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University of Witwatersrand

A research report submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce

AN ANALYSIS OF THE DIVIDEND WITHHOLDING TAX IN SOUTH AFRICA AND A BRIEF DISCUSSION ON HOW IT COMPARES TO OTHER DEVELOPING COUNTRIES

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TABLE OF CONTENTS

DECLARATION 1

ABSTRACT 2

ACKNOWLEDGEMENTS 3

CHAPTER 1: INTRODUCTION 4

1.1. INTRODUCTION TO DIVIDENDS TAX 4

1.2. RESEARCH PROBLEM 5

1.3. RESEARCH OBJECTIVES 6

1.4. SCOPE AND LIMITATIONS 7

CHAPTER 2: AN ANALYSIS OF THE PROVISIONS IN THE SOUTH AFRICAN INCOME TAX ACT RELEVANT TO DIVIDENDS TAX 8

2.1. INTRODUCTION TO THE ANALYSIS OF THE DIVIDENDS TAX LEGISLATION 8

2.2. THE DIVIDENDS TAX LEGISLATION 8

2.3. CONCLUSION 26

CHAPTER 3: ADMINISTRATION AND PRACTICAL IMPLICATIONS OF THE IMPLEMENTATION OF THE DIVIDENDS TAX LEGISLATION 29

3.1. INTRODUCTION TO ADMINISTRATION AND PRACTICAL IMPLICATIONS OF THE DIVIDENDS TAX LEGISLATION 29

3.2. THE APPLICATION AND PRACTICAL IMPLICATIONS FOR COMPANIES AND REGULATED INTERMEDIARIES 29

3.3. APPLICATION AND PRACTICAL IMPLICATIONS OF DIVIDENDS TAX SPECIFICALLY FOR COMPANIES DECLARING AND PAYING DIVIDENDS 33

3.4. ADMINISTRATION AND PRACTICAL IMPLICATIONS FOR BENEFICIAL OWNERS RECEIVING DIVIDENDS 36

3.5. CONCLUSION 36

CHAPTER 4: A BRIEF DISCUSSION ON HOW SOUTH AFRICAN DIVIDENDS TAX LEGISLATION COMPARES TO OTHER DEVELOPING COUNTRIES 38

4.1. INTRODUCTION TO THE COMPARISON WITH OTHER DEVELOPING COUNTRIES 38

4.2. TAXATION OF DIVIDENDS IN RUSSIA 39

4.3 TAXATION OF DIVIDENDS IN INDIA 44

4.4 TAXATION OF DIVIDENDS IN CHINA 47

4.5 OVERALL CONCLUSION 51

CHAPTER 5: CONCLUSION 53

LIST OF REFERENCES 56

DECLARATION

I certify that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Laws in Taxation at the University of the Witwatersrand, Johannesburg. All sources, that I have used or referred to, have been indicated and acknowledged as such by means of complete references. It has not been submitted before for any other degree or examination in any other university.

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Neo Violet Thoothe

08 October 2014

ABSTRACT

The taxation of dividends at shareholder level has been the norm in the majority of the international market. South Africa is a developing country that is constantly increasing its market share in the international stage and in order to be more competitive in the international market South Africa has to align itself with international norms and practices and this resulted, amongst other things, with the introduction of dividends tax in 2012. This study analysed the new dividends tax legislation that became effective on 1 April 2012 in South Africa, by way of a normative literature review, and briefly discusses how South Africa compares with Russia, India and China, three other developing countries. The literature review confirmed the benefits with regards to the dividends tax system; however, the review also confirmed that there are challenges within the dividends tax system. The benefits of the dividends tax system that were noted include amongst others; aligning South Africa with international tax norms, the increased tax base and the establishment of a familiar withholding tax system that can attract more foreign investment. The levying of dividends tax on beneficial owners results in an increased tax base because the number of taxpayers increases to companies and individuals, versus levying secondary tax on companies only on the companies paying the dividend. Some of the challenges of the dividends tax system are the administrative burden placed on companies and regulated intermediaries, the rate of 15% might be considered to be too high in comparison to other developing countries and the taxation of dividends in the hands of the individuals might be a disincentive to invest in equity shares. South African legislation on dividends tax differs from that of China; with the latter country taxing the dividends in the hands of the beneficial owners without a requirement on company's paying the dividend to withhold the dividends tax. The Russian legislation on taxation of dividends is similar to that of South Africa but taxes the dividend on the net amount. In India the dividend distribution tax is levied in the company making a dividend distribution.

Key words: Beneficial owner, Dividend Distribution Tax, Dividend, Dividend *in specie*, Dividends Tax, Withholding tax.

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CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION TO DIVIDENDS TAX

Dividends are an important source of cash flow for long-term investors. Prior to the introduction of dividends tax in South Africa, investors received dividends after taking Secondary Tax on Companies (STC), into account. The shift from taxing companies in terms of STC to taxing individuals in terms of dividends tax had an impact on the final amount of dividends received by individual investors (van Dyk, 2012).

The implementation of dividends tax was first announced when the Minister of Finance tabled the 2007 Budget in Parliament in terms of South African Revenue Service (SARS), (2007). The Minister of Finance (SARS, 2007) announced that dividends tax will replace STC and mentioned that this implementation will take place in phases (Marais & Vennote/Partners, 2008). The first phase of the implementation of dividends tax gave rise to the reduction of STC from 12.5% to 10%, effective from 1 October 2007, a change to the dividend definition as contained in section 1 of the Income Tax Act 58 of 1962 (the Act) and a simplification of the provisions of section 64D of the Act. The final phase, the implementation of the dividends withholding tax came into effect on 1 April 2012 in terms section 64D to section 64N of the Act.

In terms of the SARS (2007), the objectives of the introduction of the dividends tax was to align South Africa with the international norm of levying a withholding tax on dividends and the broadening of the tax base (Marais & Vennote/Partners, 2008). One of the ways that a country can expand their tax base is by attracting foreign investors to invest in the country by reducing corporate taxes, this will in turn give rise to a growth in the economy (Asafo-Adjei, 2007) and therefore more taxes will be collected. For example, the increase in foreign investment will result in increased employment in the country, which in turn will result in more people paying the employees tax. The international norm for dividends tax entails shifting the liability for the tax relating to the dividend from the company to the recipient of the dividend. (SARS, 2008)

The shareholder is referred to as the beneficial owner in terms of section 64D of the Act. The beneficial owner is liable for dividends tax at a rate of 15% on dividends that are paid or payable to them, in terms of sections 64E and 64EA of the Act. The beneficial owner receiving a dividend can either be a resident or a non-resident. In terms of the definition of gross income contained in section 1 of the Act, the amount of dividend is included in gross income. In relation

to a South African beneficial owner, the amount of dividend income derived both from South African and worldwide sources forms part of paragraph (k) of the gross income definition in terms of section 1 of the Act. With regards to non-South African beneficial owner, the amount of dividend income included in paragraph (k) of the gross income definition is the amount of dividend income derived from a source within South Africa in terms of section 1 of the Act.

The dividends tax relating to cash dividends should be withheld either by the company that declares and pays the dividend or the regulated intermediary and the dividends tax should be paid over to the SARS in terms of sections 64G and 64H of the Act. The term 'regulated intermediary' encompasses, essentially, securities depository participants, authorised users and approved nominee that holds investments on behalf of clients as contemplated or defined in the Securities Services Act No 36 of 2004 (de Koker, 2012). In terms of dividends declared that consists of a distribution of an asset *in specie,* in other words, trading stock or any asset, other than cash, distributed by the company to the beneficial owner as a result of the beneficial owner's shareholding, the company making the dividend *in specie* distribution should pay the tax and not the recipient of the dividend in terms of section 64EA of the Act.

1.2. RESEARCH PROBLEM

1.2.1 Problem statement

The introduction of the dividend tax legislation might bring about implementation and interpretation problems. Possible misinterpretation of the legislation might result in non-compliance with the dividend tax legislation. It is therefore important that taxpayers understand and apply the dividend tax correctly. The taxpayers would appreciate that the dividends tax legislation will bring about benefits and challenges upon interpretation and implementation thereof.

With the introduction of dividends tax, the South African government and SARS aimed to align South Africa with the international norm by shifting the tax burden from companies to shareholders (SARS, 2007). The dividends tax legislation brought about an administration burden on the companies and the shareholders (PKF, 2013). For this reason taxpayers need to understand the administrative requirements of the dividend tax legislation.

As a developing country; South Africa needs to evaluate whether it is in line with other developing countries and if there are any benefits for South Africa to take note of.

1.2.2 Purpose statement and methodology

The purpose of the study was to analyse and discuss the new South African legislation pertaining to the taxation of dividends. The transition from STC to dividends tax was discussed, due to the impact that the STC credits has on the dividends tax legislation.

The writer discussed how the South African legislation on dividends compares to other developing countries' legislation. The discussion determined whether South Africa managed to align itself with other developing countries and benefits that can be noted by South Africa from other developing countries

A qualitative approach, with extensive literature review was followed. The South African income tax Act, relevant case law, government documents, opinions of appropriate academics and professionals, media reports and reputable websites were reviewed. The research was focused on dividends tax applicable to South Africa, Russia, India and China.

The study was both analytical and comparative. The South African dividends tax legislation and administrative requirements of the legislation was analysed. The South African dividends tax legislation was also briefly compared with that of Russia, India and China.

1.3. RESEARCH OBJECTIVES

The study aimed to achieve the following specific objectives:

- To identify the benefits and the challenges in the dividends tax legislation.
- Identify potential problems with the application and the practical implementation of the dividends tax legislation.
- To evaluate whether the South African dividends tax legislation is aligned with that of other developing countries.
- To determine how other developing countries have adopted the dividends tax legislation and any benefits to the South African dividends tax legislation.

1.4. SCOPE AND LIMITATIONS

The research and interpretations were based on the enacted South African legislation on dividends tax up to 31 December 2013. The South African legislation relating to the taxation of dividends was analysed, while the information on the foreign legislation relating to the taxation of dividends was used to briefly compare to the South African dividends tax legislation. A detailed analysis of the foreign legislation and a detailed comparison between the South African and foreign legislation of Russia, India and China is beyond the scope of the research.

The legislation relating to the taxation of dividend distributions of other countries was considered in the study and this was based mainly on secondary sources and a limited analysis of the relevant foreign legislation.

The writer focused the discussion on trusts that hold share investments in listed and non-listed companies and a discussion of the tax implications of the Real Estate Investment Trusts (REIT) is beyond the focus of this research.

The Johannesburg Securities Exchange (JSE) Limited requirements referred to, in the definition of contributed tax capital (CTC) in section 1 of the Act, was not discussed in this research as it is not relevant for the purpose of the research.

CHAPTER 2: AN ANALYSIS OF THE PROVISIONS IN THE SOUTH AFRICAN INCOME TAX ACT RELEVANT TO DIVIDENDS TAX

2.1. INTRODUCTION TO THE ANALYSIS OF THE DIVIDENDS TAX LEGISLATION

The purpose of the research is to analyse the South African dividends tax legislation. The analysis is intended to identify benefits and challenges of the dividends tax legislation. The discussion also entails a brief discussion of STC legislation and the transition to dividends tax legislation. A discussion of the impact of the introduction of the dividends tax at a rate of 15%, higher than the anticipated rate, by businesses, of 10% (Fisher-French, 2012) is carried out.

2.2. THE DIVIDENDS TAX LEGISLATION

The dividends tax provisions are contained in Part VIII of the Act, in the provision of sections 64D to 64N. These sections make reference to the dividend definition as contained in section 1 of the Act.

Before a taxpayer can be liable for dividends tax the taxpayer needs to receive a dividend or a dividend needs to accrue to the taxpayer. It is therefore important to discuss what constitutes a dividend in terms of the Act. A dividend is defined in section 1, of the Act, as follows:

> 'Any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied —
>
> (a) by way of a distribution made by; or
> (b) as consideration for the acquisition of any share in, that company, but does not include any amount so transferred or applied to the extent that the amount so transferred or applied to the extent that the amount so transferred or applied—
> (i) results in a reduction of contributed tax capital of the company
> (ii) constitutes shares in the company; or
> (iii) constitutes an acquisition by the company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE limited Listings Requirements, where the acquisition complies with any applicable requirements prescribed

by paragraphs 5.68 and 5.72 to 5.84 of section 5 of the JSE Limited Listings Requirements;'

It is clear that there are certain concepts of the dividend definition in terms of section 1 of the Act that need to be discussed in order to understand the definition. The opening words of the dividend definition refer to '… any amount transferred or applied…' and this is not defined in the Act. Therefore case law, relating to gross income, was referred to, for guidance on the meaning of these terms. It was held in *CIR v Delfos* 1933 AD 242, 6 SATC 92 (*Delfos case*) that an 'amount' does not only refer to cash but to all receipts and accruals having money value will be taxed. The word 'distributed' was interpreted in the *CIR v Legal Assurance Society* 1963 (3) SA 876 (A), 25 SATC 303 (*Legal Assurance Society Ltd*), to mean to apportion, appropriate, allocate or apply towards.

