Dividend-stripping and share buy-back transactions

The National Treasury introduced anti-avoidance rules that target dividend-stripping and share buy-back transactions with effect from 19 July 2017. These rules result in certain dividends being taxed as proceeds upon the disposal of shares. Share buy-backs from and extraction of value by significant corporate shareholders will require careful attention going forward.

Dividends paid by one South African company to another have been exempt from both normal tax and dividends tax since April 2012 when dividends tax came into effect. This has created opportunities for taxpayers to structure transactions where shares are disposed of in a manner that the value is unlocked in the form of exempt dividends rather than proceeds on the sale of the shares, which would have attracted capital gains tax. As share buy-back transactions constitute dividends for tax purposes these transactions posed a particular risk to the *fiscus*.

With effect from 19 July 2017, the National Treasury introduced anti-avoidance rules aimed at curbing the above structuring opportunities. This article briefly reviews the anti-avoidance rules (hereafter only referred as the rules).

Scope of the rules

The rules are triggered by the disposal of shares held by a company in another company. More specifically, the rules will apply where the shareholder company held a qualifying interest in the company whose shares are being disposed at any time within the 18 month period before the disposal. A qualifying share is defined as:

- in an unlisted context, at least 20% of the equity shares or voting rights of a company, unless another person holds a majority of such shares or voting rights in which case only that person will hold a qualifying share, or
- in a listed context, at least 10% of the equity shares or voting rights in a company.

These thresholds are viewed as providing the shareholder with sufficient influence over the company to be able to divert proceeds upon disinvestment to itself via the company.

The rules target extraordinary exempt dividends. In the case of preference shares where dividends are determined with reference to a rate of interest, any dividends received that exceed an amount determined at 15% will be extraordinary. No reference is made to when the dividend is received.

In the context of any other share, an extraordinary dividend refers to the exempt dividends received as a result of the disposal or during the 18 month period before the disposal, but only to the extent that it exceeds the higher of 15% of the market value of the share disposed of at the beginning of the 18 month period or at disposal.

Effect of the rules

If the rules apply, the extraordinary dividends received in respect of the shares are treated as follows:

- if the shares were held as trading stock, then the extraordinary dividends must be included in the taxpayer's income
- if the shares were held as a capital asset, then the extraordinary dividends form part of the proceeds on the disposal of the shares for capital gains tax purposes.

It is important to note that these rules apply, even if the transaction in question qualifies for roll-over relief.

Practical implications of this development

Any transaction that involves a share buy-back from a significant corporate shareholder or extraction of value by such a shareholder from the company will require careful consideration going forward. The treatment of such a transaction may attract dividends tax or capital gains tax depending on the particular circumstances. *(January 2018)*

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