

## INTERPRETATION NOTE 126

DATE: 2 December 2022

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTION : SECTION 22B AND PARAGRAPH 43A OF THE EIGHTH SCHEDULE**  
**SUBJECT : EXTRAORDINARY DIVIDENDS TREATED AS INCOME OR PROCEEDS ON THE DISPOSAL OF CERTAIN SHARES**

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#### ***Preamble***

In this Note unless the context indicates otherwise –

- “**CFC**” means “controlled foreign company” as defined in section 1(1);
- “**company**” means “company” as defined in section 1(1);
- “**Eighth Schedule**” means the Eighth Schedule to the Act;

- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act 58 of 1962;
- “**year 1**”, “**year 2**” etc. in any of the examples refer to the respective calendar year; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes and income tax notices referred to in this Note are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issues of these documents should be consulted.

## 1. Purpose

This Note provides guidance on the interpretation and application of section 22B and paragraph 43A relating to the income tax treatment of extraordinary dividends on certain disposals and deemed disposals of shares by a company to prevent so-called “dividend stripping”.<sup>1</sup>

This Note reflects the income tax and tax administration legislation (as amended) at the time of publication and includes the following:

- The Taxation Laws Amendment Act 20 of 2021 which was promulgated on 19 January 2022 (as per *Government Gazette* 45787).
- The Tax Administration Laws Amendment Act 21 of 2021 which was promulgated on 19 January 2022 (as per *Government Gazette* 45786).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021 which was promulgated on 19 January 2022 (as per *Government Gazette* 45788).

## 2. Background

The current section 22B and paragraph 43A came into operation on 19 July 2017 and apply to any disposal of shares on or after that date, other than a disposal under an agreement all the terms of which were finally agreed to before that date by all the parties to the agreement.<sup>2</sup> These provisions are anti-avoidance provisions aimed at “dividend-stripping” when a shareholder reduces the value of a shareholding through extracting exempt dividends so that, upon the subsequent disposal, the taxable disposal proceeds are lower than would have been the case if all the reserves had still been retained in the company.

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<sup>1</sup> See **2.** for the meaning of “dividend stripping”.

<sup>2</sup> Section 22B and paragraph 43A were inserted respectively by sections 34 and 72 of the Taxation Laws Amendment Act 17 of 2017. Changes to section 22B and paragraph 43A were made by sections 38 and 80 of the Taxation Laws Amendment Act 23 of 2018 and sections 25 and 62 of the Taxation Laws Amendment Act 34 of 2019.

The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018*<sup>3</sup> explains the reasons for the necessity of provisions dealing with dividend stripping as follows:

“The anti-avoidance rules dealing with dividend stripping were first introduced in the Act in 2009. These rules were inserted to curb the use of dividend stripping structures by taxpayers as a result of the tax exemption in respect of dividends paid by a resident company to another resident company. Dividend stripping normally occurs when a resident shareholder company that is a prospective seller of shares in a target company avoids income tax (including capital gains tax) arising on the sale of shares by ensuring that the target company declares a large dividend to that resident shareholder company prior to the sale of shares in that target company to a prospective purchaser. This pre-sale dividend, which is exempt from normal tax and dividends tax, decreases the value of shares in the target company. As a result, the seller can sell the shares at a lower amount, thereby avoiding a larger normal tax (including capital gains tax) charge in respect of the sale of shares.”

Although the wording of section 22B and paragraph 43A is almost identical, section 22B applies to the disposal of shares held by a company as trading stock, while paragraph 43A applies to the disposal of shares held by a company as capital assets. Broadly, to overcome the normal tax advantage of having declared extraordinary dividends, section 22B and paragraph 43A add an additional amount to income or proceeds (as appropriate) on disposal of the applicable shares. Both provisions apply to the disposal of shares by companies only, which may be residents or non-residents,<sup>4</sup> provided all the requirements of section 22B or paragraph 43A are met.

### 3. The law

Section 22B and paragraph 43A are quoted in the **Annexure**.

### 4. Interpretation of the law

#### 4.1 Definitions [section 22B(1) and paragraph 43A(1)]

The definitions in section 22B and paragraph 43A are the same and are considered below.

##### 4.1.1 Deferral transaction

Section 22B and paragraph 43A do not apply to the disposal of shares under a deferral transaction in respect of disposals on or after 1 January 2019 (see **4.2**, **4.3** and **4.4**).<sup>5</sup>

The Act defines “deferral transaction” in section 22B(1) and paragraph 43A(1) as a transaction in respect of which the provisions of PART III of Chapter II were applied. Part III of Chapter II (the corporate rules) contains special rules relating to –

- asset-for-share transactions (section 42);
- substitutive share-for-share transactions (section 43);
- amalgamation transactions (section 44);
- intra-group transactions (section 45);
- unbundling transactions (section 46); and

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<sup>3</sup> In paragraph 2.2.

<sup>4</sup> See **Example 14** for the income tax implications for a foreign company.

<sup>5</sup> Section 22B(2) and paragraph 43A(2).

- transactions relating to liquidation, winding-up and deregistration (section 47).

Section 22B and paragraph 43A therefore do not apply to the disposal of shares under a deferral transaction which resulted in tax deferral consequences. If the definition of a specific corporate rules transaction was met but, for example, a company elected that the specific section of the corporate rules must not to apply to the disposal of the shares, the transaction would not qualify as a “deferral transaction” which may make it subject to section 22B or paragraph 43A.

#### 4.1.2 Exempt dividend

The Act defines “exempt dividend” in section 22B(1) and paragraph 43A(1) as any dividend or foreign dividend *to the extent* that the dividend or foreign dividend is –

- not subject to dividends tax<sup>6</sup> (paragraph (a) of the definition of “exempt dividend”); and
- exempt from normal tax under section 10(1)(k)(i) or section 10B(2)(a) or (b) (paragraph (b) of the definition of “exempt dividend”).

The Act defines “dividend” in section 1(1) as, amongst other things, an amount transferred or applied by a resident company in respect of any share in that company.<sup>7</sup> In contrast, “foreign dividend” is defined in section 1(1) and means, amongst other things, an amount paid or payable by a foreign company in respect of a share in that foreign company.<sup>8</sup>

##### *Not subject to dividends tax*

The Act defines “dividend” for dividends tax purposes in section 64D as any “dividend” or “foreign dividend” as defined in section 1(1), including any amount contemplated in section 31(3)(i),<sup>9</sup> that is paid by a –

- resident company; or
- foreign company if the share in respect of which the foreign dividend is paid is a listed share<sup>10</sup> and to the extent that the foreign dividend does not consist of a distribution of an asset in specie.

A dividend or foreign dividend will not be subject to dividends tax if, amongst other things –

- it is a foreign dividend paid by a foreign company which does not constitute a “dividend” as defined in section 64D, for example, it is paid in respect of a listed share but it consists of the distribution of an asset *in specie* or it is paid in respect of a share which does not constitute a listed share;

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<sup>6</sup> Under Part VIII of Chapter II.

<sup>7</sup> See the *Comprehensive Guide to Dividends Tax* for detailed commentary on the meaning of “dividend”.

<sup>8</sup> See Interpretation Note 93 “The Taxation of Foreign Dividends” for detailed commentary on the meaning of “foreign dividend”.

<sup>9</sup> Broadly, section 31(3)(i) deals with deemed dividends arising in respect of international transactions which are not based on arm’s length principles. See draft Interpretation Note “Determination of the Taxable Income of Certain Persons from International Transactions: Intra-Group Loans”.

<sup>10</sup> Definition of “listed share” in section 1(1) means a share that is listed on an “exchange” as defined in section 1 of the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act.

- it is paid by a company which is not subject to dividends tax under section 64E(1), for example, if the dividend is paid by a headquarter company; or
- any of the exemptions in sections 64F or 64FA(1) apply.

*Dividends exempt from normal tax under section 10(1)(k)(i)*

A dividend, other than a dividend paid or declared by a headquarter company,<sup>11</sup> received by or accrued to a person is exempt from normal tax under section 10(1)(k)(i) unless any of the paragraphs of the proviso to this section apply. See paragraph 4.1.12.a of the *Comprehensive Guide to Dividends Tax* for a detailed consideration of section 10(1)(k)(i).

*Foreign dividends exempt from normal tax under section 10B(2)(a)*

For the purposes of section 10B, foreign dividend means a “foreign dividend” as defined in section 1(1) and a dividend paid or declared by a headquarter company.

Under section 10B(2)(a) a foreign dividend received by or accrued to a person is exempt from normal tax if that person (whether alone or together with any other company forming part of the same group of companies<sup>12</sup> as that person) holds at least 10% of the total equity shares and voting rights in the company declaring the foreign dividend.

See Interpretation Note 93 “The Taxation of Foreign Dividends” for detailed commentary on section 10B.

*Foreign dividends exempt under section 10B(2)(b)*

For the purposes of section 10B, foreign dividend means a “foreign dividend” as defined in section 1(1) and a dividend paid or declared by a headquarter company.

Section 10B(2)(b) provides that a foreign dividend paid or declared by a foreign company to another foreign company (in context, a CFC) is exempt from normal tax if both those foreign companies are resident in the same foreign country. This exemption applies irrespective of the percentage interest that the CFC has in the participation rights or voting rights in the foreign company declaring or paying the foreign dividend.

Generally, a foreign dividend paid by a foreign company to another foreign company does not fall within the ambit of gross income, since it is not from a South African source and thus not subject to normal tax in South Africa. However, if the foreign company to which the foreign dividend is paid is a CFC, a portion of the foreign dividend may, depending on the facts, be included in a South African resident’s income by virtue of the attribution of the CFC’s net income. Under section 9D(2) a proportionate amount of a CFC’s net income<sup>13</sup> is included in the income of a resident holding a qualifying interest in the CFC.

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<sup>11</sup> Dividends paid by a headquarter company are considered for exemption under section 10B. See Interpretation Note 87 “Headquarter Companies” for detailed commentary in this regard.

<sup>12</sup> See Interpretation Note 67 “Connected Persons” for commentary on the meaning of “group of companies”.

<sup>13</sup> This Note does not provide commentary on the calculation of net income and the inclusions and exclusions as required under section 9D nor the circumstances in which section 9D(2) does not

In calculating the proportionate amount of a CFC's net income to be attributed to a resident holding a qualifying interest, the CFC is regarded under section 9D(2A) as a taxpayer and a resident for specified provisions, including the definition of "gross income" in section 1(1). Since a foreign dividend is included in "gross income" under paragraph (k) of the definition of "gross income" in section 1(1), a foreign dividend received by or accrued to a CFC from another foreign company must be taken into account for purposes of calculating the net income of the CFC. In calculating the net income of the CFC, the exemptions under section 10B must be considered.

See Interpretation Note 93 "The Taxation of Foreign Dividends" for detailed commentary on section 10B.

#### 4.1.3 Extraordinary dividend

The definition of "extraordinary dividend" distinguishes between dividends received or accrued in respect of a preference share and any other share.

*Extraordinary dividends received or accrued on preference shares (paragraph (a) of the definition of "extraordinary dividend")*

In relation to a preference share (see 4.1.4), an extraordinary dividend means –

- so much of the amount of any dividend received or accrued in respect of that share,
- as exceeds the amount that would have accrued in respect of that share had that amount been determined with reference to the consideration for which that share was issued by applying an interest rate of 15% per annum for the period in respect of which that dividend was received or accrued.

Under the proviso to the definition, a dividend *in specie* distributed under a deferral transaction must not be taken into account as an extraordinary dividend to the extent to which that distribution was made under an "unbundling transaction" as defined in section 46(1)(a) or a "liquidation distribution" as defined in section 47(1)(a).

The following is stated in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019*:<sup>14</sup>

*"In specie distributions made in terms of unbundling transactions and liquidation transactions involving resident companies.....will be disregarded when determining whether an extraordinary dividend accrued to or was received by a shareholder company. This is because these types of transactions are extraordinary dividends that are used by taxpayers to transfer assets to shareholder companies in respect of which tax on their unrealised gains will be collected in future."*

Paragraph (a) of the definition of "extraordinary dividend" does not limit the dividends to only dividends received or accrued during the 18-month period before the disposal of the share as provided for in paragraph (b) of the definition of "extraordinary dividend" for other shares (see below). The words "the amount of *any dividend* received or accrued in respect of that share" mean that the amounts of *all dividends* received or accrued in respect of that preference share must be considered. For each dividend received or accrued it is necessary to compare the actual dividend to the amount that would have been received or accrued had the amount been determined by multiplying

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apply. See section 9D for details on all the inclusions and exclusions from net income and circumstances in which section 9D does not apply.

<sup>14</sup> In paragraph 2.1.

the consideration for which the share was issued by an interest rate of 15% per annum for the period in respect of which that dividend was received or accrued. The period in respect of which a specific dividend was received or accrued may, depending on the facts, be shorter or longer than one year. The sum of the excess amounts in respect of all the dividends received or accrued is the amount of the extraordinary dividend. This principle must be applied even if the calculation is performed on an aggregate basis – see the examples below. The calculation of an extraordinary dividend will be determined by the facts of each case.

