DRAFT

DRAFT INTERPRETATION NOTE

DATE:

ACT	**:**	**INCOME TAX ACT NO. 58 OF 1962**
SECTIONS	**:**	**SECTIONS 1(1) – DEFINITION OF "FOREIGN DIVIDEND", 6*quat*, 9(4)(*a*), 9D(9)(*f*), 10B, 22(3)(*a*)(iii), 23(*q*) AND 25D AND PARAGRAPH 20(1)(*h*)(iii) OF THE EIGHTH SCHEDULE**
SUBJECT	**:**	**THE TAXATION OF FOREIGN DIVIDENDS**

CONTENTS

PAGE

Preamble 3

1. Purpose 3

2. Background 4

3. The law 4

4. Application of the law 4

4.1 Definitions [section 1(1)] 4

4.1.1 Definition of "foreign dividend" 4

(a) Meaning of any "amount" 5

(b) Meaning of "paid or payable" 6

(c) Meaning of "foreign company" 8

(d) Meaning of "in respect of a share" 8

(e) Treatment of an amount paid or payable by a foreign company in respect of a share under foreign income tax law on companies or company law (paragraphs (*a*) and (*b*) of the definition of "foreign dividend") 10

(f) Onus to obtain information on the income tax law on companies or company law of a foreign country 13

(g) Interpretation of the income tax law on companies or company law of a foreign country 14

(h) Exclusion from the definition of "foreign dividend" – Redemption or buy-back of a participatory interest in a foreign collective investment scheme (paragraph (i) of the exclusions) 14

(i) Exclusion from the definition of "foreign dividend" – An amount paid or payable by a foreign company that constitutes a share in that company (paragraph (iii) of the exclusions) 14

4.1.2 Definition of "foreign company" 15

4.1.3 Definition of "foreign return of capital" 17

4.1.4 Definition of "controlled foreign company" 17

4.2 Inclusion of foreign dividends in gross income [paragraph (*k*) of the definition of "gross income" in section 1(1)] ... 18

4.2.1 Inclusion of foreign dividends in gross income of residents and CFC's ... 18

4.2.2 Gross amount of foreign dividends included in gross income ... 18

4.2.3 Receipt or accrual of a foreign dividend ... 18

4.3 Exemption of foreign dividends (section 10B) ... 19

4.3.1 The participation exemption [section 10B(2)(*a*)] ... 19

(a) The participation exemption ... 19

(b) Application of the participation exemption to a group of companies ... 20

(c) Holding of shares ... 20

4.3.2 The country-to-country exemption [section 10B(2)(*b*)] ... 23

4.3.3 Exemption of amounts previously included in income under section 9D(2) [section 10B(2)(*c*)] ... 27

(a) Exemption of amounts previously included in income ... 27

(b) Application of either the participation exemption under section 10B(2)(*a*) or the exemption for amounts previously included in income under section 10B(2)(*c*) ... 31

4.3.4 Foreign dividends received or accrued in cash in respect of shares listed on the JSE [section 10B(2)(*d*)] ... 32

4.3.5 Foreign dividend received or accrued in respect of listed shares consisting of the distribution of an asset *in specie* [section 10B(2)(*e*)] ... 32

4.3.6 Application of the provisos to section 10B(2) ... 33

(a) Non-application of the "participation exemption" and the "country-to-country exemption" – Foreign dividends allowed as a deduction [proviso to section 10B(2)] ... 33

(b) Application of the participation exemption under section 10B(2)(*a*) to equity shares only [second proviso to section 10B(2)] ... 34

4.3.7 The partial exemption [section 10B(3)] ... 35

(a) Application of the partial exemption ... 35

(b) Application of the partial exemption to CFCs ... 38

4.3.8 Non-application of the participation exemption under section 10B(2)(*a*) and the country-to-country exemption under section 10B(2)(*b*) [section 10B(4)] ... 41

(a) Foreign dividend determined with reference to or which arose from a deductible amount paid or payable by any person [section 10B(4)(*a*)] ... 41

(b) Foreign dividends received or accrued from a foreign collective investment scheme [section 10B(4)(*b*)] ... 43

4.3.9 Non-application of the exemptions under section 10B(2) to any payments out of foreign dividends [section 10B(5)] ... 45

4.3.10 Non-application of section 10B(2) and (3) – Foreign dividends in respect of services rendered, employment or holding of office [section 10B(6)] ... 46

4.4 An amount paid or payable by a foreign company in respect of a share that does not constitute a foreign dividend ... 47

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

4.6 Source of foreign dividends [section 9(4)(*a*)] ... 48

4.7 Translation of a foreign dividend denominated in a foreign currency to rand (section 25D) ... 48

4.8 Rebate for foreign taxes on foreign dividends (section 6*quat*) ... 49

4.9 Controlled foreign companies [sections 9D(9)(*f*), 22(3)(*a*)(iii) and paragraph 20(1)(*h*)(iii)] ... 51

4.9.1 Foreign dividends not included in the net income of a CFC [section 9D(9)(*f*)] ... 51

4.9.2 Determination of the cost price of a right in a CFC held as trading stock [section 22(3)(*a*)(iii)] ... 52

4.9.3 Determination of the base cost of a right in a CFC [paragraph 20(1)(*h*)(iii)] ... 53

4.10 Anti-avoidance provisions ... 54

5. Conclusion ... 54

Annexure – The law ... 56

Preamble

In this Note unless the context indicates otherwise –

- **"CFC"** means a "controlled foreign company" as defined in section 1(1);
- **"CGT"** means capital gains tax, being the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- **"JSE"** means the securities exchange operated by JSE Ltd;
- **"OECD"** means the Organisation for Economic Co-operation and Development;
- **"paragraph"** means a paragraph of the Eighth Schedule;
- **"Schedule"** means a Schedule to the Act;
- **"section"** means a section of the Act;
- **"tax treaty"** means an agreement for the avoidance of double taxation entered into between South Africa and another country;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

In the examples, the amounts of foreign dividends, foreign tax and other amounts have already been translated from foreign currency to rand.

1. Purpose

This Note provides guidance on the interpretation and application of various provisions of the Act relating to foreign dividends. The Note does not deal with the income tax consequences of a dividend paid by a headquarter company since this is addressed in the draft Interpretation Note issued on 12 February 2015 "Headquarter Companies".

2. Background

With effect from 1 January 2011 a definition of "foreign dividend" was introduced into section 1(1) and, combined with the insertion of the definition of "foreign company" and changes to the definition of "dividend", had the result that on or after that date foreign dividends no longer fall within the definition of "dividend" in section 1(1). A dividend and a foreign dividend are mutually exclusive. A dividend relates solely to certain amounts transferred or applied by a resident company. A foreign dividend relates solely to certain amounts paid or payable by a foreign company, which by definition is a non-resident.

Broadly speaking, a foreign dividend is included in a resident's gross income but may qualify for a full or partial exemption from normal tax. With effect from March / April 2012[1] the exemptions available for foreign dividends meeting the relevant criteria under section 10(1)(*k*)(ii)(*aa*) to (*dd*) were moved to section 10B(2) and underwent some amendment. In addition, the basic exemption available to natural persons of R3 700 under section 10(1)(*i*)(xv)(*aa*)[2] for foreign dividends and foreign interest not otherwise exempt, was deleted and an alternative partial exemption was introduced under section 10B(3). The partial exemption under section 10B(3) was intended to ensure that the effective rate of tax on taxable foreign dividends would generally not exceed the 15% rate of tax applicable to local dividends under dividends tax, which was introduced on 1 April 2012.

This Note discusses the current gross income inclusion, exemptions and other provisions applicable to foreign dividends.

3. The law

The relevant provisions of the Act are quoted in the **Annexure**.

4. Application of the law

4.1 Definitions [section 1(1)]

4.1.1 Definition of "foreign dividend"

The term "foreign dividend" is defined in section 1(1) as follows:

> " **'[F]oreign dividend'**, means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to—
>
> (*a*) tax on income on companies of the country in which that foreign company has its place of effective management; or
>
> (*b*) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,
>
> but does not include any amount so paid or payable that—

[1] For an explanation of the effective dates see paragraph 4.3.2 of the *Tax Guide for Share Owners* (Issue 4) dated 17 February 2014.

[2] The basic exemption was deleted with effect from 1 March 2012.

(i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (*e*)(ii) of the definition of "company"; or

(ii) . . . . . .

(iii) constitutes a share in that foreign company;"

The various elements of the definition of "foreign dividend", including the exclusions from the definition, are discussed below.

(a) Meaning of any "amount"

The meaning of "amount" was judicially considered in *WH Lategan v CIR*[3] in relation to its use in the definition of "gross income" and the following dictum of Watermeyer J has been acknowledged and applied in a number of other cases:[4]

> "In his Lordship's opinion the word 'amount' had to be given a wider meaning and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which had a money value."

In *CIR v People's Stores (Walvis Bay) (Pty) Ltd*[5] the court in applying this principle held that the right to claim payment of a debt in the future was of such a nature that a value could be attached to it in money and the amount therefore had to be included in gross income. Similarly in *Cactus Investments (Pty) Ltd v CIR,*[6] the court included the right to receive interest in the future in gross income because it was a right of a non-capital nature which was "capable of being valued in money".

In *C: SARS v Brummeria Renaissance (Pty) Ltd & others*[7] it was held that the ability to turn a receipt or accrual into money was merely one of the tests for determining whether an accrual had a money value and it did not follow that if a receipt or accrual could not be turned into money that it had no money value.[8] The court also confirmed that the test whether a receipt or accrual had a money value was objective, not subjective.

The same meaning should be ascribed to the word "amount" within its context in the definition of "foreign dividend" in section 1(1).

A foreign dividend can therefore constitute the payment of cash or the transfer of assets (a dividend *in specie*). A foreign dividend *in specie* paid or payable by a foreign company can include amongst other things the transfer of the following:

- Shares held by the foreign company in another company.
- Debentures.
- Other movable or immovable assets.

---

[3] 1926 CPD 203, 2 SATC 16 at 19.

[4] See *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301, 13 SATC 21 at 34 and *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 21.

[5] 1990 (2) SA 353 (A), 52 SATC 9.

[6] 1999 (1) SA 315 (SCA), 61 SATC 43.

[7] 2007 (6) SA 601 (SCA), 69 SATC 205.

[8] See also Interpretation Note No. 58 (Issue 2) dated 4 October 2012 "The *Brummeria* Case and the Right to Use Loan Capital Interest Free".

The value to be placed on the transfer of assets as a foreign dividend *in specie* is their market value.[9]

(b) Meaning of "paid or payable"

A foreign dividend is, amongst other requirements, an amount that is paid or payable by a foreign company.

In *Marra Developments Ltd v BW Rofe (Pty) Ltd* it was held as follows:[10]

> "Under the general law, the payment of a dividend normally involves two steps: the declaration of the dividend by the competent authority…and the payment over of money in satisfaction of the dividend".

Paid

An amount can be paid in cash or kind. There is generally little difficulty in determining the date of payment when the dividend is paid in cash. However, the date of payment can be more difficult to establish when payment is in a form other than cash. ITC 1688[11] sets out some useful principles for determining the date of payment of a dividend when payment is in the form of set-off, cheque or loan account.

In that case the appellant company declared a dividend to its sole shareholder on 2 March 1992 and 5 March 1993. Payment of these dividends was not made in cash or by cheque, instead the resolutions declaring the dividends provided that payment of the dividend would be effected by crediting the shareholder's loan account. Journal entries were effected giving credit to the shareholder, however the shareholder's loan account was only credited on 31 July 1993. At issue was whether the dividends were subject to STC which came into operation on 17 March 1993. The relevant legislation provided that dividends declared before 17 March 1993 that were paid on or after that date were deemed to be declared on 17 March 1993 thus making them potentially subject to STC. The crisp issue was whether the dividends were paid before 17 March 1993.

In delivering his judgment Galgut J stated the following on the nature of payments generally:[12]

> "The determination of the date upon which a payment is made is of course a question of fact. When payment of a dividend is made in cash there can of course be no difficulty in determining the date of such payment. The same applies to a payment by cheque, even if the cheque is post-dated or dishonoured, because payment will be effected when the proceeds of the cheque are received by or on behalf of the payee.
>
> "Payment can of course be made other than in cash or by cheque. There are a number of possibilities. To take but one, it might happen for example that a shareholder owes his company money, and that the company thereafter becomes indebted to the shareholder by the declaration of a dividend. In such a case the company may elect to effect a set-off, provided of course all of the other requisites for a set-off are present. One such requisite is that both debts must be fully due. In such a case the shareholder would have no choice because, as was said in *Lester Investments (Pty) Ltd v Narshi* 1951 (2) SA 464 (C) at 472B-C, set-off operates *ipso*

9 *Lace Proprietary Mines Ltd v CIR* 1938 AD 267, 9 SATC 349.
10 (1977) 3 ACLR 185 CA (NSW) at 195.
11 (1999) 62 SATC 478 (N).
12 At SATC 481.

> *jure*,[13] and it is effective from the date upon which the parties became mutually indebted to each other. It would therefore operate without the shareholder's consent, and what is more it would operate immediately upon the declaration of the dividend. If the debt owing by the shareholder is recorded in a loan account with the company, then the set-off will be recorded by crediting the taxpayer's loan account in the amount concerned.
>
> "It is important to emphasise, however, that such crediting is no more than a recording of a pre-existing fact, so that the operation of the set-off will not depend upon the crediting of the loan account.
>
> "As distinct from the operation of a set-off, or from the tender of cash or (subject to certain qualifications which are not relevant for present purposes) a cheque, all other forms of payment can only discharge a debt if the creditor agrees thereto. One such agreement is where the creditor agrees, as in the present case, to lend the money concerned to the debtor, where he agrees in other words that the debtor may retain the money as a loan. In such an event, as in the case of a set-off, both the payment of the dividend and the advancing of the loan in each instance take place automatically, and as such they are effected *pari passu* with the conclusion of the agreement. As such, and this must be emphasised, payment is in each case effected on the date upon which the agreement is concluded. It would of course be otherwise were the resolution whereby the dividend is declared to contain a term showing that the dividend is to be paid at some date thereafter, or were the agreement of loan to contain a term showing that the loan would similarly be delayed. In the absence of such an indication, in the absence in other words of anything to show that the parties intended otherwise, it would be fair to conclude that both the payment of the dividend and the reciprocal advancing of the loan occurred, and were intended to occur, then and there."

In summary, the court held that payments in a form other than cash, cheque or set-off can only discharge a debt with the creditors consent. Based on the facts of the case the court found that consent took place when the respective resolutions were passed and not when the physical crediting of the loan account took place and accordingly found in favour of the appellant.

In concluding the court stated the following:[14]

> "I should emphasise finally that nothing I have said should be understood to mean that where declared dividends are left on loan in a company, it will be presumed or will necessarily mean that payment takes place at the time the dividend is declared. At the risk of repeating myself I stress that the date of payment is a question of fact, and that as such the date must be determined on the particular facts of each case."

The judge's concluding comments highlight that the outcome of ITC 1688 may have been different had the resolution contained a term indicating that payment would be made at a later date. This case emphasised the importance of the facts of the particular case in determining when an amount is considered to be paid and highlighted that the crediting of a loan account will not necessarily constitute payment.

---

13 By operation of law.

14 At SATC 482.

Payable

The declaration of a dividend creates a debt owing to a holder of a share. Such a debt arises out of a formal act performed by a company.[15] A dividend declared by a company that is not listed is generally due on the date on which the dividend is declared even if it is stipulated to be payable on a later date. In the case of a listed company a dividend declared is generally due to holders of shares listed in the share register only on the "last day to register" with payment to follow at a later specified date.

It has been held that the word "payable" can have different meanings. In *CIR v Janke*[16] Stratford J quoted[17] the judgment of Searle J in *Stafford v Registrar of Deeds*:[18]

> " 'It is clear that the word 'payable' is sometimes construed as meaning 'payable at a future time' or 'in respect of which there is a liability to pay'. It is also true that it is sometimes used to mean 'payable immediately' or 'actually due and presently demandable'.' "

In *Singh v C: SARS* Olivier JA stated that –[19]

> "[t]he word 'payable' can have at least two different meanings, *viz* '. . . (*a*) that which is due or must be paid, or (*b*) that which may be paid or may have to be paid . . . The sense of (*a*) is a present liability – due and payable – . . . (*b*) . . . a future or contingent liability'."

