



**SHARE BUYBACKS: A TAX EFFICIENT METHOD TO EXIT A COMPANY
DESPITE LEGISLATIVE AMENDMENTS TO CURB ABUSE**

By

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2631863

Submitted in partial fulfilment of the requirements for the degree of
Master of Laws by Coursework and Research Report
at the University of the Witwatersrand, Johannesburg

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Johannesburg, 2023

DECLARATION

I declare that this research report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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22 February 2024

ACKNOWLEDGEMENTS

I wish to express my sincere gratitude to the following distinguished individuals for their contributions to this research report.

I would like to thank my supervisor, Professor Carika Fritz, whose guidance, support, and insightful feedback have been indispensable throughout the journey of this research report.

To my husband, Robin Swanepoel, goes my deepest gratitude for his unwavering support, love, understanding, and late-night coffee runs through many difficult hours. His belief in me has been a constant source of strength, fuelling my determination to succeed.

Additionally, I wish to express my sincere thanks to my student friend, Jana de Clerk, whose friendship, encouragement, and shared experiences have provided companionship and support throughout this academic journey. Her camaraderie has made both the challenges more manageable and the successes more meaningful.

Lastly, I am extremely grateful to my family, friends, and all those who have offered their encouragement, understanding, and assistance along the way.

Thank You.

ABSTRACT

Share buyback transactions are a common method used by shareholders to divest from their interest in a company. Due to the favourable tax dispensation provided to dividends, corporate shareholders may dispose of their shares through a share buyback transaction and eliminate or reduce their tax liability that would otherwise have been payable in respect of a conventional sale of shares. This leads to tax arbitrage.

In 2017 and 2019, National Treasury undertook to curb the abuse of share buyback transactions. Consequently, legislative amendments were introduced to certain anti-avoidance provisions in the Income Tax Act 58 of 1962 to include share buyback transactions within their ambit. The legislative amendments aim to tax share buyback transactions on the same or similar basis as a conventional sale of shares. However, notwithstanding the legislative amendments, certain variations of share buyback transactions still fall outside their scope and application. Therefore, a share buyback transaction arguably remains a tax-efficient method for a shareholder to exit a company, despite the legislative amendments to curb abuse.

The purpose of this research report is to analyse the scope and application of the legislative amendments and evaluate their efficacy in curbing the abuse of share buyback transactions.

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I INTRODUCTION AND OVERVIEW

(a) *Introduction*

Taxpayers may structure their affairs in a manner that is tax-efficient.¹ Shareholders can therefore choose their preferred method to exit a private company ('target company'), whose tax consequences will be determined by the Income Tax Act 58 of 1962 ('Act'), read with the Eighth Schedule to the Act ('Eighth Schedule').² Shareholders can choose to exit the target company either through the disposal of their shares to another person ('conventional sale of shares') or back to the target company ('share buyback transaction') for a consideration, usually in the form of cash³ ('repurchase consideration'). The repurchase consideration is typically funded by a reduction of the target company's contributed tax capital ('CTC')⁴ and thus a return of capital,⁵ the target company's distributable reserves, or a combination of both.⁶

A corporate shareholder who receives a repurchase consideration funded by the target company's distributable reserves may be entitled to exempt dividends⁷ and circumvent the income tax consequences that may arise in respect of a conventional sale of shares. Furthermore, since the base cost of the shares could exceed the proceeds from the disposal of those shares,⁸ the corporate shareholder may also circumvent the capital gains tax ('CGT') consequences that may arise in respect of a conventional sale of shares.

In this context, share buyback transactions may be tax-neutral and hence a tax-efficient method for a corporate shareholder to exit the target company. This leads to tax arbitrage opportunities since the sale of the shares in the target company by a corporate shareholder to

¹ *IRC v Duke of Westminster* (1936) AC 1 at 19.

² Section 38(3) of the Act provides that a company shall be recognised as a private company if it is not recognised as a public company under s 38(2) of the Act.

³ AP De Koker & RC Williams *Silke on South African Income Tax* (2023) § 9.16. See also Itumeleng Nkadimeng 'The ordinary case of share buy-back transactions' 2022 *Tax Talk* 32 at 32.

⁴ 'CTC' essentially means the consideration received by or accrued to a company for the issue of its shares. See s 1(1) of the Act in this regard.

⁵ 'Return of capital' means any amount transferred by a resident company to a shareholder to the extent that the transfer reduces the CTC. See s 1(1) of the Act in this regard.

⁶ Nkadimeng op cit note 3 at 32.

⁷ See s 10(1)(k)(i) of the Act.

⁸ In terms of para 35(3)(a) of the Eighth Schedule, read with the 'gross income' definition in s 1(1) of the Act, the proceeds must be reduced by the repurchase consideration to nil. See para (a) of Section III below for further discussion.

another person would conventionally be subject to income tax or CGT. Consequently, to circumvent the anticipated income tax or CGT consequent to the conventional sale of shares, target companies and corporate shareholders often structure the sale of shares transaction in a manner that entitles the shareholder to exempt dividends.⁹

In 2017 and 2019, several legislative amendments were made to s 22B of the Act and para 43A of the Eighth Schedule (‘specific anti-avoidance provisions’) to include variations of share buyback transactions within their ambit. Pursuant to the legislative amendments, para 43A of the Eighth Schedule¹⁰ provides that any exempt dividend¹¹ that constitutes an extraordinary dividend¹² received by or accrued to a corporate shareholder within eighteen months prior to, or in respect of, the disposal of the shares held as capital assets,¹³ be re-characterised as proceeds or a capital gain for CGT purposes. Essentially, the application of the specific anti-avoidance provisions results in a share buyback transaction being taxed on the same or similar basis as a conventional sale of shares.

That said, certain variations of share buyback transactions remain outside the scope and application of the specific anti-avoidance provisions, despite the legislative amendments. Most notably, the specific anti-avoidance provisions only apply to corporate shareholders who hold a qualifying interest in the target company. Therefore, non-corporate shareholders such as trusts and natural persons and corporate shareholders who do not hold a qualifying interest in the target company will not be subject to the specific anti-avoidance provisions. Thus, whilst certain shareholders may still benefit from the favourable tax dispensation provided to dividends, corporate shareholders that hold qualifying interests are denied any arbitrage advantage resulting from such favourable tax dispensation. This preferential tax regime is available only to certain shareholders and incentivises tax planning strategies to entitle shareholders to exempt dividends. In the interest of fairness amongst taxpayers, it is arguable that the current scope and application of the specific anti-avoidance provisions are too narrow

⁹ De Koker & Williams op cit note 3 § 24.163A.

¹⁰ Section 22B of the Act that deals with shares held on revenue account for purposes of income tax can be seen as a ‘mirror’ of para 43A of the Eighth Schedule that deals with shares held on capital account for CGT purposes. For the purposes of this research report, reference is only made to para 43A of the Eighth Schedule, but will apply equally to s 22B of the Act, unless specifically stated otherwise.

¹¹ ‘Exempt dividend’ for purposes of para 43A of the Eighth Schedule means any dividend not subject to income and dividends tax.

¹² ‘Extraordinary dividend’ for purposes of para 43A of the Eighth Schedule means any exempt dividend received or accrued within eighteen months prior to or as part of the disposal of the shares, which exceeds 15 per cent of the higher of the market value of the shares at the beginning and end of the eighteen-month period.

¹³ The definition of ‘capital asset’ in s 41(1) of the Act means an ‘asset’ as defined in para 1 of the Eighth Schedule, excluding ‘trading stock’ as defined in s 1(1) of the Act. Shares that are held as trading stock are dealt with under s 22B of the Act. See SARS *Comprehensive Guide to CGT* (2020) at 420. See also De Koker & Williams op cit note 3 § 24.163A.

and hence fail to effectively curb the abuse of share buyback transactions. This raises the question of whether share buyback transactions remain a tax-efficient method for a shareholder to exit a company, despite the legislative amendments to curb abuse.

