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THE IMPACT OF THE NEW DIVIDEND WITHHOLDING TAX ON REGULATED INVESTMENT INTERMEDIARIES

Thesis in partial fulfilment of the requirements for the degree of

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ABSTRACT

The introduction of the proposed new Dividends Tax will have a significant impact on financial institutions such as Collective Investment Schemes, Linked Investment Service Providers and Long-term Insurers. The reason for this is that South African listed companies declaring local dividends will not necessarily have all the details of and know the identity of their shareholders. These financial institutions may be regarded as regulated intermediaries in terms of the new Dividends Tax legislation and therefore may have the responsibility of withholding the Dividends Tax from dividends received on behalf of their clients, who may in most cases be the beneficial owners of the underlying equity shares.

The motivating factor for the research is the fact that there does not appear to be any guidance on the impact of the new Dividends Tax on financial institutions, since the Dividends Tax is new legislation. The research problem addressed in this thesis is how the systems and processes of a financial institution will be affected by the implementation of the new Dividends Tax.

The research took the form of a case study designed to investigate the impact of the Dividends Tax on the financial institution at which the researcher is employed. The data required for the research was collected by means of a study of the relevant legislation enacted in connection

with the topic, journal articles in financial/tax journals, as well as articles published in the media. The systems and processes presently in place, as well as the changes to these systems that will be needed to accommodate the new dividend tax were ascertained by means of in-depth interviews with relevant staff at the financial institution. In addition, the researcher also applied her personal knowledge of the business of the financial institution at which she works to the problem.

As a result of the research it was determined that a Collective Investment Scheme, Linked Investment Service Provider and Long-Term Insurer will all be regarded as regulated intermediaries for the purposes of the new dividend withholding tax. This means that these financial institutions will be required to withhold Dividends Tax from dividends paid to their clients and pay this Dividends Tax so withheld to SARS.

Furthermore, the findings of the research confirmed that the new Dividends Tax will have a significant impact on the client services department in areas such as notifying clients, training of client service staff, handling of declaration of exemption forms received from clients, amending client statements and tax certificates (to cater for the new Dividends Tax). In addition to this, it was ascertained that significant systems development will be required by these financial institutions in order to comply with the new Dividends Tax legislation. This would include the development of data input fields to enable users to capture the relevant information required and development of the system to enable it to flag local dividends received to which the Dividends Tax applies. The system would also need to cater for Secondary Tax on Companies credits as well as foreign tax rebates. The system should also

be able to calculate the amount of Dividends Tax to withhold per dividend received by a client, as well as be able to handle the payment of the Dividends Tax to SARS and the refund to clients of Dividends Tax over deducted. It is essential that systems are able to flag the correct date of payment of the dividend so that the Dividends Tax can be paid over timeously to SARS in order to avoid interest and penalties being levied. To summarise, the new Dividends Tax has a significant impact on these financial institutions in areas such as client services, administration and system development.

Keywords:

- Dividend Withholding Tax
- Dividends Tax
- Financial institutions
- Regulated Intermediaries
- Declaration of Exemption
- Secondary Tax on Companies Credits
- Payment and recovery of Dividends Tax
- Refund of Dividends Tax
- Rebate in respect of foreign taxes on dividends
- Collective Investment Schemes
- Linked Investment Service Providers
- Long-term Insurers
- Systems Development

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CHAPTER 1:
INTRODUCTION

1.1 CONTEXT

According to the South African Revenue Services (SARS) Explanatory Memorandum on the Taxation Laws Amendment Bill 2009, paragraph 3.3:

> Secondary Tax on Companies (“STC”) is a tax that is levied with reference to the amount of dividends “declared” by a company reduced by dividends “accrued” to that company. The liability for STC [Secondary Tax on Companies] falls on the company distributing the dividend (as opposed to the shareholder receiving the dividend).

Secondary Tax on Companies is due to be replaced by a new tax on dividends (“Dividends Tax”) declared by companies and is to be levied at shareholder level. Secondary Tax on Companies is therefore a tax levied at the company level whereas the new dividend tax is a tax levied at the shareholder level on all dividends declared by South African resident companies. The new Dividends Tax will be levied at a rate of 10 percent.

In terms of the current Secondary Tax on Companies legislation, section 64B of the Income Tax Act 58 of 1962 (“the Act”) provides for the levy and the recovery of the Secondary Tax on Companies. Section 64B(2) is the actual taxing provision which provides that Secondary Tax on Companies is calculated at the rate of 10 percent of the net amount of any dividend declared by a company, provided that the company is a South African Resident.

The term ‗dividend' is comprehensively defined in section 1 of the Act. The introductory paragraph of the dividend definition reads as follows:

> dividend means any amount distributed by a company (not being an institution to which section 10(1)(d) applies) to its shareholders, and in this definition the expression ―amount distributed" includes . . .

Under the current Secondary Tax on Companies legislation, a dividend has to be declared, or deemed to be declared before Secondary Tax on Companies can arise. The term ―declared" is defined in section 64B(1) of the Act as follows:

> **'**declared**'**, in relation to any dividend (including a dividend in specie), means the approval of the payment or distribution thereof by the directors of the company or by some other person under authority conferred by the memorandum and articles of association of the company or, in the case of the liquidation of the company, by the liquidator thereof;

Section 64B(7) deals with the date of payment of Secondary Tax on Companies. Payment of the Secondary Tax on Companies must be made by the company that declared the dividend. Payment must be made by the last day of the month following the month in which the dividend declared accrues to the shareholders.

The new dividend withholding tax has been written into the Act and is contained in the new sections 64D to 64L. Section 64E contains the legislation relating to the levying of the new Dividends Tax and reads as follows:

> (1) There must be levied for the benefit of the National Revenue Fund a tax, to be known as the Dividends Tax, calculated at the rate of 10 per cent of the amount of any dividend paid by a company that is a resident.
>
> (2) For the purposes of this Part, the date on which the dividend is paid is deemed to be the date on which it accrues to a shareholder.

Section 64G deals with circumstances under which the company declaring the dividend is responsible to withhold the Dividends Tax and pay it over to SARS, whereas section 64H deals with circumstances in which a regulated intermediary has the responsibility to withhold the Dividends Tax and pay it over to SARS.

The payment and recovery of the new Dividends Tax is dealt with in section 64K of the Act. Like Secondary Tax on Companies, the Dividends Tax needs to be paid over to SARS by the last day of the month following the month during which the dividend is paid by the company that declared the dividend. However, the responsibility for the payment of the Dividends Tax to SARS rests either with the company that declared the dividend or a regulated intermediary.

The SARS Explanatory Memorandum on the Taxation Laws Amendment Bill 2009 (paragraph‘s 3.3 and 3.4) goes on to explain as follows:

> The person entitled to the benefit from the dividend will be the party ultimately liable for the tax (subject to withholding solely for collection purposes) . . .
>
> The revised withholding mechanism is twofold. Depending on the facts, withholding may be required either:
>
> - by the companies declaring and paying dividends, or
> - by regulated intermediaries in respect of dividends declared by other companies.
>
> Regulated intermediaries are mostly involved in respect of dividends arising from listed shares because regulated intermediaries are typically the only parties who are aware who the registered shareholders of listed companies are (especially in the case of uncertificated shares). However, regulated intermediaries may also hold listed paper shares. Regulated intermediaries include Central Securities Depository Participants, Brokers (i.e. authorised users or approved nominees), Collective Investment Schemes in securities and Linked Investment Services Providers.
>
> A company declaring and paying a dividend or the regulated intermediary will generally be liable to withhold Dividends Tax at a rate of 10 per cent of the dividend paid.

> The amount so withheld must be paid to SARS by the last day of the month following the month in which that dividend was paid. [emphasis added]

The question of who should bear the ultimate withholding obligation in the case of intermediary entities is therefore of interest, particularly in the case of Collective Investment Schemes, Linked Investment Service Providers and Long Term Insurers.

Jordaan (2009: par. 4) discusses this ultimate withholding obligation and states as follows:

> The mechanism enacted in the legislation places a withholding obligation on all companies that declare dividends as well as on various "intermediaries" that pay dividends. The term "intermediaries" is then defined to include regulated and unregulated intermediaries. Included in the list of regulated intermediaries is any Collective Investment Scheme as defined in the Collective Investment Schemes Control Act No. 45 of 2002.

As can be seen from the above, the withholding obligation is a critical consideration in the Dividends Tax mechanism. Any company declaring a dividend or any intermediate entity which physically pays dividends to the ultimate beneficial owner thereof (such as, a trust, Collective Investment Scheme or Central Securities Depositary Participant) could potentially have a withholding obligation. These entities should take note of their statutory withholding obligations and any specific requirements which need to be met in order to avail themselves of any of the exemptions afforded by the legislation.

The introduction of the proposed new Dividends Tax will therefore have a significant impact on financial institutions such as Collective Investment Schemes, Asset Managers, Multi-Managers, Linked Investment Service Providers and Long-Term Insurers (hereafter referred to as “financial institutions”). The reason for this is that South African listed companies declaring local dividends will not have all the details of and know who their shareholders are. Therefore, these financial institutions may be regarded as regulated intermediaries in terms of the new Dividends Tax and therefore may have the responsibility of withholding the tax from dividends received by their clients who, in most cases, would be the beneficial owners of the underlying equity shares.

In an article, van der Vuyver (2009: page unknown) states that:

> The CIS [Collective Investment Scheme] will have to withhold and pay the new dividend tax over to SARS. This will require excellent record keeping with regards to the legal form and tax residence of the investors in the CIS [Collective Investment Scheme] and whether the companies paying the dividends are tax resident in South Africa or not.

The motivating factor for the present research is the fact that there does not appear to be any certainty on the impact of the new Dividends Tax on financial institutions, since this Dividends Tax is new legislation that has been promulgated, but to be applied from a date yet to be determined. The researcher, who is employed by a financial institution which will be effected by the implementation of the new Dividends Tax, has therefore been inspired to research this legislation and determine the impact of the new dividend tax on financial institutions as set out above. Preliminary investigations indicated a number of areas of concern. These include the need for accurate shareholder data, including accurate tax numbers and declarations by those shareholders who are exempt from the withholding tax, the reconciliations and returns to be submitted to SARS, statements and tax certificates to be provided to clients, the refund process where amounts were withheld in error and the need to be provided with gross dividend information, rather than net dividend information, by fund managers. This will necessitate changes to accounting systems and may have an impact on the administration fee charged to clients.

The results of this research therefore add to the body of knowledge by providing financial institutions with guidance on their obligation to withhold the Dividends Tax and pay it over to SARS and by providing financial institutions with information on the nature and extent of the impact of the new Dividends Tax in areas of the business such as client services, administration, computer systems and record keeping. This will assist financial institutions in preparing adequately for the introduction of the new Dividends Tax in order to avoid penalties and interest being levied on them by SARS as a result of failure to comply with the new Dividends Tax legislation.

Sub-sections 64K(3) to 64K(7) of the Act set out the penalties and interest provisions in respect of the new Dividends Tax as follows:

> . . .
> (3) Any person that fails to withhold tax as required in terms of this Part or withholds tax but fails to pay the tax to the Commissioner as required by this Part is liable for the payment of the tax as if it were tax due by that person in terms of this Act, unless the tax is paid by any other person.
> . . .
> (5) If the Commissioner is satisfied that any Dividends Tax has not been paid in full, he or she may estimate the unpaid amount and issue to the person concerned a notice of assessment of the unpaid amount.
> (6) If a person fails to pay any Dividends Tax within the required period, interest must be paid by that person on the balance of the tax outstanding at the prescribed rate reckoned from the end of that period.
> (7) The provisions of this Act relating to the assessment and recovery of tax and administrative penalties in the event of default or omission apply, with the changes required by the context, in respect of the Dividends Tax.
> (8) Every person that controls or is regularly involved in the management of the overall financial affairs of an unlisted company as defined in section 41 or an unregulated intermediary that is liable to withhold tax and that is a shareholder or director of that company is personally liable for the Dividends Tax, additional tax, penalty or interest for which that company or intermediary is liable.

As can be seen from the above and bearing in mind that the main business of a financial institution involves the receipt of local dividends, non-compliance with the new Dividends Tax can have severe financial implications.

In his article, Jordaan (2009: par. 2) states as follows:

> Although the mechanism for the new Dividends Tax was promulgated in the Revenue Laws Amendment Act No. 60 of 2008, it is not yet effective. The new legislation takes effect on a date to be determined by the Minister by notice in the Gazette, which date must be at least three

months after the date of the notice. By all indications the effective date will be sometime in the latter part of 2010.

Therefore SARS can give only three months notice of the date of implementation of the Dividends Tax. With SARS being entitled to give only three months notice of the implementation of this Dividends Tax, it is important that financial institutions understand the impact of the Dividends Tax and to start preparing for the implementation.

1.2 GOAL OF THE RESEARCH

The goal of this research was to ascertain the dividend withholding tax obligations in respect of financial institutions, particularly Collective Investment Schemes, Linked Investment Service Providers and Long-Term Insurers. Furthermore, once a dividend withholding tax obligation was established, the impact that this obligation had on such financial institutions in areas such as (but not limited to) client services, administration, computer systems and record keeping, needed to be analysed.

1.3 METHODS, PROCEDURES AND TECHNIQUES FOLLOWED

The research took the form of a case study designed to investigate the impact of the Dividends Tax on the financial institution at which the researcher is employed. As the research problem had its origin in a practical work-related situation, a case study was an appropriate method to gain a detailed in-depth understanding of the problem in a real life situation (Leedy & Ormrod: 2005). The research was therefore qualitative in its orientation.

The data required for the research was collected by means of a study of the relevant legislation enacted in connection with the topic, journal articles in financial/tax journals, as well as articles published in the media. The systems and processes presently in place, as well as the changes to these systems that will be needed to accommodate the new dividend tax was ascertained by means of in-depth interviews with relevant staff at the financial institution. In

addition, the researcher also applied her personal knowledge of the business of the financial institution at which she works to the problem.

The validity and reliability of the data collected was ensured by conducting interviews with numerous members of staff at the financial institution to ensure correct information was obtained and that the bias associated with the view of only one or two individuals was eliminated. The data so collected was analysed and interpreted and the existing systems compared with those required to comply with the new legislation, in order to make recommendations for new systems or modifications to existing systems.

In terms of dealing with the ethical issues such as the anonymity of participants, the confidentiality regarding the specific organization, permission to carry out the investigation and publish it by way of a thesis, etc. the following actions were taken by the researcher:

- the participants remained anonymous and their responses were treated with confidentiality and were used solely for the purposes of this thesis; the participants were also informed about the research and the methods that were applied to protect them;
- the specific organization also remained anonymous and was not referred to by name in the thesis; and
- permission was obtained from the Financial Director of the specific division within the organization on which the research was focused, to carry out the investigation and publish it way of a thesis.

The results of the case study cannot be generalized to a setting beyond the setting in which the case study is carried out (Leedy & Ormrod: 2005), but as most financial institutions face similar problems, the results will have wider applicability.

1.4 LIMITATIONS OF SCOPE, IMPORTANT ASSUMPTIONS AND IMPORTANT DEFINITIONS

The research and results of this thesis were based on all enacted Dividend Tax legislation up to and including 31 August 2010.

The new term —contributed tax capital" and the provisions of the new Value-extraction tax were not included in the scope of this thesis.

Important definitions have been dealt with as and when they arise in the chapters that follow.

Due to confidentiality restrictions such ensuring the anonymity of the interviewees and the financial institution at which the researcher is employed, this may have lead to some generalization and broad explanations in this thesis which may be seen, to some degree as a restriction of the scope of the thesis.

The research has been focused on the impact of the new Dividends Tax on Collective Investment Schemes, Linked Investment Service Providers and Long-term Insurers since the Dividends Tax will have more of a significant impact on these financial institutions as compared to asset managers and multi-managers.

1.5 BRIEF OVERVIEW OF CHAPTERS

Chapter 2 provides readers of this thesis with a background to the existing Secondary Tax on Companies legislation, reasons for the replacement of Secondary Tax on Companies with the new dividend withholding tax, reasons for the delay in the Dividends Tax becoming effective as well as an in depth understanding of the new Dividends Tax legislation, which will adequately equip readers to understand the impact of the new Dividends Tax on financial institutions.

Chapter 3 deals with determining whether a Collective Investment Scheme, Linked Investment Service Provider and Long-Term Insurer meet the definition of a regulated intermediary and

then sets out the responsibilities of such regulated intermediaries. This chapter also explains the nature of the entities on which this research was based.

Chapter 4 then deals with the main reason for this thesis - to understand the impact of the new Dividends Tax on financial institutions. In this chapter the systems and processes presently in place, as well as the changes to these systems that will be needed to accommodate the new Dividends Tax are discussed. Furthermore, other issues such as the impact of the new Dividends Tax on areas such as client services, the declaration forms to be completed by clients, the refund process as well Secondary Tax on Companies credits are dealt with. The research information in this chapter was obtained by means of in-depth interviews with relevant staff at the financial institution at which the researcher works as well as the researcher‘s personal knowledge of the business of the financial institution. The outcomes of these interviews are dealt with in this chapter. This chapter also sets out the next steps financial institutions need to take in order to prepare for the implementation of the new Dividends Tax.

