Investigating whether the granting of services and the right of use of assets would constitute dividends *in specie*

by

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ABSTRACT

Dividends *in specie* are not defined by the Income Tax Act (ITA), which gives rise to uncertainty as to what could possibly fall within its ambit, specifically regarding the granting of services or the right of use of assets. This study investigates the uncertainty regarding the meaning of dividends *in specie*. The objectives were firstly to investigate whether the granting of services or the right of use of assets could constitute a dividend as defined in the ITA; secondly, to investigate whether or not the meaning of "dividend" in the Companies Act and the Internationale Financial Reporting Standards (IFRS) could provide guidance for purposes of the ITA; and thirdly, to investigate whether or not international practices in the context of taxing shareholder benefits provide tax guidance on whether the granting of services or the right of use of assets constitute a dividend *in specie* for tax purposes internationally. This was done by investigating the tax amendments to the definition of "dividend", the ordinary English meaning of the words contained in the definition, as well as the intention of the legislator in this regard. Guidance was also obtained from explanatory guides from the South African Revenue Service (SARS), the Companies Act, the IFRS and the international practices of selected countries.

This study established that a broad interpretation should be ascribed to the meaning of "dividend" and "*in specie*" based on the ordinary meaning of the words used and the amendments to the definition. The tax amendments also indicate that the intention of the legislator could be to include the granting of services or the right of use of an asset within the ambit of dividends for ITA purposes. The Companies Act also indicated that a broad interpretation is applied to the meaning of "dividend" and could possibly include benefits like the granting of services or the right of use of assets to constitute dividends *in specie*. Guidance obtained when applied in the context of dividends would suggest that the ITA should also consider these benefits to be dividends *in specie*.

The investigation regarding the purpose of the Seventh Schedule to the ITA determined that the purpose of the introduction of the taxation of fringe benefits was to prevent loopholes to avoid taxation as these benefits were granted in lieu of remuneration. This study concluded that the meaning of dividends should include the granting of services and the right of use of assets in order to avoid potential tax loopholes as these benefits are granted to beneficial owners in lieu of cash dividends.

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International practices also indicated that the granting of services or the right of use of assets is considered dividends or taxed as shareholder benefits. This study found that in a South African context, the granting of services and the right of use of assets could also constitute dividends *in specie*, similar to some other countries. This is due to the intention of the legislator to align dividends tax to that of other countries by replacing Secondary Tax on Companies (STC) with dividends tax. The study also investigated different techniques for determining the value of and the timing for paying dividends tax on the granting of services and the right of use of assets based on international practices.

Keywords: Companies Act, dividends *in specie*, dividends tax, Income Tax Act, right of use of assets, services

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OPSOMMING

Dividende *in specie* word nie deur die Inkomstebelastingwet (IBW) omskryf nie, wat aanleiding gee tot onsekerheid oor wat moontlik binne die bestek daarvan kan val, veral in die konteks van die verlening van dienste of die reg van gebruik van bates. Hierdie studie ondersoek die onsekerheid aangaande die betekenis van dividende *in specie*. Die doelwitte was eerstens om te ondersoek of die verlening van dienste of reg van gebruik van bates ’n dividend soos omskryf in die IBW kan uitmaak; tweedens, om te ondersoek of die betekenis van “dividend” in die Maatskappywet en die Internationale Finansiële Verslagdoenings-standaarde (IFRS) leiding kan bied vir doeleindes vir die IBW; en derdens, om te ondersoek of internationale praktyke in die konteks van aandeelhoursvoordele belasting leiding kan gee of die verlening van dienste of reg van gebruik van bates ’n dividend *in specie* uitmaak vir belasting doeleindes internationaal. Dit is gedoen deur die belastingwysigings aan die omskrywing van “dividend”, die gewone Engelse betekenis van die woorde in die omskrywing, asook die bedoeling van die wetgewer in hierdie verband te ondersoek. Leiding is ook verkry vanuit verklarende riglyne van die Suid-Afrikaanse Inkomstediens (SAID), die Maatskappywet, die IFVS en die internasionale praktyke van geselekteerde lande.

Die studie het vasgestel dat ’n breë interpretasie toegeskryf moet word aan die betekenis van “dividend” en “*in specie*” gebaseer op die gewone betekenis van die woorde wat gebruik word en die wysigings aan die definisie. Die belastingwysigings dui ook aan dat die wetgewer se voorneme moontlik kon wees om die verlening van die dienste of die reg van gebruik van bates binne die omvang van dividende vir IBW doeleindes in te sluit. Die Maatskappywet dui ook aan dat ‘n breë interpretasie toegeskryf moet word aan die betekenis van “dividend” en kan moontlik voordele soos die verlening van dienste of die reg van gebruik van bates as dividende *in specie* beskou. Leiding wat verkry is wanneer dit in die konteks van dividende toegepas word, blyk voor te stel dat die IBW ook hierdie voordele as dividende *in specie* behoort te beskou.

Die ondersoek rakende die doel van die Sewende Bylae tot die IBW het vasgestel dat die doel van die inwerkingtreding van die belasting op byvoordele was om skuiwergate vir belastingvermyding te verhoed, aangesien hierdie voordele in die plek van besoldiging verleen was. Hierdie studie het tot die gevolgtrekking gekom dat die betekenis van dividende die verlening van dienste en die gebruiksreg van bates moet insluit. Hierdie insluiting sal moontlike belastingskuiwergate kan voorkom aangesien hierdie voordele aan uiteindelik geregtigdes verleen word in die plek van kontantdividende.

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Internasionale praktyke het ook aangedui dat die verlening van dienste of die gebruiksreg van bates as dividende of aandeelhouersvoordele beskou moet word. Hierdie studie het gevind dat die verlening van dienste en die reg van gebruik van bates in ’n Suid-Afrikaanse konteks ook as dividende *in specie* beskou kan word, soortgelyk aan sommige ander lande. Dit is as gevolg van die wetgewer se bedoeling om dividendbelasting met dié van ander lande te belyn deur Sekondêre Belasting op Maatskappye (SBM) met dividendbelasting te vervang. Die studie het ook verskillende tegnieke ondersoek om die waarde en tydsberekening vir die betaling van dividendbelasting op die verlening van dienste en of die gebruiksreg van bates te bepaal gebaseer op internationale praktyke.

Sleutelwoorde: Dienste, dividendbelasting, dividende *in specie*, Inkomstebelastingwet, Maatskappywet, reg van gebruik van bates

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LIST OF ABBREVIATIONS

CFR	Code of Federal Regulations
CGT	Capital gains tax
CTC	Contributed tax capital
FASB	Financial Accounting Standards Board
HMRC	Her Majesty’s Revenue and Customs
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ITA	Income Tax Act
JSE	Johannesburg Stock Exchange
OECD	Organisation for Economic Co-operation and Development
PBA	Public benefit activity
RSA	Republic of South Africa
STC	Secondary Tax on Companies
UK	United Kingdom
USA	United States of America
VAT	Value-Added Tax

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CHAPTER 1
INTRODUCTION

1.1 INTRODUCTION

On 1 April 2012, the system of taxing dividends in South Africa changed from a Secondary Tax on Companies (STC) regime to a dividends tax regime; the former being a tax levied at company level and the latter a tax levied on the beneficial owner, as defined in section 64D of the Income Tax Act (No. 58 of 1962) (hereafter referred to as the ITA), of a dividend. STC was, and dividends tax is, levied in respect of dividends declared and paid by a company, as defined in terms of section 1 of the ITA, and both distinguish between cash dividends and dividends *in specie*. Dividends *in specie* are not defined in the ITA and thus some uncertainty exists whether the granting of services or the right of use of assets could constitute a dividend *in specie*.

Dividends tax is regulated in terms of sections 64D to 64N of the ITA. Section 64E(2) regulates the tax treatment for distributions other than *in specie* distributions and asset *in specie* distributions. Two types of dividends, cash and dividends *in specie*, are accordingly regulated by the ITA and are treated differently for purposes of dividends tax in terms of their valuation, timing, and liability for the payment of the dividends tax. According to Stiglingh, Koekemoer, Van Heerden, Wilcocks, De Swardt and Van der Zwan (2018:664), a dividend *in specie* is described as any dividend other than in the form of cash. The term "*in specie*" is not defined in the ITA and no examples of distributions in the form of assets *in specie* are given. The meaning of *in specie* originates from the Latin phrase that means "in its actual form" and when used in the phrase "distribution of an asset *in specie*", it indicates that the distribution of an asset will be in its actual form, rather than transforming it into cash or another form (InvestorWords, 2018). A distribution of an asset *in specie* is viable if the entity is facing liquidity problems or if it makes economic sense to distribute the asset itself instead of cash (Investopedia, 2018). Common forms of known dividends *in specie* include property, stock, scrip, and liquidating dividends (Accounting Tools, 2018).

The fact that "dividend *in specie*" is not defined by the ITA gives rise to uncertainty as to what could possibly fall within its ambit. Companies distribute multiple forms of property to their shareholders, including perks and benefits associated with their shareholding, which give them the right to such property, as well as discounts in respect of services (The Share Centre, 2018). A distribution of assets would include corporeal as well as incorporeal

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property, and the right to such property as seen in the definition of "asset" in terms of the Eighth Schedule to the ITA.

The South African Revenue Service's (SARS) *Comprehensive Guide to Dividends Tax* (2017:62) only distinguishes between financial instruments, other assets, and deemed dividends in respect of distributions of assets *in specie*. An analysis of what is meant by a dividend *in specie* is necessary to ascertain whether the granting of services or the right of use of assets by virtue of equity shares held would constitute a dividend *in specie*. In order to improve the understanding of what the legislator intended by dividend *in specie*, the history of the treatment of dividends *in specie* must be investigated. There are conditions to fall within the ambit of the definition of a dividend and these must be investigated in conjunction with the meaning of a dividend *in specie* in order to clarify whether the granting of services or the right of use of assets would constitute a dividend *in specie*.

The change from the STC regime to the dividends tax regime has also resulted in practical problems and uncertainty regarding the proper treatment of dividends *in specie* (Cobbett, 2010:7). As the declaring company will be liable for dividends tax in respect of the distribution of a dividend *in specie*, administrative problems when valuing the *in specie* dividends and setting funds aside to pay the dividends tax could arise (National Treasury, 2011:38). Distributions *in specie* could occur in many different forms and each might have different tax consequences regarding the timing and valuation for dividends tax purposes. In the context of dividends tax, the concept of accrual was also changed by the Taxation Laws Amendment Bill of 2011 to actual or constructive payment in section 64E(2) (National Treasury, 2011:36). The dividends tax is triggered when an actual payment of the dividend is made or when the dividend becomes payable to the beneficial owner (National Treasury, 2011:36). Unlike cash dividends, it may be more difficult to determine the date of payment for dividends *in specie* (ITC 1688, 1999:481; SARS, 2017:58). Uncertainty also exists regarding the valuation of dividends *in specie* as the values may be volatile over a short period of time (National Treasury, 2011:36). The tax treatment of dividends *in specie* must be investigated to clarify the uncertainties regarding the valuation and timing of *in specie* dividends.

The meaning of "*in specie*" is further complicated by the use of "in kind" in other provisions in the ITA. Uncertainty exist whether the same interpretations for "in kind" as used in other provisions would be applied to "*in specie*" in the context of dividends. "*In specie*" distributions are sometimes referred to as "in kind" distributions (National Treasury, 2012:37) and a possible relationship could exist between the terms. The term "in kind" is used in the ITA in section 18A, which regulates the tax consequences of donations to certain organisations.

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SARS issued the *Basic guide to tax-deductible donations* on 19 September 2016, which defines multiple types of donations of property "in kind" (SARS, 2016:5). The guide, with reference to the possible relationship between the term "*in specie*" as used in sections 64D to 64N of the ITA and the term "in kind" as used in section 18A, might provide guidance regarding clarifying what is meant by a dividend *in specie*. The wording used in the ITA in different sections is provided in Table 1.1.

Table 1.1: Wording used in the ITA

Section in the ITA	Wording in the ITA
"Dividend" definition in sections 1 and 64D	"any amount"
Section 8(4)(k)(ii)	"transferred in whatever manner"
Section 10B(2)(d)	"distribution of an asset *in specie*"
Section 18A(3)	"property in kind"
Section 22(8)(b)(iii)	"distributed *in specie"*
Section 64EA	"distribution of an asset *in specie*"
Section 64F	"dividend *in specie*"
Paragraph 75 of the Eighth Schedule	"distribution of an asset *in specie*"

The uncertainty on whether or not the granting of services or the right of use of assets could constitute a dividend *in specie* is therefore complicated further by the different wording used in the ITA relating to dividend *in specie*. Uncertainty regarding aspects such as how the revenue authorities will treat a certain transaction, or how and by when the legislator will introduce new legislation, or amend existing legislation, may have a profound impact on the economy of a country (Stiglingh *et al.,* 2018:6). One of the canons of a good tax system is also that the tax system should contain elements of certainty (Smith, 1776). Attempting to investigate guidance to resolve uncertainty in interpretation could therefore contribute to the certainty of tax interpretation.

Other legislation that regulate company distributions is the Companies Act (No. 71 of 2008) (hereafter referred to as the Companies Act). Provisions in the ITA directly or indirectly depend on company law definitions and principles (National Treasury, 2010:37). Due to the enactment of the new Companies Act of 2008, some changes were introduced in order to align the ITA with the new definitions and principles as per the Companies Act. For purposes of dividends tax, amendments were made to the previous definition of a dividend in order to align it with the Companies Act. The International Financial Reporting Standards (IFRS) provide rules for the accounting of dividends in financial statements. Guidance could be

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obtained by investigating whether the granting of services or the right of use of assets constitutes dividends *in specie* for Companies Act and IFRS purposes. This study submits that should the Companies Act regard the granting of services or the right of use of assets as dividends *in specie*, it could provide possible guidance on the classification as dividend *in specie* for ITA purposes. This is due to the intention of the legislator to align the ITA with the current company law principles (National Treasury, 2010a:37). Robb (2015:10) also opines that as the definition of “distribution” is not defined in the ITA the definition of “distribution” as contained in the Companies Act is the definition used and accepted by SARS. Based on this premise guidance based on the Companies Act classification is also considered in this study.

Furthermore, the STC regime was replaced with the dividends tax regime in order to align it with international practices (Venter, 2013:19). The investigation into whether the granting of services or right of use of assets constitute dividends *in specie* requires the consideration of the aspects noted above and another aspect for consideration would be international practice. Several countries have implemented dividends taxes on shareholder benefits. International experience is considered an important aspect as it could offer lessons learnt from those experiences (Arendse & Stack, 2018:1). Based on the international practice of selected countries, guidance can be obtained whether or not the granting of services or the right of use of assets could constitute dividends for ITA purposes. This study provides a cross-country investigation of international practices of levying dividends tax on shareholder benefits. This study was conducted by identifying countries that have paid attention to the granting of benefits to shareholders by companies. The countries and their respective taxing legislation used for this investigation are Canada, the United Kingdom (UK), Australia, and the United States of America (USA). The first three countries’ and South African legislation have common influence due to them being part of the commonwealth (Commonwealth, 2018), while the USA government has paid attention to the granting of services and the right of use of company assets to shareholders (Kohla, 1974:1431).