In addition to the specific anti-avoidance provisions, the following provisions must be considered as they apply to share buyback transactions:

- Paragraph 19 of the Eighth Schedule disregards capital losses realised through share buyback transactions where a shareholder receives or accrues an exempt dividend in respect of the share or as part of the disposal thereof.
- Paragraph 39 of the Eighth Schedule ring-fences capital losses realised through share buyback transactions where the target company and shareholder are connected persons in relation to each other.
- Certain share buyback transactions are specifically included as ‘reportable arrangements’ for purposes of s 35 of the Tax Administration Act 28 of 2011 (‘TAA’) and must therefore be reported to the South African Revenue Service (‘SARS’) to evaluate and identify any potential tax avoidance.
- SARS may invoke the General Anti-Avoidance Rules (‘GAAR’)¹⁴ to bring a share buyback transaction within the net of taxation where the requirements to trigger the specific anti-avoidance provisions have not been met.

(b) Overview

This research report critically analyses the scope and application of the specific anti-avoidance provisions pursuant to the legislative amendments and evaluates their efficacy in curbing the abuse of share buyback transactions. The scope of this research report is limited to South African tax law and tax consequences. It is therefore assumed that the target company and its shareholders are residents of South Africa for tax purposes,¹⁵ unless specifically stated otherwise. There have been very few academic outputs and case law on the topic of share buyback transactions and their corresponding tax consequences. While I have reviewed and analysed primary and secondary sources of law such as books, articles, reports, and other relevant sources to come to my findings, I recognise that preference should be given to academic research and I have done so to the extent that it exists.

¹⁴ See ss 80A–80L of the Act in this regard.

¹⁵ A person other than a natural person (such as a company or trust) will be considered to be a ‘resident’ in South Africa for tax purposes if it is incorporated, established, formed, or has its place of effective management in South Africa. See para (b) of the definition of ‘resident’ in s 1(1) of the Act.

This research report involves analysis on two levels. First, I analyse the tax legislation and tax consequences applicable to a conventional sale of shares and a share buyback transaction respectively. This analysis is followed by a comparison of the tax consequences applicable to the two different methods to determine the most tax-efficient method for a shareholder to exit the target company. Secondly, I examine the introduction and development of the legislative amendments to the specific anti-avoidance provisions, followed by an analysis of the scope and application of the legislative amendments as they apply to share buyback transactions. At the end of this research report, I evaluate the efficacy of the current legal position to curb the abuse of share buyback transactions.

In the interest of completeness, this research report briefly discusses whether the GAAR can be invoked by SARS to bring share buyback transactions that escape the specific anti-avoidance provisions within the tax net. However, since this research report focuses on the scope and application of the specific anti-avoidance provisions and their legislative amendments, it falls outside the scope of this research report to in detail analyse the application of the GAAR as it applies to share buyback transactions.

II TAX CONSEQUENCES OF A CONVENTIONAL SALE OF SHARES

(a) *Income tax consequences*

South Africa utilises a residence-based taxation system.¹⁶ This means that tax residents are subject to income tax¹⁷ in South Africa on their worldwide taxable income.¹⁸ In determining a person's taxable income, certain receipts or accruals that are included in a person's gross income may be exempt¹⁹ from income tax, and certain expenditure and losses may be deducted from or set off²⁰ against such a person's income.²¹ Generally, receipts or accruals of a capital nature do not form part of a person's gross income, except those capital amounts specifically

¹⁶ Refer to the definition of 'gross income' in s 1(1) of the Act in this regard.

¹⁷ Different rates of income tax chargeable apply to different persons: A statutory 45 per cent rate applies to trusts, a statutory 27 per cent rate applies to companies for years of assessment ending on or after 31 March 2023, and a marginal rate on a sliding scale of 18–45 per cent applies to natural persons. See Schedule I to the Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2022 in this regard.

¹⁸ The definition of 'gross income' in relation to a resident means 'the total amount, in cash or otherwise, received by, or accrued to or in favour of such resident;...excluding receipts or accruals of a capital nature...' In the case of a non-resident, only such amounts that are derived from a source within South Africa form part of that person's gross income. See s 1(1) of the Act.

¹⁹ See s 10(1) of the Act in this regard.

²⁰ The Act provides for general deductions in s 11(a) and other special deductions in ss 11A–37G of the Act.

²¹ 'Income' in terms of s 1(1) of the Act means the remaining gross income amount after deducting any exempt amounts.

included in subparas (a)–(n) of the definition ‘gross income’ in s 1(1) of the Act. The capital or revenue nature of receipts or accruals in respect of a conventional sale of shares must therefore be determined.

In this respect, where the shareholder held the shares in the target company for the purposes of disposing thereof in a scheme of profit-making,²² the amount received by or accrued to the shareholder in respect of the disposal of the shares will be revenue in nature and therefore included in the shareholder’s gross income (i.e., the shares are held on revenue account). Conversely, where the shareholder held the shares as a long-term investment and not in pursuance of a scheme of profit-making,²³ the amount received by or accrued to the shareholder will be capital in nature and therefore specifically excluded from the shareholder’s gross income (i.e., the shares are held on capital account). Instead, the sale of the shares held on capital account may trigger a capital gain or capital loss on disposal thereof and the CGT consequences must therefore be considered.²⁴

A disposal or deemed disposal of an asset held on capital account (i.e., a capital asset) triggers certain tax consequences and either gives rise to a taxable capital gain or an assessed capital loss. A ‘disposal’ is defined in para 11(1)(a) of the Eighth Schedule as any event or act which results in the transfer of a capital asset, and includes the sale or transfer of ownership of a capital asset. An ‘asset’ in turn is very widely defined to include a right or interest in property of whatever nature, including shares.²⁵ Therefore, the shares held by the shareholder in the target company on capital account will constitute an ‘asset’, and the sale of those shares to another person will constitute a ‘disposal’ for purposes of the application of the Eighth Schedule.²⁶ A capital gain or a capital loss is determined by deducting the base cost of the capital asset from the proceeds on the disposal or deemed disposal of such capital asset. ‘Base cost’ is broadly defined in para 20 of the Eighth Schedule and includes the expenditure actually incurred to acquire the capital asset. In turn, ‘proceeds’ is defined in para 35 of the Eighth Schedule and essentially means the amount received or accrued in respect of the disposal of the capital asset.

²² SARS *Comprehensive Guide to CGT* (2020) at 23.

²³ SARS *Comprehensive Guide to CGT* (2020) at 23 and 679. See also s 9C(2) of the Act which determines that receipts or accruals and expenditure incurred in respect of an equity share held for a continuous period of at least three years will be deemed to be of a capital nature. See also *Commissioner for the South African Revenue Service v Capstone 556 (Pty) Ltd* (2016) 4 SA 341 (SCA) in which the Supreme Court of Appeal (‘SCA’) held that where shares are not bought as trading stock in pursuance of a scheme of profit-making, it will be of a capital nature.

²⁴ L Olivier ‘Capital versus revenue: Some guidance’ 2012 *De Jure* 172 at 172.

²⁵ Paragraph 1 of the Eighth Schedule. See SARS *Comprehensive Guide to CGT* (2020) at 44.

²⁶ Paragraph 2 of the Eighth Schedule.