Chapter 5, the final chapter, concludes the thesis and summarizes the main findings and recommendations flowing from the research.

CHAPTER 2:
SECONDARY TAX ON COMPANIES VERSUS THE DIVIDEND WITHHOLDING TAX

2.1 INTRODUCTION

The goal of this research is to ascertain the dividend withholding tax obligations in respect of financial institutions, specifically in respect of Collective Investment Schemes, Linked Investment Service Providers and Long-Term Insurers. Furthermore, once a dividend withholding tax obligation is established, the impact of the new Dividends Tax on these financial institutions is to be analysed.

This chapter deals briefly with the existing Secondary Tax on Companies legislation and the reason for the replacement of Secondary Tax on Companies with the new dividend withholding tax (“Dividends Tax”) in order to set the scene and provide context to the research. It then discusses the reasons for the delay in the implementation of the Dividends Tax. This will enable financial institutions to understand the time period that they have to implement the new Dividends Tax in their organization.

In order for a financial institution to determine whether it meets the definition of a regulated intermediary it is essential that an understanding of the Dividends Tax legislation is first obtained and analysed. Once a withholding tax obligation is established, the financial institution then needs to comply with the rest of the applicable provisions of the Dividends Tax legislation. Therefore, this chapter also sets out the Dividends Tax legislation and its importance in respect of the research problem.

2.2 SECONDARY TAX ON COMPANIES

Secondary Tax on Companies was introduced in 1993 and had as its principal objective the encouragement of companies to adopt a modest dividend distribution policy. Secondary Tax on Companies is a tax on the company and is not a withholding tax on dividends. The current rate of Secondary Tax on Companies is 10% (Huxham & Haupt: 2010: 262). Therefore, since Secondary Tax on Companies is a tax levied at company level, a company wishing to declare a dividend therefore has to take the Secondary Tax on Companies into account in determining the amount that it is able to declare as a dividend. For example, in the case where the company has retained income of R110 000, it is only able to declare a dividend of R100 000 since the remaining retained profits of R10 000 (R100 000 x 10%) is payable to SARS as Secondary Tax on Companies. It would not be able to declare a dividend of R110 000 since there would then be insufficient retained income available to cover the Secondary Tax on Companies liability.

Section 64B of the Act provides for the levy and recovery of the Secondary Tax on Companies on companies whereas section 64C of the Act deals with deemed dividends. The research has not examined or dealt with section 64C of the Act since it is considered to be outside of the scope of this research for the following reason. The research focuses on the impact of the new Dividends Tax on regulated investment intermediaries. It does not deal with the situation where a deemed dividend arises, but rather considers the impact on regulated intermediaries once a dividend is declared, i.e. once a dividend arises which falls into the Dividends Tax legislation.

Before section 64B of the Act is discussed, it is important to consider the definition of a dividend which is set out in section 1 of the Act.

> **dividend** means any amount distributed by a company (not being an institution to which section 10(1)(d) applies) to its shareholders, and in this definition the expression “amount distributed” includes . . .

Section 64B(2) of the Act provides that Secondary Tax on Companies is calculated at the rate of 10% of the net amount of any dividend declared by any company, provided that the company is a South African resident. A South African resident company is one that is incorporated, established or formed or has its place of effective management in South Africa.

As can be seen from the above, the definitions of ‗declared‘ and ‗net amount‘ are important terms which need to be examined in more detail.

The definition of ‗declared‘ is contained in section 64B(1) of the Act. A dividend has to be declared or deemed to be declared (in the case of deemed dividends) before Secondary Tax on Companies can arise.

> **‘declared’**, in relation to any dividend (including a dividend in specie), means the approval of the payment or distribution thereof by the directors of the company or by some other person under authority conferred by the memorandum and articles of association of the company or, in the case of the liquidation of the company, by the liquidator thereof;

Section 64B of the Act provides for two types of dividend declaration, as follows:

- dividends that are formally declared by a company; and
- dividends that arise as a result of the distribution of cash or assets which constitute a dividend in terms of the dividend definition; in this case such dividend is deemed to be declared on the date that the shareholder becomes entitled to the cash or the assets.

Secondary Tax on Companies therefore arises when a dividend is declared or is deemed to have been declared by a company. Should the distribution be made to shareholders out of ―untainted” share capital or share premium, the distribution is not a dividend as defined in section 1 of the Act, and therefore no Secondary Tax on Companies is payable. ―Untainted” basically means that the share capital and share premium do not contain any capitalized capital or revenue profits, in other words they consist of pure share capital or share premium.

In terms of section 64B(2) of the Act, Secondary Tax on Companies is calculated on the ‗net amount‘ of any dividend declared or deemed dividend declared. The ‗net amount‘ is defined in s64B(3) as the amount by which a dividend declared

- exceeds the sum of the dividends which have accrued to the company
- during the dividend cycle in which the dividend was declared.

In the case where the dividends which accrued to the company during the dividend cycle exceed the amount of the dividend declared, the excess is carried forward to the next dividend cycle where they are treated as dividends accruing during that dividend cycle. Dividends which accrue to a company are called ―Secondary Tax on Companies credits" in terms of the new dividend withholding tax legislation which will be discussed below.

Section 64B(5) of the Act contains exemptions from Secondary Tax on Companies on the certain dividends declared such as:

- dividends declared by a company whose receipts and accruals are exempt from normal tax in terms of section 10 of the Act e.g. Government or any provincial administrations, municipalities and public benefit organizations or recreational clubs approved as such by the Commissioner;
- any dividend declared by a fixed property company contemplated in section 11(s) which is deductible under section 11(s);
- so much of any dividend declared in the course of or in anticipation of the liquidation, winding up, deregistration or final termination of the corporate existence of the company that represents:
  - a distribution of profits derived during any year of assessment which ended not later than 31 March 1993; or
  - a distribution of profits of a capital nature;
- a dividend declared by a company which has ceased mining for gold if the dividend represents a distribution of an amount received from the disposal of gold mining assets;

- dividends declared by a controlled group company to other companies in the group if it elects that the dividend is to be free of Secondary Tax on Companies, and the provisions of section 64B(5)(f) are satisfied;
- the transfer of a primary residence from a company or close corporation to the shareholders or members is free of Secondary Tax on Companies if it is free of ‗capital gains tax' in terms of paragraph 51 of the Eighth Schedule; and
- the declaration of a dividend by a company or close corporation which is a registered micro business (in terms of the 6th Schedule to the Act) is free of Secondary Tax on Companies to the extent that it does not exceed R 200 000 during the micro business's year of assessment.

Section 64B(7) of the Act deals with the date of payment of Secondary Tax on Companies. Payment of the Secondary Tax on Companies must be made by the company which declared the dividend. Payment must be made by the last day of the month following the month in which the dividend declared accrues to the shareholders. An IT56 form is the relevant form to be completed and submitted to SARS together with the payment of the Secondary Tax on Companies.

2.3 REASON FOR THE REPLACEMENT OF SECONDARY TAX ON COMPANIES WITH THE NEW DIVIDEND WITHHOLDING TAX

The over-arching purpose of the proposed change is to align the system of taxing distributions by companies with international practice since the Secondary Tax on Companies regime, which forms part of the South African tax system, is not common to the majority of tax systems in other countries (Dachs: 2010).

The possible consequence of this proposed change is that the move from Secondary Tax on Companies to the withholding tax is likely to increase foreign investment within South Africa.

In an article, Mazansky (2009: page unknown) states that:

> South Africa has just fallen in line with international tax trends with the introduction of a Dividends Tax to replace the Secondary Tax on Companies (STC), a move likely to make South Africa a more attractive foreign investment destination.
>
> However, while this may simplify tax from the perspective of foreign investors, and go some way to attracting capital flows, for local companies it introduces a number of complexities.

Brislon (2009: page unknown) comments on the reason for the change as follows:

> Many multinationals stand to benefit when the 10% dividend tax eventually replaces the current system of Secondary Tax on Companies (STC). This may be sufficient incentive for foreign investors to delay dividend declarations until such time as the new laws come into force.
>
> The impact of the new laws on an economy like South Africa may be as much a blessing as a curse and tax is but one of many factors which would affect a decision of this complexity.
>
> It has multiple impacts. STC [Secondary Tax on Companies] was little understood in the international community as South Africa is one of only three countries in the world to have such a system. It raises question marks in foreign jurisdictions and does not always allow companies to qualify for credit in the parent company's home jurisdiction. As the dividend tax is aligned with international norms, it is far more likely to encourage the free flow of funds.
>
> South Africa may experience a surge in dividend payments once the dividend tax comes into force due to lower rates and greater certainty relating to credits. Conversely, a system aligned with international norms is likely to attract capital inflows.

2.4 NEW DIVIDEND WITHHOLDING TAX

In February 2007 during his 2008 Budget Speech, the Minister of Finance announced the intended replacement of Secondary Tax on Companies with a new Dividends Tax (Dachs:2010). The intention to introduce the new Dividends Tax became final on 8 January 2009, when the proposals were promulgated into law. The intended implementation date of the new Dividends Tax was expected to be late 2010 but at this stage it appears that 2011 is more likely.

2.4.1 Reason for the Delay in the New Dividends Tax being Effective

Although the new Dividends Tax has now been promulgated into the Act, it is only to be become effective on a date to be announced by the Minister of Finance. Initial announcements were that the new Dividends Tax would become effective in the latter part of 2010. However, at this stage it appears that the effective date could be sometime in 2011. The main reason for the delay in the Dividends Tax becoming effective is the fact that all the Double Taxation Agreements (DTAs) (or referred to as Double Taxation Treaties) between South Africa and other countries in the world need to be renegotiated. The reason for the Double Taxation Agreements having to be renegotiated is that the article in the Double Taxation Agreements dealing with dividends needs to be amended to cater for the fact that South Africa now has a dividend withholding tax regime. Furthermore, the percentage withholding for residents of each country needs to be negotiated and included in the Double Taxation Agreements. The renegotiation of Double Taxation Agreements is a time consuming process, with the relevant parties in South Africa having to travel abroad to renegotiate these Double Taxation Agreements and obtain the necessary approval and signatures.

Further reasons for the delay in the new Dividends Tax becoming effective are as follows (Lai King: 2009):

- The introduction of the new Dividends Tax is being done in a novel fashion, necessitated by the complexity of the changeover from the current Secondary Tax on Companies regime. The new rules are law to the extent that the new sections have been promulgated but will only be effective in the medium term. The 2009 Tax

Amendments contain the latest refinements and amendments to the new Dividends Tax rules with significant changes to the previously published legislation. The new Dividends Tax is therefore a work in progress with further refinements and changes to be made to the legislation before it becomes effective;

- Lengthy consultation is required for this significant reform of our tax system; and
- The many practical problems of the new tax need to identified, especially those during the transition period, for example the phasing out of the Secondary Tax on Companies credits over a five year period, the new administrative obligations to be imposed on taxpayers must be understood and prepared for, double tax treaties (―DTT's") have to be renegotiated to cater for the new withholding tax and both the legislators and taxpayers require a prolonged period to internalise and understand all the effects of the new Dividends Tax.

The Dividends Tax also contains many hidden administrative problems as follows (Lai King: 2009):

- Placing the burden of collection and administration of the tax upon the company declaring the dividend and its regulated intermediaries;
- The new tax is primarily contained in eleven new sections of the Act, being sections 64D to 64N, but also affects other areas of the Act such as the taxation of foreign dividends (current income tax and Secondary Tax on Companies credit treatment). Furthermore, new anti-avoidance provisions will accompany the new Dividends Tax legislation; and
- Accounting, reporting and internal control systems need to change to cater for the new Dividends Tax. Companies therefore need to consult with their IT and accounting departments. However, before preparations can begin a full understanding of the Dividends Tax and how it will affect different corporate entities, like long term insurers and collective investment schemes needs to be acquired.

Furthermore, the introduction of the new Dividends Tax will result in SARS collecting less tax as compared to the tax collected in terms of the Secondary Tax on Companies regime. The reason for this is that in terms of the new Dividends Tax there are a number of taxpayers that

are exempt from the Dividends Tax, resulting in less Dividends Tax being withheld and paid over to SARS as compared to the case where Secondary Tax on Companies would have been applicable. Examples of such taxpayers which were previously subject to Secondary Tax on Companies but not subject to the new Dividends Tax include pension funds, pension preservation funds, provident funds, provident preservation funds, retirement annuity funds and benefit funds. With the current budget pressures at SARS it is likely that they would want to retain the Secondary Tax on Companies regime for as long as they can.

Therefore, although there has been a delay in the new Dividends Tax becoming effective, taxpayers should use this additional time to prepare for the implementation of this Dividends Tax, taking into account the complexities of this tax and the administration involved.

2.4.2 The Legislation

The new Dividends Tax has been included in the Act in sections 64D to 64N. Although the Dividends Tax has been written into the Act, it will only become effective on a date to be determined by the Minister of Finance by notice in the Government Gazette.

The new Dividends Tax sections in the Act can be summarized as follows:

- Section 64D – Dividends Tax Definitions
- Section 64E – Levy of Dividends Tax
- Section 64F – Exemptions
- Section 64G – Withholding tax
- Section 64H – Shares held by regulated intermediaries
- Section 64I – Insurers
- Section 64J – Secondary Tax on Companies Credits
- Section 64K – Payment and recovery of tax
- Sections 64L and 64M – Refund of Dividends Tax
- Section 64N – Rebate in respect of foreign taxes on dividends

These sections will now be examined in more detail below but first the new dividend definition needs to be considered.

2.4.2.1 Dividend Definition

The definition of a ‗dividend' was a complex and lengthy definition and is to be simplified when the new Dividends Tax comes into effect.

The new dividend definition in section 1 of the Act reads as follows:

> '**dividend'** means any amount transferred or applied by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company, whether—
>
> *(a)* by way of a distribution; or
>
> *(b)* as consideration for the acquisition of any share in that company, but does not include any amount so transferred or applied by the company to the extent that the amount so transferred or applied—
>
> > (i) results in a reduction of contributed tax capital;
> >
> > (ii) constitutes shares in that company;
> >
> > (iii) constitutes an acquisition by a company of its own securities as contemplated in paragraph 5.67 of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with the requirements prescribed by paragraphs 5.67 to 5.84 of section 5 of the JSE Limited Listings Requirements; or
> >
> > (iv) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph *(e)*(ii) of the definition of ‗company'.

The definition of what constitutes a dividend is essential since this is the starting point for the new Dividends Tax – without a dividend, no Dividends Tax would be required to be withheld and paid over to SARS.

2.4.2.2 Section 64D – Dividends Tax Definitions

The following terms are defined in section 64D of the Act:

> **'beneficial owner'** means the person entitled to the benefit of the dividend attaching to a share;
>
> **'dividend'** means any dividend as defined in section 1 that is—
>
> *(a)* paid by a company that is a resident; or
>
> *(b)* paid by a company that is not a resident if the share in respect of which that dividend is paid is a listed share;
>
> **'dividend cycle'** means a dividend cycle as defined in section 64B;
>
> **'effective date'** means the date on which this Part comes into operation;
>
> **'regulated intermediary'** means any—
>
> *(a)* central securities depository participant contemplated in section 34 of the Securities Services Act, 2004 (Act No. 36 of 2004);
>
> *(b)* authorised user as defined in section 1 of the Securities Services Act, 2004;
>
> *(c)* approved nominee contemplated in section 36(2) of the Securities Services Act, 2004;
>
> *(d)* nominee that holds investments on behalf of clients as contemplated in section 9.1 of Chapter 1 and section 8 of Chapter II of the Codes of Conduct for Administrative and Discretionary Financial Service Providers, 2003 (Board Notice 79 of 2003) published in *Government Gazette* No. 25299 of 8 August 2003;
>
> *(e)* portfolio of a collective investment scheme in securities; or
>
> *(f)* transfer secretary that is a person other than a natural person and that has been approved by the Commissioner subject to such conditions and requirements as may be determined by the Commissioner.
>
> **'STC credit'** means an amount determined in terms of section 64J(2).

It is essential that the above definitions are read and understood since they play an important role in the new Dividends Tax. The definition of a dividend is important since this would trigger whether a distribution by a company falls within the new Dividends Tax legislation, i.e. meets the definition of a dividend. Furthermore, it is important that financial institutions understand whether they meet the definition of a regulated intermediary in order to ascertain whether they have a withholding obligation in the sense that they may be required to withhold the Dividends Tax and pay it over to SARS. Failure to understand this would result in heavy penalties and interest being levied by SARS (see section 64K below). In addition to this, the definition of

Secondary Tax on Companies credits is required in order to understand the amount of the dividend that would be subject to the Dividends Tax.

2.4.2.3 Section 64E – Levy of Dividends Tax

Section 64E of the Act deals with the rate at which the Dividends Taax is to be levied as well as the payment date of the dividend. Section 64E states as follows:

> **64E.** (1) There must be levied for the benefit of the National Revenue Fund a tax, to be known as the dividends tax, calculated at the rate of 10 per cent of the amount of any dividend paid by any company, other than a headquarter company.
>
> (2) For the purposes of this Part, a dividend is deemed to be paid on the date on which it accrues to a shareholder.
>
> (3) Where a dividend paid by a company consists of a distribution of an asset *in specie*, the amount of that dividend must, for the purposes of subsection (1)—
>
> *(a)* where the company is a listed company, be deemed to be equal to the market value of the asset on the date of approval of the distribution by—
>
> > (i) the directors of the company; or
> >
> > (ii) some other person or body of persons with comparable authority under a law, rule or regulation to which that company is subject; or
>
> *(b)* where the company is a company other than a listed company, be deemed to be equal to the market value of the asset on the date of distribution as defined in paragraph 74 of the Eighth Schedule.