**Example 1 – Extraordinary dividend received or accrued on cumulative redeemable preference shares paid annually**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held a qualifying interest in Company B. On 1 April year 1 Company A acquired 100 000 redeemable preference shares at R1 a share in Company B. Dividends on these preference shares were payable annually at the rate of 8% above the prime rate of interest. The preference shares were redeemed on 31 March year 6. The dividends were declared and paid annually.

The shares were held on capital account.

The prime rate of interest remained unchanged during the five-year period at 10% a year.

*Result:*

If the requirements of paragraph 43A(2) are met (see **4.2**), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

Company A received an exempt dividend of R18 000 ( $R100\,000 \times 18\%$ ) during each of the five years of assessment ending on 31 March year 2 to 31 March year 6.

The extraordinary dividend is calculated as follows:

	R
Dividends received ( $R18\,000$ paid per year $\times$ 5 years)	90 000
Less: Dividends calculated by applying an interest rate of 15% a year (consideration of $R100\,000 \times 15\% \times 5$ years)	<u>(75 000)</u>
Extraordinary dividend	<u>15 000</u>

**Note:**

The shares are capital assets and therefore the extraordinary dividend of R15 000 must be taken into account as proceeds on redemption of the shares under paragraph 43A(2) (see **4.2**).

**Example 2 – Extraordinary dividend received or accrued on cumulative redeemable preference shares paid on redemption**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held a qualifying interest in Company B. On 1 April year 1 Company A acquired 100 000 cumulative redeemable preference shares at R1 a share in Company B. Dividends on these preference shares were payable annually at the rate of 8% above the prime rate of interest. The preference shares were redeemed on 31 March year 6. The dividends on the preference shares were not paid annually. However, the cumulative dividend was paid to the holders of the preference shares on redemption.

The shares were held on capital account.

The prime rate of interest remained unchanged during the five-year period at 10% a year.

*Result:*

If the requirements of paragraph 43A(2) are met (see **4.2**), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

Company A received a cumulative exempt dividend of R90 000 ( $R100\,000 \times 18\% \times 5$  years) on 31 March year 6.

The extraordinary dividend is calculated as follows:

	R
Dividend received	90 000
Less: Dividends calculated by applying an interest rate of 15% a year (consideration of $R100\,000 \times 15\% \times 5$ years)*	<u>(75 000)</u>
Extraordinary dividend	<u>15 000</u>

\* Under paragraph (a) of the definition of "extraordinary dividend" in paragraph 43A(1) the consideration of R100 000 for the issue of the preference shares is multiplied by 15% for the period in respect of which the dividend was received or accrued, this is 5 years even though a dividend was paid only on 31 March year 6, because the dividend was cumulative for the 5-year period commencing on 1 April year 1.

**Note:**

The shares are capital assets and therefore the extraordinary dividend of R15 000 must be taken into account as proceeds on redemption of the shares under paragraph 43A(2) (see **4.2**).



**Example 3 – Extraordinary dividend received or accrued on non-cumulative redeemable preference shares**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held a qualifying interest in Company B. On 1 April year 1 Company A acquired 100 000 non-cumulative redeemable preference shares at R1 a share in Company B. Dividends on these preference shares were payable annually at the rate of 8% above the prime rate of interest. The preference shares were redeemed on 31 March year 6. An annual dividend of R18 000 was paid on 31 March year 2 and 31 March year 6. No dividend was paid for the years of assessment ended 31 March year 3, year 4 and year 5.

The shares were held on capital account.

The prime rate of interest remained unchanged during the five-year period at 10% a year.

*Result:*

If the requirements of paragraph 43A(2) are met (see **4.2**), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

The annual dividend of R18 000 on the preference shares was declared and paid on 31 March year 2 and 31 March year 6. No dividend was declared in respect of the years of assessment ended 31 March year 3, year 4 and year 5.

The extraordinary dividend is calculated as follows:

	R
Dividends received (R18 000 on 31 March year 2 and R18 000 on 31 March year 6)	36 000
Less: Dividends calculated by applying an interest rate of 15% a year (consideration of R100 000 × 15% × 2 years)	<u>(30 000)</u>
Extraordinary dividend	<u>6 000</u>

**Note:**

The shares are capital assets and therefore the extraordinary dividend of R6 000 must be taken into account as proceeds on redemption of the shares under paragraph 43A(2) (see **4.2**).

*Extraordinary dividends received or accrued on shares other than preference shares (paragraph (b) of the definition of "extraordinary dividend")*

In relation to a share, other than a preference share, an extraordinary dividend means so much of the amount of any dividend received or accrued –

- within a period of 18 months before the disposal of that share; or
- in respect, by reason or in consequence of that disposal,

as exceeds 15% of the higher of the market value of that share as at the beginning of the period of 18 months and as at the date of disposal of that share.

Under the proviso to the definition, a dividend *in specie* that was distributed under a deferral transaction must not be taken into account to the extent to which that distribution was made under an “unbundling transaction” as defined in section 46(1)(a) or a “liquidation distribution” as defined in section 47(1)(a).

Taking the purpose of section 22B and paragraph 43A and the wording of paragraph (b) of the definition of “extraordinary dividend” into account, “within a period of 18 months before the disposal of that share” is interpreted to include all dividends received or accrued within that period including dividends received or accrued on the same day (day of disposal) but before the disposal of the share.

No timing requirement is mentioned for a dividend that is received or accrued “in respect, by reason or in consequence of that disposal”. Such dividend may therefore be received before, on or after the disposal of the shares concerned.

It has been held that whether “in respect of” is restricted to a direct or causal relationship, or something wider depends on the context in which the words are used.<sup>15</sup>

Viviers J in ITC 1340 summarised the position as follows:<sup>16</sup>

“As was pointed out by Solomon JA in *CIR v Crown Mines Ltd* 1923 AD 121 at 128, the expression ‘in respect of’ may be used in various senses, and in each case it is necessary to examine the context in order to ascertain the sense in which it is used. Of the numerous decided cases in which the interpretation of the words ‘in respect of’ was discussed, I need refer only to two of the more recent decisions in which the earlier decisions are referred to: *SBI v Raubenheimer* 1969 (4) SA 314 (A) at 320 (31 SATC 209) and *SIR v Wispeco Housing (Pty) Ltd* 1973 (1) SA 783 (A) where Ogilvie Thompson CJ said the following at 792:

‘No doubt the expression ‘in respect of’ must, in certain contexts, be restricted to a direct or causal relationship (cf eg *De Villiers v CIR* 1929 AD 227 at 229); but, as was pointed out in *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301 at 320, the expression ‘in respect of’ does not necessarily or invariably indicate such relationship. In that case, it was held to be used in the sense of ‘in relation to’ or ‘in reference to’. (Cf also *SBI v Raubenheimer* . . . .) The expression ‘in connection with’ *prima facie* extends the ambit of matters comprehended *in casu*, the consideration upon which duty is payable. As Kitto J put it in *Berry’s case* . . . at 658,

‘a consideration may be ‘in connection with’ more things than that ‘for’ which it is received’.

As appears from all the foregoing, the context wherein the expressions ‘in respect of’ and ‘in connection with’ occur is of vital importance. The true position was, in my opinion, happily summarized by Schreiner JA, in *Rabinowitz and another v De Beer’s Consolidated Mines Ltd and another* 1958 (3) SA 619 (A) at 631, as follows:

‘Expressions like “in respect of” and “in connection with”, though they may sometimes be used to cover a wide range of association, must in other cases be limited to the close or more direct forms of association indicated by the context.’ ”

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<sup>15</sup> *SBI v Raubenheimer* 1969 (4) SA 314 (A), 31 SATC 209 at 216; *Barnard NO v Regspersoon van Aminie & another* [1999] 4 All SA 451 (T) at 455 and ITC 1340 (1980) 43 SATC 210 (C) at 212.

<sup>16</sup> (1980) 43 SATC 210 (C) at 212.

Taking the principles from these cases into account and bearing in mind that section 22B and paragraph 43A are anti-avoidance provisions intended to curb the use of certain share buy-back schemes as well as schemes seeking to circumvent the dividend-stripping rules,<sup>17</sup> the expression “in respect of” must be widely interpreted in the context<sup>18</sup> of section 22B and paragraph 43A in the sense of “in connection with” and “in relation to”.

The question whether any dividend is received or accrued “in respect, by reason or in consequence of that disposal” must be determined on the facts of each case. It is therefore not possible to provide a list of circumstances in which dividends do and do not fall within “in respect, by reason or in consequence of that disposal”. In some cases the determination will be easy but in other cases it will be difficult. See **Example 6** for an example in which the dividends fall within “in respect, by reason or in consequence of that disposal”. Arguably, if a person sold shares in Company A at market value for cash proceeds and used those proceeds to purchase shares in Company B, the dividends received on Company B shares could be said to be received “in respect, by reason or in consequence of that disposal” given that they were purchased using the proceeds from the disposal of the Company A shares. However, taking the purpose and context of section 22B and paragraph 43A into account and the fact that the shares purchased from the proceeds are not in the same company and were purchased at market value, it is considered that an interpretation that the dividends on the shares in Company B are in respect, by reason or in consequence of the disposal of the Company A shares would be too restrictive and unintended and should not be adopted.<sup>19</sup> Taxpayers requiring certainty regarding SARS’s interpretation based on their facts may apply for an advance tax ruling if they meet the requirements.<sup>20</sup>

An extraordinary dividend received or accrued in respect, by reason or in consequence of the disposal of a share includes, amongst other things, a dividend resulting from –

- a share buy-back; and
- the liquidation, deregistration or winding-up of a company, other than a distribution in specie under section 47(1)(a).

See also **Example 6** which includes a dividend (the redemption of preference shares) resulting from the issue of capitalisation shares. The issue of capitalisation shares does not necessarily result in any dividends on the capitalisation shares being linked to the shares, or the disposal of the shares, in respect of which the capitalisation shares were issued. It depends on the facts – see **Example 6** for an example of a dividend on a capitalisation share which was received “in respect, by reason or in consequence of” the disposal of the share in respect of which the capitalisation share was issued.<sup>21</sup>

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<sup>17</sup> *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2017* in paragraph 2.4.

<sup>18</sup> The principle established in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) is that the ordinary grammatical meaning should be given to a term taking into account the context in which it appears and the purpose to which it is directed.

<sup>19</sup> See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

<sup>20</sup> See section 79 of the Tax Administration Act 28 of 2011 and the *Comprehensive Guide to Advance Tax Rulings* for more information on how to apply for an advance tax ruling.

<sup>21</sup> See also Binding Private Ruling 361 “Asset-For-Share Transaction Followed by an Unbundling Transaction, the Issue of Capitalisation Redeemable Preference Shares and the Sale of Shares to a Third Party” dated 19 March 2021.

Even though paragraph (b)(i) and (ii) of the definition of “extraordinary dividend” are separated by the word “or”, it does not mean that under a share buy-back regard should be had only to the dividend forming part of the amount received or accrued on disposal of the share. Any dividends derived during the 18 months before the disposal must also be taken into account in the calculation, since the opening words of paragraph (b) refer to “any dividend”. Were paragraph (b)(i) and (ii) to be read disjunctively, it would undermine the purpose of the provision which is to target dividends which result in the proceeds on disposal of the shares being depressed.

**Example 4 – Extraordinary dividend received or accrued on a share other than a preference share**

*Facts:*

Company A’s year of assessment ends on 31 March.

Company A held 50% of the equity shares and voting rights in Company B as capital assets. On 1 October year 3 Company A received an exempt dividend of R1,5 million and on 1 November year 3 an exempt dividend of R500 000 in respect of these shares.

Company A disposed of the equity shares on 31 March year 4 for R3 million. At the beginning of the 18-month period before the disposal of the shares, the market value of the shares was R5 million. At the date of disposal the market value of the shares was R3 million.

*Result:*

If the requirements of paragraph 43A(2) are met (see **4.2**), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

The extraordinary dividend received by Company A is calculated as follows:

	R
Dividends received within 18 months before the disposal of the shares (R1,5 million + R500 000)	2 000 000
Less: 15% × R5 million [15% of the higher of market value of R5 million (beginning of the 18-month period) or R3 million (date of disposal)]	<u>(750 000)</u>
Extraordinary dividend	<u>1 250 000</u>

**Note:**

Under paragraph 43A(2) the extraordinary dividend of R1 250 000 must be taken into account as proceeds on disposal of the shares in Company A’s year of assessment ending on 31 March year 4, since the shares were held as capital assets (see **4.2**).

**Example 5 – Extraordinary dividend received or accrued on a share other than a preference share**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held 50% of the equity shares and voting rights in Company B as capital assets which it acquired for R50 000. On 1 October year 3 Company A received an exempt dividend of R2 million in respect of these shares.

Company A disposed of the equity shares on 31 October year 3 for R100 000. At the beginning of the 18-month period before the disposal of the shares, the market value of the shares was R3 million. At the date of disposal the market value of the shares was R100 000.