Where the person then realises a net capital gain,²⁷ that amount must be multiplied by its applicable inclusion rate to calculate the taxable capital gain.²⁸ Once the taxable capital gain is calculated, s 26A of the Act specifically provides that such taxable capital gain shall be included in the person's taxable income and subject to income tax. Section 26A of the Act, therefore, links the Eighth Schedule and the main body of the Act.²⁹ This means that certain receipts and accruals of a capital nature are still subject to income tax, despite their specific exclusion from a person's gross income. Conversely, where the person realises an assessed capital loss,³⁰ s 26A of the Act does not specifically provide that such assessed capital loss be included in that person's taxable income. Therefore, by virtue of the distinctive wording adopted by s 26A of the Act, that assessed capital loss may not be set off against a person's taxable income.³¹ Accordingly, when a person realises an assessed capital loss, it must be carried forward to the next year to be set off against future capital gains realised by that person.³²

For example, a corporate shareholder acquired shares in the target company for nominal consideration (base cost) and held the shares on capital account. After five years, the shareholder decides to sell the shares to another person (conventional sale of shares). The shareholder receives or accrues proceeds of R100 million in respect of the disposal of the shares³³ and realises a capital gain of R100 million on such disposal. The shareholder's aggregate capital gain of R100 million must then be included in its taxable income³⁴ at an inclusion rate of 80 per cent³⁵ and subject to income tax at the current corporate income tax rate of 27 per cent,³⁶ thereby resulting in an effective CGT rate of 21.6 per cent on the capital

²⁷ To determine the net capital gain (per para 8 of the Eighth Schedule) for the current year, the assessed capital loss brought forward from the prior year (if any) must be deducted from the person's aggregate capital gain, which is determined by adding all calculated capital gains and subtracting all calculated capital losses to reach the net total. See *SARS Comprehensive Guide to CGT (2020)* at 37.

²⁸ In terms of para 10(1) of the Eighth Schedule, an inclusion rate of 40 per cent applies to natural persons and an 80 per cent inclusion rate applies to persons other than natural persons such as companies and trusts.

²⁹ *SARS Comprehensive Guide to CGT (2020)* at 33.

³⁰ To determine the assessed capital loss (per para 9 of the Eighth Schedule) for the current year, the assessed capital loss brought forward from the prior year (if any) must be deducted from the person's aggregate capital gain or added to its aggregate capital loss, which is determined by adding all calculated capital gains and subtracting all capital losses to reach the net total. See De Koker & Williams op cit note 3 § 24.178.

³¹ De Koker & Williams op cit note 3 § 24.178.

³² *SARS Comprehensive Guide to CGT (2020)* at 33. See also Liezel Tredoux & Kathleen van der Linde 'The taxation of dividend stripping transactions: A comparison between South Africa, Australia and Canada' 2021 *TSAR* 1 at 4.

³³ For purposes of the example, the proceeds are deemed to be equal to the market value of the shares at the time of the disposal for purposes of para 38 of the Eighth Schedule.

³⁴ Section 26A of the Act.

³⁵ Paragraph 10(1) of the Eighth Schedule.

³⁶ Schedule I to the Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2022.

gain realised.³⁷ Accordingly, the shareholder will be liable for CGT in the amount of R21,6 million³⁸ in respect of the conventional sale of shares.

(b) STT consequences

STT is governed by the Securities Transfer Tax Act 25 of 2007 ('STT Act'). STT is levied on every transfer of a share at a rate of 0.25 per cent of the taxable amount of the shares transferred.³⁹ A 'transfer' is defined in s 1 of the STT Act to include the sale or disposal of a share. Therefore, the transfer of shares from a shareholder to another person will be subject to STT. The target company that issued the shares will be liable for the payment of the STT to SARS⁴⁰ but may recover the STT payable from the person to whom the shares were transferred.⁴¹ Accordingly, per the example outlined above, the new shareholder will pay R250 000⁴² STT in respect of the conventional sale of shares.

III TAX CONSEQUENCES OF A SHARE BUYBACK TRANSACTION

(a) Income tax consequences

Any amount that is received or accrued by way of a dividend is specifically included in a person's gross income under para (k) of the 'gross income' definition in s 1(1) of the Act. For purposes of income tax, a 'dividend' means any amount transferred or applied by a resident company⁴³ to any shareholder in respect of any share in that resident company, but excluding amounts that result in a reduction of CTC of the resident company.⁴⁴ The amount can be transferred or applied either by way of a distribution made, or as consideration for the

³⁷ Patricia Williams 'Overly zealous closure of share buyback "loophole"' 2017 *Tax Breaks* 7 at 7.

³⁸ [(80 per cent (inclusion rate) x R100 million (aggregate capital gain)) x 27 per cent (corporate income tax rate)].

³⁹ Section 6(1)(a) of the STT Act determines that the taxable amount for the transfer of an unlisted share is the amount or market value of the consideration given.

⁴⁰ Section 6(2) of the STT Act.

⁴¹ Section 7(2) of the STT Act.

⁴² [R100 million (taxable amount) x 0.25 per cent (STT rate)].

⁴³ A 'foreign dividend' is an amount paid by a foreign company. Similar to a 'dividend', any amount received or accrued by way of a foreign dividend is included in a shareholder's gross income under para (k) of the 'gross income' definition in s 1(1) of the Act. However, contrary to dividends, foreign dividends are not exempt from income tax under s 10(1)(k)(i) of the Act but may be exempt or partially exempt under s 10B of the Act, the details of which fall outside the scope of this report.

⁴⁴ To the extent that an amount represents a reduction of CTC, that amount will not constitute a 'dividend' and will not be included in the shareholder's gross income. Instead, the shareholder may be subject to CGT on any capital gain realised, determined in accordance with para 3, read with para 76B of the Eighth Schedule. See David French & Rob Stretch *Income Tax in South Africa* (2023) § 5A.7.1.1.

acquisition of any share in, that resident company.⁴⁵ Therefore, to the extent that the repurchase consideration in respect of a share buyback transaction represents a distribution from sources other than CTC, such a distribution constitutes a ‘dividend’⁴⁶ and the amount will be included in the shareholder’s gross income. However, despite the specific inclusion of the repurchase consideration by way of a dividend in the shareholder’s gross income, for purposes of determining the shareholder’s taxable income, s 10(1)(k)(i) of the Act generally exempts dividends from income tax.⁴⁷ Therefore, to the extent that the repurchase consideration constitutes a ‘dividend’ for income tax purposes and is not excluded from the general exemption, the income tax consequences will be tax-neutral for the shareholder on disposal of the shares through a share buyback transaction.

As explained above,⁴⁸ the sale of the shares held by a shareholder on capital account will constitute a ‘disposal’ of an ‘asset’ by the shareholder for purposes of the Eighth Schedule. In the context of share buyback transactions, SARS, in *Binding Private Ruling 340*⁴⁹ confirmed that the share buyback constituted a ‘disposal’ by the shareholder in terms of para 11(1)(a) of the Eighth Schedule. The CGT consequences must therefore be considered on disposal of the shares through a share buyback transaction. In keeping with the example outlined above, to the extent that the corporate shareholder’s base cost of the shares is nominal and the proceeds received or accrued in respect of the disposal equal R100 million (i.e., the repurchase consideration), the shareholder will realise a capital gain of R100 million and be liable for CGT in the amount of R21,6 million.⁵⁰

To prevent double taxation⁵¹ of the repurchase consideration, para 35(3)(a) of the Eighth Schedule reduces the person’s proceeds from the disposal of an asset⁵² by any amount of the proceeds that must be or was included in that person’s gross income. Based on the example, the repurchase consideration constitutes a ‘dividend’ as defined in s 1(1) of the Act and is specifically included in the shareholder’s gross income under para (k) of the definition of ‘gross income’ in s 1(1) of the Act. Since the repurchase consideration is included in the shareholder’s

⁴⁵ Paragraph (b) of the definition of ‘dividend’ in s 1(1) of the Act.

⁴⁶ Daniel Robb ‘Buying back shares from shareholders: Dividends tax liability’ 2015 *Tax Talk* 50 at 50. See also Heinrich Louw ‘Share repurchases and dividend stripping: Where are we?’ 2019 *Tax Talk* 20 at 20.

