tax debts in the case where they received assets during the year prior to a company's liquidation.

## 4.3 REFUND PROCEDURES

### 4.3.1 Introduction

The DT legislation provides for specific refund procedures as discussed in chapter 2 (2.3.13). In order to investigate this matter further it may be useful to investigate withholding tax refund procedures in other jurisdictions.

Canada and Australia was chosen as other jurisdiction in which refund procedures could be investigated, as both of these countries have well established dividend withholding tax systems in place and appropriate guidance have been issued by the respective revenue authorities.

### 4.3.2 Refund procedures in Australia

The following applies to the refunding of withholding tax in Australia (Australia, 2012):

- In cases where the payer company over-deducted withholding tax and the error is discovered early, a refund is to be made by the company to the payee despite the withholding tax already being paid to the Australian Tax Office (ATO). Early discovery means that the error is detected before 30 June of the relevant year or where the payee requests a refund before 30 June of the relevant year.

- Where payments were already made to the ATO, the refund may be deducted from future withholding tax payments to the ATO during the relevant year. This offset is to be recorded. Where no future withholding tax payments are made in the relevant year, a refund may be requested from the ATO. Such application need to provide full details as to the overpayment of the withholding tax.

- Where the error is detected after 30 June of the relevant year, the payer is not required to refund the payee. In this case the refund is to be requested from the ATO. Such application is to include the following information in respect of the payee:

  - the tax file number,
  - an indication that the person is authorised to request the refund,
  - the value of the amount incorrectly withheld, together with an explanation for the over-deduction,
  - documentation in support of the over-payment,
  - any certificate of payment issued by the ATO relating to the withholding tax over-deducted.

### 4.3.3 Refund procedures in Canada

The following applies to the refunding of withholding tax in Canada (Canada, 2012):

- In cases where withholding tax was over-deducted, the non-resident payee is required to submit an “Application for Refund of Part XIII Tax Withheld (NR7-R)” to the CRA. A refund will only be considered where the NR7-R form is submitted to the CRA within a period of two years after the related withholding tax was received by the CRA.

- The Application for Refund (NR7-R) contains the following information (as far as dividends are concerned):

  - applicant details (name, address, Canadian tax identification number),
  - details of payment and tax withheld (tax year, gross amount, tax remitted, tax payable, tax refund, dividend security name, dividend payment date, number of shares, company reference number),
  - reason for the refund,

- participants (name and address of Canadian payer or agent both paying the amount and withholding tax),
- mandatory attachments (affidavit of beneficial ownership, structure charts and any other information explaining any tax treaty entitlement, NR4 or Canadian tax slip),
- certification of information,
- certification of tax withheld (completed and signed by payer/agent).

## 4.4 DEEMED DIVIDEND

### 4.4.1 Introduction

Under STC certain anti-avoidance provisions applied, also referred to as deemed dividends which in essence targeted transactions between companies and their shareholders and connected persons, in which amounts were transferred to these parties other than through dividend distributions, in order to avoid STC.

Despite DT applying at shareholder level, the same incentives exist to avoid DT liability. Because of this, the concept of “value extraction tax” (VET) was introduced as an “anti-avoidance” tactic to curb value extraction from resident companies (SARS, 2009:50). Where commercial reasons (other than tax) support a transaction these should, however, not fall within the ambit of the anti-avoidance rules (SARS, 2009:50).

The VET provisions were subsequently deleted before the commencement of DT. The reasons as listed below were provided (SARS, 2011:31):

- The revised dividend definition extends beyond dividend declarations to include so-called “disguised dividends”.
- The test to determine whether payments made to shareholders represent “disguised dividends” is a “facts-and-circumstances” test. The VET classifies certain value extractions to represent deemed dividends without regard to the relevant facts and circumstances.

The question arising is whether the dividend definition is in fact wide enough to include disguised dividends?

The deeming provision around loans and advances by a company to its shareholders was, however, retained and is contained in section 64E(4) of the ITA. As set out in the SARS *Explanatory Memorandum* (SARS, 2011:32), this was done in order to provide certainty related to general practise.

A further deemed dividend provision was subsequently added on 31 August 2012 relating to dividend schemes involving foreign shareholders, which is contained in section 64EB of the ITA.

### 4.4.2 Loans and advances (section 64E(4))

Also refer to the discussion in chapter 2 (2.3.3).