*Result:*

If the requirements of paragraph 43A(2) are met (see **4.2**), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

The extraordinary dividend received by Company A is calculated as follows:

	R
Dividend received within 18 months before the disposal of the shares	2 000 000
Less: 15% × R3 million [15% of the higher of market value of R3 million (beginning of the 18-month period) or R100 000 (date of disposal)]	<u>(450 000)</u>
Extraordinary dividend	<u>1 550 000</u>

**Note:**

Under paragraph 43A(2) the extraordinary dividend of R1 550 000 must be taken into account as proceeds on disposal of the shares in Company A's year of assessment ending on 31 March year 4, since the shares were held as capital assets (see **4.2**). Company A has a capital gain of R1 600 000 [(actual proceeds of R100 000 + deemed proceeds of R1 550 000) – base cost of R50 000] on disposal of the shares.

**Example 6 – Extraordinary dividend received or accrued “in respect, by reason or in consequence of” the disposal of a share other than a preference share**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held 50% of the equity shares and voting rights in Company B as capital assets which it acquired for R50 000.

On 1 October year 3 Company B issued 2 000 Class A preference shares with a capital value of R1 000 each to Company A under a capitalisation share issue in proportion to its 50% holding of equity shares. The preference shares are cumulative, redeemable preference shares that are redeemable at the discretion of Company B's board of directors. Under a separate redemption schedule it is envisaged, but it was not obligatory, that the preference shares will be redeemed within 24 months.

Company A disposed of the equity shares on 31 October year 3 for R100 000. At the beginning of the 18-month period before the disposal of the shares, the market value of the equity shares was R3 million. At the date of disposal the market value of these shares was R100 000.

Company B's board of directors redeemed the preference shares at face value within 24 months on 15 April year 5.

*Result:*

*Year of assessment ending on 31 March year 4*

If the requirements of paragraph 43A(2) are met (see 4.2), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the equity shares in Company B by Company A on 31 October year 3.

No dividends were received during the year of assessment ending on 31 March year 4, accordingly there is no extraordinary dividend which must be taken into account as proceeds under paragraph 43A(2) on disposal of the equity shares in Company B. The issue of the preference shares is specifically excluded under paragraph (ii) of the definition of "dividend" in section 1(1), since it constitutes the transfer of shares in the company.<sup>22</sup>

The capital gain on disposal of the equity shares is R50 000 (proceeds of R100 000 – base cost of R50 000).

*Year of assessment ending on 31 March year 6*

The redemption of the preference shares at R2 million (2 000 shares × R1 000 per share) on 15 April year 5 constitutes a distribution which is included in paragraph (b) of the definition of "dividend" in section 1(1). The consideration for the redemption of a share in a company is a "dividend" unless it results in the reduction of contributed tax capital.<sup>23</sup> The contributed tax capital for the preference shares is RNil, as no consideration was received by or accrued to Company B for the issue of the preference shares under a capitalisation issue. The directors could therefore not determine the consideration applied for the redemption of the preference shares to be a reduction of contributed tax capital as no contributed tax capital existed.

The dividend of R2 million received by Company A constitutes an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).

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<sup>22</sup> Section 40C stipulates that shares issued to a person for no consideration are deemed to be acquired by that person for an expenditure of RNil. The base cost of the preference shares for CGT purposes is therefore RNil.

<sup>23</sup> See the definition of "contributed tax capital" in section 1(1).

If the requirements of paragraph 43A(2) are met (see 4.2) in respect of the disposal of the equity shares in Company B by Company A on 31 October year 3, *to the extent* that the exempt dividend of R2 million constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the equity shares. As the dividend is received after the year of assessment in which the equity shares were disposed of (year of assessment ending on 31 March year 4), the extraordinary dividend is taken into account as proceeds in the year of assessment in which the dividend is received, namely, the year of assessment ending on 31 March year 6.

From the facts of this case, it is apparent that the issue and the redemption of the preference shares were adopted to provide additional compensation to Company A in respect of its divestment from Company B. Therefore, in determining if the exempt dividend of R2 million on the redemption of the preference shares constitutes an extraordinary dividend, paragraph (b) of the definition of “extraordinary dividend” is relevant, as although the exempt dividend arose on the preference shares, the issue and the redemption of the preference shares were integrally linked to the disposal of the equity shares.

Paragraph (b)(ii) of the definition of “extraordinary dividend” includes *any* dividend received or accrued “in respect, by reason or in consequence of” that disposal. As noted above, in the context of the facts and circumstances of this example the issue of the preference shares as a capitalisation issue, and the subsequent dividend (redemption of the shares), are linked to and form an integral part of the sale of the equity shares in Company B. This dividend is therefore considered to be received “in relation to”<sup>24</sup> the equity shares and “in respect, by reason or in consequence of” the disposal of the equity shares on 31 October year 3 and constitutes an extraordinary dividend (see calculation below).

Paragraph 43A(2) applies, as Company A held equity shares in Company B as a capital asset immediately before the disposal of those shares on 31 October year 3, the equity shares were disposed of under a transaction that was not a deferral transaction and Company A held a qualifying interest in Company B at any time during the period of 18 months prior to that disposal on 31 October year 3. Accordingly, paragraph 43A(2) provides that the amount of *any* exempt dividend (in this case, the preference share redemption amount of R2 million) received by or accrued to Company A in respect of the Company B shares disposed of, must, to the extent that the exempt dividend constitutes an extraordinary dividend, be taken into account as part of proceeds on the disposal of the shares. Paragraph 43A(2) further provides that when the dividend is received or accrues after the year of assessment in which the shares are disposed of (31 March year 4), the extraordinary dividend must be taken into account as proceeds in the year of assessment in which the dividend is received or accrued (year of assessment ending 31 March year 6).

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<sup>24</sup> Means “...as regards, as to, in regard to, with reference to, with regard to.....”.  
<https://www.dictionary.com/browse/in--relation--to> [Accessed 2 December 2022].

The extraordinary dividend received by Company A is calculated as follows:

	R
Dividend received “in respect, by reason or in consequence of” the disposal of the equity shares in Company B	2 000 000
Less: 15% × R3 million [15% of the higher of market value of R3 million (beginning of the 18-month period) or R100 000 (date of disposal)]	<u>(450 000)</u>
Extraordinary dividend	<u>1 550 000</u>

Therefore, the extraordinary dividend of R1 550 000 will be taken into account as proceeds on disposal of the equity shares. However, as this dividend is received after the year of assessment in which the equity shares were disposed of, the extraordinary dividend is taken into account as proceeds in the year of assessment in which the dividend is received, namely, the year of assessment ending on 31 March year 6.

**Notes:**

1. Company A has a total capital gain of R1 600 000 on disposal of the equity shares (capital gain of R50 000 in the year of assessment ending on 31 March year 4 (see above) + capital gain of R1 550 000 in the year of assessment ending on 31 March year 6).
2. Company A has a capital gain of RNil on disposal (redemption) of the preference shares [(proceeds of R2 million – dividend of R2 million included in gross income<sup>25</sup>) – base cost of the shares of RNil<sup>26</sup>].
3. See Binding Private Ruling 361 “Asset-for-Share Transaction Followed by an Unbundling Transaction, the Issue of Capitalisation Redeemable Preference Shares and the Sale of the Shares to a Third Party”.

**Example 7 – Dividend received or accrued on a share other than a preference share – Extraordinary dividend of RNil**

*Facts:*

Company A’s year of assessment ends on 31 March.

Company A held 50% of the equity shares and voting rights in Company B as capital assets. On 1 October year 3 Company A received an exempt dividend of R200 000 in respect of these shares.

Company A disposed of the equity shares on 31 March year 4 for R3 million. At the beginning of the 18-month period before the disposal of the shares, the market value of the shares was R5 million. At the date of disposal the market value of the shares was R3 million.

<sup>25</sup> Paragraph 35(3)(a).

<sup>26</sup> Section 40C.



**Result:**

If the requirements of paragraph 43A(2) are met (see 4.2), *to the extent* that an exempt dividend constitutes an extraordinary dividend, the extraordinary dividend will be taken into account as proceeds on disposal of the shares.

The extraordinary dividend received by Company A is calculated as follows:

	R
Dividend received within 18 months before the disposal of the shares	200 000
Less: 15% × R5 million [15% of the higher of market value of R5 million (beginning of the 18-month period) or R3 million (date of disposal)]	(750 000)
Extraordinary dividend	0

**Note:**

No amount is taken into account as proceeds under paragraph 43A(2), since the amount of the extraordinary dividend is RNil.

**4.1.4 Preference share**

The Act defines “preference share” in section 22B(1) and paragraph 43A(1) as a “preference share” as defined in section 8EA(1), namely, any share –

- other than an equity share [paragraph (a) of the definition of “preference share” in section 8EA(1) (see below)]; or
- that is an equity share if an amount of any dividend or foreign dividend in respect of that share is based on or determined with reference to a specified rate of interest or the time value of money [paragraph (b) of the definition of “preference share” in section 8EA(1) (see below)].

In applying the definition of “preference share” in section 8EA(1) for purposes of section 22B and paragraph 43A, it must first be determined whether a share constitutes an “equity share” as defined in section 1(1). A share not constituting an equity share will constitute a “preference share” as defined in section 8EA(1). A share constituting an “equity share” as defined in section 1(1) will not constitute a “preference share” as defined in section 8EA(1), unless the requirements of paragraph (b) of the definition of “preference share” are met (see below).

*Meaning of “equity share” as defined in section 1(1)*

The Act defines “equity share” in section 1(1) as any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution.

A distribution by a company or a foreign company generally takes the form of a distribution of profits (dividends or foreign dividends) or capital (return of capital or foreign return of capital). Provided that the share carries a right to participate beyond a specified amount in either of these types of distribution, the share will qualify as an equity share. The share will not be an equity share if both rights are limited to a specified amount. If only one of the rights is limited to a specified amount, the share will still be an equity share.

A preference share<sup>27</sup> that has, for example, an unlimited right to profits but a limited right to capital, meets the definition of and therefore qualifies as an “equity share”. This type of preference share<sup>28</sup> is often called a “participating preference share”. Even though it is an equity share, it could still meet the requirements of paragraph (b) of the definition of “preference share” (see below) and be treated as a “preference share” as defined in section 8EA(1) for purposes of section 22B and paragraph 43A. It will not be treated as a “preference share” as defined in section 8EA(1) for purposes of section 22B and paragraph 43A if it does not meet the requirements of paragraph (b). A preference share that has a limited right to profits, for example, dividends being capped at R1 million, and a limited right to capital, will not constitute an “equity share” and will be treated as a preference share as defined in section 8EA(1) for purposes of section 22B and paragraph 43A.

*Paragraph (a) of the definition of “preference share” in section 8EA(1)*

A share that does not constitute an “equity share” as defined in section 1(1) (see above) constitutes a “preference share” as defined in section 8EA(1).

*Paragraph (b) of the definition of “preference share” in section 8EA(1)*

An equity share will be a preference share for purposes of section 22B and paragraph 43A, under paragraph (b) of the definition of “preference share” in section 8EA(1), if an amount of any dividend or foreign dividend in respect of that share is based on or determined with reference to a specified rate of interest or the time value of money.

*Meaning of “interest” and “rate of interest”*

The Act does not define “interest” and “rate of interest” for purposes of the definition of “preference share” in section 8EA(1). The words should therefore be interpreted according to their ordinary meaning as applied to the subject matter with regard to which they are used.<sup>29</sup>

The common law meaning of “interest” has been considered in our courts. In *CIR v Genn & Co (Pty) Ltd* Schreiner JA stated the following on interest and commission on loans:<sup>30</sup>

“[I]t is not possible in the present case to justify a difference in treatment between the interest on the loans and the commissions; the circumstances mentioned above show that in each case the commission together with the interest formed in effect one consideration which the company had to pay for the use of the money for the period of the loan.”

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<sup>27</sup> As referred to generally in practice.

<sup>28</sup> As referred to generally in practice.

<sup>29</sup> EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworths, South Africa Series. See also LC Steyn *Die Uitleg van Wette* 5 ed (1981) Juta and Company (Pty) Ltd at 4 to 7.

<sup>30</sup> 1955 (3) SA 293 (A), 20 SATC 113 at 119.

In ITC 1485<sup>31</sup> and ITC 1496<sup>32</sup> Melamet J stated the following on the meaning of “interest”:

“ ‘Interest is the return o[r] compensation for the use o[r] retention by one person of a sum of money belonging to or owed to another...’<sup>33</sup>

‘...Interest is an expense to compensate a lender for the time period during which the money is lent to a second party’.”

“Interest” can therefore be summarised as meaning the cost of borrowing money or as the amount that is paid for the use of money for a period of time, usually expressed as a percentage per year of the amount of money borrowed.

#### *Meaning of “time value of money”*

*Freedictionary.com* defines “time value of money” as follows:<sup>34</sup>

“The time value of money is money's potential to grow in value over time.

Because of this potential, money that's available in the present is considered more valuable than the same amount in the future.”

#### **4.1.5 Qualifying interest**

“Qualifying interest” means an interest held by a company, whether alone or together with any connected persons in relation to that company, in a company that is not a listed company or in a company that is a listed company, if the required holding percentages in these companies are met.