⁴⁷ The dividend exemption is subject to certain exclusions contained in subparas (aa)–(kk) of s 10(1)(k)(i) of the Act. See also SARS *Comprehensive Guide to Dividends Tax* (2022) at 6.

⁴⁸ Paragraph (a) of Section II.

⁴⁹ SARS *Binding Private Ruling 340* (2020) at 3. A Binding Private Ruling only applies to the applicant in the ruling and has no binding effect upon SARS in respect of any other person. See s 82(2) read with s 83 of the TAA.

⁵⁰ [(80 per cent (inclusion rate) x R100 million (aggregate capital gain)) x 27 per cent (corporate income tax rate)].

⁵¹ SARS *Comprehensive Guide to CGT* (2020) at 14.

⁵² Paragraph 35(1) of the Eighth Schedule.

gross income, the shareholder's proceeds from the disposal of the shares must accordingly be reduced by the repurchase consideration amount⁵³ to nil. Considering that the base cost of the shares could essentially exceed the proceeds from the disposal of the shares, no capital gain will be realised and the CGT consequences will be tax-neutral for the shareholder on disposal of the shares through a share buyback transaction.

Therefore, as opposed to the corporate shareholder being liable for CGT at an effective rate of 21.6 per cent (or R21,6 million) in respect of a conventional sale of shares, the share buyback transaction yields a capital loss in the hands of the shareholder. In the present example, the capital loss is inconsequential as the shares were acquired by the shareholder for a nominal amount. Thus, suppose the shareholder acquired 100 issued ordinary shares in the target company for nominal consideration and sold those shares back to the target company for R100 million, the shareholder will only realise a capital loss of R100. However, suppose the base cost of the shares was R10 million, the shareholder will realise a substantial capital loss of R10 million. This capital loss is arguably 'artificial' in nature since the shareholder has, economically, recovered its base cost. In this case, the shareholder may, subject to certain anti-avoidance provisions discussed below,⁵⁴ offset that 'artificial' capital loss against any current and/or future capital gains realised by the shareholder, and thereby reduce its liability for income tax.

Moreover, shares that are subject to a share buyback transaction are returned to the target company and cancelled,⁵⁵ and restored to the status of authorised and unissued share capital.⁵⁶ Although para 11(1)(b) of the Eighth Schedule includes the redemption of an asset as a 'disposal' for CGT purposes, para 11(2)(b) of the Eighth Schedule specifically excludes the cancellation of a share in a company from constituting a 'disposal' by the company. Therefore, the cancellation by the target company of its issued shares will not constitute a 'disposal' of an asset under para 11(2)(b) of the Eighth Schedule for CGT purposes.⁵⁷ Thus, no CGT consequences will arise in the hands of the target company in respect of the cancellation of its shares.

⁵³ De Koker & Williams op cit note 3 § 9.16.

⁵⁴ Discussed in further detail in para (b) of Section V.

⁵⁵ Robb op cit note 46 at 50.

⁵⁶ See s 35(5) read with s 48 of the Companies Act 71 of 2008.

⁵⁷ SARS *Binding Private Ruling 340* (2020) at 3. Also, see French & Stretch op cit note 44 § 5A.7.1.3.

(b) *Dividends tax consequences*

A separate taxing event occurs upon the distribution of a dividend by a company to its holders of shares. Dividends tax is generally levied on the distribution of the dividend and is a tax separate from income tax.⁵⁸ For purposes of dividends tax, a ‘dividend’ is defined in s 64D of the Act as any ‘dividend’ as defined in s 1(1) of the Act that is paid by a resident company. Since the repurchase consideration constitutes a ‘dividend’ for income tax purposes⁵⁹ and is paid by a resident company (target company) it also constitutes a ‘dividend’ for dividends tax purposes, and the dividends tax consequences should thus be considered.

Dividends tax at a rate of 20 per cent is generally levied on the amount of any dividends paid by a company⁶⁰ to the beneficial owner of the share(s).⁶¹ Section 64EA(1)(a) of the Act places the liability to pay dividends tax on the beneficial owner of a cash dividend.⁶² Section 64G(1) of the Act in turn places an obligation on the target company who declares and pays the dividend to the shareholder to withhold an amount of dividends tax.⁶³ However, s 64F of the Act provides that dividends are exempt from dividends tax if the beneficial owner of the dividend is a resident company.⁶⁴ Therefore, to the extent that the shareholder is a resident company and the beneficial owner of the cash dividend, the repurchase consideration will be exempt from dividends tax. In this instance, the target company will not be obliged to withhold dividends tax from the payment of the dividend provided that the shareholder submitted the requisite declaration⁶⁵ and written undertaking⁶⁶ as required by s 64G(2)(a) of the Act before the dividend is paid. To this extent, no dividends tax consequences will arise in the hands of the shareholder on disposal of the shares through a share buyback transaction.

⁵⁸ SARS *Comprehensive Guide to Dividends Tax* (2022) at 6.

⁵⁹ See para (a) of Section III above.

⁶⁰ Section 64E of the Act.

⁶¹ A ‘beneficial owner’ of a share is defined in s 64D of the Act as ‘the person entitled to the benefit of the dividend attaching to a share.’

⁶² In terms of s 64EA(b) of the Act, the distributing company will be liable for dividends tax on dividends consisting of a distribution of an asset *in specie*.

⁶³ De Koker & Williams op cit note 3 § 9.16.

⁶⁴ In terms of s 64F(1)(a) of the Act, the exemption will apply to the extent that the dividend does not comprise a distribution of an asset *in specie*. See SARS *Comprehensive Guide to Dividends Tax* (2022) at 3.

⁶⁵ The declaration must declare that the dividend is exempt from dividends tax under s 64F(1) of the Act. See s 64G(2)(a)(i) of the Act.

⁶⁶ The notice must notify the target company if any circumstance changes whereby the dividend is no longer exempt from dividends tax, or the shareholder is no longer the beneficial owner of the dividend. See s 64G(2)(a)(ii) of the Act.

(c) *STT consequences*

As explained above,⁶⁷ STT at a rate of 0.25 per cent of the taxable amount is levied on every transfer of a share.⁶⁸ A ‘transfer’ for purposes of STT includes the cancellation or redemption of that share.⁶⁹ The transfer of the shares from the shareholder back to the target company is therefore subject to STT. However, as the shares are essentially transferred back to the target company in respect of a share buyback transaction, the target company will not be able to recover the STT payable in respect of that transfer. Accordingly, as opposed to the new shareholder paying STT in respect of the conventional sale of the shares,⁷⁰ the target company that issued the shares will be liable for the R250 000 STT payable in respect of the share buyback transaction.⁷¹

IV TAX-EFFICIENT METHOD TO EXIT A COMPANY

Commercially, a share buyback achieves the same outcome as the conventional sale of shares. From a tax perspective, if the shares held on capital account are disposed of by the shareholder to any person other than the target company, the proceeds from the disposal will be taxed as a capital gain⁷² and further attract STT at a rate of 0.25 per cent on the taxable amount of the shares so transferred.⁷³ Conversely, if the shares are disposed of to the target company through a share buyback transaction, and where the repurchase consideration is funded from the target company’s distributable reserves, the shareholder will only be subject to dividends tax at a rate of 20 per cent⁷⁴ as opposed to income tax at a rate of 27 per cent on the dividend amount.⁷⁵ As the dividends tax rate is lower than the corporate income tax rate, it achieves a favourable outcome for the shareholder who disposes of their shares through a share buyback transaction. An even more favourable outcome is achieved where the shareholder is a resident company as

⁶⁷ Paragraph (b) of Section II.

⁶⁸ In terms of s 6(1)(b) of the STT Act, the taxable amount in respect of the cancellation (transfer) of an unlisted share is the market value of that share immediately prior to the cancellation, provided that the market value of the unlisted share must be determined as if that share was never cancelled.