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1.2 PROBLEM STATEMENT

The main problem identified in this research is the uncertainty regarding whether the granting of services or the right of use of assets to beneficial owners would constitute dividends *in specie* as contemplated in the ITA. The main research problem is divided into the following research questions:

i) Does the granting of services or the right of use of assets constitute a dividend *in specie* for ITA purposes?
ii) Does the meaning of "dividend" in the Companies Act and the IFRS provide guidance on whether or not the granting of services or the right of use of assets constitute a dividend *in specie* for ITA purposes?
iii) Does international practices in the context of taxing shareholder benefits provide tax guidance on whether or not the granting of services or the right of use of assets constitute a dividend *in specie* for tax purposes internationally?

1.3 RESEARCH OBJECTIVES

For each of the research questions identified, the research objectives are:

i) To investigate the meaning of "dividend *in specie*" as contained in the ITA and the intention of the legislator in the context of dividends *in specie*. Dividends *in specie* are not defined in any tax legislation, which causes uncertainty whether the granting of services or right of use of assets would fall within its ambit. The investigation is conducted to establish whether the granting of services or the right of use of assets would constitute a dividend *in specie*. This is achieved by investigating what is meant by "in specie", and whether the granting of services and the right of use of assets would fall within the ambit of the definition of a dividend as contained in section 1(1) of the ITA. Consideration is also given whether the meaning of "*in specie*" and "in kind" are the same. The comparison between the phrases "*in specie*" and "in kind" could establish whether the Basic guide to tax-deductible donations with reference to donations in kind could provide any guidance regarding what could possibly constitute a dividend *in specie*. The Organisation for Economic Co-operation and Development's interpretation of the meaning of "dividend" is also investigated. Further guidance is also obtained from the commentaries on the articles of the Model Tax Convention (addressed in Chapter 2).

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ii) To investigate whether the Companies Act and IFRS provide guidance on whether the granting of services or the right of use of assets constitute a dividend *in specie* for ITA purposes. This investigation aims to obtain guidance from the interpretation of the meaning of "dividend" in the Companies Act and IFRS in order to determine whether the granting of services or the right of use of assets could be regarded as dividends for ITA purposes. This study will also conclude whether the meaning of "dividend" in the ITA is aligned with the meaning in the Companies Act and the IFRS (addressed in Chapter 3).

iii) To investigate international practice with regard to the taxing of shareholder benefits. The overall aim of this objective is to obtain guidance from international practice to determine whether the granting of services and right of use of assets constitute dividends *in specie* for tax purposes internationally. The aim is also to obtain guidance from international practice for determining the value and the timing for dividends tax purposes of shareholder benefits (addressed in Chapter 4).

1.4 PRACTICAL RELEVANCE OF STUDY

Apart from the preceding uncertainty that was highlighted, a practical tax issue in respect of the non-recoupment of deductions claimed by the declaring company is also conceived if services or the right of use of assets is granted to a beneficial owner. A distribution of an allowance asset would result in possible tax deductions or capital allowances for the company; however, such deductions or allowances are recouped in terms of section 8(4)(k) on distribution. A service granted could entail expenditure and possible previously allowed deductions for the company; however, with no recoupment in terms of section 8(4)(k) or section 8(4)(a) on distribution to the shareholder, as no asset was distributed or amounts recouped. A deduction could thus be claimed on services distributed to beneficial owners for something that in fact constitutes a dividend *in specie*. The fact that services provided are not regarded as a "dividend" would benefit natural person beneficial owners as no dividends tax is payable. Due to consecutive increases in the applicable tax rates of natural persons the incentive for electing a distribution which does not constitute a dividend is furthermore increased. The normal tax, effective capital gains tax (CGT), and tax on dividends prior and subsequent to the introduction of dividends tax, is illustrated in Figure 1.1 for natural persons taxed at the maximum marginal normal rate of tax.

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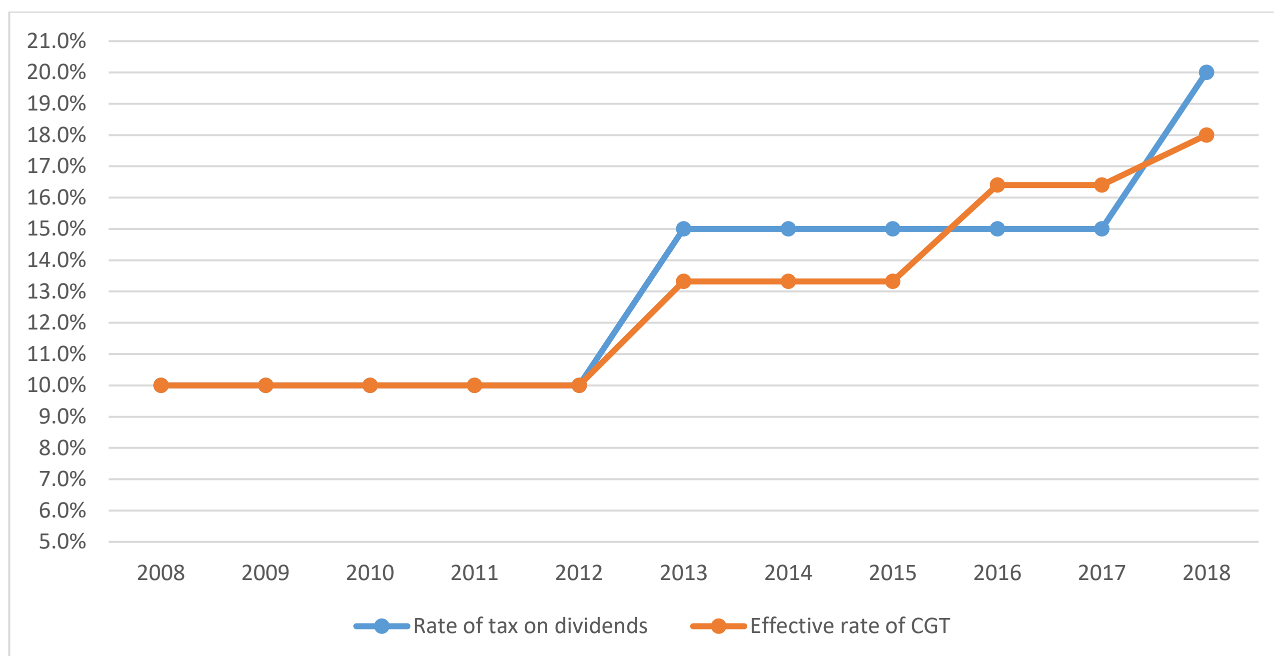
Figure 1.1: Tax rates of natural persons taxed at the maximum marginal rate of tax



Source: Compiled by author

Any distribution that falls within the ambit of the definition of “dividend” as defined in terms of s 64D(1) might be subject to dividends tax to the extent that it is not a distribution of contributed tax capital. Any distribution of contributed tax capital will be considered for CGT consequences, unless such shares were held for trading by a share dealer. Increases in the dividends tax and effective CGT rates could serve as possible motivation for a natural person taxpayer to pursue transactions in order to avoid dividends tax or CGT. A means of possible dividends tax avoidance for a natural person would be if the granting of services or the right of use of assets is not subject to dividends tax and then applied as substitution for an ordinary cash dividend. The focus is thus on higher-income individuals as these persons could have the means, in the form of influence based on shareholding, to structure their distributions in order to avoid taxes. The opportunity for exploiting such means of distribution in order to avoid tax is considered to be more prevalent in smaller privately owned companies in which corporate governance structures might not exist to prevent such exploits. The contribution of this study could be in highlighting the uncertainty regarding the tax consequences of the granting of services or the right of use of assets, which in turn could draw attention to the possible opportunity for beneficial owners to structure distributions to avoid dividends tax or CGT.

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1.5 LITERATURE REVIEW

The uncertainty that serves as basis for the research objectives of this study stems from the limited amount of academic literature available on the interpretation of dividends *in specie*. The meaning of dividend *in specie* and the dividends tax treatment if the granting of services or the right of use of assets also constitutes a dividend *in specie* will be investigated with reference to relevant publications by regulatory bodies, case law, and academic literature.

1.5.1 The meaning of a dividend *in specie* in terms of the Income Tax Act (ITA)

In order to investigate the meaning of a dividend *in specie*, an understanding of what would be defined as a dividend *in specie* is required. As the term "*in specie*" is not defined in the ITA, it must be given its ordinary dictionary meaning, unless such a meaning would be contrary to the intention of the legislator (Clegg & Stretch, 2017:par. 2.6). Since section 1 of the ITA contains no definition of the term "*in specie*", one must consider the interpretation approaches of fiscal legislation (Stiglingh *et al.*, 2018:18).

De Koker and Williams (2017:25.1A) state that where words are not defined in an Act, the golden rule is to give words wherever possible the meaning that they have in ordinary usage. The ordinary meaning of "*in specie*" in the *Collins Dictionary* (2018) is "in its actual form" or "in kind". SARS (2018) also describes "*in specie*" as a distribution to shareholders in a form other than cash. The granting of services or the right of use of assets could thus fall within the ambit of dividends *in specie* and be taxed under section 64E. In terms of the definition of a dividend, an "amount" must be transferred or applied. For the granting of a service or the right of use of an asset to be included, it would have to constitute an "amount", as per the definition of a dividend in terms of section 1(1) of the ITA.

The word "amount" is used in the definition of "gross income" as defined in section 1 of the ITA and has been judicially considered in a number of cases. Watermeyer J's dictum in the *Lategan* case with regard to the word "amount" was as follows:

> "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" (*WH Lategan v CIR* 2 SATC 16, 1926:19).

From this pronouncement it can be seen that an amount must be given a wider meaning and could include incorporeal property such as rights. In *Cactus Investments (Pty) Ltd v CIR*

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61 SATC 43, the court held that in order to comprise an "amount", rights of a non-capital nature must be "capable of being valued in money". Similarly, in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 52 SATC 9, the court held that in order to be included in gross income, an amount must be of such a nature that a monetary value can be attached to it. In *C:SARS v Brummeria Renaissance (Pty) Ltd & Others* 69 SATC 205, it was held that it did not follow that if a receipt or accrual cannot be turned into money, it had no monetary value. The "turn into money" test was merely one of the tests for determining whether an accrual had monetary value. The court confirmed that the test was objective, not subjective.

The same meaning ascribed to the word "amount" must be given in the context of the definition of "dividend" in section 1(1) of the ITA (SARS, 2017:24). The granting of services or the right of use of an asset in respect of equity shares held could thus fall within the ambit of the definition of a dividend for ITA purposes if an amount is being transferred or applied and that amount is of such a nature that a value in money could be attached thereto.

The *Collins Dictionary* (2018) meaning of the term "*in specie*" indicates that it is synonymous with the term "in kind". Given that a possible relationship exists between these two terms, it must be determined whether or not "*in specie*" bears the same meaning as "in kind". It must further be established whether or not the *Basic guide to tax-deductible donations* with reference to donations "in kind" can provide any guidance regarding what could possibly constitute a dividend *in specie*.

The purpose behind the change from STC to dividends tax could also provide some guidance on the intention of the legislator and the purpose behind the new regime. The main reason for the change from the STC regime to the dividends tax regime was to align it with international practices (Venter, 2013:19). Due to the purposeful alignment of the dividends tax regime to that of international practices, the OECD's interpretation and definitions of what constitutes a dividend could provide guidance in a South African context.

1.5.2 Guidance from the interpretation of the meaning of dividend in the Companies Act and the IFRS

As no definition of dividends *in specie* is included in the ITA, the provisions of the Companies Act and the IFRS are considered as a point of guidance on the interpretation of "dividends *in specie*". A definition of "distribution" is included in the Companies Act.

No definition is contained within the Companies Act of what constitutes a dividend. From a tax perspective, the interaction between the definition of "distribution" contained in the

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Companies Act and the definition of "dividend" in terms of section 1(1) of the ITA will have to be considered (Cliffe Dekker Hofmeyr, 2011:1).

The question arises whether or not the reference to "distribution" as contained in the definition of "dividend" " in terms of section 1(1) of the ITA will encompass all of the instances defined as a "distribution" in the Companies Act (Cliffe Dekker Hofmeyr, 2011:1). Tax legislation has attempted to harmonise itself with South African company legislation in the past (Piveteau, 2016:5). Piveteau (2016) submits that given the nature and purpose of the Companies Act, one would suggest that taxing legislation, such as the ITA, would need to align itself with legislation such as the Companies Act. The Companies Act's definition of "distribution" could therefore provide guidance on whether the granting of services or the right of use of assets constitutes dividends, which could be applied to dividends in the context of the ITA. This is due to the ITA's definition of "dividend" referring to "a distribution" in subsection (a) and that the interpretation of distribution for purposes of the ITA is derived from the definition contained in the Companies Act (Robb, 2015:10). If dissimilarity exists between the Companies Act and the ITA in terms of dividends, this study aims to shed light on the differences and suggests that the ITA aligns itself with the Companies Act.

Accounting standards have their own guidelines and interpretations for dividends and could also provide guidance on what could constitute a dividend *in specie* for ITA purposes. Aligning tax provisions to accounting rules may also enhance the simplicity and certainty of taxation (De Zilva, 2005:67). The International Financial Reporting Standards (IFRS) Interpretations Committee's (previously the International Financial Reporting Interpretations Committee [IFRIC]) IFRIC 17 deals with distributions of non-cash assets to owners for accounting purposes.

IFRIC 17's interpretation applies to the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

a) "distributions of non-cash assets (for example items of property, plant and equipment, businesses as defined in IFRS 3, ownership interests in another entity, or disposal groups as defined in IFRS 5); and
b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative" (International Accounting Standards Board [IASB], 2008a:par. 3).

Non-cash assets are not defined in IFRIC 17's interpretation or its related Basis for Conclusions. In terms of IFRIC 17, a distribution is a non-reciprocal transfer of assets from an entity to its owners, commonly referred to as a dividend. There is no restriction on the

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term “distribution” in the IFRIC 17 interpretation other than it must be non-reciprocal (Santoro & Carlson, 2009:7). *The Basis for Conclusions on IFRS 2 Share-based Payment* (IASB, 2008c) in paragraph BC47 states:

> “The Framework defines an asset and explains that the term ‘asset’ is not limited to resources that can be recognised as assets in the balance sheet (Framework, paragraphs 4.4 and 4.5). Although services to be received in the future might not meet the definition of an asset, services are assets when received.”

