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Tax Developments on one page

The fine line between dividends and income

Dividends are payments received by a person in respect of shareholding in a company. In the recent case of C:SARS v Reunert Ltd the SCA was required to consider an arrangement that involved commission to top up dividends received by a shareholder. The case shows that taxpayers have to be careful when negotiating commercial deals involving dividend payments as consideration.

Dividends are generally not subject to normal tax in the hands of the recipient. The profits from which such dividends have been paid would already have been taxed in the company where it arose. Depending on the recipient, the dividend may be subject to an additional layer of tax in the form of dividends tax. In *C:SARS v Reunert Ltd* ((971/2016) [2017] ZASCA 153) the court had to consider an arrangement that involved commission closely linked to dividends received.

Facts of the case

Reunert Ltd held 40% of the shares of Nokia Siemens Networks South Africa (Pty) Ltd (NSN SA). At some stage, the Nokia Siemens Networks (NSN) group conducted all African business through this entity, resulting is in good flow of dividends to Reunert Ltd. The group then changed its business model. This involved ceasing to conduct all African business through NSN SA. As a result, Reunert Ltd considered disposing of its interest in NSN SA due the diminished dividend prospects. Due to the strategic importance of Reunert Ltd's close business relations with South African customers, the parties entered into a sales promotion agreement (SPA) in terms of which Reunert Ltd would earn commission that would essentially put it back in the same position that it would have been in as far as dividends are concerned had the African business still been conducted through NSN SA.

The commission arrangement entailed a commission payable to Reunert Ltd every six months based on the NSN's group's turnover in Southern Africa. This commission was however subject to a reduction for the pre-tax dividends that Reunert Ltd received from NSN SA until the date of payment of the commission (which was one month after the end of the six-month period that the commission was calculated for).

Timing of the accrual

The first matter disputed was the timing of the accrual of the commission. SARS argued that the commission was determinable and accrued to the taxpayer at the end of each month. The taxpayer was of the view that the commission is only determinable once the dividends received until the date of payment of the commission was established. This event only occurred on the date when the commission had to be paid. Based on the provisions of the SPA and the commercial rationale for entering into the agreement, as explained by Reunert Ltd's retired CEO, the court agreed with the taxpayer's view that the tapxayer only became unconditionally entitled to the commission (if any) once the dividends amount was known. It is submitted that the court confirmed the established principle relating to timing of accrual.

Nature of the payments received

The second interesting angle of argument that SARS took was that the commission amount should be taxed as income as the dividends paid to Reunert Ltd by NSN SA were in fact not truly dividends. Based on disclosure in the financial statements of Reunert Ltd, SARS argued that the dividends became a method of settling commission owing to Reunert Ltd. The court rejected this argument based on a number of factors including SARS' acknowledgement of the dividends as dividends for STC/dividends tax purposes.

This line of reasoning by SARS should however be a warning to taxpayers to be careful when it comes to arrangements that use dividends to compensate for functions performed by a party or use other payments to top up dividends to a particular shareholder. These arrangements may run the risk of blurring the line between what should be taxed as a dividend or as income. *(January 2018)*

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