In the context of the definition of "foreign dividend" in section 1(1), "payable" must be interpreted to mean "payable at a future time". A dividend is payable once it is due to the holders of the shares under the principles discussed above. This approach is consistent with the determination of the timing of the accrual from a gross income perspective under paragraph (*k*) of the definition of "gross income" in section 1(1) and the exemptions in section 10B which refer back to the definition of "foreign dividend" in section 1(1). Thus, assume that a listed foreign company declared a dividend payable to holders of its shares listed in the share register on 31 December with payment to follow on 31 March. On 31 December the dividend accrued to the holder of shares and because it will be viewed as being payable by that foreign company for purposes of the definition of "foreign dividend" in section 1(1), the exemptions in section 10B can be applied if the other requirements of the section are met.

(c) Meaning of "foreign company"

See the definition of "foreign company" in **4.1.2**.

(d) Meaning of "in respect of a share"

The amount paid or payable by a foreign company must, amongst other requirements, be paid or payable "in respect of a share" in that company.

---

[15] *Boyd v CIR* 1951 (3) SA 525 (A), 17 SATC 366 at 377; *South African Iron and Steel Industrial Corp Ltd v Moly Copper Mining and Exploration Co (SWA) Ltd & others* 1993 (4) SA 705 (NMH) at 711 and 713.

[16] 1930 AD 474, 4 SATC 269.

[17] At SATC 276.

[18] 1913 CPD 379.

[19] 2003 (4) SA 520 (SCA), 65 SATC 203 at 216.

The term "share" is defined in section 1(1) as follows:

> " **'[S]hare'** means, in relation to any company, any unit into which the proprietary interest in that company is divided;"

The term "proprietary interest" is not defined in the Act. Its ordinary meaning is described as –[20]

> "[a]dvantage, profit, right, or share held by the owner of a tangible or intangible asset or property with all associated rights".

In *Standard Bank of South Africa Ltd & Another v Ocean Commodities Inc & others* Corbett JA stated the following regarding the meaning of a share:[21]

> "A share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends."

The question whether a foreign company has shares and whether an amount is paid or payable in respect of a share in that company is a factual one. It was held by Howie P in *Stevens v C: SARS*[22] that "in respect of" in paragraph (*c*) of the definition of "gross income" in section 1(1) connotes a causal relationship between the amount received and the taxpayer's services.[23] Applying this construction to the definition of "foreign dividend", there must be a causal relationship between the amount paid or payable and the share.

An amount which is unrelated to a person's shareholding will not be derived "in respect of" a share. For example, the purchase by a foreign company of an asset at an arm's length price from a holder of shares on the same terms offered to the public would not constitute a foreign dividend because the amount paid by the company to that holder would not have been paid "in respect of" the holder's shares in the company but by virtue of the arm's length acquisition of the asset by the company.

Another example arises when a holder of shares is an employee of the foreign company and receives remuneration for services rendered. The salary paid to the employee would generally not be "in respect of" the employee's shareholding but "in respect of" the employee's services and would accordingly not constitute a foreign dividend. The facts of each case must, however, be considered. For example, if the employee had sufficient shares to exercise control over the company and was able to influence the payment of an excessive salary then there may be a link to the employee's shareholding.

---

20 http://www.businessdictionary.com/definition/proprietary-interest.html [Accessed 27 October 2015].

21 1983 (1) SA 276 (A) at 288.

22 2007 (2) SA 554 (SCA), 69 SATC 1 at 7.

23 See also *De Villiers v CIR* 1929 AD 227, 4 SATC 86; ITC 1493 (1989) 53 SATC 187 (T) and ITC 1856 (2011) 74 SATC 76 (WC). See *CIR v Shell Southern Africa Pension Fund* 1984 (1) SA 672 (A), 46 SATC 1 for a discussion on causally relevant factors and their interruption.

(e) Treatment of an amount paid or payable by a foreign company in respect of a share under foreign income tax law on companies or company law (paragraphs (*a*) and (*b*) of the definition of "foreign dividend")

An amount paid or payable by a foreign company in respect of a share in that foreign company must, amongst other requirements, be treated as a dividend or similar payment by that foreign company under –

- the laws relating to tax on income on companies, that is, income tax laws on companies, of the foreign country in which that foreign company has its place of effective management; or
- the laws relating to companies in the country in which that foreign company is incorporated, formed or established, if that country does not have any applicable income tax law on companies.

The use of the words "that foreign company" indicate that in assessing whether an amount is treated as a dividend or similar payment it must be considered from the perspective of the foreign company paying the amount in respect of its shares and not from the perspective of the holder of the foreign company's shares.

The company law of a foreign country is considered only for purposes of the definition of "foreign dividend" if the foreign country in which the company has its place of effective management does not have any applicable income tax law on companies. "Applicable laws" refer to income tax laws which deal with the treatment of amounts paid or payable in respect of shares and also to the income tax laws applicable to the specific taxpayer concerned. For example, a foreign country may have different income tax provisions for amounts paid or payable in respect of shares by different types of companies. The income tax treatment of an amount paid or payable by a collective investment scheme, which constitutes a company, in respect of a share may, for example, differ from the income tax treatment of an amount paid or payable by a company incorporated with share capital in respect of a share.

Income tax laws on companies of the foreign country in which that foreign company has its place of effective management

The term "place of effective management" is not defined in the Act and must be given its ordinary meaning, taking into account international precedent and interpretation. It does not, however, have a universally accepted meaning and various countries, including members of the OECD, continue to attach different meanings to it. The principles and guidelines that will be applied for purposes of considering the term "place of effective management" in the definition of "resident" in section 1(1) are discussed in Interpretation Note No. 6 "Resident – Place of Effective Management (Companies)".[24] The following are extracts from paragraphs 4.1 and 4.2 of that Interpretation Note (Issue 2):

> "A company's place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a

[24] Issue 2 of the Interpretation Note dated 3 November 2015 applies to years of assessment commencing on or after 3 November 2015. Issue 1 dated 26 March 2002 applies to earlier periods.

> whole are in *substance* made. This approach is consistent with the OECD's commentary on the term 'place of effective management'."[25]
>
> "A company may have more than one place of management but it can only have one place of *effective* management at any one time.[26] If a company's key management and commercial decisions affecting its business as a whole are made at a single location, that location will be its place of effective management. However, if those decisions are made at more than one location, the company's place of effective management will be the location where those decisions are primarily or predominantly made."
>
> "Definitive rules cannot be laid down in determining the place of effective management and all relevant facts and circumstances must be examined on a case-by-case basis."
>
> "The place of effective management test is one of *substance over form*. It therefore requires a determination of those persons in a company who actually 'call the shots' and exercise 'realistic positive management'."

Factors which may be relevant in determining whether an amount paid or payable by a foreign company in respect of a share constitutes a dividend or similar payment from that company's perspective under the income tax law on companies of the country in which the foreign company has its place of effective management include, for example, –

- whether the amount constitutes a dividend or similar payment for determining normal or corporate tax on taxable income in the foreign country;
- whether the amount constitutes a dividend for purposes of withholding tax on dividends in the foreign country;
- whether the amount constitutes interest for purposes of withholding tax on interest in the foreign country; and
- the classification of the amount for purposes of tax treaties, namely, the tax treaty between South Africa and the foreign country in which the foreign company paying the amount is effectively managed.[27]

A foreign country in which a company has its place of effective management may under its income tax law on companies deem a dividend that is paid or payable in respect of a share to be interest that is deductible against income. For example, if the amount paid has a debt-like yield, such as a dividend calculated with reference to a specified interest rate or index, or a dividend calculated with reference to any factor other than the profits of the company which are available for distribution, the foreign tax law may deem that dividend to be interest paid by the foreign company declaring the dividend. Notwithstanding that it is paid or payable in respect of a share, from the perspective of the company paying or declaring the dividend the amount is

[25] Paragraph 24 of the *Commentaries on the Articles of the Model Tax Convention on Income and on Capital*, Condensed version, dated 15 July 2014 at 90.

[26] The view that a company can have only one place of effective management at any one time is consistent with paragraph 24 of the *Commentaries on the Articles of the Model Tax Convention on Income and on Capital*, Condensed version, dated 15 July 2014 at 91.

[27] See Binding Class Ruling: BCR 041 dated 24 July 2013 "Dividends Distributed by a Foreign Company" and Binding Class Ruling: BCR 046 dated 16 April 2015 "Dividends Distributed by Foreign Companies" dealing with the application of paragraph (*a*) of the definition of "foreign dividend" in section 1(1).

considered to be interest and not a dividend or a payment similar to a dividend. As a result, the amount does not constitute a "foreign dividend" as defined in section 1(1) and cannot qualify for any of the exemptions available under section 10B.

Example 1 – Tax treatment of an amount paid or payable by a foreign company in respect of a share under foreign income tax law on companies

Facts:

Individual A holds 2% of the equity shares in Foreign Company A. Foreign Company A is effectively managed in Foreign Country A. Foreign Company A paid R100 000 out of its profits to Individual A in respect of the 2% shares in Foreign Company A.

Under Foreign Country A's income tax law on companies any distribution of profits made by a company to its holders of shares must be treated as a dividend by that company.

Result:

The amount of R100 000 paid by Foreign Company A constitutes a foreign dividend under paragraph (*a*) of the definition of "foreign dividend" in section 1(1) because Foreign Company A must treat the amount as a dividend under the income tax law on companies of Foreign Country A.

The income tax laws on natural persons of Foreign Country A are not considered in determining whether the amount of R100 000 constitutes a foreign dividend.

Laws relating to companies in the country in which that foreign company is incorporated, formed or established, if that country does not have any applicable income tax law on companies

To determine how the company law of a foreign country treats an amount paid or payable by a foreign company in respect of a share, regard must be had to the company law of that country and not the company law of South Africa.

Example 2 – Treatment of an amount paid or payable by a foreign company in respect of a share under foreign company law

Facts:

Resident Company A holds shares in Foreign Company A which is effectively managed in Foreign Country A while it is incorporated in Foreign Country B. Foreign Country A does not have any income tax law on companies.

Foreign Company A pays R100 000 from its income reserves to Resident Company A in respect of Resident Company A's shareholding in Foreign Company A.

Under the company law of Foreign Country B any amount paid by a company incorporated in that country from income reserves in respect of shares in that company must be treated by the company paying the amount as a dividend.

Result:

Since Foreign Country A, in which Foreign Company A is effectively managed, does not have any income tax law on companies, the company law of Foreign Country B must be considered in determining whether an amount paid or payable by Foreign Company A in respect of a share constitutes a foreign dividend under paragraph (*b*) of the definition of "foreign dividend" in section 1(1).

Since the company law of Foreign Country B provides that any amount paid by a company incorporated in that country from income reserves in respect of shares in that company must be treated by the payer as a dividend, R100 000 paid by Foreign Company A constitutes a foreign dividend.

Example 3 – Treatment of amounts paid or payable by foreign companies in respect of shares under foreign company law

Facts:

Resident Company A holds shares in Foreign Company A which is incorporated and effectively managed in Foreign Country B. Foreign Country B does not have any income tax law on companies. Resident Company A also holds shares in Foreign Company X which is incorporated and effectively managed in Foreign Country Y. Foreign Country Y does not have any income tax law on companies.

Foreign Company A and Foreign Company X each pay R100 000 to Resident Company A from their share premium accounts.

Under the company law of Foreign Country B the distribution of share premium as a dividend is allowed while the company law of Country Y prohibits the distribution of share premium as a dividend.

Result:

R100 000 paid by Foreign Company A

Since the company law of Foreign Country B provides for the distribution of share premium as a dividend, the payment of R100 000 constitutes a foreign dividend under paragraph (*b*) of the definition of "foreign dividend" in section 1(1).

R100 000 paid by Foreign Company X

Since the company law of Foreign Country Y prohibits the distribution of share premium as a dividend, the payment of R100 000 does not constitute a foreign dividend. It may instead constitute a "foreign return of capital" as defined in section 1(1) for Resident Company A with attendant CGT consequences under paragraph 76B (see **4.1.3**).

(f) Onus to obtain information on the income tax law on companies or company law of a foreign country

Under section 102(1)(*a*) of the Tax Administration Act No. 28 of 2011 a taxpayer bears the onus of showing how the income tax law on companies or the company law of a foreign country, as appropriate, treats amounts paid or payable in respect of shares in a foreign company.

Depending on the facts, SARS may request that a taxpayer obtain written confirmation from the tax authority of the country in which the foreign company is effectively managed on the income tax treatment of amounts paid or payable by a foreign company in respect of shares in that company. Alternatively, when a foreign country's company law is applicable, SARS may, depending on the facts, request that a taxpayer obtain written confirmation from the government department responsible for the foreign country's company law.

(g) Interpretation of the income tax law on companies or company law of a foreign country

The foreign country's relevant tax authority bears the responsibility for the interpretation of its income tax law. Consequently SARS is generally bound to accept the determination by a foreign tax authority whether an amount paid or payable by a foreign company in respect of a share constitutes a dividend.

This principle similarly applies to a determination by the foreign country's authority relating to its company law.

(h) Exclusion from the definition of "foreign dividend" – Redemption or buy-back of a participatory interest in a foreign collective investment scheme (paragraph (i) of the exclusions)

Under paragraph (i) of the exclusions from the definition of "foreign dividend" in section 1(1) any amount paid or payable that constitutes a redemption (buy-back) of a participatory interest in an arrangement or scheme contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1(1), is excluded from the definition of "foreign dividend".

Paragraph (*e*)(ii) of the definition of "company" in section 1(1) includes –

> " (*e*) any—
>
> (ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or".

Any redemption or buy-back by a foreign collective investment scheme referred to above is therefore excluded from the definition of "foreign dividend" in section 1(1). The holders of the participatory interests are potentially liable for CGT on a redemption or buy-back if the participatory interests were held as capital assets. The amount of a redemption or buy-back will potentially be subject to normal tax if the participatory interests were held as trading stock.

(i) Exclusion from the definition of "foreign dividend" – An amount paid or payable by a foreign company that constitutes a share in that company (paragraph (iii) of the exclusions)

Under paragraph (iii) of the exclusions from the definition of "foreign dividend" in section 1(1), any amount paid or payable by a foreign company that constitutes a share in that foreign company is excluded from the definition of "foreign dividend".

The reason for this exclusion is that the transfer by a company of its own shares as capitalisation shares or bonus shares does not result in an outflow of overall value from the foreign company since all the underlying assets remain within the company. In *CIR v Collins* Innes CJ stated the following in relation to the issue of bonus shares by a company:[28]

> "The company has parted with no assets – no money or money's-worth – and the shareholders have received none. The profits dealt with remain in the business as they were before […] The total assets of the company have not been changed, and his original share represented the same proportion of the then issue as his increased shares do of the increased issue."

An amount paid or payable by a foreign company that constitutes a share in that company also does not constitute a foreign return of capital since it is specifically excluded in paragraph (ii) from the definition of "foreign return of capital" in section 1(1) (see **4.1.3**).

Section 40C provides that when a company issues shares in that company to a person for no consideration, the expenditure actually incurred by the person to acquire the shares must be deemed to be nil. The cost price of the shares under section 11(*a*) or their base cost under paragraph 20(1)(*a*) will therefore be nil. The holder of shares so acquired will therefore be taxed on the proceeds on the subsequent disposal of the shares.

Example 4 – An amount paid or payable by a foreign company that constitutes a share in that company

Facts:

Foreign Company A has share capital of R400 000 and retained income of R500 000. Foreign Company A issues 400 000 capitalisation shares of R1 each using its retained income to fund the capitalisation issue. Resident Company B holds 5% of the issued share capital in Foreign Company A. An amount of R20 000 (R400 000 × 5%) is received by Resident Company B as capitalisation shares.

Result:

The amount of R20 000 received by Resident Company B representing the issue of capitalisation shares by Foreign Company A does not constitute a foreign dividend since the issue of capitalisation shares is excluded from the definition of "foreign dividend" in section 1(1) in paragraph (iii). The amount of R20 000 also does not constitute a foreign return of capital since it is excluded in paragraph (ii) from the definition of "foreign return of capital" in section 1(1).

Under section 40C the expenditure actually incurred by Resident Company B to acquire the capitalisation shares is deemed to be nil.

4.1.2 Definition of "foreign company"

The term "foreign company" is defined in section 1(1) as follows:

> " **'[F]oreign company'** means any company[29] which is not a resident;"

---

[28] 1923 AD 347, 32 SATC 211 at 218.

[29] The term "company" is defined in section 1(1) and is quoted in the **Annexure**.

The definition of "foreign company" is relevant for purposes of the definition of "foreign dividend" in section 1(1) since a foreign dividend can be paid or be payable only by a foreign company. A dividend paid or payable by a resident company does not constitute a foreign dividend.

