

**DRAFT INTERPRETATION NOTE 93 (Issue 2)**

DATE:

**ACT : INCOME TAX ACT 58 OF 1962**

**SECTION : SECTIONS 1(1) – DEFINITION OF “FOREIGN DIVIDEND”, 6quat, 9(4)(a), 9D(9)(f), 10B, 22(3)(a)(iii), 23(f), 23(q) AND 25D AND PARAGRAPH 20(1)(h)(iii) OF THE EIGHTH SCHEDULE**

**SUBJECT : THE TAXATION OF FOREIGN DIVIDENDS**

Issue 1 of Interpretation Note 93 “The Taxation of Foreign Dividends” has been updated primarily to reflect legislative amendments. Some of the more significant amendments include the following:

- The ratios applied in section 10B(3) to calculate the partial exemption applicable to foreign dividends were amended (see **4.3.7**).
- The circumstances in which the exemption is no longer available under section 10B(5) and section 10B(6) were amended (see **4.3.9** and **4.3.10**).

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### **Preamble**

In this Note unless the context indicates otherwise –

- “**CFC**” means a “controlled foreign company” as defined in section 1(1);
- “**CGT**” means capital gains tax, being the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- “**JSE**” means the securities exchange operated by JSE Ltd;
- “**OECD**” means the Organisation for Economic Co-operation and Development;
- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;
- “**tax treaty**” means an agreement for the avoidance of double taxation entered into between South Africa and another country;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes and rulings referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issue of these documents should be consulted.

In the examples, the amounts of foreign dividends, foreign tax and other amounts have already been translated from foreign currency to rand, unless stated otherwise.

## 1. Purpose

This Note provides guidance on the interpretation and application of various provisions of the Act relating to foreign dividends. The Note does not deal with the income tax consequences of a dividend paid by a headquarter company, since this topic is addressed in Interpretation Note 87 “Headquarter Companies”.

This Note reflects the income tax and tax administration legislation (as amended) at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 17 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41342).
- The Tax Administration Laws Amendment Act 13 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41341).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 14 of 2017 which was promulgated on 14 December 2017 (as per *Government Gazette* 41323).

## 2. Background

With effect from 1 January 2011, a definition of “foreign dividend” was introduced into section 1(1) and, combined with the insertion of the definition of “foreign company” and changes to the definition of “dividend”, had the result that on or after that date foreign dividends no longer fell within the definition of “dividend” in section 1(1). A dividend and a foreign dividend are mutually exclusive. A dividend relates solely to specified amounts transferred or applied by a resident company. A foreign dividend relates solely to specified amounts paid or payable by a foreign company, which by definition is a non-resident.

Broadly speaking, a foreign dividend is included in a person’s gross income but may qualify for a full or partial exemption from normal tax under section 10B. With effect from March or April 2012<sup>1</sup> the exemptions available for foreign dividends meeting the relevant criteria under section 10(1)(k)(ii)(aa) to (dd) were moved to section 10B(2) and underwent some amendment. In addition, the basic exemption available to natural persons of R3 700 under section 10(1)(j)(xv)(aa)<sup>2</sup> for foreign dividends and foreign interest not otherwise exempt, was deleted and a partial exemption was introduced under section 10B(3). The partial exemption under section 10B(3) is intended to ensure that the maximum effective rate of tax on taxable foreign dividends does not exceed the dividends tax rate applicable to local dividends. With effect from years of assessment commencing on or after 1 March 2017,

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<sup>1</sup> For an explanation of the effective dates see the *Tax Guide for Share Owners*.

<sup>2</sup> The basic exemption was deleted with effect from 1 March 2012.

the maximum effective rate of tax on taxable foreign dividends increased from 15% to 20%.<sup>3</sup>

This Note discusses the current gross income inclusion, exemptions and other provisions applicable to foreign dividends.

### 3. The law

The relevant provisions of the Act are quoted in the **Annexure**.

### 4. Application of the law

#### 4.1 Definitions [section 1(1)]

##### 4.1.1 Definition of “foreign dividend”

The term “foreign dividend” is defined in section 1(1) as follows:

“**[F]oreign dividend**”, means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to—

- (a) tax on income on companies of the country in which that foreign company has its place of effective management; or
- (b) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable that—

- (i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of “company”; or
- (ii) . . . . .
- (iii) constitutes a share in that foreign company;”

The various elements of the definition of “foreign dividend”, including the exclusions from the definition, are discussed below.

#### (a) Meaning of any “amount”

The meaning of “amount” was judicially considered in *WH Lategan v CIR*<sup>4</sup> in relation to its use in the definition of “gross income” and the following dictum of Watermeyer J has been acknowledged and applied in a number of other cases:<sup>5</sup>

“In his Lordship’s opinion the word ‘amount’ had to be given a wider meaning and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which had a money value.”

<sup>3</sup> Section 8 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 14 of 2017.

<sup>4</sup> 1926 CPD 203, 2 SATC 16 at 19.

<sup>5</sup> See *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301, 13 SATC 21 at 34 and *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 21.

In *CIR v People's Stores (Walvis Bay) (Pty) Ltd*<sup>6</sup> the court, in applying this principle, held that the right to claim payment of a debt in the future was of such a nature that a value could be attached to it in money and the amount therefore had to be included in gross income. Similarly in *Cactus Investments (Pty) Ltd v CIR*,<sup>7</sup> the court included the right to receive interest in the future in gross income because it was a right of a non-capital nature which was "capable of being valued in money".

In *C: SARS v Brummeria Renaissance (Pty) Ltd & others*<sup>8</sup> it was held that the ability to turn a receipt or accrual into money was merely one of the tests for determining whether an accrual had a money value and it did not follow that if a receipt or accrual could not be turned into money that it had no money value.<sup>9</sup> The court also confirmed that the test whether a receipt or accrual had a money value was objective, not subjective.

The same meaning should be ascribed to the word "amount" within its context in the definition of "foreign dividend" in section 1(1).

A foreign dividend can therefore constitute the payment of cash or the transfer of assets (a dividend *in specie*). A foreign dividend *in specie* paid or payable by a foreign company can include, amongst other things, the transfer of the following:

- Shares held by the foreign company in another company.
- Debentures held in another company.
- Other movable or immovable assets.
- A debt owing to the company.

The value to be placed on the transfer of assets as a foreign dividend *in specie* is their market value.<sup>10</sup>

#### **(b) Meaning of "paid or payable"**

A foreign dividend is, amongst other requirements, an amount that is paid or payable by a foreign company. Whether an amount is paid or payable is a question of fact that must be determined on the particular facts of each case.

In *Marra Developments Ltd v BW Rofe (Pty) Ltd* it was held as follows:<sup>11</sup>

"Under the general law, the payment of a dividend normally involves two steps: the declaration of the dividend by the competent authority...and the payment over of money in satisfaction of the dividend".

#### ***Paid***

An amount can be paid in a variety of ways, including in cash, in kind, in the form of set-off or by crediting a loan account. There is generally little difficulty in determining the date of payment when the dividend is paid in cash. However, the date of payment can be more difficult to establish when payment is in a form other than cash.

<sup>6</sup> 1990 (2) SA 353 (A), 52 SATC 9.

<sup>7</sup> 1999 (1) SA 315 (SCA), 61 SATC 43.

<sup>8</sup> 2007 (6) SA 601 (SCA), 69 SATC 205.

<sup>9</sup> See also Interpretation Note 58 "The *Brummeria* Case and the Right to Use Loan Capital Interest Free".

<sup>10</sup> *Lace Proprietary Mines Ltd v CIR* 1938 AD 267, 9 SATC 349.

<sup>11</sup> (1977) 3 ACLR 185 CA (NSW) at 195.

ITC 1688<sup>12</sup> sets out some useful principles for determining the date of payment of a dividend when payment is in the form of set-off, cheque or loan account.

In that case the appellant company declared a dividend to its sole shareholder on 2 March 1992 and 5 March 1993. Payment of these dividends was not made in cash or by cheque, instead the resolutions declaring the dividends provided that payment of the dividend would be effected by crediting the shareholder's loan account. Journal entries were effected giving credit to the shareholder, however the shareholder's loan account was credited only on 31 July 1993. At issue was whether the dividends were subject to STC which came into operation on 17 March 1993. The relevant legislation provided that dividends declared before 17 March 1993 and paid on or after that date were deemed to be declared on 17 March 1993 thus making them potentially subject to STC. The crisp issue was whether the dividends were paid before 17 March 1993.

In delivering his judgment Galgut J stated the following on the nature of payments generally:<sup>13</sup>

"The determination of the date upon which a payment is made is of course a question of fact. When payment of a dividend is made in cash there can of course be no difficulty in determining the date of such payment. The same applies to a payment by cheque, even if the cheque is post-dated or dishonoured, because payment will be effected when the proceeds of the cheque are received by or on behalf of the payee.

Payment can of course be made other than in cash or by cheque. There are a number of possibilities. To take but one, it might happen for example that a shareholder owes his company money, and that the company thereafter becomes indebted to the shareholder by the declaration of a dividend. In such a case the company may elect to effect a set-off, provided of course all of the other requisites for a set-off are present. One such requisite is that both debts must be fully due. In such a case the shareholder would have no choice because, as was said in *Lester Investments (Pty) Ltd v Narshi* 1951 (2) SA 464 (C) at 472B-C, set-off operates *ipso jure*,<sup>14</sup> and it is effective from the date upon which the parties became mutually indebted to each other. It would therefore operate without the shareholder's consent, and what is more it would operate immediately upon the declaration of the dividend. If the debt owing by the shareholder is recorded in a loan account with the company, then the set-off will be recorded by crediting the taxpayer's loan account in the amount concerned.

It is important to emphasise, however, that such crediting is no more than a recording of a pre-existing fact, so that the operation of the set-off will not depend upon the crediting of the loan account.

As distinct from the operation of a set-off, or from the tender of cash or (subject to certain qualifications which are not relevant for present purposes) a cheque, all other forms of payment can only discharge a debt if the creditor agrees thereto. One such agreement is where the creditor agrees, as in the present case, to lend the money concerned to the debtor, where he agrees in other words that the debtor may retain the money as a loan. In such an event, as in the case of a set-off, both the payment of the dividend and the advancing of the loan in each instance take place automatically, and as such they are effected *pari passu* with the conclusion of the agreement. As such, and this must be emphasised, payment is in each case effected on the date upon which the agreement is concluded. It would of course be otherwise were the

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<sup>12</sup> (1999) 62 SATC 478 (N).

<sup>13</sup> At SATC 481.

<sup>14</sup> By operation of law.

resolution whereby the dividend is declared to contain a term showing that the dividend is to be paid at some date thereafter, or were the agreement of loan to contain a term showing that the loan would similarly be delayed. In the absence of such an indication, in the absence in other words of anything to show that the parties intended otherwise, it would be fair to conclude that both the payment of the dividend and the reciprocal advancing of the loan occurred, and were intended to occur, then and there.”

In summary, the court held that payments in a form other than cash, cheque or set-off can discharge a debt only with the creditors consent. Based on the facts of the case the court found that consent took place when the respective resolutions were passed and not when the physical crediting of the loan account took place and accordingly found in favour of the appellant.

In concluding the court stated the following:<sup>15</sup>

“I should emphasise finally that nothing I have said should be understood to mean that where declared dividends are left on loan in a company, it will be presumed or will necessarily mean that payment takes place at the time the dividend is declared. At the risk of repeating myself I stress that the date of payment is a question of fact, and that as such the date must be determined on the particular facts of each case.”

The judge’s concluding comments highlight that the outcome of ITC 1688 may have been different had the resolution contained a term indicating that payment would be made at a later date.

This case emphasised the importance of the facts of the particular case in determining when an amount is considered to be paid and highlighted that the crediting of a loan account will not necessarily constitute payment.

### *Payable*

The declaration of a dividend creates a debt owing to a holder of a share. Such a debt arises out of a formal act performed by a company.<sup>16</sup> A dividend declared by a company that is not listed is generally due on the date on which the dividend is declared even if it is stipulated to be payable on a later date. A dividend declared by a listed company is generally due to holders of shares listed in the share register only on the “record date”,<sup>17</sup> with payment to follow at a later specified date.

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<sup>15</sup> At SATC 482.

<sup>16</sup> *Boyd v CIR* 1951 (3) SA 525 (A), 17 SATC 366 at 377; *South African Iron and Steel Industrial Corp Ltd v Moly Copper Mining and Exploration Co (SWA) Ltd & others* 1993 (4) SA 705 (NMH) at 711 and 713.

<sup>17</sup> The term “record date” is, for example, defined in the JSE Limited Listings Requirements as “the date on which the holdings, upon which the event entitlement is based are ascertained. Record date is one settlement period after LDT [last day to trade cum div] (currently 3 business days). Record date must be on a Friday or, if Friday is a public holiday, the last trading day of the week”. In the context of shares listed on a foreign stock exchange, record date will depend on the rules of the particular exchange or the company law of the country concerned.



It has been held that the word “payable” can have different meanings. In *CIR v Janke*<sup>18</sup> Stratford J quoted<sup>19</sup> the judgment of Searle J in *Stafford v Registrar of Deeds* in which the following was stated:<sup>20</sup>

“It is clear that the word ‘payable’ is sometimes construed as meaning ‘payable at a future time’ or ‘in respect of which there is a liability to pay’. It is also true that it is sometimes used to mean ‘payable immediately’ or ‘actually due and presently demandable’.”

In *Singh v C: SARS* Olivier JA stated that –<sup>21</sup>

“[t]he word ‘payable’ can have at least two different meanings, viz ‘. . . (a) that which is due or must be paid, or (b) that which may be paid or may have to be paid . . . The sense of (a) is a present liability – due and payable – . . . (b) . . . a future or contingent liability’.”

A dividend is payable once it is due to the holders of the shares under the principles discussed above. This approach is consistent with the determination of the timing of the accrual from a gross income perspective under paragraph (k) of the definition of “gross income” in section 1(1) and the exemptions in section 10B which refer back to the definition of “foreign dividend” in section 1(1). Thus, assume that a listed foreign company declared a dividend payable to holders of its shares listed in the share register on 31 December with payment to follow on 31 March. On 31 December the dividend accrued to the holders of shares and because it will be viewed as being payable by that foreign company for purposes of the definition of “foreign dividend” in section 1(1), the exemptions in section 10B can be applied if the other requirements of the section are met.

#### **(c) Meaning of “foreign company”**

See the definition of “foreign company” in 4.1.2.

#### **(d) Meaning of “in respect of a share”**

The amount paid or payable by a foreign company must, amongst other requirements, be paid or payable “in respect of a share” in that company.

The term “share” is defined in section 1(1) as follows:

“‘[S]hare’ means, in relation to any company, any unit into which the proprietary interest in that company is divided;”

The term “proprietary interest” is not defined in the Act. Its ordinary meaning is described as –<sup>22</sup>

“[a]dvantage, profit, right, or share held by the owner of a tangible or intangible asset or property with all associated rights”.

<sup>18</sup> 1930 AD 474, 4 SATC 269.

<sup>19</sup> At SATC 276.

<sup>20</sup> 1913 CPD 379.

<sup>21</sup> 2003 (4) SA 520 (SCA), 65 SATC 203 at 216.

<sup>22</sup> [www.businessdictionary.com/definition/proprietary-interest.html](http://www.businessdictionary.com/definition/proprietary-interest.html) [Accessed 22 February 2018].

In *Standard Bank of South Africa Ltd & Another v Ocean Commodities Inc & others* Corbett JA stated the following regarding the meaning of a share:<sup>23</sup>

“A share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends.”

The question whether a foreign company has shares and whether an amount is paid or payable in respect of a share in that company is a factual one. It was held by Howie P in *Stevens v C: SARS*<sup>24</sup> that “in respect of” in paragraph (c) of the definition of “gross income” in section 1(1) connotes a causal relationship between the amount received and the taxpayer’s services.<sup>25</sup> Applying this construction to the definition of “foreign dividend”, there must be a causal relationship between the amount paid or payable and the share.

An amount which is unrelated to a person’s shareholding will not be derived “in respect of” a share. For example, the purchase by a foreign company of an asset at an arm’s length price from a holder of shares on the same terms offered to the public would not constitute a foreign dividend because the amount paid by the company to that holder would not have been paid “in respect of” the holder’s shares in the company but by virtue of the arm’s length acquisition of the asset by the company.

Another example arises when a holder of shares is an employee of the foreign company and receives remuneration for services rendered. The salary paid to the employee would generally not be “in respect of” the employee’s shareholding but “in respect of” the employee’s services and would accordingly not constitute a foreign dividend. The facts of each case must, however, be considered. For example, if the employee had sufficient shares to exercise control over the company and was able to influence the payment of an excessive salary, there may be a link to the employee’s shareholding.

Section 10B(6) is an anti-tax avoidance provision that disallows the exemptions available under section 10B in specified circumstances when a foreign dividend, which is by definition “in respect of a share”, is received by a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office or in respect of a restricted equity instrument as defined in section 8C (see **4.3.10**).

**(e) Treatment of an amount paid or payable by a foreign company in respect of a share under foreign income tax law on companies or company law (paragraphs (a) and (b) of the definition of “foreign dividend”)**

An amount paid or payable by a foreign company in respect of a share in that foreign company must, amongst other requirements, be treated as a dividend or similar payment by that foreign company under –

- the laws relating to tax on income on companies, that is, income tax laws on companies, of the foreign country in which that foreign company has its place

<sup>23</sup> 1983 (1) SA 276 (A) at 288.

<sup>24</sup> 2007 (2) SA 554 (SCA), 69 SATC 1 at 7.

<sup>25</sup> See also *De Villiers v CIR* 1929 AD 227, 4 SATC 86; ITC 1493 (1989) 53 SATC 187 (T) and ITC 1856 (2011) 74 SATC 76 (WC). See *CIR v Shell Southern Africa Pension Fund* 1984 (1) SA 672 (A), 46 SATC 1 for a discussion on causally relevant factors and their interruption.

of effective management (paragraph (a) of the definition of “foreign dividend”);  
or

- the laws relating to companies in the country in which that foreign company is incorporated, formed or established, if that country does not have any applicable income tax law on companies (paragraph (b) of the definition of “foreign dividend”).

The use of the words “that foreign company” indicate that in assessing whether an amount is treated as a dividend or similar payment it must be considered from the perspective of the foreign company paying the amount in respect of its shares and not from the perspective of the holder of the foreign company’s shares. For example, if a share buy-back or liquidation distribution by a foreign company is a dividend from the perspective of the foreign company paying the amount or making the distribution under the laws relating to tax on income on companies or relevant company laws, as appropriate, but is a distribution of a capital nature from the perspective of the holder of the foreign company’s shares, the amount will be a “foreign dividend” as defined in section 1(1) if all the other requirements of the definition are met and regardless of whether the “source” of the buy-back or liquidation distribution was retained earnings or contributed equity capital. The treatment of the amount in the hands of the holder of the shares under foreign income tax law on companies or company law is irrelevant.

The company law of a foreign country is considered for purposes of the definition of “foreign dividend” only if the foreign country in which the company has its place of effective management does not have any applicable laws relating to tax on income. The term “applicable laws” refers to income tax laws which deal with the treatment of amounts paid or payable in respect of shares and also to the income tax laws applicable to the specific taxpayer concerned. For example, a foreign country may have different income tax provisions for amounts paid or payable in respect of shares by different types of companies. The income tax treatment of an amount paid or payable by a collective investment scheme, which constitutes a company, in respect of a share may, for example, differ from the income tax treatment of an amount paid or payable by a company incorporated with share capital in respect of a share.

*Income tax laws on companies of the foreign country in which that foreign company has its place of effective management (paragraph (a) of the definition of “foreign dividend”)*

The term “place of effective management” is not defined in the Act and must be given its ordinary meaning, taking into account international precedent and interpretation. It, however, does not have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it. The principles and guidelines that will be applied for purposes of considering the term “place of effective management” in the definition of “resident” in section 1(1) are discussed in Interpretation Note 6 “Resident – Place of Effective Management (Companies)”. The following are extracts from paragraphs 4.1 and 4.2 of Interpretation Note 6 (Issue 2) which applies to years of assessment commencing on or after 3 November 2015:

“A company’s place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a

whole are in *substance* made. This approach is consistent with the OECD's commentary on the term 'place of effective management'.<sup>26</sup>

"A company may have more than one place of management but it can only have one place of *effective* management at any one time.<sup>27</sup> If a company's key management and commercial decisions affecting its business as a whole are made at a single location, that location will be its place of effective management. However, if those decisions are made at more than one location, the company's place of effective management will be the location where those decisions are primarily or predominantly made."

