South African Institute of Tax Professionals

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The National Treasury
240 Madiba Street
PRETORIA
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The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
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RE: ANTI-DIVIDEND STRIPPING RULES - 2018 DRAFT TAXATION LAWS AMENDMENT BILL

We would like to thank you for the consultation meeting held on 13 April 2018 and the opportunity to make further written submissions regarding the anti-dividend stripping rules. During the meeting the refinement of the anti-avoidance rules dealing with share buy-backs and dividend stripping in respect of preference shares as well as the interaction of the anti-avoidance rules dealing with share buy-backs and the corporate re-organisation rules were discussed.

We welcome your willingness to review the interaction of the anti-avoidance rules and the corporate reorganisation rules. However, we would like to highlight that there are also other innocent commercial transactions that may also be hampered by the wide impact of the new anti-avoidance rules.

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The rules have a much wider impact than the mischief that they seek to address. The mischief is essentially that the seller of shares in a company receives a tax-exempt dividend instead of taxable proceeds. The transactions typically have two steps – a purchaser contribution followed by a dividend / buyback for the seller. These dividends are funded, directly or indirectly by the purchaser of the shares. We understand the government concern that this provision must be drafted widely to prevent the various forms of mischief involved. Unfortunately, the new rules go too far and adversely impact wholly innocent transactions that should be fully allowed as a policy matter.

In addition to transactions that involve the corporate reorganisation rules, there are other wholly innocent commercial transactions that are being adversely affected that do not involve any outside purchaser. For example, where corporate shareholders that are involved in straight-forward share buybacks (redemptions):

> Facts:
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> Parent Company owns 700 ordinary shares of Subsidiary and BEE Company owns 300 shares of Subsidiary. Assume that all companies are domestic; the shares are valued at R1 million each; and the ownership structure has existed for 5 years. What happens if Subsidiary buys back 10 per cent of its shares from either shareholder company and no further transaction takes place?
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> Outcome:
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> Pre-2017 TLAB: Both share buybacks would be treated as a dividend under the section 1 definition (unless a capital distribution is chosen). Dividends between domestic companies are tax-free. No losses will result upon the corresponding disposal of the shares (see paragraph 19(1) of the 8th Schedule).
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> 2017 TLAB: The share buyback itself triggers new paragraph 43A, thereby converting the tax-free dividend into a taxable transaction. This outcome applies even though no external funding is involved. In effect, each shareholder of Subsidiary is "disposing of shares in another company", and there is an "exempt dividend received by or accrued to that company [is] in respect of the share disposed of". The dividend will be "extraordinary" because the full value of the shares is fully distributed in a buyback.

We appreciate and welcome the consultation in advance of the publication of the DTLAB and look forward to future consultations.

Yours sincerely

Erika de Villiers

Head of Tax Policy