A resident company is defined in section 1 of the Act, as a company that is incorporated, established or formed in South Africa or which has a place of effective management in South Africa. The dividend definition also states that the amount should be applied '…for the benefit of or on behalf any person in respect of any share in that company'. The amount does not necessarily have to be physically received by the taxpayer, even if the distribution is made to third parties on the instruction of the taxpayer, it is considered to be an amount received by the taxpayer because the distribution is made on behalf of the taxpayer. It is also imperative that the taxpayer should hold shares in a company and that the distribution must be made by virtue of shareholding in a company for an amount to be a dividend. (de Koker, 2013)

The distribution that results in a reduction in contributed tax capital, or a distribution by way of issuing share in the company and a share buy-back does not result in a dividend as defined. It is therefore important to understand what CTC, as the reduction thereof would not give rise to dividends tax. (de Koker, 2013)

In terms of section 1 of the Act, consideration received by or accrued to the company for the issue of its shares, that is, the amounts paid by the shareholders for the issue of shares to them results in CTC of the company. The company determines its amount of CTC by adding the opening balance of share and share premium immediately before 1 January 2011, to the amounts received for the shares on or after the date that the company becomes a resident. The determined amount is then reduced by the amounts transferred to the shareholder on or after 1 January 2011 and the directors need to have determined that the amount reduces CTC before the transfer. Section 1 of the Act stipulates that a company that becomes a resident on or after

1 January 2011, the opening balance is the market value of the shares on the date immediately before the company becomes a resident. (Hofmeyr, 2011)

The CTC needs to be calculated for each class of shares separately, in terms of section 1 of the Act. The requirement adds more administrative responsibilities to the company distributing the dividends (Makola, 2008). The writer will elaborate on the administrative requirements relating to the distribution of dividends in chapter 3 of this research.

The definition of CTC requires that the directors or other persons with comparable authority determine that the transfer constitutes a transfer of CTC. Should the company, declaring the dividends, decide to make a distribution out of CTC, a written resolution has to be made before the distribution can be made from CTC. This election will result in a distribution that does not constitute a dividend. (Hofmeyr, 2011)

The Johannesburg Securities Exchange (JSE) Limited requirements referred to, in the definition of CTC in section 1 of the Act, will not be discussed in this research as it is not relevant for the purpose of the research.

2.2.1 Section 64D – Definitions

Section 64D of the Act contains definitions relation to the taxation of dividends. The writer discussed these definitions in detail because they provide a basis for the understanding of the dividends tax legislation.

The terms beneficial owner, dividend, dividend cycle, effective date, regulated intermediary and STC credit are defined in section 64D of the Act.

In terms of section 64D of the Act, beneficial owner means the person entitled to the benefit of the dividend attaching to a share. A beneficial owner is a person, natural person or juristic person, who holds a share in a company for their own benefit. Companies are also included in the definition of a person, in terms of section 1 of the Act, but are specifically exempt from dividends tax in terms of section 64F of the Act.

To date this issue of beneficial owner has not been decided upon in a South African court. In the *Prévost Car Inc v The Queen* 2009 FCA 57, (2010) 2 FCR 65 court case (*Prévost case*), a decision by a Tax Court of Canada in April 2008 was therefore considered for this discussion.

The *Prévost case* is used in this research because the court decision provides more clarity on the concept of beneficial owner and supports the intention of the Act. The aforementioned court case is relevant in the South African context because the term beneficial owner is a new concept. Even though section 1 of the Act provides the definition of the term beneficial owner, there is a possibility that taxpayers might misinterpret the definition.

In the *Prévost case* the taxpayer, a company, had paid a dividend to its holding company, which was its sole shareholder and the latter in turn declared a dividend to its two shareholders, in accordance with a shareholder agreement. The court held that there was no evidence that the holding company was a mere conduit for its shareholders. Judge Justice Rip, in the *Prévost case*, stated that the holding company had no obligation to pay any dividend to its shareholders and it could use the dividends received as it wished. The holding company was therefore the beneficial owner of the dividend (*Prévost case*).

Based on the decision made in the *Prévost case*, a person holding a share in a company on behalf of the other person is not necessarily a beneficial owner.

Section 64D of the Act defines a dividend as any dividend or foreign dividend as defined in section 1 of the Act that is paid by a company that is either a resident or non-resident. Section 64D of the Act further stipulates that foreign dividends distributed to non-residents are only classified as dividends if they relate to shares listed in South Africa and the dividends are paid out in cash.

The dividend definition in term of section 64D of the Act makes reference to the dividend definition in terms of section 1 of the Act, the latter was discussed in the previous sections. The writer focuses on the specifications in terms of section 64D of the Act. In order for a distribution to qualify as a dividend in terms of section 64D of the Act, it had to be distributed by a resident company. Section 1 of the Act defines a resident company as a company incorporated in South Africa or has its place of effective management in South Africa. A company incorporated in South Africa is a company registered with Companies and Intellectual Properties Commission (CIPC), in terms of section 14 of Companies Act No 71 of 2008 (Companies Act). According to Interpretation Note 6 of the Act a place of effective management is where the day-to-day operational management and commercial decisions taken by the senior managers are actually implemented, in other words, the place where the business operations or activities are actually carried out or conducted.

Section 64D of the Act makes reference to section 64B of the Act with regards to the definition of the term dividend cycle. In terms of section 64B(1) of the Act, a dividend cycle means the period commencing on the day following the date of accrual to a company's shareholders of the last dividend declared by that company and ending on the date on which the dividend is question accrues to the shareholder concerned. In other words, a dividend declaration triggers the beginning of a dividend cycle and the dividend accrual denotes the end of the dividend cycle (de Koker, 2012). Section 64B(1) of the Act, deems the dividend cycles that had not ended on 1 April 2012, to have ended on 31 March 2012 and to be the final dividend cycle of the company. The dividends tax legislation levies dividends tax on dividends paid or payable after reduction of STC credit, if any, therefore the concept of dividend cycle will no longer be relevant when determining the timing of the liability to pay or withhold dividends tax (SARS, 2008).

The effective date of the dividends tax legislation is on the 1 April 2012, which is the date on which the dividends tax legislation came into operation, in terms of section 64D of the Act.

The company or regulated intermediaries are responsible for withholding the dividends tax paid or payable to beneficial owners and pay it over to SARS. Regulated intermediaries include inter alia, long-term insurers and collective investment schemes. These bodies hold investments on behalf of beneficial owners and generally act as a conduit to its shareholder. (Strydom, 2012)

The last definition in term of section 64D of the Act is the STC credit definition. STC credit means an amount determined in terms of section 64J (2) of the Act. In simple terms, the excess of dividends accrued to a company over dividends declared by a company during a dividend cycle in terms of the STC legislation (de Koker 2012). The writer provides the details of STC credit later in this chapter when discussing the provisions of section 64J of the Act.

2.2.2 Section 64E - Levy of dividends tax

Section 64E of the Act, covers the levy of dividends tax. The section deals inter alia with the dividends tax rate, the timing of the dividend payment, anti-avoidance provisions of deeming certain amounts to be dividends and the valuation of dividends other than in cash and those paid in foreign currency.

In terms of section 64E(1) of the Act, the rate at which dividends tax is levied is 15% of the amount of dividend paid by a company other than a headquarter company. Prior to the

introduction of the dividends tax legislation, STC was charged at 10%, therefore businesses anticipated that the dividends tax rate would also be 10% (Planting, 2012). One of the reasons for the increased rate was to mitigate the estimated loss of the change over from STC to dividends tax (Louw, 2012).

Section 64E(1) of the Act also makes reference to the term headquarter company. A headquarter company is defined in section 9I of the Act. A company that complies with the requirements of section 9I of the Act is treated as a non-resident company for the purposes of the normal tax. Since dividends tax is levied on resident companies, in terms of section 64EA of the Act, headquarter companies therefore fall outside the scope of dividends tax legislation, in terms of section 64EA of the Act.

Section 64E(2) of the Act stipulates that a cash dividend paid by a listed company is deemed to be paid on the date that dividend is paid. The cash dividend paid by an unlisted company and a distribution, by any company, of an asset as a dividend *in specie* is deemed to be paid on the earlier of the date on which the dividend is paid or becomes payable, in terms of section 64E(2) of the Act.

Once it has been established in that a dividend has become payable, the value particularly of a dividend *in specie* has to be determined (Seaber, 2012). Section 64E(3) of the Act provides the valuation of a distribution of an *in specie* dividend and stipulate that it is the market value of the asset on the date that the dividend is deemed to be paid. There is a distinction between an asset that is a financial instrument and any other asset. In relation to financial instruments listed on a recognised stock exchange distributed as a dividend, for example a share in a listed company, the value is the ruling price of that instrument on the last date before the date that the dividend is deemed to be paid in terms of the provisions of section 64E(3)(a) of the Act. In terms of any other asset other than listed financial instrument, the value of the dividend is the market value of that asset on the date that the dividend is deemed to be paid, according to section 64E(3)(b) of the Act.

Based on the opinions of various authors the distributions of *in specie* dividends create administrative burden on companies and regulated intermediaries declaring the dividend. That is a company has to keep track of all the market values of all assets that they distribute in kind (Deloitte, 2012/13). The companies and intermediaries also need to ensure that they have enough cash to pay the dividends tax based in the market value of these assets (SARS, 2011a).

Section 64E(4) of the Act also deems certain distribution to be *in specie* dividends but with specific focus on low interest loans and advances granted to natural persons, who are resident and connected persons to the company or that connected person. The definition of connected person in terms of section 1 of the Act includes inter alia, share incentive scheme of a company that holds directly or indirectly 20% or equity share or voting rights in the company. It is common for a company to advance interest-free loans to a connected a person. This interest-free loan is treated as a dividend in terms of the provisions of section 64E(4) of the Act. One of the authors is of the view that an interest-free loan to a share incentive scheme creates a tax leakage if the parties are connected (Gad and Strauss, 2012). The dividend distribution to a share incentive scheme is subject to dividends tax, as the share incentive scheme is the beneficial owner. The beneficial owners in the share incentive scheme will also incur the dividends tax liability upon distribution by the share incentive scheme. It is therefore advisable for the beneficiaries of the share incentive scheme, normally employees of the company, to hold shares directly in the company in order to curb the exposure to dividends tax (Gad and Strauss, 2012).

Section 64E(4)(b)(ii) of the Act also provides that the value of the dividend is the difference between the market related interest rate and the actual interest rate charged on the loan as it is applied on the amount of the loan or advance. The market related interest is the South African Reserve Bank's repurchase rate plus 1% (100 basis points) in terms of para 1 the Seventh Schedule of the Act. It is noteworthy that only the differential interest amount is deemed to be the amount and not the outstanding capital portion of the loan or advance (Maryke, 2013).

The deemed dividend in terms of section 64E(4)(*c*) of the Act is deemed to be paid the dividend on the last day of the year of assessment. The value of the dividend is therefore determined at the end of year of assessment. The comment submitted by one the reputable audit firms is that there is a possibility that the loan that was granted prior to the enactment of the dividends tax and was still outstanding after implementation of the dividends tax might be exposed to dividends tax legislation (BDO, 2012). The comment is raised due to the fact that section 64E(4)(*c*) of the Act refers to '...that dividend must be deemed to have been paid on the last date of that year of assessment…'. This potential problem is avoided by the fact that the deeming provisions are not applicable to dividends that were subject to STC in terms of section 64E(4)(*e*) of the Act.

Section 64E(5) of the Act stipulates that the dividend denominated in foreign currency should be translated into South African Rands using the spot rate on the date that the dividend is paid. This would apply to foreign cash dividends, denominated in foreign currency, which is paid in respect of JSE listed companies (SARS, 2011a). Dividends paid by foreign companies fall

outside the ambit of dividends tax in terms of the dividend definition contained in section 64D(1) of the Act.