The deemed dividend amount related to a loan or advance is equal to a market-related interest calculated in relation to this loan or advance, reduced by the actual interest payable in respect of the loan or advance. This rule is aligned with the provisions of the Seventh Schedule of the ITA. This provision results in an charge calculated on a basis, similar to rules applying to loan discounting related to employee fringe benefits (SARS, 2011:32).

It should be noted that a deemed dividend may result from applying the fact-and-circumstances test where there is no intention to repay the loan or advance, in which case the value of the loan will be treated as a dividend at the time of granting of the loan or advance. The exemptions provided under DT will be applicable to these discounted loans and advances (SARS, 2011:32). It is submitted that this may attract donations tax on the basis that the donations tax legislation does not provide for an exemption in respect of a dividend.

The DT resulting from this deemed dividend, is charged to the company and will not apply in respect of financial assistance granted before 1 April 2012, provided this was treated as a deemed dividend for STC purposes (SARS, 2010:36).

As mentioned previously, the deemed dividend rules exclude loans to non-residents and South African companies. It makes sense to exclude South African companies on the grounds that these are exempt from DT. One can only assume that the reason for excluding non-residents is on the basis that these loans would be subject to South African transfer pricing rules (section 31 of the ITA); the effect being that a requirement may exist that a market related interest be included in the gross income of the South African resident company, during the respective years in which the loan or advance was granted. As per section 64C(2e) of the ITA, such adjustment made under section 31(2) of the ITA will be regarded as a deemed dividend and therefore subject to STC. Under the DT provisions, there are no specific sections that will regard this benefit granted to be a dividend subject to DT. The question, however, is whether the benefit resulting from these transactions may be regarded as a dividend under the revised dividend definition in section 1 of the ITA.

### 4.4.3 Deemed dividend *in specie* (section 64EB)

In a joint media statement released by the National Treasury and SARS on 31 August 2012, the Minister of Finance made an extraordinary declaration, announcing urgent steps to eliminate tax-avoidance schemes related to DT. Aggressive tax planning was encountered in practice where tax schemes were implemented which benefited foreign shareholders by eliminating their DT obligation, without relying on a DTA. This was achieved by converting these taxable dividends into exempt income. Accordingly, anti-avoidance rules, as contained in section 64EB of the ITA, were implemented in order to eliminate the tax benefits resulting from these schemes. These changes became effective from 1 April 2012 (South Africa, 2012a:1).

As explained by the National Treasury (South Africa, 2012a:1), there are a number of different conversion schemes in practice. Examples of these schemes are summarised in Table 7 below (South Africa, 2012a:2):

**Table 7: Anti avoidance — conversion schemes**

| | **Description of scheme:** | **Tax consequences — foreign shareholder:** | **Tax consequences — independent resident company:** |
|---|---|---|---|
| 1. | Subsequent to a dividend declared, but prior to its payment, the entitlement to such dividend is sold by the foreign shareholder to a non-related resident company in return for an amount denominated in foreign currency (reduced by a charge). | The sale of the right to the dividend constitutes foreign source income, thus not taxable in RSA. | Acquisition of dividend is included in gross income and repayment (manufactured dividend) qualifies for a corporate tax deduction.<br>Dividend is exempt from DT. |
| 2. | Subsequent to a dividend declared, but prior to its payment, a foreign shareholder disposes of the shares held in a resident company cum dividend (R800k) to a non-related resident company for proceeds of $1m. Foreign shareholder subsequently repurchases these shares for $900k (after dividend received and reduced by a charge). | The sale of the right to the dividend constitutes foreign source income, thus not taxable in RSA. | Dividend is exempt income & exempt from DT. |
| 3. | Subsequent to a dividend declared, but prior to its payment, a foreign shareholder (with R800k dividend receivable) lends such shares (together with dividend receivable) to a non-related resident company. The resident company subsequently pays corresponding amount in foreign currency (equal to dividend reduced by a charge) back to foreign shareholder. | Share loan is regarded as constituting a disposal not taxable in South Africa . | Acquisition of dividend is included in gross income and repayment (manufactured dividend); qualifies for a corporate tax deduction.<br>Dividend is exempt from DT. |

| | Description of scheme: | Tax consequences — foreign shareholder: | Tax consequences — independent resident company: |
|---|---|---|---|
| 4. | A derivative is issued by a non-related resident company to a non-resident person in terms of whom a similar return with reference to a resident listed company's shares is provided. In order to hedge the derivative, an equal number of these resident listed company's listed shares is purchased. The independent resident company receives a dividend. | The profit or loss related to the derivative constitutes income from a non South African source, thus not taxable in RSA. | Dividend is exempt income & exempt from DT. Payments made to the non-resident resulting from a liability related to the derivative will qualify for a corporate tax deduction. |