Based on the aforementioned, the overlap between the reference to “distribution” in the definition of “dividend” in terms of section 1(1) of the ITA and the definition of “distribution” in the Companies Act must be clarified. The IFRS broadly refers to a dividend *in specie* as a distribution of a non-cash asset. Both the Companies Act and the IFRS’ interpretation of dividends could provide guidance on whether the granting of services or the right of use of assets could constitute a dividend *in specie* for ITA purposes. It must also be determined whether the IFRS and Companies Act align with tax legislation with regard to dividends to identify conceptual or practical issues. In cases where the meaning of dividend in different legislations are related the mixture of accounting, company law and tax interpretations complicates the tax system and creates opportunities for tax avoidance (SARS, 2009:32). Alignment would thus help to solve complications caused by different interpretations (in the context of dividends) by each act/principle.

1.5.3 Guidance from international practice with regards to shareholder benefits.

The dividends tax treatment for dividends *in specie* depend on the value of the amount transferred or applied and the timing of when the dividend is transferred or applied in terms of sections 64E(3) and 64E(2) respectively. The value to be placed in terms of section 64E(3) on the transfer of an asset as a dividend *in specie* is the market value. In *Lace Proprietary Mines Ltd v CIR* 9 SATC 349, the market value of consideration paid in shares was assessed and not the nominal value. The market value of services or the right of use of assets granted in respect of equity shares held must be investigated, as well as how to derive that market value for purposes of dividends tax.

In terms of section 64E(2), dividends *in specie* are deemed to be paid on the earlier of the date on which it is paid or becomes due and payable. Uncertainty exists regarding the timing of possible dividends tax on services and the right of use of assets granted as these rights

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are exercised by beneficial owners over a period of time. The issue therefore arises as to when these rights become due and payable for dividends tax purposes.

Dividends declared by a company are generally due on the date on which they are declared. This is due to the fact that declaring a dividend creates a debt owed by the company to the shareholder and such a debt arises from a formal act performed by a company (*Boyd v CIR* 17 SATC 366*,* 1951:377). Right of use of assets in respect of shares will, however, not always be declared by the company on a specific date and other alternatives must be considered in order to determine when these rights become due and payable. “Payable” can have different meanings (*CIR v Janke* 4 SATC 269*,* 1930:276) and further investigation is thus needed to clarify when the right of use of assets granted becomes due and payable.

With the replacement of the STC regime with the dividends tax regime, South Africa aligned itself with international practices to promote foreign investment (Venter, 2013:19). International practice in the context of dividends or benefits granted to shareholders will be investigated in order to gain an understanding of whether or not the granting of services or the right of use of assets is considered to be a dividend *in specie* for tax purposes internationally and whether guidance can be obtained on the valuing and other tax consequences of the dividend *in specie*.

1.6 RESEARCH METHODOLOGY

This study involves the analysis of the definition of “dividend” in terms of section 1(1) of the ITA as well as the intention of the legislator with regards to dividends *in specie* in the context of the ITA. Tax legislation and academic literature are used to determine the tax consequences of the granting of services or the right of use of assets by virtue of equity shares held. The study is positioned in the interpretivism paradigm and follows an inductive reasoning process. The mode of inquiry for this study is qualitative in nature and follows a doctrinal method as described by Hutchinson and Duncan (2012:101). In terms of this method, the specific requirements of the definition of “dividend” in the ITA were investigated. The intention of the legislator with regard to the dividends tax provisions was also investigated, by analysing the wording, history, and purpose of the provisions, to determine whether the granting of services or the right of use of assets would constitute a dividend *in specie* for ITA purposes. Sources were consulted to gain an understanding of the interpretation of “dividend” in the current provisions of the ITA. Primary sources included income tax legislation, while secondary sources included academic journals, theses, court

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cases, guides from SARS, OECD Commentaries on the Articles of the Model Tax Convention and articles by industry experts.

This study also contains an element of comparative analysis by comparing the meaning of “in kind” as used in “donations *in kind*”, which are accepted by SARS as valid donations, to the meaning of “*in specie*” as used in dividends *in specie*, in order to provide guidance in clarifying what is meant by a dividend *in specie*. Furthermore, comparative analysis was also performed between South Africa and other selected countries in order to obtain guidance from international practices with regard to the granting of services and the right of use of assets in a dividends context. The sources and comparative studies were used to conclude on whether the granting of services or the right of use of assets constitutes a dividend *in specie* for ITA purposes and also to provide guidance on the dividends tax treatment.

1.7 LIMITATION OF SCOPE

The objective of this study is to investigate the meaning of dividend *in specie* in order to determine whether the granting of services or the right of use of assets would constitute a dividend for ITA purposes. If a dividend *in specie* is distributed as contributed tax capital such a dividend would not be classified as a dividend as defined in the ITA. This study would therefore assume that a dividend *in specie* is not distributed as contributed tax capital.

The study does also not investigate the detail provisions of paragraph (b) of "dividend" as defined in section 64D of the ITA. These provisions, relating to foreign companies, were excluded as the current study aims to focus on South African resident companies.

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1.8 RESEARCH ASSIGNMENT OUTLINE

Chapter 1: Introduction

This chapter provides background to the changes in the systems of taxing dividends in a South African context and how uncertainty prevails in respect of what could be classified as a dividend *in specie* for ITA purposes, with specific reference to the granting of services and the right of use of assets. Chapter 1 also sets out the problem statement and research questions, research objectives, practical relevance and research methodology of the study. The limitation of scope of this study is also detailed in Chapter 1.

Chapter 2: The meaning of a dividend *in specie* in terms of the ITA

The aim of this chapter is to investigate what would be classified as a dividend *in specie*, in order to determine whether the granting of services and the right of use of assets would constitute dividends *in specie*. This is achieved by investigating what is meant by "*in specie*", and whether the granting of services and the right of use of assets would fall within the ambit of the definition of a dividend in terms of section 1(1) of the ITA. This chapter also includes consideration of whether or not the meaning of "*in specie*" and "in kind" are the same. The comparison between the phrases "*in specie*" and "in kind" could establish whether the *Basic Guide to Tax-deductible Donations* with reference to donations in kind could provide any guidance regarding what could possibly constitute a dividend *in specie.* The chapter also investigates the Organisation for Economic Co-operation and Development's (OECD, 2018a) interpretation of the meaning of "dividend". Further guidance is obtained from the Commentaries on the Articles of the Model Tax Convention.

Chapter 3: Guidance from the interpretation of the meaning of dividend in the Companies Act and the IFRS

The aim is to establish whether the Companies Act and IFRS could provide guidance regarding whether the granting of services or the right of use of assets could constitute a dividend *in specie* for ITA purposes. This chapter will also attempt to identify whether the Companies Act and the IFRS align with the ITA with regard to their interpretation of dividends as this could highlight conceptual or practical issues.

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Chapter 4: Guidance from international practices with regards to shareholder benefits

International practice is investigated to obtain guidance on whether the granting of services or the right of use of assets is considered a dividend for tax purposes and how to value these types of benefits. A further aim of this chapter is to determine the value of the granting of services or the right of use of assets in a dividends tax context and when dividends tax becomes due and payable.

Chapter 5: Conclusion

The results of the previous chapters are used to conclude on whether the granting of services or the right of use of assets constitutes a dividend *in specie* for ITA purposes. Recommendations will be made based on guidance obtained from international practices on how the value and timing for dividends tax purposes could be determined if the granting of services and the right of use of assets are considered dividends *in specie*. The chapter will also summarise the findings under each of the research questions.

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CHAPTER 2
THE MEANING OF A DIVIDEND *IN SPECIE* IN TERMS OF THE INCOME TAX ACT (ITA)

2.1 INTRODUCTION

Dividends are important to investors and potential investors (Voogt, 1996:105). Understanding what constitutes dividends for tax purposes is thus significant for investors. Dividends tax is regulated in terms of sections 64D to 64N of the ITA, which refer to cash and dividends *in specie*. The term "*in specie*" is not defined in the ITA, and section 64D only defines a dividend as:

> "any dividend or foreign dividend as defined in section 1 that is—
>
> (a) paid by a company that is a resident; or
>
> (b) paid by a foreign company-
>
> (i) if the share in respect of which that foreign dividend is paid is a listed share; and
>
> (ii) to the extent that that foreign dividend does not consist of a distribution of an asset *in specie*."

For any dividend, whether in cash or otherwise, to fall within this definition, it must adhere to the definition found in section 1(1) of the ITA. For the granting of services or the right of use of assets to constitute a dividend for ITA purposes, it must fall within the ambit of the definition of "dividend" contained in the ITA. This chapter analyses the wording contained in the definition, as well as the elements that must be adhered to in order to fall within the ambit of the definition of a dividend.

In order to obtain further guidance on whether the granting of services or the right of use of assets would constitute a dividend *in specie*, the intention of the legislator is explored. This is done by way of investigating an overview of tax amendments and the context of the definition of a dividend, as well as the purpose behind the change from the STC regime to a dividends tax regime. Further guidance can also be obtained from the *Basic Guide to Tax-deductible Donations* should a relationship exists between the terms *in specie* and "in kind", as this guide provides guidance on what constitutes donations of "property in kind".

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This chapter is structured as follows:

- Interpretation of the words and intentions of the legislator.
- Overview of tax amendments in respect of the definition of dividend in the ITA.
- Definition of a dividend in terms of the ITA.
- Guidance from explanatory guides.
- Guidance from donations in kind definitions.
- Guidance from the OECD definitions and Commentaries on the Articles of the Model Tax Convention.

2.2 INTERPRETATION OF THE WORDS AND INTENTION OF THE LEGISLATOR

When words are not explicitly defined in the ITA, the ordinary dictionary meaning must be applied, provided that the ordinary meaning does not contradict the legislator's "intention" (Clegg & Stretch, 2017:par. 2.12). As the terms "distribution" and "*in specie*" are not defined in the ITA, the ordinary meaning and intention of the legislator must be determined in order to ascertain its meaning for ITA purposes.

Statutory interpretations in South African law remain a topic of debate and are applied inconsistently (Mdumbe, 2004:472). The two main approaches that have been adopted by the South African courts are the literal approach and the purposive approach to interpretation (De Koker & Williams, 2017:par. 25.1A-25.1D). The literal approach is characterised by the strict and literal rule of interpretation of legislation by following the letter of the law, unless the legislation provides a specific definition thereof. According to Mdumbe (2004:472), the application of this rule resulted in the context playing a lesser role in the interpretation of statutes. However, in *Coopers & Lybrand v Bryant* 1995 (3) SA 761 (A) at 767, it was held that:

> "[a]ccording to the 'golden rule' of interpretation the language in the document is to be given its grammatical and ordinary meaning, unless this would result in some absurdity, or some repugnancy or inconsistency with the rest of the instrument".

The court cautioned that this form of interpretation should not be used to interpret a particular word or phrase in isolation. Based on this, the context of the statute was not considered when interpreting legislation unless the literal approach resulted in absurdity or inconsistency. The modern purposive approach to interpretation of documents from the outset considers the context and the language together, with neither predominating over the other (*Natal Municipal Joint Pension Fund v Endumeni* (2012) (4) SA 593 (SCA) 16). The

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purposive approach to interpretation therefore insists that context be considered in the first instance, especially in the case of general words, and not merely at some later stage when ambiguity might be thought to arise (*K & S Lake City Freighters Pty Ltd v Gordon & Gotch Ltd* (1985) 315).

In the past, where there has been uncertainty, ambiguity, or absurdity in the language used in legislation, the courts have departed from the strict literal approach, and instead have sought to establish the so-called "intention of the legislature" (De Koker & Williams, 2017:par. 25.1C). This is referred to as the purposive approach, which takes into consideration the words used in legislation, viewed in their context, in order to interpret the purpose for which the provision was enacted (De Koker & Williams, 2017:par. 25.1D). Goldswain (2008:113) is of the view that the South African Constitution has been a catalyst for a shift from the strict literal rule to a "purposive approach" to interpretation. This is due to the literal approach potentially resulting in hardships, but with the Constitution in place, the strict interpretation had to give way to a more equitable approach in order to establish the purpose behind the legislation (Goldswain, 2008:114).

When applying the purposive approach, the language and wording used in the legislation should not be neglected, but the specific wording, together with the context in which it is used, should be used to interpret the legislation (De Koker & Williams, 2017:par. 25.1D). If the ordinary meaning of a word therefore accords with the intention of the provision, further consideration is generally not required (Goldswain, 2012:37).

Van der Zwan (2015:22) remarks that ambiguous wording should not be seen as a pre-condition for this interpretation approach, but rather wording with several interpretations as the purpose of the legislation may not be reflected by some of them. The South African courts have set guidelines that must be considered in order to apply the purposive approach. These guidelines are to consider the precise wording of the provision, the context, and an overview of tax history of the provision when determining the purpose of the provision (Goldswain, 2012:37). The sections which follows investigate the interpretation of words used in the context of dividends in the ITA and the intention of the legislator for introducing benefits awarded instead of cash salaries in the Seventh Schedule to the ITA.

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2.2.1 Interpretation of the words used

In order to determine whether the legislator’s intention is to include the granting of services or the right of use of assets within the ambit of the definition of “dividend”, the guidelines for the purposive approach are applied to the terms “distribution” and “*in specie*”. The ordinary meanings of “distribution” and “*in specie*”, according to the *Oxford English Dictionary* (2018), are as follows:

“**Distribution (Noun):** The action of dividing and dealing out or bestowing in portions among a number of recipients; apportionment, allotment.”

“***Specie*** **(Noun):** In the real, proper, precise, or actual form; without any kind of substitution.”

The definitions in their ordinary English dictionary meaning suggest that these terms should be interpreted broadly. If the ordinary meaning of “distribution” is applied for purposes of the dividend definition as contained in the ITA, it would mean that all amounts that are “divided into portions” to beneficial owners would constitute a dividend. The ordinary meaning of “*in specie*” also indicates that as long as the dividend is in its original unaltered form, it would constitute a dividend *in specie*.

In a South African context the word “distribute” has been considered. In *CIR v Legal and General Assurance Society* 1963(3) SA 876 (AD), 25 SATC 303, Steyn, C.J. pointed out:

> “…In my view, effect can be given to this apparent intention of legislature by ascribing to ‘distribute’, in the relevant context the wider meaning of apportion, appropriate, allocate or apply towards…”

Based on the above findings a “distribution” and “*in specie*” are interpreted broadly. Conclusive guidance could, however, not be obtained from the aforementioned ordinary English meanings and interpretation of “distribution” and “*in specie*” in the context of dividends in the ITA.

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2.2.2 Intention of the legislator for introducing fringe benefits in the Seventh Schedule to the ITA

Benefits provided to employees by an employer are taxed in terms of the Seventh Schedule to the ITA. These benefits are taxed as a result of the employment relationship that exists between the employer and the employee. An investigation into the purpose of the Seventh Schedule is conducted in order to understand the reason for the implementation of the schedule, as well as whether it could provide guidance on whether or not the intention of the legislator was to include granting of services or the right of use of assets within the ambit of a dividend *in specie*.

