Dear Sir/Madam

SUBMISSION: DRAFT INTERPRETATION NOTE ON THE TAXATION OF FOREIGN DIVIDENDS

1. Thank you for affording the South African Institute of Chartered Accountants the opportunity to provide our feedback and inputs on the above matter.

2. Below are our comments. You are welcome to contact us should you wish to clarify any matter raised below.

Paragraph 4.1.1(f) and (g) - Pages 13 and 14 – ‘Onus to obtain information on the income tax law on companies or company law of a foreign country’ and ‘Interpretation of the income tax law on companies or company law of a foreign country’

3. We recognise that the taxpayer will bear the onus to prove that the amounts paid or payable by a foreign company are regarded as a dividend under the tax laws of the country in which the foreign company is effectively managed.

4. However, there are often administrative difficulties associated with obtaining formal rulings from in-country tax authorities (in some cases it is impossible to obtain such rulings). As a result, we believe that it would be pragmatic if SARS could allow taxpayers use other methods to verify the tax or company law treatment of the divided payment in the foreign country.

5. Submission: In light of the above we recommend that the sentence contained in section 4.1.1(f) be amended as follows:

“Depending on the facts, SARS may request that a taxpayer may be required to obtain either a written confirmation from the tax authority of the country in which the
foreign company is effectively managed, an extract from the applicable tax legislation or regulations of that country or a written opinion from an in-country consultant which confirms on the income tax treatment of amounts paid or payable by a foreign company in respect of shares in that company.”

Paragraph 4.1.2 - Page 16 – Definition of ‘foreign company’

6. A “foreign company” can *inter alia* be one of the following:

- “A company as defined in section 1(1) that is 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.

- “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 resident in another country” (own emphasis)

7. The Draft IN is therefore not clear on whether companies which are tax resident in both South Africa and in a country which South Africa has not concluded a tax treaty with, will be considered foreign companies or not.

8. **Submission**: In light of the above we recommend that SARS confirms its view, in the draft IN, on whether companies which are tax resident in both South Africa and in a country which South Africa has not concluded a tax treaty with, will be considered foreign companies or not.

Paragraph 4.3.1(a) - Page 19 – The participation exemption

9. **Submission**: It should be made clear that in the determination of the 10% holding of equity shares and voting rights regard is had to the number of shares held as a proportion of the total equity shares of the company and not the economic interest of the equity shares in question as a proportion of the total economic interest.

10. For example, if a foreign company has 100 A ordinary shares and 900 B ordinary shares where the A ordinary shares are entitled to 1/10th of the dividend on the B ordinary shares, the A ordinary shares will represent 10% of the total number of equity shares notwithstanding that they represent less than 10% of the economic interest attaching to the equity shares in total.
Paragraph 4.3.1(c) - Page 20 - Holding of equity shares for purposes of section 10B(2)

11. This section of the draft IN provides helpful insight into the fact that SARS considers that a person “holds” the requisite equity shares in a foreign company if such person is the beneficial owner of those shares and gives a number of practical examples.

12. In certain partnership arrangements there can be uncertainty as to who will be regarded as the beneficial owner of the equity shares. For example, in the case of an en commandite partnership, where the equity shares are registered in the name of the general partner, will SARS consider the limited partners of the partnership to be the beneficial owners thereof?

13. **Submission**: Given the uncertainty on this issue in relation to partnerships, we recommend that a further example be given in section 4.3.1(c) of the Draft IN to deal with this issue.

Paragraph 4.1.3 - Page 17 - Definition of ‘foreign return of capital’

14. The second sentence under this heading states that “an amount paid or payable by a foreign company in respect of a share in that company may therefore constitute either a foreign dividend or a foreign return of capital.”

15. This is misleading as such an amount may constitute something else, for example interest.

16. **Submission**: It is therefore submitted that the IN clarify the above-mentioned.

Paragraph 4.3.2 - Pages 25 to 26 - The country-to-country exemption

17. In examples 10 to 12 it is assumed in the draft IN, without stating it as an assumption, that a foreign company is ‘resident’ in a foreign country simply by virtue of its incorporation and effective management in that foreign country. While this is often the case in terms of that country’s domestic law, it does not always automatically follow that this will always be the case.

