Part (f) Discuss the primary ethical dilemma, including related governance and statutory implications, inherent in the share buyback proposal tabled by the two senior managers and describe the appropriate action(s) that Mr Ramokgadi should have taken

1. In terms of the Code of Professional Conduct, Mr Ramokgadi may not allow his ability to comply with the fundamental principles of integrity, objectivity, confidentiality and professional behaviour to be threatened by proposals tabled by the senior managers regarding the share buyback.  

2. The primary ethical dilemma inherent in the share buyback proposal is a conflict of interest, since the motivation of the managers (and potentially the directors) is self-enrichment, which is not necessarily in the best interests of the company which impacts his integrity, objectivity and professional behaviour. 

3. The conflict of interest relates to the management incentive scheme as the proposal tabled by the senior managers will:
   • Increase EPS and ROE
   • Which will in turn increase the management bonuses payable to them in future,
   • Also increase the degree of financial leverage (and consequently financial risk) within the company. 

4. Mr Ramokgadi, as CEO, is part of the senior management team and will therefore also receive a higher bonus. He has a personal financial interest in the matter considered at the meeting. Given that he is at the meeting considering the proposal, he is also conflicted. 

5. This is despite the fact that a credible alternative was discussed & previously agreed upon (expansion into Africa) which in the short run would not have as profound an impact on management bonuses. 

6. This is also a self-interest threat in terms of SAICA’s Code of Professional Conduct – Mr Ramokgadi is a CA(SA). He should consider the following:
   6.1 The significance of this matter will need to be considered, as he will be receiving directly a bigger bonus as a result of the share buyback. 

   6.2 Seek guidance regarding the potential conflict of interest from within the employing organisation or from others, such as a professional body, legal counsel or another chartered accountant. He should keep in mind his duty of confidentiality. 

   6.3 If the threat created by a conflict of interest is not at an acceptable level, he shall apply safeguards to eliminate the threat or reduce it to an acceptable level, for example, 
   • Declare his interest or disclose the nature of the conflict and/or 
   • Withdraw from the decision-making process related to the matter-giving rise to the conflict of interest. 
   • If safeguards cannot reduce the threat to an acceptable level, he shall decline to undertake or discontinue the professional activity that would result in the conflict of interest. 

7. In terms of the Companies Act, directors have a fiduciary duty to act in the best interest of the company – hence Mr Ramokgadi & other directors can be found to be in contravention of this law in failing to disclose a personal financial interest and furthermore the directors should be aware that this may result in a reportable irregularity. 

8. In terms of King III, the board and its directors should act in the best interests of the company. 

9. Mr Ramokgadi should have acted as follows in terms of the Companies Act and King III:
   9.1 Disclose the nature of the conflict of interest or any observations and insights to relevant parties within NAH, notably those charged with the governance of NAH (i.e. the board). This disclosure should be made before the matter is considered at a meeting of the Board however if the directors did not realise in making the decision that there was a conflict of interest, they should disclose this matter after the meeting. 

   9.2 Recommend that a committee independent of senior management eg. all independent non-executive directors or the audit committee to review the share buyback proposal and its impact on the management incentive scheme; and 

   9.3 Withdraw from the decision-making process related to the proposed share buyback, having
noted his reservations and leaving the meeting without taking part in the decision.

9.4 **Consult the company secretary** for **guidance** on the correct way to handle this matter.  

10. Mr Ramokgadi’s objection to the proposal if **properly documented** through the minutes, would mitigate the risk of him being personally held liable as a director for breach of fiduciary duty.

<table>
<thead>
<tr>
<th>Communication skills – clarity of expression</th>
<th>Total for part (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available</td>
<td>19</td>
</tr>
<tr>
<td>Maximum</td>
<td>12</td>
</tr>
</tbody>
</table>

**Total for part (f)**
**Suggested Solution**

Part (g) Discuss, with supporting calculations, the tax implications in terms of the Income Tax Act for Lindham should it sell 7.68% of its total shareholding to NAH on 30 June 2016 as part of the share buyback programme.

Assume that NAH –
- will, to the extent possible, fully utilise its CTC to buy back shares; and
- purchases shares from Lindham at R32.55 per share.