⁶⁹ Section 1 of the STT Act.

⁷⁰ See discussion in para (b) of Section II above.

⁷¹ Section 7(2) of the STT Act.

⁷² See para (a) of Section II above.

⁷³ See para (b) of Section II above.

⁷⁴ Section 64E read with s 64EA(a) of the Act.

⁷⁵ This is by virtue of the inclusion of the dividend amount in the shareholder’s gross income under para (k) of the ‘gross income’ definition in s 1(1) of the Act and the subsequent exemption of dividends from income tax under s 10(1)(k)(i) of the Act.

the dividend will also be exempt from dividends tax.⁷⁶ As such, the dividend received by or accrued to the corporate shareholder from the target company is neither subject to income tax nor dividends tax.⁷⁷

Secondly, since the repurchase consideration is specifically included in the shareholder's gross income under para (k) of the 'gross income' definition in s 1(1) of the Act, the proceeds from the disposal are reduced by the repurchase consideration.⁷⁸ This results in a capital loss for the shareholder that may be set off against current and/or future capital gains to ultimately reduce its income tax liability.

Thirdly, the target company, and not the shareholder, will be liable for STT on the shares transferred to the target company in respect of a share buyback transaction. What is more, the favourable tax dispensation provided to dividends also benefits shareholders who are trusts. Albeit, dividends received by or accrued to trust shareholders as the beneficial owners thereof are not exempt from dividends tax under s 64F(1) of the Act, the dividends tax rate of 20 per cent on the repurchase consideration in respect of a share buyback transaction is much lower than the effective CGT rate of 36 per cent⁷⁹ on the taxable proceeds in respect of a conventional sale of shares.

For these reasons, share buyback transactions are a tax-efficient method for shareholders to exit a company. The favourable tax dispensation provided to dividends thus leads to opportunities for tax arbitrage.⁸⁰ Consequently, tax planning opportunities arise⁸¹ whereby target companies and shareholders would rather structure the disposal of shares as a buyback transaction as opposed to a conventional sale of shares.⁸²

⁷⁶ Section 64F(1)(a) read with s 64G(2) of the Act. See also Stephan Zaaiman 'Buying and selling shares post 2019' 2019 *Tax Talk* 30 at 30.

⁷⁷ Pieter van der Zwan 'Share bite backs' 2017 *Tax Talk* 42 at 42.

⁷⁸ See para 35(3)(a) of the Eighth Schedule in this regard.

⁷⁹ [80 per cent (inclusion rate) x 45 per cent (trust income tax rate)].

⁸⁰ Mike Benatello 'Share repurchase and profit extraction transactions – "Dividend-stripping" activities come under SARS' microscope' 2019 *Tax Breaks* 3 at 3.

⁸¹ Tredoux & van der Linde op cit note 32 at 3.

⁸² Benatello op cit note 80 at 3.

The table below illustrates the tax efficiency to structure a disposal of shares through a share buyback transaction as opposed to a conventional sale of shares, to the extent that none of the specific anti-avoidance provisions or the GAAR⁸³ apply–

Corporate shareholders				
Transaction	Income tax (CGT)	Dividends tax	STT	Total tax liability
Conventional sale of shares	R21,6 million	N/A	R250 000	R21,85 million
Share buyback transaction	R0	R0	R0	R0
Saving				R21,85 million
Trust shareholders				
Conventional sale of shares	R36 million	N/A	R250 000	R36,25 million
Share buyback transaction	R0	R20 million	R0	R20 million
Saving				R16,25 million

V SPECIFIC ANTI-AVOIDANCE PROVISIONS PERTAINING TO SHARE BUYBACK TRANSACTIONS

(a) Introduction and development

Historically, share buyback transactions could only be attacked in terms of the GAAR.⁸⁴ This position changed in 2016 when National Treasury indicated in the *Budget Review* that the use of share buyback transactions warranted a review to determine whether stricter countermeasures are required⁸⁵ to curb its abuse. National Treasury noted in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017* that it had identified several

⁸³ See discussion in Section VI below.

⁸⁴ Louw op cit note 46 at 20. Furthermore, the common law doctrine of substance over form can also be applied to prevent tax avoidance where the form of an arrangement differs from its substance. However, to the extent that the parties intended to give effect to the share buyback transaction in accordance with its form, the substance-over-form rule will not apply.

⁸⁵ National Treasury *Budget Review, 2016* (2016) at 161. See also van der Zwan op cit note 77 at 42.

schemes by taxpayers using share buyback transactions for the tax advantage of receiving exempt dividends as opposed to paying CGT on the proceeds on the conventional sale of shares. This interaction between share buyback transactions and the dividends tax regime carried risk to the *fiscus* due to prevalent tax planning using share buyback transactions.⁸⁶ Accordingly, National Treasury introduced legislative amendments with effect from 19 July 2017,⁸⁷ which broadened the scope of the specific anti-avoidance provisions to include variations of share buyback transactions entered into to avoid the anticipated tax consequences conventionally applicable to the sale of shares.⁸⁸ This is achieved by bringing exempt dividends within the taxable realm through the re-characterisation of extraordinary dividends as proceeds for CGT purposes.⁸⁹

In 2019, National Treasury identified in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* that taxpayers would enter into schemes whereby the target company distributes a substantial dividend to an existing shareholder followed by the issue of shares to a new shareholder. As a result, the existing shareholder's effective interest in the target company would be diluted without that shareholder disposing of its shares in the target company. However, since there was no 'disposal' of shares for purposes of the Eighth Schedule, the specific anti-avoidance provisions could not be triggered. National Treasury accordingly proposed that the specific anti-avoidance provisions be extended to apply in respect of deemed disposals of shares.⁹⁰ Consequently, with effect from 20 February 2019, when the target company issues new shares to another person and the existing shareholder's effective interest in the target company is reduced as a result of the issuance of the new shares, that existing shareholder will be deemed, for purposes of the specific anti-avoidance provisions, to have disposed of a percentage of its shares in the target company.⁹¹ This deemed disposal is equal to the percentage by which the existing shareholder's effective interest in the target company has been reduced as a result of new shares issued.⁹²

In addition to the specific anti-avoidance provisions, para 19 of the Eighth Schedule presents a further obstacle that corporate shareholders must overcome in the recognition of capital losses realised in respect of share buyback transactions. Paragraph 19 of the Eighth

⁸⁶ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017* (2017) at 33–4.

⁸⁷ Section 34(1) of the Taxation Laws Amendment Act 17 of 2017.

⁸⁸ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017* (2017) at 35.

⁸⁹ See s 34(1) of Act 17 of 2017. See also David Warneke 'Major new tax burden looms' 2017 *Tax Breaks* 6 at 6.

⁹⁰ National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* (2020) at 11.

⁹¹ Section 64(1)(f) of the Taxation Laws Amendment Act 34 of 2019. See also National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* (2020) at 11. See also Zaaïman op cit note 76 at 31.

⁹² Paragraph 43A(4) of the Eighth Schedule.

Schedule aims to prevent shareholders from generating artificial capital losses⁹³ and requires that any capital loss realised on the disposal of certain shares be disregarded. The interaction between paras 19 and 43A of the Eighth Schedule was clarified in 2019.⁹⁴ Furthermore, in 2018, para 39(5) of the Eighth Schedule was inserted into the Act to bring share buyback transactions within the ambit of the provisions of para 39 of the Eighth Schedule.⁹⁵ Paragraph 39 of the Eighth Schedule essentially ring-fences or ‘clogs’ capital losses realised by shareholders on the disposal of shares⁹⁶ to connected persons. Lastly, in 2015, SARS included certain share buyback transactions as ‘reportable arrangements’ for purposes of s 35 of the TAA.⁹⁷

The current legal position in respect of the specific anti-avoidance provisions and the additional considerations applicable to share buyback transactions and their application are discussed in further detail below.