"Definitive rules cannot be laid down in determining the place of effective management and all relevant facts and circumstances must be examined on a case-by-case basis."

"The place of effective management test is one of *substance over form*. It therefore requires a determination of those persons in a company who actually 'call the shots' and exercise 'realistic positive management'."

Factors which may be relevant in determining whether an amount paid or payable by a foreign company in respect of a share constitutes a dividend or similar payment from that company's perspective under the income tax law on companies of the country in which the foreign company has its place of effective management include, for example, –

- whether the amount constitutes a dividend or similar payment, or a return of capital if that is different to a dividend, for determining tax on income of companies in the foreign country;
- whether the amount constitutes a dividend for purposes of withholding tax on dividends in the foreign country;
- whether the amount constitutes interest for purposes of withholding tax on interest in the foreign country; and
- the classification of the amount for purposes of tax treaties, namely, the tax treaty between South Africa and the foreign country in which the foreign company paying the amount is effectively managed.<sup>28</sup>

A foreign country in which a company has its place of effective management may under its income tax law on companies deem a dividend that is paid or payable in respect of a share to be interest that is deductible against income. For example, if the amount paid has a debt-like yield, such as a dividend calculated with reference to a specified interest rate or index, or a dividend calculated with reference to any factor other than the profits of the company which are available for distribution, the foreign tax law may deem that dividend to be interest paid by the foreign company declaring the dividend. Even though it is paid or payable in respect of a share, from the

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<sup>26</sup> Paragraph 24 of the *Commentaries on the Articles of the Model Tax Convention on Income and on Capital*, Condensed version, dated 15 July 2014 at 90.

<sup>27</sup> The view that a company can have only one place of effective management at any one time is consistent with paragraph 24 of the *Commentaries on the Articles of the Model Tax Convention on Income and on Capital*, Condensed version, dated 15 July 2014 at 91.

<sup>28</sup> See Binding Class Ruling 041 dated 24 July 2013 "Dividends Distributed by a Foreign Company" and Binding Class Ruling: BCR 046 dated 16 April 2015 "Dividends Distributed by Foreign Companies" dealing with the application of paragraph (a) of the definition of "foreign dividend" in section 1(1).

perspective of the company paying or declaring the dividend the amount is considered to be interest and not a dividend or a payment similar to a dividend. As a result, the amount will not constitute a “foreign dividend” as defined in section 1(1) and cannot qualify for any of the exemptions under section 10B.

**Example 1 – Tax treatment of an amount paid or payable by a foreign company in respect of a share under foreign income tax law on companies**

*Facts:*

Individual A holds 2% of the equity shares in Foreign Company A. Foreign Company A is effectively managed in Foreign Country A. Foreign Company A paid R100 000 out of its profits to Individual A in respect of the 2% shares in Foreign Company A.

Under Foreign Country A's income tax law on companies any distribution of profits made by a company to its holders of shares must be treated as a dividend by that company.

*Result:*

The amount of R100 000 paid by Foreign Company A constitutes a foreign dividend under paragraph (a) of the definition of “foreign dividend” in section 1(1) because Foreign Company A must treat the amount as a dividend under the income tax law on companies of Foreign Country A.

The income tax laws on natural persons of Foreign Country A are not considered in determining whether the amount of R100 000 constitutes a foreign dividend.

*Laws relating to companies in the country in which that foreign company is incorporated, formed or established, if that country does not have any applicable income tax law on companies (paragraph (b) of the definition of “foreign dividend”)*

To determine how the company law of a foreign country treats an amount paid or payable by a foreign company in respect of a share, regard must be had to the company law of that country and not the company law of South Africa.

The particular foreign country's law must be considered because different countries may treat the same factual position differently. For example, foreign country A's company law may treat the distribution of share premium by a company incorporated in that country as a dividend. Conversely, foreign country B's company law may under specified circumstances give a company incorporated in that country the ability to elect to treat the distribution of share premium by a company incorporated in that country as a dividend or as a return of capital.

**Example 2 – Treatment of an amount paid or payable by a foreign company in respect of a share under foreign company law**

*Facts:*

Resident Company A holds shares in Foreign Company A which is effectively managed in Foreign Country A while it is incorporated in Foreign Country B. Foreign Country A does not have any income tax law on companies.

Foreign Company A pays R100 000 from its income reserves to Resident Company A in respect of Resident Company A's shareholding in Foreign Company A.

Under the company law of Foreign Country B any amount paid by a company incorporated in that country from income reserves in respect of shares in that company must be treated by the company paying the amount as a dividend.

*Result:*

Since Foreign Country A, in which Foreign Company A is effectively managed, does not have any income tax law on companies, the company law of Foreign Country B must be considered in determining whether an amount paid or payable by Foreign Company A in respect of a share constitutes a foreign dividend under paragraph (b) of the definition of "foreign dividend" in section 1(1).

Since the company law of Foreign Country B provides that any amount paid by a company incorporated in that country from income reserves in respect of shares in that company must be treated by the payer as a dividend, R100 000 paid by Foreign Company A constitutes a foreign dividend.

**Example 3 – Treatment of amounts paid or payable by foreign companies in respect of shares under foreign company law**

*Facts:*

Resident Company A holds shares in Foreign Company A which is incorporated and effectively managed in Foreign Country B. Foreign Country B does not have any income tax law on companies. Resident Company A also holds shares in Foreign Company X which is incorporated and effectively managed in Foreign Country Y. Foreign Country Y does not have any income tax law on companies.

Foreign Company A and Foreign Company X each pay R100 000 to Resident Company A from their share premium accounts.

Under the company law of Foreign Country B the distribution of share premium as a dividend is allowed while the company law of Country Y prohibits the distribution of share premium as a dividend.

*Result:*

*R100 000 paid by Foreign Company A*

Since the company law of Foreign Country B provides for the distribution of share premium as a dividend, the payment of R100 000 constitutes a foreign dividend under paragraph (b) of the definition of "foreign dividend" in section 1(1).

*R100 000 paid by Foreign Company X*

Since the company law of Foreign Country Y prohibits the distribution of share premium as a dividend, the payment of R100 000 does not constitute a foreign dividend. It may instead constitute a "foreign return of capital" as defined in section 1(1) for Resident Company A with attendant CGT consequences under paragraph 76B (see 4.1.3).

**(f) Onus to obtain information on the income tax law on companies or company law of a foreign country**

Under section 102(1)(a) of the Tax Administration Act 28 of 2011 a taxpayer bears the onus of showing how the income tax law on companies or the company law of a foreign country, as appropriate, treats amounts paid or payable in respect of shares in a foreign company.

If a taxpayer is requested to submit supporting documentation such as copies of applicable legislation, rulings, opinions and court cases, SARS will evaluate those documents upon submission in order to determine whether the taxpayer has discharged the onus described above.

The need for supporting documentation and its appropriateness can be determined only on a case-by-case basis. For example, more detailed supporting documentation may be required in the context of hybrid-type entities which are unique to the foreign jurisdiction than for dividends declared by a listed multinational company. Depending on the facts, SARS may request that the taxpayer obtain written confirmation of the income tax treatment of amounts paid or payable by a foreign company in respect of shares in that company from the tax authority of the country in which the foreign company is effectively managed. Alternatively, if a foreign country does not have applicable income tax laws and the foreign country's company law must be applied to determine if the amount is treated as a dividend or similar payment, SARS may, depending on the facts, request that a taxpayer obtain written confirmation from the government department responsible for the foreign country's laws relating to companies. If a foreign tax authority or government department is unable to provide such written confirmation, this will be taken into consideration along with the other supporting documentation submitted.

**(g) Interpretation of the income tax law on companies or company law of a foreign country**

The foreign country's relevant tax authority bears the responsibility for the interpretation of its income tax law. Consequently SARS is generally bound to accept the determination by a foreign tax authority whether an amount paid or payable by a foreign company in respect of a share constitutes a dividend.

This principle similarly applies to a determination by the foreign country's authority relating to its company law.

**(h) Exclusion from the definition of "foreign dividend" – Redemption or buy-back of a participatory interest in a foreign collective investment scheme (paragraph (i) of the exclusions)**

Under paragraph (i) of the exclusions from the definition of "foreign dividend" in section 1(1), any amount paid or payable that constitutes a redemption (buy-back) of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of "company" in section 1(1) is excluded from the definition of "foreign dividend".

Paragraph (e)(ii) of the definition of “company” in section 1(1) includes –

- “ (e) any—
- (ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or”.

Any redemption or buy-back by a foreign collective investment scheme referred to above is therefore excluded from the definition of “foreign dividend” in section 1(1). The holders of the participatory interests are potentially liable for CGT on a redemption or buy-back if the participatory interests were held as capital assets. The amount of a redemption or buy-back will potentially be subject to normal tax if the participatory interests were held as trading stock.

**(i) Exclusion from the definition of “foreign dividend” – An amount paid or payable by a foreign company that constitutes a share in that company (paragraph (iii) of the exclusions)**

Under paragraph (iii) of the exclusions from the definition of “foreign dividend” in section 1(1), any amount paid or payable by a foreign company that constitutes a share in that foreign company is excluded from the definition of “foreign dividend”.

The transfer by a company of its own shares as capitalisation shares or bonus shares is excluded as a foreign dividend because it does not result in an outflow of overall value from the foreign company. All the underlying assets of the company remain with the company. In *CIR v Collins Innes* CJ stated the following in relation to the issue of bonus shares by a company.<sup>29</sup>

“The company has parted with no assets – no money or money’s-worth – and the shareholders have received none. The profits dealt with remain in the business as they were before [...] The total assets of the company have not been changed, and his original share represented the same proportion of the then issue as his increased shares do of the increased issue.”

An amount paid or payable by a foreign company that constitutes a share in that company also does not constitute a foreign return of capital, since it is specifically excluded in paragraph (ii) from the definition of “foreign return of capital” in section 1(1) (see **4.1.3**).

Section 40C provides that when a company issues shares in that company to a person for no consideration, the expenditure actually incurred by the person to acquire the shares must be deemed to be nil. The cost price of the shares under section 11(a) or their base cost under paragraph 20(1)(a) will therefore be nil. The holder of the shares so acquired will therefore be taxed on the amount received or accrued on subsequent disposal of the shares without the offset of any expenditure against the receipt or accrual. A person holding the shares as trading stock must include the consideration received or accrued in gross income, while a

<sup>29</sup> 1923 AD 347, 32 SATC 211 at 218.



person holding such shares on capital account must include the amount received or accrued in proceeds under paragraph 35.

**Example 4 – An amount paid or payable by a foreign company that constitutes a share in that company**

*Facts:*

Foreign Company A has share capital of R400 000 and retained income of R500 000. Foreign Company A issues 400 000 capitalisation shares of R1 each using its retained income to fund the capitalisation issue. Resident Company B holds 5% of the issued share capital in Foreign Company A. An amount of R20 000 ( $R400\,000 \times 5\%$ ) is received by Resident Company B as capitalisation shares.

*Result:*

The amount of R20 000 received by Resident Company B representing the issue of capitalisation shares by Foreign Company A does not constitute a foreign dividend, since the issue of capitalisation shares is excluded from the definition of “foreign dividend” in section 1(1) in paragraph (iii). The amount of R20 000 also does not constitute a foreign return of capital, since it is excluded under paragraph (ii) of the definition of that term in section 1(1).

Under section 40C the expenditure actually incurred by Resident Company B to acquire the capitalisation shares is deemed to be nil.

#### 4.1.2 Definition of “foreign company”

The term “foreign company” is defined in section 1(1) as follows:

“ **[F]oreign company**’ means any company<sup>30</sup> which is not a resident;”<sup>31</sup>

The definition of “foreign company” is relevant for purposes of the definition of “foreign dividend” in section 1(1), since a foreign dividend can be paid or be payable only by a foreign company. A dividend paid or payable by a resident company does not constitute a foreign dividend.

A foreign company can be one of the following:

- A company as defined in section 1(1) incorporated, formed or established in South Africa, but which has its place of effective management in another country and which is deemed to be exclusively a resident of the other country for purposes of the application of a tax treaty.<sup>32</sup>
- A company contemplated in paragraph (b) of the definition of “company” in section 1(1), namely, any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law, which is not effectively managed in South Africa or is effectively managed in South Africa but an applicable tax treaty deems it to be exclusively a resident of another country. The question whether an entity qualifies as an association, corporation, company or body corporate as contemplated in paragraph (b) of the definition of “company” is a

<sup>30</sup> The term “company” is defined in section 1(1) and is quoted in the **Annexure**.

<sup>31</sup> See the definition of “resident” in section 1(1).

<sup>32</sup> See the definition of “resident” in section 1(1).

factual one. The following factors, amongst others, will be taken into account in determining whether an entity qualifies as a company under paragraph (b):

- The nature of the agreement between the entity and its members.
  - The relationship between the entity and its members.
  - Whether the entity is separate and distinct from its members.
  - Whether the entity enjoys attributes of perpetual succession.
  - Whether the entity's assets are its exclusive property.
  - Whether the members have the right to manage the entity's business or to enter into transactions on its behalf.
  - Whether the members are liable for the entity's debts.
  - Whether the entity has the power to sue and the liability to be sued.
  - The law under which the entity is governed, that is the foreign law, will be considered in determining whether these factors apply to the entity in the foreign country.
- A company contemplated in paragraph (e)(ii) of the definition of "company" in section 1(1) not incorporated, established or formed in South Africa and which is not effectively managed in South Africa. A company contemplated in paragraph (e)(ii) is a portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest.

Two examples of companies that do not qualify as foreign companies, since they are considered to be residents,<sup>33</sup> are as follows:

- A company incorporated, formed or established in South Africa which has its place of effective management in another country with which South Africa has not concluded a tax treaty.
- A company that has its place of effective management in South Africa but which is incorporated, formed or established in another country with which South Africa has not concluded a tax treaty.

The definition of "company" in section 1(1) does not include a "foreign partnership" as defined in section 1(1).<sup>34</sup> It follows that a foreign partnership is similarly not included in the definition of "foreign company".

Any amount paid or payable by a foreign partnership in respect of a member's interest does not constitute a "foreign dividend", since it is not paid by a "foreign company" as defined in section 1(1). However, to the extent that the members of the partnership have a fractional interest in foreign dividends derived by a foreign partnership, those amounts will constitute foreign dividends derived by the members.

<sup>33</sup> See the definition of "resident" in section 1(1).

<sup>34</sup> The term "foreign partnership" is defined in section 1(1) and is quoted in the **Annexure**.

#### 4.1.3 Definition of “foreign return of capital”

The term “foreign return of capital” is defined in section 1(1) and is quoted in the **Annexure**.

The definition of “foreign return of capital” excludes an amount that constitutes a foreign dividend.<sup>35</sup> An amount paid or payable by a foreign company in respect of a share in that company will generally, but not necessarily, constitute a foreign dividend or a foreign return of capital. An amount paid or payable by a foreign company in respect of a share in that company could constitute something other than a foreign dividend or a foreign return of capital under that country’s income tax law on companies or company law, for example, interest [see **4.1.1(e)**].

The assessment whether the amount paid or payable constitutes a distribution or similar payment under the definition of “foreign return of capital” must be considered under –

- the income tax law on companies of the country in which the foreign company has its place of effective management; or
- the company law of the country in which the foreign company is incorporated, formed or established when the country in which it has its place of effective management does not have any income tax law on companies.

For shares held on capital account, an amount of a foreign return of capital received by or accrued to a person from a foreign company must be applied in reduction of the base cost of the shares under paragraph 76B. Should the base cost be exceeded, the excess is treated as a capital gain. See the paragraph in the *Comprehensive Guide to Capital Gains Tax* which deals with “Returns of capital - Reduction in base cost of shares”. The receipt or accrual of a foreign return of capital on shares held as trading stock is treated as an inclusion in gross income.

See Binding Class Ruling 061 “Foreign Return of Capital”.

#### 4.1.4 Definition of “controlled foreign company”

The term “controlled foreign company” is defined in sections 1(1) and 9D(1). These definitions are quoted in the **Annexure**.

In summary, a foreign company is a CFC –

- when more than 50% of its total participation rights are directly or indirectly held, or more than 50% of its voting rights are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies; or
- when its financial results are reflected in the consolidated financial statements of a resident as required under IFRS 10.

The exemption of foreign dividends under section 10B(2)(a), (b), (d) and (3) apply to dividends received by or accrued to a CFC for purposes of determining its net income under section 9D(2A) for proportionate inclusion under section 9D(2) in the income of residents holding a qualifying interest in the CFC.

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<sup>35</sup> In Example 3 a return of share premium by Foreign Company A is treated as a dividend under foreign company law and is accordingly not a foreign return of capital.

Specific rules apply to foreign dividends received by or accrued to a CFC in determining the –

- net income of a CFC [section 9D(9)(f)];
- cost price of a right in a CFC held as trading stock [section 22(3)(a)(iii)]; and
- base cost of a right in a CFC held as a capital asset [paragraph 20(1)(h)(iii)].

(See 4.9.)

## **4.2 Inclusion of foreign dividends in gross income [paragraph (k) of the definition of “gross income” in section 1(1)]**

### **4.2.1 Inclusion of foreign dividends in gross income of residents and controlled foreign companies**

Residents are, but for certain exclusions or exemptions, liable to normal tax on income derived from sources within and outside South Africa. The amount of a foreign dividend received by or accrued to a person is specifically included in gross income under paragraph (k) of the definition of “gross income” in section 1(1).

Foreign dividends received by or accrued to a non-resident are generally not subject to tax in South Africa because they are not from a South African source (section 9(4)(a) read with the definition of “gross income”). However, in the context of determining whether any net income of a CFC must be attributed to and included in the income of a resident, foreign dividends received by or accrued to a CFC represent an exception to this rule. In calculating the net income of a CFC to be attributed to a resident, the CFC is treated under section 9D(2A) as a taxpayer and a resident for certain sections, including the definition of “gross income” in section 1(1). Since a foreign dividend is included in “gross income” under paragraph (k) of the definition of “gross income” in section 1(1), a dividend received by or accrued to a CFC from another foreign company constitutes a foreign dividend for purposes of the net income calculation of the CFC.

### **4.2.2 Gross amount of foreign dividends included in gross income**

The gross amount of a foreign dividend, before the deduction of any foreign tax liability, for example, withholding tax, must be included in a person’s gross income.

### **4.2.3 Receipt or accrual of a foreign dividend**

A foreign dividend received by or accrued to a person must be included in gross income at the earlier of its receipt or accrual. Generally, in the context of foreign dividends the accrual precedes the receipt of the dividend. A foreign dividend generally accrues to a person on the date of declaration of the foreign dividend by the foreign company unless the declaration states that the foreign dividend is payable to shareholders registered on a certain future date.<sup>36</sup> In the latter case, the foreign dividend accrues on such future date.<sup>37</sup> It is submitted that the timing of when the dividend is paid or payable in terms of the definition of “foreign dividend” in

<sup>36</sup> The position for interim dividends may be different – see AP de Koker & RC Williams *Silke on South African Income Tax* [online] (My LexisNexis: October 2017) in § 2.8.

<sup>37</sup> See AP de Koker & RC Williams *Silke on South African Income Tax* [online] (My LexisNexis: October 2017) in § 2.8; *CIR v King* 1947 (2) SA 196 (A), 14 SATC 184; ITC 463 (1939) 10 SATC 453 (U) and GC Palmer under “Revenue Part 1” 22(1) (Second Edition Replacement Volume) *LAWSA* [online] (My LexisNexis: 31 May 2014) in paragraph 439 dealing with the accrual of dividends.

section 1(1) is consistent with the timing of when a foreign dividend is received or accrues for the purposes of the definition of “gross income” [see **4.1.1(b)**].

#### **4.3 Exemption of foreign dividends (section 10B)**

A “foreign dividend” is defined in section 10B(1) for purposes of section 10B and means any –

- foreign dividend as defined in section 1; or
- dividend paid or declared by a headquarter company.

The exemption of foreign dividends is provided for in section 10B(2) and (3). Section 10B(2) provides for exemptions that are applied separately to each foreign dividend received by or accrued to a person, while the exemption under section 10B(3) is applied to the aggregate amount of foreign dividends not otherwise exempt under section 10B(2).

A foreign dividend received by or accrued to a person may meet the requirements of more than one paragraph of section 10B(2). Since an amount can be exempt only once, only one paragraph of section 10B(2) can be applied to a specific foreign dividend and, generally speaking, an exemption which exempts the full dividend will take preference over a partial exemption. See **4.3.3(b)**, which deals with the situation in which both section 10B(2)(a) and section 10B(2)(c) apply. Under these circumstances, section 10B(2)(a) is given preference.