The company or regulated intermediary is deemed to have made a payment, of the amount of dividends tax withheld to the beneficial owner, in terms of section 64E(6) of the Act. This means that the beneficial owner is deemed to have received the dividend gross of the dividends tax withheld, even though the in actual fact the amount received is net of the dividends tax. The gross amount of the dividend is included in their gross income (de Koker, 2013).

2.2.3 Section 64EA – Liability for tax

The purpose of section 64EA of the Act is to provide guidance on the person who is ultimately responsible for the dividends tax liability. The beneficial owner of a cash dividend is responsible for the payment of dividends tax. In the case where the company fails to withhold the tax the beneficial owner will have to pay over the tax to SARS. A South African resident company making a distribution of an asset *in specie* is liable for the payment of dividends tax in respect of the dividend in kind, in terms of section 64EA(b) of the Act.

The requirement that the company or regulated intermediary withholds the dividends tax leaves the beneficial owner with no option but to rely on the company or regulated intermediary to carry out its responsibility to pay over the dividends tax to SARS. The beneficial owner therefore would not have proof that the tax was paid over to SARS, and might have to incur late payment interest and penalties on the dividends tax, that might have not been paid over to SARS. The Act does not seem to have provisions protecting the beneficial owner from dividends tax obligation relating to the dividends tax withheld and not paid over to SARS by the company or regulated intermediary. (French, 2008)

2.2.4 Section 64EB – Deemed dividends

Section 64EB of the Act provides that where a person entitled to the dividend declared by a distributing party cedes the right to the dividend. If the person receiving the ceded dividend is a person exempt from dividends tax, the dividend is deems to accrue to the person ceding the dividend in terms of section 64EB(a) of the Act. Section 64EB(a) of the Act does not apply if

the dividend is ceded together with the share attached to it, in this case the dividend accrues to the person receiving it.

Where a company that borrows a South African listed share *cum dividend*, the beneficial owner of the dividend is deemed to be the share lender in term of section 64EB(2) of the Act. Section 64EB(2) of the Act, further stipulates that the amount of the dividend is the amount repaid to the share borrower limited to the amount of the dividend received by the share borrower.

In the case where a company buys a share *cum dividend* and resells that share back to the seller of the share, the seller is deemed to be the beneficial owner of the dividends in terms of s 64EB(3) of the Act. The sale of the share can also be to a company forming the same group of companies, the seller is still deemed to be the beneficial owner of the dividend, in terms of s 64EB(3) of the Act.

Section 64EB of the Act is an anti-avoidance provision to deal with situations where a tax scheme is entered into with the purpose of avoiding dividends tax, in terms of SARS, 2012c. The schemes normally involve the conversion of taxable payment of dividends into an exempt compensation (SARS, 2012). An example in terms of SARS (2012c) is:

> A listed company declared a dividend to its beneficiary owners. After the declaration but before the payment, foreign shareholder expects to receive R100 000 of dividends from the listed company declaring the dividend. The foreign beneficial owner sells the right to a South African company in exchange for a foreign currency. The purpose of the transaction is to convert the Rand dividend to foreign currency, but the real purpose is to eliminate the dividends tax.
>
> The result is that the sale of the dividend rights by foreign beneficial owner is viewed as foreign source income, which is outside the South African taxing jurisdiction. The acquisition of the ceded dividend is included in income of the South African company but also offset by the repayment of the equivalent amount.

The above transaction could have also been attacked under the General Anti-Avoidance Rule (GAAR) as contained in section 80A to section 80L of the Act. This would be an avoidance arrangement because the sole purpose is to obtain a tax benefit. For a company that is exempt from tax to exchange cash for an asset (rights to a dividend) of the same amount, lacks commercial substance as it does not have significant effect on the business risks or net cash flows of the company acquiring the ceded dividend, in terms of section 80C of the Act. This

view is also supported in SARS 2012c; however the regulators saw the need to explicitly include the provisions in the Act.

2.2.5 Section 64F – Exemption from tax in respect of dividends other than dividends *in specie*

Dividends are exempt from dividends based on who the beneficial owner is. Section 64F of the Act exempts dividends that are paid in cash from dividends tax and section 64FA of the Act addresses the exemption of dividends *in specie* from dividends tax. Section 64FA of the Act is discussed in the next section of this chapter.

Section 64F of the Act demonstrates the fact that the dividends are taxed based on who the beneficial owner is, by excluding resident companies that are beneficial owners from dividends tax, therefore shifting the dividends tax liability to the beneficial owners. The reason for this change is that the dividends will be taxed once the profits are eventually paid through further dividends to natural persons (SARS, 2012c). The shift results in a fair tax system, where the same income is taxed once, that is the dividends tax is only withheld when the dividend is eventually paid to the beneficial owner who is a natural person (Kotze, 2012).

Government and public benefits organisations (PBO's) are generally not taxed, because they are funded from the very tax that is collected from taxpayers. It would therefore be illogical to go back and tax them again. Government and PBO's are exempt from dividends tax in terms of s 64F(*b*) and (*c*) of the Act.

Funds such as pension funds and provident fund referred to in section 10(1)(*d*)(i) or (ii) of the Act as well as collective investment schemes, are technically conduits for fund holders and are therefore not beneficial owners of the dividends. It is therefore sensible that these funds are exempt from dividends tax as specified in section 64F(*f*) of the Act.

Section 64F(*h*) of the Act also stipulates that dividends from microbusiness whose aggregate amount of dividends during the year of assessment does not exceed R200 000 are exempt from dividends tax. Non-residents who receive dividends in respect of shares of the non-resident companies listed on the JSE are exempt from dividends tax, in terms of section 64F(*j*) of the Act.

The other interesting element of section 64F(*l*) of the Act is that dividends that form part of income are exempt from dividends tax. This means that the dividends that are received by the beneficial owner that are not subject to dividends tax are not exempt from normal tax in terms of section 10(1)(*k*) of the Act. An example would be dividends received under a ceded right to that dividend, such dividends would not be exempt in term of section 10(1)(*k*) of the Act in the hands of the recipient of the dividend.

In order to avoid double taxation, by taxing a dividend under STC legislation as well as under the dividends tax legislation, section 64F(*m*) of the Act exempt any amounts that were subject to STC from dividends tax.

2.2.6 Section 64FA – Exemption from tax in respect of dividends *in specie*

Section 64FA of the Act addresses amongst other things the documentary requirements regarding the dividends tax exemption of dividends *in specie*. The beneficial owner should submit a declaration that the in *specie* dividend received would have been exempt if it was a cash dividend, in terms of section 64FA of the Act. Section 64FA of the Act also requires a written undertaking to be submitted by the beneficial to provide information regarding the exemption status of the beneficial owner.

The subsections to section 64FA of the Act came into effect from 1 April 2012, with the exception of subsec (*b*) to (*d*) of section 64FA of the Act, which came into effect on 1 January 2013 and they are applied prospectively.

The reason for the introduction of sections 64FA of the Act is to afford the dividends paid in cash and *in specie* dividends the same exemptions (SARS, 2011a). The difference would be that the liability of the dividends tax with regards to dividends *in specie* lies with the company or the regulated intermediary, due to the administrative issues mentioned previously in terms of section 64EA of the Act.

In terms of SARS, 2011a, the requirement that the beneficial owner has to submit a declaration in terms of the provisions of section 64FA(1)(*a*)(*i*) of the Act, if the beneficial owner and the company form the same group of companies, is not applicable and the exemption will automatically apply.

A company that declares a dividend that consists of an asset *in specie* may be liable to pay dividends tax at a reduced rate, in terms of section 64FA(2) of the Act. In this case the onus is on the beneficial owner to submit a declaration that the dividend *in specie* is subject to a lower tax rate as prescribed by the double tax agreement (DTA) between South Africa and the country of residence of the beneficial owner (s 64FA(2)(*a*) of the Act).

Section 64FA of the Act addresses administration requirements with regards to exemption of dividends *in specie* and will be explored in more detail in chapter 4 that addresses the administrative matters with regards to dividends tax (Brand, 2012).

2.2.7 Sections 64G to 64I – Withholding of dividends tax

The responsibility to withhold dividends tax is governed by sections 64G to 64I of the Act. The sections to be discussed in this part are section 64G of the Act that deals with withholding of dividends tax by companies declaring and paying dividends, section 64H of the Act that deals with withholding of dividends tax by regulated intermediaries and section 64I of the Act that deals with withholding of dividends tax by insurers.

Due to similarities in sections 64G and 64H of the Act, the writer discussed the sections together. In order for the company or regulated intermediary to be relieved from the liability to withhold dividends tax in terms of the provisions of sections 64G(2) and 64H(2) of the Act the dividend must be a cash dividend and the amount of the dividend should not exceed STC credit in terms of section 64J of the Act.

Similar to section 64FA of the Act, the company is not required to withhold dividends tax if the beneficial owner submit a dividend exemption declaration and written undertaking, in terms of the provisions of section 64G(2) and section 64H(2) of the Act. A company that fall within the same group of companies as the company distributing a dividend and a regulated intermediary receiving a dividend are not required to submit the aforementioned documents in terms of section 64G and section 64H of the Act.

In terms of sections 64G(3) and 64H(3) of the Act, the company or regulated intermediary is allowed to withhold dividends tax at a rate lower than 15% if the beneficial owner submits dividend exemption declaration that the DTA prescribes a lower rate another written undertaking will be required should the beneficial owner cease to be a beneficial owner or if the circumstances around the reduced rate change.

It is important for a company or regulated intermediary to identity whether the dividend is paid to the beneficial or a mere conduit, which is the regulated intermediary because payment to the latter absolves to company or regulated intermediary from the responsibility to withhold dividends tax. As decided in the *Prévost case*, the payment to a person that is not a mere conduit constitutes a payment to a beneficial owner and as such the company or regulate intermediary has to withhold dividends tax.

Sections 64G and 64H of the Act, read with dividend definition in section 1 of the Act, state that company or regulated intermediary should withhold dividends tax with regards to dividends paid to resident and non-resident, the latter should hold shares in resident companies.

The submission of declarations and written undertaking seem onerous to the regulated intermediary due to the large volume of beneficiary owners, In terms SARS, 2010, the beneficial owner is required to submit declaration that will be valid for future period until changes in the tax status of the beneficial owner.

In terms of section 64I of the Act, the insurer making a cash dividend payment is deemed to be a regulated intermediary. The normal withholding responsibilities of a regulated intermediary therefore apply to the insurer, in terms of section 64I of the Act.

2.2.8 Section 64J – STC credit

STC credits are mainly a principle of the old STC legislation. As per the STC legislation, s 64B(3) of the Act, the amount by which the total dividends that accrued to a company exceeded the total dividends declared by a company during a dividend cycle is referred to as STC credit. The amount was carried forward to the next dividend cycle and was deemed to accrue to the company in next dividend cycle. The company could carry forward the STC credit for as long as it was in business. The STC credit accrued to the company and not the beneficial owner. In terms of dividends tax legislation the company can now transfer STC credit to beneficial owners. (Louw, 2012)

In terms of the section 64B of the Act, the company is deemed to have declared dividends on the day before the dividends tax effective date. This means the last dividend cycle ended on 31 March 2012. The amount of the deemed dividend is nil and the company needs to submit the return to SARS regarding the deemed dividend cycle (SARS, 2008). The idea behind the requirements of section 64B was to facilitate the transition from STC to dividends tax and that

all companies can determine the available STC credits to be used under the dividends tax regime (Ellary, 2011). The requirement to issue the return assists SARS to keep track of the utilisation of STC credits. The principle of STC credit is now incorporated in section 64J of the Act. Section 64J(6) of the Act applies only to dividends paid by resident companies.

Section 64J(1) of the Act exempts dividends that do not exceed STC credit from dividends tax. In terms of section 64J(2) of the Act the amount of the STC credit is the amount of dividends that accrued to the company during the dividend cycle ending on 31 March 2012, less the dividends paid by the company on or after 1 April 2012 plus the dividends accrued to the company on or after 1 April 2012 that was paid from other company's STC credits. The dividend exemption applies provided the company making the dividend notifies the beneficial owner that the dividend is paid out of STC credit (Binding Class Ruling 039, 2013). The notification should be made on the date of payment and failure to submit the notification will result in the denial of the STC credit to the beneficial owner but there will still be reduction in STC credits of the company (SARS, 2010).

In terms of section 64J(2)(*a*) of the Act, the dividend that accrued before 1 April 2012 exclude the dividend that were not subject to STC in terms of section 64B(3A) of the Act. The dividends that accrued after 1 April 2012 to the company that is an insurer as defined in section 29A, are limited to dividends accrued on shares constituting an asset in the corporate fund of the company, in terms of section 64J(4) of the Act.