(b) Current legal position

(i) Paragraph 43A of the Eighth Schedule

Paragraph 43A of the Eighth Schedule is a specific anti-avoidance provision that increases the corporate shareholder’s proceeds or capital gain on disposal or deemed disposal of shares where such disposal is accompanied or preceded by the receipt or accrual of an exempt dividend by that shareholder.⁹⁸ Paragraph 43A of the Eighth Schedule applies to a corporate shareholder who disposes of shares held in a resident company as capital assets⁹⁹ immediately prior to such disposal in terms of a transaction that is not a deferral transaction.¹⁰⁰ Furthermore, for para 43A of the Eighth Schedule to apply, the shareholder must have held a qualifying interest in the target company at any time within eighteen months preceding the disposal or

⁹³ De Koker & Williams op cit note 3 § 24.154.

⁹⁴ Section 55 of Act 34 of 2019. See National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* (2020) at 61.

⁹⁵ Section 79 of the Taxation Laws Amendment Act 23 of 2018. See also National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018* (2019).

⁹⁶ Paragraph 39(5) of the Eighth Schedule includes the disposal of shares in respect of share buyback transactions.

⁹⁷ GN 212 GG 38569 of 6 March 2015. See para (b)(iii) of Section V for further discussion in this regard.

⁹⁸ Paragraph 43A(3) of the Eighth Schedule. See SARS *Comprehensive Guide to CGT* (2020) at 414.

⁹⁹ See s 41(1) of the Act. See also De Koker & Williams op cit note 3 § 24.163A.

¹⁰⁰ A ‘deferral transaction’ is defined in para 43A(1) of the Eighth Schedule to mean a transaction in respect of which the corporate restructuring rules in ss 41–47 of the Act apply. In other words, the shares were disposed of either under an asset-for-share transaction, substitutive share-for-share transaction, amalgamation transaction, intra-group transaction, unbundling transaction, or a transaction that relates to the liquidation, winding-up, or deregistration of a company.

deemed disposal of the shares and received or accrued exempt dividends that constitute extraordinary dividends in respect of the shares so disposed of.¹⁰¹

For purposes of the application of para 43A of the Eighth Schedule, a shareholder will hold a ‘qualifying interest’ in an unlisted resident company where that shareholder holds 50 per cent or more of the equity shares or voting rights in the target company, or 20 per cent or more of the equity shares or voting rights in the target company where no other person holds the majority of the target company’s equity shares or voting rights.¹⁰² It is submitted that a 50 per cent shareholding will constitute a majority shareholding for purposes of the second part of the definition of a ‘qualifying interest’.¹⁰³ Conversely, where a corporate shareholder holds 49 per cent or less of the equity shares or voting rights in the target company, and no other person holds the majority of the equity shares or voting rights in the target company, the shareholder will not hold a ‘qualifying interest’ in the target company. Since the shareholder does not hold a ‘qualifying interest’ as defined, para 43A of the Eighth Schedule will not apply to the share buyback transaction. The definition of ‘qualifying interest’ is therefore pivotal to the application of para 43A of the Eighth Schedule.

Further, for purposes of the application of para 43A of the Eighth Schedule, an ‘exempt dividend’ means a dividend that is not subject to dividends tax and is exempt from income tax.¹⁰⁴ An ‘extraordinary dividend’, in relation to a share other than a preference share (i.e., equity share), is defined to mean:

‘[S]o much of the amount of any dividend received or accrued...within a period of 18 months prior to the disposal of that share; or...in respect, by reason or in consequence of that disposal, as exceeds 15 per cent of the higher of the market value of that share as at the beginning of the period of 18 months and as at the date of disposal of that share...’¹⁰⁵

On application of para 43A of the Eighth Schedule, para 43A(2) of the Eighth Schedule specifically provides that where a corporate shareholder disposes of shares held in the target company as capital assets¹⁰⁶ and during the period of eighteen months prior to that disposal

¹⁰¹ Paragraph 43A(3) of the Eighth Schedule. See also Michael Rudnicki ‘Dividend stripping and equity funding: Limitations and restrictions’ 2018 *Business Tax & Company Law Quarterly* 14 at 16. See also Lesley Bosman ‘Inclusion of deemed disposals in the dividend stripping rules could be bad news for empowerment transactions’ 2020 *Tax Talk* 32 at 34.

¹⁰² See the definition of ‘qualifying interest’ in para 43A(1) of the Eighth Schedule which allows shareholders to hold a qualifying interest together with any connected persons. See Zaaiman op cit note 76 at 30. See also Michele Benetello ‘Dividends as proceeds on disposal of shares’ 2018 *Tax Talk* 44 at 44.

¹⁰³ Rudnicki op cit note 101 at 17.

¹⁰⁴ Paragraph 43A(1) of the Eighth Schedule.

¹⁰⁵ Ibid. See also Rudnicki op cit note 101 at 18. Further, see also Benetello op cit note 102 at 45.

¹⁰⁶ It is already assumed for purposes of this report that the shares are held on capital account and therefore this requirement has been met.

held a qualifying interest in the target company, any exempt dividend that is an extraordinary dividend received by or accrued to the corporate shareholder within eighteen months prior to or in respect of the disposal must be treated as part of the proceeds from the disposal of those shares for CGT purposes.¹⁰⁷ Consequently, the corporate shareholder's proceeds from the (actual) disposal of the shares¹⁰⁸ must include any exempt dividend that is an extraordinary dividend received by or accrued to that shareholder in respect of the shares so disposed of and may be subject to CGT in the corporate shareholder's hands.

In terms of the deeming provision contained in para 43A(4) of the Eighth Schedule,¹⁰⁹ the existing corporate shareholder that held a qualifying interest in the target company must, for purposes of para 43A of the Eighth Schedule, be treated as having disposed of a percentage of those shares by which its effective interest has been diluted as a result of the new shares issued to another person.¹¹⁰ Therefore, the provisions of para 43A(4) read with para 43A(2) of the Eighth Schedule determine that any extraordinary dividends received by or accrued to the existing shareholder in respect of those shares that are attributable to the percentage of shares deemed to be disposed of¹¹¹ must be treated as a capital gain in the hands of the existing shareholder for CGT purposes.¹¹²

From the above, it is apparent that the provisions of para 43A of the Eighth Schedule only apply if the shareholder is a company that held a qualifying interest in the target company and further received any extraordinary dividends in respect of the disposal of shares. Therefore, to the extent that the corporate shareholder in our example held a qualifying interest in the target company during the eighteen months prior to the disposal of the shares and the repurchase consideration is an exempt dividend that constitutes an extraordinary dividend, that extraordinary dividend must be re-characterised as proceeds for CGT purposes and brought into the tax sphere. However, notwithstanding the application of para 43A of the Eighth Schedule, an effective tax rate of 18.36 per cent¹¹³ applies to 'taxable' share buyback

¹⁰⁷ The mirroring provision of s 22B of the Act converts exempt dividends that constitute extraordinary dividends to income for income tax purposes.

¹⁰⁸ Paragraph 43A(2) of the Eighth Schedule.

¹⁰⁹ This provision is akin to the value-shifting provisions contained in para 11(1)(g) read with the definition in para 1 of the Eighth Schedule.

¹¹⁰ Paragraph 43A(4) of the Eighth Schedule. See Benatello op cit note 80 at 4. See also French & Stretch op cit note 44 § 5A.7.1.2. The percentage by which the shareholder's effective interest has been reduced by virtue of the issue of the new shares will constitute an 'asset' for purposes of CGT and the application of the Eighth Schedule.

¹¹¹ This deemed disposal must be treated as a part-disposal for the purposes of paras 32–3 of the Eighth Schedule.

¹¹² National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* (2020) at 12. The proviso to para 43A(2) of the Eighth Schedule excludes the amount of any extraordinary dividend previously considered as a result of a deemed disposal as contemplated by subpara (4) from subsequent disposals.