Section 64EB of the ITA provides the following:

- Where a resident company acquires the right to a dividend through cession after such dividend is declared the amount paid (limited to the dividend declared) will be regarded to constitute a dividend which is paid to the person which ceded its right to the dividend, by the company which acquired the right to the dividend.
- Where a resident company borrows a share from another person after a dividend is declared in respect of that share, the amount paid in respect of that borrowed share (limited to the dividend declared) will be regarded as a dividend which was paid to the person by the company.
- Where a resident company acquires a share (or right in respect of such share) from a person after a dividend is declared in respect of this share, and the company is under contractual obligation (fixed or contingent) to sell (or to provide an option to sell) that share, or a share of equal kind or quality, to this person the amount paid (limited to the dividend declared) to the person or connected person in respect of this person, will be regarded as a dividend which was paid to the person by the company. Where a resident company paid an amount in respect of a share derivative to a person, and that amount is calculated based on a dividend declared (whether directly or indirectly), the amount paid will be regarded as a dividend which was paid to the person by the company. "Share derivative" means "any arrangement between one person and another person that gives rise to a right of one of those persons and to a

corresponding obligation of the other person, where the value of that right and the amount of that obligation are determined directly or indirectly with reference to the value of a share (or any right in respect of a share)".

The above deemed dividends will be deemed to be an asset distributed *in specie*, which is liable for DT.

With reference to the avoidance schemes reflected in table 7 above, the tax consequences as mentioned in the table for both the foreign resident and the independent resident company will remain. The amount paid denominated in foreign currency will, however, for DT purposes be regarded to constitute an *in specie* dividend (subject to a reduction if DTA applies) (South Africa, 2012a:4).

### 4.4.4 Dividend definition

"Dividend" is defined in section 1 of the ITA (refer 1.7).

As noted in SARS *Explanatory Memorandum* (SARS, 2008:28), the term "amount transferred" will include "an operating or liquidating distribution, or any amount paid in redemption, cancellation or otherwise in exchange for shares surrender (e.g. through a buyback). The amount transferred may consist of money as well as the market value of every other form of property (i.e. dividends *in specie*)".

The following items are excluded from the dividend definition (*Explanatory Memorandum*: SARS, 2009:36):

- amounts which result in reducing CTC,
- the transfer of a company's own shares,
- where a listed company purchase its shares in the "open market",
- where a "participatory interest in a foreign collective investment scheme" is redeemed.

An extension of the dividend definition results in it differing from the definition of a dividend as it applies under South African DTAs. In the case of a share buy-back for example, the

price paid for these shares will not be regarded as a dividend for the shareholder (but it could be regarded as a dividend for the company) under DTAs which are drafted based on principles of the 'OECD Model Convention'. In the case of these DTAs, a share sale will be governed by the relevant provisions dealing with business profits or capital gains realised as far as the shareholder is concerned. Under these provisions, no requirement of beneficial ownership exists. It is uncertain whether SARS would require proof of beneficial ownership under these circumstances as this would impose a requirement on these non-residents under these DTAs to which the relevant country has not agreed (De Koker & Brincker, 2011:9.11). The question arising is how this will be dealt with from a South African DT perspective.

## 4.5 ADMINISTRATIVE BURDEN AND SYSTEMS IN PLACE

### 4.5.1 Introduction

South African companies carry a heavy administrative burden due to regulatory and other administrative compliance requirements applying to them. It is evident that an increased administrative burden is placed on these payer companies of dividends under the DT legislation than was the case under STC.

"While I welcome the replacement of a tax that has been considered to be foreign investor-unfriendly, it does appear that the introduction of the dividends tax will result in yet another set of complex administrative rules and regulations increasing the already heavy compliance burden on the taxpayer. The supporting data that will be required to be included in the dividends tax return is onerous and whether the SARS, never mind the taxpayer, will be able to cope remains to be seen" (Passmore, 2012).