Between 1990 and 2010, the South African tax system underwent many changes, which can be divided into two phases (Ndofula, 2014:25). Included in the first phase of the tax reform was the period covered by the Margo Commission and after its report in 1987. The Margo Commission was appointed in 1987 to investigate the tax system in order to alleviate the fiscal challenges faced by the country at that time (Black, Calitz & Steenekamp, 2005:154). The reform considered the restructuring of the tax system by using a base-broadening philosophy, with one of its aims being to improve tax compliance and morality (Black *et al*., 2005:154). Fringe benefits provided by employers, such as housing and housing assistance schemes, travel allowances, and rental of movable and immovable property, became taxable in 1985 (National Treasury, 1985:3). The inclusion of fringe benefits in employees' tax was a way of broadening the tax base. The broadening of the tax base was also considered by Ahmad and Stern (1989:1065) as a useful tool for redistribution to the poorest by taxing the rich. Ahmad and Stern (1989:1065) are also of the opinion that a broad base encourages lower tax rates, which in turn will reduce tax evasion. Ndofula (2014:12) also considered the broadening from an equality perspective as he was of the opinion that non-cash fringe benefits are mostly received by the rich and not the poor and should thus be included in personal income tax. These benefits were also often partially exempt from tax in order to compensate for the high marginal rate of tax during the period of the Margo Commission. Bringing fringe benefits into the tax net was thus meant to provide greater economic efficiency by eliminating the loopholes for tax evasion created by providing fringe benefits in substitution for taxable cash remuneration (Ndofula, 2014:26).

The second phase followed the Katz Commission and its reports from 1996. During this time it was noted that partially and fully untaxed fringe benefits were used to design remuneration packages that would attract less tax. These structured packages were very common in the 1990s and resulted in significant losses to the fiscus (Ndofula, 2014:35). Fringe benefits

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such as housing and holiday accommodation, company cars, and travel allowances became fully taxable in order to rectify a loophole that created a loss to the fiscus (Katz Commission, 1996:33-34). Furthermore, anti-avoidance provisions were also introduced between 1997 and 1999 to prevent the abuse of company car schemes, travel allowances, and residential accommodation for employees (Nyamongo & Schoeman, 2007:480). These reforms gradually started to decrease opportunities for tax avoidance in order to protect the tax base and to reduce loss to the fiscus. In the 2010 budget speech, the Minister of Finance emphasised that the government would tighten fringe benefit rules to reduce tax avoidance and tax structuring (National Treasury, 2010b:15). One of the main reasons for the implementation and further reforms to employees' tax in respect of fringe benefits, other than to broaden the tax base, was to combat special tax structures used to avoid tax.

The granting of services or the right of use of assets to beneficial owners as a dividend *in specie* could potentially not be taxed unless they fall within the ambit of the definition of a dividend as contained in section 1(1) of the ITA. These types of distributions would also not fall within the definition of a taxable benefit as defined in the Seventh Schedule to the ITA if no employment relationship exists. Thus, a potential structure exists for avoiding tax. Based on these findings the intention of the legislator could be to include the granting of services or the right of use of assets to beneficial owners within the ambit of the definition of a dividend as contained in section 1(1) of the ITA. The taxing of fringe benefits was due to the benefits being granted in lieu of remuneration as structures to avoid tax. The same applies to the structuring of a distribution in a manner other than a dividend in order to avoid dividends tax, which in essence would be a distribution in lieu of cash or an asset that would have been taxed. The definition of "dividend" in section 1(1) of the ITA is interpreted broadly to prevent avoidance of dividends tax by structuring distributions in a manner other than dividends (Mazansky, 2012:172). Based on these findings the benefits included in the ambit of "taxable benefits" in section 2 of the Seventh Schedule to the ITA could indicate what the legislator intended to fall within the ambit of dividends *in specie* for ITA purposes, which includes free or cheap services and the right of use of assets like residential accommodation and motor vehicles.

In order to ascertain the meaning of a provision, one must regard its history and the form in which it appeared in earlier acts (De Koker & Williams, 2017:par. 25.9). Having considered the intention of the legislator an overview of tax amendments of the definition of "dividend" is provided in order to determine the possible purpose of the provision.

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2.3 OVERVIEW OF TAX AMENDMENTS IN RESPECT OF THE DEFINITION OF "DIVIDEND" IN THE ITA

The definition of a dividend as contained in section 1(1) of the ITA has been amended multiple times since the introduction of the ITA. Some of these amendments were introduced as part of the change from the STC regime to the dividends tax regime that came into effect on 1 April 2012. In order to understand the purpose and intention of the dividends tax provision, the history of both the amendments in respect of the dividend definition and the change to the dividends tax regime is investigated.

The definition of a dividend prior to the amendments in 2007 read as follows (only the important sections, for the purposes of this research assignment, were included):

> "'Dividend' means any amount distributed by a company (not being a mutual building society or an association or institution to which section 10(1)(d) applies) to its shareholders or any amount distributed out of the assets pertaining to any unit portfolio referred to in paragraph (e) of the definition of 'company' in this section to shareholders in relation to such unit portfolio (including, in the case of any co-operative society or company referred to in section 27, any amount distributed on or after 1 April 1977 to its members, whether divided among the members in accordance with their rights as shareholders or according to the value of business transactions between individual members and such society or company or on some other basis), and in this definition the expression 'amount distributed' includes –
>
> (a) …
>
> (b) in relation to a company that is not being wound up or liquidated, any profits distributed, whether in cash or otherwise, and whether of a capital nature or not, including an amount equal to the nominal value, at the time of issue thereof, of any capitalization share awarded to shareholders and the nominal value of any bonus debentures or securities awarded to shareholders …
>
> Provided further that for the purpose of this definition an asset shall be deemed to have been given to a shareholder of a company if any asset or any interest, benefit or advantage measurable in terms of money is given or transferred to such shareholder or if the shareholder is relieved of any obligation measureable in terms of money."

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Voogt (1996:21) summarised the previous definition of a dividend for tax purposes to include the distribution of profits, whether in cash or otherwise, and whether of a capital nature or not. The definition of a dividend underwent many amendments since 2007 to arrive at the definition as currently contained in the ITA. The current definition of "dividend" was introduced with effect from 1 January 2011. The definition was amended by section 7(1)(g) of the Taxation Laws Amendment Act (No. 24 of 2011) with effect from 1 April 2012. The definition is used in the dividends tax regime, implemented with effect from 1 April 2012. Changes to the definition included the exclusion of the word "profit", and substituting the word "distributed" with the words "transferred or applied". Therefore the definition of "dividend" introduced with effect from 1 January 2011 is not concerned with the presence or absence of profits (SARS, 2017:24). Dividends therefore include any amount transferred or applied (as stated in the definition in section 1) whether or not "profits" are distributed. The reasons for this were due to a need for a change in the tax base (SARS, 2009:31). According to the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009*, problems existed with the tax base upon which STC relied. This was due to the dividend definition as used in the STC regime deriving its meaning from the word "profits", yet the word "profits" was not expressly defined in the ITA. The meaning of profits was thus derived from company law and accounting principles. Based on the definition of dividends contained in section 1(1) of the ITA and the explanatory memoranda, dividends expressly or implicitly required a reduction in profits.

In 2008, company law in South Africa underwent a major transformation with the enactment of the Companies Act (No. 71 of 2008). The new Companies Act modernised company law in line with international and economic trends. An important change from the old Companies Act (No. 61 of 1973), which had an effect on dividends, was the introduction of the solvency and liquidity test in place of the old capital maintenance rule. Provisions in the ITA directly or indirectly depend on company law definitions and principles (SARS, 2010:37). Due to the enactment of the new Companies Act, some changes were introduced in order to align the ITA with these definitions and principles as per company law. For purposes of the ITA, amendments were made to the previous definition of a dividend in order to align it with company law. Further consideration of the alignment between the Companies Act and the ITA is discussed in Chapter 3. The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010* states that, under previous company law principles, dividends were declared from after tax profits or reserves by a company. The reason for dividends to be declared from profits was to ensure that distributions were not used to strip a company of its assets and so deprive creditors and other stakeholders in the company (Van der Linde,

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2009:486; Van der Merwe, 2015:11). The new test introduced by the Companies Act was the solvency and liquidity test. In essence, the directors of companies had to ensure that before a dividend is declared, the company satisfied the solvency (assets must be more than liabilities) and liquidity (have enough cash to settle short-term obligations) test before and after the distribution. The capital maintenance rule was there to ensure that shareholders would not withdraw company funds to the detriment of corporate creditors as issued share capital could not be return to shareholders and must be maintained to act as security for corporate creditors (Van der Merwe, 2015:11). The solvency and liquidity test would ensure that the old capital maintenance rules would be achieved as assets would not fall below liabilities and the company would not encounter liquidity issues.

The previous definition of a dividend incorporated the capital maintenance requirements as per the Companies Act of 1973. Since the capital maintenance requirements “expired” with the enactment of the Companies Act of 2008, the definition of a dividend was amended to take this into consideration. These amendments resulted in the current definition of a dividend, effective 1 January 2011. All elements of profits and reserves were removed from the definition and the current definition thus regards any amount transferred or applied as a dividend, unless those dividends come from contributed tax capital (SARS, 2010:37-38). Contributed tax capital is a pure tax concept and is not discussed in this study.

As discussed, previously a dividend had to be declared from either after tax profits or a reserve for tax purposes. As profits were not defined in the ITA, this raised issues, as noted by Voogt (1996:48). In order to distribute dividends *in specie*, there had to be distributable profits. The provisos to the previous dividend definition were added to clarify what was meant by “profits” and clarified that “profits” included realised and unrealised profits (Edward Nathan Sonnenbergs Inc., 2008:1). Consequently, unrealised profits in distributions of assets *in specie* could be distributed upon liquidation of a company as a dividend (Edward Nathan Sonnenbergs Inc., 2008:1). This meant that under the amended previous definition of a dividend, directors were able to pay out whatever they believed fit – provided the company met the solvency and liquidity requirements (Edward Nathan Sonnenbergs Inc., 2008:1). The amendments to the previous definition shows an intention by the legislator to move away from the concept of dividends needing to be paid out of profits (SARS, 2009:31 -32). The current definition of a dividend is therefore not concerned with the presence or absence of profits; it is an artificial tax concept (SARS, 2017).

De Koker and Williams (2017:par. 25.7I) are of the opinion that a change in wording generally reflects a change in intention. The STC regime also contained a long list of deemed

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dividends in order to prevent avoidance of dividends tax by structuring distributions in a manner other than a dividend (Mazansky, 2012:172). Under the dividends tax regime, reliance is placed on the very wide definition given to a dividend to prevent avoidance of dividends tax (Mazansky, 2012:172). It is submitted that the overview of the amendments to the definition of a dividend suggests that the intention of the legislator, in the context of dividends, is to ascribe a broad interpretation of what could constitute a dividend for ITA purposes. This is due to the removal of the need to distribute profits from the definition, as well as the capital maintenance requirements. The previous definition of a dividend also referred to an asset including a benefit or advantage measurable in terms of money. This could indicate that the intention of the legislator was to include distributions of benefits such as the granting of services or the right of use of assets as dividends *in specie*. The current definition of a dividend refers to "any amount", which has a broad interpretation and would include a benefit or advantage measurable in terms of money as in the previous definition. The specific wording in the definition of "dividend" in terms of the ITA is subsequently considered in order to determine the possible purpose of the provision.

2.4 DEFINITION OF A DIVIDEND

In order for any distribution made by a company to a beneficial owner to be classified as a dividend for ITA purposes, it must adhere to the definition of a dividend as defined in the ITA. This definition is contained in section 1(1) of the ITA and reads as follows:

> "[It] means any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied—
>
> a) by way of a distribution made by; or
>
> b) as consideration for the acquisition of any share in,
>
> that company, but does not include any amount so transferred or applied to the extent that the amount so transferred or applied—
>
> i) results in a reduction of contributed tax capital of the company;
>
> ii) constitutes shares in the company; or
>
> iii) constitutes an acquisition by the company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.84 of section 5 of the JSE Limited Listings Requirements."

For the granting of services or the right of use of assets to constitute dividends *in specie* for ITA purposes, it must adhere to the definition as contained in section 1(1) of the ITA. Based on the definition of a dividend in the ITA the following elements are investigated in the context the granting of services or the right of use of assets:

- Amount;
- Transferred or applied by a company that is a resident; and
- For the benefit or on behalf of any person in respect of any share in that company.

2.4.1 Amount

Dividends must consist of "any amount" for purposes of the ITA. The meaning of the word "amount" is not defined in the ITA and has been considered in case law in relation to its use in the definition of "gross income". The ordinary English meaning should be ascribed to a word not defined in the ITA, unless the context indicates otherwise (Stiglingh *et al.,* 2018:18). SARS opines that the interpretation of the word "amount" in relevant case law should be ascribed to the meaning it bears in the dividend definition (SARS, 2017:24).

The word "any" is used before the word "amount". The word "any" is wide and of unqualified generality, which may be restricted by the subject matter or the context, but is unlimited (De Koker & Williams, 2017:par. 25.7I). Based on the nature of "any", a broad meaning in the context of "dividend" in terms of the ITA is submitted, unless the context indicates otherwise. The ordinary meaning of the word "amount" is determined by using dictionaries and case law as sources.

Black's Law Dictionary (Garner, 1999) and the *Oxford English Dictionary* (2018) define "amount" as follows:

- "The effect, substance, or result; the total or aggregate sum" (*Black's Law Dictionary*, 1999).
- "The sum total to which anything mounts up or reaches; in quantity, in number; the sum of the principal and interest due upon a loan; the full value, effect, significance, or import; a quantity or sum viewed as a total" (*Oxford English Dictionary*, 2018).

From the ordinary English meaning it can be seen that for a dividend to be an "amount", there must be a "value" transferred or applied. "Value is defined as the material or monetary worth of something; the amount at which something may be estimated in terms of a medium of exchange, as money or goods, or some other similar standard" (*Oxford English*

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Dictionary, 2018). The value of a distribution must be ascertainable for it to constitute a dividend.

As discussed above, the meaning of the word "amount" was also considered judicially. In *WH Lategan v CIR* 2 SATC 16, it was held that a wider meaning must be given to the word "amount" as used in the definition of "gross income" and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which had monetary value. "Property" is defined as follows in the *Oxford English Dictionary* (2018):

> "The fact of owning something or of being owned. The (exclusive) right to the possession, use, or disposal of a thing; ownership, proprietorship. A (usually material) thing belonging to a person, group of persons; a possession; (as a mass noun) that which one owns; possessions collectively; a person's goods, wealth."

From the above pronouncement and ordinary English meaning of property it can be seen that an amount must be given a wider meaning than only money and every form of property should be included. Property to be included in the meaning of "amount" would also not be limited to corporeal property but should also include incorporeal property such as intangible assets or rights. Based on the ordinary meaning of "property", the right to an asset and the right to the use thereof would be included in the word "amount".