A foreign company can be one of the following:

- A company as defined in section 1(1) that is incorporated, formed or established in South Africa, but which has its place of effective management in another country and which is deemed to be exclusively a resident of the other country for purposes of the application of a tax treaty.[30]
- A company contemplated in paragraph (*b*) of the definition of "company" in section 1(1), namely any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law, which is not effectively managed in South Africa or is effectively managed in South Africa but an applicable tax treaty deems it to be exclusively resident in another country. The question whether an entity qualifies as an association, corporation, company or body corporate as contemplated in paragraph (*b*) of the definition of "company" is a factual one. The following factors, amongst others, will be taken into account to determine whether an entity qualifies as a company under paragraph (*b*):
  - The nature of the agreement between the entity and its members.
  - The relationship between the entity and its members.
  - Whether the entity is separate and distinct from its members.
  - Whether the entity enjoys attributes of perpetual succession.
  - Whether the entity's assets are its exclusive property.
  - Whether the members have the right to manage the entity's business or to enter into transactions on its behalf.
  - Whether the members are liable for the entity's debts.
  - Whether the entity has the power to sue and the liability to be sued.

  The law under which the entity is governed, that is the foreign law, will be considered in determining whether these factors apply to the entity in the foreign country.
- A company contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1(1) that is not incorporated, established or formed in South Africa or is not effectively managed in South Africa. A company contemplated in paragraph (*e*)(ii) is a portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest.

---

[30] See the definition of "resident" in section 1(1).

The definition of "company" in section 1(1) does not include a "foreign partnership" as defined in section 1(1).[31] It follows that a foreign partnership is similarly not included in the definition of "foreign company".

Any amount paid or payable by a foreign partnership in respect of a member's interest does not therefore constitute a "foreign dividend" since it is not paid by a "foreign company" as defined in section 1(1). However, to the extent that the members of the partnership have a fractional interest in foreign dividends derived by a foreign partnership, those amounts will constitute foreign dividends derived by the members.

4.1.3 Definition of "foreign return of capital"

The term "foreign return of capital" is defined in section 1(1) and is quoted in the **Annexure**.

The definition of "foreign return of capital" excludes an amount that constitutes a foreign dividend.[32] An amount paid or payable by a foreign company in respect of a share in that company may therefore constitute either a foreign dividend or a foreign return of capital. The assessment under the definition of "foreign return of capital" as to whether the amount paid or payable constitutes a distribution or similar payment must be considered under –

- the income tax law on companies of the country in which the foreign company has its place of effective management; or
- the company law of the country in which the foreign company is incorporated, formed or established when the country in which it has its place of effective management does not have any income tax law on companies.

An amount of a foreign return of capital received by or accrued to a person from a foreign company is subject to CGT when the shares are held on capital account or to normal tax when they are held as trading stock. Paragraph 76B deals with a foreign return of capital (see paragraph 18.8 of the *Comprehensive Guide to Capital Gains Tax* (Issue 5) for a discussion of paragraph 76B).

4.1.4 Definition of "controlled foreign company"

The term "controlled foreign company" is defined in sections 1(1) and 9D(1). These definitions are quoted in the **Annexure**.

In summary, a foreign company is a CFC when more than 50% of its total participation rights are directly or indirectly held, or more than 50% of its voting rights are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies.

The exemptions of foreign dividends under section 10B(2)(*a*), (*b*), (*d*) and (3) apply to dividends that are received by or that accrue to a CFC for purposes of determining its net income under section 9D(2A) for proportionate inclusion in the income of residents holding a qualifying interest in the CFC.

---

[31] The term "foreign partnership" is defined in section 1(1) and is quoted in the **Annexure**.

[32] In Example 3 a return of share premium by Foreign Company A is treated as a dividend under foreign company law and is accordingly not a foreign return of capital.

Specific rules apply to foreign dividends received by or accrued to a CFC in determining the –

- net income of a CFC [section 9D(9)(*f*)];
- cost price of a right in a CFC held as trading stock [section 22(3)(*a*)(iii)]; and
- base cost of a right in a CFC held as a capital asset [paragraph 20(1)(*h*)(iii)].

(See **4.9.**)

4.2 Inclusion of foreign dividends in gross income [paragraph (*k*) of the definition of "gross income" in section 1(1)]

4.2.1 Inclusion of foreign dividends in gross income of residents and CFC's

Residents are, but for certain exclusions or exemptions, liable to normal tax on income derived from sources within and outside South Africa. The amount of a foreign dividend received by or accrued to a person is specifically included in gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

Foreign dividends received by or accrued to a non-resident are generally not subject to tax in South Africa because they are not from a South African source (section 9(4)(*a*) read with the definition of "gross income"). However, in the context of determining whether any net income of a CFC must be attributed to and included in the income of a resident, foreign dividends received by or accrued to a CFC represent an exception to this rule. In calculating the net income of a CFC to be attributed to a resident, the CFC is treated under section 9D(2A) as a taxpayer and a resident for certain sections, including the definition of "gross income" in section 1(1). Since a foreign dividend is included in "gross income" under paragraph (*k*) of the definition of "gross income" in section 1(1), a dividend received by or accrued to a CFC from another foreign company constitutes a foreign dividend for purposes of the net income calculation of the CFC.

4.2.2 Gross amount of foreign dividends included in gross income

The gross amount of a foreign dividend, before the deduction of any foreign tax liability, for example, withholding tax, must be included in a person's gross income.

4.2.3 Receipt or accrual of a foreign dividend

A foreign dividend received by or accrued to a person must be included in gross income at the earlier of its receipt or accrual. Generally, in the context of foreign dividends the accrual precedes the receipt of the dividend. A foreign dividend generally accrues to a person on the date of declaration of the foreign dividend by the foreign company unless the declaration states that the foreign dividend is payable to shareholders registered on a certain future date.[33] In the latter case, the foreign dividend accrues on such future date.[34] It is submitted that the timing of when the dividend is paid or payable in terms of the definition of "foreign dividend" in

---

[33] The position for interim dividends may be different – see A P de Koker & R C Williams *Silke on South African Income Tax* [online] (My LexisNexis: September 2015) in § 2.8.

[34] See A P de Koker & R C Williams *Silke on South African Income Tax* [online] (My LexisNexis: September 2015) in § 2.8; *CIR v King* 1947 (2) SA 196 (A), 14 SATC 184; ITC 463 (1939) 10 SATC 453 (U) and G C Palmer under Revenue Part 1 / Dividends 22 (Second Edition Replacement Volume) *LAWSA* [online] (My LexisNexis: 31 May 2014) in paragraph 439 dealing with the accrual of dividends.

section 1(1) is consistent with the timing of when a foreign dividend is received or accrues for the purposes of the definition of "gross income" [see **4.1.1 (b)**].

4.3 Exemption of foreign dividends (section 10B)

A "foreign dividend" is defined in section 10B(1) for purposes of section 10B and means any –

- foreign dividend as defined in section 1; or
- dividend paid or declared by a headquarter company.

The exemption of foreign dividends is provided for in section 10B(2) and (3). Section 10B(2) provides for exemptions that are applied separately to each foreign dividend received by or accrued to a person, while the exemption under section 10B(3) is applied to the aggregate amount of foreign dividends not otherwise exempt under section 10B(2).

Section 10B applies to foreign dividends received by or accrued to residents and non-residents (mainly CFCs in the context of determining net income which is attributed to and included in the income of applicable residents), unless the section states that it applies specifically to residents or resident companies only, as is the case with section 10B(2)(*c*) and (*e*) respectively, or to foreign companies only as is the case with section 10B(2)(*b*).

The exceptions contained in section 10B(2), (4), (5) and (6), provide that a specific exemption contemplated in section 10B(2) or the partial exemption under section 10B(3) may not apply under specific circumstances.

4.3.1 The participation exemption [section 10B(2)(*a*)]

(a) The participation exemption

Under section 10B(2)(*a*) a foreign dividend received by or accrued to a person is exempt from normal tax if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10% of the total equity shares and voting rights in the company declaring the foreign dividend. The person qualifying for the exemption could, amongst others, be a natural person, a trust or a company, including a CFC. When the person is a company which forms part of a group of companies as defined in section 1(1),[35] the direct holdings of the other companies in that group must be added together with that company's holding in determining whether the 10% threshold has been met.

The term "equity share" is defined in section 1(1) as follows:

> " **'[E]quity share'** means any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution;"

A distribution by a company or a foreign company could take the form of a distribution of profits (dividends or foreign dividends) or capital (return of capital or foreign return of capital). As long as the right to participate in either of these types of distribution is unrestricted the share will be an equity share. The share will not be an equity share if both of these rights are restricted.

---

[35] See **(b)** below.

The 10% holding requirement is determined at the earlier of the receipt or accrual of the foreign dividend. Dividends not exempt under section 10B(2)(*a*) because of the 10% holding requirement not being met, may be exempt under one of the other exemptions under section 10B(2) (see **4.3.1** – **4.3.6**) or partially exempt under section 10B(3) (see **4.3.7**).

The participation exemption under section 10B(2)(*a*) is in line with the relief from CGT provided under paragraph 64B on capital gains or capital losses arising on the disposal of equity shares in a foreign company and on capital gains on foreign returns of capital when an interest of at least 10% in the equity shares and voting rights is held in the foreign company.[36]

See **4.3.6**, **4.3.8**, **4.3.9** and **4.3.10** for circumstances in which the exemption is specifically prohibited.

(b) Application of the participation exemption to a group of companies

The term "group of companies" is defined in section 1(1) as follows:

> " **'[G]roup of companies'** means two or more companies in which one company (hereinafter referred to as the **"controlling group company"**) directly or indirectly holds shares in at least one other company (hereinafter referred to as the **"controlled group company"**), to the extent that—
>
> (*a*) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
>
> (*b*) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;"

In determining whether the 10% holding requirement of section 10B(2)(*a*) has been met, the combined direct interests of all the companies forming part of the same group of companies in the foreign company must be taken into account.

Therefore, when two or more companies forming part of the same group of companies each hold less than 10% of the equity shares and voting rights in a foreign company, section 10B(2)(*a*) will apply to each company in the group as long as those companies' combined interests in the foreign company are at least 10%.

Section 10B(2)(*a*) allows for the aggregation of interests in a foreign company even when the holders of the shares are not all resident companies forming part of the same group of companies. Therefore, if one of the holders of shares in the foreign company declaring the foreign dividend is a foreign company, the combined interests of that foreign company and the resident company must be considered in determining whether the 10% holding requirement has been met.

(c) Holding of shares

The participation exemption applies to the person who *holds* at least 10% of the total equity shares and voting rights in a foreign company in respect of which the foreign dividend is declared. It is considered that a person "holds" the requisite equity shares if such person is the beneficial owner of those shares.

---

[36] See paragraph 12.18 of the *Comprehensive Guide to Capital Gains Tax* (Issue 5) for a discussion of paragraph 64B.

The person named in the share register of a company, for example, an agent or intermediary, is not necessarily the beneficial owner of the share. When a person is the registered holder of a share in a foreign company but another person is the beneficial owner, the beneficial owner may claim the participation exemption if all the requirements of section 10B(2)(*a*) are met.

A person will be the beneficial owner of a share if that person made an election under section 4(1) of the Exchange Control Amnesty and Amendment of Taxation Laws Act No. 12 of 2003 which provided as follows:

> "**4**. (1) A person who is a donor (or the deceased estate of a donor) in relation to a discretionary trust which is not a resident, may elect that any foreign asset contemplated in subsection (2), which was held by that discretionary trust on 28 February 2003, must be deemed to be held by that person."

The election may be made only if the requirements in section 4(2) of that Act are met and once made has a number of effects for purposes of the Act. For example, in the context of foreign dividends, the election made under section 4(1) has the effect under section 4(3) of that Act that any foreign dividends received or accrued in respect of shares deemed to be held by a person making the election (the donor) are included in that person's gross income. That person will be entitled to make use of the participation exemption under section 10B(2)(*a*) if all the requirements of the section are met.

Example 5 – Application of the participation exemption – Section 10B(2)(*a*)

Facts:

Resident Company A holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B pays a foreign dividend of R100 000 to Resident Company A.

Result:

The foreign dividend of R100 000 received by Resident Company A is included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). This amount is exempt from normal tax under section 10B(2)(*a*) since Resident Company A holds at least 10% of the equity shares and voting rights in Foreign Company B.

Example 6 – Application of the participation exemption – Section 10B(2)(*a*)

Facts:

CFC A holds 10% of the equity shares and voting rights in Foreign Company B. CFC A and Foreign Company B are not residents of the same country. Foreign Company B pays a foreign dividend of R100 000 to CFC A.

Result:

Under section 9D(2A) CFC A is deemed to be a resident for purposes of the definition of "gross income" in section 1(1) [see **4.3.7 (b)**]. In determining net income for the purposes of section 9D(2), the foreign dividend of R100 000 received by CFC A is included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). This amount is exempt from normal tax under section 10B(2)(*a*). That is, subsequent to being included in gross income, the foreign dividend is excluded in determining net income for the purposes of section 9D(2), since CFC A holds at least 10% of the equity shares and voting rights in Foreign Company B.

Example 7 – Application of the participation exemption – Section 10B(2)(*a*)

Facts:

Resident Company A and Resident Company B are part of the same group of companies. Each company holds 5% of the equity shares and voting rights in Foreign Company A. Foreign Company A pays a cash foreign dividend of R100 000.

Result:

The foreign dividends of R5 000 (R100 000 × 5%) received by Resident Company A and Resident Company B are included in their gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). From Resident Company A's perspective the foreign dividend qualifies for exemption under section 10B(2)(*a*) because in determining whether the 10% requirement of the participation exemption is met, the direct holding of the total equity shares and voting rights of the taxpayer concerned (Resident Company A) plus the direct holdings of other companies forming part of the same group of companies (Resident Company B) is taken into account. Resident Company A's holding of 5% plus Resident Company B's holding of 5% meet the threshold of 10%. Resident Company A therefore qualifies for the exemption under section 10B(2)(*a*). For the same reasons Resident Company B also qualifies for the exemption under section 10B(2)(*a*).

Example 8 – Application of the participation exemption – Section 10B(2)(*a*)

Facts:

Individual A and Individual B, who are connected persons in relation to each other, each hold 5% of the equity shares and voting rights in Foreign Company A. Foreign Company A pays a cash foreign dividend of R100 000.

Result:

The foreign dividends of R5 000 (R100 000 × 5%) received by Individual A and Individual B are included in their gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

The foreign dividends do not qualify for exemption under section 10B(2)(*a*) because in determining whether the 10% requirement of the participation exemption is met, the direct holding of the total equity shares and voting rights of the taxpayer concerned plus, if that taxpayer is a company, the direct holdings of other companies forming part of the same group of companies as the taxpayer are taken into account. Even though Individual A and Individual B are connected persons in relation to each other, they are not part of a group of companies and accordingly on an individual basis their holding of 5% of the equity shares and voting rights falls below the required threshold of 10%.

Depending on the facts, Individual A and Individual B may qualify for an exemption under section 10B(2)(*d*) (see **4.3.4**). A partial exemption for dividends not otherwise exempt under section 10B(2) is available under section 10B(3) (see **4.3.7**).

Example 9 – Application of the participation exemption – Section 10B(2)(*a*)

Facts:

Resident A, a natural person, is an income beneficiary of Discretionary Trust A, a non-resident trust, which holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B pays a foreign dividend of R100 000 to Discretionary Trust A which distributes it in full to Resident A in the same year of assessment.

Result:

The foreign dividend of R100 000 is included in Resident A's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1) read with section 25B(1) and (2).

For the participation exemption to apply, the person receiving the foreign dividend, or to whom it accrues, must hold the underlying equity shares and voting rights in respect of which the dividend is paid. Resident A is not the beneficial owner of, and therefore does not hold, any of the equity shares and voting rights in Foreign Company B. Resident A is therefore not entitled to the participation exemption under section 10B(2)(*a*).

The foreign dividend of R100 000 is partially exempt under section 10B(3) in the hands of Resident A (see **4.3.7**).

Note:

If Resident A had a vested right in the underlying shares and voting rights, the exemption under section 10B(2)(*a*) would have applied.

4.3.2 The country-to-country exemption [section 10B(2)(*b*)]

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

proportionate amount of a CFC's net income[37] is included in the income of a resident holding a qualifying interest in the CFC.

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

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

The inclusion of foreign dividends, which are not exempt under section 10B(2) but which are partially exempt under section 10B(3), in the net income of a CFC effectively results in the inclusion of a proportional amount of the foreign dividends in the income of a resident that holds, together with a connected person, at least 10% of the participation rights and voting rights in the CFC. The amount attributed to and included in the resident's income under section 9D(2) does not, however, constitute an amount of a foreign dividend. It is included in income as a percentage of the net income of the CFC and therefore cannot qualify for any of the exemptions under section 10B in its own right.