Section 10B applies to foreign dividends received by or accrued to residents and non-residents (mainly CFCs in the context of determining net income which is attributed to and included in the income of applicable residents), unless the section states that it applies specifically to residents or resident companies only, as is the case with section 10B(2)(c) and (e) respectively, or to foreign companies only as is the case with section 10B(2)(b).

The exceptions contained in section 10B(2), (4), (5) and (6), provide that a specific exemption contemplated in section 10B(2) or the partial exemption under section 10B(3) may not apply under specific circumstances.

##### **4.3.1 The participation exemption [section 10B(2)(a)]**

###### **(a) The participation exemption**

Under section 10B(2)(a) a foreign dividend received by or accrued to a person is exempt from normal tax if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10% of the total equity shares and voting rights in the company declaring the foreign dividend.

In determining the 10% holding of equity shares, regard must be had to the total number of equity shares held by a person as a proportion of the total number of equity shares of the company and not the economic interest of the equity shares as a proportion of the total economic interest in the company. For example, if a foreign company issued 500 class A ordinary shares with one voting right each and 500 class B ordinary shares with two voting rights each, its total number of equity shares issued is 1 000 and total number of voting rights is 1 500. Assume that the holders of the class A ordinary shares are entitled to share in 40% of the total profits of the company, while the holders of the class B ordinary shares are entitled to share in

60% of the profits. A person holding 100 class A ordinary shares and no class B ordinary shares, holds at least 10%  $[(100 / 1\,000) \times 100]$  of the total equity shares in the company but holds only 6.67%  $\{[(100 \times 1) / 1\,500] \times 100\}$  of the voting rights in the company. The person therefore does not qualify for the participation exemption. The person's economic interest in the company of 8%  $(100 \text{ class A ordinary shares} / 500 \text{ class A ordinary shares} \times 40\% \text{ economic interest})$  is irrelevant.

The person qualifying for the exemption under section 10B(2)(a) could, amongst others, be a natural person, a trust or a company, including a CFC. When the person is a company which forms part of a group of companies as defined in section 1(1),<sup>38</sup> the direct holdings of the other companies in that group must be added together with that company's holding in determining whether the 10% threshold has been met.

The term "equity share" is defined in section 1(1) as follows:

“**[E]quity share**’ means any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution;”

A distribution by a company or a foreign company generally takes the form of a distribution of profits (dividends or foreign dividends) or capital (return of capital or foreign return of capital). As long as the right to participate in either of these types of distribution is unrestricted, the share will be an equity share. The share will not be an equity share if both rights are restricted.

The 10% holding requirement is determined at the earlier of the receipt or accrual of the foreign dividend. Dividends not exempt under section 10B(2)(a) because of the 10% holding requirement not being met, may be exempt under one of the other exemptions under section 10B(2) (see **4.3.1 – 4.3.6**) or partially exempt under section 10B(3) (see **4.3.7**).

The participation exemption under section 10B(2)(a) is in line with the relief from CGT provided under paragraph 64B on capital gains or capital losses arising on the disposal of equity shares in a foreign company and on capital gains on foreign returns of capital when an interest of at least 10% in the equity shares and voting rights is held in the foreign company.<sup>39</sup>

See **4.3.6**, **4.3.8**, **4.3.9** and **4.3.10** for circumstances in which the exemption is specifically prohibited.

## **(b) Application of the participation exemption to a group of companies**

The term "group of companies" is defined in section 1(1) as follows:

“**[G]roup of companies**’ means two or more companies in which one company (hereinafter referred to as the “**controlling group company**”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “**controlled group company**”), to the extent that—

- (a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

<sup>38</sup> See **4.3.1(b)**.

<sup>39</sup> See the *Comprehensive Guide to Capital Gains Tax* for a discussion of paragraph 64B.

- (b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;”

In determining whether the 10% holding requirement of section 10B(2)(a) has been met, the combined direct interests of all the companies forming part of the same group of companies in the foreign company must be taken into account.

Therefore, when two or more companies forming part of the same group of companies each hold less than 10% of the equity shares and voting rights in a foreign company, section 10B(2)(a) will apply to each company in the group as long as those companies’ combined interests in both the total equity shares and voting rights in the foreign company are at least 10%.

Section 10B(2)(a) allows for the aggregation of interests in a foreign company even when the holders of the shares are not all resident companies forming part of the same group of companies. Therefore, if one of the holders of shares in the foreign company declaring the foreign dividend is a foreign company, the combined interests of that foreign company and the resident company must be considered in determining whether the 10% holding requirement has been met.

### **(c) Holding of shares**

The participation exemption applies to the person who *holds* at least 10% of the total equity shares and voting rights in a foreign company in respect of which the foreign dividend is declared. It is considered that a person “holds” the requisite equity shares if such person is the beneficial owner of those shares.

The person named in the share register of a company, for example, an agent, intermediary or *en commandite* partnership, is not necessarily the beneficial owner of the shares. In an *en commandite* partnership,<sup>40</sup> the shares will generally be registered in the names of the general partners and not in the names of the *en commandite* partners. Even though the shares are registered in the names of the general partners, the *en commandite* partners will be the beneficial owners of a percentage of the shares in accordance with the partnership agreement.

When a person is the registered holder of a share in a foreign company but another person is the beneficial owner, the beneficial owner may claim the participation exemption if all the requirements of section 10B(2)(a) are met.

See the *Comprehensive Guide to Dividends Tax* for a discussion of the meaning of beneficial owner for purposes of dividends tax.<sup>41</sup>

A person will be the beneficial owner of a share if that person made an election under section 4(1) of the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003 which provided as follows:

“4. (1) A person who is a donor (or the deceased estate of a donor) in relation to a discretionary trust which is not a resident, may elect that any foreign asset

<sup>40</sup> On extraordinary partnerships, see A Ramdhin *et al* “Partnership – Kinds of Partnership – Extraordinary Partnerships” 19 (Second Edition Replacement Volume) *LAWSA* [online] (My LexisNexis: 29 February 2016) in paragraph 258 – 260.

<sup>41</sup> The term “beneficial owner” is defined in section 64D for purposes of dividends tax only. The commentary in the *Comprehensive Guide to Dividends Tax*, however, also considers the general meaning of beneficial owner.

contemplated in subsection (2), which was held by that discretionary trust on 28 February 2003, must be deemed to be held by that person.”

The election may be made only if the requirements of section 4(2) of the above Act are met and once made has a number of effects for purposes of the Act. For example, in the context of foreign dividends, the election made under section 4(1) has the effect under section 4(3) of the same Act that any foreign dividends received or accrued in respect of shares deemed to be held by a person making the election (the donor) are included in that person’s gross income. The electing party will be entitled to make use of the participation exemption under section 10B(2)(a) if all the requirements of the section are met.

**Example 5 – Application of the participation exemption [section 10B(2)(a)]**

*Facts:*

Resident Company A holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B pays a foreign dividend of R100 000 to Resident Company A.

*Result:*

The foreign dividend of R100 000 received by Resident Company A is included in its gross income under paragraph (k) of the definition of “gross income” in section 1(1). This amount is exempt from normal tax under section 10B(2)(a), since Resident Company A holds at least 10% of the equity shares and voting rights in Foreign Company B.

**Example 6 – Application of the participation exemption [section 10B(2)(a)]**

*Facts:*

CFC A holds 10% of the equity shares and voting rights in Foreign Company B. CFC A and Foreign Company B are not residents of the same country. Foreign Company B pays a foreign dividend of R100 000 to CFC A.

*Result:*

Under section 9D(2A) CFC A is deemed to be a resident for purposes of the definition of “gross income” in section 1(1) [see 4.3.7(b)]. In determining net income for the purposes of section 9D(2), the foreign dividend of R100 000 received by CFC A is included in its gross income under paragraph (k) of the definition of “gross income” in section 1(1). This amount is exempt from normal tax under section 10B(2)(a). In other words, subsequent to being included in gross income, the foreign dividend is excluded in determining net income for the purposes of section 9D(2), since CFC A holds at least 10% of the equity shares and voting rights in Foreign Company B.

**Example 7 – Application of the participation exemption [section 10B(2)(a)]**

*Facts:*

Resident Company A and Resident Company B are part of the same group of companies. Each company holds 5% of the equity shares and voting rights in Foreign Company A. Foreign Company A pays a cash foreign dividend of R100 000.



*Result:*

The foreign dividends of R5 000 ( $R100\,000 \times 5\%$ ) received by Resident Company A and Resident Company B are included in their gross income under paragraph (k) of the definition of “gross income” in section 1(1). From Resident Company A’s perspective, the foreign dividend qualifies for exemption under section 10B(2)(a) because in determining whether the 10% requirement of the participation exemption is met, the direct holding of the total equity shares and voting rights of the taxpayer concerned (Resident Company A) plus the direct holdings of other companies forming part of the same group of companies (Resident Company B) are taken into account. Resident Company A’s holding of 5% plus Resident Company B’s holding of 5% meet the threshold of 10%. Resident Company A therefore qualifies for the exemption under section 10B(2)(a). For the same reasons Resident Company B also qualifies for the exemption under section 10B(2)(a).

**Example 8 – Application of the participation exemption [section 10B(2)(a)]***Facts:*

Individual A and Individual B, who are connected persons in relation to each other, each hold 5% of the equity shares and voting rights in Foreign Company A. Foreign Company A pays a cash foreign dividend of R100 000.

*Result:*

The foreign dividends of R5 000 ( $R100\,000 \times 5\%$ ) received by Individual A and Individual B respectively must be included in their gross income under paragraph (k) of the definition of “gross income” in section 1(1).

The foreign dividends do not qualify for exemption under section 10B(2)(a) because in determining whether the 10% requirement of the participation exemption is met, the direct holding of the total equity shares and voting rights of the taxpayer concerned plus, if that taxpayer is a company, the direct holdings of other companies forming part of the same group of companies as the taxpayer, are taken into account. Even though Individual A and Individual B are connected persons in relation to each other, they are not part of a group of companies and accordingly on an individual basis each of their holdings of 5% of the equity shares and voting rights falls below the required threshold of 10%.

Depending on the facts, Individual A and Individual B may qualify for an exemption under section 10B(2)(d) (see 4.3.4). A partial exemption for dividends not otherwise exempt under section 10B(2) is available under section 10B(3) (see 4.3.7).

**Example 9 – Application of the participation exemption [section 10B(2)(a)]***Facts:*

Resident A, a natural person, is an income beneficiary of Discretionary Trust A, a non-resident trust, which holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B pays a foreign dividend of R100 000 to Discretionary Trust A which distributes it in full to Resident A in the same year of assessment.

*Result:*

The foreign dividend of R100 000 is included in Resident A's gross income under paragraph (k) of the definition of "gross income" in section 1(1) read with section 25B(1) and (2).

For the participation exemption to apply, the person receiving the foreign dividend, or to whom it accrues, must hold the underlying equity shares and voting rights in respect of which the dividend is paid. Resident A is not the beneficial owner of the equity shares or voting rights, and therefore does not hold any equity shares or voting rights in Foreign Company B. Resident A is therefore not entitled to the participation exemption under section 10B(2)(a).

The foreign dividend of R100 000 is partially exempt under section 10B(3) in the hands of Resident A (see 4.3.7).

**Note:**

If Resident A had a vested right in the underlying shares and voting rights, the exemption under section 10B(2)(a) would have applied.

**4.3.2 The country-to-country exemption [section 10B(2)(b)]**

Generally, a foreign dividend paid by a foreign company to another foreign company does not fall within the ambit of gross income, since it is not from a South African source and thus not subject to normal tax in South Africa. However, if the foreign company to which the foreign dividend is paid is a CFC, a portion of the foreign dividend may, depending on the facts, be included in a South African resident's income by virtue of the attribution of the CFC's net income. Under section 9D(2) a proportionate amount of a CFC's net income<sup>42</sup> is included in the income of a resident holding a qualifying interest in the CFC.

In calculating the proportionate amount of a CFC's net income to be attributed to a resident holding a qualifying interest, the CFC is regarded under section 9D(2A) as a taxpayer and a resident for specified provisions, including the definition of "gross income" in section 1(1). Since a foreign dividend is included in "gross income" under paragraph (k) of the definition of "gross income" in section 1(1), a foreign dividend received by or accrued to a CFC from another foreign company must be taken into account for purposes of calculating the net income of the CFC.

Section 10B(2)(b) provides that a foreign dividend paid or declared by a foreign company to another foreign company (in context, a CFC) is exempt from normal tax if both those foreign companies are resident in the same foreign country. This exemption applies irrespective of the percentage interest that the CFC has in the participation rights or voting rights in the foreign company paying the foreign dividend.

<sup>42</sup> This Note does not discuss the calculation of net income and the inclusions and exclusions as required under section 9D nor the circumstances in which section 9D(2) does not apply. For example, section 9D(9)(f) excludes certain foreign dividends between CFCs. See section 9D for details on all the inclusions and exclusions from net income and circumstances in which section 9D does not apply.

The inclusion of foreign dividends, which are not exempt under section 10B(2) but which are partially exempt under section 10B(3), in the net income of a CFC effectively results in the inclusion of a proportional amount of the foreign dividends in the income of a resident holding, together with a connected person, at least 10% of the participation rights and voting rights in the CFC. The amount attributed to and included in the resident's income under section 9D(2), however, does not constitute an amount of a foreign dividend. It is included in income as a percentage of the net income of the CFC and therefore cannot qualify for any of the exemptions under section 10B in its own right.

As noted above, in order to qualify for the exemption under section 10B(2)(b), the two foreign companies must both be resident in the same country. Section 10B(2)(b) is silent on how the residency of the two foreign companies must be determined. Practically, the country or countries in which the company declaring the dividend is tax resident can initially be determined by referring to the domestic tax law of the country concerned. Often residency is based on the place of incorporation or effective management. The provisions of any applicable tax treaty will also need to be considered in cases of dual residency if the provisions of the tax treaty (the tie-breaker clause in particular) impact on the residency status of the taxpayer concerned under its domestic law. For example, the definition of "resident" in section 1(1) specifically provides that if a person is deemed to be exclusively resident of another country for purposes of a tax treaty, that person is not a resident. Once the tax residence of the company declaring the dividend has been determined, the tax residence of the company receiving the dividend would be determined in the same way. Similar to the position above, this may involve a consideration of applicable tax treaties.

See **4.3.6(a)**, **4.3.8**, **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(b) is specifically prohibited.

**Example 10 – The country-to-country exemption [section 10B(2)(b)]**

*Facts:*

Resident Company A holds 100% of the participation rights and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Both foreign companies are incorporated and effectively managed in Foreign Country D and are residents of that country. Foreign Company C pays a foreign dividend to Foreign Company B.

*Result:*

Foreign Company B is a CFC in relation to Resident Company A, since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

The foreign dividend is exempt from normal tax under section 10B(2)(b), since it was paid to Foreign Company B by another foreign company (Foreign Company C) and both foreign companies are residents of the same country. The effect of the exemption under section 10B(2)(b) is that the foreign dividend will not form part of Foreign Company B's net income and hence will not be attributed to Resident Company A under section 9D(2).

**Example 11 – Country-to-country exemption – Foreign companies effectively managed in the same country [section 10B(2)(b)]**

*Facts:*

Resident Company A holds 100% of the participation and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C.

Foreign company B is incorporated and effectively managed in Foreign Country D and is a resident of that country. Foreign Company B is not considered to be tax resident under another country's domestic tax law.

Foreign Company C is incorporated in Foreign Country E but effectively managed in Foreign Country D. Under the domestic tax law of Foreign Country D, Foreign Company C is tax resident in Country D because its place of effective management is in Country D. Under the domestic tax law of Foreign Country E, Foreign Company C is *prima facie* also tax resident in Country E because it is incorporated in Country E. However, Country E's domestic tax law provides that a resident does not include a person who is deemed to be exclusively a resident of another country for purposes of the application of an applicable tax treaty. Under the tax treaty between Foreign Country D and Foreign Country E, Foreign Company C is treated as being exclusively resident where it is effectively managed. Accordingly, Foreign Company C is tax resident in Foreign Country D only.

Foreign Company C pays a foreign dividend to Foreign Company B.

*Result:*

Foreign Company B is a CFC in relation to Resident Company A, since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

Although Foreign Company B and Foreign Company C were not incorporated in the same country, they are both tax resident in Foreign Country D.

The foreign dividend is exempt from normal tax under section 10B(2)(b), since it was paid to Foreign Company B by another foreign company (Foreign Company C) and both foreign companies are residents of the same country for income tax purposes. The effect of the exemption under section 10B(2)(b) is that the foreign dividend will not form part of Foreign Company B's net income and hence will not be attributed to Resident Company A under section 9D(2).

**Example 12 – Country-to-country exemption – Foreign companies not effectively managed in the same country [section 10B(2)(b)]**

*Facts:*

Resident Company A holds 100% of the participation and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C.

Foreign company B is incorporated and effectively managed in Foreign Country D and is a resident of that country. Foreign Company B is not considered to be tax resident under another country's domestic tax law.

Foreign Company C is incorporated in Foreign Country D but effectively managed in Foreign Country E. Under the domestic tax law of Foreign Country E, Foreign Company C is tax resident in Country E because its place of effective management is in Country E. Under the domestic tax law of Foreign Country D, Foreign Company C is *prima facie* tax resident in Country D because it is incorporated in Country D. However, Country D's domestic tax law provides that a resident does not include a person who is deemed to be exclusively a resident of another country for purposes of the application of an applicable tax treaty. Under the tax treaty between Foreign Country D and Foreign Country E, Foreign Company C is treated as being exclusively resident where it is effectively managed. Accordingly, Foreign Company C is tax resident in Country E only.

Foreign Company C pays a foreign dividend to Foreign Company B.

*Result:*

Foreign Company B is a CFC in relation to Resident Company A, since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

Foreign Company B is tax resident in Foreign Country D and Foreign Company C is tax resident in Country E. The foreign dividend is not exempt from normal tax under section 10B(2)(b), since it was paid to Foreign Company B by another foreign company (Foreign Company C) which is not resident in the same country for tax purposes. The foreign dividend will qualify for a partial exemption under section 10B(3) with the effect that a portion of the foreign dividend will form part of Foreign Company B's net income and hence a portion will be attributed to Resident Company A under section 9D(2).

**4.3.3 Exemption of amounts previously included in income under section 9D(2) [section 10B(2)(c)]**

**(a) Exemption of amounts previously included in income**

Under section 9D(2) a portion of the net income of a CFC is included in the income of a resident who, together with a connected person, holds at least 10% of the participation rights and voting rights in the CFC. In the absence of an exemption, any portion of the net income of the CFC included in the income of a resident that is

subsequently declared to that resident as a foreign dividend would be taxed twice. Section 10B(2)(c) provides relief by generally exempting any foreign dividend paid from amounts previously included in the income of a resident under section 9D(2).

Each resident subject to section 9D is entitled to the exemption under section 10B(2)(c) for amounts previously included in income under that section. Thus, for example, when two residents who are natural persons and connected persons in relation to one another, individually hold less than 10% of the participation rights and voting rights in a CFC while their combined holding in the CFC equals 10% or more, they will not be entitled to the participation exemption under section 10B(2)(a) on a foreign dividend declared by the CFC, since each person's holding in the CFC is less than 10%.<sup>43</sup> However, both residents will be entitled to the exemption under section 10B(2)(c) for amounts previously included in income under section 9D(2).<sup>44</sup>

Under the proviso to section 10B(2)(c) the net income of any CFC included in the income of a resident must be determined without taking into account the partial exemption under section 10B(3). The partial exemption under section 10B(3) has the effect that only 71,43% ( $20 / 28 \times 100$ ) of the amount of a foreign dividend is included in the net income of a CFC.<sup>45</sup> It is a percentage of this taxable amount that is included in the income of a resident under section 9D(2). In applying section 10B(2)(c), 100% of the amount of a foreign dividend and not the 71,43% included in income, is taken into account in determining amounts previously included in the income of a resident under section 9D(2).

The calculation of the amount of a foreign dividend exempt under section 10B(2)(c) is summarised as follows:

The aggregate of all amounts included in the resident's income under section 9D in this year and any previous year of assessment that relate to the net income of the CFC declaring the foreign dividend [section 10B(2)(c)(i)]. Net income for this purpose must be determined without regard to section 10B(3).

Add: The aggregate of all amounts included in the resident's income under section 9D in this year and any previous year of assessment that relate to the aggregate net income of any other CFC by virtue of the resident's participation rights held indirectly in other CFCs through the CFC declaring the foreign dividend [section 10B(2)(c)(ii)]. Net income for this purpose must be determined without regard to section 10B(3).