The company cannot choose whether or not they want to use the STC credit, STC credits must be exhausted first. The STC credits are automatically utilised and everything not utilised will have a nil value on 1 April 2015 in terms of the provisions of section 64J(5) of the Act. The period allowed for the utilisation of STC credits was reduced from 5 year to 3 year (Revenue Law Amendment Bills, 2008). The reason provided in the media statement is, due to the dividends tax rate of 15% versus the initial proposal of 10%, the STC credits are anticipated to be used up quicker. The other reason was that due to the delayed implementation of dividends tax, the taxpayers had sufficient time to prepare their systems for dividends tax legislation. (Grant Thornton, 2013)

It appears that the reduction of the period to utilise STC credit might be unfair to the taxpayers as this a new legislation and taxpayers still need to administratively adjust to it. Due to the slower growth rate in the economy companies might not pay as much dividends, therefore might not use up the STC credits within 3 years (South African Institute of Chartered Accountants (SAICA), 2008).

The STC credit can be transferred from company to company, until the company on declares and pays a dividend to a beneficial owner. STC credits must be allocated on a pro rata basis amongst all shareholder within the same class entitled to the dividends, irrespective of whether those shareholders are exempt from the dividends tax however, notification of the STC credit transferred will only be required if the recipient of the dividend is a South African resident company. (Explanatory Memorandum, 2010)

Should the company fail to withhold the dividends tax due to incorrect notification, the company will be responsible for the payment of dividends tax in terms of the provisions of s 64J(7) of the Act. The reasoning behind this provision is that the company is in possession of the information regarding the available STC credits and not the regulated intermediary or the beneficial owner. As such, the company should be held liable for any incorrect amount of dividends tax withheld (Consolidated response to Draft Taxation Laws Amendments Bill, 2012) (Tax Administration Amendment Bill, 2012).

The dividends tax is levied on the 'net amount' of the dividend per section 64J of the Act, after taking STC credits into account in other words the STC credit reduces the dividend being paid by the company that is subject to dividends tax, unlike the provisions of section 64N of the Act where the foreign tax rebate is utilised to reduce the dividends tax itself.

2.2.9 Section 64K – Payment and recovery of tax

Section 64K of the Act provides for the responsibility for payment of dividends tax, the documents required to be submitted to the tax authority and the timing of payment of dividends tax.

The company or regulated intermediary is liable to withhold the dividends tax, in terms of sections 64G, 64H and 64I of the Act. SARS has the right to recover dividends tax from the beneficial owner, with regards to cash dividends, should the company or regulated intermediary fail to withhold dividends tax, in terms of section 64EA(*a*) of the Act. The beneficial owner is relieved from paying dividends tax when the company or regulated intermediary has paid the dividends tax, because the dividends tax would have paid by any person in terms of section 64K(1)(*a*) of the Act.

In terms of dividends *in specie*, the company declaring the dividend is responsible for paying the dividends tax, in terms of section 64K(1)(*b*) of the Act.

The amount that should be paid over to SARS should be reduced by refund due to beneficial owners as per section 64L and section 64M in terms of section 64K(1)(*c*) of the Act. The refunds are discussed in the next section of this chapter. Section 64K(1)(*d*) of the Act requires the company or regulated intermediary making dividend payment to submit a return to SARS. The Tax Laws Amendment Act of No 22, 2012 (TLAA, 2012) requires the company or regulated intermediary to submit the return irrespective of whether the company has to pay dividends tax or not.

Section 64K(1)(*a*) of the Act states that the party liable for the payment of dividends tax should pay the dividends tax over to SARS on the last day of month following the month in which the dividend is paid by the company. For example, if the dividend is paid on 25 August 2013, then the dividends tax has to be paid on 30 September 2013.

The requirement to submit the return form even if the dividends tax is not paid is in order for the companies, regulated intermediaries and SARS to keep record of the dividend transactions. In terms of section 64K(1)(d) of the Act the person paying or receiving a dividend that is exempt from dividends tax in terms of section 64F of the Act should also submit a tax return to SARS by the last day of the month following the month during which the dividend is paid or received.

2.2.10 Sections 64L and 64M– Refund of tax

The legislation governing the claiming of refund of dividends tax on dividends declared and paid by companies is contained in section 64L of the Act and the refund of dividends tax paid by regulated intermediaries is contained in the provisions of section 64M of the Act.

Sections 64L and 64M of the Act mainly cater for the beneficial owners who fail to submit written dividend exemption or reduced dividends tax declaration (the declaration) and written undertaking on time, as required by sections 64G and 64H of the Act and beneficial owners who fail to submit proof of payment of foreign dividends tax, as stipulated in sections 64M(1A) and 64L(1A) of the Act.

A company or regulated intermediary does not need to withhold dividends tax, if the beneficial owner provides the written declaration and written undertaking to the company or regulated intermediary in terms of sections 64G(2) and 64H(2) of the Act. Should the company withhold the dividends tax due non receipt of the declaration and written undertaking, the beneficial has a

period of 3 years to submit the said documents in order to claim refund of the dividends tax withheld, in terms of sections 64L(1)(*a*) and (*c*) and 64M(1)(*a*) and (*c*) of the Act.

In instances where the beneficial owner fails to submit the proof payment of foreign dividends tax as required by section 64N of the Act, the company or regulated intermediary is required to withhold the dividends tax, according to sections 64L(1A)(*b*) and 64M(1A)(*b*) of the Act. If the beneficial owner later submits the proof of payment but within 3 year, then they can claim the refund of the dividends tax from SARS, in terms of sections 64L(1)(*c*) and 64M (1)(*c*) of the Act.

Section 64L(2)(*a*) of the Act requires the company to refund the beneficial owner within 1 year of receipt of the declaration and the written undertaking. The source of the refund, to the extent that it does not exceed dividends tax withheld, is the future dividends tax to be withheld from future dividends paid. It is therefore clear that the refund is partially dependent on future declarations. (Reifarth, 2012)

Where the amount of the refund exceeds the actual dividends tax withheld, then the company can claim the excess from SARS within 4 years of the date of dividend payment, as stipulated in sections 64L(2) and 64L(4) of the Act. Consider the following example:

> Company A pays a dividend of R100 000 at the beginning year 1 and withholds dividends tax at 15% of R15 000. After 6 months of the dividend payment the beneficial owner submits the exemption declaration. The beneficial owner is entitled to a refund within 1 year that is within 6 months of year 2. The company then declares a dividend of R80 000 at the beginning of year 2, the dividends tax to be withheld at 15% is R12 000. The company can claim the excess of R3 000 from SARS.

The Act does not address circumstances where the company does not make a dividend declaration within 1 year. The company should be able to claim the refund from SARS, should the company not make a declaration within a year as required by the Act. The same principle of claiming the excess in terms of section 64L(2)(*b*) of the Act, should apply. The dividends tax that was withheld by company would have been paid over to SARS.

Section 64M(2) of the Act requires the regulated intermediaries to make payment of the dividends tax refund to the beneficial owner. The Act does not allow the regulated intermediary to claim excess dividends tax from SARS, unlike refund made in respect of dividends paid by the company, in terms of section 64L of the Act. The only source for the refunds from dividends

tax is from future dividend payments. Regulated intermediaries normally rely on the companies paying dividends in order make any dividends tax refunds, this result in time delays with regards to beneficial owners receiving dividends tax refunds. (Reifarth, 2010)

From the above discussion the following should be noted, sections 64L and 64M of the Act only make reference dividends tax refunds with regards to cash dividends and not dividends *in specie* (BDO 2012). Companies are forced to wait 1 year before they can make a claim of refund from SARS, in terms of BDO (2012). BDO (2012) also recommended that the Act cater for companies that are not planning to declare and pay dividends within 1 year of the dividend payment to enable the company to claim the excess dividends tax from SARS. Even though the ultimate responsibility to withhold dividends tax lies with the beneficial owner, the Act does not make any provision for the beneficial owner to make direct claim of the dividends tax refund from SARS. (Reifarth 2010)

2.2.11 Section 64N – Rebate in respect of foreign taxes on dividends

South African residents are taxed on world-wide income. There are instances when the income derived from foreign countries is subject to tax in that foreign country according to the said country's tax legislation. The same income can also be subject to tax in South Africa in terms of the South African tax legislation. South Africa has a couple of DTA's entered into with foreign countries. The DTA's requirements overrule the tax legislation. The taxpayer would therefore take the requirements of the DTA into account before applying the requirements of the Act, in terms of section 108 of the Act

Section 64N of the Act, is one of the sections in the Act that addresses instances when a DTA between South Africa and a foreign country does not exist or when the DTA exists but does not cover how the dividends tax from foreign country should be treated. This aforementioned section specifically provides for rebate against South African dividends tax with regards to a dividend that was subject to a tax in a foreign jurisdiction where the company is registered, in terms of section 64N(1) of the Act. The rebate is allowed if the dividend is declared by a JSE listed company and it is a cash dividend, as stipulated in section 64N(1) of the Act.

The amount of the rebate may not exceed the amount of dividends tax that the taxpayer paid in relation to that dividend, in terms of section 64N(3) of the Act. This applies where for example a foreign country levies dividends tax at a rate less that 15%, the rebate is limited to the actual

dividends tax paid in the foreign country. In other words the rebate cannot result in a refund due to the taxpayer, if the foreign country levies dividends tax at a rate exceeding 15%. The taxpayer should not have a right to recover the dividends tax incurred from any tax authority in order to qualify for the rebate (section 64N(2) of the Act). One of the ways this provision would be applicable would be if the foreign legislation allows a taxpayer to claim the dividends tax paid in that country, like in the case of value-added tax (VAT) charged in terms of the provisions of section 7(1) of the Value-Added Tax Act No. 89 of 1991 (the VAT Act) paid by a foreign person in South Africa on goods to be used in a foreign countries, such VAT can be claimed when the taxpayer departs from the said country. If the dividends tax is recoverable in this way or another, the rebate in terms of section 64N of the Act will not be allowed.

The amount of the rebate should to be translated to South African Rands using the same exchange rate, spot rate, used to translate the amount of the related dividend on the date the dividend is paid in terms of the provisions of section 64N(4) of the Act. The fact that translation into South African currency occurs on date of payments avoids any existence of foreign exchange differences regarding both the dividend amount and the related tax. Failure by the legislator to put this provision into the Act would have created an administrative nightmare with regards to the treatment of foreign differences. Section 64N(5) of the Act stipulates that in order for the rebate to be applicable, the Act requires the company or a regulated intermediary to obtain proof of payment of foreign tax. One of the views expressed (National Treasury and SARS, 2012), was that the requirement for proof of payment is onerous, especially with regards to regulated intermediaries who have thousands of dividend payments. The response from National Treasury and SARS (2012) was that the need to provide proof to SARS is important and cannot make expect SARS to provide relief based on *prima facie* statements. The response seems reasonable because if there are no supporting documents provided as evidence that foreign tax was paid, it would be difficult for SARS to know if the foreign tax was paid. This is also due to the fact that SARS does not have jurisdiction in foreign countries to get the information. If there is a way for SARS to get information, it would be very cumbersome for SARS to obtain the information, especially from countries that do not have DTA's with South Africa (Croome and Sacks, 2010).

2.3. CONCLUSION

The dividends tax legislation shifts the responsibility of dividends tax from the company to the beneficial owner. The distributing company that declares a dividend, to a person who is not

exempt from dividends tax, is responsible to withhold the dividends tax and pay it over to SARS. The company declaring a dividend *in specie* is however liable for dividends tax. The dividends tax is levied on the amount of dividends distributed after taking into account any STC credits. The tax is payable end of the month following the date the dividend is declared.