The draft legislation was released in advance to allow taxpayers to implement the required systems required prior to the effective date of DT.

In order to investigate this matter further it may be useful to investigate administrative procedures in respect of withholding tax in other jurisdictions. Canada and Australia was chosen as other jurisdiction, in which administrative procedures could be investigated, as

both of these countries have well established dividend withholding tax systems in place and appropriate guidance have been issued by the respective revenue authorities.

### 4.5.2 Administrative procedures – South Africa

As noted by Passmore (2012), it is imperative that dividend paying companies have implemented the appropriate systems.

According to Croome (2008:32), the administrative burden of companies is increased since companies need to know the nature of their shareholders in order to determine whether DT is payable or not. In addition, separate records need to be maintained in order to determine whether payments to shareholders represent a dividend or return of CTC.

As noted by SAIPA Tax Committee (2011:44), “Companies will be required to issue a certificate to each beneficial owner of the dividend declared, the value of withholding tax paid to SARS, and reasons for not withholding tax or applying a reduced tax rate. Considering the number of shareholders, frequency of changes in shareholders, and regularity of dividends declared this could prove to be a very arduous administrative burden on companies”.

According to Reifarth (2010:6), “systems which do not comply with the legislation may result in dividend payments being made whereby dividends tax is incorrectly withheld, and taxpayers may then be required to rely on the refund provisions. These factors may add to the importance of taxpayers gaining an understanding of the legislation and obtaining advice where necessary, in order to ensure that their systems cater for dividends tax and to ensure compliance with the legislation”.

As noted by Ellary (2011b:11), as a result of companies being required to submit declarations and notifications, the utilisation of STC credits will place an additional administrative burden on these companies.

A company paying dividends must ensure that all the required declarations, in the format prescribed by SARS, are received timely in order to secure adequate time for processing

related administrative requirements to reduce or exempt the DT obligation on such dividends. It should be noted that the payer company sets such deadline for submission of the required declarations. If a date is not set, it is to be received by the date of payment. An undertaking from the beneficial owner is to be included in such declaration that the company will be notified when it is no longer the beneficial owner of dividends declared by the company (SARS, 2008:34).

The declaring company and not SARS issues declarations. Such declarations only need to be issued once per company or withholding agent, or until the status of the beneficial owner change. If a beneficial owner holds more than one share per regulated intermediary, only one declaration is required (SARS, 2012b.5).

Prescribed minimum wording for the declarations and undertakings for both exemption and reduced DT (when a DTA is applicable) are provided in the Business Requirement Specification, Annexure G, as issued by SARS (2012c:73). Should the beneficial owner neglect to inform the entity of an amendment in its 'tax status' it will result in a penalty being payable (SARS, 2010:35).

Dividend payments to the following entities qualify for automatic exemptions, thus no declarations are required (SARS, 2009:43):

- regulated intermediaries,
- if the recipient and payer are included in the 'same group of companies' (as defined in section 41 of the ITA).

The administrative burden of a company is impacted by the classification of its shares as either certified shares or uncertified shares due to different withholding tax obligations that apply. Share certificates related to certified shares are in paper format, while share certificates of uncertified shares are in electronic format.

Because share certificates are in electronic format, in the case of uncertified shares, regulated intermediaries would know the relevant shareholder information. In the case of uncertified shares, the dividend payments are paid via regulated intermediaries, thus no

withholding tax is applicable to such company, thereby limiting its administration. The normal administrative requirement, as mentioned above, remains with the company in respect of certified shares.

As a number of listed and unlisted companies have outsourced their transfer secretarial function to external transfer secretaries, which are not regarded as regulated intermediaries, an application may be made to SARS for these to be regarded as regulated intermediaries for DT purposes. These approvals will, however, be limited to "external juristic persons or partnerships transfer secretaries". In assessing the approval, SARS will consider the financial sustainability, as well as the diversity of its clients (SARS, 2010:34).

To the extent that a reduced DT rate applies under DTAs concluded with the UK, Netherlands, Germany and Switzerland (IT25, IT25, IT26 & IT27), recipients of these dividends are required to submit additional forms to SARS as per section 69(2)(b) of the ITA, in addition to the declarations required under the DT legislation. These additional forms pose various questions that also require the foreign tax authority to certify the taxpayer's tax residency in that country (PwC, 2012).

