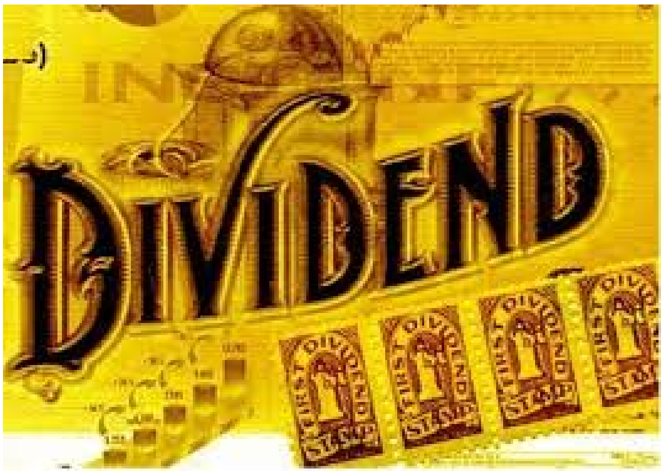
Accrual of amount on cession of right to dividends



Author: Ben Strauss (Tax Director at Cliffe Dekker Hofmeyr).

Generally speaking, dividends paid by South African companies are exempt from income tax in the hands of shareholders. The dividends may, however, be subject to dividends tax, subject to certain exemptions.

Dividends are exempt from income tax even if a person receives the dividend by virtue of a cession to that person of the right to receive the dividend. A notable exception to this principle is that, if a shareholder cedes only the right to receive dividends (that is, without transferring the other rights attaching to the underlying shares) to a company, then the dividend accruing to the company is subject to income tax, in terms of paragraph (ee) of the proviso to s10(1)(k) of the Income Tax Act, No 58 of 1962.
However, what are the tax implications of the *right to receive a dividend* in the hands of the cessionary (that is, the person to whom the right is ceded)?

That question was the subject matter in the case of *CSARS v KWJ Investments Service (Pty)* Ltd (142/2017) [2018] ZASCA 81 (31 May 2018).

The facts of the case were relatively complex. Put simply, the taxpayer made an investment with a bank. The return on the investment was that the bank ceded rights to dividends on listed shares to the taxpayer antecedently, that is before the entitlement to the dividends themselves arose. The question that arose is whether the dividend right constituted an amount that accrued to the taxpayer.

SARS contended that where rights to dividends are ceded to a taxpayer there are two distinct accruals in the hands of the taxpayer: first, there is an accrual of the dividend right; and second, there is an accrual of the dividend when the company actually declares the dividend. The taxpayer contended that while the mode of delivery (the cession) was unconditional, the right ceded was conditional on the dividends being actually declared by the companies and the taxpayer therefore merely held a contingent right.

On this point, the court found in favour of SARS. It held that the right to the dividends to be declared in future cannot be classified as dividends and, accordingly, the right was a separate amount. That right has a monetary value despite the fact that the entitlement to dividends was conditional and, hence, was an amount that accrued to the taxpayer.

Ultimately, the taxpayer won the case on a separate technical point, namely, that SARS had raised the additional assessment after the statutory prescription period.

The takeaway from the case is this: Where a taxpayer acquires the right to receive dividends, the taxpayer must account for tax separately on two distinct receipts: first, on the accrual of the amount of dividends if and when declared by the relevant company; and, second, on the accrual of the amount of the right to the dividend. As pointed out above, the first accrual may, depending on the circumstances, be subject to, or exempt from income tax or dividends tax in the hands of the taxpayer.

As to the second accrual, the incidence of tax will depend on the transaction giving rise to the receipt. For example, if a taxpayer transfers a revenue asset (for instance, trading stock) to a person, and that person in exchange transfers the right to receive a dividend to the taxpayer, then the taxpayer would need to include the amount of the dividend right as gross income for income tax purposes. If a taxpayer transfers a capital asset to a person and that person in exchange transfers the right to receive a dividend to the taxpayer, then the taxpayer would, for capital gains tax purposes, need to include the amount of the dividend right as proceeds on disposal of the capital asset.

What the case also shows again is that the incidence of tax on the cession of the rights to dividends is a minefield, and taxpayers should exercise great caution when entering into transactions of this kind.