Less: Aggregate amount of foreign tax payable in respect of amounts included in the resident's income under section 9D as indicated in the two points above in this year and any previous year of assessment [section 10B(2)(c)(aa)].<sup>46</sup>

Less: Aggregate amount of foreign dividends received by or accrued to the resident from the above CFCs in this year and any previous year of assessment that were exempt under section 10B(2)(a), (b) or (d) [section 10B(2)(c)(bb)(A)].

<sup>43</sup> See Example 8 in 4.3.1.

<sup>44</sup> They would not have qualified for the exclusion from attribution of net income under paragraph (A) of the proviso to section 9D(2) which considers the combined holdings of connected persons and allows for exclusion from attribution if the combined holding in the participation and voting rights is less than 10%.

<sup>45</sup> Under section 10B(3)(b)(ii)(bb)(A) the ratio of 8 to 28 of the amount of foreign dividends received by or accrued to a company is exempt. For years of assessment commencing before 1 March 2017 the ratio was 13 to 28. The ratio of 20 to 28 (15 to 28 for years of assessment commencing before 1 March 2017) is applied to determine the taxable amount of such foreign dividends.

<sup>46</sup> The amount of foreign tax payable would have qualified for a foreign tax rebate under section 6quat (see 4.8).

*Less:* Aggregate amount of foreign dividends received or accrued from the above CFCs that were not included in the resident's income because of a prior inclusion under section 9D and which were exempt under section 10B(2)(c) [section 10B(2)(c)(bb)(B)].

= the amount of the exemption under section 10B(2)(c) for the specific foreign dividend

*limited* to the amount of the foreign dividend received or accrued from the CFC declaring the dividend as indicated above.

See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(c) is specifically prohibited.

**Example 13 – Exemption of amounts previously included in income  
[section 10B(2)(c)]**

*Facts:*

Resident Company A on its own holds 5%, and together with a connected person, Resident Company B, holds 10% of the participation rights and voting rights in Foreign Company B. Resident Company A and Resident Company B are not companies forming part of the same group of companies. Foreign Company B holds 100% of the participation rights and voting rights in Foreign Company C. Foreign Company C holds 100% of the participation rights and voting rights in Foreign Company D. The participation rights and voting rights in Foreign Company B, Foreign Company C and Foreign Company D were all acquired at the beginning of Resident Company A's 2015 year of assessment. All the foreign companies are CFCs in relation to Resident Company A and have a December year-end.

The portion (5%) of the net income of the CFCs determined under section 9D(2A) that was included in Resident Company A's income under section 9D(2) during the 2016 and 2017 years of assessment was as follows:

	2016 R	2017 R
CFC B	800 000	700 000
CFC C	700 000	600 000
CFC D	<u>650 000</u>	<u>500 000</u>
Total amount included in Resident Company A's income	<u>2 150 000</u>	<u>1 800 000</u>
Foreign tax payable on the net income of the CFCs	130 000	300 000
Amounts of foreign dividends paid by CFC B to Resident Company A	1 250 000	3 000 000

*Result:*

Under section 9D(2) the net income of R2 150 000 and R1 800 000, representing 5% of the CFCs' total net income determined under section 9D(2A), was included in Resident Company A's income in the 2016 and 2017 years of assessment respectively. Even though Resident Company A holds directly or indirectly only 5% of the participation rights and voting rights in the CFCs, it holds together with a connected person, at least 10% of the participation rights and voting rights and is therefore subject to attribution under section 9D(2).

The foreign dividends received from CFC B of R1 250 000 and R3 million are included in Resident Company A's gross income under paragraph (k) of the definition of "gross income" in section 1(1). The exemption under section 10B(2)(a) is not applicable because although Resident Company A and Resident Company B are connected persons in relation to each other they are not members of the same group of companies. As a result, when assessing whether the threshold of 10% in section 10B(2)(a) is met, their holdings are not combined. The non-aggregation of their holdings means that they do not qualify for exemption under section 10B(2)(a), since they each hold only 5% of the equity shares and voting rights in Foreign Company B.

The foreign dividends may be exempt or partially exempt under section 10B(2)(c) and (3). The amounts exempt under section 10B(2)(c) are calculated as follows:

<i>2016 year of assessment</i>	R
Portion of the aggregate net income of CFC B, C and D included in Company A's income in the 2016 year of assessment under section 9D(2)	2 150 000
Less: The aggregate amount of foreign tax payable in respect of amounts included in Company A's income	(130 000)
Less: The aggregate amount of foreign dividends received or accrued from the above CFCs that are or were exempt under section 10B(2)(a), (b) or (d)	(0)
Less: The aggregate amount of foreign dividends previously exempt under section 10B(2)(c)	<u>(0)</u>
Amount available for exemption under section 10B(2)(c)	<u>2 020 000</u>

The amount of the foreign dividend of R1 250 000 received or accrued from CFC B is exempt in full under section 10B(2)(c), since it is less than the amount available for exemption under section 10B(2)(c).

<i>2017 year of assessment</i>	R
Portion of the aggregate net income of CFC B, C and D included in Company A's income in the 2016 and 2017 years of assessment under section 9D(2) (R2 150 000 + R1 800 000)	3 950 000
Less: The aggregate amount of foreign tax payable for the 2016 and 2017 years of assessment in respect of amounts included in Company A's income (R130 000 + R300 000)	(430 000)
Less: The aggregate amount of foreign dividends received from CFC B that is or was exempt under section 10B(2)(a), (b) or (d)	(0)
Less: The aggregate amount of foreign dividends previously exempt under section 10B(2)(c)	<u>(1 250 000)</u>
Amount available for exemption under section 10B(2)(c)	<u>2 270 000</u>

Only R2 270 000 of the amount of the foreign dividend of R3 million received from CFC B is exempt under section 10B(2)(c).



The amount of the foreign dividend not exempt under section 10B(2)(c) of R730 000 (R3 million – R2 270 000) qualifies for the partial exemption under section 10B(3). The exempt amount is calculated as follows:

The ratio<sup>47</sup> of 13 to 28 multiplied by the amount of the foreign dividend not exempt under section 10B(2)(c)

$$= [(13 / 28) \times R730\,000]$$

$$= R338\,929 \text{ [amount exempt under section 10B(3)]}.$$

The amount of the foreign dividend exempt under section 10B for the 2017 year of assessment is as follows:

	R
Amount exempt under section 10B(2)(c)	2 270 000
Amount exempt under section 10B(3)	<u>338 929</u>
Total amount exempt under section 10B	<u>2 608 929</u>

The difference of R391 071 (R3 million – R2 608 929) is included in Resident Company A's income under section 9D(2).

**Note:**

See 4.3.7 for a discussion of section 10B(3).

**(b) Application of either the participation exemption under section 10B(2)(a) or the exemption for amounts previously included in income under section 10B(2)(c)**

As noted previously in the Note, under section 9D(2) a resident who alone or together with one or more connected persons in relation to that person, holds at least 10% of the participation rights and voting rights in a CFC must include a proportional amount of the net income of the CFC in that person's income.

Both section 10B(2)(a) and section 10B(2)(c) contain a requirement that at least 10% of the equity shares or participation rights and voting rights must be held in the foreign company declaring the foreign dividend. In calculating the 10% requirement, section 10B(2)(a) takes into account the combined holdings of companies in the same group of companies and section 10B(2)(c) through its link to section 9D(2) takes into account the combined holdings of connected persons. Therefore, any resident subject to section 9D who holds, together with a company forming part of the same group of companies if applicable, at least 10% of the equity shares and voting rights in a foreign company declaring a foreign dividend, will, on the face of it, potentially qualify for the participation exemption under section 10B(2)(a) as well as the exemption for amounts previously included in income under the CFC rules in section 10B(2)(c).

Section 10B(2)(a) exempts the full amount of the dividend while section 10B(2)(c) is based on the application of a formula that does not necessarily result in a full exemption.

<sup>47</sup> With effect from years of assessment commencing on or after 1 March 2017 the ratio is 8 to 28. See section 8(1)(b) of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 14 of 2017.

For example, assume a resident, who is a natural person, holds 100% of the participation rights and voting rights in a CFC. If the CFC realises a capital gain of R100 000 during its 2017 year of assessment ending on 28 February, R40 000 (40%)<sup>48</sup> would be included in the natural person's income under section 9D(2). Should the CFC pay the full amount of the capital gain of R100 000 as a foreign dividend in the 2018 year of assessment, the exemption under section 10B(2)(c) would amount to R40 000, being the amount of the net income of the CFC included in the income of the resident. The balance of R60 000 will qualify for the partial exemption under section 10B(3), which amounts to R33 333  $[(25 / 45) \times R60\,000]$ . This example illustrates that section 10B(2)(c) does not necessarily result in a full exemption of the amount of a foreign dividend declared by a CFC. The portion of the foreign dividend of R100 000 exempt under section 10B amounts to R73 333 [R40 000 under section 10B(2)(c) plus R33 333 under section 10B(3)]. However, should the participation exemption under section 10B(2)(a) be applied, the amount of the foreign dividend of R100 000 would be exempt in full.

If both section 10B(2)(a) and (c) apply in a particular situation, the issue as to which section takes precedence arises. Section 10B(2)(c) establishes the order of precedence by providing in section 10B(2)(c)(bb)(A) that the amount of the exemption under section 10B(2)(c) must be reduced by any foreign dividends exempt from tax under section 10B(2)(a), (b) or (d). Also, generally speaking, a full exemption will take preference over a partial exemption. Section 10B(2)(a) must therefore be applied before section 10B(2)(c).

#### **4.3.4 Foreign dividends received or accrued in cash in respect of listed shares [section 10B(2)(d)]**

Foreign dividends received or accrued in cash in respect of listed shares are exempt from normal tax under section 10B(2)(d).<sup>49</sup> This exemption also applies to such foreign dividends received by or accrued to a CFC. Section 10B(2)(d) was introduced because these foreign dividends are potentially subject to dividends tax.<sup>50</sup> A foreign dividend paid in cash in respect of a listed share to a beneficial owner that is not a resident, for example a CFC, is exempt from dividends tax under section 64F(1)(j).<sup>51</sup>

The term "listed share" is defined in section 1(1) and means a share that is listed on an exchange as defined in section 1 of the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act. The JSE, ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd are the only exchanges currently licensed under section 9 of the Financial Markets Act.<sup>52</sup> If a foreign company has its shares listed on a South African exchange as well as on a foreign exchange, it is only the shares listed on the South African exchange that will qualify for the foreign dividend exemption under section 10B(2)(d).

<sup>48</sup> Paragraph 10(a) read with paragraph (f) of the proviso to section 9D(2A). The inclusion rate increased from 33,3% to 40% for years of assessment commencing on or after 1 March 2016.

<sup>49</sup> Binding Class Ruling 042 dated 7 February 2014 "Preferred Securities Issued by a Company Registered in a Foreign Country" confirmed that preferred securities issued to South African investors by a foreign company listed on the JSE constituted listed shares.

<sup>50</sup> Under paragraph (b) of the definition of "dividend" in section 64D, read with section 64E(1). See paragraphs 2.3.2 and 3.1.1 of the *Comprehensive Guide to Dividends Tax* for commentary on these sections.

<sup>51</sup> See the *Comprehensive Guide to Dividends Tax*.

<sup>52</sup> The Financial Services Board Press Release dated 1 September 2016 announced that ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd had been granted exchange licences with conditions.

Cash dividends received or accrued from a resident company on listed shares are similarly exempt from normal tax under section 10(1)(k)(i), unless one of the paragraphs of the proviso to section 10(1)(k)(i) applies.

See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(d) is specifically prohibited.

**Example 14 – Foreign dividends received or accrued in cash on listed shares [section 10B(2)(d)]**

*Facts:*

Resident Individual A holds 5% of the equity shares in Foreign Company B which are listed on the JSE. Resident Individual A received a foreign dividend in cash from Foreign Company B.

*Result:*

The foreign dividend received by or accrued to Resident Individual A is included in gross income under paragraph (k) of the definition of “gross income” in section 1(1). The foreign dividend is, however, exempt from normal tax under section 10B(2)(d), since it is received or accrued from a foreign company on listed shares. The dividend is, however, subject to dividends tax.

**4.3.5 Foreign dividends received or accrued in respect of listed shares consisting of the distribution of an asset in specie [section 10B(2)(e)]**

A foreign company that pays a foreign dividend on listed shares<sup>53</sup> by way of the distribution of an asset *in specie* is not liable for dividends tax, since a distribution of this nature is not included in paragraph (b) of the definition of “dividend” in section 64D.<sup>54</sup>

A foreign dividend received by or accrued to a resident company on a listed share by way of the distribution of an asset *in specie* is exempt from normal tax under section 10B(2)(e).<sup>55</sup> Such foreign dividend will be included in the resident company’s profits and can potentially be paid as dividends to holders of its shares. These dividends may be subject to either dividends tax or normal tax.

In calculating a CFC’s net income under section 9D(2), the exemption under section 10B(2)(e) does not apply to foreign dividends received by or which accrued to a CFC, since a CFC is not a resident and is not treated as being a resident for purposes of section 10B under section 9D(2A).

See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(e) is specifically prohibited.

<sup>53</sup> See **4.3.4** for the meaning of “listed share”.

<sup>54</sup> See the *Comprehensive Guide to Dividends Tax* for commentary on paragraph (b) of the definition of “dividend” in section 64D.

<sup>55</sup> Section 10B(2)(e) applies to foreign dividends received or accrued on or after 1 March 2014.

**Example 15 – Foreign dividends *in specie* received or accrued on listed shares [section 10B(2)(e)]**

*Facts:*

Resident Company A holds 5% of the equity shares in Foreign Company B which are listed on the JSE. Foreign Company B distributed all its shares it held in Foreign Company C to its holders of shares. Resident Company A therefore received a foreign dividend *in specie* from Foreign Company B.

*Result:*

The foreign dividend *in specie* received by or accrued to Resident Company A is included in its gross income under paragraph (k) of the definition of “gross income” in section 1(1). It is exempt from normal tax under section 10B(2)(e), since it is received by or accrues to a resident company from a foreign company in respect of listed shares.

#### **4.3.6 Application of the provisos to section 10B(2)**

**(a) Non-application of the “participation exemption” and the “country-to-country exemption” – Foreign dividends allowed as a deduction [proviso to section 10B(2)]**

The proviso to section 10B(2) provides that the participation exemption under section 10B(2)(a) and the country-to-country exemption under section 10B(2)(b) do not apply to any foreign dividend to the extent that the foreign dividend is deductible by the foreign company declaring or paying the dividend in the determination of any tax on income on companies of the country in which it has its place of effective management. The exemptions under section 10B(2)(c), (d) and (e) and the partial exemption under section 10B(3) may apply even when the proviso to section 10B(2) applies.

For example, if the income tax law on companies of a foreign country provides a deduction for dividends paid or payable in determining taxable income, the foreign dividend received by or accrued to a person will not be exempt under section 10B(2)(a) or (b), because of the proviso to section 10B(2).

This proviso contemplates a foreign dividend taken into account as a deduction against income in determining taxable income and not a foreign dividend taken into account as a rebate against tax in determining income tax payable.

In determining whether a recipient of a foreign dividend that has met the requirements of section 10B(2)(a) and (b) is prevented from qualifying for an exemption under those sections, the proviso looks at whether the foreign company declaring or paying the dividend qualifies for a deduction in the foreign country in which it has its place of effective management. The proviso does not look at the tax treatment of the recipient of the foreign dividend in the foreign country. For example, if the recipient is held to have gross income in the foreign country but qualifies for an exemption or a deduction of the dividend in determining taxable income in that country, it is irrelevant for purposes of determining whether the proviso applies.

The deductibility of an amount determined to be a foreign dividend paid or payable by a foreign company under the income tax law on companies of the foreign country in which that foreign company is effectively managed, and therefore the application of

the proviso, does not affect the nature of that amount as a foreign dividend for its recipient. Such an amount still constitutes a “foreign dividend” as defined in section 1(1) if it complies with all the requirements of that definition, but does not qualify for the exemptions under section 10B(2)(a) and (b).

**Example 16 – Non-application of section 10B(2)(a) and (b) – Foreign dividends allowed as a deduction**

*Facts:*

Foreign Company A is effectively managed in Foreign Country B. Under the income tax law on companies of Foreign Country B, any distribution of profits by a company is treated as a dividend by the company paying the dividend. The income tax law on companies of that country further provides that the foreign dividend is deductible in determining the tax on income of the company paying the dividend. Foreign Company A pays a foreign dividend to Resident B.

*Result:*

The amount received by Resident B constitutes a foreign dividend as contemplated in paragraph (a) of the definition of “foreign dividend” in section 1(1) because it is treated as a dividend under the income tax law on companies of Foreign Country B.

Since the foreign dividend is deductible in determining Foreign Company A's taxable income, it does not qualify for the exemptions under section 10B(2)(a) and (b) because of the proviso to section 10B(2). The foreign dividend may qualify for exemption under section 10B(2)(c), (d) or (e) if the requirements of those provisions are met, and the partial exemption under section 10B(3).

**(b) Application of the participation exemption under section 10B(2)(a) to equity shares only [second proviso to section 10B(2)]**

The second proviso to section 10B(2) provides that the participation exemption under section 10B(2)(a) must not apply to a foreign dividend received by or accrued to a person in respect of a share that is not an equity share.<sup>56</sup> Section 10B(2)(a) determines that a person, whether alone or together with a company forming part of the same group of companies, must hold at least 10% of the equity shares and voting rights in the company declaring the foreign dividend. The second proviso to section 10B(2) ensures that foreign dividends received or accrued to a person in respect of non-equity shares held in a foreign company in which that person holds at least 10% of its equity shares, are not exempt under section 10B(2)(a).

Any foreign dividend received or accrued on non-equity shares, for example, non-participating preference shares, may nevertheless be exempt from normal tax under section 10B(2)(b), (c), (d) or (e).

To the extent a foreign dividend received or accrued on non-equity shares is not exempt under section 10B(2) it may be partially exempt under section 10B(3).

An amount received or accrued from a foreign company or a headquarter company in respect of a share that is not an equity share, will still constitute a “foreign dividend” as defined in section 10B(1) provided it meets the requirements of that definition.

<sup>56</sup> The second proviso to section 10B(2) applies to foreign dividends received or accrued on or after 1 April 2014.

#### 4.3.7 The partial exemption [section 10B(3)]

##### (a) Application of the partial exemption

Section 10B(3)(a) provides for a partial exemption of foreign dividends received by or accrued to a person which do not qualify for an exemption under section 10B(2). It applies in addition to the exemptions under section 10B(2). See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(3) is specifically prohibited.

Section 10B(3)(a) applies to the aggregate of –

- any amount of a foreign dividend which, after applying the exemptions under section 10B(2), is not exempt; and
- any amount of a foreign dividend to which the exemptions under section 10B(2) do not apply.

Under section 10B(3)(b) the following ratio is applied to determine the amount of foreign dividends which are exempt for a year of assessment:

$A = B \times C$  in which –

- “A” represents the amount to be exempted.
- “B” represents the applicable ratios in relation to a foreign dividend received by or accrued to any of the following persons:
  - A natural person, deceased estate, insolvent estate or trust – 25 to 45.<sup>57</sup>
  - A company, or an insurer in respect of its company policyholder fund, corporate fund or risk policy fund – 8 to 28.<sup>58</sup>
  - An insurer in respect of its individual policyholder fund – 10 to 30.<sup>59</sup>
- “C” represents the aggregate amount of foreign dividends received by or accrued to a person during a year of assessment that is not exempt from normal tax under section 10B(2).

The purpose of the partial exemption is to reduce the maximum effective normal tax rate on a taxable foreign dividend to 20%,<sup>60</sup> which equals the maximum dividends tax rate.

<sup>57</sup> With effect from the 2018 year of assessment. The ratio was 26 to 41 for the 2016 and 2017 years of assessment and 25 to 40 for previous years.

<sup>58</sup> With effect from years of assessment commencing on or after 1 March 2017. The ratio was 13 to 28 for previous years.

<sup>59</sup> With effect from years of assessment commencing on or after 1 March 2017. The ratio was 15 to 30 for previous years.

<sup>60</sup> 15% for years of assessment commencing before 1 March 2017.

The maximum effective normal tax rate of 20% is demonstrated below in relation to the respective persons on the assumption that a foreign dividend of R100 is not exempt from normal tax under section 10B(2):

Aggregate amount of foreign dividends not exempt under section 10B(2) (R100);  
 Less: The exempt amount of the foreign dividends calculated under section 10B(3)(b);  
 = Taxable amount of foreign dividends after applying section 10B(3);  
*Multiplied* by the maximum normal tax rate;  
 Divided by the gross amount of the dividend;  
 Multiplied by 100.