The analysis of the dividends tax legislation yielded the following benefits and challenges;

Benefits	**Challenges**
	The identification of a beneficial owner might be a challenge. The definition of the term beneficial owner might be open to abuse or misinterpretation by taxpayers. (Part 2.2.1 of this chapter)
	The dividends tax rate of 15% might be considered to be high in comparison to the STC rate of 10%. This might be a disincentive to investors. (Part 2.2.2 of this chapter)
The dividends tax legislation is clearer and more simplified, therefore leads to less misinterpretation problems (Part 1.1 of this chapter)	
The determination of the dividend cycle is not required because it is not required under dividends tax legislation. (Part 2.2.8 of this chapter)	Companies and regulated intermediaries are required to keep track of market values of any assets distributed as dividends *in specie*, resulting in more administrative burden on the companies and regulated intermediaries. (Part 2.2.2 of the chapter)
Beneficial owners can enjoy reduced dividends tax if the declaring company reduces the dividend amount by the STC credits, provided they are used within 3 years of the effective date, that is, on 1 April 2015. (Part 2.2.8 of this chapter)	The companies and regulated intermediaries are exposed to more administrative burden in order to comply with the legislation. (Part 2.2 of this chapter)
Amounts that were taxed under the STC legislation are exempt from dividends tax (for example low-interest rate loans that were subject to STC. (Part 2.2.2 of this chapter)	Companies are liable for dividends tax if the notifications to beneficial owners did not take place or if the calculation of STC credits is incorrect. (Part 2.2.8 of this chapter)

Dividends and dividends tax denominated in foreign currency are translated at spot rate to local currency. The foreign exchange differences are avoided. (Part 2.2.11 of this chapter)	Refund of dividends tax that is incorrectly withheld from distributions to beneficial owners depends on future dividend distributions by companies. The beneficial owner would therefore not be able to claim a refund if the company does not declare dividends. (Part 2.2.10 of this chapter)
The income flowing into the company as a dividend is not subject to dividends tax because companies are exempt from dividends tax. Dividends are only subject to dividends tax when distributed to beneficial owners. The result is that same income declared as a dividend is taxed once. (Part 2.2.5 of this chapter)	Regulated intermediaries also need to rely on companies to make dividend distributions in order to be able to refund any incorrectly withheld dividends tax. Regulated intermediaries cannot claim any excess dividends tax from SARS, unlike companies. (Part 2.2.10 of the chapter)
The legislation affords cash dividends and dividends *in specie* the same exemptions. There is therefore no preferential treatment in terms of the form of payment of the dividend. (Part 2.2.6 of this chapter)	Beneficial owners, who bear the dividends tax liability, cannot claim dividends tax incorrectly withheld directly from SARS, but have to claim the refund from the distributing company. The beneficial owners thus have to wait for a refund. (Part 2.2.9 of the chapter)
Residents and non-residents are exposed to the same dividends tax requirements in relation to local sourced dividends. (Part 2.2.1 of this chapter)	The beneficial owners have to rely on the companies and regulated intermediaries to pay the dividends tax over to SARS on their behalf. There is no recourse for beneficial owners if the companies and regulated intermediaries do not pay the dividends tax over to SARS. (Part 2.2.9 of this chapter)

CHAPTER 3: ADMINISTRATION AND PRACTICAL IMPLICATIONS OF THE IMPLEMENTATION OF THE DIVIDENDS TAX LEGISLATION

3.1. INTRODUCTION TO ADMINISTRATION AND PRACTICAL IMPLICATIONS OF THE DIVIDENDS TAX LEGISLATION

The writer submits that, it is not peculiar for the introduction of new legislation to bring about challenges with regards to the implementation thereof. The correct implementation by companies and regulated intermediary might be affected by, amongst other things, misinterpretation of the dividends tax legislation, lack of readiness of companies' and regulated intermediaries systems and lack of resources. Chapter 2 focused on the analysis of the dividends tax legislation, addressing benefits and challenges of the dividends tax legislation. This chapter examines the administration and the practical implication matters of the dividends tax legislation by way of a literature review of opinions of opinions of academics, professionals, media reports and reputable websites.

The administrative and practical implications for companies, regulated intermediaries and beneficial owners are deliberated on under appropriate headings. The practical implications regarding the identification of beneficial owners, the information control with regards to submissions to SARS, the utilisation of STC credits as well practical implications of declaring dividends *in specie*. The writer then concludes on the discussions.

3.2. THE APPLICATION AND PRACTICAL IMPLICATIONS FOR COMPANIES AND REGULATED INTERMEDIARIES

Companies and regulated intermediaries are required to identify beneficial owners, this requirement places administrative burden on companies and regulated intermediaries. The other administrative requirement that is discussed is the SARS documents required for submission by the companies and regulated intermediaries in terms of SARS (2013a).

3.2.1. Identification of beneficial owners – trusts

The Act does not require the company or regulated intermediaries to determine who the beneficial owners are, it is however inevitable for the companies or a regulated intermediaries to understand the composition of their beneficial owners in order to identify circumstances that

require a company or a regulated intermediary to comply with the dividends tax legislation (Williams, 2012). The general principle in terms of the Act is that if a beneficial owner is not exempt in terms of sections 64F and 64FA of the Act, the company or regulated intermediary should withhold dividends tax. The responsibility is not imposed if the beneficial owner provides the company of regulated intermediary with written declaration and undertaking indicating that the dividend is exempt from dividends tax, in terms of sections 64G(2)(*aa*) and (*bb*) and 64H(2)(*aa*) and (*bb*) of the Act.

It is not the purpose of this study to analyse regulated intermediaries but simply to discuss the overall dividends tax implications for companies and regulated intermediaries.

Listed companies generally distribute the dividends through regulated intermediaries. Under the STC legislation the company declaring a dividend was liable for the STC. The dividends tax legislation requires regulated intermediaries to withhold dividends tax, a responsibility they did not have under the STC legislation (Williams, 2012). This places more legal compliance and administrative responsibility on the regulated intermediary. The regulated intermediaries would be in a better position to gather information on the beneficial owners, because they have more access to the beneficial owners than the companies (PWC, 1998).

The identification of beneficial owners becomes more important when dealing with trusts, because they normally have numerous beneficial owners with different tax statuses. As indicated in the scope and limitations the report focuses the discussion on trusts that hold share investments in listed and non-listed companies and not on the Real Estate Investment Trusts (REIT). A trust that holds share investments is generally viewed as a conduit, through which dividends, or any other distributions, are distributed to trust beneficiaries without losing their character as dividends. A trust can be classified as either a vesting trust or a discretionary trust (Lippstreu, 2012). In a vesting trust the beneficiaries of the trust have an unconditional right to the income and capital of the trust and in a discretionary trust the beneficiaries the trustees have the discretion to vest the income and capital assets of the trust (SAICA, 2012).

Beneficiaries of a vesting trust have an unconditional right, in terms of the trust deed, to the dividends distributed to the trust. The beneficiaries are therefore beneficial owners and if the beneficial owners are not exempt, the company or regulated intermediary paying the dividend has to withhold the dividends tax (Brand, 2012). The dividends tax is withheld when the company or regulated intermediary declares the dividend and not when the dividend is distributed to the beneficiaries of the trust (Brincker, 2012).

On the other hand the beneficiaries of discretionary trust do not have an unconditional right to dividends earned by the trust (Lippstreu, 2012). The trust is deemed to be the beneficial owner of the dividend received. The beneficiaries of the trust become beneficial owners when the trustees exercise their discretion and distribute the dividend to the beneficiaries. When reference is made to the beneficiaries of a trust the beneficiaries can be individuals or companies. (Ernst & Young, 2013)

When dealing with vesting trusts the implementation of dividends tax appears more straightforward, unlike discretionary trusts. One of the challenges with trusts is that the companies and the regulated intermediaries paying dividends do not know who the beneficial owners are; because the registered shareholder in the company's or regulated intermediary's records would be the trust (Lippstreu, 2012). The other challenge particularly with regards to beneficiaries of a discretionary trust is that the beneficiaries cannot provide the company or regulated intermediary with exemptions declarations and undertakings until the trustees distribute the dividends to the beneficiaries. This will result in the company or regulated intermediary withholding dividends tax on dividends whose beneficial owners might be exempt, for example resident companies. (Lippstreu, 2012)

Lippstreu (2012) is on the view that the beneficial owners of a discretionary should submit the exemption declarations and undertakings irrespective of whether the trustees pay the dividend or not. The said writer is of the opinion that this will save the beneficial owner and the trust the administrative burden of having to apply for a dividends tax refund when the exemption documentation is later submitted to the company or regulated intermediary. The beneficial owner who is exempt would therefore not have to claim a refund, which can take up to hear to receive. (Lippstreu, 2012)

Dividend distributions to the beneficiaries should be made within the same year of assessment in which the dividend was received or accrued to the trust; otherwise the dividend loses its character (BCR 031, 2011). Should the trustees distribute the dividend within the same year of assessment in which the dividend is received or accrued, the beneficiaries will be the beneficial owners and subject to dividends tax. If the dividend is distributed after the end of the year of assessment of the trust in which the dividend was received or accrued to the trust, then the trust is deemed to be the beneficial owner of the dividend and subject to dividends tax (Brincker, 2012). The implication is that if the beneficiaries of the trust are exempt from dividends tax (for example resident companies), the tax benefit is lost if the trustees retain the dividends in the trust past the end of the year of assessment of the trust. It is important for trustees to ensure that they act in the best interest of the trust and the beneficiaries. (Brincker, 2012)

In terms of the Amendment Act (2012), the company that is beneficial owner of a dividend in respect of the company's own shares is exempt from dividends tax. SARS issued a Binding Private Ruling 129 (2012) (BPR 129), to address instances where a company is a beneficial owner of a dividend from a share incentive trust that owns shares in that company. The BPR 129 (2012) specifically focuses on dividend pertaining to shares that are unallocated to the beneficiaries of the trust. In terms of BPR 129 (2012), the company had a discretionary share incentive trusts, for the benefit of its employees and pays dividends to these trusts. These dividends will be exempt from dividends tax, should the trustees of the trust pay the dividends back to the company. This applies to the period after the declaration date and before the date of trade of these unallocated shares. (BPR 129, 2012)

The ruling is consisted with the requirements of section 64F(1)(*a*) of the Act that resident companies that receive dividend are exempt from dividends tax.

In conclusion, it is important for companies and regulated intermediaries to identify who the beneficial owners of the dividends are. This will assist the companies and regulated intermediaries in carrying out their responsibility to withhold dividends tax where applicable. The dividends tax implications for trusts can be complex and the administrative burden cannot be taken for granted. (Ernst & Young, 2012/13) (Mollagee, 2012)

3.2.2. Submissions to SARS

SARS requires the submission of Dividend Tax Transactions Information Declaration (DTR01), by companies and regulated intermediaries responsible of withholding dividends tax. After the submission of the DTR01 the company or regulated intermediary can then file a Dividend Tax Return (DTR02). The DTR01 requires companies and regulated intermediaries to provide information about dividends received and paid. The DTR01 also requires information on exempt dividends; therefore resident companies should disclose all the dividends received. Companies and regulated intermediaries are required to supply supporting information regarding the information provided in the DTR01 (SARS, 2013), for example signed declarations by exempt beneficial owners.

The information that should be provided by companies declaring in terms of the DTR01 is the number of individual beneficial owners, non-individual beneficial owners and the number of regulated intermediaries (SARS, 2013a).

It is evident that the information required in the DTR01 and DTR 02 is not the kind of information that companies and regulated collected in the past under the STC legislation (Grant Thornton, 2013). Companies and regulated intermediaries are required to file returns and pay dividends tax to SARS, one month after the date of dividend declaration and payment. Should this information not be collected on time, this will result in late submission of the return and late payment of the dividends tax and will expose the company to interest and penalties due to late submission. (SARS, 2013b)

The collection of information can be a tedious exercise that companies and regulated intermediaries have to carry out. Companies and regulated intermediaries will have to go back into their records and trace all the shareholders. In cases where beneficial owners are not shareholders, for example one person is holding a voting right attaching to the share and the other person holding the right to a dividend attaching to the share (Brand, 2012). The beneficial owner as defined in section 64D of the Act is a person holding a right to a dividend attaching to a share. The company or regulated intermediary would have to find out who the beneficial owner really is. Gathering of this information requires companies and regulated intermediaries to invest time and resources, in order to comply with the dividends tax legislation. (PWC, 2009) (Louw, 2012)

3.3. APPLICATION AND PRACTICAL IMPLICATIONS OF DIVIDENDS TAX SPECIFICALLY FOR COMPANIES DECLARING AND PAYING DIVIDENDS

3.3.1. STC credit utilisation

A company is not required to withhold dividends tax on cash dividends declared and paid by the company to the extent that the dividend does not exceed the STC credit, in terms of section 64J(1) of the Act. Any dividend that is declared and paid will first reduce the company's STC credit, even if the dividend is paid to an exempt person. In a group context a subsidiary is allowed to transfer STC credit to the holding company (Louw, 2013). Section 64J(1)(*b*) of the Act requires the company to first submit a written notification to the person to whom the payment is made. The notification needs to indicate how much of the dividend paid was used to reduce the company's STC credit, in terms of section 64J(1)(*b*) of the Act.