As can be seen from the above, the Dividends Tax is levied at rate of ten percent of the amount of any dividends paid by any company. Dividends Tax is triggered on the date of payment of the dividend which differs from the Secondary Tax on Companies regime where Secondary Tax on Companies arises on the date of declaration of the dividend. In terms of section 64E(2) of the Act, the date on which the dividend accrues to the shareholder is deemed to be the date of payment to a shareholder.

The date of accrual of a dividend is essential for a regulated intermediary since it has the responsibility of deducting the dividend tax and paying it over to SARS by the end of the month

following the month in which the dividend is paid (or accrues to the shareholder/beneficial owner). The date of accrual and rate of Dividends Tax would need to be catered for on a regulated investment intermediary's administration system in order to ensure accurate and timely payment of the Dividends Tax over to SARS.

2.4.2.4 Section 64F – Exemptions

Section 64F of the Act includes the following exemptions from the Dividends Tax:

> **64F.** A dividend is exempt from the Dividends Tax if the beneficial owner is—
>
> *(a)* a company which is a resident;
>
> *(b)* the Government, a provincial administration or a municipality;
>
> *(c)* a public benefit organisation approved by the Commissioner in terms of section 30(3);
>
> *(d)* a trust contemplated in section 37A; or
>
> *(e)* an institution, board or body contemplated in section 10(1)*(c*A*);*
>
> *(f)* a fund contemplated in section 10(1)*(d)*(i) or (ii);
>
> *(g)* a person contemplated in section 10(1)*(t)*;
>
> *(h)* a shareholder in a registered micro business, as defined in the Sixth Schedule, paying that dividend, to the extent that the aggregate amount of dividends paid by that registered micro business to its shareholders during the year of assessment in which that dividend is paid does not exceed the amount of R200 000;
>
> (i) a shareholder that is a natural person and the dividend constitutes a disposal of an interest in a residence as contemplated in paragraph 51A of the Eighth Schedule; or
>
> *(i*A*)* the dividend constitutes a disposal of an interest in a residence as contemplated in paragraph 51A of the Eighth Schedule; or
>
> (j) a person that is not a resident and the dividend is a dividend contemplated in paragraph *(b)* of the definition of 'dividend' in section 64D.

A regulated investment intermediary such as a Long-Term Insurer or a Collective Investment Scheme has numerous different types of clients. Clients of regulated investment intermediaries may be individuals, trusts, companies, etc, each of which may either be drawn into the Dividends Tax net or qualify for exemption in respect of the new Dividends Tax. Regulated

investment intermediaries therefore need have information on the nature of their clients and their particulars in order to classify their clients as taxable or exempt in terms of the Dividends Tax legislation. The systems of regulated investment intermediaries would then only calculate and withhold Dividends Tax in respect of clients who are taxable. Furthermore, the rate at which Dividends Tax is deducted from a dividend received from a company on behalf of the beneficial owner of a share will differ in the case of, for example, non-residents where the rate at which the Dividends Tax is withheld should be at a reduced rate in terms of the relevant Double Taxation Agreement between South Africa and their country of residence.

2.4.2.5 Section 64G – Withholding Tax

The actual responsibility for the withholding of the Dividends Tax is dealt with in section 64G of the Act. Section 64G states as follows:

> **64G.** (1) Subject to subsections (2) and (3), a company that declares and pays a dividend must withhold dividends tax from that payment at a rate of 10 per cent of the amount of that dividend.
>
> (2) A company must not withhold any dividends tax from the payment of a dividend contemplated in subsection (1) if—
>
> *(a)* the person to whom the payment is made has—
>
> (i) by a date determined by the company; or
>
> (ii) if the company did not determine a date as contemplated in subparagraph (i), by the date of payment of the dividend, submitted to the company—
>
> *(aa)* a declaration by the beneficial owner in such form as may be prescribed by the Commissioner that the dividend is exempt from the dividends tax in terms of section 64F; and
>
> *(bb)* a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the company in writing should the beneficial owner cease to be the beneficial owner;
>
> *(b)* the beneficial owner forms part of the same group of companies, as defined in section 41, as the company that paid the dividend; or
>
> *(c)* the payment is made to a regulated intermediary.

(3) A company must withhold dividends tax from the payment of a dividend contemplated in subsection (1) at a reduced rate if the person to whom the payment is made has—

(a) by a date determined by the company; or

(b) if the company did not determine a date as contemplated in paragraph *(a)*, by the date of payment of the dividend, submitted to the company—

(i) a declaration by the beneficial owner in such form as may be prescribed by the Commissioner that the dividend is subject to that reduced rate as a result of the application of an agreement for the avoidance of double taxation; and

(ii) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the company in writing should the beneficial owner cease to be the beneficial owner.''.

Huxham and Haupt (2010: 378) summarize the withholding tax requirements as follows:

Although the Dividends Tax is a tax borne by the shareholder, it is the responsibility of the company paying the dividend to withhold the tax at a rate of 10% of the dividend.

There are some exceptions to this requirement, i.e. –

- No tax needs to be withheld where the person to whom the payment is made has submitted a written declaration to the company (from the beneficial owner and in such form as prescribed by SARS) that the dividend is exempt from the Dividends Tax. The declaration must be submitted to the company by the date it sets. If it sets no date, the declaration must be submitted by the date of payment of the dividend. In other words, a dividend paid to a South African company is only exempt from the Dividends Tax if the declaration is made.
- No tax needs to be withheld where the beneficial owner forms part of the same group of companies as the company paying the dividend. The term ‗group' is defined in section 41 of the Income Tax Act (read with section 1). Basically, there has to be a 70% or more holding in the subsidiary company, either by the shareholder or by other companies in the group. The relevance of this provision is that it is not necessary for the group company to submit a written declaration that it is exempt from the tax.
- No tax needs to be withheld if payment is to a regulated intermediary.

If the dividend is subject to a tax of less than 10% (because of a double tax agreement which South Africa has with the country in which the shareholder is resident), then the shareholder has to submit a form (as prescribed by the Commissioner for SARS) to the company stating what the reduced tax should be.

Section 64G applies to the withholding responsibilities of companies and not regulated intermediaries. Since this research is focusing on the impact of the new Dividends Tax on regulated investment intermediaries, this section of the Act will not be discussed.

2.4.2.6 Section 64H – Shares Held by Regulated Intermediaries

According to Huxham and Haupt (2010: 379):

> An intermediary holds a share on behalf of another person. Intermediaries may be regulated (such as a central securities depository participant, a collective investment scheme, a long-term insurer, or approved users and nominees under the Securities Services Act) or unregulated. The rules in s64H apply to regulated intermediaries.

Section 64H of the Act is set out below:

> **64H.** (1) Subject to subsections (2) and (3), a regulated intermediary that pays a dividend that was declared by any other person must withhold dividends tax from that payment at a rate of 10 per cent of the amount of that dividend.
>
> (2) A regulated intermediary must not withhold any dividends tax from the payment of a dividend contemplated in subsection (1) if—
>
> *(a)* the person to whom the payment is made has—
>
> (i) by a date determined by the regulated intermediary; or
>
> (ii) if the regulated intermediary did not determine a date as contemplated in subparagraph (i), by the date of payment of the dividend, submitted to the regulated intermediary—
>
> *(aa)* a declaration by the beneficial owner in such form as may be prescribed by the Commissioner that the dividend is exempt from the dividends tax in terms of section 64F; and

(bb) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the regulated intermediary in writing should the beneficial owner cease to be the beneficial owner; or

(b) the payment is made to another regulated intermediary.

(3) A regulated intermediary must withhold dividends tax from the payment of a dividend contemplated in subsection (1) at a reduced rate if the person to whom the payment is made has—

(a) by a date determined by the regulated intermediary; or

(b) if the regulated intermediary did not determine a date as contemplated in paragraph *(a)*, by the date of payment of the dividend, submitted to the regulated intermediary—

(i) a declaration by the beneficial owner in such form as may be prescribed by the Commissioner that the dividend is subject to that reduced rate as a result of the application of an agreement for the avoidance of double taxation; and

(ii) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the regulated intermediary in writing should the beneficial owner cease to be the beneficial owner.

Regulated investment intermediaries who are in the possession of information on who the beneficial owners of the underlying equity investments are, will need to withhold the Dividends Tax and pay this over to SARS in respect of dividends received on behalf of the beneficial owners. However, should the regulated investment intermediary pay the dividend to another regulated investment intermediary, it will have no obligation to withhold the tax. A regulated investment intermediary will also have no responsibility to withhold Dividends Tax where a client completes a written declaration stating that dividends received by it are exempt from the Dividends Tax.

When the intermediary receives a dividend, it is paid on to the beneficial owner. The intermediary has to withhold the 10% Dividends Tax, unless –

- The beneficial owner has given the intermediary a written declaration that it is exempt from the Dividends Tax (by the relevant dates).
- The intermediary is passing the dividend on to another regulated intermediary (because then the responsibility for withholding the tax falls on the other regulated intermediary).

If the dividend is payable to a non-resident and the Dividends Tax has to be levied at less than 10% (due to the requirements of a double tax agreement), the intermediary must have the form prescribed by SARS on file from the person to whom payment is made, authorizing the lower tax rate.

2.4.2.7 Section 64I – Insurers

Section 64I of the Act deals with dividends paid to long-term insurers which are taxed in terms of section 29A of the Act:

> **64I.** If a dividend is paid to an insurer as defined in section 29A, the insurer must be deemed to be a regulated intermediary and the dividend must, to the extent that the dividend is allocated to a fund contemplated in section 29A(4)*(b)*, be deemed to be paid to a natural person that is a resident by the regulated intermediary on the date that the dividend is paid to the insurer.

Huxham and Haupt (2010: 380) explain section 64I of the Act as follows:

> If a dividend is paid to a South African insurance company no tax must be withheld, because the insurer is treated as a regulated intermediary. No declaration needs to be made by the insurer.
>
> If all or part is allocated to the individual policyholder fund, the insurer must withhold the 10% dividend tax and pay it over to SARS.

As a result of the above section, a long-term insurer is deemed to be a regulated intermediary. To the extent that the dividend is allocated to the individual policyholder fund it must be deemed to have been paid to a natural person that is a resident by the regulated intermediary on the date that the dividend is paid to the insurer. The regulated intermediary will then have the responsibility to withhold the Dividends Tax and pay it over to SARS.

2.4.2.8 Section 64J – Secondary Tax on Companies Credits

> **64J.** (1) A dividend paid by a company is not subject to the dividends tax to the extent that—
> *(a)* the dividend does not exceed the STC credit of the company; and

(b) the company has by the date of payment notified the person to whom the dividend is paid of the amount by which the dividend reduces the STC credit of the company.

(2) The STC credit of a company is an amount equal to the sum of—

(a) the amount by which the dividends accrued to that company during the dividend cycle ending on the day immediately before the effective date and the dividends which are deemed in terms of section 64B to have accrued to that company during that dividend cycle exceed the dividends declared on that day by that company; and

(b) the dividends accrued to that company to the extent that the person paying the dividend submits prior written notice to the company of the amount by which the dividend reduces the STC credit of that person or any other person on behalf of whom the dividend is paid by that person, reduced by the dividends declared and paid by the company to the extent that the dividends are paid by the company on or after the effective date.

(3) For purposes of subsections (1)*(b)* and (2)*(b)*, the amount by which the STC credit of a company or person is reduced is deemed to be equal to an amount which bears to the dividend paid by that company or person to the person or company contemplated in those subsections the same ratio as the amount by which the STC credit of that company or person is reduced as a result of the payment of that dividend to all shareholders bears to the total dividend paid to all shareholders.

(4) In the determination of the STC credit of a company that is an insurer as defined in section 29A, the amount to be taken into account in terms of subsection (2)*(b)* in respect of dividends accrued to that company must be limited to dividends accrued on shares constituting an asset in the corporate fund of the company.

(5) The STC credit of a company or person on or after the fifth anniversary of the effective date is deemed to be nil.

As can be seen from the above, a Secondary Tax on Companies credit can be used for up to 5 years from the effective date of the Dividends Tax.

A company will therefore need to advise their shareholders to whom the dividend is paid, how much of the Secondary Tax on Companies credit has been used in respect of a dividend, where the company does not withhold Dividends Tax, or withholds less than 10%, because it is using its Secondary Tax on Companies credit. However, should the company fail to give this written advice to its shareholders by the date of payment of the dividend, the full amount of the dividend it pays will be subject to the Dividends Tax. When a company with a Secondary Tax

on Companies credit pays a dividend to its shareholder after the effective date of the implementation of the Dividends Tax, it has to apportion the Secondary Tax on Companies credit among them. The Secondary Tax on Companies credit of a company or person on or after the fifth anniversary of the effective date is deemed to be nil.

Regulated investment intermediaries therefore need to make sure that sure that their systems can cater for the Secondary Tax on Companies credits in the sense that they can be captured into their systems and appropriately used in the calculation of the amount of the Dividends Tax to withhold from each client. The systems also need to be able to appropriately report to clients the amount of the Secondary Tax on Companies credit received in respect of each dividend received.

2.4.2.9 Section 64K – Payment and Recovery of Tax

Section 64K deals with the payment and recovery of the Dividends Tax and reads as follows:

> **64K.** (1) A beneficial owner is liable for the Dividends Tax and must pay the tax by the last day of the month following the month during which the dividend is paid by the company that declared the dividend, unless the tax has been paid by any other person.
>
> (2) *(a)* Any person that withholds any Dividends Tax in terms of this Part must pay the tax to the Commissioner by the last day of the month following the month during which the dividend is paid by the company that declared the dividend.
>
> *(b)* The amount of tax that must be paid to the Commissioner may be reduced by any amount refundable in terms of section 64L or 64M.
>
> (3) Any person that fails to withhold tax as required in terms of this Part or withholds tax but fails to pay the tax to the Commissioner as required by this Part is liable for the payment of the tax as if it were tax due by that person in terms of this Act, unless the tax is paid by any other person.
>
> (4) Where a person has, in terms of section 64G(3) or 64H(3), withheld Dividends Tax in accordance with a reduced rate in respect of the payment of any dividend, the person must submit to the Commissioner any declaration—
>
> (i) submitted to the person by or on behalf of a beneficial owner; and

(ii) relied upon by the person in determining the amount of Dividends Tax so withheld, at the time and in the manner prescribed by the Commissioner.

(5) If the Commissioner is satisfied that any Dividends Tax has not been paid in full, he or she may estimate the unpaid amount and issue to the person by whom the tax is due a notice of assessment of the unpaid amount.

(6) If a person fails to pay any Dividends Tax within the required period, interest must be paid by that person on the balance of the tax outstanding at the prescribed rate reckoned from the end of that period.

(7) The provisions of this Act relating to assessment and recovery of tax and administrative penalties in the event of default or omission apply, with the changes required by the context, in respect of the Dividends Tax.

(8) Every person that controls or is regularly involved in the management of the overall financial affairs of an unlisted company as defined in section 41 that is liable to withhold tax and that is a shareholder or director of that company is personally liable for the Dividends Tax, additional tax, penalty or interest for which that company or intermediary is liable.

It is therefore essential that regulated investment intermediaries understand their obligation in respect of the withholding of the Dividends Tax and the payment thereof to SARS. Failure to understand their withholding obligations and adapt their systems to cater for this new Dividends Tax could result in the following:

- The regulated investment intermediary being liable to SARS for the withholding tax in the event they do not withhold the tax and pay it over to SARS and are unable to recover it from the client;
- Payment of interest to SARS should the withholding tax not be paid by the end of the month following the month in which the dividend was paid; and
- Payment of administrative penalties due to failure to pay the withholding tax over to SARS timeously.

2.4.2.10 Sections 64L and 64M – Refund of Dividends Tax

Section 64L of the Act sets out the provisions in terms of the refund of dividends tax in respect of dividends declared and paid by companies.

> **64L.** (1) If—
>
> *(a)* an amount is withheld by a company from the payment of a dividend in terms of section 64G(1);
>
> *(b)* a declaration contemplated in subsection (2)*(a)* or (3) of that section in respect of that dividend is not submitted to the company by the date contemplated in the relevant subsection; and
>
> *(c)* a declaration contemplated in section 64G(2)*(a)* or (3) is submitted to the company within three years after the payment of the dividend in respect of which it is made, so much of that amount as would not have been withheld had that declaration been submitted by the date contemplated in the relevant subsection is refundable to the person to whom the dividend was paid.
>
> (2) Any amount that is refundable in terms of subsection (1) must be refunded by the company that withheld that amount to the person to whom the dividend was paid—
>
> *(a)* from any amount of dividends tax withheld by that company within a period of one year after the submission of the declaration contemplated in subsection (1)*(c)*; or
>
> *(b)* to the extent that the amount that is refundable exceeds the amount of dividends tax withheld as contemplated in paragraph *(a)*, from an amount recovered by the company from the Commissioner in terms of subsection (3).
>
> (3) Subject to subsection (4), if any amount is refundable to any person by a company in terms of subsection (1) and that amount exceeds the amount of dividends tax withheld as contemplated in subsection (2)*(a)*, the company contemplated in subsection (2) may recover the excess from the Commissioner.
>
> (4) No amount may be recovered in terms of subsection (3) if the company submits the claim for recovery to the Commissioner after the expiry of a period of four years reckoned from the date of the payment contemplated in subsection (1)*(a)*.