The administrative requirements can therefore be summarised as follows:

- Analysing the nature of shareholders, in order to assess possible exemption from or reduction of DT obligations under a DTA.
- Declarations to be received from the beneficial owner where a dividend is exempt or where a reduced withholding rate under a DTA applies.
- Written undertakings are to be received from beneficial owners stating that they will advise the company in the case where their status as beneficial owner changes.
- Communicating the date determined by the company for such declarations and undertakings to be received (if not, such date is deemed the earliest of the date of payment, or date when such dividend becomes payable).
- The DT withheld is payable by the last day of the month subsequent to the month in which the respective dividend was paid.
- Administering of refund procedures, including requesting refunds from SARS.

- Beneficial owners are to be notified of STC credits applicable to a dividend paid to them.
- Maintaining detailed records to determine whether payments represent a dividend or return of CTC.
- Issuing certificate to the beneficial owner reflecting gross dividend and withholding tax together with reasons for a reduced rate or exemption.
- Completion of DT Return (DTR02).

### 4.5.3 Administrative procedures — Australia

The following applies to the refunding of withholding tax in Australia (Australia, 2012):

- In Australia, a payer of dividends is required to issue a payment summary to its payees. In addition a “PAYG withholding from interest, dividends and royalties paid to non-residents — annual report (NAT 7187)” is required to be submitted.

- Payment summaries must include the following information:

    - The dividend Payer Company, Australian business number and branch number if applicable.
    - The payee’s name, address, Australian business number or tax file number.
    - The period in which the payment was made.
    - The gross payment amount or market value of non-cash benefits.
    - The withholding tax amount.

- No payment summary is required where the company is an agent who receives amounts on behalf of non-residents.

- To the extent that an “investment body” pays dividends to Australian residents who temporarily live overseas, such dividend payments are not subject to withholding tax if such payees advised that they continue to be residents of Australia and have provided their tax file number or Australian business number.

- Persons or entities responsible for collection of the withholding tax are categorised as either small withholders, medium withholders or large withholders. This classification is based on the annual amount of withholding taxes collected and, based on this classification, different reporting requirements apply:

    - Small withholders — withhold less than A$25,000 per annum and are required to report and pay the withholding amounts on a quarterly basis.
    - Medium withholders — withhold between A$25,000 and A$1,000,000 per annum and are required to report and pay the withholding amounts on a monthly basis.
    - Large withholders — withhold more than A$1,000,000 per annum and are required to report and pay electronically.

- The Australian Tax Office issues “certificates of payment” to non-residents in cases where proof of payment is required in order to meet the tax requirements of their residential country if a tax treaty is concluded by Australia with this country. One certificate per payee is issued per annum and covers the financial year of the resident country. These certificates are issued on request by completing an “application for certificate of payment (NAT 6408)”.

### 4.5.4 Administrative procedures — Canada

The following applies to the refunding of withholding tax in Canada (Canada, 2012):

- The payer or agent is required to report income and withholding tax per a “NR4 information return”, which comprise “NR4 slips” and associated “NR4 Summary”. This reporting is done annually and is to be submitted by the end of March subsequent to the calendar year relating to the return information.

- In addition, a payer or agent is required to complete and issue a certificate of an ownership (“Form NR601, Non-Resident Ownership Certificate — Withholding Tax,

and form NR602, Non-Resident Ownership Certificate — No withholding Tax"). Failure to do so is subject to penalties.

- The CRA have issued forms ("Form NR301, Declaration of eligibility for benefits under a tax treaty for a non-resident taxpayer, Form NR302, Declaration of eligibility for benefits under a tax treaty for a partnership with non-resident partners, and Form NR303, Declaration of eligibility for benefits under a tax treaty for a hybrid entity") to assist a payer or agent to gather information, which includes certification that the dividend recipient is:

    - The 'beneficial owner' of the dividend.
    - Resident in a country with whom a tax treaty was entered into by Canada.
    - Eligible for a reduced rate in respect of income received under such tax treaty.

- The form, as completed by the payee, is to be received by the payer prior to applying a reduction in the rate of withholding tax due to a tax treaty applying. These forms need not be completed where a payee does not qualify for a reduced rate of withholding tax resulting from a tax treaty applying or where the CRA have issued a "letter of exemption".