The Act imposes additional administrative responsibility on companies. Companies declaring and paying dividends have to provide all the beneficial owners of the dividends with the

notification of the utilisation of STC credits. The company does not only have to prepare the notification but also has to ensure delivery of the notification to dividend recipient by the date of dividend payment. The administration burden is also aggravated by the fact that SARS does not provide a template that all companies can use in preparing the notifications. SARS however, guides the companies and regulated intermediaries on the required wording and minimum information (SARS, 2012b). Companies can therefore use this information as a basis for designing the required documents.

SARS released Binding Class Ruling 39 (2013) (BCR 039), providing guidance on what constitutes sufficient notification by listed companies to beneficial owners. The BCR 039 (2013) provides that the notification can be communicated as follows; through stock exchange news services (SENS), through central securities depository system of Strate Ltd, the company paying the dividend can publish the notification on their website and publication of the full details of the dividends in the company's interim and annual results.

A non-listed company can therefore follow the guidance of the BCR 039 (2013) and publish their notification on the company's website before the date of the dividend payment. Enough time should be allowed for the beneficial owner to access the notification prior to receipt of the dividend payment. The reader has to take cognisance of the fact that even if the notification is published on the company's website, it does not necessarily mean that the beneficial owner has received the notification. An example would be an elderly taxpayer who might not know how to access the information on the internet.

In order to determine the amount of the STC credits at the commencement of the dividends tax legislation; companies were deemed to have declared a dividend on 31 March 2012. This was done in order to trigger the end of a dividend cycle in order to determine the STC credit that can be carried forward into the dividends tax regime (PKF, 2012). The company has to ensure that their calculations of STC credits are accurate, according to section 64J(7) of the Act. This is important because the same calculation will be used to allocate the STC credits on a pro rata basis, amongst the beneficial owners within the same class. The company has to ensure that they have systems in place to support the correct calculations and allocations of STC credits. The administrative burden might me tedious but overcoming the hurdle has benefits. It will assist the company in avoiding any further dividends tax liabilities, in terms of section 64J(7) of the Act and allow the effective utilisation of STC credits to benefit the beneficial owners.

3.3.2. Dividend *in specie*

This part of the research the writer discusses the application and practical implications of dividend *in specie*.

A company that declares and pays a dividend of an asset *in specie* is liable for dividends tax, in terms of section 64EA of the Act. This implies that the dividends tax is not the withholding tax on the beneficial owner (Mollagee, 2012). As discussed in chapter 2, the distribution of a dividend *in specie* is exempt from dividends tax if the beneficial owner submits the declaration that if the portion of the dividend *in specie*, was paid in cash it would have been exempt from dividends tax section 64FA(1)(*a*) of the Act or taxed at a lower rate, in terms of section 64FA(2)(*a*) of the Act. The beneficial owner also needs to provide a written undertaking, should the exemption status change, in terms of sections 64FA(1)(*b*) and 64FA(2)(*b*) of the Act. Dividends *in specie* are also exempt from dividends tax if the beneficial owner forms part of the same group of companies as defined in section 41 of the Act, in terms of section 64FA(*b*) of the Act. Distribution of dividend *in specie* by company or trust that ceases to be a resident or upon liquidation is also exempt from dividends tax, as stipulated in section 64FA(1)(*d*) of the Act.

Since the tax liability rests with the company when dealing with *in specie* dividends, there is therefore no tax treaty relief when paying dividends *in specie* to non-residents. Based on the wording of section 64FA(1)(*a*) of the Act, the distribution will be treated as if it is a cash dividend to determine relief in terms of tax treaty (Kruger, 2012). The company paying and declaring a dividend will be allowed to use a lower rate as per the treaty, if applicable. The declaring companies have the responsibility to keep up with the available treaties that apply to them and ensure that the requirements to these treaties are complied with. When particularly dealing with dividends *in specie*, being up to date with treaty requirements will save the companies money when reduced rates are used to determine the dividends tax amount to be paid to SARS. (Kruger, 2012)

On the other hand, if the necessary declarations and undertakings, in terms of section 64FA of the Act, are not submitted to a company distributing a dividend *in specie* the requirements of section 9 of the Act would apply. In terms of section 9 of the Act dividends from a South African source are taxed in terms of normal tax in South Africa. Section 9 of the Act does not distinguish between cash and *in specie* dividends. A non-resident beneficial owner of the dividend *in specie* is therefore liable for normal tax in South Africa the dividends tax legislation would therefore not apply. (Kruger, 2012)

In conclusion, the distributions of *in specie* dividends create administrative responsibilities on companies and regulated intermediaries declaring the dividend. That is a company's systems should keep track of all the market values of all assets that they distribute as dividends in kind. The companies and intermediaries also need to ensure that they have enough cash to pay the dividends tax based on the market value of these assets (SARS, 2011a). As noted in chapter 2, companies cannot claim refund of dividends tax paid on dividends *in specie*. It is therefore important that the company values the assets that they distribute as dividend *in specie* accurately and apply the provisions of the tax treaty correctly.

3.4. ADMINISTRATION AND PRACTICAL IMPLICATIONS FOR BENEFICIAL OWNERS RECEIVING DIVIDENDS

In order for a company not to withhold dividends tax or withhold the dividends tax at a rate lower that 15%, due to the application of a DTA, the beneficial owner should submit a declaration and undertaking to the company or regulated intermediary paying the dividend, in terms of sections 64FA, 64G and 64H of the Act.

The onus is on the beneficial owner to provide a declaration and undertaking to every company that they hold shares in or regulated intermediary through which the beneficial owner holds the share (SARS, 2012). Even if the beneficial owner has a number of shares in a company, the beneficial owner provides that company with one form (SARS, 2012b).

The beneficial owner does not seem to have enormous administrative burden, unlike companies and regulated intermediaries. The beneficial owner has the responsibility to accurately and timeously complete the necessary forms provided by the companies and regulated intermediaries. Failure to do so might result the beneficial owner having to go through the process of claiming the refund, which can be lengthy. In actual fact these basic requirement by the Act, are for the benefit of the beneficial owner. The beneficial owner is taxed at lower rate or be exempt from dividends tax if they provide the company or regulate intermediary with the necessary documents, as provided in sections 64FA, 64G and 64H of the Act.

3.5. CONCLUSION

In summary application and practical implication noted in this chapter are the identification of beneficial owners in complex business structures, the compliance requirements in terms of

returns to be submitted to SARS, accurate calculations and utilisation of STC credits and ensuring that the market values of dividends *in specie* are accurate.

The application and practical implications of dividends tax for companies and regulated intermediaries might be tedious at the initial stages of implementation of the dividends tax legislation. These will however be overcome over time through continuous improvement of the legislation and the companies' and regulated intermediaries information control systems. Companies are no stranger to withholding of taxes; for example the withholding of employees tax. Based on the discussions in this chapter the administrative hurdles will be overcome by both companies and regulated intermediaries and the dividends tax collection will be effective in future.

CHAPTER 4: A BRIEF DISCUSSION ON HOW SOUTH AFRICAN DIVIDENDS TAX LEGISLATION COMPARES TO OTHER DEVELOPING COUNTRIES

4.1. INTRODUCTION TO THE COMPARISON WITH OTHER DEVELOPING COUNTRIES

Developing countries are continuously reforming their tax systems in order to position themselves internationally and to improve revenue collection for the government. One of the methods to improve revenue collection is to increase the tax base, by imposing tax on more taxpayers (Brodzka, 2013). As discussed in chapter one of this report one of the way of increasing the tax base is to levy dividends tax on beneficial owners rather than on the companies declaring and paying the dividend.

The South African dividends tax legislation was reviewed in light of the dividends tax legislation adopted by other developing countries such as Russia, India and China, in this chapter. The purpose of the review is to determine how other countries within the BRICS countries tax the distributions in the form of dividend and to assess how the South African dividends tax legislation compares with the legislation of other BRICS countries. The countries considered in this study are Russia, India and China. The writer determined whether there are possible changes that South Africa can consider to incorporate in the South African dividends tax legislation that would improve the current legislation.

Due to the fact that dividend distributions are exempt from tax in Brazil (Article 10 of the Brazilian National Tax Code Law No. 9,249/1995); there is limited published material on the subject. The Brazilian Revenue Service issued normative instruction (IN) 1,397/2013, explaining how the tax exemption applies based on the accounting system adopted (KPMG, 2013). The issue of the IN led to uncertainties regarding the taxation of dividends and lack of support by the legislation (Salerno, Vianello and Leiman, 2013). Brazil was therefore not considered for purpose of this study due to the reasons provided.

Although a detail comparison between the dividends tax legislation of Russia, India, China and South Africa, are beyond the scope of this research, it is important to mention that all the tax legislation of the countries considered in this study tax on source basis. The chapter provides a review of the most important aspects on the taxation of dividends of the respective countries under study.

4.2. TAXATION OF DIVIDENDS IN RUSSIA

4.2.1 Background

Russia has experienced growth in its economy in the past couple of years (Pogorletskiy and Söllner, 2008). One of the contributing factors to the growth of the Russian economy was the reformations of the tax legislation that took place since the year 2000 (Pogorletskiy et al, 2008). According to Pogorletskiy et al (2008) the tax reform that took place in 2008 included the reduction of the dividend withholding tax for both individuals and companies. The focus of this research is on dividends tax, therefore, the details of the dividend withholding tax with regards to natural persons and companies are discussed in the following sections.

The Russian tax legislation is set out in the Tax Code of the Russian Federation Part One Federal Law No. 146-FZ of July 31, 1998 (the Code I) and the Tax Code of the Russian Federation Part Two Federal Law No. 117-FZ of August 5, 2000 (the Code II). The Russian law on taxation of corporate profits and the taxation of dividends are set out in Chapter 25 the Code II. The taxation of dividends is governed by Articles 214, 224, 275 and 284 of the Code II. The company declaring and paying a dividend is a tax agent and is responsible to withhold the dividends tax and pay over to the tax authority, in terms of Articles 214 and 275 of the Code II. Reference to a company in this section of the research includes any other tax agent in terms of the Code II.

Dividends paid by a Russian company are subject to dividend withholding tax, irrespective of whether the recipients of the dividend are individuals, companies, Russian residents or non-residents, according to Article 275 of the Code II.

When considering the taxation of dividends it is significant to understand what constitutes a dividend in terms of legislation. In terms of the Russian tax legislation, Article 43 of the Code I definitions a dividend as a distribution to a shareholder in respect of shares held by that shareholder in that company in proportion of the shares held in the distributing company.

The definition of dividend implies that the amount over and above the proportional distribution would not be a dividend and will be taxed like any other income. It is clear from the definition that the meaning of dividend is generally similar to the South African dividend definition as discussed in chapter 2 of this research report.

4.2.2 Companies

In terms of clause 2 of Article 275 of the Code II, dividends paid by a Russian company to another Russian company are subject to dividend withholding tax. Dividends paid by a Russian company to a Russian company are subject to a withholding tax at a rate of 9% in terms subsec 1, clause 3 of Article 284 of the Code II. The company paying the dividend is allowed to deduct the dividends received from a Russian source, from the dividend declared and paid during the tax period, when calculating the dividend withholding tax, as stipulated in clause 2 of Article 275 of the Code II. Therefore dividends flowing through a number of tiers in a group structure are taxed once and no further tax applies on those dividends (Astakhov and O'Donoghue, 2003).

Foreign companies that do not have Russian permanent establishment are subject to dividend withholding tax in Russia on Russian sourced dividends, in terms of clause 1, Article 275 of the Code II. Clause 3 of Article 275 and subsection 3 of clause 3 of Article 284 of the Code II, stipulates that dividends paid to a foreign company are subject to a withholding tax at a rate of 15% on the amount of dividend paid. In such a case the dividend withholding tax is levied on the full amount of the dividend paid and not the net dividend paid.

The rate of 9%, also applies to dividends received by resident companies from non-resident companies, in terms of clause 3, Article 284 of the Code II. The amount of tax can be reduced by an applicable DTA, in terms of clause 1 of Article 275 of the Code II.