<table>
<thead>
<tr>
<th>Income tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of shares sold by Lindham 80 000 000 shares x 5.5% x 7.68%</td>
<td>337 920</td>
</tr>
<tr>
<td>Amount received by Lindham = 337 920 x R32.55</td>
<td>10 999 296</td>
</tr>
<tr>
<td>The amount received by Lindham will constitute neither a “dividend”</td>
<td></td>
</tr>
<tr>
<td>Nor a “return of capital”</td>
<td>1</td>
</tr>
<tr>
<td>Since both definitions specifically exclude.</td>
<td></td>
</tr>
</tbody>
</table>

Amounts that constitute an acquisition by the company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.84 of section 5 of the JSE Limited Listings Requirements.

The sale of the shares by Lindham in terms of the share buyback implemented by NAH is capital in nature.

<table>
<thead>
<tr>
<th>Capital gains tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lindham no longer owns the shares, therefore there is a disposal of an asset in terms of the Eighth Schedule (par. 11).</td>
<td></td>
</tr>
<tr>
<td>Capital gain calculation</td>
<td></td>
</tr>
<tr>
<td>Par. 35 - Proceeds (337 920 x R32.55)</td>
<td>10 999 296</td>
</tr>
<tr>
<td>Par. 20 - Base cost (R8 x 337 920)</td>
<td>(2 703 360)</td>
</tr>
<tr>
<td>Capital Gain</td>
<td>8 295 936</td>
</tr>
<tr>
<td>The inclusion rate of the capital gain is 66.6% * and only R5 525 093 will be included in the taxable income of Lindham and subject to normal tax at 28%.</td>
<td>1</td>
</tr>
</tbody>
</table>

**Dividends Tax**

Since this is not a dividend, no dividends tax implications will need to be considered.

| Available | 13 |
| Maximum | 12 |

Communication skills – clarity of expression 1

Total for part (g)

* or 80% and only R6 636 749 (as the required stated the sale was on 30 June 2016 and the CGT inclusion rate for companies changed on 1 March 2016 from 66.6% to 80%)
Part (g) Alternate Solution

The issue on hand would be to identify whether the amount received by Lindham will constitute a dividend and a reduction of contributed tax capital.

### Income tax

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of shares sold by Lindham</td>
<td>80 000 000 shares x 5.5% x 7.68%</td>
</tr>
<tr>
<td>Amount received by Lindham</td>
<td>337 920 x R32,55</td>
</tr>
</tbody>
</table>

A dividend is a distribution to shareholders **less a reduction of contributed tax capital**.

The **share buyback is not excluded from the definition of a dividend** (s1) in terms of proviso (iii) as the specific JSE listing requirements in terms of “subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.84 of section 5 of the JSE Limited Listings Requirements” has not been complied with.

Therefore, of the amount received, there is a reduction of CTC (definition of dividend(s1) proviso(i)) amounting to (R40 000 000 x 5.5% x 7.68%) (168 960)

Therefore, the difference is the dividend received by Lindham 10 830 336

The dividend of R10 830 336 must be included in gross income of Lindham in terms of special inclusion par(k) and is **exempt** under s10(1)(k).

### Capital gains tax

Lindham no longer owns the shares, therefore there is a **disposal of an asset** in terms of the Eighth Schedule (par. 11)

**Capital gain calculation**

- Par. 35 - Proceeds (R10 999 296 - R10 830 336)
  - 168 960

- Par. 20 - Base cost (R8 x 337 920)
  - 2 703 360

**Capital loss**

- (2 534 400)

This will qualify as an **exempt dividend** as defined in par 19(1)(a) of the Eighth Schedule as it is exempt from both dividends tax and income tax.

Lindham is not subject to dividends tax at the time NAH declares the dividends as it is a dividend declared to a resident company and the dividends received by Lindham from NAH is exempt in terms of s10(1)(k) for income tax purposes.

The capital loss must be disregarded to the extent of exempt dividends received in the last 18 months:

- Div for 2015 year, paid March 2016 (R304 000 000 x 50% x 5.5% x 7.68%)
  - 642 048

- Div for 2014 year, paid March 2015 (R261 000 000 x 50% x 5.5% x 7.68%)
  - 551 232

- Capital loss disregarded
  - 1 193 280

Capital loss allowed = R2 534 400 – R 1 193 280

The loss of R1 341 120 shall be offset against other capital gains of Lindham.

### Dividends tax

Provided that the necessary declarations and undertakings in terms of s64G is submitted, the company will **not be subject to dividend tax** in terms of s64F as Lindham is a SA resident company.

If the necessary declarations and undertakings in terms of s64G is not submitted, Lindham will be subject to **dividends tax of 15%**. Lindham could claim a refund in terms of s64L.

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<table>
<thead>
<tr>
<th>Communication skills – clarity of expression</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total for part (g)</td>
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Available: 16

Maximum: 12