*A natural person, deceased estate, insolvent estate or trust*

$R100 - R55,56 [(25 / 45) \times R100]$   
 $= R44,44 \times 45\%$   
 $= R20$   
 $R20 / R100 \times 100$   
 $= 20\%.$

The maximum effective normal tax rate of 20% will be achieved only if a natural person, deceased estate or insolvent estate's marginal tax rate is 45%. The maximum effective normal tax rate on foreign dividends will be less than 20% if a person pays normal tax at a rate that is less than the maximum marginal tax rate. A trust is taxed at the marginal tax rate of 45%, meaning that the effective tax rate on foreign dividends included in its taxable income will be 20%, unless it has an assessed loss, in which event the effective tax rate on the gross amount of foreign dividends will be between 0% and 20% depending on the extent of the assessed loss.

*A company, or an insurer in respect of its company policyholder fund, corporate fund and risk policy fund*

$R100 - R28,57 [(8 / 28) \times R100]$   
 $= R71,43 \times 28\%$   
 $= R20$   
 $R20 / R100 \times 100$   
 $= 20\%.$

*An insurer in respect of its individual policyholder fund*

$R100 - R33,33 [(10 / 30) \times R100]$   
 $= R66,67 \times 30\%$   
 $= R20$   
 $R20 / R100 \times 100$   
 $= 20\%.$

**Example 17 – Partial exemption and natural persons [section 10B(3)]***Facts:*

A resident natural person received a foreign dividend of R200 000 by virtue of a 2% shareholding in a foreign company during the 2018 year of assessment. The foreign dividend is not exempt from normal tax under section 10B(2). Assume three different scenarios in which the resident pays normal tax at the following marginal rates:

- (a) 45%
- (b) 25%
- (c) 0% (because of an assessed loss).

*Result:*

The amount of the foreign dividend exempt under section 10B(3) and the normal tax payable on the foreign dividend are calculated as follows:

	R
Foreign dividend included in gross income under paragraph (k) of the definition of "gross income in section 1(1)	200 000
Less: Portion of the foreign dividend exempt under section 10B(3):	
$A = B \times C$	
$A = [(25 / 45) \times R200\ 000]$	
$A = R111\ 111$	(111 111)
Taxable portion of foreign dividend	<u>88 889</u>

*(a) Normal tax payable at the maximum rate of 45%*

Normal tax payable at 45% ( $R88\ 889 \times 45\%$ ) 40 000,05

The effective normal tax rate on the gross amount of the foreign dividend is 20% ( $R40\ 000,05 / R200\ 000 \times 100$ ).

*(b) Normal tax payable at a marginal rate of 25%*

Normal tax payable at 25% ( $R88\ 889 \times 25\%$ ) 22 222,25

The effective normal tax rate on the gross amount of the foreign dividend is 11,11% ( $R22\ 222,25 / R200\ 000 \times 100$ ).

*(c) Normal tax payable at 0% because of an assessed loss*

Normal tax payable at 0% ( $R88\ 889 \times 0\%$ ) Nil

The effective normal tax rate on the gross amount of the foreign dividend is 0% ( $RNil / R200\ 000 \times 100$ ).

**Example 18 – Partial exemption and resident companies [section 10B(3)]***Facts:*

A resident company received a foreign dividend of R200 000 by virtue of a 2% shareholding in a foreign company during its 2018 year of assessment commencing on 1 March 2017. The foreign dividend is not exempt from normal tax under section 10B(2). The resident company does not have an assessed loss.



*Result:*

The portion of the foreign dividend exempt from normal tax under section 10B(3) and the normal tax payable on the foreign dividend are calculated as follows:

	R
Amount of foreign dividend included in gross income under paragraph (k) of the definition of "gross income" in section 1(1)	200 000
Less: Portion of the foreign dividend exempt under section 10B(3):	
$A = B \times C$	
$A = [(8 / 28) \times R200\ 000]$	
A = R57 143	<u>(57 143)</u>
Taxable amount of foreign dividend	<u>142 857</u>
Normal tax payable @ 28%	39 999,96
The effective tax rate on the gross amount of the foreign dividend is 20% (R39 999,96 / R200 000 × 100).	

**(b) Application of the partial exemption to controlled foreign companies**

Under section 9D(2) a proportionate amount of the net income of a CFC is attributed to the income of residents holding a qualifying interest in the CFC.

In calculating the net income of a CFC for purposes of attributing it to a resident, the CFC is regarded as a taxpayer and a resident for certain sections, amongst others, the definition of "gross income" in section 1(1).<sup>61</sup> Since a foreign dividend is included in gross income under paragraph (k) of the definition of "gross income", a dividend received by or accrued to a CFC from another foreign company constitutes a foreign dividend for purposes of the net income calculation of the CFC.

The exemptions under section 10B apply to foreign dividends received by or accrued to a person, which includes a CFC. Since a CFC is a company, the ratio under section 10B(3)(b)(ii)(bb) of 8<sup>62</sup> to 28 is applied to determine the portion of the foreign dividend that is exempt under section 10B(3). An amount attributed to a resident under section 9D(2) does not constitute a foreign dividend, but only a proportional amount of the CFC's net income. The legal status of the person holding an interest in the CFC is therefore not considered when the ratio under section 10B(3)(b) is applied.

An effective normal tax rate of 20%<sup>63</sup> will be achieved if the person holding a qualifying interest in the CFC is a company, or an insurer in respect of its company policyholder fund, corporate fund or risk policy fund. A different effective rate will, however, be achieved for other persons, namely a natural person, deceased estate, insolvent estate, trust or an insurer in respect of its individual policyholder fund, holding a qualifying interest in a CFC, since these persons' effective tax rates may range from 0% to 45%.

<sup>61</sup> Section 9D(2A).

<sup>62</sup> The ratio is 13 to 28 for years of assessment commencing before 1 March 2017.

<sup>63</sup> 15% for years of assessment commencing before 1 March 2017.

**Example 19 – Effect of the application of the partial exemption under section 10B(3) when the net income of a CFC is attributed to a company***Facts:*

The years of assessment of all companies in this example end on the last day of February.

Resident Company A holds 10% of the participation rights and voting rights in CFC B. CFC B holds 10% of the equity shares and voting rights in Foreign Company C. CFC B and Foreign Company C are not residents of the same country. Foreign Company C paid a dividend of R20 000 to CFC B during the 2018 year of assessment.

CFC B holds 5% of the equity shares and voting rights in Foreign Company D. CFC B and Foreign Company D are residents of the same country. Foreign Company D paid a dividend of R50 000 to CFC B during the 2018 year of assessment.

CFC B holds shares in Foreign Company E, the shares of which are listed on the JSE. Foreign Company E paid a cash dividend of R6 000 to CFC B during the 2018 year of assessment.

CFC B holds 5% of the equity shares and voting rights in Foreign Company F. CFC B and Foreign Company F are not residents of the same country. Foreign Company F paid a dividend of R100 000 to CFC B during the 2018 year of assessment.

CFC B did not receive any other income nor incur any deductible expenses during the 2018 year of assessment.

*Result:*

The amounts of R20 000, R50 000, R6 000 and R100 000 constitute foreign dividends for CFC B for purposes of paragraph (k) of the definition of “gross income” in section 1(1) and for determining its net income under section 9D(2A).

The foreign dividend of R20 000 received from Foreign Company C is exempt under the participation exemption in section 10B(2)(a), since CFC B holds at least 10% of the equity shares and voting rights in Foreign Company C.

The foreign dividend of R50 000 received from Foreign Company D is exempt under the country-to-country exemption in section 10B(2)(b), since CFC B and Foreign Company D are residents of the same foreign country.

The foreign dividend of R6 000 received from Foreign Company E is exempt under section 10B(2)(d), since it is a foreign dividend received in cash in respect of a share listed on the JSE.

The foreign dividend of R100 000 received from Foreign Company F is not exempt under section 10B(2), but qualifies for the partial exemption under section 10B(3).

The portion of the foreign dividend received from Foreign Company F which is exempt under section 10B(3)(b) is calculated as follows:

$$A = B \times C$$

$$A = [(8 / 28) \times R100\,000]$$

$$A = R28\,571$$

The taxable portion of the foreign dividend is R71 429 (R100 000 – R28 571).

The amount attributable to Resident Company A under section 9D(2) amounts to R7 143 (R71 429 × 10%). This amount represents “income” and not a foreign dividend for Resident Company A. Resident Company A is therefore not entitled to claim any of the exemptions under section 10B in respect of the income attributed from CFC B.

The normal tax payable by Resident Company A on the amount of R7 143 included in income is R2 000,04 (R7 143 × 28%) resulting in an effective tax rate of 20% [R2 000,04 / (R100 000 × 10%) × 100] payable on the gross amount of the underlying foreign dividend attributable to Resident Company A.

**Example 20 – Effect of the application of the partial exemption under section 10B(3) when the income of a CFC is attributed to a natural person**

*Facts:*

Resident A, a natural person, holds 100% of the participation and voting rights in CFC B. During its foreign tax year ending 28 February 2018, CFC B received foreign dividends of R100 000 from Foreign Company C, which is not a CFC in relation to Resident A. Assume that CFC B does not receive any other income and does not incur any deductible expenses. The foreign companies are not residents of the same country. CFC B does not qualify for the exemptions under section 10B(2). Resident A pays normal tax at the maximum marginal rate of 45%.

*Result:*

The amount of R100 000 constitutes a foreign dividend for CFC B for purposes of the definition of “gross income” in section 1(1) and for determining its net income under section 9D(2A).

The portion of the foreign dividend exempt under section 10B(3)(b) is calculated as follows:

$$A = B \times C$$

$$A = [(8 / 28) \times R100\,000]$$

$$A = R28\,571$$

The taxable amount of the foreign dividend is R71 429 (R100 000 – R28 571).

The amount attributable to Resident A under section 9D(2) amounts to R71 429 (R71 429 × 100%). The normal tax payable on R71 429 included in Resident A's income is R32 143,05 (R71 429 × 45%), resulting in an effective normal tax rate of 32,14% (R32 143,05 / R100 000 × 100).

**Notes:**

- (1) This example illustrates that a maximum effective normal tax rate of 20% is not necessarily achieved on the inclusion of net income in the income of a resident resulting from foreign dividends received by or accrued to a CFC.
- (2) A maximum effective normal tax rate of 20% would have been achieved had Resident A directly held the shares in Foreign Company C.

#### **4.3.8 Non-application of the participation exemption under section 10B(2)(a) and the country-to-country exemption under section 10B(2)(b) [section 10B(4)]**

##### **(a) Foreign dividend determined with reference to or which arose from a deductible amount paid or payable by any person [section 10B(4)(a)]**

The participation exemption under section 10B(2)(a) and the country-to-country exemption under section 10B(2)(b) are subject to an anti-tax avoidance provision in section 10B(4)(a).

In particular, these exemptions will not apply to any foreign dividend received by or accrued to a person if –

- the amount of the foreign dividend is determined directly or indirectly with reference to; or
- the foreign dividend arises directly or indirectly from,

any amount paid or payable by any person to any other person and the amount paid or payable is deductible from the income of the payer and –

- is not subject to normal tax in the hands of the recipient; and
- when the recipient is a CFC, is not taken into account in determining the net income of that CFC under section 9D(2A),

unless the amount so paid or payable is paid or payable as consideration for the acquisition of trading stock by the payer.

The words “directly” and “indirectly” referred to above are not defined in the Act. The ordinary meaning of “directly” is described as follows:

“1. [I]n a direct manner.”<sup>64</sup>

“3 Completely, absolutely; exactly.

4 Without an intermediary, by a direct process.”<sup>65</sup>

The ordinary meaning of “indirectly” is described as follows:

“1 By indirect action, means, or connection; through an intervening person or thing.

**b** Not in express terms; by suggestion or implication.”<sup>66</sup>

“2. [C]oming or resulting otherwise than directly or immediately, as effects or consequences: *an indirect advantage*.”<sup>67</sup>

<sup>64</sup> M Makins *Collins English Dictionary* 3 ed (1991) Harper Collins Publishers.

<sup>65</sup> A Stevenson *Shorter Oxford English Dictionary on Historical Principles* 6 ed (2007) Oxford University Press in vol 1.

<sup>66</sup> A Stevenson *Shorter Oxford English Dictionary on Historical Principles* 6 ed (2007) Oxford University Press in vol 1.

<sup>67</sup> [www.dictionary.com/browse/indirectly](http://www.dictionary.com/browse/indirectly) [Accessed 20 February 2018].

“1 In a way that is not directly caused by something; incidentally:...”<sup>68</sup>

The anti-avoidance provision in section 10B(4)(a) is aimed at a situation in which a person claims a deduction for an amount paid to a foreign company which is then routed to that person or another person in the form of a tax-free foreign dividend.

Whether a foreign dividend received by or accrued to a person is determined directly or indirectly with reference to, or arises directly or indirectly from, an amount paid or payable by any person to any other person is a question of fact that must be determined on the specific facts of each case. The onus is on a taxpayer<sup>69</sup> to prove that the anti-tax avoidance provision in section 10B(4)(a) does not apply.

The words “subject to tax” are not defined in the Act. In *Paul Weiser v The Commissioners for HM Revenue and Customs* the first-tier tribunal stated that it agreed with the following extract from HMRC’s International Tax Manual on the meaning of these words:<sup>70</sup>

**“INTM332210 – DT applications and claims – Subject to tax**

**Background**

The expression “subject to tax” usually means that the person must actually pay tax on the income in their country of residence.

However, a person is still regarded as “subject to tax” if, for example, he or she does not pay tax because their income is sufficiently small that it is covered by personal allowances that are available to set [off] against liability to tax in the other country.

A person is not regarded as “subject to tax” if the income in question is exempted from tax because the law of the other country provides for a statutory exemption from tax....’ ”

An amount is similarly not considered to be subject to normal tax in South Africa if it is exempt under the Act or if a tax treaty provides for relief from double taxation by prohibiting the right of one of the Contracting States to tax the income.<sup>71</sup>

An amount paid or payable as consideration for the acquisition of trading stock is specifically excluded from section 10B(4)(a) because any deduction for the acquisition of trading stock is cancelled by the inclusion in taxable income for trading stock held and not disposed of at the end of a year of assessment under section 22(1) or by an inclusion in gross income in section 1(1) upon its disposal.

Foreign dividends not exempt because of the application of section 10B(4), which denies an exemption under section 10B(2)(a) or (b), may nevertheless be exempt under section 10B(2)(c), (d)<sup>72</sup> or (e)<sup>73</sup> or partially exempt under section 10B(3) (see 4.3.7).

<sup>68</sup> <https://en.oxforddictionaries.com/definition/indirectly> [Accessed 20 February 2018].

<sup>69</sup> Under section 102(1)(a) of the Tax Administration Act 28 of 2011.

<sup>70</sup> [2012] UKFTT 501 (TC) in paragraphs 37 and 38.

<sup>71</sup> See Binding Private Ruling 127 dated 21 November 2012 “Relief from Double Taxation of Foreign Income”.

<sup>72</sup> In respect of shares of a foreign company that are listed shares.

<sup>73</sup> See above.

**Example 21 – Non-application of the participation exemption under section 10B(2)(a) – Foreign dividend determined with reference to a deductible amount paid or payable by any person [section 10B(4)(a)]**

*Facts:*

Resident Company B holds 15% of the equity shares and voting rights in Foreign Company C, a CFC. The shares of Foreign Company C are not listed shares as defined in section 1(1).

Resident Company A pays technical service fees to Foreign Company C for services rendered by Foreign Company C outside South Africa.

Foreign Company C pays a cash dividend to Resident Company B that arises directly from the technical service fees paid by Resident Company A. The technical service fees form part of Foreign Company C's foreign business establishment.

*Result:*

The foreign dividend received by Resident Company B from Foreign Company C is included in Resident Company B's gross income under paragraph (k) of the definition of "gross income" in section 1(1).

The foreign dividend does not qualify for the participation exemption under section 10B(2)(a) because –

- the foreign dividend arises directly from the technical service fees payable by Resident Company A;
- the technical service fees are deductible from Resident Company A's income under section 11(a);
- the technical service fees received by Foreign Company C are not subject to normal tax because Foreign Company C is not a resident and the amount is not derived from a source in South Africa; and
- the technical service fees are also not taken into account in determining Foreign Company C's net income under section 9D(2A) because they form part of its foreign business establishment and are excluded under section 9D(9)(b). It is assumed that none of the exclusions from section 9D(9)(b) in section 9D(9A) apply.

**Note:**

The exemption under section 10B(2)(c) and the partial exemption under section 10B(3) may apply.

**Example 22 – Non-application of the country-to-country exemption under section 10B(2)(b) – Foreign dividend determined with reference to a deductible amount paid or payable by any person [section 10B(4)(a)]**

*Facts:*

Foreign Company B, a CFC, holds 15% of the equity shares and voting rights in Foreign Company C, also a CFC. Foreign Company B and Foreign Company C are both residents of Foreign Country B.

Resident Company A pays management fees to Foreign Company C. The management fees form part of Foreign Company C's foreign business establishment and are derived from a source outside South Africa. Foreign Company C pays a dividend to Foreign Company B that arises directly from the management fees paid by Resident Company A.

*Result:*

The foreign dividend received by Foreign Company B from Foreign Company C is included in Foreign Company B's gross income under paragraph (k) of the definition of "gross income" in section 1(1) for purposes of determining its net income under section 9D(2A).

The foreign dividend does not qualify for the country-to-country exemption under section 10B(2)(b) because –

- the foreign dividend arises directly from the management fees payable by Resident Company A;
- the management fees are deductible from Resident Company A's income under section 11(a);
- the management fees received by Foreign Company C are not subject to normal tax because Foreign Company C is not a resident and the fees are from a source outside South Africa; and
- the management fees are also not taken into account in determining Foreign Company C's net income under section 9D(2A) because they form part of its foreign business establishment and are excluded under section 9D(9)(b).

**Note:**

The partial exemption under section 10B(3) may still apply.

**Example 23 – Non-application of the participation exemption under section 10B(2)(a) – Foreign dividend determined with reference to a deductible amount paid or payable by any person [section 10B(4)(a)]**

*Facts:*

Resident Company A holds 15% of the equity shares and voting rights in Foreign Company B, which is not a CFC. Foreign Company B's shares are not listed shares as defined in section 1(1).

Foreign Company B lent money to Resident Company A at *libor*<sup>74</sup> plus 2%. Resident Company A paid the interest to Foreign Company B. The interest paid qualifies as a deduction under section 24J(2). Foreign Company B paid a cash dividend to Resident Company A calculated at 50% of the interest received.

<sup>74</sup> The London Interbank Offered Rate is the average of interest rates estimated by each of the leading banks in London that it would be charged were it to borrow from other banks. It is usually abbreviated to *Libor* [<https://en.wikipedia.org/wiki/Libor> (Accessed 20 February 2018)].

*Result:*

The foreign dividend received by Resident Company A from Foreign Company B is included in Resident Company A's gross income under paragraph (k) of the definition of "gross income" in section 1(1).

The foreign dividend does not qualify for the participation exemption under section 10B(2)(a) because –

- the foreign dividend is determined directly with reference to the interest paid by Resident Company A;
- the interest is deductible from Resident Company A's income under section 24J(2); and
- the interest received by Foreign Company B is not subject to normal tax under section 10(1)(h) because Foreign Company B is not a resident.

**Note:**

The partial exemption under section 10B(3) may apply.

**Example 24 – Non-application of the participation exemption under section 10B(2)(a) – Foreign dividend determined with reference to a deductible amount paid or payable by any person [section 10B(4)(a)]**

*Facts:*

Resident Company A holds 100% of the equity shares and voting rights in Resident Company B. Foreign Company C was specifically set up to lend money to Resident Company B at <sup>75</sup>libor plus 2%.

Foreign Company D holds 100% of Foreign Company C's equity shares and voting rights. Foreign Company D's shares and voting rights are held equally by five natural persons, one of which is a resident. Foreign Company C and Foreign Company D's shares are not listed shares as defined in section 1(1). The natural persons are not connected persons in relation to Resident Company A or Resident Company B.

Resident Company B paid interest of R100 000 to Foreign Company C. The interest paid qualifies as a deduction under section 24J(2). Resident Company B withheld and paid withholding tax on interest of R15 000 ( $R100\,000 \times 15\%$ ) to SARS.

Foreign Company C declared and paid a cash dividend to Foreign Company D of R85 000 which in turn declared and paid a dividend to its 5 holders of shares of R17 000 each. Foreign Company C and Foreign Company D are special purpose vehicles and the transactions listed above are the only transactions which occurred in these companies.