As noted above, in order to qualify for the exemption under section 10B(2)(*b*) the two foreign companies must both be resident in the same country. Section 10B(2)(*b*) is silent on how the residency of the two foreign companies must be determined. Practically the country or countries in which the company declaring the dividend is tax resident can initially be determined by referring to the domestic tax law of that country. Often residency is based on the place of incorporation or effective management. The provisions of any applicable tax treaty will also need to be considered in cases of dual residency if the provisions of the tax treaty (the tie-breaker clause in particular) impact on the residency status of the taxpayer concerned under its domestic law. For example, the definition of "resident" in section 1(1) specifically provides that if a person is deemed to be exclusively resident of another country for purposes of a tax treaty, that person is not a resident. Once the tax residence of the company declaring the dividend has been determined, the tax residence of the company receiving the dividend would be determined in the same way. Similar to the position above this may involve a consideration of applicable tax treaties.

See **4.3.6 (a)**, **4.3.8**, **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(*b*) is specifically prohibited.

---

[37] This Note does not discuss the calculation of net income and the inclusions and exclusions as required under section 9D nor the circumstances in which section 9D(2) does not apply. For example, section 9D(9)(*f*) excludes certain foreign dividends between CFCs. See section 9D for details on all the inclusions and exclusions from net income and circumstances in which section 9D does not apply.

Example 10 – The country-to-country exemption – Section 10B(2)(*b*)

Facts:

Resident Company A holds 100% of the participation rights and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Both foreign companies are incorporated and effectively managed in Foreign Country D. Foreign Company C pays a foreign dividend to Foreign Company B.

Result:

Foreign Company B is a CFC in relation to Resident Company A since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

The foreign dividend is exempt from normal tax under section 10B(2)(*b*) since it was paid to Foreign Company B by another foreign company (Foreign Company C) and both foreign companies are residents of the same country. The effect of the exemption under section 10B(2)(*b*) is that the foreign dividend will not form part of Foreign Company B's net income and hence will not be attributed to Resident Company A under section 9D(2).

Example 11 – Country-to-country exemption – Foreign companies effectively managed in the same country – Section 10B(2)(*b*)

Facts:

Resident Company A holds 100% of the participation and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Foreign company B is incorporated and effectively managed in Foreign Country D. Foreign Company C is incorporated in Foreign Country E but effectively managed in Foreign Country D.

Under the domestic tax law of Foreign Country D, Foreign Company C is tax resident in Country D because its place of effective management is in Country D. Under the domestic tax law of Foreign Country E, Foreign Company C is *prima facie* also tax resident in Country E because it is incorporated in Country E. However, Country E's domestic tax law provides that a resident does not include a person who is deemed to be exclusively a resident of another country for purposes of the application of an applicable tax treaty. Under the tax treaty between Foreign Country D and Foreign Country E, Foreign Company C is treated as being exclusively resident where it is effectively managed. Accordingly, Foreign Company C is tax resident in Foreign Country D only.

Foreign Company B is tax resident under Foreign Country D's domestic tax law because it is both incorporated and effectively managed in Country D. It is not considered to be tax resident under another country's domestic tax law.

Foreign Company C pays a foreign dividend to Foreign Company B.

Result:

Foreign Company B is a CFC in relation to Resident Company A since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

Although Foreign Company B and Foreign Company C were not incorporated in the same country, they are both tax resident in Foreign Country D.

The foreign dividend is exempt from normal tax under section 10B(2)(*b*) since it was paid to Foreign Company B by another foreign company (Foreign Company C) and both foreign companies are residents of the same country for income tax purposes. The effect of the exemption under section 10B(2)(*b*) is that the foreign dividend will not form part of Foreign Company B's net income and hence will not be attributed to Resident Company A under section 9D(2).

Example 12 – Country-to-country exemption – Foreign companies not effectively managed in the same country – Section 10B(2)(*b*)

Facts:

Resident Company A holds 100% of the participation and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Foreign company B is incorporated and effectively managed in Foreign Country D. Foreign Company C is incorporated in Foreign Country D but effectively managed in Foreign Country E.

Under the domestic tax law of Foreign Country E, Foreign Company C is tax resident in Country E because its place of effective management is in Country E. Under the domestic tax law of Foreign Country D, Foreign Company C is *prima facie* tax resident in Country D because it is incorporated in Country D. However, Country D's domestic tax law provides that a resident does not include a person who is deemed to be exclusively a resident of another country for purposes of the application of an applicable tax treaty. Under the tax treaty between Foreign Country D and Foreign Country E, Foreign Company C is treated as being exclusively resident where it is effectively managed. Accordingly, Foreign Company C is tax resident in Country E only.

Foreign Company B is tax resident under Foreign Country D's domestic tax law because it is both incorporated and effectively managed in Country D. It is not considered to be tax resident under another country's domestic tax law.

Foreign Company C pays a foreign dividend to Foreign Company B.

Result:

Foreign Company B is a CFC in relation to Resident Company A since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

Foreign Company B is tax resident in Foreign Country D and Foreign Company C is tax resident in Country E. Accordingly the foreign dividend is not exempt from normal tax under section 10B(2)(*b*) since it was paid to Foreign Company B by another foreign company (Foreign Company C) which is not resident in the same country for tax purposes. The foreign dividend will qualify for a partial exemption under section 10B(3) with the effect that a portion of the foreign dividend will form part of Foreign Company B's net income and hence a portion will be attributed to Resident Company A under section 9D(2).

4.3.3 Exemption of amounts previously included in income under section 9D(2) [section 10B(2)(*c*)]

(a) Exemption of amounts previously included in income

Under section 9D(2) a portion of the net income of a CFC is included in the income of a resident who, together with a connected person, holds at least 10% of the participation rights and voting rights in the CFC. In the absence of an exemption, any portion of the net income of the CFC included in the income of a resident that is subsequently declared to that resident as a foreign dividend would be taxed twice. Section 10B(2)(*c*) provides relief by generally exempting any foreign dividend paid from amounts previously included in the income of a resident under section 9D(2).

Each resident subject to section 9D is entitled to the exemption under section 10B(2)(*c*) for amounts previously included in income under that section. Thus, for example, when two residents who are natural persons and connected persons in relation to one another, individually hold less than 10% of the participation rights and voting rights in a CFC while their combined holding in the CFC equals 10% or more, they will not be entitled to the participation exemption under section 10B(2)(*a*) on a foreign dividend declared by the CFC since each person's holding in the CFC is less than 10%.[38] However, both residents will be entitled to the exemption under section 10B(2)(*c*) for amounts previously included in income under section 9D(2).[39]

Under the proviso to section 10B(2)(*c*) the net income of any CFC included in the income of a resident must be determined without taking into account the partial exemption under section 10B(3). The partial exemption under section 10B(3) has the effect that only 53,57% (15 / 28 × 100) of the amount of a foreign dividend is included

---

[38] See Example 8 in **4.3.1**.

[39] They would not have qualified for the exclusion from attribution of net income under proviso A to section 9D(2), the proviso looks at the combined holdings of connected persons and allows for exclusion from attribution if the combined holding in the participation and voting rights is less than 10%.

in the net income of a CFC.[40] It is a percentage of this taxable amount that is included in the income of a resident under section 9D(2). In applying section 10B(2)(*c*), 100% of the amount of a foreign dividend and not the 53,57% included in income, is taken into account in determining amounts previously included in the income of a resident under section 9D(2).

The calculation of the amount of a foreign dividend exempt under section 10B(2)(*c*) is summarised as follows:

All amounts included in the resident's income under section 9D in this year and any previous year of assessment that relate to the net income of the CFC declaring the foreign dividend [section 10B(2)(*c*)(i)]. Net income for this purpose must be determined without regard to section 10B(3).

Add: All amounts included in the resident's income under section 9D in this year and any previous year of assessment that relate to the aggregate net income of any other CFC by virtue of the resident's participation rights held indirectly in other CFCs through the CFC declaring the foreign dividend [section 10B(2)(*c*)(ii)]. Net income for this purpose must be determined without regard to section 10B(3).

Less: Aggregate amount of foreign tax payable in respect of amounts included in the resident's income under section 9D as indicated in the two points above in this year and any previous year of assessment [section 10B(2)(*c*)(*aa*)].[41]

Less: Aggregate amount of foreign dividends received by or accrued to the resident from the above CFCs in this year and any previous year of assessment that were exempt under section 10B(2)(*a*), (*b*) or (*d*) [section 10B(2)(*c*)(*bb*)(A)].

Less: Aggregate amount of foreign dividends received or accrued from the above CFCs that were not included in the resident's income because of a prior inclusion under section 9D and which were exempt under section 10B(2)(*c*) [section 10B(2)(*c*)(*bb*)(B)].

= the amount of the exemption under section 10B(2)(*c*) for the specific foreign dividend

limited to the amount of the foreign dividend received or accrued from the CFC declaring the dividend as indicated above.

See **4.3.9** and **4.3.10** for circumstances in which the exemption is specifically prohibited.

[40] Under section 10B(3)(*b*)(ii)(*bb*)(A) the ratio of 13 to 28 of the amount of foreign dividends received by or accrued to a company is exempt. Therefore, the ratio of 15 to 28 is applied to determine the taxable amount of such foreign dividends.

[41] The amount of foreign tax payable would have qualified for a foreign tax rebate under section 6*quat* (see **4.8**).

Example 13 – Exemption of amounts previously included in income – Section 10B(2)(*c*)

Facts:

Resident Company A on its own holds 5%, and together with a connected person, Resident Company B, holds 10% of the participation rights and voting rights in Foreign Company B. Resident Company A and Resident Company B are not companies forming part of the same group of companies. Foreign Company B holds 100% of the participation rights and voting rights in Foreign Company C. Foreign Company C holds 100% of the participation rights and voting rights in Foreign Company D. The participation rights and voting rights in Foreign Company B, Foreign Company C and Foreign Company D were all acquired at the beginning of Resident Company A's 2015 year of assessment. All the foreign companies are CFCs in relation to Resident Company A and have a December year-end.

The portion (5%) of the net income of the CFCs determined under section 9D(2A) that was included in Resident Company A's income under section 9D(2) during the 2015 and 2016 years of assessment was as follows:

	2015 R	2016 R
CFC B	800 000	700 000
CFC C	700 000	600 000
CFC D	650 000	500 000
Total amount included in Resident Company A's income	2 150 000	1 800 000
Foreign tax payable on the net income of the CFCs	130 000	300 000
Amounts of foreign dividends paid by CFC B to Resident Company A	1 250 000	3 000 000

Result:

Under section 9D(2) the net income of R2 150 000 and R1 800 000, representing 5% of the CFCs' total net income determined under section 9D(2A), was included in Resident Company A's income in the 2015 and 2016 years of assessment respectively. Even though Resident Company A holds directly or indirectly only 5% of the participation rights and voting rights in the CFCs, it holds together with a connected person, at least 10% of the participation rights and voting rights and is therefore subject to attribution under section 9D(2).

The foreign dividends received from CFC B of R1 250 000 and R3 million are included in Resident Company A's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). The exemption under section 10B(2)(*a*) is not applicable because although Resident Company A and Resident Company B are connected persons they are not members of the same group of companies. As a result, when assessing whether the threshold of 10% in section 10B(2)(*a*) is met, their holdings are not combined. The non-aggregation of their holdings means that they do not qualify for exemption under section 10B(2)(*a*) since they each hold only 5% of the equity shares and voting rights in Foreign Company B.

The foreign dividends may be exempt or partially exempt under section 10B(2)(*c*) and (3). The amounts exempt under section 10B(2)(*c*) are calculated as follows:

2015 year of assessment

	R
Portion of the aggregate net income of CFC B, C and D included in Company A's income in the 2015 year of assessment under section 9D(2)	2 150 000
Less: The aggregate amount of foreign tax payable in respect of amounts included in Company A's income	(130 000)
Less: The aggregate amount of foreign dividends received or accrued from the above CFCs that are or were exempt under section 10B(2)(*a*), (*b*) or (*d*)	(0)
Less: The aggregate amount of foreign dividends previously exempt under section 10B(2)(*c*)	(0)
Amount available for exemption under section 10B(2)(*c*)	2 020 000

The amount of the foreign dividend of R1 250 000 received or accrued from CFC B is exempt in full under section 10B(2)(*c*) since it is less than the amount available for exemption under section 10B(2)(*c*).

2016 year of assessment

Portion of the aggregate net income of CFC B, C and D included in Company A's income in the 2015 and 2016 years of assessment under section 9D(2) (R2 150 000 + R1 800 000)	3 950 000
Less: The aggregate amount of foreign tax payable for the 2015 and 2016 years of assessment in respect of amounts included in Company A's income (R130 000 + R300 000)	(430 000)
Less: The aggregate amount of foreign dividends received from CFC B that is or was exempt under section 10B(2)(*a*), (*b*) or (*d*)	(0)
Less: The aggregate amount of foreign dividends previously exempt under section 10B(2)(*c*)	(1 250 000)
Amount available for exemption under section 10B(2)(*c*)	2 270 000

Only R2 270 000 of the amount of the foreign dividend of R3 million received from CFC B is exempt under section 10B(2)(*c*).

The amount of the foreign dividend not exempt under section 10B(2)(*c*) of R730 000 (R3 million – R2 270 000) qualifies for the partial exemption under section 10B(3). The exempt amount is calculated as follows:

The ratio of 13 to 28 multiplied by the amount of the foreign dividend not exempt under section 10B(2)(*c*)

= [(13 / 28) × R730 000]

= R338 929 [amount exempt under section 10B(3)].

The amount of the foreign dividend exempt under section 10B for the 2016 year of assessment is as follows:

Amount exempt under section 10B(2)(*c*)	2 270 000
Amount exempt under section 10B(3)	338 929
Total amount exempt under section 10B	2 608 929

The difference of R391 071 (R3 million – R2 608 929) is included in Resident Company A's income.

Note:

See **4.3.7** for a discussion of section 10B(3).

(b) Application of either the participation exemption under section 10B(2)(*a*) or the exemption for amounts previously included in income under section 10B(2)(*c*)

As noted previously in the Note, under section 9D(2) a resident who alone or together with one or more connected persons in relation to that person, holds at least 10% of the participation rights and voting rights in a CFC must include a proportional amount of the net income of the CFC in that person's income.

Both section 10B(2)(*a*) and section 10B(2)(*c*) contain a requirement that at least 10% of the equity shares or participation rights and voting rights must be held in the foreign company declaring the foreign dividend. In calculating the 10% requirement section 10B(2)(*a*) takes into account the combined holdings of companies in the same group of companies and section 10B(2)(*c*) through its link to section 9D(2) takes into account the combined holdings of connected persons. Therefore, any resident subject to section 9D who holds, together with a company forming part of the same group of companies if applicable, at least 10% of the equity shares and voting rights in a foreign company declaring a foreign dividend, will, on the face of it, potentially qualify for the participation exemption under section 10B(2)(*a*) as well as the exemption for amounts previously included in income under the CFC rules in section 10B(2)(*c*).

Section 10B(2)(*a*) is an absolute exemption while section 10B(2)(*c*) is based on the application of a formula that does not necessarily result in a full exemption.

For example, assume a resident, who is a natural person, holds 100% of the participation rights and voting rights in a CFC. If the CFC realises a capital gain of R100 000, R33 300 (33,3%)[42] would be included in the natural person's income under section 9D(2). Should the CFC pay the full amount of the capital gain of R100 000 as a foreign dividend in the next year of assessment, the exemption under section 10B(2)(*c*) would amount to R33 300, being the amount of the net income of the CFC included in the income of the resident. The balance of R66 700 will qualify for the partial exemption under section 10B(3), which amounts to R30 968 [(13 / 28) × R66 700]. This example illustrates that section 10B(2)(*c*) does not necessarily result in an absolute exemption of the amount of a foreign dividend declared by a CFC. The portion of the foreign dividend of R100 000 exempt under section 10B amounts to R64 268 [R33 300 under section 10B(2)(*c*) plus R30 968 under section 10B(3)]. However, should the participation exemption under

[42] Paragraph 10(*a*) read with paragraph (*f*) of the proviso to section 9D(2A).

section 10B(2)(*a*) be applied, the amount of the foreign dividend of R100 000 would be exempt in full.

If both section 10B(2)(*a*) and (*c*) apply in a particular situation, the issue as to which section takes precedence arises. Section 10B(2)(*c*) establishes the order of precedence by providing in section 10B(2)(*c*)(*bb*)(A) that the amount of the exemption under section 10B(2)(*c*) must be reduced by any foreign dividends exempt from tax under section 10B(2)(*a*), (*b*) or (*d*). Section 10B(2)(*a*) must therefore be applied before section 10B(2)(*c*).