- In circumstances where payments are effected to 'non-resident agents or nominees/ financial intermediaries' and a tax treaty applies, the non-resident agent or nominee is required to complete the certification in "Information Circular IC76-12, Applicable rate of Part XIII tax on amounts paid or credited to persons in countries with which Canada has a tax convention". A reduced rate under a tax treaty may only be relied on to the extent that the agent or dividend payer was provided with certification of beneficial ownership, resident country and eligibility for reduced rate under such tax treaty prior to payments being made.

- The CRA may under certain circumstances issue a "letter of exemption" or confirmation that an exemption from withholding tax or a reduced withholdings tax rate apply due to a tax treaty being in place on the basis that a declaration from a non-

resident payee may not be relevant or sufficient. These include payments to foreign governments, pensions and payments under the Canada – USA Tax Convention.

- The payer is required to issue an NR4 slip to each recipient non-resident subject to withholding tax, including to those non-residents for which no withholding tax was deducted. These NR4 slips are to be submitted to the CRA. The NR4 slips are to contain the following information:

  - Calendar year.
  - Code of recipient.
  - Code of country.
  - Identification code of payer.
  - Tax identification number (Foreign or Canadian).
  - Code of income.
  - Code of currency.
  - Amount of gross income paid.
  - Amount of 'non-resident tax' withheld.
  - Code of exemption.
  - Name and address of non-resident.
  - Agent/payer's name and address.
  - Account number of non-resident.

## 4.6 CONCLUSION

The conclusions reached in this chapter are summarised below:

### 4.6.1 Personal liability

In respect of the personal liability of directors under the DT legislation there is no requirement for directors to be responsible for non-payment of DT or for an intention to

evade the DT. It is submitted that this constitutes an unfair practice by SARS, one that may be challenged as unconstitutional. Although the DT legislation is new, the personal liability provision for unpaid employee tax has been in force for a number of years. It is, however, unclear to what extent SARS have in the past issued assessments to directors for unpaid employee tax.

The reason for the personal liability of directors and shareholders provided for under section 64K(8) of the ITA only applying in the case of non-listed companies is unclear. A possible reason for this may be that dividends are normally paid via a regulated intermediary. Where the dividend is payable by a regulated intermediary which fails to pay over the DT to SARS, the ITA places the obligation to pay the DT on the regulated intermediary, therefore SARS will only have recourse against the regulated intermediary for the non-payment of DT. SARS may also have recourse against the beneficial owner.

It may be questioned why it is necessary to have a personal liability provision in the DT legislation if the TAA also contains personal liability provisions. It is submitted that section 180 of the TAA will not apply in the context of DT on the basis that DT does not form part of a company's tax debt (in its capacity as taxpayer), on the basis that it is a tax levied at shareholder level. On this basis it appears that there is a basis for the personal liability provision in the DT legislation.

It is therefore recommended that this provision of the DT legislation be revised in order to align it with the TAA, CA and CTA.

### 4.6.2 Refund procedures

Unlike in the case of Australia and Canada, there are currently no formal application forms issued by SARS in respect of claiming refunds of DT, neither is there prescribed information that such a request for refunds should contain. It is therefore recommended that SARS either issue a prescribed application form, or prescribe the minimum information (similar to the situation in Australia and Canada) to be included in a refund application. It is recommended that SARS issue guidance as to the required supporting

documentation that should be in place to support refunds made by a dividend payer company or regulated intermediary and whether these should be submitted to SARS.

In the case of refund applications being directed to dividend payer companies, where such refunds cannot be funded from future dividend withholding tax within the one year period, it is the company and not the beneficial owner of the dividend who is responsible for submitting the refund application to SARS. It is uncertain whether such a refund request to SARS should be done in aggregate or per beneficial owner. It is further uncertain whether the company would be obliged to refund the beneficial owner prior to the company being refunded by SARS. It is therefore recommended that SARS issue guidance on these matters. It is submitted that this refund requirement increases the administrative burden placed on companies. SARS may therefore consider the possibility that the request for a refund of DT be submitted to it by the beneficial owner and not the company. Should the application for refund include a certification by the company, similar to the situation in Canada, it would eliminate concerns regarding the validity of such a request.