In *Cactus Investments (Pty) Ltd v CIR* 61 SATC 43, the court held that in order to comprise an "amount", rights of a non-capital nature must be "capable of being valued in money". Similarly, in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 52 SATC 9, the court held that in order to be included in gross income, an amount must be of such a nature that a value can be attached to it in money. Expanding on the wider meaning of "amount" in the *Lategan* case, which included all forms of property, the courts held that in order for income to comprise an "amount", it must be capable of being valued in money or some monetary value should be attached thereto. As stated in *Commissioner for Inland Revenue v Delfos* 6 SATC 92, if something does not have monetary value or cannot be turned into money, that "amount" is not regarded as income. However, in *C:SARS v Brummeria Renaissance (Pty) Ltd & Others* 69 SATC 205, the courts held that if a receipt or accrual cannot be turned into money, it does not preclude that receipt or accrual from having no monetary value. Whether a receipt or accrual can be turned into money is only one of the manners in which the courts can determine whether or not a receipt or accrual has monetary value (*Brummeria supra*). For a receipt or accrual to be included in the meaning of "amount", it is not necessary that

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the receipt or accrual be capable of being turned into money; only that the receipt or accrual be capable of being valued in money (*Brummeria supra*).

According to SARS (2017:24), the same meaning of the word "amount", as judicially considered in relation to the definition of "gross income", should also be ascribed to the word "amount" in the context of the definition of "dividend" in section 1(1) of the ITA. If this same broad meaning of "amount" is applied in the context of dividends, then the granting of services or the right of use of assets could fall within this meaning of "amount" as a value can be placed on them and could thus constitute a dividend – provided that the other elements of the definition are met.

2.4.2 Transferred or applied by a company that is a resident

Another element of the definition of a dividend is that the amount must be transferred or applied. According to SARS (2017:25), the word "transferred" encompasses a transfer of ownership of an asset, while the word "applied" would, for example, include the payment of a debt owed by a holder of shares or a payment to a person providing a service to a holder of shares.

According to the *Oxford English Dictionary* (2018), "transferred" and "applied" are defined as follows:

"**Transfer** (Verb): To convey or make over (title, right, or property) by deed or legal process."

"**Apply** (Verb): To connect (something abstract) with (a person or thing) as its attribute or cause; to refer, ascribe, attribute. To put to a special use or purpose; to devote, appropriate to. To have a practical bearing upon something; to have valid or suitable reference to."

The granting of services or the right of use of assets would, based on the ordinary English meaning, be "transferred" and "applied" if legal ownership is transferred to the beneficial owner or is put to purpose or used by the beneficial owner.

2.4.3 For the benefit or on behalf of any person and in respect of any share in that company

According to definition of a dividend, the amount must be "for the benefit or on behalf of any person". A person would benefit from the receipt or accrual of a dividend, but a person who pays, for example, market-related consideration for an asset transferred by a company, does not derive a "benefit" since there is an equal *quid pro quo* (SARS, 2017:25). An amount

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could be transferred by a company "on behalf of" a person if, for example, a company pays a debt owed by the beneficial owner to another person (SARS, 2017:25). The intention of these provisions is to broaden the scope of the application of the ITA by using the word "any" in "any person" and "any share" (De Koker & Williams, 2017:par. 25.7I). From an interpretation point of view, the elements "any person" and "any share" is submitted to merely broaden the application of the ITA.

2.5 GUIDANCE FROM EXPLANATORY GUIDES

Guides and interpretation notes issued by SARS do not constitute legislation but can be used to interpret legislation and provide guidance (Stiglingh *et al.*, 2018:18). In *ITC 1572* (1993) 56 SATC 175 at 186, Zulman J stated:

> "Departmental practice is not necessarily, of course, an indication of what the law means. However, it seems to me that the departmental practice is a very sensible approach to what should be done in this type of case. Plainly the procedure and the practice laid down by the Commissioner in that regard, is, if nothing else, commercial wisdom and good sense."

Guides issued by SARS are therefore considered in the meaning of dividends *in specie*. SARS's *Comprehensive Guide to Dividends Tax* (2017) provides the following inclusions in the definition of "dividend":

> "Paragraph (a) of the definition of 'dividend' in terms of section 64D of the Act includes any amount transferred or applied by a company by way of a distribution. Typical examples of a distribution include–
>
> - a common law dividend;
> - a return of share capital, share premium or stated capital that is not determined to come out of the company's CTC;
> - the difference between the market value of an asset and its selling price when the asset is sold at less than fair market value to the holder of a share or to another person on behalf of such holder;
> - a donation of cash or assets to a holder of a share or to some other person on such holder's behalf; and
> - the waiver of debt owed by a holder of a share."

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The granting of services or the right of use of assets is not specifically included in the examples. The specific exclusions listed in the previous and current dividend definitions do not preclude the granting of services or the right of use of assets.

2.6 GUIDANCE IN RESPECT OF DONATIONS IN KIND

According to the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011*, distributions *in specie* are sometimes referred to as distributions in kind (SARS, 2012:37). "*In specie*" and "in kind" are synonymous and can be used interchangeably (SARS, 2012:37). In terms of section 18A of the ITA, donations can be made either in cash or in kind. SARS (2016) provided a *Basic Guide to Tax-deductible Donations*, which can be used as an additional resource for further guidance of what is meant by "*in specie*" in the context of taxation.

The *Basic Guide to Tax-deductible Donations* lists the following examples of in kind donations (SARS, 2016:5):

- "A financial instrument provided it is a share in a listed company or is issued by a financial institution as defined in section 1 of the Financial Services Board Act 97 of 1990.
- Trading stock which forms part of the business undertaking or trading activity conducted by the taxpayer. Such trading stock may include livestock or produce donated by a farmer, goods such as computers, foodstuffs, medical supplies, furniture and motor vehicles.
- An asset used by the taxpayer in conducting the taxpayer's trade but which is not trading stock. Such assets may include computers, furniture, office equipment, delivery vehicles, cash registers, garden equipment, crockery or kitchen utensils.
- An asset which is not trading stock or used in the business of the taxpayer. This may include personal assets or assets bought by the taxpayer such as vehicles, computers, furniture or sport equipment.
- Property purchased, manufactured, erected, installed or constructed by or on behalf of the taxpayer. Property of this nature may include carpets or cupboards installed, security fencing and buildings such as classrooms erected by or on behalf of the taxpayer for purposes of conducting any PBA [public benefit activity] in Part II."

However, section 7.1.2 in the guide mentions that no deduction will be allowed for a donation of property in kind that constitutes fiduciary rights, usufruct or other similar rights, or even

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intangible assets. In section 7.1.3 of the guide, donations of services such as time and skill will not qualify for a section 18A deduction as services do not constitute a donation of "property made in kind" (SARS, 2016:5). Hence, given that SARS does not interpret the granting of services or rights as donations of "property made in kind", SARS might not interpret that services or the right of use of assets could constitute dividends *in specie* for ITA purposes, given that "in kind" and "*in specie"* are synonymous. It must, however, be noted that SARS's interpretations do not constitute legislation, and the context of donations also differs from that of dividends. Rudnicki (2010) submits that "distribution" means any distribution by a company to its shareholders. Donations are a gratuitous distribution, while dividends are any distribution by an entity to a beneficial owner by virtue of his or her shareholding. It is submitted that the reason for not allowing donations of services and the right of use of assets is to regulate the deductions for the purposes of section 18A of the ITA. In the context of dividends the deduction is not submitted as the focus, but rather, the inclusion for the beneficial owner. Conclusive guidance is as result not obtained from the aforementioned meaning of "in kind" when applying the interpretation in the context of donations to that of *in specie* as used in the dividends tax provisions.

2.7 GUIDANCE FROM THE OECD DEFINITIONS AND COMMENTARIES ON THE ARTICLES OF THE MODEL TAX CONVENTION

The purpose behind the change from STC to dividends tax could also provide some guidance on the intention of the legislator and the purpose behind the new dividends tax regime. The main reason for the change from the STC regime to the dividends tax regime was to align it with international practices (Venter, 2013:19). Due to the purposeful alignment of the dividends tax regime to that of international practices, the OECD's interpretation and definitions of what constitutes a dividend could provide guidance in a South African context. The OECD is an intergovernmental economic organisation established to stimulate economic growth and world trade, with 35 countries as members as at 2018. South Africa is not a member but does have observer status (OECD, 2018b). This means that South Africa participates in the activities of the OECD, including commentaries regarding international taxation and treaties between countries. The OECD (2018c) defines "dividends" and "in kind" as follows:

"**Dividends:** Dividends are a form of property income received by owners of shares to which they become entitled as a result of placing funds at the disposal of corporations."

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"In kind: Broadly speaking, a distribution or payment other than in money."

If the definitions used by the OECD are applied to dividends in the South African context, it could be indicative that a broad meaning must be given to dividends *in specie*. The OECD, in its Commentaries on the Articles of the Model Tax Convention, is of the view that the significant differences between the laws of member states make it impossible to define dividends fully and exhaustively (OECD, 2018a:191). Even after the revision of the 1963 Draft Convention, it was held that a definition of the concept of a dividend that does not refer to each country's domestic law is not possible as there are too many dissimilarities (OECD, 2018a:191). The definition thus contained in the OECD Model Tax Convention merely provides a few examples and is not exhaustive. The OECD (2018a) remains of the view that the definition refers to domestic law and that it is open to each state when considering double tax agreements to include under the definition of a dividend any other payments by companies that each state deems to be dividends. The OECD (2018a), in its commentaries, provides some additional guidance to that of domestic law in that the OECD also regards payments not distributed out of profits as dividends, and as a result, other benefits in money or money's worth, such as disguised distributions of profits, will also be considered a dividend (OECD, 2018a:192). In terms of the OECD definitions, the granting of services or the right of use of assets could be construed as being included in the meaning of dividends *in specie*. Distributions that reduce membership rights, for instance capital reimbursements, are not regarded as dividends by the OECD (2018a:191). The OECD (2018a:192) is also of the view that benefits received by a closely connected person of the shareholder may constitute dividends in the hands of the shareholder. Similarly, a dividend may exist if a person receives a benefit from a company where there are legal relations between such a person and the company that are regarded as a holding in the company (OECD, 2018a:192).

2.8 CONCLUSION

In order for a dividend *in specie* to constitute a dividend it must fall within the ambit of the definition of a dividend as contained in section 1(1) of the ITA. The definition of a dividend refers to "any amount" that has been held to have a broad meaning and should be capable of being valued in money.

The meaning of the definition of a dividend was interpreted by investigating the ordinary English meaning of the words used, the history and context of the definition, as well as the purpose of the change from the STC regime to the dividends tax regime. The interpretation of a dividend based on the ordinary meaning of the words used, and the amendments to the

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definition indicate that the word "dividend" must be interpreted broadly. Furthermore "*in specie*" is also a broad term that includes any form of property in its actual form. The history of the provisions and definition also indicates that the intention of the legislator could be to include the granting of services or the right of use of assets within the ambit of dividends tax. This is because the previous definition of a dividend included benefits and advantages measurable in terms of money, which will also be included in the current definition due to the use of the wording "any amount". Under the dividends tax regime the reliance is placed on the very wide definition given to a dividend to prevent avoidance of dividends tax by structuring distributions in a manner other than a dividend (Mazansky, 2012:172). Distributions can be structured in a manner other than a dividend the same as structuring fringe benefits in lieu of remuneration. Based on this the benefits included in "taxable benefits" in section 2 of the Seventh Schedule to the ITA could also indicate what the legislator could interpret as "dividend *in specie*".

The term "*in specie"* is a substitute for "in kind" and thus SARS guidance on what would constitute a donation of property in kind provided guidance on whether the granting of services or the right of use of assets would constitute "property in kind". SARS's interpretation of donations of "property in kind" in the *Basic Guide to Tax-deductible Donations* indicated that the granting of services and the right of use of assets would not constitute "property in kind" and, based on this argument, could also be interpreted to not constitute distributions of assets *in specie* for ITA purposes. It is submitted that the reason for not allowing donations of services and the right of use of assets is to regulate the deductions for the purposes of section 18A of the ITA. In the context of dividends the deduction is not submitted as the focus, but rather, the inclusion for the beneficial owner. Conclusive guidance is as result not obtained from the aforementioned meaning of "in kind" when applying the interpretation in the context of donations to that of "*in specie"* as used in the dividends tax provisions.

Based on the above, the granting of services or the right of use of assets could constitute a dividend *in specie* based on the broad definition of a dividend. Further guidance is however submitted as necessary for any indication of the specific inclusion or exclusion of these benefits as dividends *in specie* in terms of the Companies Act and the IFRS. As differing interpretations for accounting, company law and tax could complicate the tax system, alignment would thus help to solve complications caused by different interpretations (in the context of dividends) by different legislation and is considered in Chapter 3 which follows.

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CHAPTER 3
THE MEANING OF DIVIDEND *IN SPECIE* IN TERMS OF THE COMPANIES ACT AND THE IFRS

3.1 INTRODUCTION

In order to gain a better understanding of the meaning of "dividend" in terms of the ITA, the definitions and interpretations with respect to dividends in the Companies Act and the IFRS will be analysed, including the differences and similarities in the respective definitions and interpretations. The aim of this chapter is to investigate whether the interpretations with regard to dividends in the Companies Act and the IFRS could provide guidance of whether services or the right of use of assets could constitute a dividend *in specie* in terms of the ITA. This chapter also discusses the alignment of the above mentioned legislation and regulations with regard to dividends, the potential benefits of alignment, and feasibility, in order to identify conceptual or practical issues.

The alignment between legislations and also accounting standards within a country could have potential benefits, as well as disadvantages. Alignment would bring about benefits such as increased simplicity, decreased compliance cost, greater certainty, greater durability, and an increased ability to undertake future modifications (De Zilva, 2005:67-68). Simplicity will be achieved due to an entity not needing to create separate accounts or reports for tax, accounting, and company regulations (De Zilva, 2005:67-68). Alignment would also decrease compliance cost as experts are currently needed for each field in order to correctly adhere to each act and regulation (De Zilva, 2005:67-68). It is submitted that entities will also have certainty regarding the consequences of a transaction in terms of tax, accounting, and company regulations. Alignment would also improve the "substance over form" approach, given that transactions with the same economic substance would receive the same taxation consequences, even if the legal form differs (De Zilva, 2005:69).

The reasons for alignment not being feasible are the perceived differences in the underlying objectives of the systems, the wide discretion and choice generally provided under financial accounting rules, the reluctance of the relevant authorities to relinquish power, and the significant transaction costs (De Zilva, 2005:71). Based on the above the main aspect to consider in the context of dividends is the underlying objectives of each regulation. The objectives of the Companies Act in the context of dividends are to regulate distributions and to protect creditors, as can be seen by the implementation of the solvency and liquidity

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provisions (previously, the Companies Act of 1973 had capital maintenance rules in place) (Van der Linde, 2009:486). In addition, Voogt (1996:11) submits that the Companies Act should provide some degree of investor protection. For taxation purposes, the objective is to tax any distributions of dividends made by a company in respect of a share (Mazansky, 2012:172). De Koker and Williams (2017:par. 1.1) opine that income tax is a matter of law and accounting principles, which, although relevant, are not part of tax law and they deviate from each other in important respects due to their objectives.

