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Broadened anti-dividend stripping tax rules

The Taxation Laws Amendment Bill of 2019, as introduced in Parliament on 30 October 2019, broadens the scope of the anti-dividend stripping rules to apply to dilutive share issue arrangements. This article briefly explains the amendments and considers some practical uncertainties that stem from it.

The National Treasury announced in the 2019 Budget Review that the anti-dividend stripping rules will be amended to apply to certain dilutive arrangements that undermined these rules. The Taxation Laws Amendment Bill of 2019, which was introduced in Parliament on 30 October 2019, contains the revised anti-dividend stripping rules. This article briefly reviews these rules.

The anti-dividend stripping rules before the amendment

Dividends paid by a South African resident company to another South African resident company are exempt from dividends tax and normal tax. If a shareholder sells shares in a company, this disposal is subject to capital gains tax (at an effective rate of 22,4% in the hands of a company). Taxpayers attempted to structure proceeds from the disposals of shares in a manner that it accrued in the form of exempt dividends, rather than taxable proceeds.

In 2017, the legislature strengthened the anti-dividend stripping rules to curb this practice. Essentially, the revised rules apply to a disposal of shares in a company (investee company) by another company (shareholder company), where the shareholder company held a qualifying interest in that investee company during the 18 months prior to the disposal. If the rules apply, any extraordinary dividends received by the shareholder company are treated as proceeds from the disposal of the shares and taxed accordingly.

During the 2018 legislative cycle, amendments were made to ensure that the anti-dividend stripping rules do not obstruct transactions that otherwise qualified for roll-over relief.

Broadened rules

The amendments are aimed at schemes that circumvent the anti-dividend stripping rules. The shareholder company extracts value from the investee company through a substantial dividend. This is followed by a subscription for shares by another person, which dilutes the shareholder company's shares in the investee company. Although the shareholder company may have divested itself from the investee company and received a dividend in the process, the anti-dividend stripping rules do not apply because the shareholder company does not dispose of any shares in the investee company.

With effect from 20 February 2019, a shareholder company is deemed to have disposed of shares in an investee company if:

- the investee company issues shares to another person, and
- as a result of this share issue, the *effective interest* of the shareholder company in the equity shares of the investee company is reduced.

The shareholder company is deemed to have disposed of so many shares as the percentage by which its *effective interest* in the equity shares of the investee company has been reduced.

The concept of effective interest in equity shares is central to the amendment. This term is not defined in the legislation. In the draft document that sets out the National Treasury's response to comments raised, it is stated that:

- A facts and circumstances analysis is required to determine if a shareholder's effective interest in a company is reduced.
- Where only one class of shares is involved, the percentage of issued shares may well represent the effective interest.
- Where more than one class of share is involved, a reduction in effective interest may have to be established with reference to the value of the shareholder's interest.

This arguably leaves taxpayers in an uncertain position if the legislation should be interpreted on the basis of a facts and analysis, presumably in accordance with its spirit and purpose. This may not be clear to all taxpayers, especially those not closely involved with the developments as it progressed or the schemes that resulted in the rules as they are now. Taxpayers would be well advised to formulate fact specific positions and obtain fact specific advice, rather than rely on generic views in this regard.