Therefore, in order for a dividend to be exempt from the Dividends Tax, the beneficial owner has to submit a declaration to the company by a date set by the company (or by the date of payment should the company not set a date), that the shareholder/beneficial owner is exempt from the tax. However, this not a requirement if the shareholder/beneficial owner is part of the same group of companies as the company paying the dividend.

Where this declaration is necessary, and has not been received by the company, the company paying the dividend has to withhold the 10% Dividends Tax, even though it may be aware of the fact that it is paying the dividend to another company, or PBO for example (which are effectively exempt from the Dividends Tax).

In terms of section 64L(1), if after paying the dividend net of the 10% Dividends Tax to the beneficial owner, the company may refund the Dividends Tax to the beneficial owner provided that the beneficial owner gives the written declaration of exemption to the company within three years from the date of payment of the dividends.

The refund works as follows:

1. In terms of section 64L(2), if within one year after receiving the declaration (in respect of a subsequent dividend) any dividends tax has been withheld and not yet been paid to SARS, this can be used to make the refund to the beneficial owner.
2. In terms of section 64L(3), if this tax is not enough to cover the refund, the company can recover the shortfall from SARS. However, section 64(L)(4) requires that this recovery must be made within a period of 4 years from the date that the dividend was originally paid.

Section 64M of the Act deals with the refund of tax in respect of dividends paid by regulated intermediaries.

> **64M.** (1) If—
> *(a)* an amount is withheld by a regulated intermediary from the payment of a dividend in terms of section 64H(1);

(b) a declaration contemplated in subsection (2)*(a)* or (3) of that section in respect of that dividend is not submitted to the regulated intermediary by the date contemplated in the relevant subsection; and

(c) a declaration contemplated in section 64H(2)*(a)* or (3) is submitted to the regulated intermediary within three years after the payment of the dividend in respect of which it is made, so much of that amount as would not have been withheld had that declaration been submitted by the date contemplated in the relevant subsection is refundable to the person to whom the dividend was paid.

(2) Any amount that is refundable in terms of subsection (1) must be refunded by the regulated intermediary contemplated in subsection (1)*(a)* from any amount of dividends tax withheld by the regulated intermediary after the submission of the declaration as contemplated in subsection (1)*(c)*.

Therefore, in terms of section 64M, the regulated intermediary can refund the Dividends Tax to the beneficial owner in the case where a regulated intermediary has withheld the 10% Dividends Tax, and a beneficial owner submits a declaration to the intermediary that no tax should have been withheld on the dividend paid to it. However, in terms of section 64M(1), in order to qualify for the refund the declaration must be submitted to the regulated intermediary within 3 years from the date the dividends tax was paid.

Section 64M(2) provides that the regulated intermediary must refund the amount from any amount of Dividends Tax withheld by the regulated intermediary after it received the declaration. There is no time limit imposed on the regulated intermediary for the refund. However, the refund cannot be claimed from SARS.

Therefore, should a regulated intermediary not receive a declaration form from its client and then default to withholding the Dividends Tax at a rate of 10% when in actual fact the rate of withholding tax should have been zero as per the declaration form finally submitted by the client (within three years from the date of payment of the dividend), the regulated intermediary will have the responsibility of refunding the client this amount of dividend withholding tax over deducted. What the regulated investment intermediary then needs to do is to pay the client the amount over deducted out of the dividend withholding tax withheld in respect of recent dividends paid to clients but in respect of which the withholding tax is not yet due to SARS.

When the regulated investment intermediary then submits its next dividend withholding tax return and makes payment, the amount of the refund will be set off the amount of Dividends Tax declared and to be paid by the regulated investment intermediary. No refund can be claimed from SARS. The regulated investment intermediaries' systems will need to be able to cater for refunds to be made to clients.

2.4.2.11 Section 64N – Rebate in respect of Foreign Taxes on Dividends

Section 64N deals with rebates in respect of foreign taxes paid on local dividends declared. Where, for example, a foreign company, listed on a South African stock exchange, has withheld the South African Dividends Tax, a rebate of any foreign tax incurred on the dividend can be deducted from the amount of the Dividends Tax payable in South Africa.

> **64N.** (1) A rebate determined in accordance with this section must be deducted from the Dividends Tax payable in respect of a dividend contemplated in paragraph *(b)* of the definition of ‗dividend' in section 64D.
>
> (2) The amount of the rebate contemplated in subsection (1) is equal to the amount of any tax paid to any sphere of government of any country other than the Republic, without any right of recovery by any person, on a dividend contemplated in subsection (1) that is not exempt from the Dividends Tax in terms of section 64F.
>
> (3) For the purposes of subsection (2), the amount of the rebate contemplated in that subsection must not exceed the amount of the Dividends Tax imposed in respect of the dividend contemplated subsection (1).
>
> (4) For the purposes of this section, the amount of any tax paid as contemplated in subsection (2) must be translated to the currency of the Republic by applying the exchange rate used to convert the amount of the dividend in respect of which that tax is paid to the currency of the Republic.

Therefore, should a regulated investment intermediary be required to withhold Dividends Tax in respect of dual listed companies, systems need to cater for foreign tax rebates in determining the amount of Dividends Tax to withhold and pay over to SARS.

2.5 CONCLUSION

The existing Secondary Tax on Companies legislation provides that the company declaring the dividend has the responsibility to pay the Secondary Tax on Companies over to SARS. Secondary Tax on Companies is levied at a rate of ten percent of the amount of the dividend declared by the company. The Secondary Tax on Companies is payable to SARS by the end of the month following the month in which the dividend is declared. There are certain companies who are exempt from Secondary Tax on Companies in respect of dividends declared by them.

In terms of the new Dividends Tax legislation, the Dividends Tax is a tax levied on the beneficial owner of the share with the company declaring the dividend or the regulated intermediary having only a responsibility to withhold this Dividends Tax and pay it over to SARS. In terms of the new Dividends Tax legislation, the Dividends Tax is payable to SARS by the end of the month following the month in which the dividend is paid to the beneficial owner of the share. Unlike the Secondary Tax on Companies legislation which exempts the dividends declared by certain companies from Secondary Tax on Companies, the Dividends Tax legislation provides that certain beneficial owners of shares may be exempt from the Dividends Tax.

The difference between the main features of the Secondary Tax on Companies legislation and the new Dividends Tax legislation is summarized below:

Main features	Secondary Tax on Companies	New Dividends Tax
Liability for tax	Company declaring dividend	Beneficial owner of the share
Rate of tax	10% on the amount of dividends declared by those companies subject to Secondary Tax on Companies	10% on the amount of dividend paid by a company but certain beneficial owners are exempt from the dividend tax. Double Tax Agreement could also reduce withholding rate of tax.
Payment Date	By the end of the month following the month in which the dividend was declared	By the end of the month following the month in which the dividend was paid
Responsibility for payment to SARS	Company declaring the dividend is liable for payment to SARS	Company declaring the dividend or a regulated intermediary is responsible for withholding the tax and paying it over to SARS
Dividends received by company declaring dividend	Dividends received are set off against the dividend declared in order to obtain the net amount of the dividend subject to Secondary Tax on Companies	Secondary Tax on Companies credits are valid for a period of 5 years from the effective date of the Dividends Tax and can be offset against the dividend paid in calculating the amount on which the dividend withholding rate can be applied

Now that the new Dividends Tax legislation has been examined in detail as well as the reasons for the change from the current Secondary Tax on Companies legislation, the impact of the new Dividends Tax on regulated investment intermediaries will be examined.

CHAPTER 3:
DETERMINING THE RESPONSIBILITY FOR THE WITHHOLDING AND PAYMENT OF THE DIVIDENDS TAX

3.1 INTRODUCTION

The goal of the research was to determine the impact of the new Dividends Tax legislation on regulated investment intermediaries. Chapter 2 summarised and compared the provisions of the Act in relation to the Secondary Tax on Companies and the new Dividends Tax. However, before the impact of the new Dividends Tax on regulated investment intermediaries could be determined, it was first necessary to understand the nature of the financial institution. Once the nature of the financial institution was understood, the new Dividends Tax legislation was applied in order to determine whether such financial institution met the definition of a regulated intermediary. Once the financial institution met the definition of a regulated intermediary, the date of payment as well as the responsibility for the withholding and payment of the Dividends Tax to SARS was analysed. The present chapter addresses these issues.

This research was based on a case study design. The results of a single case study cannot be generalized to the broader population of financial service providers. To assist other financial service providers in applying the results and recommendations of the research in their institutions, it was necessary to provide a profile of the institution used for the case study. This was set out in the present chapter.

3.2 DETERMINING THE RESPONSIBILITY FOR THE WITHHOLDING AND PAYMENT OF THE DIVIDENDS TAX TO SARS

The nature of the various regulated investment intermediaries must be first be understood before proceeding to determine their withholding obligations in respect of the new Dividends Tax. Therefore, Collective Investment Schemes, Linked Investment Service Providers and Long-term Insurer‘s have all been defined in the sections below before proceeding to determine whether they meet the definition of a regulated intermediary (in terms of sections 64D and section 64I of the Act) and therefore have a responsibility to withhold Dividends Tax and pay it over to SARS.

3.2.1 Collective Investment Schemes

The definition of a Collective Investment Scheme as set out in the Collective Schemes Control Act no 45 of 2002 is as follows:

> ―Collective Investment Scheme" means a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which -
>
> a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
>
> b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed,
>
> but not a collective investment scheme authorised by any other Act;

The Association for Savings and Investment in South Africa defines a Collective Investment Scheme as follows on their website:

> Unit trusts are the pooled resources of thousands of investors who have entrusted their money to a management company.
>
> The management company buys shares on the Johannesburg Stock Exchange on behalf of the investors. The trust does not give the shares to the investor, but combines them in a portfolio. The management then divides the portfolio into many equal "units." The investor receives a certain number of units for the money he has entrusted to the company that manages the unit trust.

Investment into a Collective Investment Scheme can take place in the following ways:

A) Direct investment into the Collective Investment Scheme by beneficial owners; or
B) Investment into the Collective Investment Scheme by a Linked Investment Service Provider or by a Long-term insurer through, for example, an endowment policy

Investment can take place by one of the above parties into one or more funds or into a fund of funds structure.

Fund of Funds:

A "fund of funds" is a mutual fund that invests in other mutual funds or simply speaking a unit trust fund which invests in the units of other unit trusts. This method is sometimes known as "multi-management". A fund of funds allows investors to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories that are all wrapped up into one fund.

The Association for Savings and Investment in South Africa defines a fund of funds structure as follows on their website:

> A fund of funds is a collective investment portfolio fund that invests in a range of other collective investment portfolios. These could be funds within a collective investment portfolio management company's own range (internal fund of fund) or a selection of funds managed by various collective investment portfolio management companies (external fund of fund). A fund of funds may not invest in less than two underlying collective investment portfolios.
>
> **Ownership of units in a fund of funds**
>
> When an investor invests in a collective investment portfolio, the investor buys units of a fund which in turn uses the money to invest in assets which may include shares, bonds and cash. The investor owns the units or a portion of the collective investment portfolio relative to the number of units bought. However, when an investor purchases units in a fund of funds, the investor only owns the units in the fund of funds and not in the units of the underlying collective investment portfolios which make up the fund of funds. These units in the fund of funds are subject to the same legislation as the underlying funds.

A Collective Investment Scheme is essentially a vesting trust. Therefore, when dividends are distributed by the Collective Investment Scheme, they vest in the unit holders of the Collective Investment Scheme. However, in terms of a legal fiction created by the Act, the Collective Investment Scheme is treated as a company despite the fact that it is actually is a trust. Distributions declared by the Collective Investment Scheme to its unit holders are essentially treated as dividends declared by a company to its shareholders.

Section 25BA of the Act sets out the tax implications in respect of amounts received by or accrued to portfolio's of Collective Investment Schemes and reads as follows:

> **25BA. Amounts received by or accrued to portfolios of collective investment schemes in securities and holders of participatory interests in portfolios**
>
> Any amount, other than an amount of a capital nature, received by or accrued to any portfolio of a collective investment scheme in securities must—

a) to the extent that the amount is distributed by that portfolio—

i) to any person who is entitled to the distribution by virtue of the person being a holder of a participatory interest in that portfolio; and

ii) within 12 months of its receipt by that portfolio,

be deemed to have directly accrued to the person on the date of the distribution; and

b) to the extent that the amount is not distributed as contemplated in paragraph (a) within 12 months of its receipt by that portfolio, be deemed to have accrued to that portfolio on the last day of the period of 12 months commencing on the date of its receipt by that portfolio.

Therefore, provided that the Collective Investment Scheme distributes any interest or dividends or any other amount of income which is received by accrued to any portfolio of the Collective Investment Scheme, other than amounts of a capital nature, within 12 months of its receipt by the portfolio, these amounts will not be taxed in the Collective Investment Scheme‘s hands. These amounts will be taxed (for income tax purposes) in the hands of the unit holders and will be deemed to have accrued to the unit holder on the date of distribution by the Collective Investment Scheme.

3.2.1.1 Nature of the Collective Investment Scheme of the Financial Institution at which the Researcher is Employed

This research has been based on a Collective Investment Scheme which consists of a Management Company which has approximately 69 funds under its management and administration. This Collective Investment Scheme provides investors with access to a range of unit trust funds across all major asset classes and for varying risk profiles. The Management Company is an unlisted public company which needs to comply with the Collective Investment Schemes Control Act no 45 of 2002. The Management Company holds a Financial Services Provider 1 licence with the Financial Services Board in South Africa.

Of the 69 funds under the Management Company‘s management and administration, approximately 23% are offshore funds with the balance being local funds. This enables clients to invest their money both locally and offshore. The clients of this Collective Investment Scheme are mainly middle to upper class individuals, trusts and companies/close corporations. In addition to this there are bulk accounts to cater for the investment of a Linked Investment Service Provider, for example, into the Collective Investment Scheme. The majority of the clients are South African residents.

Over the past financial year the Management Company of the Collective Investment Scheme on which the research was based earned service fee income from the administration and management of the funds in the region of R260 million. The assets under the management and administration of the Management Company at the end of the previous financial year amounted to approximately R42 billion.

3.2.1.2 Dividends Tax Implications

A Collective Investment Scheme is defined as a regulated intermediary in terms of section 64D of the Act. It will therefore have to adhere to the withholding responsibilities of regulated intermediaries in terms of section 64H of the Act. Section 64H of the Act states that a regulated intermediary, a Collective Investment Scheme in this case, will need to withhold the Dividends Tax from dividends distributed to its unit holders unless one of its unit holders is a regulated intermediary themselves or the unit holder is exempt from the Dividends Tax and has furnished the Collective Investment Scheme with a declaration form declaring its exempt status.

Local dividends are received by the funds from their underlying equity investments. The underlying equity investments mostly consist of shares in companies listed on the Johannesburg Stock Exchange. In terms of section 64D of the Act, a dividend is defined as a dividend (as defined in section 1 of the Act) that is declared by a company that is resident or a dividend declared by a non-resident company which is listed on the Johannesburg Stock Exchange. Therefore, when a listed South African company declares a dividend to its shareholders, one of which is the Collective Investment Scheme, the listed company will not

need to withhold any Dividends Tax (or essentially the Central Securities Depositary Participant on behalf of the listed company – the Central Securities Depositary Participant is also seen as a regulated intermediary) since the dividend will be paid to another regulated intermediary – this is in terms of section 64H of the Act which states that a South African company declaring a dividend will not have any obligation to withhold Dividends Tax should the dividend be paid to a regulated intermediary. The Collective Investment Scheme, as a regulated intermediary, will have the responsibility to withhold the Dividends Tax in respect of dividends distributed to its unit holders unless the unit holder is another regulated intermediary e.g. a Linked Investment Service Provider or a Long-Term Insurer or it receives a declaration of exemption form from its unit holder.

It is important to establish the date of payment of the dividend to the unit holders since the Dividends Tax must be paid over to SARS by the end of the month following the month in which the dividend was paid in terms of section 64K(1) of the Act. In terms of section 64E(2) of the Act, the dividend is deemed to be paid to the beneficial owner on the date that the dividend accrues to them. In the case of a Collective Investment Scheme, it will receive the dividends from the underlying equity investments. However, it may choose to distribute the dividend to unit holders a month later. It would seem then that the date that the dividend is distributed by the Collective Investment Scheme to its unit holders is that date that the dividend is paid to them. The date of payment of a dividend in respect of a Collective Investment Scheme is discussed in detail in 4.5.1 below. Therefore, it would seem that the Dividends Tax would be due to SARS by the end of the month following the month in which the dividend was distributed by the Collective Investment Scheme to its unit holders.