The definition and interpretation of dividends in the context of taxation and legal definitions were discussed in Chapter 2. The meanings in terms of the Companies Act and the IFRS are respectively considered as a starting point in this chapter; followed by a comparison between these respective meanings and the ITA. The guidance provided by the Companies Act and the IFRS with respect to the granting of services and the right of use of assets is then summarised.

3.2 MEANING IN TERMS OF THE COMPANIES ACT

Companies in South Africa are regulated by the Companies Act (No. 71 of 2008) (The Companies Act) and as a result dividend distributions are regulated in terms of the provisions contained in the Companies Act. Dividends are not expressly defined in the Companies Act however this Act uses the word "distribution" to refer to distributions made by a company.

In terms of section 1 of the Companies Act, a "distribution" is defined as:

"a direct or indirect—

(a) transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one more holders of any of the shares of that company or of another company within the same group of companies, whether—
    - (i) in the form of a dividend;
    - (ii) as a payment in lieu of a capitalisation share, as contemplated in section 47;
    - (iii) as consideration for the acquisition—
        - (aa) by the company of any of its shares, as contemplated in section 48; or
        - (bb) by any company within the same group of companies, of any shares of a company within that group of companies; or

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(iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164(19);

(b) incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies; or

(c) forgiveness or waiver by a company of a debt or other obligation owed to the company by one or more holders of any of the shares of that company or of another company within the same group of companies, but does not include any such action taken upon the final liquidation of the company."

Subsection (a)(i) of the definition of "distribution" refers to the transfer of money or property by way of a dividend. Consideration must be given to what constitutes a dividend as contemplated in subsection (a)(i) of the definition of "distribution". The Companies Act of 1973 contained no definition for either "dividend" or "distribution". Guidance from United Kingdom law is applicable in a South African context as there are similarities in our judiciary systems (Cloete, 2012:556). In *Halsbury's law of England* (Blackburn, 2014:58.515), "dividend" is defined as a distribution of an amount proportionate to the owner's shares.

Further guidance is obtained from the South African courts. In the case of *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at 550-551, Innes CJ said that a registered company is a legal persona distinct from the members who comprise it and that property vested in a company is not regarded as vested in all or any of its members. In *Hood-Barrs v Commissioners of Inland Revenue* [1946] 2 All ER 768 (CA) at 775, Lord Greene MR, regarding the rights of shareholders, stated:

> "He has no property in, nor right to, any particular asset. He has only the right to have all assets administered by the directors in accordance with the constitution of the company, and his rights to a dividend only arise when the dividend is declared."

Dividends therefore refer to a shareholder's share, in accordance to the rights attached to the share, in distributable profits that were declared by the company and not the distribution of a share of the assets in a company (Van Dorsten, 1993:26). Based on the above, it is found that a shareholder does not have a right to any asset in an entity and therefore also no implied right of use of assets of the entity as a shareholder. Thus benefits, like services and the right of use of assets, can only be received in respect of shares by way of a dividend that has been declared. A right to participate in a dividend is usually created by a declaration (Van Dorsten, 1993:92). The word "declare" was judicially considered and meant "to make

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known", which necessarily connotes a person or persons to whom something is made known (*Swart v Vosloo* 1965 (1) SA 100 (A)). It is submitted that the granting of services and right of use of assets wouldn't be excluded from a dividend based on the requirement that it needs to be declared as the person receiving the services and right of use will be "made known" of such a right.

3.2.1 Comparison between the Companies Act and the ITA with regard to dividends

The Companies Act refers to a dividend in the definition of "distribution", but no definition is provided for a dividend. From a tax perspective, the interaction between "dividend" as defined in section 1(1) of the ITA and "distribution" as defined in section 1 of the Companies Act is analysed.

The definition of a distribution contained in the Companies Act provides for three instances that meet the definition of a distribution. These instances are found in paragraphs (a) to (c) in the definition and can be summarised as follows:

- The transfer of money or property of the company,
- incurrence of a debt or other obligation for the benefit of a shareholder, or
- the waiver of a debt or other obligation owed to the company.

When comparing this to the definition of a dividend contained in the ITA, it can be seen that there are only two instances, subsection (a) and (b) that would constitute a dividend, namely the transfer of any amount by way of a distribution, or as consideration for the acquisition of any share in that company. The reference to distribution in the definition of "dividend" as contained in the ITA results in uncertainty whether it encompasses all three subsections of the definition of "distribution" as contained in the Companies Act.

Subsection (a) of the definition of "distribution" as contained in the Companies Act includes four sub-paragraphs to further define a distribution in terms of the transfer of money or property. Paragraph (a)(iii) provides that transfers of money or property as consideration for the acquisition of shares in that company would also constitute a distribution. When comparing this to the dividend definition in the ITA, one notes that "distribution" and "consideration for the acquisition for any share in that company" are listed separately. For purposes of the ITA, a distribution would not include consideration transferred by a company for its own shares, hence the separate inclusion in the dividend definition. No definition of "distribution" is contained in the ITA and the meaning is thus sought from the definition of "distribution" contained in the Companies Act (Robb, 2015:10). However, the inclusion of

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consideration for the acquisition of shares in the definition of "distribution" in the Companies Act but listing it separately from "distribution" in the ITA indicates that the legislator of each Act interpreted the meaning of "distribution" differently. Thus the uncertainty of what is meant by "distribution" as contained in the definition of a "dividend" in the ITA remains.

Subsection (b) of the definition of "distribution" as contained in the Companies Act refers to the waiver of debt. There is also uncertainty whether such a waiver of a debt would constitute a dividend for purposes of the ITA, seeing as a waiver of debt is considered a distribution from a Companies Act perspective. SARS (2017:25) is of the opinion that the inclusion of the word "applied" within the definition of a dividend would include the payment of a debt owed by a holder of shares or the waiver of a debt owed to the company by the holder of shares. Specific tax treatment exists for the forgiveness of debt in terms of paragraph 12A of the Eighth Schedule to the ITA and section 19 of the ITA which could interact with section 64F for dividends tax purposes. Section 64F of the ITA contains all the exemptions for dividends tax purposes and section 64F(1)(l) specifically provides that any dividend to the extent that the dividend constitutes income of a person would be exempt from dividends tax. Thus it is the intention of the legislator that any forgiveness or waiver of debt to the extent that it is already included in the income of a shareholder in terms of paragraph 12A of the Eighth Schedule to the ITA and section 19 of the ITA would be exempt from dividends tax.

Distributions, as defined in the Companies Act, exclude any of the instances defined as distributions that are made upon the final liquidation of the company. This exclusion is not explicitly included in the context of the ITA as the concept of contributed tax capital would result in the exclusion of such distributions. The reason for the specific exclusion in the Companies Act is due to the objective of creditor protection contained in the Companies Act in the context of distributions (Van der Linde, 2009:486). During final liquidation, the remaining assets are distributed to the shareholders only after all other creditors and debts have been paid as they rank last in the liquidation hierarchy (Van der Linde, 2009:486). Thus the need to protect creditors falls away when it comes to distributions upon final liquidation in the case of ordinary shares.

Table 3.1 summarises the similarities and differences between the meaning of "dividend" as contained in the ITA and "distribution" as contained in the Companies Act.

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Table 3.1: Comparison between the meanings of "dividend" and "distribution" as contained in the ITA and the Companies Act respectively

Distribution (Companies Act)	Dividend (ITA)
Direct or indirect	N/A[1]
Transfer by a company of money or other property of the company	Any amount transferred or applied
Other than its own shares	ii) But does not constitute shares in the company
To or for the benefit of one or more holders of any of the shares of that company	For the benefit or on behalf of any person in respect of any share in that company
Or of another company within the same group of companies	Any company
(i) in the form of a dividend; (ii) as a payment in lieu of a capitalisation share, as contemplated in section 47; (iv) otherwise in respect of any of the shares of that company or of another company within the same group of companies, subject to section 164(19)	a) By way of a distribution
(iii) is consideration for the acquisition— (aa) by the company of any of its shares, as contemplated in section 48; or (bb) by any company within the same group of companies, of any shares of a company within that group of companies	b) As consideration for the acquisition of any share in that company
Incurrence of a debt or other obligation	N/A[2]
Forgiveness or waiver by a company of a debt or other obligation owed to the company	Considered to be included due to the word "applied" used in the definition

Source: Compiled by author

[1] *Despite the definition of "dividend" not explicitly referring to direct or indirect distributions. Indirect distributions is still conceived based on the use of wording "to any person" in the definition of "dividend".*

[2] *Deemed a dividend in terms of section 64E(4)(a) of the ITA.*

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The Companies Act of 1973 contained capital maintenance rules in order to protect creditors' and debt issuers' interest in the company (Van der Linde, 2009:486). The Companies Act of 2008 effectively removed these capital maintenance rules and substituted them with the solvency and liquidity test in order to retain the essence of the capital maintenance rules. It is submitted that in the context of the objective of the Companies Act, any distribution that would reduce the capital base of the company must be included in the definition of "distribution" in order for it to be regulated in terms of the Companies Act through the solvency and liquidity test; otherwise companies could potentially distribute value to shareholders that would not fall within the definition and would thus not require the company to perform the solvency and liquidity tests, which could negatively impact creditors and debt issuers. Hence the inclusion of "group of companies", "waiver of debt", and "incurrence of debt" in the definition of a "distribution", which could all negatively impact creditors and debt issuers if not regulated. Based on the findings the definition of "distribution" in the Companies Act has this broad application in order to bring such distributions within the scope of the solvency and liquidity test in order to protect creditors and debt issuers.

On the other hand, the objective of the ITA, regarding dividends, is to specifically tax any distributions from a company to a beneficial owner. Excluded from the definition of a dividend is contributed tax capital (CTC), which in essence is the capital portion of the original contribution made for the share by the shareholder, which will have CGT consequences in terms of the Eighth Schedule to the ITA once distributed. Waivers of debt have their own tax treatment in terms of section 19 of the ITA and paragraph 12A of the Eighth Schedule to the ITA. The incurrence of debt is treated under section 64E(4)(a) of the ITA, which effectively only deems the difference between the market-related interest and the actual interest paid, if the actual interest paid is less than the market-related interest, as a dividend. From these treatments it can be seen that in the context of dividends tax, the ITA aims to tax the income portion, as any capital portions will have their own tax consequences in terms of the Eighth Schedule to the ITA. CTC is purely a tax concept and accounting or company law classifications in terms of distributions have now become irrelevant (Cliffe Dekker Hofmeyr, 2014:1).

Based on the above, it can be seen that the objectives of different legislation could differ. The Companies Act's objective in the context of company distributions is to provide creditor protection while the ITA aims to tax any distribution made by a company in respect of shares. Due to these differences identified between the definition of "dividend" and "distribution" in

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the ITA and Companies Act respectively, the tax consequences of a distribution made in accordance with the definition contained in the Companies Act will have to be considered on an individual basis in the context of that specific case (Cliffe Dekker Hofmeyr, 2011:3). Based on the findings it is submitted that for dividends tax purposes, a distribution in terms of the Companies Act will not necessarily be treated as a dividend as defined in the ITA.

3.2.2 Practical relevance of alignment

An alignment of these two acts would solve the uncertainty regarding whether a distribution as contained in the definition of "dividend" in the ITA would encompass all the instances as defined in the definition of "distribution" as contained in the Companies Act, and will also make clear the legislator's interpretation of what is regarded as a distribution for both acts. Academics and industry professionals have voiced concerns regarding the definition of "distribution" as contained in the Companies Act. Jooste (2009:634) suggests that there is uncertainty whether the sub-parts (i) to (iv) contained in paragraph (a) of the definition of a distribution should also be taken into consideration in paragraphs (b) and (c), even though they are not listed under these paragraphs. Van der Merwe (2015:124) opines that the inclusion of a group of companies in the Companies Act definition of distribution is redundant as the word "indirect" in the definition already encompasses a distribution in the context of a group of companies. Alignment could also provide the opportunity to address these uncertainties; however, caution should be applied as these two acts have clearly different purposes. The alignment must resolve the confusion while maintaining the objective of each act.

In conclusion, when inconsistencies arise between the Companies Act and any other national legislation, section 5(4) of the Companies Act states that the provisions of both acts should be applied concurrently to the extent possible. The Companies Act will, however, prevail over the provisions of the ITA if it is impossible to apply them concurrently as the ITA is not listed as legislation that will prevail over the Companies Act in section 5(4). Based on this and the above differences, the interpretation of "distribution" in the Companies Act will not necessarily apply to the interpretation of "dividends" as contained in the ITA and must be considered on an individual case basis. The reference made to dividends as contained in the definition of "distribution" in the Companies Act will also not be limited by the interpretation of "dividend" contained in the ITA due to the overriding provision contained in section 5 of the Companies Act. A practical issue thus conceived is that the interpretation of "distribution" in the Companies Act cannot be used as the definition accepted for ITA purposes as opined by Robb (2015:10). It is submitted that the legislature erred in not

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aligning the two Acts. Alignment of these two legislations with regards to company distributions would ensure certainty in the specific treatment of a distribution by a company under both legislations.

3.2.3 Guidance obtained from the definition of "distribution" in the Companies Act with respect to the granting of services and the right of use of assets

The findings of the investigation revealed that the definition of a "distribution" in the Companies Act refers to a dividend in subsection (a) and the definition of a "dividend" in the ITA refers to a distribution in subsection (a), resulting in a possible circular reference when comparing the definitions. None of the subparagraphs of the definition of "distribution" in the Companies Act makes reference to the granting of services or the right of use of assets. Paragraph (a) of the definition of "distribution" in the Companies Act refers to a transfer of money or property. Distributions, as defined in the Companies Act, include property, and property, in turn, includes rights. For purposes of the Companies Act, the right of use of assets could thus fall within the meaning of "distribution".

Jooste (2009:635) compared the South African Companies Act to that of New Zealand and found similarities. The phrase "to or for" as used in "to or for the benefit of one or more shareholder" as contained in the definition of "distribution" is also used in the definition of "distribution" as contained in the New Zealand Companies Act. These similarities may be of assistance in interpreting the South African Companies Act's definition of "distribution", as it was held in *Re DML Resources Ltd (In Liquidation)* [2004] 3 NZLR 490 (HC) at 505 that the concepts captured by the elements of the definition of "distribution" in the New Zealand Companies Act:

> "are the transfer of property (or the incurring of a debt) by the company; the corresponding provision of a benefit to or for its shareholders; and receipt of the benefit by, or on behalf of, the shareholder in its capacity as a shareholder. A link must be established between the outflow of wealth from the company and the benefit received by or on behalf of a shareholder. The use of the expressions 'direct or indirect' and 'to or for' the benefit of the shareholder serve to confirm the necessary link between the negative impact on the net value of the company and the positive impact on the net value of the shareholder. They also emphasise that the inquiry is one of substance rather than form. An analysis based on the substance of the transaction lessens the likelihood of a shareholder using its influence, as an insider,

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to mask the true nature of the transaction to avoid compliance with the distribution rules".