*Result:*

The foreign dividend received by the resident holder of shares from Foreign Company D is included in gross income under paragraph (k) of the definition of "gross income" in section 1(1).

<sup>75</sup> See above.



The foreign dividend does not qualify for the participation exemption under section 10B(2)(a) even though the resident holder of the shares holds more than 10% of the equity shares and voting rights because –

- the foreign dividend arises indirectly from the interest paid by Resident Company B;
- the interest is deductible from Resident Company B's income under section 24J(2); and
- the interest received by Foreign Company C is not subject to normal tax under section 10(1)(h) because Foreign Company C is not a resident.

**Notes:**

- (1) The position reflected above is not impacted by Foreign Company C's liability for withholding tax on interest under section 50C(1), meaning that section 10B(4)(a) applies.
- (2) The fact that Foreign Company C and Foreign Company D's holders of shares are not connected persons in relation to Resident Company A or Resident Company B is irrelevant.
- (3) The partial exemption under section 10B(3) may apply.

**Example 25 – Application of the participation exemption under section 10B(2)(a) – Foreign dividend not determined with reference to a deductible amount paid or payable by any person [section 10B(4)(a)]**

*Facts:*

Resident Company A holds 50% of the equity shares and voting rights in Foreign Company B, a CFC. The shares of Foreign Company B are not listed shares as defined in section 1(1).

Resident Company A pays technical service fees of R100 000 to Foreign Company B for services rendered by Foreign Company B outside South Africa. The technical service fees form part of Foreign Company B's foreign business establishment. Foreign Company B pays a cash dividend of R10 million to its shareholders, based on the profits of the foreign business establishment as a whole.

*Result:*

The foreign dividend of R5 million (R10 million × 50%) received by Resident Company A from Foreign Company B is included in Resident Company A's gross income under paragraph (k) of the definition of "gross income" in section 1(1).

The foreign dividend qualifies for the participation exemption under section 10B(2)(a) because Resident Company A holds 50% of the equity shares and voting rights in Foreign Company B, which is more than the required 10%.

Section 10B(4)(a) does not apply because the technical service fees of R100 000 paid by Resident Company A to Foreign Company B are negligible compared to the other business profits underlying the dividend of R10 million, *and* the amount of the dividend was determined without specifically considering and taking into account the amount of or the profits from those particular technical service fees. As a result, the foreign dividend is not considered to be determined directly or indirectly with reference to or to arise directly or indirectly from the technical service fees paid by Resident Company A. The foreign dividend was a discretionary dividend based on the profits of the foreign business establishment as a whole of which the technical service fees from Resident Company A were incidental.

In the absence of being determined directly or indirectly with reference to or arising directly or indirectly from the technical service fees paid by Resident Company A, it is irrelevant for purposes of section 10B(4)(a) that –

- the technical service fees are deductible from Resident Company A's income under section 11(a);
- the technical service fees received by Foreign Company B are not subject to normal tax as a result of Foreign Company B not being a resident and the amount not being derived from a source in South Africa; and
- the service fees are not taken into account in determining Foreign Company B's net income under section 9D(2A) because they form part of its foreign business establishment and are excluded under section 9D(9)(b).

**(b) Foreign dividends received or accrued from a foreign collective investment scheme [section 10B(4)(b)]**

The participation exemption under section 10B(2)(a) and the country-to-country exemption under section 10B(2)(b) do not apply to a foreign dividend received by or accrued to a person from a portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participatory interest. The exemptions under section 10B(2)(c) or section 10B(3) may nevertheless still apply.

The effect of section 10B(4)(b) is that a foreign dividend received or accrued from a portfolio in these investment schemes constitutes income for a unit holder to the extent that it is not exempt under section 10B(2)(c) or section 10B(3).

A foreign dividend received or accrued from a portfolio in these investment schemes is not subject to dividends tax.<sup>76</sup>

The tax treatment of resident portfolios of collective investment schemes in securities and their unit holders differs from that of foreign investment schemes and is dealt with in section 25BA.<sup>77</sup>

<sup>76</sup> See also the *Comprehensive Guide to Dividends Tax*.

<sup>77</sup> See also the *Comprehensive Guide to Dividends Tax*.

**Example 26 – Non-application of the participation exemption under section 10B(2)(a) – Foreign dividends received or accrued from a foreign collective investment scheme**

*Facts:*

Resident Company A holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B is a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold participatory interests. Foreign Company B pays a foreign dividend of R10 000 to Resident Company A.

*Result:*

The foreign dividend of R10 000 received by Resident Company A is included in its gross income under paragraph (k) of the definition of “gross income” in section 1(1). Section 10B(4)(b) provides that the participation exemption under section 10B(2)(a) does not apply, since the foreign dividend was received from a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold participatory interests.

The partial exemption under section 10B(3) does, however, apply, which means that an amount of R2 857 ( $R10\,000 \times 8 / 28^{78}$ ) is exempt from normal tax.

**Example 27 – Non-application of the country-to-country exemption under section 10B(2)(b) – Foreign dividends received or accrued from a foreign collective investment scheme**

*Facts:*

Resident Company A holds 100% of the participation rights and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Both foreign companies are incorporated and effectively managed in Foreign Country D. Foreign Company C is a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold participatory interests. Foreign Company C pays a foreign dividend to Foreign Company B.

*Result:*

Foreign Company B is a CFC in relation to Resident Company A, since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of “gross income” in section 1(1). The foreign dividend paid by Foreign Company C to Foreign Company B is therefore included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

<sup>78</sup> The ratio is 13 to 28 for years of assessment commencing before 1 March 2017.

Section 10B(4)(b) determines that the foreign dividend is not exempt from normal tax under section 10B(2)(b), since it was received from a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold participatory interests. The foreign dividend does, however, qualify for the partial exemption under section 10B(3).

The amount attributable to Resident Company A under section 9D(2) represents “income” and not a foreign dividend. Resident Company A is therefore not entitled to claim any of the exemptions under section 10B in respect of the income attributed from Foreign Company B.

#### **4.3.9 Non-application of the exemptions under section 10B(2) and (3) to any portion of an annuity or payments out of foreign dividends [section 10B(5)]**

Under section 10B(5) the exemptions under section 10B(2) and (3)<sup>79</sup> do not –

- apply in respect of any portion of an annuity;<sup>80</sup> or
- extend to any payments out of any foreign dividend received by or accrued to any person.<sup>81</sup>

The purpose of section 10B(5) is to prevent payments not comprising foreign dividends from being characterised as such in order to enable the recipient of the payments to take advantage of the exemptions in section 10B(2) and (3).

Section 10B(5) does not apply if a foreign dividend is distributed through multiple foreign subsidiaries, with the final foreign dividend being received by the ultimate holder as a foreign dividend. Each foreign subsidiary is declaring a foreign dividend in its own right as opposed to merely paying an amount out of a foreign dividend received or accrued and as a result section 10B(5) will not apply. There is thus no question of a payment that is not a foreign dividend being recharacterised as a foreign dividend.

A beneficiary of a discretionary trust who receives a foreign dividend from the trust in the same year of assessment will be unaffected by section 10B(5). Under section 25B(1) a foreign dividend received by or accrued to a trust is deemed to accrue to its beneficiary if distributed during the same year of assessment. The nature of the amount in the beneficiary’s hands as a foreign dividend is thus not determined through payment but through the deemed accrual.

<sup>79</sup> The reference to the partial exemption in section 10B(3) was inserted by the Taxation Laws Amendment Act 17 of 2017 with effect from the date of promulgation of that Act, 18 December 2017.

<sup>80</sup> The reference to an annuity was inserted by the Taxation Laws Amendment Act 17 of 2017 and applies with effect from the date of promulgation of that Act, 18 December 2017. A similar reference to an annuity can be found in section 10(2)(b) which provides that the exemptions under section 10(1)(h) and (k) shall not apply in respect of any portion of an annuity.

<sup>81</sup> This provision is similar to the one in section 10(3)(a) which provides that the exemptions under section 10(1) shall not apply in respect of any payments out of the receipts, accruals, amounts or profits mentioned in section 10(1).

**Example 28 – Non-application of section 10B(2) – Payment of an amount out of foreign dividends**

*Facts:*

Resident Company A holds shares in a foreign company listed on the JSE and received foreign dividends in cash of R300 000 from that company during the year of assessment. Resident Company A used R150 000 of the cash to pay bonuses to its employees during the same year of assessment.

*Result:*

The amount of R300 000 constitutes a “foreign dividend” as defined in section 1(1) and is included in Resident Company A’s gross income under paragraph (k) of the definition of “gross income” in section 1(1). Resident Company A qualifies for the exemption under section 10B(2)(d), since the foreign company’s shares are listed on the JSE.

The bonus constitutes gross income for the relevant employees. The bonus is not a foreign dividend and the employees will not be entitled to any of the exemptions in section 10B. Section 10B(5) clarifies that the exemptions under section 10B are unavailable. The fact that the underlying cash funds may have come from a foreign dividend is irrelevant.

**Example 29 – Non-application of section 10B(2) and (3) – Payment of an annuity out of foreign dividends**

*Facts:*

Resident A, a natural person, is a beneficiary of a resident testamentary trust. Under the trust deed, Resident A is entitled to a monthly annuity of R20 000, with effect from 1 January 2018, payable out of foreign dividends received by or accrued to the trust. Resident A does not have a vested right in any other amounts received by or accrued to the trust. The trust holds shares in a foreign company listed on the JSE and received foreign dividends in cash of R50 000 from that company during the 2018 year of assessment.

*Result:*

The amount of R40 000 ( $R20\,000 \times 2$ ) constitutes a “foreign dividend” as defined in section 1(1) and is included in Resident A’s gross income under paragraph (k) of the definition of “gross income” in section 1(1) read with section 25B(1). The foreign dividends received are received as part of an annuity. The exemptions under section 10B(2) and (3) accordingly do not apply to these amounts.

Resident A would have qualified for the exemption under section 10B(2)(d)<sup>82</sup> if the amounts were not paid by way of an annuity. The dividends would, however, have been subject to dividends tax.

<sup>82</sup> The foreign dividends were paid in respect of a “listed share” as defined in section 1(1), which is a share listed on an exchange as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act.

#### **4.3.10 Non-application of section 10B(2) and (3) – Foreign dividends in respect of services rendered, employment or holding of office or in respect of restricted equity instruments [section 10B(6)]**

*Amounts received or accrued on or before 1 March 2017*

Section 10B(6)<sup>83</sup> is an anti-tax avoidance provision aimed at structures involving foreign companies under which income received by or accrued to a person for services rendered is categorised as a foreign dividend. The following is stated in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013*:<sup>84</sup>

“... many share schemes hold pure equity shares where the sole intent of the scheme is to generate dividends for employees as compensation for past or future services rendered to the employer, without the employees ever obtaining ownership of the shares. The dividend yield in these instances effectively operates as disguised salary for employees (that is not deductible by employers) even though these dividends arise from equity shares.”

The exemptions under section 10B(2) and (3) do not apply to any foreign dividend received by or accrued to a person –

- in respect of services rendered or to be rendered; or
- in respect of or by virtue of employment or the holding of any office.

However, any foreign dividend received by or accrued to a person under any of the circumstances mentioned above in respect of a restricted equity instrument as defined in section 8C<sup>85</sup> *held* by that person or in respect of a share *held* by that person, is not subject to section 10B(6) and qualifies for the exemptions under section 10B.

Foreign dividends received by or accrued to persons who are the holders of the shares will therefore be exempt under section 10B(2) and (3) even though the foreign dividends are paid in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office.

The non-application of section 10B(6) to holders of shares can be justified because –

- the beneficial owner of a share will be taxed on the proceeds derived on its subsequent disposal; and
- any gain or loss upon vesting of a restricted equity instrument will be included in the income of the holder under section 8C(1)(a).

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<sup>83</sup> Section 10B(6) applies to foreign dividends received or accrued on or after 1 March 2014.

<sup>84</sup> In paragraph 1.8.

<sup>85</sup> The term “restricted equity instrument” is defined in section 8C(7).

**Example 30 – Non-application of section 10B(2) and (3) – Income disguised as a foreign dividend [section 10B(6)]**

*Facts:*

Resident A, a natural person, is an employee of Foreign Company B. A discretionary trust holds shares in Foreign Company B for the benefit of the employees of Foreign Company B as part of an employee share incentive scheme. The trust is the beneficial owner of the shares. The trustees distributed foreign dividends of R100 000 to Resident A under the share incentive scheme during the 2017 year of assessment.

*Result:*

The foreign dividends of R100 000 are included in Resident A's gross income under paragraph (k) of the definition of "gross income" in section 1(1) read with section 25B(1) and (2). Under section 10B(6) the exemptions under section 10B(2) and (3) do not apply to the foreign dividend of R100 000 received by Resident A by virtue of Resident A's employment in Foreign Company B. Resident A does not hold the underlying shares.

**Notes:**

- (1) Should Resident A have had a vested right in the shares, section 10B(6) would not have applied and the exemptions under section 10B(2) and (3) would have applied.
- (2) Section 10B(6)(a) would apply in respect of amounts received or accrued after 1 March 2017.

*Amounts received or accrued after 1 March 2017*

For foreign dividends received or accrued after 1 March 2017, section 10B(6) is divided into two parts, namely –

- section 10B(6)(a) dealing with foreign dividends received by or accrued to a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office; and
- section 10B(6)(b) dealing with specified foreign dividends received by or accrued to a person in respect of restricted equity instruments.

*Foreign dividends received by or accrued to a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office [section 10B(6)(a)]*

The exemptions in section 10B(2) and (3) do not apply to foreign dividends received by or accrued to a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office, unless the foreign dividend is in respect of a share held by the person. See Example 30 – the same result would be achieved under section 10B(6)(a) for amounts received or accrued after 1 March 2017.

*Specified foreign dividends received by or accrued to a person in respect of restricted equity instruments [section 10B(6)(b)]*

A detailed discussion of section 8C is beyond the scope of this Note, but it is briefly mentioned here to explain the reason for denial of the exemptions in section 10B(2) and (3) under section 10B(6)(b) as discussed below.

Broadly, section 8C deals with the taxation of equity instruments and restricted equity instruments acquired by directors and employees by virtue of their employment or office of director. The employee or director is required to include the gain in income or deduct the loss from income as calculated under section 8C(2) in the year in which the equity instrument or restricted equity instrument “vests”. Section 8C(3) sets out various circumstances in which a share “vests” but generally vesting occurs when all the restrictions preventing the disposal of the share at market value are lifted.

Furthermore, section 8C(1A) requires any amount received or accrued in respect of restricted equity instruments, excluding, amongst others, gains or losses already dealt with under section 8C(1) and dividends and foreign dividends, to be included in income. Dividends and foreign dividends received on restricted equity instruments are excluded from inclusion under section 8C(1A) since these amounts are included in gross income under paragraph (k) of the definition of “gross income” in section 1(1). Dividends and foreign dividends potentially qualify for exemption from normal tax under sections 10(1)(k)(i) or 10B(2) or (3).

Section 10B(6)(b), however, determines that section 10B(2) and (3) do not apply to any foreign dividend received by or accrued to a person in respect of a restricted equity instrument that was acquired in the circumstances contemplated in section 8C if that foreign dividend is derived directly or indirectly from, or constitutes –

- an amount transferred or applied by a company as consideration for the acquisition or redemption of any share in that company or received or accrued in anticipation or in the course of the winding up, liquidation, deregistration or final termination of a company; or
- an equity instrument that does not qualify, at the time of the receipt or accrual of that foreign dividend, as a restricted equity instrument as defined in section 8C.

The words “directly” and “indirectly” are not defined in the Act. See **4.3.8(a)** for the ordinary meaning of these words. Whether a foreign dividend is derived directly or indirectly or constitutes an amount or equity instrument described in section 10B(6)(b) is a question of fact that must be determined on the specific facts of each case.

In the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2016*<sup>86</sup> it was stated that section 8C is based on the implicit assumption that the full value of the shares underlying a restricted equity instrument will vest in the employee when the restrictions fall away. It was further stated that the value derived from the underlying shares could be liquidated in full or in part by means of distributions, for example, through redemption of the shares or a return of capital effected before these restrictions fall away.<sup>87</sup>

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<sup>86</sup> In paragraph 1.7.

<sup>87</sup> See above.



Section 10B(6)(b) deals with specified situations which could potentially result in a substantial portion of the value of a restricted equity instrument being returned to an employee or director in the form of a foreign dividend before the instrument is deemed to vest under section 8C. In the absence of section 10B(6)(b), such foreign dividend could be wholly exempt from normal tax if it qualified under section 10B(2) or partially exempt under section 10B(3). The effect of such a re-characterisation of value as a foreign dividend would be to reduce the rate of tax for an employee or director that would otherwise have been payable under section 8C from a maximum of 45% to a rate varying between 0% and 20%.

**Example 31 – Non-application of section 10B(2) and (3) – Foreign dividend received in respect of restricted equity instruments – Share buy-back**

*Facts:*

Resident employees of Foreign Company A hold restricted equity instruments in that company which they acquired from an Employee Share Trust by virtue of employment.

Foreign Company A bought back 10% of the restricted equity instruments held by the employees. Under the income tax laws on companies of the foreign country in which Foreign Company A has its place of effective management, the consideration given for the share buy-back is treated as a dividend.

*Result:*

The dividend paid by Foreign Company A to resident employees constitutes a “foreign dividend” as defined in section 1(1). The foreign dividend must be included in the gross income of the employees under paragraph (k) of the definition of “gross income” in section 1(1).

The foreign dividend does not qualify for the exemptions under section 10B(2) and (3) by virtue of section 10B(6)(b)(i)(aa), since it was deemed to accrue to each employee in respect of a restricted equity instrument acquired by virtue of employment and constituted an amount transferred or applied by Foreign Company A as consideration for the acquisition of shares in that company.

**Example 32 – Non-application of section 10B(2) and (3) – Foreign dividend received in respect of restricted equity instruments in anticipation of the winding-up of a company**

*Facts:*

Resident employees and directors of Foreign Company A hold restricted equity instruments in that company which they acquired from an Employee Share Trust by virtue of employment or office of director.

Foreign Company A paid a dividend to its resident employees and directors in anticipation of the winding-up of the company. Under the income tax laws on companies of the foreign country in which Foreign Company A has its place of effective management, the distribution of profits in anticipation of the winding-up of a company is regarded as a dividend.

*Result:*

The dividend paid by Foreign Company A to resident employees and directors constitutes a “foreign dividend” as defined in section 1(1). The foreign dividend must be included in the gross income of the employees and directors under paragraph (k) of the definition of “gross income” in section 1(1).

The foreign dividend does not qualify for the exemptions under section 10B(2) and (3) by virtue of section 10B(6)(b)(i)(bb), since it was deemed to accrue to each employee and director in respect of a restricted equity instrument that was acquired by virtue of employment or office of director and constituted an amount received in anticipation of the winding-up of Foreign Company A.

**Example 33 – Non-application of section 10B(3) – Foreign dividend received in respect of restricted equity instruments – Share buy-back***Facts:*

Resident employees and directors of Foreign Company A hold restricted equity instruments in that company which they acquired from an Employee Share Trust by virtue of employment or office of director.

Foreign Company A holds shares in Foreign Company B which were acquired for R1 million.

Foreign Company B bought back 10% of the shares held by Foreign Company A for R500 000. 5% of the profit of R400 000 [R500 000 – R100 000 (R1 million × 10%)] made on the share buy-back was distributed by Company A to its resident employees and directors. Under the income tax laws on companies of the foreign country in which Foreign Company A has its place of effective management, the distribution by Foreign Company A of the profit on disposal of the shares in Foreign Company B is treated as a dividend.

*Result:*

The dividend paid by Foreign Company A to resident employees and directors of R20 000 [R400 000 × 5%] constitutes a “foreign dividend” as defined in section 1(1). The foreign dividend must be included in the gross income of the employees and directors under paragraph (k) of the definition of “gross income” in section 1(1).

The foreign dividend does not qualify for the exemptions under section 10B(2) and (3) by virtue of section 10B(6)(b)(i)(aa), since it was deemed to accrue to each employee and director in respect of a restricted equity instrument that was acquired by virtue of employment or office of director and derived indirectly from an amount transferred or applied by Foreign Company B as consideration for the acquisition of shares in Foreign Company B.

**Example 34 – Non-application of section 10B(2) and (3) – Foreign dividend received in respect of restricted equity instruments – Distribution of unrestricted equity instruments***Facts:*

Resident employees and directors of Foreign Company A hold restricted equity instruments in that company which they acquired from an employee share trust by virtue of employment or office of director. Foreign Company A holds equity shares in Foreign Company B.