In the event of a fund of fund structure, a local dividend received by an underlying unit trust fund from its equity investments will be passed up through the fund of fund structure to the unit holder of the fund of fund. In this scenario, each unit trust fund will be a regulated intermediary. However, only the final fund to which the dividend is passed before it reaches the unit holders who are the beneficial owners of the shares will have the responsibility of withholding the dividend tax. Therefore, when a dividend is passed by a regulated intermediary (no 1) to

another regulated intermediary (no 2), there is no responsibility imposed on regulated intermediary no 1 to withhold any dividend tax.

As mentioned above, a client, for example an individual or company, can invest directly into a Collective Investment Scheme (e.g. unit trust fund or fund of fund) or a Linked Investment Service Provider through is wrap fund product can invest in a Collective Investment Scheme. A Long-Term Insurer can also invest into a Collective Investment Scheme for example through an endowment policy or retirement annuity fund. The withholding tax implications of the Collective Investment Scheme in the case of these types of client holdings will be examined below.

A) Direct Investment into the Collective Investment Scheme by Beneficial Owners

In the case of a direct investment into a Collective Investment Scheme, the Collective Investment Scheme will be the final regulated intermediary in the chain since it will be distributing the dividend to the beneficial owner of the units. In this case, the Collective Investment Scheme will have an obligation to withhold Dividends Tax and pay it over to SARS unless it receives a declaration of exemption in the form prescribed by SARS from the client declaring their exempt status either before the first dividend is distributed to the unit holder or by an earlier date set by the Collective Investment Scheme.

Generally, unit holders who are individuals or non-residents (individuals or companies) will be subject to the withholding tax. However, non-residents may qualify for a reduced withholding percentage in terms of a Double Taxation Agreement between South Africa and the non-resident‘s country. This reduction generally occurs only if the unit holder to whom the dividend accrues owns a minimum percentage of shares in the company paying the dividend (typically between 10 and 25 per cent). Should the unit holder qualify for treaty relief, a declaration for treating relief should be submitted to the Collective Investment Scheme in the time period set by the Collective Investment Scheme – the Collective Investment Scheme will then be obliged to withhold Dividends Tax at the reduced rate in terms of the Double Taxation Agreement.

B) Investment into the Collective Investment Scheme by a Linked Investment Service Provider or by a Long-term Insurer

Should the unit holder not be a company, individual or another unit trust fund but a Linked Investment Service Provider or a Long-Term Insurer investing into the Collective Investment Scheme (through, for example, an endowment policy), the dividend tax implications will be as follows:

- A Linked Investment Service Provider and Long-Term Insurer are regulated intermediaries (see discussions which follow below), therefore the Collective Investment Scheme will have no responsibility to withhold the dividend tax and pay it over to SARS when declaring dividends to a Linked Investment Service Provider and a Long-Term Insurer – this is in terms of the withholding rules for regulated intermediaries as set out in sections 64H and 64I of the Act. The effect of the Dividends Tax on a Linked Investment Service Provider or a life insurer is discussed below.

3.2.2 Linked Investment Service Provider

The Association for Savings and Investment in South Africa, on their website, define a Linked Investment Service Provider as follows:

> **Linked Investment Services Providers (LISPs)**
>
> A LISP [Linked Investment Service Provider] is a company, offering a range of investments linked to collective investment portfolios and other underlying investments. LISPs [Linked Investment Service Provider] are not product suppliers as such, but provide administrative systems to gain access to various suppliers of retail investment products including fund of funds, multi-manager funds and wrap funds. LISPs [Linked Investment Service Providers] can link collective investment portfolio investments with other investment products such as retirement annuities and provident funds.

How does a LISP [Linked Investment Service Provider] work?

LISPs [Linked Investment Service Providers] develop investment packages comprising collective investment portfolios and other instruments in line with the investment needs of their client. They buy the units in bulk from collective investment portfolio companies, repackage them to provide investors with a choice of collective investment portfolios, and the opportunity to combine collective investment portfolios with other compulsory investment types such as retirement annuities or provident funds, or specialist plans. Buying in bulk allows LISPs [Linked Investment Service Providers] to negotiate favourable initial charges and switching fees with the relevant Management Companies.

LISPs [Linked Investment Service Providers] are regulated by Section 4 of the Stock Exchanges Control Act (1985) and Section 5 of the Financial Markets Control Act (1989).

Products offered by LISPs [Linked Investment Service Providers]

Products offered by LISPs [Linked Investment Service Providers] can divided into three broad categories:

Voluntary contributions: these are savings from after-tax income and are invested into growth/lifestyle funds or wrap funds.

Pre-retirement savings: these include retirement annuities, pension and provident funds and preservation funds.

Retirement products: these include living annuities and guaranteed income plans.

It is therefore essential that the definition of a ―Wrap Fund" is examined. The Association for Savings and Investment in South Africa defines a ―Wrap Fund" as follows on their website:

Wrap Funds

A wrap fund is a portfolio consisting of a number of underlying investment tools wrapped into a single product. Wrap funds are not classified as funds of funds as the wrap fund itself is not a collective investment portfolio, but is in fact a portfolio of separate collective investment portfolios and money market accounts/instruments. The underlying combination of investment tools or instruments is selected to target the risk/return requirements of individual investors. The combination of the underlying instruments may be conservative, balanced or aggressive.

Ownership and management of units in a wrap fund

> With a wrap fund the investor has direct ownership of the underlying investments. Wrap funds are not regulated by the Collective Investment Schemes Control Act and do not have separate legal status. They are controlled by the same legislation pertaining to Linked Investment Services Providers (LISPs), namely the Stock Exchanges Control Act and the Financial Markets Control Act. Wrap funds can be managed by almost anyone provided they are registered with the Financial Services Board (FSB) as a portfolio manager. Wrap Funds are offered by some Linked Product Companies and Asset Management Groups. Any registered portfolio manager can establish his own wrap fund and act as investment advisors for that fund. Investors are advised as to which of the wrap funds is suitable based on their risk profiles and investment needs.

As can be seen from the above, a Linked Investment Service Provider never owns the units or shares that it buys. The client owns the underlying investments of the wrap fund product (which are unitised) which they have bought into i.e. they own the shares in the case of a direct investment or the units in the case of unit trust fund or fund of fund investments.

The Linked Investment Service Provider itself is a Financial Services Provider and must be registered as such with the Financial Services Board in South Africa. A Linked Investment Service Provider should have a ―Category Three" Financial Service provider licence with the Financial Services Board.

Section 64D of the Act, which deals with the definitions in respect of the new Dividends Tax, includes the following in the definition of a ―regulated intermediary":

> *(d)* nominee that holds investments on behalf of clients as contemplated in section 9.1 of Chapter 1 and section 8 of Chapter II of the Codes of Conduct for Administrative and Discretionary Financial Service Providers, 2003 (Board Notice 79 of 2003) published in *Government Gazette* No. 25299 of 8 August 2003;

A Linked Investment Service Provider is a Financial Services Provider and is governed by the Codes of Conduct for Administrative and Discretionary Financial Service Providers, 2003. A Linked Investment Service Provider therefore needs to establish a nominee company which will be the registered holder and custodian of the investments of its clients in a nominee capacity. This is due to the fact that a Linked Investment Service Provider does not own the underlying investments, its clients do.

Section 9.1 of Chapter 1 and section 8 of Chapter II of the Codes of Conduct for Administrative and Discretionary Financial Service Providers, 2003 reads as follows:

> 9.1) An administrative FSP [Financial Services Provider] must prior to commencing business, subject to such conditions and restrictions as may be imposed by the registrar under section 8(4) of the Act, and the applicable provisions of regulations made under the Act, enter into a written agreement with a company or trust, whether local or foreign, the main object of which is being the registered holder and custodian of the investments of clients, and which agreement provides for termination of the agreement by either party on written notice of not less than 90 days.
>
> 8) A discretionary FSP may establish a nominee company with the main object of being the registered holder and custodian of the investments of clients, subject to such conditions and restrictions as may be imposed by the Registrar under section 8(4) of the Act, and the applicable provisions of regulations made under the Act, and enter into a written agreement with the company, which provides for termination of the agreement by either party on written notice of not less than 90 days. Where a discretionary FSP elects not to establish such a nominee company, an appropriate existing nominee company, approved by the Registrar, must be utilised by the discretionary FSP.

Therefore, the nominee company established by the Linked Investment Service Provider will be the regulated intermediary in terms of the Dividends Tax.

A Linked Investment Service Provider can invest into the following, for example, on behalf of its clients via their wrap fund product:

A) Collective Investment Schemes
   - Unit Trusts
   - Fund of funds
B) Direct share Investments.

3.2.2.1 Nature of the Linked Investment Service Provider of the Financial Institution at which the Researcher is Employed

The Linked Investment Service Provider on which the research was based is registered as such with the Financial Services Board in South Africa and holds a Financial Services Provider 3 license. The Linked Investment Services Provider is registered as a private company in South Africa. This entity focuses on the upper income class of individuals, trusts and companies/close corporations. Other Linked Investment Service Providers or Long-term Insurer's may invest into this company, in which case their investments are bulked into bulk accounts. This Linked Investment Service Provider accepts a minimum lump sum investment of R50 000 when investing into one of the products. The clients of this company are mostly South African residents. The company offers a wide range of investment products through which the client can investment in a wide range of investment instruments including local and offshore unit trusts, Fund of Funds, Direct Shares (direct investment into the listed shares on the Johannesburg Securities Exchange for example) and more.

At the end of the previous financial year, the company had R18.7 billion of assets under management using their Linked Investment Service Provider License. The company also manages and administers assets on behalf of the Long-Term Insurer in the Group of Companies which they form part of. The assets under management and administration using the Life License of the Long-Term Insurer, amount to approximately R38 billion. The revenue earned by the Linked Investment Service Provider over the past financial year consists of management fees earned for hosting clients' investments (approximately R46 million) as well

as rebate income (approximately R85 million) and ad hoc transactional fees such as switch fees (when a client wishes to transfer their investment from one fund to another fund for example) and initial fees charged in respect of new investments. Rebate income is essentially a discount received from the underlying fund managers of the funds into which the Linked Investment Service Provider has invested in respect of the fees charged by the fund managers. The rebate or discount received is awarded to the Linked Investment Service Provider due to the level of their investments into the underlying funds and the fact that they invest in a bulk account reducing the administrative burden for the fund manager.

3.2.2.2 Dividends Tax Implications

In terms of section 64D of the Act, the Linked Investment Service Provider's nominee company will be the regulated intermediary for purposes of the Dividends Tax. Regulated intermediaries are not the beneficial owners of the shares. The withholding responsibilities of a regulated intermediary are provided for in section 64H of the Act. In terms of section 64H of the Act, a regulated intermediary will have to withhold the 10% Dividends Tax, unless –

- The beneficial owner has given the intermediary a written declaration that it is exempt from the Dividends Tax (by the relevant dates); or
- The intermediary is passing the dividend on to another regulated intermediary (because then the responsibility for withholding the tax falls on the other regulated intermediary).

The investors of a Linked Investment Service Provider can be diverse. The nature of the investors of a Linked Investment Service Provider could be any one of the following and depending on the Dividends Tax status of the investors, Dividends Tax may or may not need to be withheld by the Linked Investment Service Provider's nominee company as follows:

Nature of client/investor into Wrap Fund	Dividends Tax Status
(i) Individual – Resident of South Africa	Taxable
(ii) Individual – Non-resident	Taxable – at possibly reduced rate per a Double Taxation Agreement
(iii) Company/Close Corporation - SA resident	Exempt
(iv) Company/Close Corporation/Trust - Non-resident	Taxable – at possibly reduced rate per a Double Taxation Agreement
(v) Trust – SA resident	Exempt
(vi) Government, a provincial administration or a municipality	Exempt
(vii) Public Benefit Organisation approved in terms of section 30(3);	Exempt
(viii) An institution, board or body contemplated in section 10(1)*(c*A) (i.e. whose receipts and accruals are exempt from income tax);	Exempt
(ix) A fund contemplated in section 10(1)*(d)*(i) or (ii) i.e. a benefit fund;	Exempt
(x) a person contemplated in section 10(1)*(t)*;	Exempt

A) Investment by the Linked Investment Service Provider into Collective Investment Schemes for their Wrap Fund Product

Depending on the underlying investments of the unit trust fund or fund of fund into which the Linked Investment Service Provider invests on behalf of their clients owning wrap funds, returns such as interest (in the case of for example money market investments) and dividends (in the case of equity investments) may be received.

Since the Linked Investment Service Provider does not own the underlying units in the Collective Investment Scheme and only acts as an administrator, local dividends received by

the Linked Investment Service Provider are received by the Linked Investment Service Provider on behalf of their unit holders (clients/investors). The local dividends are then passed on to the unit holders by the Linked Investment Service Provider.

This means that the neither the Linked Investment Service Provider, nor its nominee company, will be subject to the Dividends Tax since the ultimate owner of the underlying shares from which the dividend is received is the unit holder in the wrap fund and not the Linked Investment Service Provider or nominee company. However, as a regulated intermediary, the Linked Investment Service Provider‘s nominee company will have the responsibility of withholding Dividends Tax on dividends paid to its unit holders. Similarly, when the Collective Investment Scheme, for example, passes on a dividend to the Linked Investment Service Provider, the Collective Investment Scheme will not have the responsibility to withhold any dividend tax since it is passing on the dividend to another regulated intermediary – the Linked Investment Service Provider‘s nominee company. The Linked Investment Service Provider‘s nominee company will then withhold and pay over the dividend tax on the dividends passed on to its investors. The withholding will take place at ten percent of the dividend should a declaration of exemption or a declaration for treaty relief not be submitted by the client to the Linked Investment Service Provider. It is also possible for another regulated intermediary to invest in a wrap fund of a Linked Investment Service Provider, such as a Long-Term Insurer. A Long-Term Insurer is also defined as a regulated intermediary and is governed by section 64I of the Act. In the case of dividends paid to another regulated intermediary, the Linked Investment Service Provider‘s nominee company will not have to withhold any Dividends Tax and pay it over to SARS in accordance with section 64H of the Act.

B) Investment by the Linked Investment Service Provider into Direct Share Investments for their Wrap Fund Product

A Listed Investment Service Provider can hold direct share investments on behalf their clients in their wrap fund product.

Local dividends received by the Linked Investment Service Provider from the direct share investments will be received through the Central Securities Depositary Participant which will be a regulated intermediary, as defined in section 64D of the Act. However, since the Central Securities Depositary Participant will be passing on the local dividend to another regulated intermediary, the Linked Investment Service Provider's nominee company, the Central Securities Depositary Participant will not have the responsibility of withholding Dividends Tax. The Linked Investment Service Provider's nominee company will have the responsibility of withholding Dividends Tax and paying it over to SARS when the Linked Investment Service Provider passes the dividend on to its investors. The withholding will take place according to the Dividends Tax status of the investors, i.e. exempt from Dividends Tax, fully taxable at ten percent etc.

As mentioned above, it is also possible for another regulated intermediary to invest in a wrap fund of a Linked Investment Service Provider, such as a Long-Term Insurer. A Long-Term Insurer is also defined as a regulated intermediary and is governed by section 64I of the Act. In the case of dividends paid to another regulated intermediary, the Linked Investment Service Provider's nominee company will not have to withhold any Dividends Tax and pay it over to SARS in accordance with section 64H of the Act.

3.2.3 Long-Term Insurers

A long-term insurer with a Financial Services Board Long Term Insurance License can offer the following investment products to clients:

A) Endowment Policies

B) Annuities

C) Retirement products such as Preservation Funds and Retirement Annuity Funds.

Through these investment products the client can investment into a wide range of investment instruments such as local and offshore unit trusts, direct shares (i.e. equity shares listed on the JSE), money market accounts and hedge funds, and others.

3.2.3.1 Nature of the Long-Term Insurer of the Financial Institution at which the Researcher is Employed

The Long-Term Insurer on which the research is based is an unlisted, South African public company holding a long-term insurer‘s license with the Financial Services Board. The company targets high income earning individuals, trusts and companies/close corporations as a single lump sum investment of a minimum of R50 000 is required. The clients of this Long-Term Insurer are mostly South African residents. The Long-Term Insurer offers a wide range of investment products such as endowment policies, compulsory and voluntary annuities, retirement products such as preservation funds and retirement annuity funds. Through these investment products the client can investment into a wide range of investment instruments such as local and offshore unit trusts, direct shares (i.e. equity shares listed on the JSE), money market accounts and hedge funds. The company has assets of approximately R38 billion invested across their various investment products. During the past financial year, this Long-Term Insurer earned approximately R145 million in management fees.

3.2.3.2 Dividends Tax Implications

A) Endowment Policies

Through an Endowment Policy, an investor can invest into a vast variety of investments such as (but not limited to) Unit Trust Funds, Funds of Funds or directly into the listed shares on the JSE (Johannesburg Stock Exchange).

