Legislative developments: Draft amendments to anti-dividend stripping rules released for public comment

12 June 2019

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Scott Berry
Johannesburg
(011) 797 4066
scott.berry@pwc.com

Charl Du Toit
Cape Town
(021) 529 9367
charl.du.toit@pwc.com

Frank Mosupa
Durban
(011) 797 5294
frank.mosupa@pwc.com

In brief

Following an announcement in the Budget in February 2019 and as part of the annual legislative process, National Treasury, on Monday 10 June 2019, released for public comment draft amendments to the anti-avoidance rules that deal with dividend stripping.

As was announced in the Budget, it is proposed that the amendments take effect on 20 February 2019 (i.e. on Budget Day).

In detail

Background

"Dividend stripping" generally involves the sale by a shareholder of its shares in a "target company". Ordinarily, if the shares in the target company are sold, there will be a gain (that will be subject to tax, whether on capital or revenue account). In order to avoid the anticipated tax, the target company (before the sale of the shares) distributes a dividend to the shareholder. If the shareholder is a company, the dividend is exempt from dividends tax. As a result of the payment of the dividend, the value of the shares (and therefore the taxable gain on their subsequent disposal) is reduced.

Section 22B of the Income Tax Act, 1962 (Act No. 58 of 1962) ("theAct"), and paragraph 43A of the Eighth Schedule to the Act, contain anti-dividend stripping rules. These rules were amended both in 2017 and in 2018 (in 2017, the amendments were aimed at strengthening the rules, and in 2018 to address anomalies arising from the amendments made in 2017).

In this year's Budget Review, it was announced that further amendments would be made to the anti-dividend stripping rules in order to curb the use of certain arrangements that can, effectively, result in a dividend strip, but that does not involve a disposable of

pwc

shares in the target company.

The arrangements that are of concern to Government also involve the distribution of a dividend by the target company. However, this distribution is not followed by a disposal of shares by the shareholder in the target company, but instead by the issue of additional shares in the target company to a third party. Effectively, therefore, the transaction results in the shareholder company having a negligible interest in the shares of the target company without having triggered the current anti-dividend stripping rules (on the basis that there has been no disposal of the shares in the target company, which is a requirement for the rules to be triggered).

The proposal as per the draft amendments

In order to deal with the perceived abuse, it is proposed that, where the target company issues shares to a third party and the market value of the existing shares (i.e. the shares held by the shareholder before the issue) in the target company is reduced as a result of that issue, the shareholder will be deemed to have disposed of a percentage of its shares immediately after the new shares were issued, which percentage will be equal to the percentage by which the market value of those shares has been reduced by reason of the new shares issued by the target company.

As is the case with the current rules, the amount that will be re-characterized will be so much of the tax exempt dividends that were received by or accrued to the shareholder company within 18 months of the deemed disposal that exceed 15% of the higher of the market value of the shares in the target company at the beginning of such 18 month period or the market value of the shares held by the shareholder company in the target company.

As was also announced in the Budget, it is proposed that the above amendments be effective from the date of the announcement on Budget day (i.e. 20 February 2019) and that they apply, generally, in respect of transactions entered into on or after that date.

In General

Although the proposed amendments have been issued in draft format for public comment (and are therefore likely to undergo changes before being promulgated), taxpayers should be aware that they will take effect from 20 February 2019.

This Alert is provided by PricewaterhouseCoopers Tax Services (Pty) Ltd for information only, and does not constitute the provision of professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional advisers. Before making any decision or taking any action, you should consult a professional adviser who has been provided with all the pertinent facts relevant to your particular situation. No responsibility for loss occasioned to any person acting or refraining from acting as a result of using the information in the Alert can be accepted by PricewaterhouseCoopers Tax Services (Pty) Ltd, PricewaterhouseCoopers Inc. or any of the directors, partners, employees, sub-contractors or agents of PricewaterhouseCoopers Tax Services (Pty) Ltd, PricewaterhouseCoopers Inc. or any other PwC entity.

© 2019 PricewaterhouseCoopers (“PwC”), a South African firm, PwC is part of the PricewaterhouseCoopers International Limited (“PwCIL”) network that consists of separate and independent legal entities that do not act as agents of PwCIL or any other member firm, nor is PwCIL or the separate firms responsible or liable for the acts or omissions of each other in any way. No portion of this document may be reproduced by any process without the written permission of PwC.