*Holding requirement in a company that is not a listed company (paragraph (a) of the definition of “qualifying interest”)*

An interest in a company that is not a listed company will constitute a qualifying interest if at least –

- 50% of the equity shares or voting rights in the company that is not listed is held by another company, whether alone or together with any connected persons in relation to that other company (paragraph (a)(i) of the definition); or
- 20% of the equity shares or voting rights in the company that is not listed is held by another company, whether alone or together with any connected persons in relation to that other company, and no other person (whether alone or together with any connected persons in relation to that person) holds the majority (more than 50%) of the equity shares or voting rights in the company that is not listed (paragraph (a)(ii) of the definition).

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<sup>31</sup> (1990) 52 SATC 337 (T) at 342.

<sup>32</sup> (1990) 53 SATC 229 (T) at 248 and 249.

<sup>33</sup> ‘*Halsbury’s Laws of England* 4ed Vol 32 para 106, see also Vol 33 para 524. *Words and Phrases Legally Defined* 3ed (D-J) s v ‘Interest’ at p 564. Lee and Honore *The South African Law of Obligations* para 174.’

<sup>34</sup> <https://financial-dictionary.thefreedictionary.com/time+value+of+money> [Accessed 2 December 2022].

*Holding requirement in a listed company (paragraph (b) of the definition of “qualifying interest”)*

An interest in a listed company will constitute a qualifying interest if at least 10% of the equity shares or voting rights in the listed company is held by another company, whether alone or together with any connected persons in relation to that other company.

The Act defines “listed company” in section 1(1) as a company whose shares or depository receipts in respect of its shares are listed on any of the following exchanges:

- An “exchange” as defined in section 1 of the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act. The JSE Ltd (JSE), Cape Town Stock Exchange (CTSE), A2X Markets (Pty) Ltd (A2X) and Equity Express Securities Exchange (Pty) Ltd (EESE) are currently licensed under section 9 of the Financial Markets Act.
- A stock exchange in a country other than the Republic which has been recognised by the Minister of Finance as contemplated in paragraph (c) of the definition of “recognised exchange” in paragraph 1. The list of recognised exchanges in countries outside the Republic was published in the *Government Gazette*<sup>35</sup> and is available on the SARS website.

*Meaning of “connected person”*

A detailed analysis of the meaning of “connected person” is beyond the scope of this Note. See Interpretation Note 67 “Connected Persons” for more detail.

Paragraph (d) of the definition of “connected person” in section 1(1) identifies the persons that are connected persons in relation to a company. The following persons are connected persons in relation to a company:

- A company that would form part of the same group of companies as another company if the criteria specified below are met. For the purposes of the definition of “connected person” a company will form part of the same group of companies if more than 50% of its equity shares or voting rights are directly held by a controlling company, one or more other controlled group companies or any combination of such companies and the controlling group company directly holds more than 50% of the equity shares or voting rights in at least one controlled group company [paragraph (d)(i)]. It is therefore not a requirement that more than 50% of both the equity shares and voting rights must be held. It will suffice if more than 50% of the equity shares or the voting rights are held.
- Any person (other than a “company” as defined in section 1 of the Companies Act 71 of 2008), that alone or together with any connected person in relation to that person, holds, directly or indirectly, at least 20% of the equity shares or voting rights in a company [paragraph (d)(iv)].
- A company holding at least 20% of the equity shares or voting rights in another company if no holder of shares holds the majority (more than 50%) voting rights in that other company [paragraph (d)(v)].

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<sup>35</sup> Government Notice R 997 in *Government Gazette* 22723 of 2 October 2001 and Government Notice 1088 in *Government Gazette* 30484 of 16 November 2007 which added the Channel Islands Stock Exchange.

- Any other company that is managed or controlled by a connected person in relation to the first-mentioned company or by any person that is a connected person in relation to the first-mentioned connected person [paragraph (d)(vA)].

The following persons are connected persons in relation to a company which is a close corporation:

- A member of the close corporation [paragraph (d)(vi)(aa)].
- A relative of a member of the close corporation [paragraph (d)(vi)(bb)].
- A trust (other than a portfolio of a collective investment scheme) that is a connected person in relation to a member of the close corporation [paragraph (d)(vi)(bb)].
- A close corporation or a company that is a connected person in relation to any of the following persons:
  - A member of the close corporation [paragraph (d)(vi)(cc)(i)].
  - Any relative of a member of the close corporation [paragraph (d)(vi)(cc)(ii)].
  - Any trust (other than a portfolio of a collective investment scheme) that is a connected person in relation to a member of the close corporation [paragraph (d)(vi)(cc)(ii)].

#### **Example 8 – Qualifying interest in a company that is not a listed company**

*Facts:*

Company A holds 10% of the equity shares and 50% of the voting rights in Company B. Company B is not a listed company.

*Result:*

Since Company A holds at least 50% of Company B's voting rights, it holds a qualifying interest in Company B under paragraph (a)(i) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1).

**Note:**

It is not a requirement that at least 50% of the equity shares and voting rights must be held to constitute a qualifying interest under paragraph (a)(i) of the definition of "qualifying interest".

#### **Example 9 – Qualifying interest in a company that is not a listed company**

*Facts:*

Company A holds 51% of the equity shares in both Company B and Company C. Company B and Company C respectively hold 30% and 20% of the equity shares in Company D. Company D is not a listed company.

**Result:**

Company A, Company B and Company C are connected persons in relation to one another under paragraphs (d)(i) and (e) of the definition of “connected person” in section 1(1), since they form part of the same group of companies as contemplated in the definition of “connected person”.

**Qualifying interest held by Company B**

Company B holds a qualifying interest in Company D under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it holds, together with Company C, at least 50% (30% + 20%) of Company D’s equity shares.

**Qualifying interest held by Company C**

Company C holds a qualifying interest in Company D under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it holds, together with Company B, at least 50% (20% + 30%) of Company D’s equity shares.

**Example 10 – Qualifying interest in a company that is not a listed company****Facts:**

Natural person A holds 20% of the equity shares in Company A. Natural person A holds 40% of the equity shares and 10% of the voting rights in Company B. Company A holds 5% of the equity shares and 40% of the voting rights in Company B. Company B is not a listed company.

**Result:**

Natural person A and Company A are connected persons in relation to one another under paragraphs (d)(iv) and (e) of the definition of “connected person” in section 1(1), since Natural person A holds at least 20% of Company A’s equity shares.

**Qualifying interest held by Company A**

Company A holds a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it holds, together with Natural person A, at least 50% (40% + 10%) of Company B’s voting rights. It is not a requirement that at least 50% of the equity shares and voting rights must be held to constitute a qualifying interest under paragraph (a)(i) of the definition of “qualifying interest”.

**Note:**

Natural person A does not hold a qualifying interest in Company B, since only a company can hold a qualifying interest in another company under the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1).

**Example 11 – Qualifying interest in a company that is not a listed company***Facts:*

Company A holds 20% of the equity shares in Company B. The remaining 80% of Company B's equity shares are held equally by four natural persons who are not connected persons in relation to one another. No person holds more than 50% of the equity shares or voting rights in Company B. Company B is not a listed company.

*Result:**Qualifying interest held by Company A*

Company A holds a qualifying interest in Company B under paragraph (a)(ii) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1), since it holds at least 20% of Company B's equity shares and no other person (whether alone or together with any connected persons in relation to that person) holds the majority (more than 50%) of the equity shares or voting rights in Company B.

It is not a requirement that at least 20% of the equity shares and voting rights must be held to constitute a qualifying interest under paragraph (a)(ii) of the definition of "qualifying interest".

**Note:**

The four natural persons do not hold a qualifying interest in Company B, since only a company can hold a qualifying interest in another company under the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1).

**Example 12 – Qualifying interest in a company that is not a listed company***Facts:*

Company A holds 30% of the equity shares and voting rights in Company C. Company B holds 70% of the equity shares and voting rights in Company C. Company C is not a listed company.

*Result:**Company A not holding a qualifying interest*

Company A does not hold a qualifying interest in Company C under paragraph (a)(i) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1), since it does not hold at least 50% of Company C's equity shares or voting rights.

Company A also does not hold a qualifying interest in Company C under paragraph (a)(ii) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1), since Company B holds the majority (more than 50%) of Company C's equity shares and voting rights.

*Qualifying interest held by Company B*

Company B holds a qualifying interest in Company C under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), because it holds at least 50% of Company C’s equity shares and voting rights as required under paragraph (a)(i). Since the requirements of paragraph (a)(i) of the definition of “qualifying interest” are met, it is not necessary to determine whether the requirements of paragraph (a)(ii) are also met.

**Note:**

Although Company B holds 70% of the equity shares and voting rights in Company C, the same answer would result if Company B held 70% of either the equity shares or the voting rights.

**Example 13 – Qualifying interest in a listed company***Facts:*

Natural person A holds 20% of the equity shares in Company A. Company A and Natural person A each hold 5% of the equity shares in Listed Company B.

*Result:*

Natural person A and Company A are connected persons in relation to each other under paragraphs (d)(iv) and (e) of the definition of “connected person” in section 1(1), since Natural person A holds at least 20% of the equity shares in Company A.

*Qualifying interest held by Company A*

Company A holds a qualifying interest in Listed Company B under paragraph (b) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it holds, together with Natural person A at least 10% (5% + 5%) of Listed Company B’s equity shares.

It is not a requirement that at least 10% of the equity shares and voting rights must be held to constitute a qualifying interest under paragraph (b) of the definition of “qualifying interest”.

**Note:**

Natural person A does not hold a qualifying interest in Listed Company B, since only a company can hold a qualifying interest in another company under the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1).



#### **4.2 Extraordinary dividend included in a company's income or taken into account as proceeds on the disposal of certain shares [section 22B(2) and paragraph 43A(2)]**

Section 22B(2) and paragraph 43A(2) respectively provide for the amount of an exempt dividend, *to the extent* that it is an extraordinary dividend, received by or accrued to a company in respect of shares disposed of or deemed to be disposed of under section 22B(4) or paragraph 43A(4) to be –

- included in the company's income if the company held the shares as trading stock immediately before the disposal or deemed disposal under section 22B(4) (see 4.4);
- taken into account as part of proceeds from the disposal of the shares if the company held the shares as capital assets<sup>36</sup> immediately before the disposal; or
- taken into account as a capital gain if the company held the shares as capital assets<sup>37</sup> immediately before the deemed disposal under paragraph 43A(4) (see 4.4).

The amount of the extraordinary dividend must be included in income or taken into account as proceeds or a capital gain on the disposal or deemed disposal of the shares –

- in the year of assessment in which the shares are disposed of;
- in the year of assessment in which the shares are treated as having been disposed of under section 22B(4) or paragraph 43A(4) (see 4.4); or
- if the dividend is received or accrues after that year of assessment, in the year of assessment in which the dividend is received or accrues.

Section 22B(2) or paragraph 43A(2) will apply if the following requirements are met:

- A company holding shares in another company disposes of any of those shares.
- The shares are not disposed of under a deferral transaction.
- The company disposing of the shares held a qualifying interest in that other company at any time during the period of 18 months before the disposal of the shares. The qualifying interest requirement applies at any time during the 18 months preceding the disposal of the shares. A continuous holding of the qualifying interest is not required. Therefore, even if a company momentarily holds a qualifying interest in the other company, this requirement will be met. In determining the qualifying interest, the interests of connected persons in relation to the company disposing of the shares must be included.

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<sup>36</sup> The definition of "capital asset" in section 41 applies and means an "asset" as defined in paragraph 1 which does not constitute trading stock. Shares held as trading stock must be dealt with under section 22B(2) (see the preceding bullet point).

<sup>37</sup> The definition of "capital asset" in section 41 applies and means an "asset" as defined in paragraph 1 which does not constitute trading stock. Shares held as trading stock must be dealt with under section 22B(2) (see the preceding bullet point).

Section 22B(2) and paragraph 43A(2) are respectively subject to section 22B(3) and paragraph 43A(3) which, under specified circumstances, deal with the disposal of shares within 18 months after having acquired the shares under a deferral transaction, other than an unbundling transaction. If applicable, section 22B(3) and paragraph 43A(3) treat specified amounts as dividends received by the holder disposing of the shares or as an exempt dividend in respect of the shares disposed of (see 4.3) that must be taken into account, as appropriate, under section 22B(2) or paragraph 43A.

*The proviso to section 22B(2) and paragraph 43A(2)*

When a company disposes of shares that were previously treated as having been disposed of under section 22B(4) or paragraph 43A(4) by that company, the amount of any extraordinary dividend in respect of those shares must be included in income or taken into account as proceeds only *to the extent* that it has not previously been included in income or taken into account in respect of those shares under section 22B(2) or paragraph 43A(2) (see 4.4 and **Examples 22** and **23**).

The following is stated in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* on the interaction of the deemed disposal rule and the actual disposal rule:<sup>38</sup>

“In order to ensure that the deemed disposal rule and the actual disposal rule in respect of dividend stripping do not both apply in respect of the same dividend, it is provided that where a company disposes of a (sic) shares that have previously been treated as having been disposed of under the deemed disposal rule, any amount of an extraordinary dividend should only be treated as income or a capital gain to the extent that (sic) has not previously been treated as such.”

**Example 14 – Extraordinary dividend included in income or taken into account as proceeds on disposal of equity shares**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A held 50% of the equity shares in Company B. Company A disposed of these shares on 31 January year 3 for R5 million. At the beginning of the 18-month period before the disposal of the shares, the market value of the shares was R6 million.