An ‗endowment policy‘ is defined by Shaun Latter in his article ―Endowment Policies 101” (year and page unknown) as follows:

> An endowment policy is a savings vehicle through which an investor is able to invest and have access to various funds covering a multitude of asset classes and fund managers. It is a contractual agreement between an investor and an insurance company whereby the investor agrees to pay a lump sum or a regular premium to the insurer and the insurance company agrees to pay the investor the savings as a lump sum, after the period agreed to by the parties (minimum of five years), 'tax free'.
>
> The policy is issued in terms of the Long Term Insurance Act (LTIA) by a registered life insurer. In terms of this Act, the policy has a restriction period of five years during which the investor has two access points to their funds via one loan and one surrender.
>
> …
>
> Because the funds essentially sit on the books of the life company, the investor will not be responsible for the tax administration on the growth of the investment over the period. This is because the insurance company will pay tax in terms of the 'four funds approach'. The 'four funds approach' distinguishes between four 'pools' of investors, namely: companies, corporates, untaxed (e.g. PBOs and churches) and individuals. In the case of an individual investor, the tax levied is 30 percent of all net rental income and interest accrued as well as 7.5 percent of Capital Gains.

Therefore, the long term insurer is responsible for paying the tax over to SARS in respect of taxable investment income earned by their funds within their endowment policies. The taxable income of Long-Term Insurers is taxed in accordance with the Four Fund Approach as set out in section 29A of the Act. The four funds are as follows:

- Individual Policyholder Fund
- Company Policyholder Fund
- Corporate Policyholder Fund
- Untaxed Policyholder Fund.

Long-Term Insurers operating under the four funds system require special rules for the Dividends Tax because the system is based on the trustee principle. Section 64I of the Act specifically deals with the Dividends Tax implications of Long-Term Insurers. Section 64I of the Act reads as follows:

64I. If a dividend is paid to an insurer as defined in section 29A, the insurer must be deemed to be a regulated intermediary and the dividend must, to the extent that the dividend is allocated to a fund contemplated in section 29A(4)*(b)*, be deemed to be paid to a natural person that is a resident by the regulated intermediary on the date that the dividend is paid to the insurer.

Section 29A(4)(b) of the Act refers to the individual policyholder fund as follows:

4) (b) a fund, to be known as the individual policyholder fund, in which shall be placed assets having a market value equal to the value of liabilities determined in relation to any policy (other than a policy contemplated in paragraph (a)) of which the owner is any person other than a company;

Therefore, in terms of section 64I of the Act, the untaxed, company and corporate policyholder funds all represent taxpayers who are exempt under the Dividends Tax. However, dividends allocated to the individual policyholder fund represent amounts conceptually within the Dividends Tax system. The reason for this is that investors allocated to the untaxed fund are essentially those taxpayers whose receipts and accruals are exempt from income tax in terms of section 10 of the Act. In terms of the Dividends Tax legislation, section 64F of the Act sets out those taxpayers who are exempt from the Dividends Tax. Taxpayer‘s who are exempt from the Dividends Tax include the following:

(a) a company which is a resident;
(b) the Government, a provincial administration or a municipality;
(c) a public benefit organisation approved by the Commissioner in terms of section 30(3);
(d) a trust contemplated in section 37A; or
(e) an institution, board or body contemplated in section 10(1)*(c*A*);*
(f) a fund contemplated in section 10(1)*(d)*(i) or (ii);
(g) a person contemplated in section 10(1)*(t)*;
(j) a person that is not a resident and the dividend is a dividend contemplated in paragraph *(b)* of the definition of ‗dividend‘ in section 64D.

As can be seen from the above, persons listed under (b), (c), (e), (f), (g) are taxpayers who are currently exempt from income tax and hence allocated to the untaxed policyholder fund. Investors in the untaxed policyholder fund should therefore not be subject to the Dividends Tax and are also not subject to income tax.

Furthermore, as can be seen from the (a) above, South African companies are also exempt from the Dividends Tax. Therefore, the company and corporate funds should also not fall within the Dividends Tax net. Individuals (SA and non-SA residents) are subject to the Dividends Tax. Hence all dividends allocated to the individual policyholder fund will have to have Dividends Tax withheld from them and paid over to SARS.

As mentioned above, through an endowment policy an investor can invest into a wide variety of investment instruments such as (but not limited to) Unit Trust Funds, Funds of Funds or directly into the listed shares on the Johannesburg Stock Exchange. Any dividends received from the above underlying investments by a Long-Term Insurer will be subject to the Dividends Tax to the extent that they are allocated by them to the Individual Policyholder fund. In terms of section 64I of the Act, these dividends will be deemed to have been paid to the individual policyholder fund on the date that they were received by the insurer. Section 64I also specifically deems the Long-Term Insurer to be a regulated intermediary. The Long-Term Insurer will therefore have the responsibility of withholding the Dividends Tax from dividends allocated to its individual policyholder fund and paying it over to SARS. It is important to note from a timing of payment of the Dividends Tax point of view that a Long-Term Insurer must pay over the withholding tax in respect of dividends allocated to their individual policyholder fund by the end of month following the month in which the dividend was received by the Long-Term Insurer.

B) Retirement Products

Retirement funds such as pension, provident or retirement annuity funds invest their clients' monies into investment instruments such as (but not limited to) Collective Investment Schemes or directly into securities. These retirement funds are the beneficial owners of these

investments and have a corresponding obligation in the form of a liability owing to their clients in respect of withdrawals (due to retirement, death, resignation, etc) by their clients from their funds. These funds are usually administered by a Listed Investment Service Provider platform. However, retirement funds are exempt from the dividend withholding tax in terms of section 64F(f). Since they are the beneficial owners of the underlying investments and are exempt from the Dividends Tax, no Dividends Tax needs to be deducted and paid over to SARS in respect of dividends earned by them. Retirement funds are allocated to the untaxed policyholder fund of the Long-Term Insurer.

Therefore, should, for example, one the underlying investments of a pension fund be an investment into a Collective Investment Scheme, when dividends are distributed by the Collective Investment Scheme it has no obligation to withhold the Dividends Tax since it is paying the dividend to another regulated intermediary (section 64H of the Act), being the Long-Term Insurer. Since the pension fund would be included in the untaxed policyholder fund of the Long-Term Insurer, any dividends allocated to it would not subject to the Dividends Tax.

C) Annuity Products

Investors into a pension fund or retirement annuity fund will be required on retirement from their fund to take no more than 1/3rd of their retirement benefits due to them in the form of a lump sum and with the balance they will need to purchase an annuity. Investors can also elect to purchase a voluntary annuity with after-tax money in respect of which they will also receive recurring annuity income.

Income received from an annuity is included in the ―gross income” definition in section 1 of the Act and is therefore subject to income tax. Therefore, the new Dividends Tax will have no impact on the annuity products since taxpayers will be in receipt of annuity income (on which they will be subject to income tax) and not in receipt of local dividends.

3.2.4 OFFSHORE INVESTMENT PLATFORMS

Most large financial institutions will have an offshore investment platform (such as an offshore Linked Investment Service Provider) in order to allow South African investors to invest in the offshore market. The offshore Linked Investment Service Provider should be a company registered offshore, which is not a South African resident for tax purposes. Investors into offshore platforms would be in receipt of foreign dividends to which the new dividend withholding tax does not apply.

Long-term Insurers may have offshore branches through which they offer an international endowment option product. In respect of international endowment option products, the four fund tax approach in South Africa applies, since all income from this foreign branch needs to be taxed in South Africa. However, in respect of the underlying investments of the endowment policies, they are likely to consist of foreign equity share investments only, to which the new Dividends Tax will not apply.

3.3 CONCLUSION

The introduction of the new Dividends Tax will have a significant impact on financial institutions. The reason for this is that South African listed companies declaring local dividends will not have all the details and know who their shareholders are. Therefore, financial institutions as such will be regarded as regulated intermediaries in terms of the new Dividends Tax and will have the responsibility of withholding the Dividends Tax from dividends received on behalf of their clients who will, in most cases, be the beneficial owners of the underlying equity shares.

A Collective Investment Scheme is defined as a regulated intermediary and will therefore need to withhold dividend‘s tax pay and pay it over to SARS on behalf of its clients unless it transfers a dividend to another regulated intermediary. A Linked Investment Service Provider is also a regulated intermediary and will therefore need to withhold Dividends Tax pay and pay over to SARS on behalf of its clients, unless it transfers a dividend to another regulated intermediary.

Long-Term Insurers are defined as regulated intermediaries in terms of section 64I of the Act and will need to withhold and pay over to SARS the Dividends Tax on any dividends allocated to their individual policy holder funds. The dividend must, to the extent that the dividend is allocated to the individual policyholder fund, be deemed to be paid to a natural person that is a resident by the regulated intermediary on the date that the dividend is paid to the insurer.

Once the responsibility for the withholding of the dividend tax and the payment to SARS has been established within a financial institution in respect of its product offerings, the financial institution then needs to proceed with the following:

- Obtaining an understanding of the impact of the new withholding tax on the client services department of the financial institution; and
- Understanding the scope and extent of the systems development required.

This will now be discussed in the next chapter.

CHAPTER 4:
IMPACT OF THE NEW DIVIDENDS TAX ON REGULATED INVESTMENT INTERMEDIARIES

4.1 INTRODUCTION

The goal of this research was to determine the impact of the new Dividends Tax on regulated investment intermediaries. As a result of interviews with staff at the financial institution at which the researcher is employed as well as the researcher‘s knowledge of the new Dividends Tax legislation and the financial institution itself, the impact of the new Dividends Tax on Collective Investment Schemes, Linked Investment Service Providers and Long-Term Insurers was determined. The impact of the new Dividends Tax on the client services department of the financial institution as well as the systems development required has been set out in detail below. In addition to this, specific issues raised by staff during the interviews have been dealt with in this chapter.

4.2 INTERVIEWS WITH STAFF

A number of interviews with various different members of staff of the financial institution on which this research was based on, were carried out. The reason for the interviews being carried out was to confirm the researcher‘s understanding of the impact of new Dividends Tax on the various areas of business within the financial institution as well as to obtain an understanding of the systems and processes presently in place and the changes to these systems that will be needed to accommodate the new Dividends Tax. Furthermore, the validity and reliability of the data collected was ensured by conducting interviews with numerous members of staff at the financial institution to ensure that correct information was obtained and

that the bias associated with the view of only one or two individuals was eliminated. The staff interviewed were as follows:

- Chief Financial Officer and the financial manager of each company included in the research (i.e. the Finance Department);
- Business Analysts of each company included in the research as well as the Information Technology developers who will be responsible for the development of the systems to cater for the new Dividends Tax (i.e. the IT Department);
- The risk manager responsible for the risk management of the three entities covered in the research;
- Chief Operating Officer of each company included in the research as well as representatives of the Client Services Department for each entity which also included a marketing representative for each entity (i.e. Client Services/Business Department);
- Group Tax Department representative responsible for the new Dividends Tax from a Group Tax level;
- Product Development representatives; and
- The Head of Projects.

No internal audit staff were interviewed nor were any external audit consultants interviewed. In total, approximately 25 staff members were interviewed. The outcome of the above interviews have been summarised in this chapter.

4.3 IMPACT OF THE NEW DIVIDENDS TAX ON THE CLIENT SERVICES DEPARTMENT

4.3.1 Notifying Clients

The client services department within a financial institution has an important role to play in respect of the implementation of the new dividend withholding tax and their role should not be underestimated. The roles and responsibilities of the client services department in respect of the implementation are discussed below.

The client services department needs to notify all the clients of the new dividend withholding tax and the impact that this new legislation will have in respect of their investments, in particular the impact on their local dividends received. They should ensure that the clients obtain an understanding of how the new Dividends Tax works and be aware of the intended implementation date. They should also notify clients that, should they be exempt from the Dividends Tax or qualify for a reduced withholding tax rate in terms of treaty relief in the case of non-residents, the necessary declaration form (see discussion below) will need to be completed by the clients by the earlier of the date of payment of the dividend or the date set by the financial institution for these forms to be returned.

4.3.2 Training of Staff

The call centre and front office staff within the client services department who are dealing with clients need to be trained on the new dividend withholding tax legislation in order for them to able to answer questions from clients after receiving the notification in respect of the new dividend withholding tax. Furthermore, once the Dividends Tax has been implemented, these staff also need to be able to answer questions as to how their dividend withholding tax was calculated, the rate used, etc.

4.3.3 Declaration Forms

In terms of section 64H(2)(a)(ii) of the new Dividends Tax legislation, no Dividends Tax needs to be withheld by the regulated intermediary should payment be made either to another regulated intermediary or where the beneficial owners of shares complete a declaration form, declaring their exempt status in respect of the new Dividends Tax. These declaration forms will be prescribed by SARS and should be available on the SARS website when the new Dividends Tax is implemented. In terms of section 64H, these forms should be submitted to the regulated intermediary by the date set by it or if no date was set by it, before the payment of the dividend by the regulated intermediary. The declaration of exemption forms are only required to be submitted to the regulated intermediary and not to SARS. However, in the case of non-residents wishing to obtain treaty relief, these declaration forms would need to be

submitted to both the financial institution and SARS. However, it is unlikely that many declaration forms for treaty relief should be received by a financial institution since generally, in terms of the Double Tax Agreements, only shareholders owning between 10% and 25% of the shares in the foreign company will qualify for the treaty relief. Regulated intermediaries qualify for automatic exemption and therefore no declaration of exemption form needs to be completed by them when dividends are paid to them by another regulated intermediary.

In terms of the legislation regarding declaration of exemption forms in section 64H(2) of the Act, it appears that these declaration forms must be submitted by the client before the payment of each dividend, i.e. the client must declare his/her/its exemption status in respect of each dividend received. In the case of a private South African company which declares a dividend once a year, this is a reasonable request. However, in the financial services industry, clients holding units in a unit trust, for example, receive dividends monthly, as the unit trusts usually distribute dividends on a monthly basis. It would not seem practical for SARS to expect these clients who are exempt from the Dividends Tax or qualify for treaty relief to submit a declaration to the financial institution in respect of each dividend received. It would seem that financial institutions would need to get clarity on this from SARS through an organization such as the Association for Savings and Investment in South Africa. It would seem reasonable for financial institutions to request that clients who are exempt from the Dividends Tax to submit a declaration of exemption form annually, or when their exempt status changes. Furthermore, in terms of section 64H(2), the onus would rest on the beneficial owner of the security to inform the regulated intermediary within 30 days of them ceasing to be the beneficial owner of the security.

In order to assist clients, especially those clients who are not familiar with the SARS website, it is likely that the client services department will need to send such declaration form to all their clients who, based on the existing client details on the system, will qualify for exemption status. Furthermore, a covering letter will need to be drawn up by the marketing specialists and reviewed by the tax department, which will explain to clients how to complete this form and the importance of supplying correct information and returning the form to the financial institution on time. The existing staff in client services should be able to handle the sending out of these

forms, however, additional staff may need to be employed when the completed returned forms start being received from clients. The reason for this is that these forms need to be checked to ensure that they have been completed correctly and completely and then the relevant data from these forms (see Input Fields under the System Development section below) needs to be captured onto the systems. Quality controllers will also be required to review these inputs by the client services staff in order to ensure that the client's exemption status has been correctly captured onto the system. Furthermore, should forms not be completed correctly, the client services department would need to contact these clients and ask them to re-complete their forms. In addition to this, they would also need to follow up on clients who did not complete and return their declaration forms in order to reduce the number of refunds due as a result of using the default withholding tax rate of 10% when in actual fact the client was exempt from the Dividends Tax or qualified for a reduced rate (see the Refunds section under Systems Development below).

What is also unclear at this stage is when SARS intends to release these standard declaration forms. Due to the significant amount of time that is involved in getting these forms to clients, receiving the completed forms back and inputting the data from these forms onto the systems, it is essential that SARS releases these forms as soon as possible. It is essential that SARS releases these forms before they announce the effective date since they are entitled, in terms of a regulation to give only three months notice of the intended effective date of implementation.

4.3.4 Client Statements

Currently, quarterly statements are sent out by the client services department to clients in respect of their investments, which contain details such as opening market value, closing market value, disposals and acquisitions for the period, interest earned, local dividends earned, etc. These client statements need to be updated in order to reflect the amount of gross local dividend received as well as the Dividends Tax withheld. It is likely that should there have been Secondary Tax on Companies credits received in respect of a particular dividend, these would also need to be reported to clients on their statements, as well as if there was any

foreign tax paid in respect of a local dividend (e.g. from a dual listed company) which has been set off against the Dividends Tax due to SARS.

4.3.5 Tax Certificates

In terms of section 69 and 70B of the Income Tax Act, an IT3b tax certificate is required to be submitted to both the client and SARS by a financial institution in respect of each year of assessment, should any foreign or local interest and dividends have been earned by the client for the year in question.

These IT3b tax certificates currently do not provide of the reporting of any withholding tax in respect of local dividends. The tax certificate template therefore needs to be updated to contain a field which reflects the amount of Dividends Tax withheld in respect of local dividends received by the client. Furthermore, the necessary systems development will need to take place in the systems and programs used to extract this data for the tax certificates.

SARS will also need to update their Business Requirement Specification in respect of their IT3b tax certificates to include the new Dividends Tax. The client services department will need to work in conjunction with the tax department and systems developers to ensure that the necessary changes are made to the tax certificates.