4.3.4 Foreign dividends received or accrued in cash in respect of shares listed on the JSE [section 10B(2)(*d*)]

Foreign dividends received or accrued in cash from a foreign company in respect of shares listed on the JSE are exempt from normal tax under section 10B(2)(*d*).[43] This exemption also applies to such foreign dividends received by or accrued to a CFC. Section 10B(2)(*d*) was introduced because these foreign dividends are potentially subject to dividends tax.[44]

Cash dividends received or accrued from a resident company on listed shares are similarly exempt from normal tax under section 10(1)(*k*)(i), unless one of the paragraphs of the proviso to section 10(1)(*k*)(i) applies.

See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(*d*) is specifically prohibited.

Example 14 – Foreign dividends received or accrued in cash on listed shares – Section 10B(2)(*d*)

Facts:

Resident Individual A holds 5% of the equity shares in Foreign Company B which are listed on the JSE. Resident Individual A receives a foreign dividend in cash from Foreign Company B.

Result:

The foreign dividend received by or accrued to Resident Individual A is included in gross income under paragraph (*k*) of the definition of “gross income” in section 1(1). It is, however, exempt from normal tax under section 10B(2)(*d*) since it is received or accrued from a foreign company on listed shares. The dividend is, however, subject to dividends tax.

4.3.5 Foreign dividend received or accrued in respect of listed shares consisting of the distribution of an asset *in specie* [section 10B(2)(*e*)]

A foreign company that pays a foreign dividend on listed shares, namely, shares listed on the JSE, by way of the distribution of an asset *in specie* is not liable for

[43] The term “listed share” is defined in section 1(1). The JSE is the only exchange currently licensed under section 9 of the Financial Markets Act No. 19 of 2012. Binding Class Ruling: BCR 042 dated 7 February 2014 “Preferred Securities Issued by a Company Registered in a Foreign Country” confirmed that preferred securities issued to South African investors by a foreign company listed on the JSE constituted listed shares.

[44] Under paragraph (*b*) of the definition of “dividend” in section 64D, read with section 64E(1).

dividends tax since a distribution of this nature is not included in paragraph (*b*) of the definition of "dividend" in section 64D.

A foreign dividend received by or accrued to a resident company on a listed share by way of the distribution of an asset *in specie* is exempt from normal tax under section 10B(2)(*e*).[45] Such foreign dividend will be included in the resident company's profits and can potentially be paid as dividends to holders of its shares. These dividends may be subject to either dividends tax or normal tax.[46]

See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(2)(*e*) is specifically prohibited.

Example 15 – Foreign dividends *in specie* received or accrued on listed shares – Section 10B(2)(*e*)

Facts:

Resident Company A holds 5% of the equity shares in Foreign Company B which are listed on the JSE. Resident Company A receives a foreign dividend *in specie* from Foreign Company B.

Result:

The foreign dividend received by or accrued to Resident Company A is included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). The foreign dividend is exempt from normal tax under section 10B(2)(*e*) since it is received or accrued from a foreign company in respect of listed shares.

4.3.6 Application of the provisos to section 10B(2)

(a) Non-application of the "participation exemption" and the "country-to-country exemption" – Foreign dividends allowed as a deduction [proviso to section 10B(2)]

The proviso to section 10B(2) provides that the participation exemption under section 10B(2)(*a*) and the country-to-country exemption under section 10B(2)(*b*) do not apply to any foreign dividend to the extent that the foreign dividend is deductible by the foreign company declaring or paying the dividend in the determination of any tax on income on companies of the country in which it has its place of effective management. The exemptions under section 10B(2)(*c*), (*d*) and (*e*) and the partial exemption under section 10B(3) may apply even when the proviso to section 10B(2) applies.

This proviso contemplates a foreign dividend taken into account as a deduction against income in determining taxable income and not a foreign dividend taken into account as a rebate against tax in determining income tax payable.

For example, if the income tax law on companies of a foreign country provides a deduction for dividends paid or payable in determining taxable income when a foreign company on-distributes income received in the form of dividends by way of a

[45] Section 10B(2)(*e*) was inserted by section 25(1)(*c*) of the Taxation Laws Amendment Act No. 31 of 2013 and applies to foreign dividends received or accrued on or after 1 March 2014.

[46] See the *Comprehensive Guide to Dividends Tax* for the exemption of dividends from normal tax under section 10(1)(*k*)(i) and the exemptions from dividends tax under sections 64F and 64FA.

dividend,[47] the foreign dividend received by or accrued to a person will not be exempt under section 10B(2)(*a*) or (*b*), because of the proviso to section 10B(2).

The deductibility of an amount determined to be a foreign dividend paid or payable by a foreign company under the income tax law on companies of the foreign country in which that foreign company is effectively managed does not affect the nature of that amount as a foreign dividend for its recipient. Such an amount still constitutes a "foreign dividend" as defined in section 1(1) if it complies with all the requirements of that definition.

Example 16 – Non-application of section 10B(2)(*a*) and (*b*) – Foreign dividends allowed as a deduction

Facts:

Foreign Company A is effectively managed in Foreign Country B. Under the income tax law on companies of Foreign Country B, any distribution of profits by a company is treated as a dividend by the company paying the dividend. The income tax law on companies of that country further provides that the foreign dividend is deductible in determining the tax on income of the company paying the dividend. Foreign Company A pays a foreign dividend to Resident B.

Result:

The amount received by Resident B constitutes a foreign dividend as contemplated in paragraph (*a*) of the definition of "foreign dividend" in section 1(1) since it is treated as a dividend under the income tax law on companies of Foreign Country B.

Since the foreign dividend is deductible in determining Foreign Company A's taxable income, it does not qualify for the exemptions under section 10B(2)(*a*) and (*b*) because of the proviso to section 10B(2). The foreign dividend may qualify for exemption under section 10B(2)(*c*), (*d*) or (*e*) if the requirements of those provisions are met, and the partial exemption under section 10B(3).

(b) Application of the participation exemption under section 10B(2)(*a*) to equity shares only [second proviso to section 10B(2)]

The second proviso to section 10B(2) provides that the participation exemption under section 10B(2)(*a*) must not apply to a foreign dividend received by or accrued to a person in respect of a share that is not an equity share. Section 10B(2)(*a*) determines that a person, whether alone or together with a company forming part of the same group of companies, must hold at least 10% of the equity shares and voting rights in the company declaring the foreign dividend. The second proviso to section 10B(2) ensures that foreign dividends received or accrued to a person in respect of non-equity shares held in a foreign company in which that person holds at least 10% of its equity shares, are not exempt under section 10B(2)(*a*).

Any foreign dividend received or accrued on non-equity shares, for example, non-participating preference shares, may be exempt from normal tax under section 10B(2)(*b*), (*c*), (*d*) or (*e*).

A foreign dividend received or accrued on non-equity shares not exempt under section 10B(2) may be partially exempt under section 10B(3).

[47] A similar approach is followed in South Africa in the context of REITs under section 25BB.

An amount received or accrued from a foreign company in respect of a share that is not an equity share, will still constitute a “foreign dividend” as defined in section 1(1) provided it meets the requirements of that definition.

4.3.7 The partial exemption [section 10B(3)]

(a) Application of the partial exemption

Section 10B(3)(*a*) provides for a partial exemption of foreign dividends received by or accrued to a person which do not qualify for an exemption under section 10B(2). It applies in addition to the exemptions under section 10B(2). See **4.3.9** and **4.3.10** for circumstances in which the exemption under section 10B(3) is specifically prohibited.

Section 10B(3)(*a*) applies to the aggregate of the following:

- Any amount of a foreign dividend which, after applying the exemptions under section 10B(2), is not exempt.
- Any amount of a foreign dividend to which the exemptions under section 10B(2) do not apply.

Under section 10B(3)(*b*) the following ratio is applied to determine the amount of foreign dividends which are exempt for a year of assessment:

A = B × C in which –

- “A” represents the amount to be exempted.
- “B” represents the applicable ratios in relation to a foreign dividend received by or accrued to any of the following persons:
  - ➢ A natural person, deceased estate, insolvent estate or trust – 26 to 41.[48]
  - ➢ A company, or an insurer in respect of its company policyholder fund, corporate fund or risk policy fund – 13 to 28.
  - ➢ An insurer in respect of its individual policyholder fund – 15 to 30.
- “C” represents the aggregate amount of foreign dividends received by or accrued to a person during a year of assessment that is not exempt from normal tax under section 10B(2).

The purpose of the partial exemption is to reduce the maximum effective normal tax rate on a taxable foreign dividend to 15%, which equals the maximum dividends tax rate.

The maximum effective normal tax rate of 15% is demonstrated below in relation to the respective persons on the assumption that a foreign dividend of R100 is not exempt from normal tax under section 10B(2):

Aggregate amount of foreign dividends not exempt under section 10B(2) (R100);

Less: The exempt amount of the foreign dividends calculated under section 10B(3)(*b*);

= Taxable amount of foreign dividends after applying section 10B(3);

Multiplied by the maximum normal tax rate;

Divided by the gross amount of the dividend;

---

[48] With effect from the 2016 year of assessment. The ratio was 25 to 40 for previous years.

Multiplied by 100.

A natural person, deceased estate, insolvent estate or trust

R100 – R63,41 [(26 / 41) × R100]

= R36,59 × 41%

= R15

R15 / R100 × 100

= 15%.

The maximum effective normal tax rate of 15% will be achieved only if a natural person, deceased estate or insolvent estate's marginal tax rate is 41%. The maximum effective tax rate on foreign dividends will be less than 15% if a person pays normal tax at a rate that is less than the maximum marginal tax rate. A trust is taxed at the marginal tax rate of 41%, meaning that the effective tax rate on foreign dividends included in its taxable income will be 15%, unless it has an assessed loss, in which event the effective tax rate on the gross amount of foreign dividends will be between 0% and 15% depending on the extent of the assessed loss.

A company, or an insurer in respect of its company policyholder fund, corporate fund and risk policy fund

R100 – R46,43 [(13 / 28) × R100]

= R53,57 × 28%

= R15

R15 / R100 × 100

= 15%.

An insurer in respect of its individual policyholder fund

R100 – R50 [(15 / 30) × R100]

= R50 × 30%

= R15

R15 / R100 × 100

= 15%.

Example 17 – Partial exemption and natural persons – Section 10B(3)

Facts:

A resident natural person received a foreign dividend of R200 000 by virtue of a 2% shareholding in a foreign company during the 2016 year of assessment. The foreign dividend is not exempt from normal tax under section 10B(2). Assume three different scenarios in which the resident pays normal tax at the following marginal rates:

(a) 41%

(b) 25%

(c) 0% (because of an assessed loss).

Result:

The amount of the foreign dividend exempt under section 10B(3) and the normal tax payable on the foreign dividend are calculated as follows:

	R
Foreign dividend included in gross income under paragraph (*k*) of the definition of "gross income in section 1(1)	200 000
Less: Portion of the foreign dividend exempt under section 10B(3):	
A = B × C	
A = [(26 / 41) × R200 000]	
A = R126 829	(126 829)
Taxable portion of foreign dividend	73 171

(a) Normal tax payable at the maximum rate of 41%

Normal tax payable at 41% (R73 171 × 41%)	30 000,11

The effective normal tax rate on the gross amount of the foreign dividend is 15% (R30 000,11 / R200 000 × 100).

(b) Normal tax payable at a marginal rate of 25%

Normal tax payable at 25% (R73 171 × 25%)	18 292,75

The effective normal tax rate on the gross amount of the foreign dividend is 9,15% (R18 292,75 / R200 000 × 100).

(c) Normal tax payable at 0% because of an assessed loss

Normal tax payable at 0% (R73 171 × 0%)	Nil

The effective normal tax rate on the gross amount of the foreign dividend is 0% (RNil / R200 000 × 100).

Example 18 – Partial exemption and resident companies – Section 10B(3)

Facts:

A resident company received a foreign dividend of R200 000 by virtue of a 2% shareholding in a foreign company during the 2016 year of assessment. The foreign dividend is not exempt from normal tax under section 10B(2). The resident company does not have an assessed loss.

Result:

The portion of the foreign dividend exempt from normal tax under section 10B(3) and the normal tax payable on the foreign dividend are calculated as follows:

	R
Amount of foreign dividend included in gross income under paragraph (*k*) of the definition of "gross income" in section 1(1)	200 000
Less: Portion of the foreign dividend exempt under section 10B(3):	
A = B × C	
A = [(13 / 28) × R200 000]	
A = R92 857	(92 857)
Taxable amount of foreign dividend	107 143
Normal tax payable @ 28%	30 000,04

The effective tax rate on the gross amount of the foreign dividend is 15% (R30 000,04 / R200 000 × 100).

(b) Application of the partial exemption to CFCs

Under section 9D(2) a proportionate amount of the net income of a CFC is attributed to the income of residents holding a qualifying interest in the CFC.

In calculating the net income of a CFC for purposes of attributing it to a resident, the CFC is regarded as a taxpayer and a resident for certain sections, amongst others, the definition of "gross income" in section 1(1).[49] Since a foreign dividend is included in gross income under paragraph (*k*) of the definition of "gross income" in section 1(1), a dividend received by or accrued to a CFC from another foreign company constitutes a foreign dividend for purposes of the net income calculation of the CFC.

The exemptions under section 10B apply to foreign dividends received by or accrued to a person, which includes a CFC. Since a CFC is a company, the ratio under section 10B(3)(*b*)(ii)(*bb*) of 13 to 28 is applied to determine the portion of the foreign dividend that is exempt under section 10B(3). An amount attributed to a resident under section 9D(2) does not constitute a foreign dividend, but only a proportional amount of the CFC's net income. The legal status of the person holding an interest in the CFC is therefore not considered when the ratio under section 10B(3)(*b*) is applied.

An effective normal tax rate of 15% will be achieved if the person holding a qualifying interest in the CFC is a company, or an insurer in respect of its company policyholder fund, corporate fund or risk policy fund. A different effective rate will, however, be achieved for other persons, namely a natural person, deceased estate, insolvent estate, trust or an insurer in respect of its individual policyholder fund, holding a qualifying interest in a CFC, since these persons' effective tax rates may range from 0% to 41%.

---

[49] Section 9D(2A).

Example 19 – Effect of the application of the partial exemption under section 10B(3) when the net income of a CFC is attributed to a company

Facts:

Resident Company A holds 10% of the participation rights and voting rights in CFC B. CFC B holds 10% of the equity shares and voting rights in Foreign Company C. CFC B and Foreign Company C are not residents of the same country. Foreign Company C paid a dividend of R20 000 to CFC B during the 2016 year of assessment.

CFC B holds 5% of the equity shares and voting rights in Foreign Company D. CFC B and Foreign Company D are residents of the same country. Foreign Company D paid a dividend of R50 000 to CFC B during the 2016 year of assessment.

CFC B holds shares in a Foreign Company E, the shares of which are listed on the JSE. Foreign Company E paid a cash dividend of R6 000 to CFC B during the 2016 year of assessment.

CFC B holds 5% of the equity shares and voting rights in Foreign Company F. CFC B and Foreign Company F are not residents of the same country. Foreign Company F paid a dividend of R100 000 to CFC B during the 2016 year of assessment.

CFC B did not receive any other income nor incur any deductible expenses during the 2016 year of assessment.

Result:

The amount of R176 000 (R20 000 + R50 000 + R6 000 + R100 000) constitutes a foreign dividend for CFC B for purposes of paragraph (*k*) of the definition of "gross income" in section 1(1) and for determining its net income under section 9D(2A).

The foreign dividend of R20 000 received from Foreign Company C is exempt under the participation exemption in section 10B(2)(*a*), since CFC B holds at least 10% of the equity shares and voting rights in Foreign Company C.

The foreign dividend of R50 000 received from Foreign Company D is exempt under the country-to-country exemption in section 10B(2)(*b*) since CFC B and Foreign Company D are residents of the same foreign country.

The foreign dividend of R6 000 received from Foreign Company E is exempt under section 10B(2)(*d*) since it is a foreign dividend received in cash in respect of a share listed on the JSE.

The foreign dividend of R100 000 received from Foreign Company F is not exempt under section 10B(2), but qualifies for the partial exemption under section 10B(3).

The portion of the foreign dividend exempt under section 10B(3)(*b*) is calculated as follows:

A = B × C

A = [(13 / 28) × R100 000]

A = R46 429

The taxable portion of the foreign dividend is R53 571 (R100 000 – R46 429).

The amount attributable to Resident Company A under section 9D(2) amounts to R5 357 (R53 571 × 10%). This amount represents "income" and not a foreign dividend for Resident Company A. Resident Company A is therefore not entitled to claim any of the exemptions under section 10B in respect of the income attributed from CFC B.