Foreign Company A distributed the equity shares held in Foreign Company B to its resident employees and directors as a *dividend in specie* out of its current year's profits. The shares in Foreign Company B so distributed were unrestricted equity instruments in the hands of the directors and employees. Under the income tax laws on companies of the foreign country in which Foreign Company A is effectively managed, the distribution of a dividend *in specie* out of profits is treated as a dividend.

*Result:*

The dividend *in specie* paid by Foreign Company A to resident employees and directors constitutes a "foreign dividend" as defined in section 1(1). The foreign dividend must be included in the gross income of the employees and directors under paragraph (k) of the definition of "gross income" in section 1(1).

The foreign dividend does not qualify for the exemptions under section 10B(2) and (3) by virtue of section 10B(6)(b)(ii), since it was deemed to accrue to each employee and director in respect of a restricted equity instrument that was acquired by virtue of employment or office of director and constituted equity instruments that did not qualify at the time of the receipt or accrual of that foreign dividend as a restricted equity instrument as defined in section 8C.

**Example 35 – Non-application of section 10B(2) and (3) – Foreign dividend received in respect of restricted equity instruments in anticipation of the liquidation of a company***Facts:*

Foreign Company A awarded resident Employee A 10 shares for no consideration as a bonus in recognition of good performance. Employee A was not entitled to sell the shares for a period of 10 years. The shares constituted restricted equity instruments under section 8C. The 10 shares constituted a holding of 10% of the total equity shares and voting rights in Foreign Company A.

Before the 10-year period lapsed, the directors of Company A decided to declare all the company's profits as a dividend and to place the company in voluntary liquidation. Foreign Company A paid a foreign dividend of R100 000 in anticipation of its liquidation. Upon dissolution, Foreign Company A's share capital was returned to its holders of shares. Foreign Company A was liquidated in the same year of assessment in which the dividend was paid.

Immediately before the declaration of the dividend, Foreign Company A's balance sheet appeared as follows:

	R
Share capital (100 shares)	100
Retained income	<u>100 000</u>
Share capital and retained income	<u>100 100</u>
Cash	<u>100 100</u>
Total assets	<u>100 100</u>

Each share in the company was valued at  $R100\ 100 / 100 = R1\ 001$ . Employee A's 10 shares were therefore worth  $R1\ 001 \times 10 = R10\ 010$ .

Under the income tax laws on companies of the foreign country in which Foreign Company A has its place of effective management, the distribution of profits in anticipation of liquidation is regarded as a dividend.

*Result:*

The dividend paid by Foreign Company A to Employee A constitutes a "foreign dividend" as defined in section 1(1). The foreign dividend must be included in Employee A's gross income under paragraph (k) of the definition of "gross income" in section 1(1).

Notwithstanding that Employee A holds 10% of the equity shares and voting rights in Foreign Company A, Employee A does not qualify for the exemption in section 10B(2)(a) because section 10B(6)(b)(i)(bb) provides that the exemption does not apply to a foreign dividend received in respect of a restricted equity instrument under section 8C if the foreign dividend constitutes an amount received in anticipation of the liquidation of a company. Likewise, the partial exemption under section 10B(3) is not allowed.

On final liquidation of Foreign Company A, Employee A will have a disposal of the shares. Under section 8C(3)(b)(ii) the restricted equity instruments are deemed to vest in Employee A immediately before disposal of the shares. Accordingly, a gain of R10 [proceeds of R10 (10 shares  $\times$  R1) (Note 1) – base cost of Rnil] as calculated under section 8C(2)(a)(ii) must be included in Employee A's income under section 8C(1)(a).

**Notes:**

- (1) All the value in Foreign Company A had previously been distributed as a dividend in anticipation of its liquidation.
- (2) The denial of the exemption under section 10B(6)(b) results in the same outcome that would have ensued if, instead of declaring a dividend in anticipation of liquidation, the shares were redeemed at market value on liquidation. In that event, the redemption would have resulted in vesting occurring and a gain of R10 010 [proceeds of R10 010 (10 shares  $\times$  R1 001 market value) – base cost of Rnil] would have been included in Employee A's income.
- (3) In the absence of section 10B(6)(b), the foreign dividend would have been exempt from normal tax and Employee A would not have been subject to normal tax on the gain effectively obtained as a result of employment services rendered to Foreign Company A.

#### **4.4 An amount paid or payable by a foreign company in respect of a share that does not constitute a foreign dividend**

Any amount paid or payable by a foreign company to a person in respect of a share in that company that does not constitute a “foreign dividend” as defined in section 1(1) does not qualify for exemption under section 10B.

Any amount not constituting a “foreign dividend” or a “foreign return of capital” as defined in section 1(1) paid or payable by a foreign company to a person in respect of a share in that company from income reserves may constitute a receipt or accrual of a revenue nature. Thus, even if the amount is not a foreign dividend and falls outside paragraph (k) of the definition of gross income, it may still require inclusion in gross income.

##### **Example 36 – An amount paid or payable by a foreign company in respect of a share that does not constitute a foreign dividend**

###### *Facts:*

Foreign Company A, which is effectively managed in and a resident of Foreign Country A, paid an amount of R100 000 from its retained profits to Resident A in respect of shares held in Foreign Company A. Under the income tax law on companies of Foreign Country A the amount is deemed to be interest and qualifies for a tax deduction in Foreign Country A.

###### *Result:*

The amount of R100 000 received by Resident A does not constitute a “foreign dividend” as defined in section 1(1), since it is deemed to be interest and is not treated as a dividend or a similar payment under the income tax law on companies of Foreign Country A. The amount is also not a foreign return of capital because Foreign Company A is entitled to a tax deduction for the deemed interest expense.

From Resident A's perspective, the income is of a revenue nature and must be included in gross income. The amount will be subject to normal tax, since it is not a foreign dividend and as a result Resident A does not qualify for an exemption under section 10B.

#### **4.5 Prohibition of a deduction for expenditure incurred in the production of foreign dividends [section 23(f) and section 23(q)]**

Section 23(q) prohibits the deduction of any expenditure incurred in the production of income in the form of foreign dividends. For example, if the facts are such that the foreign dividend income is derived from carrying on a trade, and the expenditure incurred in respect of the portion of the foreign dividend which is not exempt under section 10B meets the requirements for a deduction under section 11(a), section 23(q) will deny that deduction.

Section 23(f) prohibits the deduction of any expenses incurred in respect of amounts received or accrued which do not constitute “income” as defined in section 1(1). This prohibition includes expenditure incurred in the production of the portion of a foreign dividend which is exempt under section 10B.

Examples of the type of expenditure disqualified as a deduction under section 23(q) include interest incurred on money borrowed to finance the acquisition of shares and bank charges (see Example 38).

#### **4.6 Source of foreign dividends [section 9(4)(a)]**

Section 9(4)(a) provides that an amount is received by or accrues to a person from a source outside South Africa if it constitutes a foreign dividend received by or accrued to that person. The source of foreign dividends is relevant, amongst other things, for the granting of a rebate under section 6*quat* against normal tax payable on the amount of foreign dividends included in taxable income.

#### **4.7 Translation of a foreign dividend denominated in a foreign currency to rand (section 25D)**

A foreign dividend received by or accrued to a person, which is required to be included in the person's income, will usually be denominated in a foreign currency. For South African normal tax purposes the amount of a foreign dividend must be translated to rand by applying one of the translation methods provided for in section 25D. Under the general rule in section 25D(1), foreign dividends must be translated to rand at the relevant spot rate on the date on which the foreign dividend was received or accrued.

A natural person and a non-trading trust may elect under section 25D(3) to translate a foreign dividend at the average exchange rate for the year of assessment rather than the spot rate. The same method of translation must be applied consistently during a year of assessment to translate all income received or accrued and expenditure incurred in a foreign currency during that year of assessment to rand.<sup>88</sup>

Different rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies – see Interpretation Note 63 “Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule” for details.

#### **Example 37 – Translation to rand of a foreign dividend denominated in a foreign currency**

##### *Facts:*

A foreign dividend of \$100 000 accrued to Individual A, a resident, on 3 April 2017. The spot rate on that date was \$1 : R13,5770. Individual A did not elect to translate income and expenses at the average exchange rate for the 2018 year of assessment.

<sup>88</sup> See Interpretation Note 63 “Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule” for the interpretation of section 25D.

*Result:*

The foreign dividend of \$100 000 that accrued to Individual A must be included in gross income under paragraph (k) of the definition of “gross income” in section 1(1). Under section 25D(1) the foreign dividend must be translated to rand at the spot rate on the date of accrual. The amount to be included in gross income is R1 357 700 (\$100 000 × R13,5770).

#### 4.8 Rebate for foreign taxes on foreign dividends (section 6quat)

Amounts of income received by or accrued to a resident from a foreign source may be taxed in both the country of source and South Africa, resulting in juridical double taxation. Section 6quat(1) provides relief in these circumstances by allowing a rebate for foreign taxes to be deducted from normal tax payable.

One of the requirements of the rebate is that the foreign tax must be proved to be payable on income from a source outside South Africa which is included in taxable income.<sup>89</sup> However, under paragraph (ii) of the proviso to section 6quat(1A), in calculating the amount of foreign taxes which potentially qualify for a rebate, an amount included in a person’s taxable income must be determined without regard to section 10B(3). The proviso applies only for purposes of the application of section 6quat(1A). The result is that any foreign tax proved to be payable in respect of foreign dividends exempt under section 10B(3) qualifies to be taken into account as a foreign tax rebate under section 6quat(1). But for the proviso, the foreign taxes qualifying for rebate purposes would have been limited to the portion of the foreign dividend included in income (for example, 20 / 45 for an individual or 20 / 28 for a company). For example, Resident A, a natural person, received a foreign dividend of R100 on which foreign tax of R10 was payable. Resident A qualified for an exemption of R55,56 (25 / 45 × R100) under section 10B(3)(b)(ii)(aa) which means R44,44 was included in taxable income (R100 – R55,56 or R100 × the non-exempt portion of 20 / 45). Paragraph (ii) of the proviso to section 6quat(1A) provides that R10 of foreign tax potentially qualifies for a rebate and not only R4,44 (R10 × 20 / 45) which is the portion of the foreign tax relating to the amount of the foreign dividend (R44,44) which is included in taxable income.

Paragraph (ii) of the proviso does not impact on the overall limitation of foreign taxes qualifying for rebate purposes under section 6quat(1B). The amount of foreign taxes calculated under section 6quat(1A) which qualifies for the section 6quat(1) rebate in a particular year of assessment is limited to the amount calculated under the limitation formula in section 6quat(1B)(a), namely:

Taxable income derived from all foreign sources (A) / Taxable income derived from all sources (B)] × Normal tax payable on (B).

The portion of foreign dividends exempt under section 10B(3) does not form part of either (A) or (B) in the above formula. Even though the amount of foreign tax that potentially qualifies for a rebate is increased by the amount of foreign tax proved to be payable in respect of foreign dividends exempt under section 10B(3), the foreign taxable income and total taxable income are not increased by the exempt income for purposes of calculating the amount of the foreign tax rebate.

<sup>89</sup> See Interpretation Note 18 “Rebate or Deduction for Foreign Taxes on Income” for commentary on the rebate for foreign taxes.

Any portion of the foreign tax that does not qualify for the foreign tax rebate because of the formula in section 6quat(1B)(a) may be carried forward to the following year of assessment, but is not allowed to be carried forward for more than seven years under paragraph (iii) of the proviso to section 6quat(1B)(a).

Foreign tax proved to be payable in respect of foreign dividends included in a person's taxable income during a year of assessment, must be translated to rand on the last day of the year of assessment at the average exchange rate for that year of assessment under section 6quat(4).<sup>90</sup>

**Example 38 – Rebate for foreign taxes under section 6quat in respect of foreign dividends**

*Facts:*

Resident A, a natural person under the age of 65, received a foreign dividend of R100 000 by virtue of a 2% shareholding in Foreign Company B during the 2018 year of assessment. Foreign tax of R10 000 ( $R100\,000 \times 10\%$ ) was withheld from the payment of the foreign dividend. No tax treaty exists between South Africa and the country in which Foreign Company B is a resident.

None of the exemptions under section 10B(2) applies. Resident A incurred expenses of R3 000 in production of the foreign dividend. Resident A received other taxable income of R1 million from a South African source for the 2018 year of assessment.

*Result:*

<i>Calculation of the taxable amount of foreign dividends</i>	R
Foreign dividend included in gross income under paragraph (k) of the definition of "gross income" in section 1(1)	100 000
Less: Portion exempt under section 10B(3) $[(25 / 45) \times R100\,000]$	<u>(55 556)</u>
Taxable foreign dividend	<u>44 444</u>

*Calculation of total taxable income*

Taxable amount of foreign dividend	44 444
Other taxable income	<u>1 000 000</u>
Total taxable income	<u>1 044 444</u>

*Normal tax on taxable income*<sup>91</sup>

$$\begin{aligned}
 &R209\,032,00 + [41\% \times (R1\,044\,444 - R708\,310)] \\
 &= R209\,032,00 + R137\,814,94 \\
 &= R346\,846,94
 \end{aligned}$$

<sup>90</sup> See above.

<sup>91</sup> As per tax tables for the 2018 year of assessment.



*Calculation of the rebate under section 6quat(1)*

The full foreign tax of R10 000 potentially qualifies for a foreign tax rebate under section 6quat(1) even though R5 555,60 of that amount ( $R55\,556 \times 10\%$ ) relates to the exempt portion of the foreign dividend.<sup>92</sup> Under the limitation formula in section 6quat(1B)(a) the maximum amount of the rebate that may be allowed is R14 759,30 ( $R44\,444 / R1\,044\,444 \times R346\,846,94$ ). The amount of the limitation is greater than the amount of the foreign taxes potentially qualifying for a rebate, with the result that the amount of the rebate is equal to the amount of foreign tax withheld of R10 000.

*Calculation of normal tax payable after taking into account the rebate under section 6quat(1)*

	R
Normal tax payable before rebates	346 846,94
Less: Primary rebate [section 6(2)(a)]	(13 635,00)
Less: Section 6quat(1) rebate	<u>(10 000,00)</u>
Normal tax payable	<u>323 211,94</u>

**Note:**

Section 23(q) prohibits the deduction of any expenses incurred in the production of income in the form of foreign dividends (see 4.5) and section 23(f) prohibits the deduction of any expenses not incurred in the production of income. The expenses of R3 000 incurred in the production of the taxable portion and the exempt portion of the foreign dividend are therefore not deductible.

#### **4.9 Controlled foreign companies [sections 9D(9)(f), 22(3)(a)(iii) and paragraph 20(1)(h)(iii)]**

Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

##### **4.9.1 Foreign dividends not included in the net income of a controlled foreign company [section 9D(9)(f)]**

Section 9D(9)(f) provides that, subject to section 9D(9A), in determining the net income of a CFC under section 9D(2A), there must not be taken into account any amount which is attributable to any foreign dividend declared to that CFC, by any other CFC in relation to the resident, to the extent that the foreign dividend does not exceed the aggregate of all amounts which have been or will be included in the income of the resident under section 9D in any year of assessment, which relate to the net income of –

- the company declaring the dividend; or
- any other company which has been included in the income of that resident by virtue of that resident's participation rights in that other company held indirectly through the company declaring the dividend,

reduced by –

- the amount of any foreign tax payable, in respect of the amounts so included in that resident's income; and

<sup>92</sup> Paragraph (ii) of the proviso to section 6quat(1A).

- so much of all foreign dividends received by or accrued to that CFC as was –
  - excluded from the application of section 9D under section 9D(9)(f) or section 10B(2)(a), (b) or (c); or
  - previously not included in the income of that resident by virtue of any prior inclusion under section 9D.

**Example 39 – Foreign dividend not included in the net income of a CFC [section 9D(9)(f)]**

*Facts:*

The years of assessment of all companies in this example end on the last day of February.

Resident Company A holds 100% of the equity shares and voting rights in Foreign Company B. Foreign Company B holds 100% of the equity shares and voting rights in Foreign Company C. Foreign Company B and Foreign Company C are not residents of the same country. Foreign Company C's net income is R100 000 for a year of assessment. Foreign Company C declared a dividend of R100 000 to Foreign Company B at the end of that year of assessment.

*Result:*

Both Foreign Company B and Foreign Company C are CFCs in relation to Resident Company A. The net income of R100 000 of Foreign Company C must be included in Resident Company A's income under section 9D(2).

Under section 9D(9)(f) the foreign dividend of R100 000 must not be taken into account in determining Foreign Company B's net income, since this amount was attributed by Foreign Company C to Resident Company A.

**4.9.2 Determination of the cost price of a right in a controlled foreign company held as trading stock [section 22(3)(a)(iii)]**

Section 22(3)(a) deals with the determination of the cost price of trading stock. Section 22(3)(a)(iii) determines the cost price of a right in a CFC held as trading stock.

Section 22(3)(a)(iii)(aa) provides that the cost price of a right in a CFC held directly by a resident includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)<sup>93</sup> of that CFC and of any other CFC in which that CFC and that resident directly or indirectly have an interest, which was included in the income of that resident under section 9D during any year of assessment. The cost price of the right so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the resident during any year of assessment which was exempt under section 10B(2)(a)<sup>94</sup> or (c).

<sup>93</sup> The inclusion rates of capital gains.

<sup>94</sup> The reference to section 10B(2)(a) was inserted by the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation of that Act, 8 January 2016.

Section 22(3)(a)(iii)(*bb*) provides that the cost price of a right in a CFC held directly by another CFC, includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)<sup>95</sup> of that first-mentioned CFC and of any other CFC in which both the first- and second-mentioned CFCs directly or indirectly have an interest, which during any year of assessment would have been included in the income of the second-mentioned CFC under section 9D had it been a resident. The cost price of the right so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the second-mentioned CFC if that dividend would have been exempt under section 10B(2)(a)<sup>96</sup> or (c) had the second-mentioned CFC been a resident.

The effect of section 22(3)(a)(iii) is to increase the cost price of the right in a CFC by amounts already included in the income of a resident under section 9D(2). This treatment ensures that any income from the disposal of a right in a CFC is not subject to normal tax to the extent of amounts already subjected to normal tax because of the application of section 9D(2). The increased cost price of the right in a CFC is reduced by foreign dividends that were exempt under section 10B(2)(c).

#### **4.9.3 Determination of the base cost of a right in a controlled foreign company [paragraph 20(1)(h)(iii)]**

Paragraph 20 determines the base cost of an asset acquired by a person on or after the valuation date. Paragraph 20(1)(h)(iii) determines the base cost of a right in a CFC.

Paragraph 20(1)(h)(iii)(*aa*) provides that the base cost of a right in a CFC held directly by a resident includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)<sup>97</sup> of that CFC and of any other CFC in which the first-mentioned CFC and the resident directly or indirectly have an interest, which was included in the income of the resident under section 9D during any year of assessment. The amount so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the resident during any year of assessment which was exempt from tax under section 10B(2)(a) or (c).<sup>98</sup>

Paragraph 20(1)(h)(iii)(*bb*) provides that the base cost of a right in a CFC held directly by another CFC, includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)<sup>99</sup> of the first-mentioned CFC and of any other CFC in which both the first- and second-mentioned CFCs directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned CFC under section 9D had it been a resident. The amount so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned

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<sup>95</sup> The inclusion rates of capital gains.

<sup>96</sup> The reference to section 10B(2)(a) was inserted by the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation of that Act, namely, 8 January 2016.

<sup>97</sup> The inclusion rates of capital gains.

<sup>98</sup> The reference to section 10B(2)(c), which replaced an erroneous reference to section 10B(2)(b), was inserted by the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation of that Act, 8 January 2016.

<sup>99</sup> The inclusion rates of capital gains.

CFC to the second-mentioned CFC if that dividend would have been exempt under section 10B(2)(a) or (c)<sup>100</sup> had the second-mentioned CFC been a resident.

The effect of paragraph 20(1)(h)(iii) is to increase the base cost of the right in a CFC by amounts already included in the income of a resident under section 9D(2). This treatment ensures that proceeds from the disposal of a right in a CFC are not subject to CGT to the extent of amounts already subjected to normal tax because of the application of section 9D(2). The increased base cost of the right in a CFC is reduced by any foreign dividends that were exempt under section 10B(2)(a) or (b).

See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 20(1)(h)(iii).