¹¹³ [85 per cent (extraordinary dividend) x 21.6 per cent (effective CGT rate)].

transactions, which rate is lower than the 20 per cent dividends tax rate and 21.6 per cent CGT rate applicable to companies. It is thus possible for the corporate shareholder to withdraw in a tax-neutral manner an amount equal to the extraordinary dividend.¹¹⁴

(ii) *Paragraphs 19 and 39 of the Eighth Schedule*

As explained above,¹¹⁵ shareholders disposing of shares may realise a capital loss to the extent that the base cost of the shares exceeds the proceeds from the disposal. In respect of share buyback transactions, the shareholder may realise an ‘economical’ capital gain from the disposal of the shares. However, because the proceeds have been reduced to nil in accordance with para 35(3)(a) of the Eighth Schedule, the base cost of the shares could exceed the proceeds from the disposal, resulting in a capital loss. The ‘artificial’ capital loss may result in an asymmetrical tax position¹¹⁶ when the shareholder later deducts that capital loss against current and/or future capital gains and ultimately reduces its income tax liability.¹¹⁷ Paragraph 19 of the Eighth Schedule seeks to address this tax asymmetry.

Paragraph 19(1)(a) of the Eighth Schedule applies to share buyback transactions and limits any capital loss on such disposal as does not exceed any ‘exempt dividends’.¹¹⁸ Further, para 19(1)(b) of the Eighth Schedule applies when a person disposes of a share as a result of any other circumstance as contemplated in subpara (a) and limits any capital loss on such disposal as does not exceed any ‘extraordinary exempt dividends’.¹¹⁹ By way of example, if the shareholder realised a capital loss of R1 million and the exempt dividends or extraordinary dividends are R800 000, only R800 000 of the capital loss must be disregarded. Paragraph 19 is subject to para 43A of the Eighth Schedule¹²⁰ and therefore will not apply to the extent that the dividend is subject to dividends tax¹²¹ or does not constitute an ‘extraordinary dividend’ as defined in para 43A of the Eighth Schedule.

¹¹⁴ Bosman op cit note 101 at 34.

¹¹⁵ Paragraph (a) of Section II.

¹¹⁶ SARS *Comprehensive Guide to CGT* (2020) at 778.

¹¹⁷ See the discussion in para (a) of Section II above.

¹¹⁸ ‘Exempt dividends’ for purposes of para 19 of the Eighth Schedule means dividends that are exempt from both income and dividends tax. See also SARS *Comprehensive Guide to CGT* (2020) at 778.

¹¹⁹ ‘Extraordinary exempt dividends’ for purposes of para 19 of the Eighth Schedule ‘means so much of the amount of the aggregate of any exempt dividends received or accrued within the period of 18 months...as exceeds 15 per cent of the proceeds received or accrued from the disposal; and...as has not been taken into account as an extraordinary dividend in terms of paragraph 43A(2)’. See para 19(3)(c) of the Eighth Schedule. See also SARS *Comprehensive Guide to CGT* (2020) at 782.

¹²⁰ Section 55 of the Taxation Laws Amendment Act 34 of 2019.

¹²¹ SARS *Comprehensive Guide to CGT* (2020) at 742.

Albeit this provision aims to curb the abuse of share buyback transactions, its effectiveness is arguable as non–corporate shareholders generally fall outside the ambit of its application on the basis that they do not qualify for the dividend exemption.¹²² Paragraph 19 of the Eighth Schedule only applies where exempt dividends or extraordinary exempt dividends have been received by or accrued to a shareholder in respect of the share or as part of the disposal thereof. In this respect, non–corporate shareholders who realise an ‘artificial’ capital loss on disposal of the shares in respect of a share buyback transaction will likely be subject to dividends tax on the repurchase consideration, and the dividend is therefore not an ‘exempt dividend’ for purposes of the application of para 19 of the Eighth Schedule. Non–corporate shareholders are therefore entitled to utilise the artificial capital loss and set it off against current or future capital gains realised, subject to the provisions of para 39 of the Eighth Schedule. Although the benefit of the use of the ‘artificial’ capital loss comes at the expense of dividends tax which may provide some degree of tax neutrality, para 19 of the Eighth Schedule creates tax arbitrage where shareholders do not receive exempt or extraordinary exempt dividends.

In addition to para 19 of the Eighth Schedule, where the target company redeems its shares, para 39(5) of the Eighth Schedule provides that the holder of those shares must, for the purposes of para 39(1) of the Eighth Schedule, be treated as having disposed of those shares to the target company. Accordingly, para 39(5) of the Eighth Schedule brings share buyback transactions into the ambit of the ring–fencing provisions contained in para 39 of the Eighth Schedule.¹²³ In terms of para 39(1) of the Eighth Schedule, when determining the shareholder’s aggregate capital gain or loss, any capital loss realised by the shareholder on disposal of an asset¹²⁴ to a person who is a connected person in relation to that shareholder immediately prior to the disposal or that person forms part of the same group of companies of the shareholder immediately after the disposal,¹²⁵ must be disregarded. The disregarded capital loss may then only be deducted from the shareholder’s capital gains realised in respect of disposals of assets during the current and/or future years to that same connected person, to the extent that that person is still a connected person in relation to the shareholder at the time of those disposals.¹²⁶

¹²² Section 64F(1) of the Act.

¹²³ Section 79 of Act 23 of 2018. See also National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018* (2019) at 59.

¹²⁴ See para (a) of Section II for further discussion.

¹²⁵ See De Koker & Williams op cit note 3 § 24.161.

¹²⁶ Paragraph 39(2) of the Eighth Schedule. See also De Koker & Williams op cit note 3 § 24.161.

Therefore, the capital loss is in effect ring-fenced or ‘clogged’ as it may only be deducted from current and/or future capital gains realised on disposals of assets to that same connected person.

Again, albeit this provision aims to curb the abuse of share buyback transactions, it only applies if the target company is a connected person in relation to the shareholder. In terms of s 1 of the Act, a ‘connected person’ in relation to a company is defined as, among other things, any other company that holds at least 20 per cent of the equity shares or voting rights in the company and there is no majority shareholder.¹²⁷ Therefore, to the extent that the corporate shareholder held less than 20 per cent of the equity shares or voting rights in the target company and is therefore not a connected person in relation to the target company, any capital loss realised on the disposal of the shares in respect of the share buyback transaction will not be ring-fenced. The shareholder will therefore be entitled to apply such capital loss against any current or future capital gains of the shareholder, subject to the provisions of para 19 of the Eighth Schedule. This too creates tax arbitrage where shareholders and target companies are not connected persons in relation to each other and realise a capital loss disposal of the shares.

(iii) Section 35 of the TAA

Section 35(2) of the TAA expands the definition of reportable arrangements¹²⁸ and determines that ‘[a]n “arrangement” is a “reportable arrangement” if the Commissioner has listed the ‘arrangement’ in a public notice’. SARS identified certain share buyback transactions to be ‘reportable arrangements’ for purposes of s 35 TAA.¹²⁹ Pursuant to the Government Notice published in 2015, an arrangement is identified as a ‘reportable arrangement’ where a company repurchases its shares for an aggregate amount exceeding R10 million and issues or is required to issue shares within 12 months thereof. The parties to a ‘reportable arrangement’ as defined in s 35(1) read with s 35(2) of the TAA are required to notify SARS of the arrangement and disclose information pertaining to the reportable arrangement to SARS.¹³⁰ This affords SARS additional scrutiny over the share buyback transaction to identify the potential application of any anti-avoidance provisions.

¹²⁷ Paragraph (d)(iv) of the definition of ‘connected person’ in s 1(1) of the Act. See also SARS *Interpretation Note 67* ‘Connected Persons’ (2020).

