

# Tax Alert

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## New tax treatment of company distributions

The Taxation Laws Amendment Bill currently before Parliament introduces fundamental changes to the definition of a dividend. These changes were originally intended as part of the change to a dividends tax regime to replace STC, but their implementation has now been brought forward to 1 January 2011, ostensibly because of the expected implementation of the new Companies Act early in the new year.

### What is new?

The definition of what constitutes a dividend is to be replaced by a new definition, which includes the following:

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

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

but does not include any amount so transferred or applied by the company to the extent that the amount so transferred or applied—

results in a reduction of contributed tax capital...”

Contributed tax capital (“CTC”) is an entirely new concept in South African tax law. The following definition will also come into effect on 1 January 2011:

“contributed tax capital”, in relation to a class of shares issued by a company, means—

- (a) in the case of a company that is not a resident and that becomes a resident on or after 1 January 2011, an amount equal to the sum of—
  - (i) the market value of all shares in that company immediately before the date on which that company becomes a resident; and
  - (ii) the consideration received by or accrued to that company for the issue of shares on or after that date; or
- (b) in the case of any other company, an amount equal to the sum of—
  - (i) the stated capital or share capital and share premium of that company immediately before 1 January 2011 in relation to shares issued by that company before that date, less so much of the stated capital or share capital and share premium as would have constituted a dividend, as defined before that date, had the stated capital or share capital and share premium been distributed by that company immediately before that date; and
  - (ii) the consideration received by or accrued to that company for the issue of shares on or after that date,

reduced by so much of that amount as the company has transferred on or after that date to shareholders in relation to those shares, and has by the date of the transfer been determined by the directors of the company or by some other person or body of persons with comparable authority to be an amount so transferred: Provided that the amount so transferred to a shareholder of any class of shares is deemed to be an amount that bears to the total of the amount of



contributed tax capital attributable to that class of shares immediately before the distribution the same ratio as the number of shares of that class held by that shareholder bears to the total number of shares of that class.”

## Action needed

All SA resident companies will have to make a determination of contributed tax capital (CTC) at 1 January 2011 as set out in paragraph (b)(i) of the definition.

It is not sufficient, particularly in the case of long established companies, to assume that the stated capital or the issued share capital and share premium as reflected in the accounting or statutory records at 31 December 2010 will represent the company's CTC at 1 January 2011.

The main area where statutory share capital and contributed tax capital may differ is where the company has at any time made a capitalisation issue. If any such issue has been made on or after 1 January 1974, in terms of which amounts were transferred from reserves to share capital or share premium, such amounts would be treated as amounts available for distribution under current rules and be recognised as a dividend if distributed, unless, in the circumstances of that issue, the capitalisation issue constituted a dividend.

It would be prudent to examine the statutory records for all allotments of shares and share capital reductions on or after 1 January 1974 to establish with precision the qualifying share capital and share premium.

This can be a complex and difficult task and companies should seek professional advice where appropriate.

## The ongoing requirements

After 1 January 2011, resident companies will need to maintain a record of increases and reductions in the CTC.

On the face of it this appears a relatively straightforward task: increase the CTC by the consideration received in respect of all future issues

and reduce it by the amounts that are resolved to have been paid out of CTC as set out in the definition.

Two issues arise in this regard:

- Amendments made to the corporate reorganisation provisions in 2008, in anticipation of the switch to a dividends tax, contain rules for the determination of CTC in asset-for-share, amalgamation and unbundling transactions, will come into effect on 1 January 2011. The increase or decrease in CTC arising from these transactions may differ from the amounts reflected as additional share capital and share premium in the statutory records; and
- Distributions will not be recognised as CTC reductions unless, the directors or the shareholders in general meeting have determined it to be a return of CTC. Companies should specify that a distribution is a reduction of CTC in resolutions passed to return share capital or share premium to shareholders.

It is recommended that companies take early steps to identify and record the amount of CTC at 1 January 2011.

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