The normal tax payable on the amount of the taxable foreign dividend is R1 499,96 (R5 357 × 28%) resulting in an effective tax rate of 15% [R1 499,96 / (R100 000 × 10%) × 100] payable on the gross amount of the income included in Resident Company A's income.

Example 20 – Effect of the application of the partial exemption under section 10B(3) when the income of a CFC is attributed to a natural person

Facts:

Resident A, a natural person, holds 100% of the participation and voting rights in CFC B. During its foreign tax year ending 28 February 2016, CFC B received foreign dividends of R100 000 from Foreign Company C, which is not a CFC in relation to Resident A. Assume that CFC B does not receive any other income and does not incur any deductible expenses. The foreign companies are not residents of the same country. CFC B does not qualify for the exemptions under section 10B(2). Resident A pays normal tax at the maximum marginal rate of 41%.

Result:

The amount of R100 000 constitutes a foreign dividend for CFC B for purposes of the definition of "gross income" in section 1(1) and for determining its net income under section 9D(2A).

The portion of the foreign dividend exempt under section 10B(3)(*b*) is calculated as follows:

A = B × C

A = [(13 / 28) × R100 000]

A = R46 429

The taxable amount of the foreign dividend is R53 571 (R100 000 – R46 429).

The amount attributable to Resident A under section 9D(2) amounts to R53 571 (R53 571 × 100%).

The normal tax payable on R53 571 included in Resident A's income is R21 964,11 (R53 571 × 41%), resulting in an effective normal tax rate of 21,96% (R21 964,11 / R100 000 × 100).

Note:

This example illustrates that a maximum effective normal tax rate of 15% is not necessarily achieved on the inclusion of net income in the income of a resident which results from foreign dividends received by or accrued to a CFC.

4.3.8 Non-application of the participation exemption under section 10B(2)(*a*) and the country-to-country exemption under section 10B(2)(*b*) [section 10B(4)]

(a) Foreign dividend determined with reference to or which arose from a deductible amount paid or payable by any person [section 10B(4)(*a*)]

The participation exemption under section 10B(2)(*a*) and the country-to-country exemption under section 10B(2)(*b*) are subject to an anti-tax avoidance provision in section 10B(4)(*a*). This anti-avoidance provision is aimed at a situation in which a resident claims a deduction for an amount paid to a foreign company which is then routed to another resident in the form of a tax-free foreign dividend.

In particular, these exemptions will not apply to any foreign dividend received by or accrued to a person if –

- the amount of the foreign dividend is determined directly or indirectly with reference to; or
- the foreign dividend arises directly or indirectly from,

any amount paid or payable by any person to any other person; and

- the amount paid or payable is deductible from the income of the payer and –
  - is not subject to normal tax in the hands of the recipient; and
  - when the recipient is a CFC, is not taken into account in determining the net income of that CFC under section 9D(2A).

An amount paid or payable as consideration for the acquisition of trading stock by the payer is specifically excluded from section 10B(4)(*a*).

The words "subject to tax" are not defined in the Act. In *Paul Weiser v The Commissioners for HM Revenue and Customs* the first-tier tribunal stated that it agreed with the following extract from HMRC's International Tax Manual on the meaning of these words:[50]

> " '**INTM332210 – DT applications and claims – Subject to tax**
>
> **Background**
>
> The expression "subject to tax" usually means that the person must actually pay tax on the income in their country of residence.
>
> However, a person is still regarded as "subject to tax" if, for example, he or she does not pay tax because their income is sufficiently small that it is covered by personal allowances that are available to set [off] against liability to tax in the other country.
>
> A person is not regarded as "subject to tax" if the income in question is exempted from tax because the law of the other country provides for a statutory exemption from tax….' "

An amount is similarly not considered to be subject to normal tax in South Africa if it is exempt under the Act or if a tax treaty provides for relief from double taxation by prohibiting the right of one of the Contracting States to tax the income.[51]

An amount paid or payable as consideration for the acquisition of trading stock is specifically excluded from section 10B(4)(*a*) because any deduction for the

[50] [2012] UKFTT 501 (TC) in paragraphs 37 and 38.

[51] See Binding Private Ruling: BPR 127 dated 21 November 2012 "Relief from Double Taxation of Foreign Income".

acquisition of trading stock is cancelled by the inclusion in taxable income for trading stock held and not disposed of at the end of a year of assessment under section 22(1) or by an inclusion in gross income in section 1(1) upon its disposal.

Foreign dividends not exempt because the application of section 10B(4) denies an exemption under section 10B(2)(*a*) or (*b*) may be exempt under section 10B(2)(*c*), (*d*)[52] or (*e*)[53] or partially exempt under section 10B(3) (see **4.3.7**).

Example 21 – Non-application of the participation exemption under section 10B(2)(*a*) – Foreign dividend determined with reference to a deductible amount paid or payable by any person – Section 10B(4)(*a*)

Facts:

Resident Company A pays technical service fees to Foreign Company C for services rendered by Foreign Company C outside South Africa. Resident Company B holds 15% of the equity shares and voting rights in Foreign Company C, a CFC. The shares of Foreign Company C are not listed on the JSE. Foreign Company C pays a cash dividend to Resident Company B that arises directly from the technical service fees paid by Resident Company A. The technical service fees form part of Foreign Company C's foreign business establishment.

Result:

The foreign dividend received by Resident Company B from Foreign Company C is included in Resident Company B's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

The foreign dividend does not qualify for the participation exemption under section 10B(2)(*a*) because –

- the foreign dividend arises directly from the technical service fees payable by Resident Company A;
- the technical service fees are deductible from Resident Company A's income under section 11(*a*);
- the technical service fees received by Foreign Company C are not subject to normal tax because Foreign Company C is not a resident and the amount is not derived from a source in South Africa; and
- the technical service fees are furthermore not taken into account in determining Foreign Company C's net income under section 9D(2A) because they form part of its foreign business establishment and are excluded under section 9D(9)(*b*). It is assumed that none of the exclusions from section 9D(9)(*b*) in section 9D(9A) apply.

Note:

The exemption under section 10B(2)(*c*) and the partial exemption under section 10B(3) may apply.

[52] In respect of shares of a foreign company that are listed on the JSE.
[53] In respect of shares of a foreign company that are listed on the JSE.

Example 22 – Non-application of the country-to-country exemption under section 10B(2)(*b*) – Foreign dividend determined with reference to a deductible amount paid or payable by any person – Section 10B(4)(*a*)

Facts:

Resident Company A pays management fees to Foreign Company C, a CFC. The management fees form part of Foreign Company C's foreign business establishment and are derived from a source outside South Africa. Foreign Company B, a CFC, holds 15% of the equity shares and voting rights in Foreign Company C. Foreign Company B and Foreign Company C are both residents of Foreign Country B. Foreign Company C pays a dividend to Foreign Company B that arises directly from the management fees paid by Resident Company A.

Result:

The foreign dividend received by Foreign Company B from Foreign Company C is included in Foreign Company B's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1) for purposes of determining its net income under section 9D(2A).

The foreign dividend does not qualify for the country-to-country exemption under section 10B(2)(*b*) because –

- the foreign dividend arises directly from the management fees payable by Resident Company A;
- the management fees are deductible from Resident Company A's income under section 11(*a*);
- the management fees received by Foreign Company C are not subject to normal tax because Foreign Company C is not a resident and the fees are from a source outside South Africa; and
- the management fees are furthermore not taken into account in determining Foreign Company C's net income under section 9D(2A) because they form part of its foreign business establishment and are excluded under section 9D(9)(*b*).

Note:

The partial exemption under section 10B(3) may still apply.

(b) Foreign dividends received or accrued from a foreign collective investment scheme [section 10B(4)(*b*)]

The participation exemption under section 10B(2)(*a*) and the country-to-country exemption under section 10B(2)(*b*) do not apply to a foreign dividend received by or accrued to a person from a portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participatory interest. The exemptions under section 10B(2)(*c*) or section 10B(3) may still apply.

The effect of section 10B(4)(*b*) is that a foreign dividend received or accrued from a portfolio in these investment schemes constitutes income for a unit holder to the extent that it is not exempt under section 10B(2)(*c*) or section 10B(3).

A foreign dividend received or accrued from a portfolio in these investment schemes is not subject to dividends tax.[54]

The tax treatment of resident portfolios of collective investment schemes in securities and their unit holders differ from that of foreign investment schemes and is dealt with in section 25BA.[55]

Example 23 – Non-application of the participation exemption under section 10B(2)(*a*) – Foreign dividends received or accrued from a foreign collective investment scheme

Facts:

Resident Company A holds 10% of the equity shares and voting rights in Foreign Company B. Foreign Company B is a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participating interest. Foreign Company B pays a foreign dividend of R10 000 to Resident Company A.

Result:

The foreign dividend of R10 000 received by Resident Company A is included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). Section 10B(4)(*b*) determines that the participation exemption under section 10B(2)(*a*) does not apply since the foreign dividend was received from a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participatory interest.

The partial exemption under section 10B(3) applies which means that an amount of R4 643 (R10 000 × 13 / 28) is exempt from normal tax.

Example 24 – Non-application of the country-to-country exemption under section 10B(2)(*b*) – Foreign dividends received or accrued from a foreign collective investment scheme

Facts:

Resident Company A holds 100% of the participation rights and voting rights in Foreign Company B which in turn holds 5% of the participation and voting rights in Foreign Company C. Both foreign companies are incorporated and effectively managed in Foreign Country D. Foreign Company C is a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participating interest. Foreign Company C pays a foreign dividend to Foreign Company B.

[54] See paragraph 3.1.1 of the Comprehensive Guide to Dividends Tax.
[55] See paragraph 5.4 of the Comprehensive Guide to Dividends Tax.

Result:

Foreign Company B is a CFC in relation to Resident Company A since the latter company holds 100% of its participation rights and voting rights. Under section 9D(2A) Foreign Company B is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Therefore, the foreign dividend paid by Foreign Company C to Foreign Company B is included in Foreign Company B's gross income for purposes of determining its net income under section 9D(2A).

Section 10B(4)(*b*) determines that the foreign dividend is not exempt from normal tax under section 10B(2)(*b*) since it was received from a portfolio which carries on an investment scheme outside South Africa that is comparable to a portfolio of a collective investment scheme in securities in which members of the public are invited or permitted to hold a participatory interest.

The foreign dividend qualifies for the partial exemption under section 10B(3).

The amount attributable to Resident Company A under section 9D(2) represents "income" and not a foreign dividend. Resident A is therefore not entitled to claim any of the exemptions under section 10B in respect of the income attributed from Foreign Company B.

4.3.9 Non-application of the exemptions under section 10B(2) to any payments out of foreign dividends [section 10B(5)]

Under section 10B(5) the exemptions under section 10B(2) do not extend to any payments out of any foreign dividend received by or accrued to any person. This provision is similar to the one in section 10(3)(*a*) which provides that the exemptions under section 10(1) shall not apply in respect of any payments out of the receipts, accruals, amounts or profits mentioned in section 10(1).

Section 10B(5) does not apply if a foreign dividend is distributed through multiple foreign subsidiaries, with the final foreign dividend being received by the ultimate holder as a foreign dividend. Each foreign subsidiary is declaring a foreign dividend in its own right as opposed to merely paying an amount out of a foreign dividend received or accrued and as a result section 10B(5) will not apply.

Example 25 – Non-application of section 10B(2) – Payment of an amount out of foreign dividends

Facts:

Resident Company A holds shares in a foreign company listed on the JSE and received foreign dividends in cash of R300 000 from that company during the 2016 year of assessment. Resident Company A used R150 000 of the cash to pay bonuses to its employees.

Result:

The amount of R300 000 constitutes a "foreign dividend" as defined in section 1(1) and is included in Resident Company A's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). Resident Company A qualifies for the exemption under section 10B(2)(*d*).

The bonus constitutes gross income for the relevant employees. The bonus is not a foreign dividend and the employees will not be entitled to any of the exemptions in section 10B. Section 10B(5) clarifies that the exemptions under section 10B(2) are unavailable. The fact that the underlying cash funds may have come from a foreign dividend is irrelevant.

4.3.10 Non-application of section 10B(2) and (3) – Foreign dividends in respect of services rendered, employment or holding of office [section 10B(6)]

Section 10B(6)[56] is an anti-tax avoidance provision aimed at structures involving foreign companies under which income received by a person for services rendered is categorised as a foreign dividend. The following is stated in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013*:[57]

> "… many share schemes hold pure equity shares where the sole intent of the scheme is to generate dividends for employees as compensation for past or future services rendered to the employer, without the employees ever obtaining ownership of the shares. The dividend yield in these instances effectively operates as disguised salary for employees (that is not deductible by employers) even though these dividends arise from equity shares."

The exemptions under section 10B(2) and (3) do not apply to any foreign dividend received by or accrued to a person –

- in respect of services rendered or to be rendered; or
- in respect of or by virtue of employment or the holding of any office.

However, any foreign dividend received by or accrued to a person under any of the circumstances mentioned above in respect of a restricted equity instrument[58] as defined in section 8C *held* by that person or in respect of a share *held* by that person, is not subject to section 10B(6) and qualifies for the exemptions under section 10B.

Foreign dividends received by or accrued to persons who are the holders of the shares will therefore be exempt under section 10B(2) and (3) even though they are paid in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office.

The non-application of section 10B(6) to holders of shares can be justified because –

- the beneficial owner of a share will be taxed on the proceeds derived on its subsequent disposal; and
- any gain or loss upon vesting of an equity instrument will be included in the income of the holder under section 8C(1)(*a*).

---

56 Section 10B(6) was inserted by section 25(1)(*e*) of the Taxation Laws Amendment Act No. 31 of 2013 and applies to foreign dividends received or accrued on or after 1 March 2014.

57 In paragraph 1.8.

58 The term "restricted equity instrument" is defined in section 8C(7).

Example 26 – Non-application of section 10B(2) and (3) – Income disguised as a foreign dividend – Section 10B(6)

Facts:

Resident A, a natural person, is an employee of Foreign Company B. A discretionary trust holds shares in Foreign Company B for the benefit of the employees of Foreign Company B as part of an employee share incentive scheme. The trust is the beneficial owner of the shares. The trustees distribute foreign dividends of R100 000 to Resident A under the share incentive scheme during the 2016 year of assessment.

Result:

The foreign dividends of R100 000 are included in Resident A's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1) read with section 25B(1) and (2). Under section 10B(6) the exemptions under section 10B(2) and (3) do not apply to the foreign dividend of R100 000 received by Resident A by virtue of Resident A's employment in Foreign Company B.

Note:

Should Resident A have had a vested right in the shares, section 10B(6) would not have applied and the exemptions under section 10B(2) and (3) would have applied.

4.4 An amount paid or payable by a foreign company in respect of a share that does not constitute a foreign dividend

Any amount paid or payable by a foreign company to a person in respect of a share in that company that does not constitute a "foreign dividend" as defined in section 1(1) does not qualify for exemption under section 10B.

Any amount paid or payable by a foreign company to a person in respect of a share in that company from income reserves which does not constitute a "foreign dividend" or a "foreign return of capital" as defined in section 1(1) may constitute a receipt or accrual of a revenue nature. Accordingly, even though it is not a foreign dividend and does not fall within paragraph (*k*) of the definition of gross income it may still require inclusion in gross income.

Example 27 – An amount paid or payable by a foreign company in respect of a share that does not constitute a foreign dividend

Facts:

Foreign Company A, which is effectively managed in and a resident of Foreign Country A, paid an amount of R100 000 from its retained profits to Resident A in respect of shares held in Foreign Company A. Under the income tax law on companies of Foreign Country A the amount is deemed to be interest and qualifies for a tax deduction in Foreign Country A.

Result:

The amount of R100 000 received by Resident A does not constitute a "foreign dividend" as defined in section 1(1) since it is deemed to be interest and is not treated as a dividend or a similar payment under the income tax law on companies of Foreign Country A. The amount is also not a foreign return of capital because Foreign Company A is entitled to a tax deduction for the deemed interest expense.

From Resident A's perspective the income is of a revenue nature and must be included in gross income. The amount will be subject to normal tax since it is not a foreign dividend and as a result Resident A does not qualify for an exemption under section 10B.

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

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

Examples of the type of expenditure disqualified as a deduction under section 23(*q*) include interest incurred on money borrowed to finance the acquisition of shares and bank charges.

4.6 Source of foreign dividends [section 9(4)(*a*)]

Section 9(4)(*a*) provides that an amount is received by or accrues to a person from a source outside the Republic if that amount constitutes a foreign dividend received by or accrued to that person. The source of foreign dividends is relevant, amongst other things, for the granting of a rebate under section 6*quat* against normal tax payable on the amount of foreign dividends included in taxable income.