An adapted example demonstrating the withholding tax on dividends paid by resident company to another resident company and a non- company is as follows (Aminev, 2003);

<table>
<tr><td colspan="2">Company A consists of 1000 shares, of which 400 shares belong to resident company and 600 shares belong to a non-resident company. Company A paid a dividend of 1 rouble per share and received a dividend of 100 roubles from Company B, during the same tax period. The dividend withholding tax is calculated as follows:</td></tr>
<tr><th>Non-resident company</th><th>Resident company</th></tr>
<tr><td>Dividend withholding tax is:

600 rouble x 15% = 90 roubles</td><td>Dividend withholding tax is:

400 roubles – 100 roubles (dividends received) x 9% = 27 roubles</td></tr>
</table>

It appears that there is an incentive for the resident companies receiving the dividend as they are taxed on the net amount of the dividend paid.

Certain dividends paid to resident companies by other resident companies are subject to dividend withholding tax at 0%. In terms of subsection 1, clause 3 of Article 284 of the Code II, the 0% dividend withholding rate applies to a dividends paid to a resident company provided; the resident company owns at least 50% of shares in the company (either foreign or Russian company) paying the dividend for at least 365 consecutive days and resident company is entitled to at least 50% of total dividend distributed.

Dividends received from foreign companies that are registered in low tax jurisdictions are excluded from the 0% rule. Some of the countries indicated in the list established by the Russian Finance Ministry are Cyprus, Jersey and British Virgin Islands (BVI) as stipulated in clause 3, Article 275 of the Code II. The dividends from the countries mentioned and those from companies where the participation holding is less than 50% continue to be taxed at 9% in terms of clause 3, Article 284 of the Code II.

4.2.3 Natural persons

Article 214 of the Code I provides for the taxation of dividends received by natural persons from the Russian and foreign companies. A resident who receives a dividend is taxed at 9% on the amount of dividend received in terms clause 4 of Article 224 of the Code II. Clause 2 of Article 275 of the Code II states that the amount of dividends tax to be withheld should be based in the net dividends paid.

Dividends distributed to a non-resident individual are subject to dividend withholding tax at 15% on the amount of dividends paid, in terms of subsec 3, clause 3 of Article 284 of the Code II.

In terms of dividends received by residents from non-resident companies, the amount of dividends tax that a natural person is liable for is reduced by the amount of dividends tax withheld by a non-resident company, as stated in clause 1 Article 214 of the Code II. The rule only applies if Russia has a DTA with the country that the distributing company is a resident of, according to clause 1 Article 214 of the Code II. Article 214 of the Code II, also stipulates that

if the amount of foreign dividends tax paid exceeds the amount of dividends tax calculated in terms of the Russian tax legislation the difference cannot be claimed as a refund. An example would be if the distributing company withheld dividends tax at 15%, the Russia resident can only offset an amount of 9% against their dividends tax and the difference of 6% cannot be claimed as a refund.

4.2.4. Comparison to South Africa

A comparison between Russia and South Africa regarding the taxation of dividends is summarised as follows;

Russia	South Africa
Russian companies are subject to dividends tax, provided an exemption does not apply.	South African companies are exempt dividends tax, other than dividends paid *in specie*.
Non-residents are subject to dividends tax on dividends received from Russian companies.	Non-residents are subject to dividends tax received from unlisted South African companies
Dividends tax charged on net dividends declared.	Dividends tax levied on gross dividend declared.
Dividends tax rate is 9% for Russian companies and 15% for non-resident companies.	Dividends tax rate is 15% for both residents and nor-resident beneficial owners.

4.2.5. The benefits and challenges of taxing the net dividend paid

The benefits and challenges of taxing the net dividend paid are summarised as follows:

Benefits of taxing net dividends paid	Challenges of taxing the net dividends paid
Dividends are taxed once in a group structure. That is, the dividend paid is reduced by the dividend received because the latter was subject to dividend	It can be an administrative burden to keep record of all the dividends received and paid, if the companies' systems are not appropriate. A company should ensure that the dividends

withholding tax upon initial distribution.	received were not taken into account in past, when calculating taxable dividends (Aminev, 2003).
Only if there is a positive net dividend paid will the company withhold the dividends tax. Therefore the receiver of the dividend is not be liable for any dividend withholding tax if the amount is negative there is no claim against the tax authority in terms of clause 2, Article 275 of the Code II.	The allocation of the taxable dividends between organisations and individuals can be complex and errors are likely to occur. Errors can result in incorrect tax being withheld and might lead to liability incurred by agent. (Article 24 of the Code I)
Taxing net dividend paid stimulates investment in Russian equity by domestic companies. Resident companies pay less dividends tax, than foreign investors, if the distributing company received dividends.	Due to the fact that the system of taxing net dividends paid is only applicable to residents might discourage foreign investment or might open the system to illegal structures being formed to take advantage of the tax benefit. This would normally be the case if the non-resident does not have a DTA with Russia.

4.2.6. Conclusion

There are some similarities and differences between the South African and the Russian legislations with regards to dividend withholding tax. The Russian legislation appears to favour the resident investors, who pay dividends tax at 9% on the net amount. The South African dividends tax legislation seems to favour the resident companies, who pay cash dividends and non-resident investors who invest in South African listed shares as they are not liable for dividends tax.

Based on the discussion of the Russian dividends tax system, South Africa would not have to do anything differently in terms of the current dividend tax levied by South Africa. The South African dividends tax legislation exempt companies from dividends tax, therefore ensuring that dividends are taxed once that is, when they are distributed to beneficial owners. There is no administrative requirement on South African companies to calculate the net dividends, in order to account for dividends tax. Non- resident and resident beneficial owners receiving dividends from South African source are taxed at the same rate of 15%, therefore none of the beneficial

owners are receiving preferential dividends tax rate, resulting in a fair tax system. Based on the comparison between the Russian and South African dividends tax system there are no improvements noted that South Africa can make on the way dividends are taxed in terms of the dividends tax legislation.

4.3 TAXATION OF DIVIDENDS IN INDIA

4.3.1. Background

In India dividends were taxed in the hands of the shareholders like any other income prior to 1997 (Diljeet, 2006). The Dividend Distribution Tax (DDT) was introduced by the Finance Bill of 1997 (FA97) and was effective since 1 June 1997.The DDT, similar to STC, is a tax levied on the company paying the dividend and not the recipient of the dividend (Warren, Fischl and Narasimhan, 2010). Dividend distributions tax is a separate and additional tax on the resident company, in terms of section 115O of the Income Tax Act of 1961 (ITA). Dividend distributions are therefore not subject to a withholding tax.

4.3.2. Companies

Dividend distribution tax is levied at 15% in terms of section 115O(1) of the ITA. Dividends received by a resident company from a specified foreign company are subject to DDT at 15%, in terms of section 115BBD of the ITA. Section 115BBD(3) of the ITA, states that a specified foreign company is a company in which an Indian company holds 26% or more in of the equity interest of the foreign company. A credit for withholding tax is normally available for foreign tax paid in terms of section 115BBD of the ITA.

Foreign investors receiving dividends from Indian companies can claim tax credit for dividends taxes paid by an Indian company (Diljeet, 2006). This, however, depends on the DTA between India and the investor's country of residence.

The levy of DDT on companies is seen as one of the ways to implement the simplified and efficient tax collection (Butani, 2003). The tax authority collects that DDT from a single point, rather than to compel companies to calculate the tax for individual shareholders (Finance Bill,

2003). The collection of tax from shareholders was considered to be an administrative burden, especially for listed companies that had numerous shareholders (Butani, 2003).

The shareholders were required to disclose the dividend income at a gross amount. Shareholders were then entitled to a tax deduction of the amount of dividends tax withheld by the company that distributed the dividend. This was considered to be a complex method of calculating the tax liability (Titus, 2006). The introduction of DDT simplified this process by exempting the dividends in the hands of the shareholders.

The other reason, provided by the Indian government, for the introduction of DDT was to discourage companies from paying exorbitant dividends in order to promote capital investment (Indian Fiscal Budget 1997-98). The Indian government aimed to improve long terms growth in the economy (Singhania, 2006). This also results in the elimination of double taxation of retained earnings.

4.3.3. Natural persons

Indian residents are taxed on total income, including dividends, in terms of section 4 of the ITA. Income received from both Indian source and foreign source form part of total income of a resident, according to section 5 of the ITA. Dividends subject to DDT at are exempt from tax in the hands of the recipient, that is a natural person, in terms of section 10(34) of the ITA (Ganguli, 2011).

Dividends received by resident individuals from foreign companies will be taxed under income from other sources, in terms of section 56 of the ITA.

4.4.4. Comparison to South Africa

A comparison of the taxation of dividends between India and South Africa is provided in the following table.

India	South Africa
Dividend distribution tax levied on resident companies distribution dividends.	Dividends tax levied on dividend beneficial owners.
Resident companies receiving dividends from	Resident companies are exempt from

specified foreign companies are liable for DDT.	dividends tax on cash dividends.
Dividend distribution tax is levied on each distributing company; therefore there is no relief for a group of companies (Purandare and Narvekar, 2002).	Exemption of companies provides for a relief in a group structure because the dividend is not taxed as it is distributed through various levels of the group of companies.
Collection of DDT is simplified and more efficient as it is collected from a single point (Finance Bill, 2003).	Dividends tax collection results in an administrative burden on companies and regulated intermediary.
Foreign investors of countries that do not have DTA with India might not be able to claim the DDT (in their respective countries) because it is the tax paid by distributing company (Butani, 2003).	Foreign investors who are liable for dividends tax claim the dividends tax as they were liable for the tax.
There is a possibility for owner-managed companies to engage in tax evasion by paying excessive management fees instead dividends, therefore not paying DDT and get a tax deduction (Shenoy, 2013).	Dividends tax can curbs the possibility of tax evasion by shifting the dividends tax liability to shareholders.

4.4.5. How India attracts foreign investment

In order for a country to attract foreign investment, amongst other factors, the tax policy in place needs to be favourable to foreign investors. Indian government reports and media reports indicate that India has managed to attract foreign direct investment in India, by amongst other things, the bringing down the fiscal deficit more technological advancement, growth in manufacturing and relaxation of foreign direct investment regulations (Ernst & Young, 2014). Prior to 2012 the adverse tax policy by India, discouraged foreign investment (Kapadia, 2013). The 2012 budget cleared uncertainties relating to international taxation. The tax policy is one of the many factors affecting foreign investments. Factors like political stability, the infrastructure, foreign exchange policies play a role in the decision making process of foreign investors. It is therefore clear that even though India charges DDT, unlike the international norm of companies withholding dividends tax, it takes more than a tax policy for a country to attract foreign investors.

4.4.6. Conclusion

India introduced DDT due to challenges experienced by taxing dividends in the hands of the shareholders. The DDT system is considered to be a simpler and more efficient manner of collection of the tax relating to dividends.

South Africa should ensure that companies and SARS have good systems in place to ensure compliance with the dividends tax legislation in order to avoid the same challenges experienced by India when dividends were taxed in the hands of the beneficial owners. Based on the comparison between India and South Africa in this research South Africa does not need to change or improve with regards to the dividends tax legislation, because it is an effective method to increase the tax base and aligns the South African taxation on dividends with that of the international norm.

4.4 TAXATION OF DIVIDENDS IN CHINA

4.4.1. Background

The latest significant corporate tax reform was in 2008, when China adopted the Law of the People's Republic of China on the Enterprise Income Tax new of Enterprise Income Tax Law of the People's Republic of China of 2007 (EIT) which became effective on 1 January 2008. The implementation rules for the new CIT were general and therefore more clarity was provided in Chai shui (circulars) (Granville, 2008). The main feature of the CIT was that it unified the different tax systems which resulted in foreign and local companies having the same tax obligations (Cheng and Shanshan, 2012). The reform removed the preferential treatment that was given to foreign companies investing in China (Cheng et al, 2012).

China does not impose the withholding of dividends tax. Individual taxpayers are taxed at their personal level and companies are taxed at company level (Brys, Matthews, Herd and Wang, 2013). Non-residents, who do not have permanent establishment in China, are subject to withholding tax on dividends received from China, in terms of Article 3 of the CIT.

4.4.2. Companies

Dividends paid by a Chinese company to another Chinese company are exempt from dividends tax, in terms of item 2, Article 26 of Chapter IV of the EIT. Dividends received by a resident

company from a Chinese listed company are also exempt from dividends tax provided they are related to shares held for a period exceeding 12 months, in terms of Article 83 of CIT implementation rules. With regards to the dividends received from listed shares held for less than 12 months the dividends are subject to tax, according to Article 83 of CIT implementation rules.

Item 2 of Article 26 of the CIT, states that qualified dividends are exempt from CIT. This means that dividends that do not qualify as qualified dividends are subject to CIT at 25%, in terms of Article 26. Qualified dividends are dividends received by a resident company from another resident company in which the recipient holds any direct interest, in terms of Article 83 of the CIT Implementation rules, 2007.