4.4 SYSTEMS DEVELOPMENT

Currently, the systems of financial institutions are not designed to deal with the proposed South African dividend withholding tax. Therefore, significant systems development needs to take place. Depending on the size of the financial institution and the type of systems which will be impacted by the new Dividends Tax, the length of time for systems development could be in the region of six months or longer. It is therefore unlikely that the three month notice period of the effective date of implementation of the Dividends Tax to be given by SARS is sufficient to carry out all the necessary development. For this reason it is imperative that financial institutions start attending to this as soon as possible. As a result of discussions with the

business analysts and information technology staff, the systems development required will include the following:

4.4.1 Data Input Fields

Data input fields need to be developed so that the relevant information on the declaration forms submitted by clients can be captured onto the system. The fields required will be:

- Nature of client - there should be a drop down box with a list to select from as follows:

Nature of Client	Exempt/Taxable
(i) Individual – Resident of South Africa	Taxable
(ii) Individual – Non-resident	Taxable – at possibly reduced rate per a Double Taxation Agreement
(iii) Company/Close Corporation - SA resident	Exempt
(iv) Company/Close Corporation/Trust - Non-resident	Taxable – at possibly reduced rate per a Double Taxation Agreement
(v) Trust – SA resident	Exempt
(vi) Government, a provincial administration or a municipality	Exempt
(vii) Public Benefit Organisation approved in terms of section 30(3);	Exempt
(viii) An institution, board or body contemplated in section 10(1)*(c*A) *;*	Exempt
(ix) A fund contemplated in section 10(1)*(d)*(i) or (ii);	Exempt
(x) a person contemplated in section 10(1)*(t)*;	Exempt

- Based on the nature of the client selected, this should link to data tables on the system which contain the applicable dividend tax rate, i.e. SA Company selected and 10% withholding tax rate applied from the table.

- Should numbers (ii) or (iv) above be selected, then another input field should be available in order to input the country of residence of the non-resident. A drop down selection box should be available to select a particular country.
- In respect of non-residents, all the possible countries should be listed in a table on the system together with the applicable reduced withholding tax rates per the Double Taxation Agreement with South Africa for each country. Depending on which country is selected, the applicable withholding tax rate should be applied to the dividend received.
- In the case where no declaration of exemption forms or treaty relief forms are received, the system should default to withhold 10% of the dividend in respect of Dividends Tax.

4.4.2 Flag Local Dividends

Systems need to be able to identify dividends paid by South African resident companies as well as dividends paid by foreign companies who are listed on the Johannesburg Stock Exchange, since these are the dividends included in the Dividends Tax net in terms of the definition of a ‗dividend' in section 64D of the Act.

4.4.3 Secondary Tax on Companies Credits

As mentioned previously, currently dividends received by South African companies can be set off against any dividends declared by them in calculating the net amount on which Secondary Tax on Companies is payable. In terms of section 64J of the new dividend withholding tax legislation, companies can pass down to their shareholders any excess dividends received, which are called Secondary Tax on Companies credits in terms of the new legislation. These Secondary Tax on Companies credits are then offset against the amount of the dividend before calculating the amount of Dividends Tax to withhold and pay over to SARS. Secondary Tax on Companies credits must be passed down with each dividend declared until they have been used up and companies do not have an option to elect for them not to be passed down. Companies must notify the relevant parties should they have Secondary Tax on Companies credits which have been passed down. These Secondary Tax on Companies credits must be allocated to each shareholder based on their shareholding regardless of whether they are

exempt from the Dividends Tax or not. In the case of a Collective Investment Scheme, the asset manager should notify them should an Secondary Tax on Companies credit be passed down with a dividend and they should provide all the necessary details to the Collective Investment Scheme.

Systems must be able to cater for Secondary Tax on Companies credits for a period of five years from the effective date of implementation of the dividend withholding tax, after which these Secondary Tax on Companies credits expire. There should be a field on the system to store the amount of the Secondary Tax on Companies credit per dividend received by each shareholder. This field must be able to be used in the calculation of the amount of Dividends Tax to withhold in respect of each dividend received. Besides this field being used in the calculation of the Dividends Tax withheld, it should also be available to be extracted for disclosure purposes on client statements and tax certificates.

4.4.4 Rebate in respect of Foreign Taxes Paid

There are a number of foreign companies which are listed on the South African stock exchange and whose dividends declared are subject to the new Dividends Tax. However, since they are registered for tax in their own tax jurisdictions, it is likely that their dividends declared would have also been subject to tax in their country of residence – in all likelihood it would also be a dividend withholding tax at shareholder level.

Section 64N of the Act states that should foreign tax have been incurred in respect of the dividend which cannot be recovered from the foreign tax authorities, then this foreign tax incurred on the dividend can be deducted from the South African dividend withholding tax due to SARS. However, the amount of the foreign tax that can be deducted is limited to the amount of the dividend withholding tax in South Africa.

Systems therefore need to be able to cater for foreign taxes incurred in respect of a local dividend declared and this information should be able to be stored on the systems and be used in the calculation of the final amount of dividend tax due to SARS. Besides this field being used

in the calculation of the Dividends Tax withheld, it should also be available to be extracted for disclosure purposes on client statements and tax certificates.

Another point worth noting is that once this foreign tax paid has been set off against the dividend withholding tax payable it is unlikely that this would be available to be claimed as a section 6quat deduction by the taxpayer as well.

4.4.5 Calculation

The systems need to be able calculate the amount of the Dividends Tax due to SARS in respect of each dividend received by the beneficial owners of the underlying shares. This calculation needs to identify each case where the company is the regulated intermediary and has the responsibility of calculating and withholding the Dividends Tax due to SARS. Then, the system needs to perform the following calculations:

Calculation 1 – Working out the net amount of the dividend received:

- Gross dividend received - Secondary Tax on Companies credits (if any) = Net dividend received

Calculation 2 – Applying the applicable withholding tax rate to the net amount:

- Net dividend received x applicable withholding tax rate *

  * = the applicable rate in relation to the nature of the client (see Data input field above)

Calculation 3 – Set-off any foreign taxes paid and not recoverable against the withholding tax obtained per Calculation 2:

- Withholding tax obtained in terms of Calculation 2 - foreign taxes paid

Note that the answer obtained in terms of Calculation 3 cannot be less than zero and the system should limit it to zero. The answer obtained in Calculation 3 is the final amount of Dividends Tax to be paid over to SARS.

Due to the fact that each legal entity within a financial institution is likely to have a number of products which are administered across different systems, it is essential that the system responsible for the dividend withholding tax can aggregate a number of fields across the systems and products. This is due to the fact that one Dividends Tax return per legal entity needs to be submitted and the Dividends Tax withheld paid to SARS. Therefore, the system needs to aggregate information to be disclosed on the return such as gross dividends paid to clients, total Secondary Tax on Companies credits, total refunds, total foreign tax rebates, total Dividends Tax due to SARS for the month, etc. for the legal entity.

4.4.6 Date of Payment

Another very important aspect in the systems development would be for the systems to be able to identify the correct date for payment of the dividend and a date of payment field may need to be built into the system. The reason for the date of payment being so important is that as in terms of section 64K(1) of the Act, the Dividends Tax needs to be paid over to SARS by the regulated intermediary by the end of the month following the month in which the dividend was paid to the shareholder. In terms of section 64E(2) of the Act, the date on which the dividend is paid to the shareholder is deemed to be the date on which it accrues to a shareholder. Failure by regulated intermediaries to identify the correct date of payment may result in a late payment of the Dividends Tax to SARS, which may result in penalties and interest being levied by SARS in accordance with section 64K of the Act (which will be discussed below).

With specific reference to the various financial institutions, the date of payment should be as follows:

- In the case of a Collective Investment Scheme, the dividend would only accrue to the unit holder when the Collective Investment Scheme distributes the dividend to its unit holders and not when the Collective Investment Scheme receives the dividend. The date of payment of the dividend to the unit holder is for the purposes of section 64E(2), the date it accrues to the shareholder. The date of payment of a dividend in respect of a Collective Investment Scheme is discussed further in 4.5.1 below.
- In the case of a Listed Investment Service Provider in respect of its wrap fund products, the date that the dividends are paid to the Listed Investment Service Provider in respect of the underlying investments would in all likelihood be the date that the dividend accrued to the unit holder in the wrap fund.
- In respect of a Long-Term Insurer, section 64I of the Act deems the dividends allocated to the individual policyholder fund to have been paid to a natural person who is resident on the date that the dividends were paid to the Long-Term Insurer.

4.4.7 Refunds

Section 64M of the Act deals with the refund process in respect of regulated intermediaries. A client of a financial institution, for example a unit holder in a Collective Investment Scheme is entitled to claim back any Dividends Tax over deducted by the Collective Investment Scheme in respect of a dividend distributed to the unit holder. In the case of regulated intermediaries, the refund process works as follows:

Should a client fail to submit a declaration form stating his/its declaration status which is ―exempt”, for example, and the regulated intermediary withholds Dividends Tax at the full rate of 10% which it is obliged to do, the client is entitled to claim a refund back from the regulated intermediary. The client has three years from the date of payment of the dividend in question to complete the declaration form and submit it to the regulated intermediary. The regulated intermediary then needs to pay the client the amount of the over-deducted Dividends Tax due out of any amount of Dividends Tax withheld by the regulated intermediary, after it received the declaration. No amount of the refund is claimable from SARS.

Therefore, systems need to be able to handle refunds to clients. Systems need to recalculate back in time what the correct amount of Dividends Tax is that should have been deducted in accordance with the now submitted declaration form(s) and compare that to the dividend tax already deducted. The difference then needs to be paid over to the client.

Once a refund transaction has been processed on the system, this should initiate payment to a client through the payment system/module. Bank details would either need to be submitted at the time of submitting the declaration form or should they already be on the system, they would need to be confirmed so that payment of the refund can be made timeously to the client.

The system must also be able to aggregate across all products (and across multiple systems if necessary) the total amount of refunds paid out to clients for a specific month. This total amount of refunds for the month then needs to be subtracted by the system from the total Dividends Tax payable to SARS for the month in question.

4.4.8 Submission Form and Payment

In terms of section 64K(2) of the Act, a regulated intermediary that withholds any Dividends Tax must pay the tax to the Commissioner by the last day of the month following the month during which the dividend is paid by the company that declared the dividend. SARS would need to design a submission form which will replace the current IT56 form in respect of dividends declared by companies under the Secondary Tax on Companies regime. However, it is important that this form is released sooner rather than later, since it is important that financial institutions obtain an understanding of the level of detail that SARS requires on these forms and ensure that their systems are developed in such a way that they have all the information in the correct format as required by SARS.

As discussed under the Calculation section above, it is likely that one form per legal entity will need to be submitted to SARS every month. Therefore, it is imperative that systems can aggregate all the required data for the form across all products/systems falling into each legal entity.

In respect of the payment of the Dividends Tax over to SARS, it is likely that SARS will capture the specific forms on the system and cater for the payment to be made on the SARS e-filing system. What SARS will also need to do is update their systems so that the IT3b tax certificates can be submitted to SARS via the SARS Easyfile system.

In terms of section 64K(6) of the Act, if a regulated intermediary fails to pay any Dividends Tax within the required period, interest must be paid by that person on the balance of the tax outstanding at the prescribed rate reckoned from the end of that period. Like the Secondary Tax on Companies regime, there does not appear to be a specific penalty written into the legislation for the late payment of Dividends Tax. However, in terms of section 64K(7) of the Act, the provisions of the Act relating to assessment and recovery of tax and administrative penalties in the event of default or omission apply, with the changes required by the context, in respect of the Dividends Tax. Therefore, section 75B of the Act which provides for administrative penalties in respect of non-compliance should apply in the case of non-payment or late payment of the Dividends Tax for example.

4.4.9 User Acceptance Testing and Testing of System

Once the system development is completed, it is essential that the system is tested by the system developers, business analysts and most importantly the tax specialists within the financial institution in order to ensure that the system is working in accordance with the legislation and the correct amount of Dividends Tax is calculated and withheld and paid over timeously to SARS. It is also essential to ensure that the refund process is in place from the start since until clients understand the importance of the declaration form in the case where they did not return it immediately, it is likely that there will be many refunds necessary at the start.

The system specification for the new Dividends Tax should be well documented by the system developers so that if changes to the specifications are necessary these can easily be made.

4.4.10 User Training

All the staff involved with the new Dividends Tax need to be trained on, for example, how to capture the particulars of the client in respect of the new Dividends Tax onto the system, how to change the particulars of the client, how to process a refund transaction, how to look up information, draw necessary reports, etc.

4.4.11 Internal Controls and Risk Reporting

It is essential that internal controls are built into the system development. Examples of such internal controls would be a check that the system performs a function which compares the particulars of the client captured in the Dividends Tax module to the particulars of the client on the existing client details module to ensure that the particulars of the client are, for example, a South African resident individual, in both modules. Other internal controls to be put in place include the requirement for a second approver to release refund payments to client, approval to change the nature of a client on the Dividends Tax module and quality controllers to check the input of information from the declaration forms onto the system.

Risk reports which can be drawn from the systems and reviewed should also be put in place. A report is required, which analyses the refunds per month or an exception report which reports on all clients whose dividend tax status has changed to —exempt” for example.

4.4.12 System Documentation

It is essential that the system developers document the changes to be made to the system in a system specification document.

4.5 SPECIFIC ISSUES IDENTIFIED DURING INTERVIEWS

4.5.1 Collective Investment Scheme Business Unit

During the interview with the relevant staff in the Collective Investment Scheme business unit, they confirmed the researcher‘s understanding of the new dividends legislation which has already been discussed above. However, the following specific concerns were raised by them:

a) Date of accrual of the dividend to the unit holders
b) Joint Accounts
c) Bulk Accounts
d) Gross versus net dividends declared.

a) Date of Accrual

The staff in the Collective Investment Scheme business unit expressed uncertainty in terms of the Dividends Tax legislation as to exactly when the dividends accrue (and are hence paid) to the beneficial owners of the units. Their question was essentially, does the dividend accrue on the date that the listed company, for example, declares the dividend to the Collective Investment Scheme or the date that the dividend is distributed to the beneficial owners of the units? Their query arose as a result of section 64K(2)(a) which states that any person that withholds any Dividends Tax in terms of this Part must pay the tax to the Commissioner by the last day of the month following the month during which the dividend is paid by the company that declared the dividend.

When dividends are received by the Collective Investment Scheme from the asset manager in respect the fund‘s underlying equity investments, the fund has a year in which to distribute the dividends to its unit holders before the Collective Investment Scheme itself becomes subject to income tax thereon. This is in terms of the trustee principle in section 25BA of the Act where a ―look-through" principle applies in respect of income received by a Collective Investment Scheme. In terms of this section of the Act, to the extent that an amount is distributed by a portfolio within 12 months of its receipt thereof to any person who is entitled to the distribution

by virtue of the person being a holder of a participatory interest in that portfolio, the amount must be deemed to have accrued directly to the person on the date of the distribution. Therefore, for income tax purposes it is clear that the dividend accrues to the unit holder on the date of distribution of the dividend by the Collective Investment Scheme to the unit holders. It is unlikely that SARS would want the date of accrual to be any different in terms of the new Dividends Tax legislation.

In terms of section 64E(2) of the Act, the dividend is deemed to be paid to the beneficial owner on the date that the dividend accrues to them. Since the Collective Investment Scheme can determine whether or not it distributes dividends received by it to its unit holders or not and the time frame in which it does distribute, it cannot be said that the dividends accrue to the beneficial owners of the units in the Collective Investment Scheme before the Collective Investment Scheme distributes these dividends to the unit holders. Therefore, the distribution of the dividend by the Collective Investment Scheme can essentially be seen as the ‗declaration of the dividend by the company‘ as set out in section 64K(2).