It is further recommended that the following discrepancies be addressed by legislation:

- In the case of a refund application being made to regulated intermediaries, refunds may only be funded from future dividend withholding-tax payments. In cases where no such future withholding taxes are withheld, the regulated intermediary will not be able to claim a refund from SARS. It is further unclear whether in such an instance the regulated intermediary would be obliged to issue a refund to the beneficial owner.
- In the case where DT was incorrectly withheld on payment to a regulated intermediary, or to a company included in the ‘same group of companies’ (as defined), there are no formal provisions made in the DT legislation pertaining to the refund of this DT incorrectly withheld.
- In the case of *in specie* dividends, there are no provision made for refunds to the payer company resulting from DT withheld due to the prescribed declarations not being received in time.

### 4.6.3 Deemed dividend

Without guidance it will be difficult to assess whether an amount, other than a cash dividend payment, will constitute a dividend by reason of the dividend definition in order to ensure that the DT provisions are complied with and the resulting DT liability settled. It is submitted that SARS may also have difficulty in assessing these dividends. It is therefore recommended that SARS issue guidance on this matter or expand the deemed dividend provisions in order to provide clarity to taxpayers as to when an amount will constitute a dividend.

### 4.6.4 Administrative burden

It is important for dividend-paying companies and regulated intermediaries to gain a detailed understanding of the DT legislation and its requirements in order to ensure compliance with these requirements. They should also ensure that they have adequate systems and procedures in place to ensure compliance with the DT legislation.

Similar to the case of Australia and Canada, it may be useful for South Africa to implement the following:

- SARS may issue guidance on the prescribed minimum information to be included in “payment summaries” to be issued to beneficial owners.
- SARS may issue “certificates of payment” of dividend withholding tax to foreign residents where such proof of payment may be a requirement in their resident country.
- SARS may issue “confirmation letters” to dividend-paying companies and regulated intermediaries, confirming exemption or reduction in DT withholding rates due to a DTA applying.
- SARS may consider implementing annual reconciliations for DT together with related supporting documentation required to be held by companies and whether these should be submitted with these reconciliations. This will, however, increase the administrative burden. In light of this, an alternative would be to include a reduced reconciliation as part of the IT14SD forms.

- Currently a DT return is to be submitted in respect of every dividend payment despite the DT withheld being of a small monetary value. In order to lighten the administrative burden in these instances, SARS may consider similar classification as is the case of Australia as small, medium or large withholders with different administrative requirements applying to each of these categories.

Where dividends are paid to a foreign intermediary, the onus would be on the resident regulated intermediary/company to comply with the administrative requirements under DT. It may be useful for SARS to issue guidance as to whether resident regulated intermediaries/companies may rely on a consolidated declaration being submitted by the foreign intermediary, or whether declarations and undertakings are to be obtained from every individual beneficial owner receiving dividend payments via this foreign intermediary.

Dividend payments may be made to South African residents who temporary live in a foreign country via a foreign intermediary. It may be useful for SARS to issue guidance as to the DT requirements under these circumstances. This may include how this can be verified to curb incorrect reduction of DT due to the application of a DTA, or whether these persons should be deemed to be foreign residents, if they are not residing in the country during a specified time period, within a year of assessment.

In the next chapter a brief overview will be provided of the purposes statement, problem statement and research objectives, and how these were addressed in this study. The conclusions reached in this study will also be summarised.

# CHAPTER 5

# CONCLUSION

## 5.1 INTRODUCTION

In this chapter the conclusions made from the critical analysis of South Africa's DT legislation will be summarised. It will also address the purpose statement, problem statement and research objectives in chapter 1.

## 5.2 ADDRESSING THE RESEARCH OBJECTIVES

In light of the fact that DT legislation is a new and unfamiliar concept to South African taxpayers, the purpose of the study was defined as the critical analysis of the new DT legislation in order to identify possible problem areas and to make recommendations, where appropriate, to address perceived problems in this legislation.

The research objectives of the study were to obtain a good overall understanding of the DT legislation in order to identify potential problem areas, to investigate these problem areas and how they were addressed in other jurisdictions, and to make recommendations, where appropriate, to address these problem areas.

The research objectives were limited to a review of DT within the South African context only and only covered other jurisdictions to the extent that they provided solutions to problem areas identified. It did not include a review of CTC and related provisions and did not focus on a specific industry. It did not include a review of the taxation of dividends for income tax purposes.

The next section discusses how the research objectives of this study were achieved together with the conclusions reached. This is followed by a list of recommendations made to address identified problem areas and recommendations made for future research.