#### 4.10 Anti-avoidance provisions

Although not discussed in this Note, regard must be had to the following sections and paragraphs aimed at combatting tax avoidance arising in relation to foreign dividends:<sup>101</sup>

- Section 8E – Dividends on certain shares deemed to be income in relation to recipients thereof.
- Section 8EA – Dividends on third-party backed shares deemed to be income in relation to recipients thereof.
- Section 22B – Dividends treated as income on disposal of certain shares.
- Paragraph 19 – Losses on disposal of certain shares.
- Paragraph 43A – Dividends treated as proceeds on disposal of certain shares.

#### 5. Conclusion

A foreign dividend received by or accrued to a person is included in that person's gross income under paragraph (k) of the definition of "gross income" in section 1(1).

Section 10B provides for exemptions of foreign dividends received by or accrued to a person. The exemptions under section 10B(2) are applied separately to each foreign dividend received or accrued while the partial exemption under section 10B(3) applies to the aggregate amount of foreign dividends not exempt under section 10B(2). The partial exemption is determined by applying the applicable ratio to a specific type of person. The exemptions will not apply to the extent that section 10B(4), (5) or (6) applies.

With effect from years of assessment commencing on or after 1 March 2017, the maximum effective rate of tax on taxable foreign dividends increased from 15% to 20%.

<sup>100</sup> The reference to section 10B(2)(c), which replaced an erroneous reference to section 10B(2)(b), was inserted by the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation of that Act, 8 January 2016.

<sup>101</sup> See the *Tax Guide for Share Owners* and the *Comprehensive Guide to Capital Gains Tax* for commentary on certain of these provisions.

Foreign dividends received by or accrued to a person constitute income from a foreign source under section 9(4)(a). Foreign tax paid on foreign dividends potentially qualifies for a tax rebate under section 6quat(1).

Under section 25D a foreign dividend received by or accrued to a person is translated from a foreign currency to rand at the spot rate, or at the average exchange rate if a natural person or non-trading trust so elects. Special rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies. Foreign tax payable on a foreign dividend is translated to rand on the last day of a year of assessment at the average exchange rate for that year of assessment under section 6quat(4).

Section 23(g) prohibits the deduction of expenditure incurred in the production of foreign dividends which are not exempt from normal tax under section 10B. Section 23(f) prohibits the deduction of any expenses incurred in respect of amounts received or accrued which do not constitute "income" as defined in section 1(1), such as foreign dividends exempt under section 10B.

For the purposes of determining the net income of a CFC, a CFC is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Foreign dividends received by or accrued to a CFC are therefore included in its gross income. Section 10B also applies to foreign dividends received by or accrued to a CFC for purposes of determining its net income for inclusion in a resident's income. Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

The anti-avoidance provisions of sections 8E, 8EA, 22B and paragraphs 19 and 43A are relevant when entering into share or dividend transactions.

#### **Legal Counsel**

#### **SOUTH AFRICAN REVENUE SERVICE**

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## Annexure – The law

### Section 1(1) – Definition of “company”

“company” includes—

- (a) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or
- (b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or
- (c) any co-operative; or
- (d) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or
- (e) any—
  - (i) . . . . .
  - (ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or
  - (iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x) of the JSE Limited Listings Requirements; or
- (f) a close corporation,

but does not include a foreign partnership;

### Section 1(1) – Definition of “controlled foreign company”

“controlled foreign company” means a controlled foreign company as defined in section 9D, and includes any reference in this Act, prior to the amendment thereof by the Revenue Laws Amendment Act, 2002, to a controlled foreign entity;

### Section 1(1) – Definition of “foreign dividend”

“foreign dividend” means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to—

- (a) tax on income on companies of the country in which that foreign company has its place of effective management; or
- (b) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable that—

- (i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of “company”; or

- (ii) . . . . .
- (iii) constitutes a share in that foreign company;

### Section 1(1) – Definition of “foreign partnership”

**“foreign partnership”**, in respect of any year of assessment, means any partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic if—

- (a) for the purposes of the laws relating to tax on income of the country in which that partnership, association, body of persons or entity is formed or established—
  - (i) each member of the partnership, association, body of persons or entity is required to take into account the member’s interest in any amount received by or accrued to that partnership, association, body of persons or entity when that amount is received by or accrued to the partnership, association, body of persons or entity; and
  - (ii) the partnership, association, body of persons or entity is not liable for or subject to any tax on income, other than a tax levied by a municipality, local authority or a comparable authority, in that country; or
- (b) where the country in which that partnership, association, body of persons or entity is formed or established does not have any applicable laws relating to tax on income—
  - (i) any amount—
    - (aa) that is received by or accrued to; or
    - (bb) of expenditure that is incurred by,
 the partnership, association, body of persons or entity is allocated concurrently with the receipt, accrual or incurral to the members of that partnership, association, body of persons or entity in terms of an agreement between those members; and
  - (ii) no amount distributed to a member of a partnership, association, body of persons or entity may exceed the allocation contemplated in subparagraph (i) after taking into account any prior distributions made by the partnership, association, body of persons or entity;

### Section 1(1) – Definition of “foreign return of capital”

**“foreign return of capital”** means any amount that is paid or payable by a foreign company in respect of any share in that foreign company where that amount is treated as a distribution or similar payment (other than an amount that constitutes a foreign dividend) by that foreign company for the purposes of the laws relating to—

- (a) tax on income on companies of the country in which that foreign company has its place of effective management; or
- (b) companies of the country in which that foreign company is incorporated, formed or established, where that country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable to the extent that the amount so paid or payable—

- (i) is deductible by that foreign company in the determination of any tax on income of companies of the country in which that foreign company has its place of effective management; or

- (ii) constitutes shares in that foreign company;

### Section 6quat(1), (1A), (1B) and (4)

**6quat. Rebate or deduction in respect of foreign taxes on income.**—(1) Subject to subsection (2), where the taxable income of any resident during a year of assessment includes—

- (a) any income received by or accrued to such resident from any source outside the Republic; or
- (b) any proportional amount contemplated in section 9D; or
- (c) . . . . .
- (d) . . . . .
- (e) any taxable capital gain contemplated in section 26A, from a source outside the Republic; or
- (f) any amount—
  - (i) contemplated in paragraph (a) or (b) which is received by or accrued to any other person and which is deemed to have been received by or accrued to such resident in terms of section 7;
  - (ii) of capital gain of any other person from a source outside the Republic and which is attributed to that resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule; or
  - (iii) contemplated in paragraphs (a), (b) or (e) which represents capital of a trust, and which is included in the income of that resident in terms of section 25B(2A) or taken into account in determining the aggregate capital gain or aggregate capital loss of that resident in terms of paragraph 80(3) of the Eighth Schedule,

in determining the normal tax payable in respect of that taxable income there must be deducted a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment) by—

- (a) such resident in respect of—
  - (i) any income contemplated in subsection (1)(a); or
  - (ii) . . . . .
  - (iii) any amount of taxable capital gain as contemplated in subsection (1)(e); or
- (b) any controlled foreign company, in respect of such proportional amount contemplated in subsection (1)(b), subject to section 72A(3); or
- (c) . . . . .
- (d) . . . . .
- (e) . . . . .
- (f) any other person contemplated in subsection (1)(f)(i) or (ii) or any trust contemplated in subsection (1)(f)(iii), in respect of the amount included in the taxable income of that resident as contemplated in subsection (1)(f),



which is so included in that resident's taxable income: Provided that—

- (i) where such resident is a member of any partnership or a beneficiary of any trust and such partnership or trust is liable for tax as a separate entity in such other country, a proportional amount of any tax payable by such entity, which is attributable to the interest of such resident in such partnership or trust, shall be deemed to have been payable by such resident; and
- (ii) for the purposes of this subsection, the amount so included in such resident's taxable income must be determined without regard to section 10B (3).

(1B) Notwithstanding the provisions of subsection (1A)—

- (a) the rebate or rebates of any tax proved to be payable as contemplated in subsection (1A), shall not in aggregate exceed an amount which bears to the total normal tax payable the same ratio as the total taxable income attributable to the income, proportional amount, taxable capital gain or amount, as the case may be, which is included as contemplated in subsection (1), bears to the total taxable income: Provided that—
  - (i) in determining the amount of the taxable income that is attributable to that income, proportional amount, taxable capital gain or amount, any allowable deductions contemplated in section 18A must be deemed to have been incurred proportionately in respect of income derived from sources within and outside the Republic;
  - (iA) the taxes contemplated in subsection (1A)(b) that are attributable to any proportional amount which—
    - (aa) . . . . .
    - (bb) relates to any amount contemplated in section 9D(9A)(a) which is not excluded from the application of section 9D(2) in terms of that section or section 9D(9)(b),
 shall in aggregate be limited to the amount of the normal tax which is attributable to those proportional amounts;
  - (iB) the taxes contemplated in subsection (1A)(a)(iii) which are attributable to any taxable capital gain in respect of an asset which is not attributable to a permanent establishment of the resident outside the Republic, must in aggregate be limited to the amount of normal tax which is attributable to that taxable capital gain;
  - (ii) where the sum of any such taxes proved to be payable (excluding any taxes contemplated in paragraphs (iA) and (iB) of this proviso) exceeds the rebate as so determined (hereinafter referred to as the excess amount), that excess amount may—
    - (aa) be carried forward to the immediately succeeding year of assessment and shall be deemed to be a tax on income paid to the government of any other country in that year; and
    - (bb) be set off against the amount of any normal tax payable by that resident during that year of assessment in respect of any amount derived from any other country which is included in the taxable income of that resident during that year, as contemplated in subsection (1), after any tax payable to the government of any other country in respect of any amount so included during such year of assessment which may be deducted in terms of subsections (1) and (1A), has been deducted from the amount of such normal tax payable in respect of such amount so included; and

(iii) the excess amount shall not be allowed to be carried forward for more than seven years reckoned from the year of assessment when such excess amount was for the first time carried forward;

- (b) . . . . .
- (c) . . . . .
- (d) . . . . .
- (e) . . . . .

(4) For the purpose of this section the amount of any foreign tax proved to be payable as contemplated in subsection (1A) or any amount paid or proved to be payable as contemplated in subsection (1C) in respect of any amount which is included in the taxable income of any resident during any year of assessment, shall be translated to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment.

#### **Section 9(4)(a)**

(4) An amount is received by or accrues to a person from a source outside the Republic if that amount—

- (a) constitutes a foreign dividend received by or accrued to that person;

#### **Section 9D(1) – Definition of “controlled foreign company”**

**“controlled foreign company”** means—

(a) any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies: Provided that—

- (i) no regard must be had to any voting rights in any foreign company—
  - (aa) which is a listed company; or
  - (bb) if the voting rights in that foreign company are exercisable indirectly through a listed company;
- (ii) any voting rights in a foreign company which can be exercised directly by any other controlled foreign company in which that resident (together with any connected person in relation to that resident) can directly or indirectly exercise more than 50 per cent of the voting rights are deemed for purposes of this definition to be exercisable directly by that resident; and
- (iii) a person is deemed not to be a resident for purposes of determining whether residents directly or indirectly hold more than 50 per cent of the participation rights or voting rights in a foreign company, if—
  - (aa) in the case of a listed company or a foreign company the participation rights of which are held by that person indirectly through a listed company, that person holds less than five per cent of the participation rights of that listed company; or
  - (bb) in the case of a scheme or arrangement contemplated in paragraph (e)(ii) of the definition of “company” in section 1 or a foreign company the participation rights of which are held and the voting rights of which may be exercised by that person indirectly through such a scheme or arrangement, that person—
    - (A) holds less than five per cent of the participation rights of that scheme or arrangement; and

- (B) may not exercise at least five per cent of the voting rights in that scheme or arrangement,

unless more than 50 per cent of the participation rights or voting rights of that foreign company or other foreign company are held by persons who are connected persons in relation to each other; and

(b) any foreign company where the financial results of that foreign company are reflected in the consolidated financial statements, as contemplated in IFRS 10, of any company that is a resident;

### Section 9D(9)(f)

(9) Subject to subsection (9A), in determining the net income of a controlled foreign company in terms of subsection (2A), there must not be taken into account any amount which—

- (f) is attributable to any foreign dividend declared to that controlled foreign company, by any other controlled foreign company in relation to the resident, to the extent that the foreign dividend does not exceed the aggregate of all amounts which have been or will be included in the income of the resident in terms of this section in any year of assessment, which relate to the net income of—

- (i) the company declaring the dividend; or
- (ii) any other company which has been included in the income of that resident by virtue of that resident's participation rights in that other company held indirectly through the company declaring the dividend,

reduced by—

- (aa) the amount of any foreign tax payable, in respect of the amounts so included in that resident's income; and
- (bb) so much of all foreign dividends received by or accrued to that controlled foreign company as was—
  - (A) excluded from the application of this section in terms of this paragraph or section 10B(2)(a), (b) or (c);
  - (B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D;

### Section 10B

**10B. Exemption of foreign dividends and dividends paid or declared by headquarter companies.**—(1) For the purposes of this section, “foreign dividend” means any—

- (a) foreign dividend as defined in section 1; or
- (b) dividend paid or declared by a headquarter company.

(2) Subject to subsection (4), there must be exempt from normal tax any foreign dividend received by or accrued to a person—

- (a) if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in the company declaring the foreign dividend;
- (b) if that person is a foreign company and the foreign dividend is paid or declared by another foreign company that is resident in the same country as that person;
- (c) who is a resident to the extent that the foreign dividend does not exceed the aggregate of all amounts which are included in the income of that resident in terms of section 9D in any year of assessment, which relate to the net income of—

- (i) the company declaring the foreign dividend; or
- (ii) any other company which has been included in the income of that resident in terms of section 9D by virtue of that resident's participation rights in that other company held indirectly through the company declaring the foreign dividend,

reduced by—

- (aa) the amount of any foreign tax payable in respect of the amounts so included in that resident's income; and
- (bb) so much of all foreign dividends received by or accrued to that resident at any time from any company contemplated in subparagraph (i) or (ii), as was—
  - (A) exempt from tax in terms of paragraph (a), (b) or (d); or
  - (B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D:

Provided that for the purposes of this paragraph, the net income of any company contemplated in subparagraphs (i) and (ii) must be determined without regard to subsection (3);

- (d) to the extent that the foreign dividend is received by or accrues to that person in respect of a listed share and does not consist of a distribution of an asset *in specie*; or
- (e) to the extent that the foreign dividend is received by or accrues to a company that is a resident in respect of a listed share and consists of the distribution of an asset *in specie*:

Provided that paragraphs (a) and (b) must not apply to any foreign dividend to the extent that the foreign dividend is deductible by the foreign company declaring or paying that foreign dividend in the determination of any tax on income on companies of the country in which that foreign company has its place of effective management: Provided further that paragraph (a) must not apply to any foreign dividend received by or accrued to that person in respect of a share other than an equity share.

(3) In addition to the exemption provided for in subsection (2), there must be exempt from normal tax so much of the amount of the aggregate of any foreign dividends received by or accrued to a person during a year of assessment as—

- (a) is not exempt from normal tax in terms of subsection (2) for that year of assessment; and
- (b) does not during the year of assessment exceed an amount determined in accordance with the following formula:

$$A = B \times C$$

in which formula:

- (i) "A" represents the amount to be exempted for a year of assessment in terms of this paragraph;
  - (ii) "B" represents—
    - (aa) where the person is a natural person, deceased estate, insolvent estate or trust, the ratio of the number 25 to the number 45;
    - (bb) where the person is—
      - (A) a person other than a natural person, deceased estate, insolvent estate or trust; or
      - (B) an insurer in respect of its company policyholder fund, corporate fund and risk policy fund,
- the ratio of the number 8 to the number 28; or

(cc) where the person is an insurer in respect of its individual policyholder fund, the ratio of the number 10 to the number 30; and

(iii) “C” represents the aggregate of any foreign dividends received by or accrued to the person during a year of assessment that is not exempt from normal tax in terms of subsection (2).

(4) Subsections (2)(a) and (2)(b) do not apply in respect of any foreign dividend received by or accrued to any person—

(a) if—

(i) (aa) any amount of that foreign dividend is determined directly or indirectly with reference to; or

(bb) that foreign dividend arises directly or indirectly from, any amount paid or payable by any person to any other person; and

(ii) the amount so paid or payable is deductible from the income of the person by whom it is paid or payable and—

(aa) is not subject to normal tax in the hands of the other person contemplated in subparagraph (i); and

(bb) where that other person contemplated in subparagraph (i) is a controlled foreign company, is not taken into account in determining the net income, contemplated in section 9D(2A), of that controlled foreign company,

unless the amount so paid or payable is paid or payable as consideration for the purchase of trading stock by the person by whom the amount is paid or payable; or

(b) from any portfolio contemplated in paragraph (e)(ii) of the definition of “company” in section 1.

(5) The exemptions from tax provided by subsections (2) and (3) do not apply in respect of any portion of an annuity or extend to any payments out of any foreign dividend received by or accrued to any person.

(6) Subsections (2) and (3) do not apply to any foreign dividend received by or accrued to a person in respect of—

(a) services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office, other than a foreign dividend in respect of a share held by that person; or

(b) a restricted equity instrument as defined in section 8C that was acquired in the circumstances contemplated in that section if that foreign dividend is derived directly or indirectly from, or constitutes—

(i) an amount—

(aa) transferred or applied by a company as consideration for the acquisition or redemption of any share in that company; or

(bb) received or accrued in anticipation or in the course of the winding up, liquidation, deregistration or final termination of a company; or

(ii) an equity instrument that does not qualify, at the time of the receipt or accrual of that foreign dividend, as a restricted equity instrument as defined in section 8C.

**Section 22(3)(a)(iii)**

(3) (a) For the purposes of this section the cost price at any date of any trading stock in relation to any person shall—

(iii) in the case of—

- (aa) a right in a controlled foreign company held directly by a resident, include an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10 of the Eighth Schedule) of that company and of any other controlled foreign company in which that controlled foreign company and that resident directly or indirectly have an interest, which was included in the income of that resident in terms of section 9D during any year of assessment, reduced by the amount of any foreign dividend distributed by that company to that resident during any year of assessment which was exempt from tax in terms of section 10B(2)(a) or (c); or
- (bb) a right in a controlled foreign company held directly by another controlled foreign company, include an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10 of the Eighth Schedule) of that first-mentioned controlled foreign company and of any other controlled foreign company in which both the first- and second-mentioned controlled foreign companies directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned controlled foreign company in terms of section 9D had it been a resident, reduced by the amount of any foreign dividend distributed by that first-mentioned controlled foreign company to the second-mentioned controlled foreign company if that dividend would have been exempt from tax in terms of section 10B(2)(a) or (c) had that second-mentioned controlled foreign company been a resident;

**Section 23(f) and section 23(q)**

**23. Deductions not allowed in determination of taxable income.**—No deductions shall in any case be made in respect of the following matters, namely—

- (a) to (e) .....
- (f) any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one;
- (g) to (p) .....
- (q) any expenditure incurred in the production of income in the form of foreign dividends; or
- (r) .....

**Section 25D(1) and (3)**

**25D. Determination of taxable income in foreign currency.**—(1) Subject to subsections (2), (3) and (4), any amount received by or accrued to, or expenditure or loss incurred by, a person during any year of assessment in any currency other than the currency of the Republic must be translated to the currency of the Republic by applying the spot rate on the date on which that amount was so received or accrued or expenditure or loss was so incurred.

(3) Notwithstanding subsection (1), a natural person or a trust (other than a trust which carries on any trade) may elect that all amounts received by or accrued to, or expenditure or losses incurred by that person or trust in any currency other than the currency of the Republic, be translated to the currency of the Republic by applying the average exchange rate for the relevant year of assessment.

**Paragraph 20(1)(h)(iii)**

**20. Base cost of asset.**—(1) Despite section 23(b) and (f), but subject to paragraphs 24, 25 and 32 and subparagraphs (2) and (3), the base cost of an asset acquired by a person is the sum of—

(h) in the case of—

(iii) (aa) a right in a controlled foreign company held directly by a resident, an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10) of that company and of any other controlled foreign company in which that controlled foreign company and that resident directly or indirectly have an interest, which was included in the income of that resident in terms of section 9D during any year of assessment, reduced by the amount of any foreign dividend distributed by that company to that resident during any year of assessment which was exempt from tax in terms of section 10B(2)(a) or (c); or

(bb) a right in a controlled foreign company held directly by another controlled foreign company, an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10) of that first-mentioned controlled foreign company and of any other controlled foreign company in which both the first- and second-mentioned controlled foreign companies directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned controlled foreign company in terms of section 9D had it been a resident, reduced by the amount of any foreign dividend distributed by that first-mentioned controlled foreign company to the second-mentioned controlled foreign company if that dividend would have been exempt from tax in terms of section 10B(2)(a) or (c) had that second-mentioned controlled foreign company been a resident;