When applying the interpretation by the New Zealand courts, it would mean that in any instance where a distribution causes wealth to flow from the company to the shareholder, it would be classified as a distribution in terms of the Companies Act, subject to exclusions in the definition. The definition is interpreted as such in order to ensure that the substance of the transaction is regarded and not the form, to ensure that it is regulated by the Companies Act. If the Companies Act's interpretation is applied to that used in the definition of "dividend" in the ITA, it would necessitate that any transfer of wealth from the company to the beneficial owner in respect of the beneficial owner's shareholding would be considered a dividend for tax purposes, subject to the specific exemptions. When applying this to the granting of services or the right of use of assets, wealth is transferred to the shareholder in respect of shareholding. The beneficial owner receives a benefit, either in the form of services or the use of company assets. The company, on the other hand, experiences a negative impact on its net value either due to costs associated with performing the services or allowing the beneficial owner to use company assets, or in the form of lost income (opportunity costs).

The inclusion of the words "to or for the benefit of one or more shareholder" as contained in the definition of "distribution" in the Companies Act is similar to the phrase "for the benefit or on behalf of" as contained in the definition of "dividend" in the ITA. In conclusion, based on the aforementioned, some guidance is provided by the Companies Act on whether the granting of services or the right of use of an assets would constitute a dividend for tax purposes. When applying the guidance obtained from the Companies Act, any benefit received or conferred on a beneficial owner as a result of his or her shareholding would be considered a distribution and thus falls within the ambit of paragraph (a) of the definition of a dividend in the ITA. There must be a link between the net value of the company decreasing and the beneficial owner's net value increasing. When considering whether or not any benefit received by a beneficial owner in his or her capacity as a beneficial owner constitutes a dividend for tax purposes, the inquiry into the substance of the transaction is important and not its legal form. The granting of a service or the right of use of an asset to a shareholder in respect of the shareholder's shareholding could thus be considered a distribution for Companies Act purposes and by inference a dividend for ITA purposes.

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3.3 MEANING IN TERMS OF THE IFRS

In the context of South Africa, accounting standards are based on the IFRS. The South African government adopted new company regulations with the enactment of the Companies Act of 2008, which prescribe the reporting frameworks for regulated entities. Regulation 27 of the Companies Regulations, 2011 require the use of the IFRS for compiling financial statements. The principles in the IFRS are thus used when accounting for dividends in a South African context. The term "dividend", however, has not been defined in any of the standards included in the IFRS. Despite not being explicitly defined, the word "dividend" features in many standards and is also part of concepts like "dividends per share" and "dividend yield", which are defined by accounting literature as a whole (Voogt, 1996:10).

When transactions or events are not covered by existing IFRS standards, a Conceptual Framework exists in order to assist preparers of financial statements for those transactions (IASB, 2010:A19). The Conceptual Framework also assists users of financial statements to interpret the information contained in financial statements prepared in compliance with the IFRS (IASB, 2010:A19). Financial statements generally include a Statement of Comprehensive Income and a Statement of Financial Position, which measure the performance and financial position of an entity respectively (IASB, 2010:A19). The Conceptual Framework assists in grouping transactions and other events into broad classes according to their economic characteristics (IASB, 2010:4.2). The broad classes are termed the elements of financial statements (IASB, 2010:4.2). The Conceptual Framework provides the definition and criteria for recognising the elements of financial statements (IASB, 2010:A19). The elements that measure financial position are assets, liabilities, and equity (IASB, 2010:4.4). The definitions of these elements are found in paragraph 4.4 of the Conceptual Framework (IASB, 2010), and are defined as follows:

a) "An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
c) Equity is the residual interest in the assets of the entity after deducting all its liabilities."

Paragraph 4.6 of the Conceptual Framework states that in assessing whether an item meets the definition of an asset, liability, or equity, attention must be given to its underlying

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substance and economic reality and not merely to its legal form. Financial performance consists of two elements, income and expenses, which are defined in paragraph 4.25 of the Conceptual Framework (IASB, 2010) as follows:

a) "Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants."

Dividends that are distributed by an entity on face value do not meet the definition of either of the five elements mentioned. The Conceptual Framework only states that income includes dividends received by an entity, and the definition of expenses specifically excludes distributions to equity participants (as equity is the residual interest of the assets of an entity after deducting liabilities, and represents the interest attributable to the owners of the entity) (IASB, 2010:4.25). Any distributions to these owners are accounted for as a reduction in equity and are not presented on either the Statement of Comprehensive Income or the Statement of Financial Position (IASB, 2014:IN11). In the context of dividends *in specie*, the definition of an asset in terms of the Conceptual Framework could provide guidance on what type of assets could be distributed to the owners. Paragraph 4.11 of the Conceptual Framework (IASB, 2010) states that many assets have physical form but that physical form is not essential for an asset to exist. The Conceptual Framework (IASB, 2010:4.12) also states that right of ownership is not necessary to determine the existence of an asset. As long as the entity controls the asset and can prevent the economic benefits from flowing to another party, the definition of an asset would be satisfied (IASB, 2010:4.12). Lastly, to meet the definition of an asset, future economic benefits must flow to the entity (IASB, 2010:4.4). Examples of how future economic benefits might flow to the entity in the Conceptual Framework include the distribution of that asset to the owners of the entity (IASB, 2010:4.10). This means that the act of distributing an asset to the owners of an entity would satisfy the requirement of the future economic benefits flowing to the entity.

Other accounting literature that has considered dividends submitted the meaning as being a payment designated by a company's board of directors to be distributed among shareholders (Johnson, 1983:453). Some literature refers to a narrow and a broad definition. Narrowly defined, dividends are cash flows received by a shareholder, with other finance literature including all cash distributions to shareholders, which include share repurchases

(Ackert & Smith, 1993:1147). The interpretation of dividends in the context of tax and companies law is indicative of a broader interpretation of dividends and includes assets distributed to shareholders. In the context of dividends, the IFRS and literature do not provide a definite definition, which seemingly results in any distribution to owners of an entity being accounted for as a dividend, considering the definition of an asset in the context of dividends *in specie*. The Conceptual Framework defines an asset very broadly, and a wide variety of distributions would thus meet the definition in the context of dividends *in specie*. The possible reason for the IFRS not providing a definition for dividends is due to the IFRS being an international body that sets standards in order to guide companies in creating financial statements that fairly reflect the transactions and events of an entity (IASB, 2010:A19). The purpose is thus to guide the preparers on how to account for a dividend, rather than defining a dividend as each country would have its own interpretation or definition of what constitutes a dividend. Based on the preceding it is submitted that a broad interpretation is applied in an accounting context as well. In November 2008, the IASB, however, issued IFRIC 17, which is a standard that provides guidance on accounting for distributions of non-cash assets to owners, which is subsequently discussed to obtain guidance in the context of dividend in the ITA.

3.3.1 Comparison between the IFRS and the ITA with regard to dividends

IFRIC 17 (IASB, 2008a:2) states that the IFRS do not provide guidance on how an entity should measure distributions (commonly referred to as dividends) to its owners. International Accounting Standard (IAS) 1 (IASB, 2014:IN11) requires an entity to present details of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements. IFRIC 17 applies to non-reciprocal distributions of assets by an entity to its owners and gives the following examples of distributions of non-cash assets: items of property, plant and equipment, businesses as defined in IFRS 3, and ownership interests in another entity or disposal groups as defined in IFRS 5. These examples are non-exhaustive and merely provide illustrations as the scope of the interpretation places no restrictions on the term “distribution”, other than that it must be non-reciprocal (Santoro & Carlson, 2009:7). Neither the legal characteristics nor the reason for the transfer of the asset is a factor in determining whether the distribution falls within the scope of IFRIC 17 (Santoro & Carlson, 2009:7). Any asset that is distributed would thus fall within the scope of IFRIC 17. IFRIC 17 does not define “asset”, and the definition contained in the Conceptual Framework is therefore used to define what constitutes a non-cash asset distributed to shareholders.

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IFRIC 17 furthermore provides guidance on the measurement of the liability for non-cash asset distribution, which is the fair value of the asset distributed. IFRIC 17 also provides guidance on when to recognise the dividend-payable liability. IFRIC 17 states that the dividend will be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, the timing of which is either of the following:

a) "when declaration of the dividend, for example by management or the board of directors, is approved by the relevant authority, for example the shareholders, if the jurisdiction requires such approval, or
b) when the dividend is declared, for example by management or the board of directors, if the jurisdiction does not require further approval (IASB, 2008a: par. 10)."

When comparing the guidance obtained from the IFRS for the accounting of dividends to the meaning and definition of "dividend" as contained in the ITA, the following similarities can be extracted from the definitions and discussions above in the context of dividends:

- A dividend is a transfer of cash or a non-cash asset.
- A dividend is made to shareholders.
- A dividend must be authorised by the board of directors of the entity.

Further similarities arise when considering the recognition criteria for elements of financial statements in terms of the Conceptual Framework. The recognition criteria are as follows (IASB, 2010:4.38):

- It is probable that any future economic benefit associated with the item will flow to or from the entity.
- The item has a cost or value that can be measured with reliability.

Despite dividends not being disclosed on either the Statement of Comprehensive Income or the Statement of Financial Position, the Conceptual Framework requires that the element must have a cost or value that can be measured. As discussed, this is also a requirement for dividends in the ITA, as was held by the courts when interpreting what was meant by "amount".

In both the accounting and tax definitions of an asset, it is not necessary for an asset to have physical form and an asset can thus include patents, copyrights, and rights to or in assets. The IFRS also include that ownership status is not necessary for an asset to meet the definition of an asset as an entity would only need to ensure that it has a right to the inflow of future economic benefits. Rights and obligations with regard to the asset are thus a more

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important indicator of whether it meets the definition of an asset than ownership. The meanings of what constitutes a dividend in both the IFRS and the ITA seem to align.

3.3.2 Guidance obtained from the IFRS with respect to the granting of services and the right of use of assets

Guidance from the IFRS with regard to dividends suggests that any distribution of an asset that meets the definition of an asset falls within the scope of IFRIC 17. The question thus arises whether the granting of services or the right of use of assets would fall within the scope of IFRIC 17 and thus could be considered a dividend for accounting purposes. This could provide guidance whether the granting of services or the right of use of assets could constitute a dividend for ITA purposes. As discussed, assets do not need physical form and also include the rights to physical assets. These rights can be divided into two separate assets: bare dominium and usufruct (Stiglingh *et al.*, 2018:914). Bare dominium is simply ownership without the right of use, which is the usufruct (Stiglingh *et al.*, 2018:914). As ownership is not necessary for an asset to fall within the definition of an asset (IASB, 2010:4.12), a usufruct, right to use the asset, is submitted as an asset as the economic benefits of the right of use of the asset flow towards the shareholder who receives the benefit. Thus, for accounting purposes, the granting of the right of use of an asset could fall within the scope of IFRIC 17.

For the granting of services to fall within the scope of IFRIC 17, it must also meet the definition of an asset. Guidance regarding whether services are classified as an asset is found in *The Basis for Conclusions on IFRS 2 Share-based Payments*. IFRS 2 (IASB, 2008b) provides guidance for accounting for transactions where shares were used to pay for the transaction. The issue raised by standard setters was that paying for services using shares does not meet the definition of an expense as no outflow of an asset nor an incurrence of a liability is present. Furthermore, services would not meet the criteria for recognition as an asset, and the consumption of those services thus does not represent a depletion of assets (IASB, 2008c:BC46). The Conceptual Framework, however, states that the term “asset” is not limited to resources that can be recognised as assets on the Statement of Financial Position (IASB, 2010:4.5). Thus, although services to be received might not meet the definition of an asset to be recognised on the Statement of Financial Position, services are assets once received (IASB, 2008c:BC47). This is also explained in the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements:

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> "Services provided by other entities, including personal services, cannot be stored and are received and used simultaneously. They can be assets of an entity only momentarily – as the entity receives and uses them – although their use may create or add value to other assets of the entity" (IASB, 2008c:BC47, par. 31).

This interpretation applies to all types of services, for example employee, telephone, or legal services (IASB, 2008c:BC48). In the context of accounting, services are consumed either to form a recognisable asset, which results in the service being capitalised to an asset, or the services do not create a recognisable asset, in which case it is recognised as an expense (IASB, 2008c:BC49). Services that do not create a recognisable asset are still interpreted as assets that were received by the entity but were immediately consumed and thus an expense is recognised (IASB, 2008c:BC47). However in order for services to be distributed as a dividend for accounting purposes there has to be a previously recognised asset on the statement of financial position that has to be derecognised in order to recognise the dividend.

From *The basis for conclusions on IFRS 2 share-based payments* (IASB, 2008c) and the aforementioned discussions, the submission is that whether or not the distribution of services would constitute a distribution of a non-cash asset for IFRS purposes is inconclusive. This is because even though services are resources that are just immediately consumed and would meet the requirement of future economic benefits as per the asset definition by being distributed to owners, there is no prior recognised asset to derecognise for the distribution. No conclusive guidance was thus obtained when comparing the meaning of "dividend" in terms of the IFRS with the meaning of "dividend" in terms of the ITA, with specific reference to the granting of services or the right of use of assets.

3.4 CONCLUSION

The investigation into the meaning of distributions in terms of the Companies Act and the underlying objectives regarding distributions showed that the objective of the Companies Act is to regulate distributions in order to protect creditors by preventing shareholders from transferring value from the company to the shareholders, which could be prejudicial to the creditors. The objective of the ITA in the context of dividends is to tax any distribution by a company in respect of shares. Although the objectives are different, the basis of each of the acts is that the distributions consist of a benefit received by the shareholder in respect of shareholding. The guidance obtained from the Companies Act emphasises that any benefit that causes an outflow of wealth from the company to the shareholder will constitute a

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distribution, and that the substance of the transaction should be considered, rather than the legal form. Some variances and uncertainty are caused by the differences in the interpretations of the legislator of each act with regard to distributions, and alignment could provide more certainty of what would be considered a distribution for the purposes of each act. The Companies Act's definition of "distribution" has a broad interpretation that covers different forms of distributions, and by inference, when applying this guidance to "dividend" in terms of the ITA, the meaning of "distribution" as contained in paragraph (a) of the definition would also have such a broad interpretation.

The findings based on the IFRS show that non-cash assets distributed to owners of an entity have no specific restrictions of what would be considered a non-cash asset as long as it is made to a shareholder and declared by a board of directors. In terms of the IFRS, an asset does not require physical form or ownership status. Services, even though recognised as an expense in accounting records, are resources when received, which are either immediately consumed to form another asset or consumed and recognised as an expense. The distribution of such services would meet the requirement of future economic benefits flowing to the entity, as required by the definition of an asset, by being distributed to owners of the entity. However in order to account for a distribution for IFRS purposes there has to be a previously recognised asset that needs to be derecognised for the distribution. Based on these findings, it is inconclusive whether or not the granting of services or the right of use of assets would fall within the scope of IFRIC 17 *Distributions of Non-cash Assets to Owners*. No conclusive guidance was thus obtained from an IFRS perspective.