18. **Submission**: It is thus submitted that examples 10, 11 and 12 in the draft IN specifically state that the foreign country is a resident of a particular foreign country.

Paragraph 4.3.5 - Page 32 - Foreign dividend received or accrued in respect of listed shares consisting of the distribution of an asset in specie

19. This section requires that the recipient of the foreign dividend be a resident. Although a CFC is regarded as a resident for purposes of a number of provisions of the Act, including the definition of ‘gross income’, it is our view that section 10B(2)(e) could not be applied to a foreign dividend received by or accrued to a CFC.
20. Submission: The application of section 10B(2)(e) to foreign dividends received by a CFC, for purposes of the section 9D calculation of ‘net income’ of the CFC, should be clarified.

Paragraph 4.3.6 - Page 33 - Non-application of the “participation exemption” and the “country-to-country exemption” – Foreign dividends allowed as a deduction

21. The second proviso to section 10B(2)(e) states:

“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” and was only added to the legislation in 2013 with effect from 1 April 2014.

22. Submission: It is submitted that the IN make it clear as to the date from which this provision applies (1 April 2014).

Paragraph 4.3.8 - Page 41 - 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)]

23. The draft IN does not address the most difficult aspects of s10B(4)(a), namely paragraph (i).

24. The following questions reveal some of the practical difficulties experienced regards to the interpretation of the provision:

- When is a dividend determined directly or indirectly with reference to the amount paid by another person?
- What is meant by ‘indirect’ in the context of this provision?
- When does a dividend arise directly or indirectly from an amount paid by another person?
- What about the situation where only a portion of the dividend arises from such a payment; is the entire dividend tainted or only the portion arising from the payment?
- How is one to determine if a dividend is paid out of such profits if there is no specific declaration to this effect?

25. This provision does not extend only to deductible payments made by connected persons in relation to the recipient of the dividend, but also to third parties. Practically, how are taxpayers expected to make this determination and to what extent do
taxpayers claiming the exemptions have an onus to determine the application of this provision?

26. **Submission**: It is submitted that these very crucial issues be addressed in the IN.

**Paragraph 4.3.8(a) - Page 41 - 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)]**

27. The draft IN states:

   "This anti-avoidance provision is aimed at a situation in which a resident claims a deduction for an amount paid to a foreign company which is then routed to another resident in the form of a tax-free foreign dividend." (own emphasis)

28. This statement is not necessarily correct as section 10B(4)(a) will find application even in the case where the foreign dividend is routed back to the resident which claimed the income tax deduction.

29. Section 10B(4)(a) will additionally find application even in the case where the foreign dividend is routed to a non-resident (typically a Controlled Foreign Company). This is confirmed by the example provided in the Draft IN (Example 22).

30. Accordingly the above mentioned sentence, contained in section 4.3.8(a) is technically incorrect.

31. **Submission**: Having regard to the above mentioned comments we suggest that the sentence contained in section 4.3.8(a) should be amended as follows:

   "This anti-avoidance provision is aimed at a situation in which a resident claims a deduction for an amount paid to a foreign company which is then routed to another person in the form of a tax-free foreign dividend."

**Paragraph 4.5 - Page 48 - Prohibition of a deduction for expenditure incurred in the production of foreign dividends [section 23(q)]**

32. The draft IN states:

   "Section 23(q) prohibits the deduction of any expenditure incurred in the production of income in the form of foreign dividends."

33. Accordingly section 23(q) prohibits the deduction of any expenditure incurred to produce foreign dividends, irrespective whether the amount is exempt or partially exempt in terms of section 10B.

34. **Submission**: To ensure that this point is brought to the attention of the reader, it is submitted that the above-mentioned sentence be amended as follows:
“Section 23(q) prohibits the deduction of any expenditure incurred in the production of income in the form of foreign dividends, irrespective whether the amount is exempt or partially exempt in terms of section 10B.”

Yours faithfully

Pieter Faber
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The South African Institute of Chartered Accountants