¹²⁸ Milton Seligson ‘Restructuring companies via the corporate rules: Tax methodology and analysis’ 2019 *Business Tax & Company Law Quarterly* 1 at 11.

¹²⁹ GN 212 GG 38569 of 6 March 2015.

¹³⁰ Section 38 of the TAA requires the information to be submitted to SARS in relation to a reportable arrangement, such as a description of the steps and its key features, a list of the relevant agreements, particulars of the participants and their assumed ‘tax benefits’, and a financial model embodying the projected tax treatment.

This additional scrutiny is however only afforded to SARS in limited circumstances as share buyback transactions below the R10 million threshold or that are not followed by the issue of shares do not constitute reportable arrangements for purposes of s 35 of the TAA. The parties to those share buyback transactions are therefore not required to report the details of the transaction to SARS and thereby circumvent the additional scrutiny from SARS.

(c) Legislative amendments effective to curb abuse or not?

The efficacy of the legislative amendments to curb abuse must be evaluated, taking into account the current legal position and the challenges posed by the application of the specific anti-avoidance provisions in respect of share buyback transactions.

First, para 43A of the Eighth Schedule only applies to corporate shareholders and does not affect non-corporate shareholders such as trusts.¹³¹ Therefore, a trust shareholder that disposes of its shares in the target company through a share buyback transaction and receives dividends prior to or as part of the repurchase consideration of the disposal of the shares will not be subject to the provisions of para 43A of the Eighth Schedule. In respect of a trust shareholder, no amount is required to be included in the proceeds or capital gain of the trust shareholder. This yields a favourable tax outcome for the trust shareholder who will only be subject to dividends tax at the lower rate of 20 per cent as opposed to CGT at an effective rate of 36 per cent in respect of a conventional sale of shares.

Secondly, para 43A of the Eighth Schedule does not directly affect minority corporate shareholders below the 50 per cent or 20 per cent threshold, as the case may be. Minority corporate shareholders therefore still escape the consequences of para 43A of the Eighth Schedule¹³² and enjoy tax neutrality when they enter into share buyback transactions.

Thirdly, even if para 43A of the Eighth Schedule applied to a corporate shareholder in respect of a share buyback transaction, an effective tax rate of 18.36 per cent¹³³ will apply to such 'taxable' share buyback transactions that fall within the ambit of the specific anti-avoidance provisions of para 43A of the Eighth Schedule. The effective CGT rate applicable to a 'taxable' share buyback transaction still yields a favourable tax outcome for the corporate shareholder compared to the 21.6 per cent effective CGT rate applicable to a conventional sale of shares.¹³⁴

¹³¹ Williams op cit note 37 at 7.

¹³² Zaaiman op cit note 76 at 31.

¹³³ [85 per cent (extraordinary dividend) x 21.6 per cent (effective CGT rate of companies)].

¹³⁴ Zaaiman op cit note 76 at 31.

Fourthly, non–corporate shareholders who do not receive ‘exempt dividends’ in respect of the share buyback transaction will not be precluded under para 19 of the Eighth Schedule from utilising the ‘artificial’ capital loss against its current and/or future capital gains.

Fifthly, only shareholders who are connected persons in relation to the target company immediately prior to the share buyback transaction will be subject to the ring–fencing of the capital loss realised on disposal of those shares to the target company. Shareholders who hold less than 20 per cent of the shares in the target company are generally excluded from the ring–fencing provisions.

And lastly, share buyback transactions concluded for less than R10 million, or that are not followed by the issue of shares, are not required to be reported to SARS.

Considering the above, the current specific anti–avoidance provisions applicable to share buyback transactions are not broad enough to capture all the variations of share buyback transactions, and a large majority of disposals (actual or deemed) remain outside the ambit of the application of these provisions.

VI GENERAL ANTI–AVOIDANCE RULES

Where a share buyback transaction falls outside the ambit of the specific anti–avoidance provisions, SARS may¹³⁵ still invoke the GAAR to prevent tax avoidance.¹³⁶ The application of the GAAR enables SARS to make certain adjustments, including the reclassification of income,¹³⁷ to bring a share buyback transaction within the net of taxation.

The provisions of the GAAR are set out in ss 80A–80L of the Act and apply to ‘impermissible avoidance agreements’. An ‘impermissible avoidance agreement’ essentially means an ‘avoidance arrangement’¹³⁸ if its sole or main purpose is to obtain a ‘tax benefit’.¹³⁹ Therefore, for the GAAR to apply, there must first be an arrangement that results in a tax benefit, and secondly, the sole or main purpose of that arrangement must be to obtain that tax benefit (i.e., ‘impermissible avoidance arrangement’).

¹³⁵ There is no case law yet on the application of the GAAR on share buyback transactions.

¹³⁶ Tredoux & van der Linde op cit note 32 at 11. The common law doctrine of substance over form can also be applied to prevent tax avoidance where the form of an arrangement differs from its substance.

¹³⁷ Section 80B of the Act. See also De Koker & Williams op cit note 3 § 24.163A.

¹³⁸ ‘Arrangement’ is defined in s 80L of the Act to include any transaction, agreement, operation, or understanding. See also s 80H of the Act which determines that steps or parts of an arrangement constitute an ‘arrangement’ themselves. See French & Stretch op cit note 44 § 26.3.2.

¹³⁹ See s 80A of the Act. See also the definition of ‘tax benefit’ in s 1 of the Act which includes the avoidance or reduction of ‘tax’. Further, see also the definition of ‘tax’ in s 80L of the Act which includes any tax imposed in terms of the Act or any other act that is administered by the Commissioner of SARS.

While the application of the GAAR to share buyback transactions is beyond the scope of this report, it is briefly discussed as share buyback transactions must still withstand the application of the GAAR where it falls outside the scope and application of the specific anti-avoidance provisions. However, the likelihood of SARS invoking the GAAR to set aside a share buyback transaction where it meets the requirements of an impermissible avoidance arrangement is yet to be determined as there is currently no case law on this subject matter.

VII CONCLUSION

Despite the legislative amendments, there are still certain variations of share buyback transactions that fall outside the scope and application of the specific anti-avoidance provisions. Most notably, the specific requirements for the application of para 43A of the Eighth Schedule do not rule out the possibility of the target company and its non-corporate shareholder or corporate shareholder with no qualifying interest to enter into a share buyback transaction and use the favourable tax dispensation provided to dividends. Therefore, taxpayers may still, through careful tax planning and proper implementation, circumvent or reduce the tax consequences that would have otherwise applied in respect of a conventional sale of shares.

Accordingly, it is submitted that the ambit of the specific anti-avoidance provisions remains very narrow despite the legislative amendments, and its aim to curb abuse is often missed. This inefficacy of the current legal position affirms share buyback transactions as a tax-efficient method for a shareholder to exit a company over the conventional sale of shares. To effectively curb the abuse of share buyback transactions, it is suggested that the current specific anti-avoidance provisions as they apply to share buyback transactions be expanded to include the variations that currently do not fall within their ambit. However, the drawback of this suggestion is that such further legislative amendments will be subject to increasing legislative complexity.¹⁴⁰

While the specific anti-avoidance provisions continue to develop within our tax law,¹⁴¹ the latest legislative amendments were introduced more than four years ago. National Treasury has also not included any proposed legislative amendments in the Draft Taxation Laws Amendment Bill, 2023.¹⁴² Accordingly, the future expansion of the scope and application of the current specific anti-avoidance provisions remains uncertain. In another vein, it would be

¹⁴⁰ Zaaiman op cit note 76 at 31.

¹⁴¹ Rudnicki op cit note 101 at 14.

¹⁴² Published on 31 July 2023.

beneficial to both taxpayers and tax advisers for the courts to provide guidance and clarity on the application of the GAAR as they apply to share buyback transactions that constitute impermissible avoidance arrangements.

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