

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

Facts:

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 C's net income is R100 000 for the 2016 year of assessment. Foreign Company C declared a dividend of R100 000 to Foreign Company B at the end of the 2016 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 CFC 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)⁸¹ 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

⁸¹ The inclusion rates of capital gains.

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)⁸² or (c).

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)⁸³ 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)⁸⁴ 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 CFC [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)⁸⁵ 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)⁸⁶.

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)⁸⁷ 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-

⁸² Section 10B(2)(a) was included by section 37(1)(b) of the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

⁸³ The inclusion rates of capital gains.

⁸⁴ Section 10B(2)(a) was included by section 37(1)(b) of the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

⁸⁵ The inclusion rates of capital gains.

⁸⁶ Section 10B(2)(c) was included by section 108(1)(b) of the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

⁸⁷ The inclusion rates of capital gains.

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 CFC to the second-mentioned CFC if that dividend would have been exempt under section 10B(2)(a) or (c)⁸⁸ 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 paragraph 8.13 of the *Comprehensive Guide to Capital Gains Tax* (Issue 5) 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:⁸⁹

- 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.

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).

⁸⁸ Section 10B(2)(c) was included by section 108(1)(b) of the Taxation Laws Amendment Act 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

⁸⁹ See the *Tax Guide for Share Owners* (Issue 4) and the *Comprehensive Guide to Capital Gains Tax* (Issue 5) for commentary on certain of these provisions.

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 sections 11(n), 18 and 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 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—

- (a) no regard must be had to any voting rights in any foreign company—
 - (i) which is a listed company; or
 - (ii) if the voting rights in that foreign company are exercisable indirectly through a listed company;
- (b) 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
- (c) 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—
 - (i) 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
 - (ii) 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—
 - (aa) holds less than five per cent of the participation rights of that scheme or arrangement; and

(bb) 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;

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 26 to the number 41;
 - (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 13 to the number 28; or
 - (cc) where the person is an insurer in respect of its individual policyholder fund, the ratio of the number 15 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 subsection (2) do not 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 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 received or accrued in respect of a restricted equity instrument as defined in section 8C held by that person or in respect of a share held by that person.

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;