Seventeen months before the disposal of the shares, Company A received a dividend of R1 million in respect of the shares.

Company A and Company B are residents and are not listed companies.

*Result:*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A disposed of shares it held in Company B.
- The shares were not disposed of under a deferral transaction (**Note 1**).

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<sup>38</sup> In paragraph 2.1.

- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it held at least 50% of Company B’s equity shares.
- The dividend of R1 million received by Company A is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received within 18 months before the disposal of the shares	1 000 000
<i>Less: 15% × R6 million [15% of the higher of market value of R6 million (beginning of the 18-month period) or R5 million (date of disposal)]</i>	<u>(900 000)</u>
Extraordinary dividend	<u>100 000</u>

If immediately before the disposal Company A held the shares as trading stock, it must include the extraordinary dividend of R100 000 in its income under section 22B(2) in its year of assessment ending on 31 March year 3.

Alternatively, if immediately before the disposal Company A held the shares as capital assets, it must take the extraordinary dividend of R100 000 into account as proceeds from the disposal of the shares under paragraph 43A(2) in its year of assessment ending on 31 March year 3.

The total amount to be included in Company A’s income or taken into account as proceeds in determining a capital gain or loss, as the case may be, is R5 100 000 [R5 million (proceeds) + R100 000 (extraordinary dividend)].

**Notes:**

1. If the shares were disposed of under a deferral transaction, section 22B and paragraph 43A would not apply.
2. Section 22B and paragraph 43A may also apply if Company A was a foreign company, provided the dividend of R1 million constituted an exempt dividend. The dividend would generally be exempt from normal tax under section 10(1)(k)(i). The dividend would generally be subject to dividends tax, unless, for example, it is not subject to dividends tax under a tax treaty. The disposal of shares by a foreign company is subject to CGT if the shares constitute an “interest in immovable property”, contemplated in paragraph 2(2). The proceeds from the disposal of shares that were held as trading stock by a foreign company, are generally included in gross income, if on the facts the proceeds are determined to be from a South African source.

### **Example 15 – Extraordinary dividend taken into account as proceeds on disposal of preference shares**

*Facts:*

Company A's year of assessment ends on 31 March.

Company A acquired 100 000 redeemable preference shares in Company B on 1 April year 1 at R1 a share and also acquired 10% of its equity shares on that date. Dividends of R18 000 were paid annually at the rate of 8% above the prime rate of interest on the preference shares. The preference shares were redeemable on 31 March year 6. The prime rate remained unchanged at 10% during the five-year period.

Company A and Company B are residents. Company A is not a listed company. Company B is a listed company.

The preference shares and equity shares were held as capital assets during the five-year period. The preference shares were redeemed on 31 March year 6 at R1 a share.

*Result:*

Paragraph 43A(2) applies, since the following requirements are met:

- Company A disposed of the preference shares in Company B that it held as capital assets immediately before the disposal.
- The shares were not disposed of under a deferral transaction (**Note**).
- Company A held a qualifying interest in Company B under paragraph (b) of the definition of "qualifying interest" in paragraph 43A(1), since it held at least 10% of the equity shares in Company B.
- The dividends of R90 000 (R18 000 × 5) received by Company A constitute an exempt dividend, since they are exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividends received (R18 000 × 5 years)	90 000
Less: Dividends calculated by applying an interest rate of 15% a year (consideration of R100 000 × 15% × 5 years)	<u>(75 000)</u>
Extraordinary dividend	<u>15 000</u>

The extraordinary dividend of R15 000 must be taken into account as part of proceeds on disposal of the shares in Company A's year of assessment ending on 31 March year 6 for purposes of calculating the capital gain or capital loss on disposal of the shares, since the preference shares were held as capital assets immediately before their disposal.

The total amount to be taken into account as proceeds in determining a capital gain or capital loss, as the case may be, is R115 000 [R100 000 (proceeds) + R15 000 (extraordinary dividend)].

**Note:**

If the shares were disposed of under a deferral transaction, paragraph 43A would not apply.

**Example 16 – Extraordinary dividend included in income or taken into account as proceeds on disposal of equity shares***Facts:*

Company A's year of assessment ends on 31 March.

Natural person A held 20% of the equity shares in resident Company A. Company A and Natural person A respectively held 45% and 5% of the equity shares and voting rights in non-resident Company B. Company A disposed of its holding of these shares on 31 January year 3 to a resident for R4 million. At the beginning of the 18-month period before the disposal, the market value of the shares was R8 million.

One month before the disposal of the shares, Company A received a foreign dividend of R3 million in respect of the shares.

Company A and Company B are not listed companies.

*Result:*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A disposed of shares it held in Company B.
- The shares were not disposed of under a deferral transaction (**Note 1**).
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1), since it held, together with Natural person A at least 50% (45% + 5%) of the equity shares and voting rights in Company B. Natural person A and Company A are connected persons in relation to each other under paragraphs (d)(iv) and (e) of the definition of "connected person" in section 1(1), since Natural person A held at least 20% of Company A's equity shares.
- The foreign dividend of R3 million received by Company A constitutes an exempt dividend. It is exempt from normal tax under section 10B(2)(a), because Company A held at least 10% of the equity shares and voting rights in Company B, and it is not subject to dividends tax (see bullet point below).
- The foreign dividend of R3 million is not subject to dividends tax under section 64E(1), since it was paid by a foreign company in respect of shares which did not constitute listed shares and therefore does not constitute a "dividend" as defined in section 64D.
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:	
	R
Dividend received within 18 months before the disposal of the shares	3 000 000
Less: 15% × R8 million [15% of the higher of market value of R8 million (beginning of the 18-month period) or R4 million (date of disposal)]	<u>(1 200 000)</u>
Extraordinary dividend	<u>1 800 000</u>
<p>In the year of assessment ending on 31 March year 3 the extraordinary dividend of R1 800 000 must, if the shares were held immediately before their disposal as –</p> <ul style="list-style-type: none"> <li>• trading stock, be included in Company A's income; or</li> <li>• capital assets, be taken into account as part of proceeds on disposal of the shares.</li> </ul> <p>The total amount to be included in Company A's income or taken into account as proceeds in determining a capital gain or loss, as the case may be, is R5 800 000 [R4 million (proceeds) + R1 800 000 (extraordinary dividend)] <b>(Note 2)</b>.</p> <p><b>Notes:</b></p> <ol style="list-style-type: none"> <li>1. If the shares were disposed of under a deferral transaction, section 22B and paragraph 43A would not apply.</li> <li>2. Company A is not entitled to the participation exemption in paragraph 64B,<sup>39</sup> since it disposed of the shares in Company B to a resident.</li> </ol>	

<p><b>Example 17 – Extraordinary dividend taken into account as proceeds on disposal of equity shares</b></p> <p><i>Facts:</i></p> <p>Company A's year of assessment ends on 31 March.</p> <p>Company A held 50% of the equity shares in Company B as capital assets which it acquired in year 1 at a cost of R600 000. During the year of assessment ending on 31 March year 7 the board of directors of Company B resolved to wind up the company and took the necessary steps to give effect to the resolution. The market value of the shares on the date of dissolution (30 April year 7) was RNil. At the beginning of the 18-month period, the market value of the shares was R1 million.</p> <p>On 1 April year 7 Company A received a dividend of R400 000 and a return of capital of R600 000 in consequence of the winding-up of the company.</p> <p>Company A and Company B are residents and are not listed companies.</p>
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<sup>39</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 64B.

*Result:*

Paragraph 43A(2) applies, since the following requirements are met:

- Company A disposed of the equity shares in Company B that it held as capital assets immediately before the disposal.
- The shares were not disposed of under a deferral transaction (**Note 1**).
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividend of R400 000 received by Company A is an exempt dividend as it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received in respect, by reason or in consequence of the deemed disposal of the shares ( <b>Note 2</b> )	400 000
Less: 15% × R1 million [15% of the higher of market value of R1 million (beginning of the 18-month period) or RNil on 30 April year 7 (date of deemed disposal) ( <b>Note 2</b> )]	<u>(150 000)</u>
Extraordinary dividend	<u>250 000</u>

The extraordinary dividend of R250 000 must be taken into account as part of proceeds on the deemed disposal of the shares, since the shares were held as capital assets. Since the dividend accrued on 1 April year 7, the extraordinary dividend of R250 000 must be taken into account as part of proceeds on the deemed disposal of the shares in Company A’s year of assessment ending on 31 March year 8.

Company A’s capital gain is determined as follows:

	R
Proceeds ( <b>Note 2</b> )	250 000
Less: Base cost	
Cost of acquisition of the shares	600 000
Less: Return of capital under paragraph 76B(2) ( <b>Note 3</b> )	<u>(600 000)</u>
Capital gain	<u>250 000</u>

**Notes:**

1. The transaction is not a deferral transaction, since it does not constitute a “liquidation distribution” as defined in section 47(1)(a) [Company A and Company B are not part of the same “group of companies” as defined in section 41(1)] and section 47 does not therefore apply. If the shares were disposed of under a deferral transaction, paragraph 43A would not apply.

2. Under paragraph 77(1)(a)<sup>40</sup> Company A is deemed to have disposed of the shares on date of dissolution of the company, namely, on 30 April year 7. At that time Company A had already disposed of all its assets by way of a distribution and hence there were no further proceeds in addition to the deemed proceeds under paragraph 43A(2). The total amount to be taken into account as proceeds in determining the capital gain is R250 000 [RNil (proceeds) + R250 000 (extraordinary dividend)].
3. When a return of capital is received by or accrues to a holder of a share in respect of that share on or after 1 April 2012 and before the disposal of that share, the holder of that share must reduce the expenditure (base cost) in respect of the share by the amount of the return of capital on the date of receipt or accrual.<sup>41</sup>

### **Example 18 – Extraordinary dividend taken into account as proceeds on disposal of equity shares**

#### *Facts:*

Company A's year of assessment ends on 31 March.

Company A held 70% of the equity shares in Company B as capital assets which it acquired in year 1 at a cost of R100 000.

On 1 April year 6 Company A received a cash dividend of R50 000 from Company B.

During the year of assessment ending on 31 March year 7 the board of directors of Company B resolved to wind up the company and took the necessary steps to give effect to the resolution. Company A and Company B elected under section 47(6)(b) that section 47 must not apply to the liquidation distribution.

The market value of the 70% shares held in Company B on the date of dissolution (30 April year 7) was RNil. At the beginning of the 18-month period, the market value of the shares was R1 million.

On 1 April year 7 Company A received a cash dividend of R300 000 and a dividend *in specie* of R100 000 in consequence of the winding-up of the company.

Company A and Company B are residents and are not listed companies.

#### *Result:*

Paragraph 43A(2) applies, since the following requirements are met:

- Company A disposed of the equity shares in Company B which it held as capital assets immediately before the disposal.
- The shares were disposed of under a liquidation transaction but Company A and Company B elected that section 47 must not apply (**Note 1**).

<sup>40</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 77(1)(a).

<sup>41</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 76B(2).



- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividends of R450 000 (R50 000 + R300 000 + R100 000) received by Company A constitute exempt dividends since they are exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividends of R450 000 received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Cash dividend received during the 18-month period preceding the deemed disposal of the shares	50 000
Cash dividend received in respect, by reason or in consequence of the deemed disposal of the shares <b>(Note 2)</b>	300 000
Dividend <i>in specie</i> received in respect, by reason or in consequence of the deemed disposal of the shares <b>(Note 3)</b>	100 000
Less: 15% × R1 million [15% of the higher of market value of R1 million (beginning of the 18-month period) or RNil on 30 April year 7 (date of deemed disposal) <b>(Note 2)</b> ]	<u>(150 000)</u>
Extraordinary dividend	<u>300 000</u>

The extraordinary dividend of R300 000 must be taken into account as part of proceeds on the deemed disposal of the shares, since the shares were held as capital assets. Since the deemed disposal was on 30 April year 7, the extraordinary dividend of R300 000 must be taken into account as part of proceeds on the deemed disposal of the shares in Company A's year of assessment ending on 31 March year 8.

Company A's capital gain is determined as follows:

	R
Proceeds <b>(Note 2)</b>	300 000
Less: Base cost	<u>(100 000)</u>
Capital gain	<u>200 000</u>

**Notes:**

1. The transaction is not a deferral transaction, although it qualified as a “liquidation distribution” as defined in section 47(1)(a), since Company A and Company B elected that section 47 must not apply. If Company A and Company B had not made that election and section 47 applied, paragraph 43A(2) would not have applied as the transaction would be a “deferral transaction”.
2. Under paragraph 77(1)(a)<sup>42</sup> Company A is deemed to have disposed of the shares on date of dissolution of the company, namely, on 30 April year 7. At that time Company A had already disposed of all its assets by way of a distribution and hence there were no further proceeds in addition to the deemed proceeds under paragraph 43A(2). The total amount to be taken into account as proceeds in determining the capital gain is R300 000 [RNil (proceeds) + R300 000 (extraordinary dividend)].

<sup>42</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 77(1)(a).