Dividends received by a resident company from a foreign company that does not have permanent establishment in China are included in taxable income, in terms of Article 3 of the CIT and Article 7 of CIT implantation rules, 2007. The tax rate on these foreign dividends is 25%, according to Article 4 of the CIT. A resident company that's derives foreign dividends is allowed a tax credit on the tax paid on the dividend in the foreign country, in terms of Circular No 125, 2009. The tax credit is allowed provided the resident company holds more the 20% of the shares in that foreign country, in terms Circular No 125, 2009.

Non- resident companies are subject to withholding taxes on dividends from a Chinese source, in terms of Article 37 and Article 19 of the CIT. Dividends are deemed to be from a Chinese source if they are received from a company established or have place of effective management is in China, in terms of item 1 of Article 7 of the CIT implementation rules, 2007.

Prior to 2008 Chinese foreign investment enterprises (FIE) were not subject to dividend withholding tax (Brigitte, 2008). FIE are foreign companies that hold more than 25% in Chinese companies (Brigitte, 2008). On 22 February 2008 the Chinese ministry of Finance and SAT issued circular no.1 (2008), clarifying the taxation of dividends distributed from earnings obtained by Chinese companies prior to 2008 (Chu, Qiu, Wang, Yong, Zhang, Huan, Su, Lee, Ni and Chan, 2008). In terms of Circular No 1 dividends paid out of profits obtained prior to 2008 are exempt from the withholding tax (O' Donnell, Bennett and Torbert, 2008).

The tax exemption fell away effective 1 January 2008. Therefore FIE are liable for tax at a rate of 10% on all dividends distributed out of earnings post-2008, in terms of the Detailed Implementation Regulations (DIR) of the CIT and circular no. 1 (2008). The rate of 10% applies unless it is reduced under a tax treaty (Granville, 2011). The dividend paying company acts as a

withholding agent and pays over the dividends tax to the tax authorities, in terms of Article 37 of the CIT.

SAT issued circular 601 in October 2009, which stated that foreign companies receiving certain Chinese-sourced passive income, including dividends, must be beneficial owners of the dividends in order to enjoy the DTA reduced rates. The requirements of circular 601 made it difficult for foreign companies to hold investments in China (Ming Ho, 2012). This resulted in the introduction of Circular No 30 on 30 June 2012. Circular No 30, states that, a foreign company that is a resident of a country that is party to a DTA with China and is listed in that foreign country is a beneficial owner of the dividend. Circular No 30 also states that even if the foreign holding company is not listed but is 100% directly or indirectly owned by a listed company, the holding company will benefit from the provisions of the DTA (Dalton, 2012).

4.4.3. Natural persons

Resident and non -resident individuals were taxed on dividends at a rate of 20%, in item 5 of Article 3 of the Individual Income Tax Law of the of the People's Republic of China (IIT) of 1980. A non-resident individual is liable for tax on income that is from a Chinese source, in terms of paragraph 2 of Article 1 of the IIT. Therefore dividends distributed by non-resident companies to non-resident individuals are not subject to tax in China.

Since 13 June 2005 dividends tax rate relating to dividends paid to individual investors was reduced from 20% to 10% (Ministry of Finance and State Administration of Taxation (SAT), 2005). The rate of 10% applied to both resident and non-resident individuals.

On 16 November 2012 the Ministry of Finance and SAT issued a document called Cai Shui (Circular) No 85 (2012), effective from 1 January 2013. In terms of Circular No 85, individuals holding shares in listed companies are subject to dividend withholding taxes at differential tax rates. In terms of Circular No 85 (2012), the differential dividends tax rates are applied based on the length of investment as follows; dividends from shares held of one month or less is taxed at 20%, investors holding shares from one month to one year, dividends tax rate is 10% and shares held for more than one year, dividends tax rate is 5%.

The introduction of the differential tax rates is intended to discourage short term speculation in shares and to develop the Chinese stork markets (Swire, 2012).

It is worth noting that those dividends paid to individuals from companies that are not listed are charged a dividends tax at a flat rate of 10% (SAT, 2005). The dividends from listed companies are taxed at differential tax rates, in terms of Circular No 85, 2012, and the rates are between 5% and 20%.

4.4.4. Comparison to South Africa

The following table provides a comparison between the Chinese the South African dividends tax legislation:

China	South Africa
Dividend recipient pays dividends tax at recipient level.	Companies are required to withhold dividends tax.
Dividend withholding tax only applicable to non-resident shareholders.	Both non-residents are residents are subject to dividends tax.
Qualified dividends are exempt from normal tax.	Dividends subject to dividends tax are exempt from normal tax.
Dividends taxed at a differential rate from 5% to 20% (unless provisions of DTA apply).	Dividend withholding tax at a flat rate of 15% (unless provisions of DTA of apply).
Dividends distributed amongst resident companies are exempt from dividends tax, with the exception of dividends in respect of share held for less than 12 months.	South African companies are exempt from dividends tax irrespective of the period the related shares are held.
Non-residents receiving dividends from a Chinese source are taxed at 10%.	Non-resident receiving South African dividends are taxed at 15%.

4.4.5. Conclusion

Based on the discussion above, China makes attempts to encourage individual investors to invest in listed shares by taxing the dividend payments at differential tax rates. The maximum dividends tax rate for dividends considered to be speculative is 20%. In comparison to South African dividend withholding tax at 15%, the rate of 20% appears to be too high. However when one compares like with like, the South African dividends on shares held for speculative

purposes may be taxed at a marginal tax rate of 40% as they are not considered to be dividends and therefore not exempt from tax.

South Africa, like China, should consider taxing dividends on a differential tax rates in order to promote long terms investment in equity.

On the other had the lowest dividends tax rate, in China, on individual tax rates is 5% for long terms investors. South Africa is therefore charging excessive dividends tax in comparison to China on this basis. It appears that even though the introduction of dividend withholding tax in South Africa of 15% was an attempt to make up for the shortfall that might be suffered by the tax authority (due to the introduction of the dividends tax), this rate needs to be evaluated from time to time to determine whether it is fair for taxpayers. This high dividend withholding tax levied by South Africa might discourage investment by individual investors. The introduction of progressive tax rate similar to China might benefit both the economy and the individual investors.

The taxation of foreign investors at 10% also makes China more attractive as compared to South Africa that levies dividend withholding tax at 15%. The levy of dividends tax at 15% by South Africa to both resident and non-resident beneficial owners is a fair system that does not give any beneficial owner an unfair advantage.

4.5 OVERALL CONCLUSION

South African dividend withholding tax proves to be unique in comparison to other developing countries considered in the study. The differences that arise are particularly in terms of the liability for the tax relating to dividends, the tax rates and the amount on which the dividends tax is charged. Russia levies dividends tax on all beneficial owners, and the amount of dividends tax levies on resident beneficial owners is the net dividends declares. The result is that there are administrative responsibilities on declaring companies on keeping track of received. The Indian legislation levies dividends tax on declaring companies, similar to South African STC legislation. The South African dividends tax is a good tax system and when compared to Russia and India, there are no improvements that can be noted by South Africa.

The Chinese dividends tax system is very similar to the South African legislation, and the difference is that dividends are taxed on differential tax rates. The differential rates are based on the period that the shares relating to the dividends declared are held by the beneficial owner.

South African legislators should consider levying dividends tax rate at differential rates in order to promote long terms investments in stock markets and to incentivise foreign investors for long term investment in South African share capital.

CHAPTER 5: CONCLUSION

The objectives of the research were to analyse the South African dividends tax legislation, in order to identity benefits and challenges with regards to the dividends tax legislation, and to discuss the implications and administrative requirements of the dividends tax legislation. The third objective was to compare the South African dividends tax legislation with the similar legislation of certain developing countries within the BRICS group of countries in order to evaluate whether South Africa is aligned with other developing countries with regards to the taxation of dividends. The final objective was to determine how the developing countries considered in this research tax the dividends and to identify any benefits that can be derived by South Africa from those countries. An extensive literature review was carried out, focusing on dividends tax legislation of South Africa, India, Russia and China.

The analysis of the legislation in contained in chapter two of this research, The benefits of the dividends tax include the alignment of South African dividends tax system with international standards of levying the dividends tax in the hands of the beneficial owners. The levying of the tax in the hands of the beneficial owners results in an increased tax base. The dividends tax is a simplified tax system. The dividends tax legislation proves to be a fair tax system because cash and *in species* dividends are afforded the same exemptions and resident and non-resident beneficial owners, receiving dividends from a South African source are treated the same and taxed at the same tax rate.

Some of the challenges identified are; investors might consider the rate of dividend tax rate of 15% to be too high, taking into account the previous rate of STC at 10%. The legislation brings about added administrative responsibilities on companies and regulated intermediaries. The legislation imposes the dividends tax liabilities on companies who fail to accurately calculate and communicate the utilisation of STC credits. The beneficial owners have to rely on future dividend declarations in order to claim dividends tax refunds from companies and regulated intermediaries. The legislation does not allow regulated intermediaries to claim excess refunds from SARS, unlike in the case of companies. Regulated intermediaries also need to rely on companies to make dividend distributions in order to be able to refund any incorrectly withheld dividends tax to beneficial owners.

In chapter three, the practical and application requirements were discussed. One of challenges faced by companies and regulated intermediaries is the identification of beneficial owners, particularly when dealing with complex group structures with trusts included. The collection of

information on beneficial owners by companies and regulated intermediaries proved to be a tedious exercise where there are numerous and different beneficial owners. The distributing regulated intermediaries are now faced with a responsibility to withhold the dividends tax and submit tax return, a responsibility that did not had before the implementation of the dividends tax legislation. The requirement on companies to calculate and keep track of the utilisation of STC credits might also be a challenge if the companies do not have good systems in place. Companies need to insure that they value the asset, distributed as dividends *in specie*, correctly in order to account for the correct dividends tax. Due to the fact that companies and regulated intermediaries take on more administrative responsibilities there does not appear to be added administrative duties on beneficial owners.

The dividends tax legislation should undergo continuous improvements in order to overcome the teething problems identified. Companies, regulated intermediaries should familiarise themselves with the requirement of the legislation to ensure that comply with the dividends tax requirements. Companies and regulated intermediaries should ensure that there information systems are up to speed with the requirements of the dividends tax requirements.

A comparison of the South African dividends tax legislation with Russia, India and China was performed in chapter four. The South African dividends tax legislation is aligned with the dividends tax system of China but not with that of Russia and India. In China recipients of dividends are taxed on the dividends received, whereas in India companies are liable for dividends tax. In terms of the Russian dividends tax legislation companies and individuals receiving dividends are liable for dividends tax.

Dividends tax is levied on a net amount at a rate of 9% for Russian companies and 15% for non-Russian companies. Russian companies need to keep track of the dividends received as they are taken into account when calculating the dividends tax and this adds an even more onerous administrative requirement that our dividends tax system do not have. The Russian dividends tax system is similar to the South African STC regime, with the exception that all Russian beneficial holders are subject to the dividends tax. There were no benefits identified in the study that South Africa can take from the Russian dividend tax system,

Indian companies are liable for DDT on the amount of local and foreign dividends received. The benefit that South Africa can note from the Indian dividends tax system is that, there is less administrative burden on companies as they do not need to identify and keep record the beneficial owners.

The Chinese dividends tax legislation is similar to the South African dividends tax system, in that the recipient of the dividends is liable for dividends tax. The main difference is that China imposes differential tax rates based on period that shares relating to the dividend distributed are held. South Africa can consider taking this approach because it has the potential to promote long term investment on South African equity shares. The dividend tax is levied at recipient level; therefore distributing companies do not need to withhold the dividends tax. Although the South African dividends tax system places more administrative burden on companies and regulated intermediaries, it is more efficient and effective for companies and regulated intermediaries to withhold the tax and pay over to SARS.

The introduction of dividends tax in South Africa has brought about benefits and challenges for South Africa. The application and implementation of the legislation has various problems, as identified in this research, which will be overcome over time, when the systems are further refined and when the taxpayers better understand the requirements of the dividends tax legislation. It was determined in the research that South Africa is not completely aligned with other developing BRICS countries, with the exception of China, in terms of the taxation of dividend distributions. The main benefit noted that SARS might consider in the refinement of dividends tax was from the Chinese dividends tax legislation is that dividends are taxed on a progressive scale, depending on the period the shares are held in the company, therefore encouraging long investment in companies.

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