Therefore the date on which the company in which the Collective Investment Scheme holds shares pays the dividend is not the accrual date for the unit holders. The date the Collective Investment Scheme pays the dividend to its unit holders would be the date on which the dividend accrues to the unit holders. The Collective Investment Scheme would then have to pay over the withholding tax to SARS by the end of the month following the month in which the dividend was paid to the unit holders (date of accrual). It would therefore be essential for a Collective Investment Scheme to ensure that they get the date of accrual correct, especially where distributions are paid around month end, in order to avoid paying over the Dividends Tax outside the timeframe set by SARS. It is therefore also important that the date on which the dividend accrues to the Collective Investment Scheme is recorded and that the dividend is distributed to the unit holders within twelve months after that date. It would probably be beneficial to the Collective Investment Scheme to get clarity on the date of payment of the dividend from SARS.

b) Joint Accounts

Certain Collective Investment Schemes allow clients to hold joint accounts. In the event that the owners of the account are, for example, an individual and a company, different withholding tax rates will apply. In the case of a South African (―SA") resident individual, a withholding tax at a rate of 10% would apply, but in respect of a SA company, no Dividends Tax would need to be withheld. Financial institutions do not always know what percentage ownership each entity/person has within a joint account and in the past have not been required to ask for this information. However, the question is whether in this case SARS would require financial institutions to obtain this information and then split the dividend received according to the ownership percentages of each owner in a joint account and withhold the Dividends Tax accordingly, or whether they would simply want the total dividend received by a joint account to be taxed at the highest withholding tax rate of the two owners of the joint account. This question has been referred to the Association for Savings and Investments in South Africa to take up with SARS.

c) Bulk Accounts

There may be instances where a bulk account is held in a Collective Investment Scheme by, for example, a broker or an independent administrator (e.g. a Linked Investment Service Provider). A bulk account would be one account which contains a number of investments which is managed on behalf of a number of investors by such broker or independent administrator. In this case, a Collective Investment Scheme would not know who the beneficial owners of the units were and would only have contact and other details in respect of the broker or administrator. Therefore, in the case of bulk accounts, the broker or administrator would have the withholding tax obligation. The Collective Investment Scheme would then not have any responsibility to withhold Dividends Tax in respect of dividends paid to bulk accounts. The broker or the independent administrator would have the obligation to withhold and pay the dividend tax to SARS. However, it would make sense for a Collective Investment Scheme to inform the brokers/independent administrators of bulk accounts that the Collective Investment Scheme does not have the responsibility to withhold the Dividends Tax so that these other

parties are aware of this and can start preparing for the withholding tax and payment implications. The broker/administrator of the bulk account would therefore in essence be seen as another regulated intermediary in the chain.

d) Gross Versus Net Dividends Declared

Asset managers who manage the underlying asset‘s into which a Collective Investment Scheme invests, i.e. equity investments, would be a regulated intermediary in the sense that it would receive the dividends declared by the companies into which the Collective investment scheme has invested. The Central Securities Depositary Participant would in all probability receive the dividends declared by the companies and would pass the dividend on to the asset manager. The asset manager, being a regulated intermediary, would then pass the dividends on to the Collective Investment Scheme. However, although the asset manager receives the gross dividends declared by the companies into which the Collective Investment Scheme has invested, it incurs certain expenses in administering the receipt and payment of these dividends. The expenses are usually termed ―management fees" by the asset manager and are deducted against the gross amount of the dividends declared. The net amount of the dividend is then distributed to the Collective Investment Scheme which then passes this net dividend on to its unit holders.

The issue is whether the unit holders, being the beneficial owners of the underlying equity investments, should be subject to the Dividends Tax on the gross amount of the dividend or the net amount of the dividend.

Prior to the introduction of the Dividends Tax, local dividends were exempt from income tax in the hands of the investors since the company declaring the dividend paid the Secondary Tax on Companies to SARS. Therefore, due to the fact that local dividends were exempt from income tax, no expenditure incurred by an investor in connection with the dividend income received could be deducted in terms of section 11(a) of the Act since they were not incurred in the production of income. However, with the introduction of the dividend withholding tax, these

local dividends are now subject to a withholding tax which is a final tax on this dividend income.

Now that local dividends are no longer exempt from income tax, the question arises whether any expenses incurred by the unit holders, for example the management fees deducted by the asset manager, can be deducted before the withholding tax is calculated. Essentially should SARS allow the deduction of expenses, this would mean that the unit holders would be able to be taxed on the lower net amount instead of the gross amount of the dividend received.

It would also need to be ascertained whether the management fees deducted from the gross dividend by the asset manager would be an expense incurred by the unit holder or rather an expense incurred by the Collective Investment Scheme manager.

Currently only the net amounts of dividends are passed on to the Collective investment scheme and most Collective Investment Scheme systems only cater for the receipt of a net dividend. This same net dividend amount is then passed on to the unit holder. Should SARS prohibit the deduction of expenditure and hence require that unit holders be taxed on the gross amount of the dividends received by the asset manager, systems would need to be developed by the Collective Investment Scheme to cater for both gross and net dividends. Asset managers would then need to report both gross and net dividend figures to the Collective Investment Scheme Management Company.

4.5.2 Listed Investment Service Provider and Life Insurance Business Unit

Whilst interviewing the staff within the Listed Investment Service Provider and Long-term Insurance business unit, the following concerns were raised by them:

a) Different classes (with different withholding tax rates) in respect of each policyholder fund
b) Possible payment of interest to clients.

a) Different Classes (with different Withholding Tax Rates) in respect of each Policyholder Fund

Section 64I of the Act, which deals with the withholding responsibilities of Long-Term Insurers, states that if a dividend is paid to a Long-Term Insurer, the insurer must be deemed to be a regulated intermediary and the dividend must, to the extent that the dividend is allocated to the individual policyholder fund, be deemed to be paid to a natural person that is a resident by the regulated intermediary on the date that the dividend is paid to the insurer. Two anomalies in respect of this section were identified by the Long-Term Insurance business unit and are explained below.

In practice, in the case of the corporate and company policyholder funds, foreign companies may be included in these funds. These non-residents are in terms of the Dividends Tax legislation subject to the Dividends Tax at a possibly reduced rate under the Double Taxation Agreement between South Africa and the foreign country. However, is the intention of section 64I of the Act that only dividends allocated to the individual policyholder fund should be subject to the Dividends Tax?

Furthermore, care must be exercised in the case of trusts since, in practice, trusts are allocated to the four funds depending on the nature of their beneficiaries. In terms of the section 64F of the Act, South African trusts are exempt from the Dividends Tax – Dividends Tax will only be withheld and paid over to SARS by the trust when dividends are paid by the trust to its beneficiaries. Therefore, should a trust have beneficiaries who are individuals, the trust would be included in the individual policyholder fund. Dividends earned by this trust within the individual policyholder fund should not be subject to the dividend withholding tax. However, section 64I of the Act states that that dividends allocated to the individual policyholder fund should be deemed to be paid to natural persons who are resident. A trust is however not a natural person and should not be exempt from the Dividends Tax.

Another issue arises in that, in practice, non-resident individuals are included in the individual policyholder fund. Section 64I states that the dividends allocated to this fund should be

‗deemed to be paid to natural persons who are resident – does this mean that the non-resident individuals allocated to the individual policyholder fund should be taxed as though they are residents, i.e. not taxed on their dividends in accordance with the double-taxation agreement with their country of residence?

These issues would need to be addressed with SARS by an institution like Association for Savings and Investment in South Africa since these would be industry wide issues within the financial services sector that would need to be clarified by SARS. Perhaps the intention of the legislation is that all investors within the individual policyholder fund are taxed, however this does not appear to be in alignment with the taxpayers SARS intends to bring into the Dividends Tax net and those which they do not. A possible solution to this problem should SARS require, for example, that trusts included in the individual policyholder fund be exempt from the Dividends Tax, would be for long-term insurers to create classes of investors within the four funds depending on their Dividends Tax status. It will be assumed that SARS only intends that those taxpayers included in the individual policyholder fund will be subject to the Dividends Tax.

b) Possible Payment of Interest to Clients

Dividends Tax returns and payments for a particular month will be in respect of dividends paid to beneficial owners of shares in the previous month. This is due to the fact that, like Secondary Tax on Companies, Dividends Tax is to be paid to SARS by the end of the month following the month in which the dividend was paid.

What must considered is the timing between the withholding of the tax from the dividend paid to the beneficial owner and the actual payment of the Dividends Tax to SARS and whether any interest is due to the beneficial owner of the shares. Administratively what is likely to happen is that the Dividends Tax is to be withheld from the dividend on the date that it is paid (accrues) to the shareholder. This Dividends Tax will then be held in the financial institution‘s bank account until the end of the following month after the month in which the dividend was paid. The financial institution may then earn interest on this withholding tax during this period. The

question is whether this interest is due to the beneficial owner of the security or whether it can be said to accrue to the company/regulated intermediary in lieu of the costs of the administration involved in the withholding and payment of the Dividends Tax to SARS. This is one issue that the Association for Savings and Investments in South Africa may need to refer to SARS for approval in order to avoid such queries possibly being raised by clients of financial institutions. Previously in the Secondary Tax on Companies regime this was not an issue due to the fact that Secondary Tax on Companies was a tax on companies themselves and not on the shareholders.

4.5.3 Finance Staff

The finance staff noted that the Dividends Tax would impact their division in the following way: new ledger accounts in the finance system would need to be opened. One ledger account needs to be opened to which Dividends Tax withheld from dividends paid to clients would need to be credited. Another ledger account would need to be opened to which the refunds paid to clients for a particular month would be debited. The balances at the end of each month on these two accounts would then need to be transferred to a control account. The amount reflected in the control account at the end of month one would then need to be paid to SARS by the end of month two. These additional ledger accounts will need to be reconciled and reviewed on a monthly basis.

In addition to the above, reports would need to be built into the finance system so that finance staff are able to run queries in the system such as a report of all Dividends Tax refunds made to clients for a particular month for audit and investigation to ensure valid and accurate refunds are made to only those clients entitled to them. Additional reports for internal control purposes should also be built into the system, such as a report of all clients where the withholding tax rate is less than 10% (this will enable the finance division to check whether these clients are in actual fact exempt from the Dividends Tax or qualify for treaty relief in the case of non-residents) and a report to show how the Dividends Tax was calculated in the case of each withholding from a dividend received by a client. These reports should be available per regulated intermediary required to withhold and pay the Dividends Tax over to SARS.

The Finance Division would also need to ensure that the staff responsible for completing the Dividends Tax submission form know how to complete the form and submit it via e-filing on the SARS website. Staff should also know how to pay the Dividends Tax over to SARS via e-filing. Finance also raised the concern that the administration of this dividend withholding tax is going to be an additional cost to the business. However, it is unlikely that these costs can be recovered from the client by increasing the administration fees charged to them due to the current competition within the industry in respect of fees.

4.6 THE NEXT STEPS

Should a financial institution be defined as a regulated intermediary in terms of section 64D or section 64I of the Act, it will have the responsibility to ensure that Dividends Tax is withheld and paid over to SARS. Once this has been established it is essential that the financial institution commence with the following:

- All business units within the financial institution need to understand the new dividend withholding tax and the impact thereof on their areas of responsibility. Presentations should be made by the group tax department within the financial institution or by external consultants who should be contacted in to present the new Dividends Tax legislation to the staff;
- A project team within the financial institution needs to be set-up in order to manage the ―roll-out" of the new Dividends Tax;
- A business requirements document should be drawn up explaining the new Dividends Tax legislation and the impact on the financial institution and the requirement that the appropriate systems development and implementation needs to take place. This document should be approved by the relevant parties so as to give the go ahead for the project;
- A document should be drawn up and sent to an organization such as the Association for Savings and Investment in South Africa requesting them to clarify certain areas of uncertainty within the financial institution in respect of the Dividends Tax such as:

  - Date of payment of dividend in respect of a Collective Investment Scheme;
  - Gross versus net dividends declared in the case of a Collective Investment Scheme;
  - Withholding in respect of joint and bulk accounts of a Collective Investment Scheme; and
  - The requirement by SARS to only withhold Dividends Tax on dividends allocated to the individual policyholder fund;
- The Client Services department should commence with the following:
  - Undergo training on the new Dividends Tax
  - Notify clients of the new Dividends Tax
  - Prepare for the sending out, receipt and capturing of declaration forms
  - Ensure that client statements are updated to cater for the Dividends Tax
  - Ensure that tax certificate templates are updated for the Dividends Tax;
- A system specifications document detailing the systems development that is required should be drawn up by the developers and business analysts. These systems specifications should be reviewed by the tax specialists to ensure that they comply with the Dividends Tax legislation. It should also be reviewed by the finance department to ensure that the necessary internal controls have been put in place. Once the systems specification is completed, system development should commence;
- The necessary systems development should take place;
- The systems development should be documented and tested;
- User acceptance testing should be performed and users should be trained on the new system development; and
- The finance department should open the necessary ledger accounts and ensure the necessary reports required for internal control and reporting purposes are developed. They should also ensure that they are competent to deal with e-filing in respect of the submission form and payment.

4.7 CONCLUSION

A Collective Investment Scheme, Listed Investment Service Provider and Long-term Insurer are all defined as regulated intermediaries in terms of the Act and therefore have a responsibility to withhold Dividends Tax and pay it over to SARS. Due to the number of clients of a financial institution as well as the fact that dividends are declared almost monthly to these clients, the dividends tax will form part of the everyday processing of transactions in these organizations. Therefore, as can be seen from the discussion in this chapter, the impact of the new dividends tax on financial institutions is quite significant and almost every department within such an organization will be affected by it. The client services department has an important role to play in this implementation as do the system developers, finance department and group tax department.

The present chapter discussed the impact of the new Dividends tax on these departments as was ascertained from interviews with key employees with the departments. Potential problems relating to the implementation of the Dividends Tax raised during interviews with employees were also documented. Some of the issues where clarity is required would need to be referred to the Association for Savings and Investments in South Africa, to be taken up with SARS.

The final chapter will conclude the thesis by briefly summarising the important findings of the research.

CHAPTER 5:
CONCLUSION

The goal of this research was to determine the impact of the new Dividends Tax on regulated investment intermediaries. However, before the impact could be determined it was necessary to first compare the existing Secondary Tax on Companies Legislation to the new Dividends Tax legislation in order to provide the context to the research and to provide an understanding of the extent of change between the two different taxing systems. Chapter 2 therefore dealt with the Secondary Tax on Companies legislation as well as the new Dividends Tax legislation. In summary, Secondary Tax on Companies is a tax levied at a company level on dividends declared by South African companies whereas the new Dividends Tax legislation is a withholding tax levied at a shareholder level with the companies declaring the dividend or a regulated intermediary having the responsibility to withhold the Dividends Tax and pay it over to SARS on behalf of the shareholder. Generally, individual clients, clients in the individual policyholder fund and non-resident clients will be subject to the Dividends Tax. The reason for the change from Secondary Tax on Companies to the new Dividends Tax legislation is to align the system of taxing distributions by companies with international practice, since the majority of the rest of the countries in the world provide for dividend withholding tax on dividends. The main reason for the delay in implementation of the Dividends Tax is due to the fact that the Double Taxation Agreements between South Africa and the rest of the world need to be renegotiated in respect of the article on dividends.

Chapter 3 then dealt with determining the withholding responsibility of regulated investment intermediaries. In terms of the new Dividends Tax legislation, a Collective Investment Scheme, Listed Investment Service Provider and Long-term Insurer are all defined as regulated intermediaries in terms of the Act and therefore have a responsibility to withhold Dividends Tax

and pay it over to SARS in respect of dividends received by their clients, unless the dividend is to be paid to another regulated intermediary or the regulated intermediary receives a declaration of exemption form from their client

Chapter 4 then analysed the impact on the new Dividends Tax on a Collective Investment Scheme, Linked Investment Service Provider as well as a Long-Term Insurer. Due to the number of clients of a financial institution as well as the fact that dividends are declared almost monthly to these clients, the Dividends Tax will form part of the everyday processing of transactions in these organizations. As a result of the research it was determined that the impact of the new Dividends Tax on financial institutions is quite significant and almost every department within such an organization will be affected by it. The client services department has a big role to play in this implementation as do the systems developers, the finance department and the group tax department.

The following is a summary of the impact of the new Dividends Tax on regulated investment intermediaries such as Collective Investment Schemes, Linked Investment Service Providers and Long-Term Insurers:

The following needs to be carried out by the client services department:

- Clients need to be notified about the new Dividends Tax legislation and its impact on their investments;
- Training needs to be provided to the call centre and client staff in respect of the new Dividends Tax;
- Declaration of exemption forms need to be sent to clients and those clients who qualify for exemption from the Dividends Tax need to complete such form and send it back to the financial institution which then needs to capture this detail on the system;
- Client statements need to be amended to reflect the amount of Dividends Tax withheld; and
- Tax certificate templates need to be amended to cater for the Dividends Tax withheld.

The following system development needs to be carried by the business analysts/IT developers:

- Data input fields need to be created on the system so that users can capture the relevant information required for the Dividends Tax;
- The system must be able to flag local dividends declared;
- The system must be able to cater for Secondary Tax on Companies credits;
- The system must be able to cater for rebates in respect of foreign tax paid on local dividends declared by dual listed companies;
- The system must be able to calculate the amount of Dividends Tax to withhold in respect of each dividend received by a client;
- The date of payment of the dividend must be catered for on the system so as to ensure timely payment of the Dividends Tax to SARS;
- Refunds of over-deducted Dividends Tax must be able to be processed by the systems and clients must be able to be paid this refund;
- The system must be able to collate all dividends declared and the Dividends Tax withheld per entity since one Dividends Tax return form per legal entity needs to be submitted to SARS;
- User acceptance testing as well as user training needs to be carried out in respect of the systems changes;
- Internal controls and risk reporting need to be put in place in respect of the new Dividends Tax; and
- The Dividends Tax system specifications need to be documented.

Due to the magnitude of the impact of this new Dividends Tax on regulated investment intermediaries it would probably be essential that a financial institution manages the implementation of this as a high priority project with a dedicated project manager allocated to it. It would also be essential to get the group tax department to form part of the project team or if the organization does not have in-house tax specialists, that external tax consultants are contracted in to form part of the project team. The tax specialists would need to sign off the system specifications and be on hand to ensure that the project team understands the new

Dividends Tax legislation and that the system developers implement it in accordance with the legislation. During the discussions with the system developers it was noted that the system development and testing itself should take in the region of at least six months. This six month period does not include preparing the system specifications. In terms of the regulation, SARS is entitled to give only a three month notice period for the intended effective date of the legislation. It is therefore recommend that financial institutions start preparing for the implementation of this Dividends Tax as soon as possible.

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