Dear Sir

COMMENTS ON THE NEW SHAREHOLDER DIVIDEND TAX AND STC CREDITS

Further to our meeting on 23 March 2009 at which you requested our comments on the new shareholder dividend tax legislation, we summarise below the submission of the SAICA Dividend Tax Sub-Committee (a sub-committee of SAICA’s National Taxation Committee) for your consideration.

INTRODUCTION
Under the preliminary legislation on the new Shareholder Dividend Tax system, which will replace STC during the latter half of 2010, existing STC credits at the time of transition will be retained, and may be used within a 5 year period. This is a welcome development. These credits will, however, only be available for offset against the withholding tax due under the new system. While this is far more preferable to the credits simply falling away, this creates an anomaly in that the underlying tax which was borne within the corporate sector, is not available for offset against that tax previously borne by this sector. In addition, this requires companies to make distributions, by penalising those that retain their income for future investment, which in the current environment, is detrimental to the economy as a whole.

POSSIBLE SOLUTIONS
Set out below are some thoughts on the possibility of the STC credit under the new Dividend Tax system being offset within the corporate sector, as a credit against the dividend payer’s own income tax liability. For illustrative purposes, we have assumed below for simplicity, that the Dividend Tax rate is 10%, and that the STC credit of the affected company at the time STC is replaced is R500.

THREE OPTIONS
There are 3 options to give effect to this:

(1) Total dividend approach:
The credit available for offset is computed by reference to the total dividend distributed.

**Example:** Gross dividend is R1000. Gross Dividend Tax is R100, but is reduced to R40, as many shareholders are exempt or have lower rates under double tax agreements (DTAs). The credit claimable by the company, however, remains a full R100.

This continues until the STC credit of R500 is exhausted.

**Advantages:**
Relatively simple.

**Disadvantages:**
SARS is prejudiced from a cashflow perspective, where there is a high proportion of exemptions and/or DTA protected shareholders. Also, this requires dividends to be paid – and this penalises companies that conserve their resources for reinvestment. Further, this system is ineffective if the company receives no taxable income, for example, a pure holding company receiving (and reinvesting) only dividend income.

(2) **Taxable dividend approach:**
The credit available for offset is computed by reference to the *taxable* dividend distributed.

**Example:**
Gross dividend is R1000. Gross Dividend Tax is R100, but is reduced to R40 as many shareholders are exempt or have lower rates under DTAs. The credit claimable by the company is consequentially reduced to R40.

This continues until the STC credit of R500 is exhausted.

**Advantages:**
SARS is not prejudiced from a cashflow perspective.

**Disadvantages:**
A little more complex than approach (1) above. Similarly to option (1), this requires dividends to be paid – penalising companies that conserve their resources for reinvestment. Further (similarly to (1)) this system is ineffective if the company receives no taxable income, for example, a pure holding company receiving (and reinvesting) only dividend income. Finally, this system requires complex tracking, where dividends are paid to other companies.
(3) **Cash credit approach:**

The credit available for offset is computed as an ‘amortisation’ over a fixed period.

**Example:**

At the date of transition, companies with STC credits must obtain external audit
certification of the *quantum* of these credits and the effective ratio of taxable to total
shareholders, as defined in the new dividend tax rules, but taken to a maximum of two
levels of ‘higher shareholders’ but stopping at the level of any listed company or non-
resident company. For illustrative purposes, assume the *quantum* to be R500 and the
effective ratio to be 40%. An effective R200 credit is available and is claimable
against corporate tax evenly over 5 years, at R40 *per annum*.

To the extent the corporate tax liability is insufficient, it is refunded as a tax-free
payment, on assessment of the relevant tax return.

**Advantages:**

Arguably the simplest approach of all. SARS is unlikely to be prejudiced on cash flow
unless the fixed period for amortisation is very short. In addition, this approach does
not penalise companies that conserve their resources for reinvestment. Pure holding
companies are also not penalised. No complex tracking is required.

**Disadvantages:**

None perceived.

**GENERAL DISCUSSION**

A point (relevant to all three options referred to above) is that when STC was
introduced there were meetings with Mr Derek Keys, then Finance Minister, to point
out the anomaly of again taxing earnings that had previously (pre-STC) been subject
to the higher level of corporate tax. The entire logic of STC was that the corporate tax
rate would be reduced, going forward, and the earnings that had been thus lightly
taxed would only again be taxed (via STC) should they be distributed to ultimate
shareholders.

Mr Keys acknowledged this anomaly, but stated that:

(a) the ring-fencing of prior reserves (and thus allowing them to be distributed without
    STC) would be too complex a matter for SARS to administer, and
(b) as compensation for this anomaly, corporates would benefit in their income
    statements from the new lower corporate tax rate, including on their deferred tax
    liabilities, and this would increase their ratings.

This logic was accepted, and the matter was thus allowed to rest.
Now that STC is to be terminated, we believe that it is important that this policy logic should remain consistent as far as it is practical. The policy of allowing STC credits (in existence at the date STC is terminated) to reduce corporate tax liabilities is consistent in this context, as these credits represent amounts that the corporate sector has already booked to their tax charges in their income statements, when originally distributed by the company earning the originating operating (non-dividend) income. It is thus logical that since these earnings will not have flowed out of the corporate sector to ultimate shareholders during the STC period, the STC cost should not be reflected in the income statements of the corporate sector. Whilst STC is still in operation, this is achieved through the accounting tax credit provisions of Accounting Interpretation AC501.

The proposed solutions articulated above simply ensure that this accounting credit need not be reversed and so reflect the reduced tax charge referred to by Mr Keys.

**SPECIFIC DISCUSSION OF THE THREE OPTIONS**

We understand that SARS (through National Treasury) is wary of granting STC credits to corporations on the grounds of complexity and possible revenue losses. On this, we are willing to concede that Options (1) and (2) above do involve some complexity and the potential for revenue loss (especially Option (1)) and our sympathy is with SARS. We believe that Option (3), however, is exceedingly simple, and will not result in any significant revenue loss (if any at all) to SARS. Further, this approach has many practical precedents, including the phasing out of LIFO reserves and the like. If SARS and National Treasury require this, we are certain that the private sector (through SAICA and other bodies) is able to recommend the simplest and most effective manner of implementing this.

Thank you for the opportunity to indulge in meaningful debate on the subject. Please contact me should you wish to discuss any aspect further.

Yours faithfully

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