

### **BINDING CLASS RULING: BCR 047**

DATE: 24 August 2015

# ACT:INCOME TAX ACT NO. 58 OF 1962 (the Act)SECTION:SECTION 10(1)(k)(i)(hh)SUBJECT:LIMITATION OF DIVIDEND EXEMPTION

### 1. Summary

This ruling deals with the limitation of the exemption from income tax of dividends accruing to the issuer of a derivative, in circumstances where those dividends are referenced in that derivative.

### 2. Relevant tax laws

This is a binding class ruling issued in accordance with section 78(2) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the Act, applicable as at 30 July 2015. Unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of section 10(1)(k)(i)(hh).

## 3. Class

The class members to whom this ruling will apply will be the members of a trade association of South Africa.

## 4. Parties to the proposed transaction

The Applicant: A Class member who applied on its own behalf and on behalf of the remaining members of a trade association

## 5. Description of the proposed transaction

A Class member physically holds (and beneficially owns) equity instruments, like listed shares, on which dividends are declared. The Class member will receive an interim dividend in respect of these listed shares at the end of the first quarter of its financial year.

The Class member will issue a derivative, for example an exchange traded note, at the end of the second quarter of its financial year. In terms of the derivative contract, the Class member has a contractual obligation to pay the holder a return,

linked to the performance of the listed shares that the Class member beneficially owns and dividends declared on those shares for a specified period that commences on the issue date. This contract is referred to as 'a derivative' in this document.

At the end of the third quarter of the Class member's financial year (therefore within the same year of assessment), the Class member will incur a deductible expense or will have a reduction in income by virtue of an amount which is taken into account under section 24JB(2), for the derivative in respect of the final dividend declaration by a listed company. For accounting purposes, the Class member will mark to market the listed shares and the derivative under the provisions of International Financial Reporting Standards issued by the International Accounting Standards Board.

In the context of the proposed transaction, the question for consideration is whether the reduction of income or the deduction of the expenditure in respect of the final dividend to be received by the Class member will negate the exempt nature of the interim dividend that accrues to the Class member.

### 6. Conditions and assumptions

This binding class ruling is not subject to any additional conditions and assumptions.

## 7. Ruling

The question whether an interim dividend that accrues on a share prior to the issue of a derivative that references that share and subsequent dividends is taxable, depends on whether deductible expenditure, or an amount that has the effect of reducing income in the application of section 24JB(2), is determined directly or indirectly with reference to the dividend.

The ruling made in connection with the proposed transaction is as follows:

The income tax exemption of the interim dividend declared by a listed company, and which is not referenced in the derivative, will not be limited by virtue of section 10(1)(k)(i)(hh). However, the final dividend, which is referenced in the derivative, will be taxable up to the amount of any deductible expenditure incurred or any amount taken into account that has the effect of reducing income in the application of section 24JB(2), as referred to in section 10(1)(k)(i)(hh).

#### 8. Period for which this ruling is valid

This binding class ruling is valid for a period of 3 years from 30 July 2015.

Legal and Policy Division: Advance Tax Rulings SOUTH AFRICAN REVENUE SERVICE