4.7 Translation of a foreign dividend denominated in a foreign currency to rand (section 25D)

A foreign dividend received by or accrued to a person, which is required to be included in the person's income, will usually be denominated in a foreign currency. For South African normal tax purposes the amount of a foreign dividend must be translated to rand by applying one of the translation methods provided for in section 25D. Under the general rule in section 25D(1), foreign dividends must be translated to rand at the relevant spot rate on the date on which the foreign dividend was received or accrued.

A natural person and a non-trading trust may elect under section 25D(3) to translate a foreign dividend at the average exchange rate for the year of assessment rather than the spot rate. The same method of translation must be applied consistently during a year of assessment to translate all income received or accrued and expenditure incurred in a foreign currency during that year of assessment to rand.[59]

Different rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies – see Interpretation Note No. 63 (Issue 2) dated 12 August 2015 "Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule" for details.

[59] See Interpretation Note No. 63 (Issue 2) dated 12 August 2015 "Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule" for the interpretation of section 25D.

Example 28 – Translation to rand of a foreign dividend denominated in a foreign currency

Facts:

A foreign dividend of $100 000 accrued to Individual A, a resident, on 1 April 2015. The spot rate on that date was $1 : R11,9872. Individual A did not elect to translate income and expenses at the average exchange rate for the 2016 year of assessment.

Result:

The foreign dividend of $100 000 that accrued to Individual A must be included in gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). Under section 25D(1) the foreign dividend must be translated to rand at the spot rate on the date of accrual. The amount to be included in gross income is R1 198 720 ($100 000 × R11,9872).

4.8 Rebate for foreign taxes on foreign dividends (section 6*quat*)

Amounts of income received by or accrued to a resident from a foreign source may be taxed in both the country of source and South Africa, resulting in juridical double taxation. Section 6*quat*(1) provides relief in this regard by providing for a rebate for foreign taxes to be deducted from normal tax payable.

One of the requirements of the rebate is that the foreign tax must be proved to be payable on income from a source outside South Africa which is included in taxable income.[60] However, under paragraph (ii) of the proviso to section 6*quat*(1A), in calculating the amount of foreign taxes which potentially qualify for a rebate, an amount included in a person's taxable income must be determined without regard to section 10B(3). The proviso applies only for purposes of the application of section 6*quat*(1A). The result is that any foreign tax proved to be payable in respect of foreign dividends exempt under section 10B(3) qualifies to be taken into account as a foreign tax rebate under section 6*quat*(1). But for the proviso, the foreign taxes qualifying for rebate purposes would have been limited to the portion of the foreign dividend included in income (for example, 15 / 41 for an individual or 15 / 28 for a company). For example, Resident A, a natural person, received a foreign dividend of R100 on which foreign tax of R10 was payable. Resident A qualified for an exemption of R63,41 (26 / 41 × R100) under section 10B(3)(*b*)(*ii*)(*aa*) which means R36,59 was included in taxable income (R100 – R63,41 or R100 × the non-exempt portion of 15 / 41). Paragraph (ii) of the proviso to section 6*quat*(1A) provides that R10 of foreign tax potentially qualifies for a rebate and not only R3,66 (R10 × 15/41) which is the portion of the foreign tax relating to the amount of the foreign dividend (R36,59) which is included in taxable income.

60 See Interpretation Note No. 18 (Issue 3) dated 26 June 2015 "Rebate or Deduction for Foreign Taxes on Income" for a discussion of the rebate for foreign taxes.

Paragraph (ii) of the proviso does not impact on the overall limitation of foreign taxes qualifying for rebate purposes under section 6*quat*(1B). The amount of foreign taxes calculated under section 6*quat*(1A) which qualify for the section 6*quat*(1) rebate in a particular year of assessment is limited to the amount calculated under the limitation formula in section 6*quat*(1B)(*a*), namely:

> Taxable income derived from all foreign sources (A) / Taxable income derived from all sources (B)] × Normal tax payable on (B).

The portion of foreign dividends exempt under section 10B(3) does not form part of either (A) or (B) in the above formula. Even though the amount of foreign tax that potentially qualifies for a rebate is increased by the amount of foreign tax proved to be payable in respect of foreign dividends exempt under section 10B(3), the foreign taxable income and total taxable income are not increased by the exempt income for purposes of calculating the amount of the foreign tax rebate.

Any portion of the foreign tax that does not qualify for the foreign tax rebate because of the formula in section 6*quat*(1B)(*a*) may be carried forward to the following year of assessment, but is not allowed to be carried forward for more than seven years under paragraph (iii) of the proviso to section 6*quat*(1B)(*a*).

Foreign tax proved to be payable in respect of foreign dividends included in a person's taxable income during a year of assessment, must be translated to rand on the last day of the year of assessment at the average exchange rate for that year of assessment under section 6*quat*(4).[61]

Example 29 – Rebate for foreign taxes under section 6*quat* in respect of foreign dividends

Facts:

Resident A, a natural person under the age of 65, received a foreign dividend of R100 000 by virtue of a 2% shareholding in Foreign Company B during the 2016 year of assessment. Foreign tax of R10 000 (R100 000 × 10%) was withheld from the payment of the foreign dividend. No tax treaty exists between South Africa and the country in which Foreign Company B is a resident. None of the exemptions under section 10B(2) applies. Resident A incurred expenses of R3 000 in production of the foreign dividend. Resident A received other taxable income of R1 million from a South African source for the 2016 year of assessment.

Result:	R
Calculation of the taxable amount of foreign dividends	
Foreign dividend included in gross income under paragraph (*k*) of the definition of "gross income" in section 1(1)	100 000
Less: Portion exempt under section 10B(3) [(26 / 41) × R100 000]	(63 415)
Taxable foreign dividend	36 585
Calculation of total taxable income	
Taxable amount of foreign dividend	36 585
Other taxable income	1 000 000
Total taxable income	1 036 585

[61] See Interpretation Note No. 18 (Issue 3) dated 26 June 2015 "Rebate or Deduction for Foreign Taxes on Income" for a discussion of the rebate for foreign taxes.

Normal tax on taxable income[62]

R208 587,00 + [41% × (R1 036 585 – R701 300)]
= R208 587,00 + R137 466,85
= R346 053,85

Calculation of the rebate under section 6quat(1)

The full foreign tax of R10 000 potentially qualifies for a foreign tax rebate under section 6*quat(1) even though* R6 341,50 of that amount (R63 415 × 10%) relates to the exempt portion of the foreign dividend.[63] Under the limitation formula in section 6*quat*(1B)(*a*) the maximum amount of the rebate that may be allowed is R12 213,55 (R36 585 / R1 036 585 × R346 053,85). The amount of the limitation is greater than the amount of the foreign taxes potentially qualifying for a rebate, therefore the amount of the rebate is equal to the amount of foreign tax withheld of R10 000.

Calculation of normal tax payable after taking into account the rebate under section 6quat(1)

Normal tax payable before rebates	346 053,85
Less: Primary rebate [section 6(2)(*a*)]	(13 257,00)
Less: Section 6*quat*(1) rebate	(10 000,00)
Normal tax payable	322 796,85

Note:

Section 23(*q*) prohibits the deduction of any expenses incurred in the production of foreign dividends. Therefore, the expenses of R3 000 incurred in the production of the foreign dividends are not deductible.

4.9 Controlled foreign companies [sections 9D(9)(*f*), 22(3)(*a*)(iii) and paragraph 20(1)(*h*)(iii)]

Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

4.9.1 Foreign dividends not included in the net income of a CFC [section 9D(9)(*f*)]

Section 9D(9)(*f*) provides that, subject to section 9D(9A), in determining the net income of a CFC under section 9D(2A), there must not be taken into account any amount which is attributable to any foreign dividend declared to that CFC, by any other CFC in relation to the resident, to the extent that the foreign dividend does not exceed the aggregate of all amounts which have been or will be included in the income of the resident under section 9D in any year of assessment, which relate to the net income of –

- the company declaring the dividend; or
- any other company which has been included in the income of that resident by virtue of that resident's participation rights in that other company held indirectly through the company declaring the dividend,

[62] As per tax tables for the 2016 year of assessment.
[63] Paragraph (ii) of the proviso to section 6*quat*(1A).

reduced by –

- the amount of any foreign tax payable, in respect of the amounts so included in that resident's income; and
- so much of all foreign dividends received by or accrued to that CFC as was –
  - excluded from the application of section 9D under section 9D(9)(*f*) or section 10B(2)(*a*), (*b*) or (*c*); or
  - previously not included in the income of that resident by virtue of any prior inclusion under section 9D.

Example 30 – Foreign dividend not included in the net income of a CFC – Section 9D(9)(*f*)

Facts:

Resident Company A holds 100% of the equity shares and voting rights in Foreign Company B. Foreign Company B holds 100% of the equity shares and voting rights in Foreign Company C. Foreign Company C's net income is R100 000 for the 2016 year of assessment. Foreign Company C declared a dividend of R100 000 to Foreign Company B at the end of the 2016 year of assessment.

Result:

Both Foreign Company B and Foreign Company C are CFCs in relation to Resident Company A. The net income of R100 000 of Foreign Company C must be included in Resident Company A's income under section 9D(2).

Under section 9D(9)(*f*) the foreign dividend of R100 000 must not be taken into account in determining Foreign Company B's net income since this amount was attributed by Foreign Company C to Resident Company A.

4.9.2 Determination of the cost price of a right in a CFC held as trading stock [section 22(3)(*a*)(iii)]

Section 22(3)(*a*) deals with the determination of the cost price of trading stock. Section 22(3)(*a*)(iii) determines the cost price of a right in a CFC held as trading stock.

Section 22(3)(*a*)(iii)(*aa*) provides that the cost price of a right in a CFC held directly by a resident includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)[64] of that CFC and of any other CFC in which that CFC and that resident directly or indirectly have an interest, which was included in the income of that resident under section 9D during any year of assessment. The cost price of the right so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the resident during any year of assessment which was exempt under section 10B(2)(*a*)[65] or (*c*).

Section 22(3)(*a*)(iii)(*bb*) provides that the cost price of a right in a CFC held directly by another CFC, includes an amount equal to the proportional amount of the net

[64] The inclusion rates of capital gains.

[65] Section 10B(2)(*a*) was included by section 37(1)(*b*) of the Taxation Laws Amendment Act No. 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

income (without having regard to the percentage adjustments contemplated in paragraph 10)[66] of that first-mentioned CFC and of any other CFC in which both the first- and second-mentioned CFCs directly or indirectly have an interest, which during any year of assessment would have been included in the income of the second-mentioned CFC under section 9D had it been a resident. The cost price of the right so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the second-mentioned CFC if that dividend would have been exempt under section 10B(2)(*a*)[67] or (*c*) had the second-mentioned CFC been a resident.

The effect of section 22(3)(*a*)(iii) is to increase the cost price of the right in a CFC by amounts already included in the income of a resident under section 9D(2). This treatment ensures that any income from the disposal of a right in a CFC is not subject to normal tax to the extent of amounts already subjected to normal tax because of the application of section 9D(2). The increased cost price of the right in a CFC is reduced by foreign dividends that were exempt under section 10B(2)(*c*).

4.9.3 Determination of the base cost of a right in a CFC [paragraph 20(1)(*h*)(iii)]

Paragraph 20 determines the base cost of an asset acquired by a person on or after the valuation date. Paragraph 20(1)(*h*)(iii) determines the base cost of a right in a CFC.

Paragraph 20(1)(*h*)(iii)(*aa*) provides that the base cost of a right in a CFC held directly by a resident, includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)[68] of that CFC and of any other CFC in which the first-mentioned CFC and the resident directly or indirectly have an interest, which was included in the income of the resident under section 9D during any year of assessment. The amount so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the resident during any year of assessment which was exempt from tax under section 10B(2)(*a*) or (*c*)[69] .

Paragraph 20(1)(*h*)(iii)(*bb*) provides that the base cost of a right in a CFC held directly by another CFC, includes an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10)[70] of the first-mentioned CFC and of any other CFC in which both the first- and second-mentioned CFCs directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned CFC under section 9D had it been a resident. The amount so determined is reduced by the amount of any foreign dividend distributed by the first-mentioned CFC to the second-mentioned CFC if that dividend would have been exempt under section 10B(2)(*a*) or (*c*)[71] had the second-mentioned CFC been a resident.

---

66 The inclusion rates of capital gains.

67 Section 10B(2)(*a*) was included by section 37(1)(*b*) of the Taxation Laws Amendment Act No. 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

68 The inclusion rates of capital gains.

69 Section 10B(2)(*c*) was included by section 108(1)(*b*) of the Taxation Laws Amendment Act No. 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

70 The inclusion rates of capital gains.

71 Section 10B(2)(*c*) was included by section 108(1)(*b*) of the Taxation Laws Amendment Act No. 25 of 2015 with effect from the date of promulgation, namely 8 January 2016.

The effect of paragraph 20(1)(*h*)(iii) is to increase the base cost of the right in a CFC by amounts already included in the income of a resident under section 9D(2). This treatment ensures that proceeds from the disposal of a right in a CFC are not subject to CGT to the extent of amounts already subjected to normal tax because of the application of section 9D(2). The increased base cost of the right in a CFC is reduced by any foreign dividends that were exempt under section 10B(2)(*a*) or (*b*).

See paragraph 8.13 of the *Comprehensive Guide to Capital Gains Tax* (Issue 5) for a discussion of paragraph 20(1)(*h*)(iii).

4.10 Anti-avoidance provisions

Although not discussed in this Note, regard must be had to the following sections and paragraphs aimed at combatting tax avoidance arising in relation to foreign dividends:[72]

- Section 8E – Dividends on certain shares deemed to be income in relation to recipients thereof.
- Section 8EA – Dividends on third-party backed shares deemed to be income in relation to recipients thereof.
- Section 22B – Dividends treated as income on disposal of certain shares.
- Paragraph 19 – Losses on disposal of certain shares.
- Paragraph 43A – Dividends treated as proceeds on disposal of certain shares.

5. Conclusion

Any amount received by or accrued to a person as a foreign dividend is included in that person's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

Section 10B provides for exemptions of foreign dividends received by or accrued to a person. The exemptions under section 10B(2) are applied separately to each foreign dividend received or accrued while the partial exemption under section 10B(3) applies to the aggregate amount of foreign dividends not exempt under section 10B(2). The partial exemption is determined by applying the applicable ratio to a specific type of person. The exemptions will not apply to the extent that section 10B(4), (5) or (6) applies.

Foreign dividends received by or accrued to a person constitute income from a foreign source under section 9(4)(*a*). Foreign tax paid on foreign dividends potentially qualifies for a tax rebate under section 6*quat*(1).

Under section 25D a foreign dividend received by or accrued to a person is translated from a foreign currency to rand at the spot rate, or at the average exchange rate if a natural person or non-trading trust so elects. Special rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies. Foreign tax payable on a foreign dividend is translated to rand on the last day of a year of assessment at the average exchange rate for that year of assessment under section 6*quat*(4).

---

[72] See the *Tax Guide for Share Owners* (Issue 4) and the *Comprehensive Guide to Capital Gains Tax* (Issue 5) for a discussion of certain of these provisions.

Section 23(*q*) prohibits the deduction of expenditure incurred in the production of foreign dividends.

For the purposes of determining its net income, a CFC is deemed to be a resident for purposes of the definition of "gross income" in section 1(1). Foreign dividends received by or accrued to a CFC are therefore included in its gross income. Section 10B also applies to foreign dividends received by or accrued to a CFC for purposes of determining its net income for inclusion in a resident's income. Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

The anti-avoidance provisions of sections 8E, 8EA, 22B and paragraphs 19 and 43A are relevant when entering into share or dividend transactions.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Annexure – The law

Section 1(1) – Definition of "controlled foreign company"

"controlled foreign company" means a controlled foreign company as defined in section 9D, and includes any reference in this Act, prior to the amendment thereof by the Revenue Laws Amendment Act, 2002, to a controlled foreign entity;

Section 1(1) – Definition of "company"

"company" includes—

(*a*) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or

(*b*) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or

(*c*) any co-operative; or

(*d*) any association (not being an association referred to in paragraph (*a*) or (*f*)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or

(*e*) any—

(i) . . . . . .

(ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or

(iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x) of the JSE Limited Listings Requirements; or

(*f*) a close corporation,

but does not include a foreign partnership;

Section 1(1) – Definition of "foreign dividend"

"foreign dividend" means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to—

(*a*) tax on income on companies of the country in which that foreign company has its place of effective management; or

(*b*) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable that—

(i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (*e*)(ii) of the definition of "company"; or

(ii) . . . . . .