3. The dividend *in specie* of R100 000 is not excluded under the proviso to the definition of “extraordinary dividend” in paragraph 43A(1), since it was not distributed in terms of a deferral transaction (see **Note 1** above).

**Example 19 – Extraordinary dividend taken into account as proceeds on disposal of equity shares**

*Facts:*

Company A’s year of assessment ends on 31 March.

Company A held 50% of the equity shares in Company B as capital assets. The board of directors of Company B resolved to buy back Company A’s shares on 31 March year 3 for R9 million. The board of directors of Company B did not elect that any part of the consideration for the buy-back would be paid out of the company’s contributed tax capital.<sup>43</sup>

The market value of the shares held by Company A on 31 March year 3, as at the date of disposal, was R9 million, being the consideration paid by Company B to buy back its shares. At the beginning of the 18-month period before the share buy-back, the market value of the shares was R10 million.

Company A and Company B are residents and are not listed companies.

*Result:*

Paragraph 43A(2) applies, since the following requirements are met:

- Company A disposed of the equity shares in Company B that it held as capital assets immediately before the disposal.
- The shares were not disposed of under a deferral transaction (**Note**).
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The amount of R9 million which accrued in respect of the share buy-back is a “dividend” as defined in section 1(1) and section 64D. The dividend is an exempt dividend as it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

<sup>43</sup> Definition of “contributed tax capital” in section 1(1). See the *Comprehensive Guide to Dividends Tax* for commentary on the meaning of “contributed tax capital”.

The extraordinary dividend is calculated as follows:	
	R
Dividend received in consequence of the disposal of the shares	9 000 000
Less: 15% × R10 million [15% of the higher of market value of R10 million (beginning of the 18-month period) or R9 million (date of disposal)]	<u>(1 500 000)</u>
Extraordinary dividend	<u>7 500 000</u>
<p>The extraordinary dividend of R7,5 million must be taken into account as part of proceeds on the disposal of the shares in the year of assessment ending on 31 March year 3, since the shares were held as capital assets.</p> <p>The actual amount received by or accrued to Company A in respect of the share buy-back was R9 million, being the actual amount paid by Company B. This amount must, however, be reduced to RNil under paragraph 35(3)(a)<sup>44</sup> by the dividend of R9 million included in gross income under paragraph (k) of the definition of “gross income” in section 1(1).</p> <p>The total amount to be taken into account as proceeds in determining a capital gain or capital loss, as the case may be, is R7,5 million [RNil (proceeds) + R7,5 million (extraordinary dividend)].</p> <p><b>Note:</b></p> <p>If the shares were disposed of under a deferral transaction, paragraph 43A would not apply.</p>	

#### 4.3 Disposal of shares within 18 months after their acquisition under a deferral transaction, other than an unbundling transaction [section 22B(3) and paragraph 43A(3)]

Section 22B(3) and paragraph 43A(3) deal with the scenario in which a company disposes of shares under a transaction that is not a deferral transaction within a period of 18 months after having acquired those shares under a deferral transaction, other than an unbundling transaction.

The following is stated in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018* on the reason for the introduction of section 22B(3) and paragraph 43A(3):<sup>45</sup>

“[I]t is proposed that anti-avoidance rules dealing with dividend stripping should be triggered when the corporate re-organisation rules are abused by taxpayers that use the corporate re-organisation rules with the intention of subsequently disposing of their shares to unrelated purchasers outside of the realm of the re-organisation rules.”

Section 22B(3) and paragraph 43A(3) address two types of transaction in item (a) and (b), which are considered below.

<sup>44</sup> See the *Comprehensive Guide to Capital Gains Tax* for commentary on paragraph 35(3)(a).

<sup>45</sup> In paragraph 2.2.

*Transferee company disposing of reduced-value shares [section 22B(3)(a) and paragraph 43A(3)(a)]*

The anti-avoidance provisions in section 22B(3)(a) and paragraph 43A(3)(a) aim to prevent a person from extracting exempt dividends from a company, transferring the reduced value shares tax-free to another company under a deferral transaction, and using the latter company to dispose of them to a third party in order to avoid or reduce income tax that might otherwise have become payable had the initial holder of the shares disposed of them directly to the third party. Typically the initial holder of the shares that disposed of them under a deferral transaction would be a company but it could be any other person to whom an exempt dividend accrued or was received.

For example, section 22B(3)(a) or paragraph 43A(3)(a) may apply when Company B transfers shares in Company C to Company A under an asset-for-share transaction under section 42 after receiving an exempt dividend from Company C. Company A holds a qualifying interest in Company C and subsequently sells the reduced value shares in Company C to another person. Absent section 22B(3) or paragraph 43A(3), the exempt dividend received by Company B does not fall within the ambit of section 22B(2) or paragraph 43A(2), since the shares were disposed of to Company A under a deferral transaction. However, after applying section 22B(2) read with section 22B(3) or paragraph 43A(2) read with paragraph 43A(3), on disposal of the Company C shares Company A must include in income or take into account as proceeds the amount of the extraordinary dividend, the determination of which takes into account the exempt dividend received by Company B before the deferral transaction as well as any exempt dividends received by or accrued to Company A.

Section 22B(3)(a) and paragraph 43A(3)(a) apply under the following circumstances:

- A company must dispose of shares otherwise than under a deferral transaction. In other words, the provisions of sections 42 to 47 must not apply to the disposal of the shares.
- Those shares must have been acquired by the company under a deferral transaction, other than an unbundling transaction, during the 18-month period preceding the disposal. In other words, the provisions of sections 42, 43, 44, 45 or 47 must have applied to the acquisition of the shares.
- During the 18-month period preceding the disposal of the shares by the company, an exempt dividend in respect of those shares was received by or accrued to the person who disposed of the shares to the company under a deferral transaction (other than an unbundling transaction).
- The person who disposed of the shares and the company that acquired the shares under the deferral transaction were connected persons in relation to one another at any time during the 18-month period or immediately after that disposal.

For purposes of section 22B and paragraph 43A the exempt dividend referred to above is treated as a dividend received by or accrued to the company that disposed of the shares otherwise than under a deferral transaction in respect of the shares disposed of within the period during which that company held those shares. The amounts that are treated as an exempt dividend received by or accrued to a company under section 22B(3) or paragraph 43A(3) must be added to the amount of any exempt dividend actually received by or accrued to that company in respect of the shares disposed of. Further, to *the extent* that the exempt dividend constitutes an

extraordinary dividend, assuming the requirements of section 22B(2) or paragraph 43A(2) are met (see 4.2), it must be included in income under section 22B(2) or taken into account as part of proceeds under paragraph 43A(2) on disposal of the shares.

**Example 20 – Transferee company disposing of reduced-value shares – Paragraph 43A(3)(a)**

*Facts:*

Company A acquired 51% of the equity shares in Company C from Company B under an asset-for-share transaction under section 42 as capital assets. Section 42 applied to the transaction. Six months after acquisition of the shares Company A received a dividend of R100 000 in respect of the shares in Company C. Twelve months later but within 18 months after acquisition of the shares, Company A disposed of these shares for R5 million.

At the beginning of the 18-month period before the disposal of the shares by Company A, the market value of the shares disposed of was R6 million. Seventeen months before disposal of the shares by Company A, Company B received an exempt dividend of R1 million in respect of the Company C shares.

Company A, Company B and Company C are residents and are not listed companies. Company A and Company B form part of the same group of companies.

*Result:*

Paragraph 43A(3)(a) applies, since the following requirements are met:

- Company A disposed of shares it held in Company C under a transaction which was not a deferral transaction.
- The Company C shares were disposed of by Company A within a period of 18 months after being acquired under a deferral transaction, other than an unbundling transaction.
- Company B received an exempt dividend of R1 million in respect of the Company C shares that were disposed of to Company A, within 18 months before the disposal by Company A of these shares.
- Company B was a connected person in relation to Company A under paragraph (d)(i) of the definition of “connected person” in section 1(1) within the period of 18 months before the disposal of the Company C shares by Company A (**Note**).

Therefore, for purposes of paragraph 43A, the dividend of R1 million received by Company B in respect of the Company C shares is deemed to have been received by or accrued to Company A during the period it held the shares.

Paragraph 43A(2) applies, since the following requirements are met:

- Company A disposed of the equity shares in Company C that it held as capital assets immediately before the disposal under a transaction which did not constitute a deferral transaction.
- Company A held a qualifying interest in Company C under paragraph (a)(i) of the definition of “qualifying interest” in paragraph 43A(1), since it held at least 50% of the equity shares in Company C.
- The exempt dividend of R1 million received by Company B is deemed to be a dividend received by or accrued to Company A for purposes of paragraph 43A in respect of the Company C shares during the period that it held those shares (see above).
- The dividend of R1 million deemed to have been received by or accrued to Company A is an exempt dividend as it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- The dividend of R100 000 received by Company A is an exempt dividend as it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividends received or accrued or deemed to have been received by or accrued to Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received or accrued or deemed to have been received or accrued within 18 months before the disposal by Company A of the Company C shares (R1 million + R100 000)	1 100 000
Less: 15% × R6 million [15% of the higher of market value of R6 million (beginning of the 18-month period) or R5 million (date of disposal)]	<u>(900 000)</u>
Extraordinary dividend	<u>200 000</u>

The extraordinary dividend of R200 000 must be taken into account as part of proceeds on disposal of the Company C shares by Company A, in the year of assessment in which the shares were disposed of. The proceeds for purposes of calculating the capital gain or capital loss on disposal of the shares are R5 200 000 [(actual proceeds of R5 million) + (deemed proceeds of R200 000 under paragraph 43A(2), constituting the extraordinary dividend)].

**Note:**

Company A and Company B were connected persons in relation to each other, since they formed part of the same group of companies under paragraph (d)(i) of the definition of “connected person” in section 1(1).

*Transferor of “old shares” disposing of reduced-value “new shares” acquired under a deferral transaction [section 22B(3)(b) and paragraph 43A(3)(b)]*

The requirements of section 22B(3)(b) and paragraph 43A(3)(b) are as follows:

- A company must dispose of “new shares” otherwise than under a deferral transaction.
- The “new shares” must have been acquired by the company under a deferral transaction, other than an unbundling transaction, during the 18-month period preceding the disposal of the “new shares”.
- The “new shares” must have been acquired in return for or by virtue of the holding of “old shares” that were disposed of under that deferral transaction.
- An exempt dividend (other than in the form of “new shares”) was received by or accrued to the company in respect of the “old shares” within the 18-month period preceding the disposal of the “new shares”.

If the above requirements are met, the exempt dividend must for purposes of section 22B and paragraph 43A be treated as an amount that accrued to or was received by the company as an exempt dividend in respect of the “new shares”.

The anti-avoidance provision in section 22B(3)(b) and paragraph 43A(3)(b) is illustrated by the following example that includes an asset-for-share transaction under section 42. Company B receives an exempt dividend from Company C. Company B subsequently transfers the reduced-value “old shares” in Company C to Company A under an asset-for-share transaction under section 42 in exchange for “new shares” in Company A. The “new shares” in Company A are subsequently disposed of to another person. Absent section 22B(3)(b) or paragraph 43A(3)(b), the exempt dividend received by Company B on the “old shares” does not fall within the ambit of section 22B(2) or paragraph 43A(2), since the shares were disposed of to Company A under a deferral transaction. However, after applying section 22B(2) read with section 22B(3)(b) or paragraph 43A(2) read with paragraph 43A(3)(b), Company B must, on disposal of the “new shares” in Company A, include in income or treat as proceeds the amount of the extraordinary dividend, the determination of which takes into account the exempt dividend received by Company B on the “old shares” and any exempt dividends in respect of the Company A shares received by or accrued to Company B within the 18-month period before disposal.

**Example 21 – Transferor of “old shares” disposing of “new shares” acquired under a deferral transaction – Section 22B(3)(b)**

*Facts:*

Company B holds all the equity shares in Company C. On 15 January year 3 Company C paid a dividend of R1 million to Company B. This dividend was exempt from normal tax and dividends tax. On 31 January year 3 Company B incorporated Company A.

On 15 February year 3 Company B disposed of the Company C shares to Company A in return for the issue of all the equity shares in Company A in an asset-for-share transaction under section 42. Section 42 applied to the transaction. The Company A shares were held as trading stock. On 1 July year 4 Company B disposed of the Company A shares for R6 million.

Company A, Company B, and Company C are residents and are not listed companies. Company B's year of assessment ends on 31 March.

*Result:*

Section 22B(3)(b) applies, since the following requirements are met:

- Company B disposed of shares it held in Company A under a transaction that did not constitute a deferral transaction.
- The Company A shares were disposed of by Company B within a period of 18 months after acquiring those shares under a deferral transaction, other than an unbundling transaction. The Company A shares were acquired on 15 February year 3 and disposed of on 1 July year 4.
- The Company A shares were acquired in return for the Company C shares held by Company B before the asset-for-share transaction.
- Company B received an exempt dividend of R1 million in respect of the Company C shares within the 18-month period preceding the date of disposal of the Company A shares. The dividend is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).

Therefore, the dividend of R1 million received by Company B in respect of the Company C shares is deemed for purposes of section 22B to be an exempt dividend received by or accrued to Company B in respect of the Company A shares.