## 5.3 CONCLUSION

The introduction of DT seeks to improve investment in South Africa by it representing a dividend withholding tax which is in line with international practise.

In chapter 2, the DT legislation (sections 64D to 64N) were critically analysed to obtain a good overall understanding of the DT legislation and a comparison was made between DT and STC. Resulting from this analysis, certain potential problems areas were identified for further investigation. These included the meaning of "beneficial owner", the refund procedures of DT, DT anti-avoidance provisions, STC credits, personal liability of both shareholders and directors and the administrative burden of dividend-paying companies.

In chapter 3 the meaning of "beneficial owner" was considered from both a local and international point of view. International case law was reviewed which could provide guidance in interpreting the meaning of the term beneficial owner. On the basis that the meaning of beneficial ownership has not yet been considered by South African courts, it was found that, although South Africa is not bound by this international case law, it may provide a framework for courts and taxpayers through which beneficial ownership can be assessed.

The recognition of STC credits under DT was also considered, together with alternative approaches to the utilisation thereof, by affording relief to companies as opposed to their shareholders on the basis that STC was a tax borne by companies and not by their shareholders.

In chapter 4 the application of the principle of personal liability of shareholders and directors within the context of other applicable South African law, as well as other jurisdictions, was considered. It was found that discrepancies exist between the personal liability provision under DT, and the provisions under CA, TAA and the practice in other jurisdictions.

Refund procedures were investigated in comparison with withholding tax refund procedures in other jurisdictions.

The specific deemed dividend provisions under the DT legislation were reviewed. The reason for the VET provisions being deleted from the DT legislation was explored. The question posed was whether the extension of the dividend definition, within the context of dividends tax, would be sufficient to cover all forms of “disguised dividends”.

The administrative requirements imposed by the DT legislation were reviewed and it was found that increased administrative burdens are placed on dividend-paying companies. The administrative procedures in respect of dividend withholding tax in other jurisdictions were reviewed. It was found that it is necessary for dividend-paying companies and regulated intermediaries to ensure that they have adequate systems and procedures in place to ensure compliance with the DT legislation.

The conclusions reached in this study illustrate that deficiencies exist in the current DT legislation which need to be addressed.

Although DT is more aligned to international practice, being a dividend withholding tax which is a more familiar concept to foreign investors, as opposed to STC, it is evidently more costly from an administrative compliance perspective. The changeover from STC to DT is likely to result in a loss to the fiscus. This is due to the extension of exemptions and a reduced withholding tax rate applicable in terms of DTAs concluded by South Africa. The question thus posed is whether the benefits resulting from the introduction of DT will outweigh its disadvantages and costs, and whether indeed it will result in an increase in direct foreign investment into South Africa.

## 5.4 RECOMMENDATIONS

The following recommendations are made resulting from this study:

- That the term beneficial ownership in the context of DT be aligned with its international tax meaning. This would avoid discrepancies when assessing beneficial ownership in the context of DTAs.

- That the current DT provisions governing the utilisation of STC credits be reviewed in order to reduce the administrative requirements imposed by the DT legislation and the tracking of these by SARS.

- That the DT provision dealing with personal liability of shareholders and directors be aligned with the TAA, CA and CTA.

- That certain discrepancies noted related to refunds of DT be addressed. Recommendations were also made for the improvement of refund procedures related to South African DT. These include guidance to be issued in respect of minimum information to be included in a refund application and related required supporting documentation.

- That guidance be issued as to which payments will be regarded as dividends by virtue of the extended dividend definition, in terms of which a framework or criteria is provided through which potential transactions could be assessed, other than those specifically provided for in the DT legislation.

- Certain recommendations were made to improve the administration of the DT. These include guidance to be issued in respect of “payment summaries” issued to beneficial owners, the issuing of “confirmation letters” related to exemption from or reduction in DT, the issuing of “certificate of payments” and annual reconciliation of DT.

## 5.5 FUTURE RESEARCH

It is recommended that the following aspects be further explored through future research:

- Whether the extension of the dividend definition, within the context of dividends tax, would be sufficient to cover all forms of “disguised dividends”.

- Whether the benefits resulting from the introduction of DT will outweigh its disadvantages and costs, and whether indeed it will result in an increase in direct foreign investment into South Africa.

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