(iii) constitutes a share in that foreign company;

Section 1(1) – Definition of "foreign partnership"

"foreign partnership", in respect of any year of assessment, means any partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic if—

(*a*) for the purposes of the laws relating to tax on income of the country in which that partnership, association, body of persons or entity is formed or established—

(i) each member of the partnership, association, body of persons or entity is required to take into account the member's interest in any amount received by or accrued to that partnership, association, body of persons or entity when that amount is received by or accrued to the partnership, association, body of persons or entity; and

(ii) the partnership, association, body of persons or entity is not liable for or subject to any tax on income, other than a tax levied by a municipality, local authority or a comparable authority, in that country; or

(*b*) where the country in which that partnership, association, body of persons or entity is formed or established does not have any applicable laws relating to tax on income—

(i) any amount—

(*aa*) that is received by or accrued to; or

(*bb*) of expenditure that is incurred by,

the partnership, association, body of persons or entity is allocated concurrently with the receipt, accrual or incurral to the members of that partnership, association, body of persons or entity in terms of an agreement between those members; and

(ii) no amount distributed to a member of a partnership, association, body of persons or entity may exceed the allocation contemplated in subparagraph (i) after taking into account any prior distributions made by the partnership, association, body of persons or entity;

Section 1(1) – Definition of "foreign return of capital"

"foreign return of capital" means any amount that is paid or payable by a foreign company in respect of any share in that foreign company where that amount is treated as a distribution or similar payment (other than an amount that constitutes a foreign dividend) by that foreign company for the purposes of the laws relating to—

(*a*) tax on income on companies of the country in which that foreign company has its place of effective management; or

(*b*) companies of the country in which that foreign company is incorporated, formed or established, where that country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,

but does not include any amount so paid or payable to the extent that the amount so paid or payable—

(i) is deductible by that foreign company in the determination of any tax on income of companies of the country in which that foreign company has its place of effective management; or

(ii) constitutes shares in that foreign company;

Section 6*quat*(1), (1A), (1B) and (4)

6*quat*. Rebate or deduction in respect of foreign taxes on income.—(1) Subject to subsection (2), where the taxable income of any resident during a year of assessment includes—

(*a*) any income received by or accrued to such resident from any source outside the Republic; or

(*b*) any proportional amount contemplated in section 9D; or

(*c*) . . . . . .

(*d*) . . . . . .

(*e*) any taxable capital gain contemplated in section 26A, from a source outside the Republic; or

(*f*) any amount—

(i) contemplated in paragraph (*a*) or (*b*) which is received by or accrued to any other person and which is deemed to have been received by or accrued to such resident in terms of section 7;

(ii) of capital gain of any other person from a source outside the Republic and which is attributed to that resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule; or

(iii) contemplated in paragraphs (*a*), (*b*) or (*e*) which represents capital of a trust, and which is included in the income of that resident in terms of section 25B(2A) or taken into account in determining the aggregate capital gain or aggregate capital loss of that resident in terms of paragraph 80(3) of the Eighth Schedule,

there must be deducted from the normal tax payable in respect of that taxable income a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment) by—

(*a*) such resident in respect of—

(i) any income contemplated in subsection (1)(*a*); or

(ii) . . . . . .

(iii) any amount of taxable capital gain as contemplated in subsection (1)(*e*); or

(*b*) any controlled foreign company, in respect of such proportional amount contemplated in subsection (1)(*b*), subject to section 72A(3); or

(*c*) . . . . . .

(*d*) . . . . . .

(*e*) . . . . . .

(*f*) any other person contemplated in subsection (1)(*f*)(i) or (ii) or any trust contemplated in subsection (1)(*f*)(iii), in respect of the amount included in the taxable income of that resident as contemplated in subsection (1)(*f*),

which is so included in that resident's taxable income: Provided that—

(i) where such resident is a member of any partnership or a beneficiary of any trust and such partnership or trust is liable for tax as a separate entity in such other country, a proportional amount of any tax payable by such entity, which is attributable to the interest of such resident in such partnership or trust, shall be deemed to have been payable by such resident; and

(ii) for the purposes of this subsection, the amount so included in such resident's taxable income must be determined without regard to section 10B (3).

(1B) Notwithstanding the provisions of subsection (1A)—

(*a*) the rebate or rebates of any tax proved to be payable as contemplated in subsection (1A), shall not in aggregate exceed an amount which bears to the total normal tax payable the same ratio as the total taxable income attributable to the income, proportional amount, taxable capital gain or amount, as the case may be, which is included as contemplated in subsection (1), bears to the total taxable income: Provided that—

(i) in determining the amount of the taxable income that is attributable to that income, proportional amount, taxable capital gain or amount, any allowable deductions contemplated in sections 11(*n*), 18 and 18A must be deemed to have been incurred proportionately in respect of income derived from sources within and outside the Republic;

(iA) the taxes contemplated in subsection (1A)(*b*) that are attributable to any proportional amount which—

(*aa*) . . . . . .

(*bb*) relates to any amount contemplated in section 9D(9A)(*a*) which is not excluded from the application of section 9D(2) in terms of that section or section 9D(9)(*b*),

shall in aggregate be limited to the amount of the normal tax which is attributable to those proportional amounts;

(iB) the taxes contemplated in subsection (1A)(*a*)(iii) which are attributable to any taxable capital gain in respect of an asset which is not attributable to a permanent establishment of the resident outside the Republic, must in aggregate be limited to the amount of normal tax which is attributable to that taxable capital gain;

(ii) where the sum of any such taxes proved to be payable (excluding any taxes contemplated in paragraphs (iA) and (iB) of this proviso) exceeds the rebate as so determined (hereinafter referred to as the excess amount), that excess amount may—

(*aa*) be carried forward to the immediately succeeding year of assessment and shall be deemed to be a tax on income paid to the government of any other country in that year; and

(*bb*) be set off against the amount of any normal tax payable by that resident during that year of assessment in respect of any amount derived from any other country which is included in the taxable income of that resident during that year, as contemplated in subsection (1), after any tax payable to the government of any other country in respect of any amount so included during such year of assessment which may be deducted in terms of subsections (1) and (1A), has been deducted from the amount of such normal tax payable in respect of such amount so included; and

(iii) the excess amount shall not be allowed to be carried forward for more than seven years reckoned from the year of assessment when such excess amount was for the first time carried forward;

(*b*) . . . . . .

(*c*) . . . . . .

(*d*) . . . . . .

(*e*) . . . . . .

(4) For the purpose of this section the amount of any foreign tax proved to be payable as contemplated in subsection (1A) or any amount paid or proved to be payable as contemplated in subsection (1C) in respect of any amount which is included in the taxable income of any resident during any year of assessment, shall be translated to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment.

Section 9(4)(*a*)

(4) An amount is received by or accrues to a person from a source outside the Republic if that amount—

(*a*) constitutes a foreign dividend received by or accrued to that person;

Section 9D(1) – Definition of "controlled foreign company"

"controlled foreign company" means any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies: Provided that—

(*a*) no regard must be had to any voting rights in any foreign company—

(i) which is a listed company; or

(ii) if the voting rights in that foreign company are exercisable indirectly through a listed company;

(*b*) any voting rights in a foreign company which can be exercised directly by any other controlled foreign company in which that resident (together with any connected person in relation to that resident) can directly or indirectly exercise more than 50 per cent of the voting rights are deemed for purposes of this definition to be exercisable directly by that resident; and

(*c*) a person is deemed not to be a resident for purposes of determining whether residents directly or indirectly hold more than 50 per cent of the participation rights or voting rights in a foreign company, if—

(i) in the case of a listed company or a foreign company the participation rights of which are held by that person indirectly through a listed company, that person holds less than five per cent of the participation rights of that listed company; or

(ii) in the case of a scheme or arrangement contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1 or a foreign company the participation rights of which are held and the voting rights of which may be exercised by that person indirectly through such a scheme or arrangement, that person—

(*aa*) holds less than five per cent of the participation rights of that scheme or arrangement; and

(*bb*) may not exercise at least five per cent of the voting rights in that scheme or arrangement,

unless more than 50 per cent of the participation rights or voting rights of that foreign company or other foreign company are held by persons who are connected persons in relation to each other;

Section 9D(9)(*f*)

(9) Subject to subsection (9A), in determining the net income of a controlled foreign company in terms of subsection (2A), there must not be taken into account any amount which—

(*f*) is attributable to any foreign dividend declared to that controlled foreign company, by any other controlled foreign company in relation to the resident, to the extent that the foreign dividend does not exceed the aggregate of all amounts which have been or will be included in the income of the resident in terms of this section in any year of assessment, which relate to the net income of—

(i) the company declaring the dividend; or

(ii) any other company which has been included in the income of that resident by virtue of that resident's participation rights in that other company held indirectly through the company declaring the dividend,

reduced by—

(*aa*) the amount of any foreign tax payable, in respect of the amounts so included in that resident's income; and

(*bb*) so much of all foreign dividends received by or accrued to that controlled foreign company as was—

(A) excluded from the application of this section in terms of this paragraph or section 10B(2)(*a*), (*b*) or (*c*);

(B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D;

Section 10B

10B. Exemption of foreign dividends and dividends paid or declared by headquarter companies.—(1) For the purposes of this section, "foreign dividend" means any—

(*a*) foreign dividend as defined in section 1; or

(*b*) dividend paid or declared by a headquarter company.

(2) Subject to subsection (4), there must be exempt from normal tax any foreign dividend received by or accrued to a person—

(*a*) if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in the company declaring the foreign dividend;

(*b*) if that person is a foreign company and the foreign dividend is paid or declared by another foreign company that is resident in the same country as that person;

(*c*) who is a resident to the extent that the foreign dividend does not exceed the aggregate of all amounts which are included in the income of that resident in terms of section 9D in any year of assessment, which relate to the net income of—

(i) the company declaring the foreign dividend; or

(ii) any other company which has been included in the income of that resident in terms of section 9D by virtue of that resident's participation rights in that other company held indirectly through the company declaring the foreign dividend,

reduced by—

(*aa*) the amount of any foreign tax payable in respect of the amounts so included in that resident's income; and

(*bb*) so much of all foreign dividends received by or accrued to that resident at any time from any company contemplated in subparagraph (i) or (ii), as was—

(A) exempt from tax in terms of paragraph (*a*), (*b*) or (*d*); or

(B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D:

Provided that for the purposes of this paragraph, the net income of any company contemplated in subparagraphs (i) and (ii) must be determined without regard to subsection (3);

(*d*) to the extent that the foreign dividend is received by or accrues to that person in respect of a listed share and does not consist of a distribution of an asset *in specie*; or

(*e*) to the extent that the foreign dividend is received by or accrues to a company that is a resident in respect of a listed share and consists of the distribution of an asset *in specie:*

Provided that paragraphs (*a*) and (*b*) must not apply to any foreign dividend to the extent that the foreign dividend is deductible by the foreign company declaring or paying that foreign dividend in the determination of any tax on income on companies of the country in which that foreign company has its place of effective management: Provided further that paragraph (*a*) must not apply to any foreign dividend received by or accrued to that person in respect of a share other than an equity share.

(3) In addition to the exemption provided for in subsection (2), there must be exempt from normal tax so much of the amount of the aggregate of any foreign dividends received by or accrued to a person during a year of assessment as—

(*a*) is not exempt from normal tax in terms of subsection (2) for that year of assessment; and

(*b*) does not during the year of assessment exceed an amount determined in accordance with the following formula:

$$A = B \times C$$

in which formula:

(i) "A" represents the amount to be exempted for a year of assessment in terms of this paragraph;

(ii) "B" represents—

(*aa*) where the person is a natural person, deceased estate, insolvent estate or trust, the ratio of the number 26 to the number 41;

(*bb*) where the person is—

(A) a person other than a natural person, deceased estate, insolvent estate or trust; or

(B) an insurer in respect of its company policyholder fund, corporate fund and risk policy fund,

the ratio of the number 13 to the number 28; or

(*cc*) where the person is an insurer in respect of its individual policyholder fund, the ratio of the number 15 to the number 30; and

(iii) "C" represents the aggregate of any foreign dividends received by or accrued to the person during a year of assessment that is not exempt from normal tax in terms of subsection (2).

(4) Subsections (2)(*a*) and (2)(*b*) do not apply in respect of any foreign dividend received by or accrued to any person—

(*a*) if—

(i) (*aa*) any amount of that foreign dividend is determined directly or indirectly with reference to; or

(*bb*) that foreign dividend arises directly or indirectly from,

any amount paid or payable by any person to any other person; and

(ii) the amount so paid or payable is deductible from the income of the person by whom it is paid or payable and—

(*aa*) is not subject to normal tax in the hands of the other person contemplated in subparagraph (i); and

(*bb*) where that other person contemplated in subparagraph (i) is a controlled foreign company, is not taken into account in determining the net income, contemplated in section 9D(2A), of that controlled foreign company,

unless the amount so paid or payable is paid or payable as consideration for the purchase of trading stock by the person by whom the amount is paid or payable; or

(*b*) from any portfolio contemplated in paragraph (*e*)(ii) of the definition of "company" in section 1.

(5) The exemptions from tax provided by subsection (2) do not extend to any payments out of any foreign dividend received by or accrued to any person.

(6) Subsections (2) and (3) do not apply to any foreign dividend received by or accrued to a person in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office, other than a foreign dividend received or accrued in respect of a restricted equity instrument as defined in section 8C held by that person or in respect of a share held by that person.

Section 22(3)(*a*)(iii)

(3) (*a*) For the purposes of this section the cost price at any date of any trading stock in relation to any person shall—

(iii) in the case of—

(*aa*) a right in a controlled foreign company held directly by a resident, include an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10 of the Eighth Schedule) of that company and of any other controlled foreign company in which that controlled foreign company and that resident directly or indirectly have an interest, which was included in the income of that resident in terms of section 9D during any year of assessment, reduced by the amount of any foreign dividend distributed by that company to that resident during any year of assessment which was exempt from tax in terms of section 10B(2)(*a*) or (*c*); or

(*bb*) a right in a controlled foreign company held directly by another controlled foreign company, include an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10 of the Eighth Schedule) of that first-mentioned controlled foreign company and of any other controlled foreign company in which both the first- and second-mentioned controlled foreign companies directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned controlled foreign company in terms of section 9D had it been a resident, reduced by the amount of any foreign dividend distributed by that first-mentioned controlled foreign company to the second-mentioned controlled foreign company if that dividend would have been exempt from tax in terms of section 10B(2)(*a*) or (*c*) had that second-mentioned controlled foreign company been a resident;

Section 23(*q*)

23. Deductions not allowed in determination of taxable income.—No deductions shall in any case be made in respect of the following matters, namely—

(*q*) any expenditure incurred in the production of income in the form of foreign dividends; or

Section 25D(1) and (3)

25D. Determination of taxable income in foreign currency.—(1) Subject to subsections (2), (3) and (4), any amount received by or accrued to, or expenditure or loss incurred by, a person during any year of assessment in any currency other than the currency of the Republic must be translated to the currency of the Republic by applying the spot rate on the date on which that amount was so received or accrued or expenditure or loss was so incurred.

(3) Notwithstanding subsection (1), a natural person or a trust (other than a trust which carries on any trade) may elect that all amounts received by or accrued to, or expenditure or losses incurred by that person or trust in any currency other than the currency of the Republic, be translated to the currency of the Republic by applying the average exchange rate for the relevant year of assessment.

Paragraph 20(1)(*h*)(iii)

20. Base cost of asset.—(1) Despite section 23(*b*) and (*f*), but subject to paragraphs 24, 25 and 32 and subparagraphs (2) and (3), the base cost of an asset acquired by a person is the sum of—

(*h*) in the case of—

(iii) (*aa*) a right in a controlled foreign company held directly by a resident, an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10) of that company and of any other controlled foreign company in which that controlled foreign company and that resident directly or indirectly have an interest, which was included in the income of that resident in terms of section 9D during any year of assessment, reduced by the amount of any foreign dividend distributed by that company to that resident during any year of assessment which was exempt from tax in terms of section 10B(2)(*a*) or (*c*); or

(*bb*) a right in a controlled foreign company held directly by another controlled foreign company, an amount equal to the proportional amount of the net income (without having regard to the percentage adjustments contemplated in paragraph 10) of that first-mentioned controlled foreign company and of any other controlled foreign company in which both the first- and second-mentioned controlled foreign companies directly or indirectly have an interest, which during any year of assessment would have been included in the income of that second-mentioned controlled foreign company in terms of section 9D had it been a resident, reduced by the amount of any foreign dividend distributed by that first-mentioned controlled foreign company to the second-mentioned controlled foreign company if that dividend would have been exempt from tax in terms of section 10B(2)(*a*) or (*c*) had that second-mentioned controlled foreign company been a resident;