Section 22B(2) applies, since the following requirements are met:

- Company B disposed of shares it held in Company A under a transaction that did not constitute a deferral transaction.
- Company B held a qualifying interest in Company A under paragraph (a)(i) of the definition of "qualifying interest" in section 22B(1), since it held at least 50% of the equity shares in Company A.
- The exempt dividend of R1 million received by Company B in respect of the Company C shares is deemed to be an exempt dividend received by Company B for purposes of section 22B in respect of the Company A shares.
- A portion of the exempt dividend deemed to have been received by Company B in respect of the Company A shares is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received within 18 months before the disposal of the Company A shares	1 000 000
Less: 15% × R6 million [15% of the higher of market value of RNil (beginning of the 18-month period) or R6 million (date of disposal)]	<u>(900 000)</u>
Extraordinary dividend	<u>100 000</u>



The extraordinary dividend of R100 000 must be included in Company B's income in its year of assessment ending on 31 March year 5, namely, the year of assessment during which the Company A shares were disposed of. The total amount to be included in Company B's income on disposal of the Company A shares is R6 100 000 [(actual proceeds of R6 million) + (extraordinary dividend of R100 000 deemed to be received on the Company A shares)].

#### **4.4 Dilution of the effective interest in a target company's equity shares by issuing shares to another person [section 22B(4) and paragraph 43A(4)]**

Section 22B(4) and paragraph 43A(4) are deemed to have come into operation on 20 February 2019 and apply to equity shares held by a company in a target company if the effective interest held by the company in the equity shares of the target company is reduced on or after that date. In determining the effective interest held by a company in the equity shares of the target company and whether there has been a reduction, regard must be had to the number of equity shares held by the company in the target company as a proportion of the total number of equity shares issued by the target company. The possible reduction in voting rights and economic value is not relevant in determining if the effective interest held by the company in the equity shares of the target company has been reduced.

Section 22B(4) and paragraph 43A(4) deem a disposal of shares to occur for purposes of section 22B(2) and paragraph 43A(2) when a company's effective interest in a target company's equity shares is diluted through the issue of shares by the target company to another person.

Section 22B(4) and paragraph 43A(4) apply when –

- a company holds equity shares in another company (the target company);
- the target company issues “new shares” to a person other than that company; and
- the effective interest of that company in the equity shares of the target company is reduced by reason of the “new shares” issued by the target company.

Under the above circumstances the company holding equity shares in the target company must, for purposes of section 22B and paragraph 43A, be treated as having disposed, immediately after the “new shares” are issued, of a percentage of those equity shares. The percentage of shares deemed to be disposed of is equal to the percentage by which the effective interest of that company in the equity shares of the target company has been reduced by reason of the “new shares” issued by the target company.

The relevant deemed disposal of a percentage of the equity shares is a disposal for purposes of section 22B and paragraph 43A only. The deemed disposal is not treated as a disposal for the Act as a whole and consequently, notwithstanding a possible inclusion in income or as a capital gain under section 22B(2) or paragraph 43A(2), there is no disposal for purposes other than section 22B or paragraph 43A. Consequently, for example, there is no deduction for the cost or base cost of the shares deemed to have been disposed of under section 22B(4) or paragraph 43A(4) and the

capital gain cannot be disregarded under paragraph 64B even if the other requirements of that paragraph are met.<sup>46</sup>

Any “new shares” that are convertible to equity shares must for purposes of section 22B(4) and paragraph 43A(4) be treated as equity shares.<sup>47</sup>

*Meaning of “effective interest” in equity shares*

A company can hold an effective interest in the equity shares of another company directly, indirectly or in combination (directly and indirectly). For example, Company B has 100 issued equity shares and Company C has 200 issued equity shares. If Company A holds 60% of the equity shares in Company B (60 shares / 100 shares) and Company B holds 40% (80 shares / 200 shares) of the equity shares in Company C, Company A has a direct effective interest of 60% in Company B’s equity shares and Company B has a direct effective interest of 40% in Company C’s equity shares. Company A also has an indirect effective interest of 24% (60% × 40%) in Company C’s equity shares. If Company A also holds 5% of the equity shares in Company C directly, Company A’s effective interest in Company C’s equity shares would be 29% (indirect effective interest of 24% + direct effective interest of 5%).

A person’s effective interest in a company with different classes of issued equity shares, is determined by dividing the person’s total number of equity shares in the company by the total number of the company’s issued equity shares, multiplied by 100. For example, Company A holds 60 Class “A” and 40 Class “B” equity shares in Company C. Company B holds the remaining 40 Class “A” and 60 Class “B” equity shares. Company A’s effective interest in Company C’s equity shares is 50% [(60 Class “A” shares + 40 Class “B” shares) / (Company C’s total issued equity shares of 200) × 100]. Company B’s effective interest in Company C’s equity shares is 50% [(40 Class “A” shares + 60 Class “B” shares) / (Company C’s total issued equity shares of 200) × 100].

**Example 22 – Dilution of effective interest in a target company by issuing shares to another person – Section 22B(4) and paragraph 43A(4)**

*Facts:*

Company A’s year of assessment ends on the last day of February.

On 1 January year 1 Company A acquired all the equity shares (100 shares) in Company B. On 1 January year 1 the market value of these shares was R930 000.

On 30 June year 2 Company B paid a cash dividend of R900 000 to Company A. Immediately after payment of the dividend, Company B issued 25 shares to Company C. The market value of the 100 equity shares held by Company A on 30 June year 2 was R1 million after the payment of the dividend but before the issue of the 25 shares to Company C.

Company A disposed of all its shares held in Company B to Company D on 30 June year 3 for R5 million. On 1 January year 2 the market value of the 100 equity shares held by Company A was R3 million.

<sup>46</sup> See Binding Private Ruling 364 “Extraordinary Dividend Followed by the Dilution of Shareholder’s Interest” dated 26 May 2021.

<sup>47</sup> The proviso to section 22B(4) and paragraph 43A(4).

*Result:*

*Year of assessment ending on 28 February year 3*

*Application of section 22B(4) or paragraph 43A(4)*

Company A's effective interest in the equity shares of Company B decreased from 100% (100 shares) to 80% (100 shares / 125 shares × 100), by reason of Company B issuing 25 equity shares to Company C. This decrease in the effective interest of equity shares in the target company (Company B), triggers a deemed disposal, immediately after the issue of the 25 equity shares by Company B, for Company A under section 22B(4) or paragraph 43A(4), for purposes of section 22B or paragraph 43A.

*Application of section 22B(2) or paragraph 43A(2)*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A is deemed to have disposed of 20% of its equity shares in Company B for purposes of section 22B or paragraph 43A (see above). The deemed disposal is not a deferral transaction.
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of "qualifying interest" in section 22B(1) and paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividend of R900 000 received by Company A is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received or accrued within 18 months before the deemed disposal of the equity shares	900 000
<i>Less: 15% × R1 million [15% of the higher of market value of R930 000 (beginning of the 18-month period) or R1 million (date of deemed disposal)]</i>	<u>(150 000)</u>
Extraordinary dividend	<u>750 000</u>

Since Company A's effective interest in Company B decreased by 20%, Company A is treated for purposes of section 22B(2) or paragraph 43A(2) as having disposed of 20% of its equity shares in Company B. The portion of the extraordinary dividend attributable to the deemed disposal of 20% of the equity shares is R150 000 (R750 000 × 20%). This amount must be included in Company A's income under section 22B(2) or taken into account as a capital gain on the deemed disposal of the equity shares under paragraph 43A(2) in the year of assessment ending on 28 February year 3.

*Year of assessment ending on 28 February year 4*

*Application of section 22B(2) or paragraph 43A(2)*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A disposed of its equity shares in Company B under a transaction which did not constitute a deferral transaction.
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividend of R900 000 received by Company A is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received within 18 months before the disposal of the equity shares	900 000
Less: 15% × R5 million [15% of the higher of market value of R3 million (beginning of the 18-month period) or R5 million (date of disposal)]	<u>(750 000)</u>
Extraordinary dividend	<u>150 000</u>

*Application of the proviso to section 22B(2) and paragraph 43A(2)*

Under section 22B(4) or paragraph 43A(4) Company A was in the year of assessment ending on 28 February year 3, deemed to have disposed of 20% of its equity shares in Company B for purposes of section 22B or paragraph 43A. An extraordinary dividend of R150 000 (R750 000 × 20%) was taken into account under section 22B(2) or paragraph 43A(2) in respect of the deemed disposal of 20% of the shares (see above).

Under the proviso to section 22B(2) and paragraph 43A(2), an extraordinary dividend on the actual disposal of shares must be included in income or taken into account as proceeds only *to the extent* that it was not previously so included or taken into account.

*Portion of the extraordinary dividend relating to the deemed disposal of 20% of the equity shares*

RNil [R30 000 (20% of the extraordinary dividend of R150 000) – R150 000 (20% × R750 000) relating to and taken into account in respect of the equity shares deemed to be disposed of on 30 June year 2, negative therefore limited to RNil] must be included in income or taken into account as proceeds on disposal of 20% of the shares, since R30 000 was already included in income or taken into account in the year of assessment ending on 28 February year 3.

*Portion of the extraordinary dividend not relating to the deemed disposal of 20% of the equity shares*

The 80% portion of the extraordinary dividend, not relating to the 20% equity shares deemed to be disposed of previously, must be included in income or taken into account as proceeds in respect of the disposal of the equity shares, namely R120 000 (80% of the extraordinary dividend of R150 000), since no portion of this amount was previously taken into account in the deemed disposal of 20% on 30 June year 3.

In total R120 000 (RNil + R120 000) of the extraordinary dividend of R150 000 relating to the equity shares disposed of on 30 June year 3 must be included in income or taken into account as proceeds on disposal of the shares, since this amount was not already included in income or taken into account in relation to the deemed disposal of 20% of the equity shares on 30 June year 2.

**Example 23 – Dilution of effective interest in a target company by issuing shares to another person – Section 22B(4) and paragraph 43A(4)**

*Facts:*

Company A's year of assessment ends on the last day of February.

On 1 January year 1 Company A acquired all the equity shares (100 shares) in Company B. On 1 January year 1 the market value of these shares was R930 000.

On 30 June year 2 Company B paid a cash dividend of R900 000 to Company A. Immediately after payment of the dividend, Company B issued 25 shares to Company C. The market value of the 100 equity shares held by Company A on 30 June year 2 was R5,9 million after the payment of the dividend but before the issue of the 25 shares to Company C.

Company A disposed of all its shares held in Company B to Company D on 30 June year 3 for R5,5 million. On 1 January year 2 the market value of the 100 equity shares held by Company A was R4,5 million.

*Result:*

*Year of assessment ending on 28 February year 3*

*Application of section 22B(4) or paragraph 43A(4)*

Company A's effective interest in the equity shares of Company B decreased from 100% (100 shares) to 80% (100 shares / 125 shares × 100), by reason of Company B issuing 25 equity shares to Company C. This decrease in the effective interest of equity shares in the target company (Company B), triggers a deemed disposal, immediately after the issue of the 25 equity shares by Company B, for Company A under section 22B(4) or paragraph 43A(4), for purposes of section 22B or paragraph 43A.

*Application of section 22B(2) or paragraph 43A(2)*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A is deemed to have disposed of 20% of its equity shares in Company B for purposes of section 22B or paragraph 43A (see above). The deemed disposal is not a deferral transaction.
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividend of R900 000 received by Company A is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received or accrued within 18 months before the deemed disposal of the equity shares	900 000
Less: 15% × R5,9 million [15% of the higher of market value of R930 000 (beginning of the 18-month period) or R5,9 million (date of deemed disposal)]	<u>(885 000)</u>
Extraordinary dividend	<u>15 000</u>

Since Company A's effective interest in Company B decreased by 20%, Company A is treated for purposes of section 22B(2) or paragraph 43A(2) as having disposed of 20% of its equity shares in Company B. The portion of the extraordinary dividend attributable to the deemed disposal of 20% of the equity shares is R3 000 (R15 000 × 20%). This amount must be included in Company A's income under section 22B(2) or taken into account as a capital gain on the deemed disposal of the shares under paragraph 43A(2) in the year of assessment ending on 28 February year 3.

*Year of assessment ending on 28 February year 4**Application of section 22B(2) or paragraph 43A(2)*

Section 22B(2) or paragraph 43A(2) applies, since the requirements of these provisions are met:

- Company A disposed of its equity shares in Company B under a transaction which did not constitute a deferral transaction.
- Company A held a qualifying interest in Company B under paragraph (a)(i) of the definition of “qualifying interest” in section 22B(1) and paragraph 43A(1), since it held at least 50% of the equity shares in Company B.
- The dividend of R900 000 received by Company A is an exempt dividend, since it is exempt from normal tax under section 10(1)(k)(i) and dividends tax under section 64F(1)(a).
- A portion of the exempt dividend received by Company A is an extraordinary dividend.

The extraordinary dividend is calculated as follows:

	R
Dividend received within 18 months before the disposal of the equity shares	900 000
Less: 15% × R5,5 million [15% of the higher of market value of R4,5 million (beginning of the 18-month period) or R5,5 million (date of disposal)]	<u>(825 000)</u>
Extraordinary dividend	<u>75 000</u>

*Application of the proviso to section 22B(2) and paragraph 43A(2)*

Under section 22B(4) or paragraph 43A(4) Company A was in the year of assessment ending on 28 February year 3, deemed to have disposed of 20% of its equity shares in Company B for purposes of section 22B or paragraph 43A. An extraordinary dividend of R3 000 (R15 000 × 20%) was taken into account under section 22B(2) or paragraph 43A(2) in respect of this deemed disposal of shares (see above).

Under the proviso to section 22B(2) and paragraph 43A(2), an extraordinary dividend on the actual disposal of shares must be included in income or taken into account as proceeds only *to the extent* that it was not previously so included or taken into account.

*Portion of the extraordinary dividend relating to the deemed disposal of 20% of the equity shares*

Only R12 000 [R15 000 (20% of the extraordinary dividend of R75 000) – R3 000 (20% × R15 000) relating to and taken into account in respect of the equity shares deemed to be disposed of on 30 June year 2] must be included in income or taken into account as proceeds in respect of the disposal of 20% of the equity shares, since R3 000 was already included in income or taken into account in the year of assessment ending on 28 February year 3.

*Portion of the extraordinary dividend not relating to the deemed disposal of 20% of the equity shares*

The 80% portion of the extraordinary dividend, not relating to the 20% equity shares deemed to be disposed of previously, must be included in income or taken into account as proceeds in respect of the disposal of 80% of the equity shares, namely R60 000 (80% of the extraordinary dividend of R75 000), since no portion of this amount was previously taken into account in the deemed disposal of 20% of the equity shares on 30 June year 3.

In total R72 000 (R12 000 + R60 000) of the extraordinary dividend of R75 000 relating to the equity shares disposed of on 30 June year 3 must be included in income or taken into account as proceeds on disposal of the shares, since this amount was not already included in income or taken into account in relation to the deemed disposal of 20% of the shares on 30 June year 2.

## 5. Conclusion

Section 22B and paragraph 43A are anti-avoidance provisions aimed at “dividend-stripping” when a shareholder reduces the value of a shareholding through extracting exempt dividends so that, upon the subsequent disposal, the taxable disposal proceeds are lower than would have been the case if all the reserves had still been retained in the company. These two provisions apply only to companies.

Section 22B(2) and paragraph 43A(2) respectively provide for the amount of an exempt dividend, *to the extent* that it is an extraordinary dividend, received by or accrued to a company in respect of the disposal or deemed disposal of shares under section 22B(4) or paragraph 43A(4) to be –

- included in the company’s income if the company held the shares as trading stock immediately before the disposal or deemed disposal under section 22B(4);
- taken into account as part of proceeds on the disposal of the shares if the company held the shares as capital assets immediately before the disposal; or
- taken into account as a capital gain if the company held the shares as capital assets immediately before the deemed disposal under paragraph 43A(4).

The amount of the extraordinary dividend must be included in income or taken into account as proceeds on disposal of the shares –

- in the year of assessment in which those shares are disposed of or deemed to be disposed of; or
- if the dividend is received or accrues after that year of assessment, in the year of assessment in which the dividend is received or accrues.

Section 22B(2) or paragraph 43A(2) will apply if the following requirements are met:

- A company disposes of shares in another company under a transaction that does not constitute a deferral transaction.
- The company disposing of shares in another company must hold a qualifying interest in that company at any time during the period of 18 months before the disposal of the shares.

Section 22B(3) and paragraph 43A(3) deal with the consequences when a company disposes of shares within 18 months after having acquired those shares under a deferral transaction, other than an unbundling transaction.

Section 22B(4) and paragraph 43A(4) deem a disposal of shares to occur for purposes of section 22B(2) and paragraph 43A(2) when a company’s effective interest in a target company’s equity shares is reduced through the issue of “new shares” by the target company to another person. Under these circumstances the company holding equity shares in the target company before the issue of the “new shares” must, for purposes of section 22B and paragraph 43A only, be treated as having disposed, immediately after the “new shares” were issued, of a percentage of those equity shares.



**Annexure – The law****Section 22B**

**22B. Dividends treated as income on disposal of certain shares.**—(1) For the purposes of this section—

“**deferral transaction**” means a transaction in respect of which the provisions of PART III of this Chapter were applied;

“**exempt dividend**” means any dividend or foreign dividend to the extent that the dividend or foreign dividend is—

- (a) not subject to tax under Part VIII of Chapter II; and
- (b) exempt from normal tax in terms of section 10(1)(k)(i) or section 10B(2)(a) or (b);

“**extraordinary dividend**” means, in relation to—

- (a) a preference share, so much of the amount of any dividend received or accrued in respect of that share as exceeds the amount that would have accrued in respect of that share had that amount been determined with reference to the consideration for which that share was issued by applying an interest rate of 15 per cent per annum for the period in respect of which that dividend was received or accrued;
- (b) any other share, so much of the amount of any dividend received or accrued:
  - (i) within a period of 18 months prior to the disposal of that share; or
  - (ii) in respect, by reason or in consequence of that disposal,  
as exceeds 15 per cent of the higher of the market value of that share as at the beginning of the period of 18 months and as at the date of disposal of that share:

Provided that a dividend *in specie* that was distributed in terms of a deferral transaction must not be taken into account to the extent to which that distribution was made in terms of an unbundling transaction as defined in section 46(1)(a) or a liquidation distribution as defined in section 47(1)(a);

“**preference share**” means a preference share as defined in section 8EA(1); and

“**qualifying interest**” means an interest held by a company in another company, whether alone or together with any connected persons in relation to that company, that constitutes—

- (a) if that other company is not a listed company, at least—
  - (i) 50 per cent of the equity shares or voting rights in that other company; or
  - (ii) 20 per cent of the equity shares or voting rights in that other company if no other person (whether alone or together with any connected person in relation to that person) holds the majority of the equity shares or voting rights in that other company; or
- (b) if that other company is a listed company, at least 10 per cent of the equity shares or voting rights in that other company.

(2) Subject to subsection (3), where a company holds shares in another company and disposes of any of those shares in terms of a transaction that is not a deferral transaction and that company held a qualifying interest in that other company at any time during the period of 18 months prior to that disposal, the amount of any exempt dividend received by or that accrued to that company in respect of the shares disposed of must—

- (a) to the extent that the exempt dividend constitutes an extraordinary dividend; and
- (b) if that company immediately before that disposal held the shares disposed of as trading stock,

be included in the income of that company in the year of assessment in which those shares are disposed of or, where that dividend is received or accrues after that year of assessment, the year of assessment in which that dividend is received or accrues: Provided that where a company disposes of shares that are treated as having been disposed of previously by that company in terms of subsection (4), the amount of any extraordinary dividend in respect of those shares must be included in the income of that company only to the extent to which it has not previously been included in the income of that company in terms of this subsection.

(3) Where a company holds shares in another company and disposes of any of those shares in terms of a transaction that is not a deferral transaction within a period of 18 months after having acquired those shares in terms of a deferral transaction, other than an unbundling transaction and—

- (a) within a period of 18 months prior to the disposal of those shares by that company an exempt dividend in respect of those shares accrued to or was received by a person that—
  - (i) disposed of those shares in terms of a deferral transaction; and
  - (ii) was a connected person in relation to that company at any time within that period, that dividend must for purposes of this section be treated as a dividend that accrued to or was received by that company in respect of those shares within the period during which that company held those shares; and
- (b) if that company acquired those shares (hereinafter referred to as ‘new shares’) in terms of that deferral transaction in return for or by virtue of the holding, by that company, of other shares (hereinafter referred to as ‘old shares’) that were disposed of in terms of that deferral transaction and an exempt dividend in respect of the old shares, other than a dividend consisting of new shares, accrued to or was received by that company within a period of 18 months prior to the disposal by that company of the new shares, that dividend must for purposes of this section be treated as an amount that accrued to or was received by that company as an exempt dividend in respect of the new shares.

(4) Where a company holds equity shares in another company (hereinafter referred to as the “target company”) and—

- (a) the target company issues shares (hereinafter referred to as the “new shares”) to a person other than that company; and
- (b) the effective interest of that company in the equity shares of the target company is reduced by reason of the new shares issued by the target company,

that company must for purposes of this section be treated as having disposed, immediately after the new shares were issued, of a percentage of those equity shares that is equal to the percentage by which the effective interest of that company in the equity shares of the target company has been reduced by reason of the new shares issued by the target company: Provided that any new shares that are convertible to equity shares must for purposes of this subsection be treated as equity shares.

#### Paragraph 43A

**43A. Dividends treated as proceeds on disposal of certain shares.**—(1) For the purposes of this paragraph—

“**deferral transaction**” means a transaction in respect of which the provisions of PART III of Chapter II were applied;

“**exempt dividend**” means any dividend or foreign dividend to the extent that the dividend or foreign dividend is—

- (a) not subject to tax under Part VIII of Chapter II; and
- (b) exempt from normal tax in terms of section 10(1)(k)(i) or section 10B(2)(a) or (b);

**“extraordinary dividend”**, in relation to—

- (a) a preference share, means so much of the amount of any dividend received or accrued in respect of that share as exceeds the amount that would have accrued in respect of that share had it been determined with reference to the consideration for which that share was issued by applying an interest rate of 15 per cent per annum for the period in respect of which that dividend was received or accrued;
- (b) any other share, means so much of the amount of any dividend received or accrued—
  - (i) within a period of 18 months prior to the disposal of that share; or
  - (ii) in respect, by reason or in consequence of that disposal,
 as exceeds 15 per cent of the higher of the market value of that share as at the beginning of the period of 18 months and as at the date of disposal of that share:

Provided that a dividend in specie that was distributed in terms of a deferral transaction must not be taken into account to the extent to which that distribution was made in terms of an unbundling transaction as defined in section 46(1)(a) or a liquidation distribution as defined in section 47(1)(a);

**“preference share”** means a preference share as defined in section 8EA(1); and

**“qualifying interest”** means an interest held by a company in another company, whether alone or together with any connected persons in relation to that company, that constitutes—

- (a) if that other company is not a listed company, at least—
  - (i) 50 per cent of the equity shares or voting rights in that other company; or
  - (ii) 20 per cent of the equity shares or voting rights in that other company if no other person (whether alone or together with any connected person in relation to that person) holds the majority of the equity shares or voting rights in that other company; or
- (b) if that other company is a listed company, at least 10 per cent of the equity shares or voting rights in that other company.

(2) Subject to subparagraph (3), where a company holds shares in another company and disposes of any of those shares in terms of a transaction that is not a deferral transaction and that company held a qualifying interest in that other company at any time during the period of 18 months prior to that disposal, the amount of any exempt dividend received by or that accrued to that company in respect of the shares disposed of must—

- (a) to the extent that the exempt dividend constitutes an extraordinary dividend; and
- (b) if that company immediately before that disposal held the shares disposed of as a capital asset (as defined in section 41),

be taken into account as part of the proceeds from the disposal of those shares or, if those shares are treated as having been disposed of in terms of subparagraph (4), as a capital gain in respect of those shares, in the year of assessment in which those shares are disposed of or are treated as having been disposed of or, where that dividend is received or accrues after that year of assessment, the year of assessment in which that dividend is received or accrues: Provided that where a company disposes of shares that are treated as having been disposed of previously by that company in terms of subparagraph (4), the amount of any extraordinary dividend in respect of those shares must be included in the proceeds from that disposal only to the extent to which it has not previously been taken into account in respect of those shares in terms of this subparagraph.

(3) Where a company holds shares in another company and disposes of any of those shares in terms of a transaction that is not a deferral transaction within a period of 18 months after having acquired those shares in terms of a deferral transaction, other than an unbundling transaction and—

(a) within a period of 18 months prior to the disposal of those shares by that company an exempt dividend in respect of those shares accrued to or was received by a person that—

(i) disposed of those shares in terms of a deferral transaction; and

(ii) was a connected person in relation to that company at any time within that period or immediately after that disposal,

that dividend must for purposes of this paragraph be treated as a dividend that accrued to or was received by that company in respect of those shares within the period during which that company held those shares; and

(b) if that company acquired those shares (hereinafter referred to as “new shares”) in terms of that deferral transaction in return for or by virtue of the holding, by that company, of other shares (hereinafter referred to as “old shares”) that were disposed of in terms of that deferral transaction and an exempt dividend in respect of the old shares, other than a dividend consisting of new shares, accrued to or was received by that company within a period of 18 months prior to the disposal of the new shares, that dividend must for purposes of this paragraph be treated as an amount that accrued to or was received by that company as an exempt dividend in respect of the new shares.

(4) Where a company holds equity shares in another company (hereinafter referred to as the “target company”) and—

(a) the target company issues shares (hereinafter referred to as the “new shares”) to a person other than that company; and

(b) the effective interest of that company in the equity shares of the target company is reduced by reason of the new shares issued by the target company,

that company must for purposes of this paragraph be treated as having disposed, immediately after the new shares were issued, of a percentage of those equity shares that is equal to the percentage by which the effective interest of that company in the equity shares of the target company has been reduced by reason of the new shares issued by the target company: Provided that any new shares that are convertible to equity shares must for purposes of this subparagraph be treated as equity shares.