This chapter showed that the alignment of legislation has benefits, of which certainty is of importance in the context of dividends. Alignment ensures that an entity or a person would have certainty regarding the treatment of a transaction for purposes of different legislations. In the context of dividends, alignment would ensure that more clarity is provided on what constitutes a dividend due to each legislation attributing the same meaning to the concept "dividend".

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CHAPTER 4
GUIDANCE FROM INTERNATIONAL PRACTICES WITH REGARDS TO SHAREHOLDER BENEFITS

4.1 INTRODUCTION

The broad interpretation of the meaning of "dividend" and the guidance obtained from the Companies Act indicate that the granting of services or the right of use of assets could constitute a dividend *in specie* for purposes of the ITA. If the granting of services or the right of use of assets could constitute a dividend for ITA purposes, a value must be determined for dividends tax purposes, and it should be determined when the dividends tax will become payable. The value in terms of section 64E(3) of a dividend *in specie* is deemed to be the market value thereof. It is submitted that there is uncertainty relating to the value on which the dividends tax should be levied with regard to distributions by an entity of the granting of services or the right of use of assets. These types of distributions are utilised over a period of time, as well as at irregular intervals, which could affect the value of the distribution. Granting of services or the right of use of assets could be declared by a company, and as a result granted, in a specific year with the use of the asset or receiving of the service spanning multiple years, resulting in the specific consideration of timing in the value of the distributions.

The potential dividends tax treatment of the granting of services or the right of use of assets for dividends tax purposes are thus investigated. By investigating the international tax consequences of shareholder benefits, guidance is obtained from an international perspective on whether such distributions are considered dividends for purposes of each country's taxation of dividends.

4.2 INTERNATIONAL PRACTICES

The South African tax legislation has gone through many phases of tax reform; one of which started after the year 2000, which saw the adaptation of the tax system to conform to international tax law (Nyamongo & Schoeman, 2007:480). Specifically, with regard to the taxing of distributions to shareholders, the STC regime was replaced with the dividends tax regime in order to align it with international practices (Venter, 2013:19). Investigating the tax implications of distributions by entities to shareholders in the context of international practices could provide guidance whether the granting of services or the right of use of

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assets could constitute dividends for ITA purposes. International practices could also provide guidance on the dividends tax treatment of the granting of services or the right of use of assets for purposes of dividends tax in a South African context. The countries and their respective taxing legislation used for this investigation are Canada, the United Kingdom (UK), Australia, and the United States of America (USA). The first three countries and South Africa are part of the Commonwealth, with the Commonwealth countries' legislation having common influences as these countries were once territories of the British Empire (Commonwealth, 2018). Notwithstanding the fact that the USA does not form part of the Commonwealth countries, the inclusion of the USA as a country for investigation is considered as it provides practical guidance from a government that has paid attention to the granting of services and the right of use of company assets to shareholders (Kohla, 1974:1431).

4.2.1 Canada

Taxable dividend distributions made by companies to shareholders are included in the taxable income of the shareholder in terms of section 82(1) of the Canadian Income Tax Act. Section 82(1)(a)(i) reads as follows:

> "In computing the income of a taxpayer for a taxation year, there shall be included the total of the following amounts:
>
> (a) the amount, if any, by which
>
> (i) the total of all amounts, other than eligible dividends and amounts described in paragraph (c), (d) or (e), received by the taxpayer in the taxation year from corporations resident in Canada as, on account of, in lieu of payment of or in satisfaction of, taxable dividends."

The term "taxable dividend" is defined in the Canadian Income Tax Act R.S.C. of 1985 under section 89. A taxable dividend is defined in section 89 as a dividend other than certain exempt dividends that are listed in subsection (a) and (b) of the definition of a taxable dividend. This provides no insight into what would constitute a dividend other than the common law cash dividend. The Canadian Income Tax Act, however, contains a specific section, section 15, that deals with benefits conferred on shareholders. Section 15(1) states that if, at any time, a benefit is conferred by a corporation on a shareholder of the corporation or on a future shareholder of the corporation, then the amount or value of the benefit is to be included in computing the income of the shareholder, unless the benefit is deemed to be

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a dividend in terms of section 84. Section 84 deems the decrease of paid-up capital, distributions on winding-up, and the redemption of shares as dividends. Specific subsections exist for the forgiveness of debt (section 15(1.2)), provision of shareholder debt (section 15(2)), and automobile benefits (section 15(5)). The value of the automobile benefit conferred on the shareholder is determined based on the provisions for taxable amounts to be included from employment. In terms of section 15(1.3), the value of all property and services conferred specifically includes all taxes paid for such property or services or should have been paid had the individual not been exempt from any such taxes. Section 15(2), relating to shareholder debt, is not applicable to non-residents, ordinary lending practices, when the loan is repaid within one year, and when the debt is provided to an employee in respect of employment.

Based on the above, section 15 has a broad scope in terms of what would be considered a benefit conferred on a shareholder (Mitchell, 2012:4). Even though the Canadian Income Tax Act has a number of provisions to prevent shareholders from extracting wealth from a corporation without incurring a tax liability, subsection 15(1) provides a general provision to include benefits not covered by other provisions in the taxable income of a shareholder in the year the benefit is conferred. Thus, if shareholders extract wealth from a corporation other than through employment remuneration or investment income (common cash dividends and interest), all of which will be taxed under relevant provisions, then section 15, especially subsection 15(1), will include the value of the wealth extraction in the taxable income of the shareholder. Mitchell (2012:5) identifies three important definitions that are relevant to the concept of a shareholder benefit, which are “shareholder”, “benefit”, and “value”. A shareholder is defined as a person who is entitled to a dividend. The word “benefit” is not defined in the Canadian Income Tax Act, and a broad interpretation has been applied, which results in a broad range of transactions being regarded as benefits (Mitchell, 2012:5). Taxable benefits are interpreted to include, among others, the following (Mitchell, 2012:5):

- Personal use of corporate assets (e.g. real estate, aircraft, horses);
- Corporate payment of personal expenses;
- Gifts to shareholders’ relatives;
- Inadequate consideration for sale of corporate assets; and
- Travel reward points.

The “value” of the benefit is considered by the Canadian Revenue Authority to be the fair market value of that benefit (Mitchell, 2012:5). In *Youngman v The Queen*, 90 DTC 6322,

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(1990) 2 C.T.C. 10, it was held that in circumstances where the fair market value rent for the property is not appropriate or cannot be determined, the amount or value of the benefit will generally be determined by multiplying a normal rate of return with the greater of the cost or fair market value of the property. This will be the case when, for example, an asset is built specifically for the shareholder, as not merely the right to use the asset is conferred but also the right to use an asset built specifically for the shareholder. The Canadian courts have thus held that in circumstances where the fair market value rent is not appropriate, the value of the benefit would be the income the corporation would have earned had the capital been productively employed. Shareholder benefits that trigger section 15 will be taxed at the individual's marginal rate of tax due to the value of the benefit being included in the taxable income of the individual receiving the benefit. The amount is also not deductible by the corporation (Hennessey, 2016:1). Section 15(1) will not apply to *bona fide* business transactions or if the benefit arose due to employment and not due to shareholding.

In a South African context the definition of a dividend also refers to any amount for the benefit of any person that is transferred or applied. It is submitted that based on the taxing of shareholder benefits by the Canadian Income Tax Act it should also be included in a South African context due to the use of "benefit" in the dividend definition. Guidance from the Canadian Income Tax Act indicate that the granting of services and the right of use of assets would be included within the ambit of the dividend definition in the ITA. A broad interpretation is applied to the word "benefit" in the Canadian Income Tax Act and academics have interpreted "benefit" to include personal use of corporate assets. It is submitted that this same broad interpretation should be applied in a South African context. Section 15(1) of the Canadian Income Tax Act provides for all other cases where wealth is extracted from a corporation other than through remuneration or investment income. South Africa does not contain such a general provision and it is submitted that the dividend definition contained in the ITA has a broad interpretation in order to also include wealth extraction from a corporation other than through remuneration or investment income.

Guidance obtained from the Canadian courts on how to determine the fair market value of the benefit indicates that it would be the fair market value rent for that benefit. In cases where the fair market value rent is not appropriate or cannot be determined the value of the benefit is the income the corporation would have earned had the capital been productively employed. These principles could be applied in a South African context to value the granting of services or right of use of asset for dividends tax purposes.

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4.2.2 United Kingdom (UK)

Taxing provisions for dividends and company distributions are contained in sections 382 to 401 of the Income Tax (Trading and Other Income) Act of 2005. Within these sections, reference is made to dividends and other distributions. No definition of "distribution" is contained within the Income Tax (Trading and Other Income) Act of 2005, and the definition of "distribution" for purposes of this act is contained within the Corporation Tax Act of 2010 (Her Majesty's Revenue and Customs [HMRC], 2015:1). Section 1000(1) of the Corporation Tax Act of 2010 defines the meaning of "distribution" and includes any dividend or any other distribution out of the assets of the company. Also included are any securities issued by the company or any interest or other distribution out of the assets of the company, whether in cash or not. Section 1000(2) of the Corporation Tax Act of 2010 also includes in the definition of "distribution" any amount treated as a distribution in terms of section 1064.

Section 1064 regards certain expenses of close corporations as distributions and applies to expenses incurred by a close corporation on behalf of any participator in the close corporation. A participator is defined as "a person having a share or interest in the capital or income of the company". Section 1064(2) states that:

> "where a close company incurs expense in or in connection with the provision for any participator of living or other accommodation, of entertainment, of domestic or other services, or of other benefits or facilities of whatever nature, the company shall be treated as making a distribution to the participator of an amount equal to so much of that expense as is not made good to the company by the participator".

When comparing this to the dividend definition in the ITA of South Africa the words "applied" and "on behalf of" is also used which would include expenses paid by a company on behalf of a person in respect of a share. Guidance from the UK would indicate that in a South African context any expenses paid for on behalf of a person in respect of a share would be interpreted to be included in the ambit of a dividend. The granting of services and the right of use of assets would thus fall within the ambit of a dividend if the company pays for the granting of services or right of use of assets on behalf of a person in respect of a share. As the ITA provisions in South Africa also includes distributions on behalf of any person in respect of any share no further guidance is obtained from the UK practice.

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4.2.3 Australia

Australian taxation legislation is contained in different acts. The most relevant for purposes of this discussion are the Income Tax Assessment Act of 1936, the Taxation Administration Act of 1953, and the Income Tax Assessment Act of 1997. The main sections in the Australian Income Tax Assessment Act of 1936 that contain provisions for the taxing of dividends are section 44 for resident shareholders and section 128B for withholding tax on non-resident shareholders. In terms of section 44(1), dividends are paid to shareholders by the company from profits derived from any source. Section 44(1A) states that for purposes of the Income Tax Assessment Act of 1936, in terms of dividends paid out of an amount other than profits, the dividends are deemed paid out of profits. Section 44 also refers to dividends being in the form of money or other property. The definition of “property” can be found in section 343 of this act, which states that property includes money. This provides no guidance in terms of what would be considered property distributed for purposes of dividends tax. The definition of a dividend found in section 995.1 of the Income Tax Assessment Act of 1997 states that “dividend” has the meaning given by section 6(1) of the Income Tax Assessment Act of 1936. In terms of section 6(1)(a), a dividend includes any distribution made by a company to any of its shareholders, whether in money or other property. No particular guidance is obtained from these sections on what would constitute “other property”.

Further guidance is sought from the provisions that regulate distributions to non-resident shareholders. The Taxation Administration Act of 1953 regulates the withholding arrangements for dividends to non-residents, which are found in divisions 12 and 14 of this Act. Division 14: Non-cash benefits and accruing gains, for which amounts must be paid to the commissioner, has the objective of putting entities that provide non-cash benefits, and entities that receive them, in a position similar to their position under division 12. Division 14 thus treats the benefit as if a payment of money had been made instead of a non-cash benefit being provided. Included in division 12 is the withholding tax provisions for dividends paid to non-residents. Thus, if an entity provides non-cash benefits to non-residents, it will be treated in the same manner as if it had been a cash dividend. Division 14 prevents entities from avoiding their obligation to withhold tax on distributions by providing non-cash benefits as an alternative. Subdivision 14-10 states that if an entity receives a dividend in the form of a non-cash benefit, tax must be withheld and paid over to the commissioner. The meaning of “entity” is found in section 960-100 of the Income Tax Assessment Act of 1997, which includes individuals and corporates. The specific inclusion of division 14 in the Taxation

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Administration Act of 1953 indicates that the legislator's intention was that the meaning of "other property" as contained in the definition of "dividend" would include non-cash benefits. The Income Tax Assessment Act of 1997 defines non-cash benefits in terms of section 995.1 as "property or services in any form except money".

Further guidance on the meaning of non-cash benefits is obtained from the provisions that regulate non-cash business benefits, which are found in section 21A of the Income Tax Assessment Act of 1936. Section 21A states that for the purpose of the act, if a non-cash business benefit is not convertible to cash, it is deemed as if it were convertible to cash, and any restrictions or prevention of converting the benefit to cash will be disregarded when valuing the benefit. The benefit shall be brought into account at its arm's-length value reduced by any contribution paid by the recipient for the benefit. Arm's-length value is defined in section 21A(5) as:

> "the amount that the recipient could reasonably be expected to have been required to pay to obtain the benefit from the provider under a transaction where the parties to the transaction are dealing with each other at arm's length in relation to the transaction".

In terms of section 21A, non-cash business benefits are non-cash benefits provided in respect of a business relationship and includes property and services. Services are further defined in the Income Tax Assessment Act of 1936 as "any benefit, right (including the right in relation to, and an interest in, real or personal property), privilege or facility and, without limiting the generality of the foregoing, includes a right, benefit, privilege, service or facility that is, or is to be, provided" in respect of a business relationship. The meaning of a "non-cash benefit" in the provisions for dividends tax is ascribed to the term "other property" due to the reference to non-cash benefits in the administration of the withholding tax on dividends. Thus, for purposes of the Australian tax system, a "dividend" would include, among others, the granting of services or the right of use of assets. When considering the timing of when such a benefit is obtained and tax should be levied, Taxation Ruling 96/6 (1996) states that the facts of each case must be considered, but guidance is given that this would most likely be when there are no more steps required in order to become entitled to the benefit.

The definition of dividend in the ITA of South Africa refers to any "amount" being transferred or applied, with "amount" including not only cash but every forms of property. Applying the guidance from the Australian Income Tax Acts regulating distributions indicates that property

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includes non-cash benefits which in term includes services and rights. The granting of services and the right of use of assets could thus constitute dividends *in specie*. Guidance on valuing the benefit indicates that the arm's length value is the most appropriate value, similar to the market value, to be placed on dividends *in specie* in the section 64E(3) of the ITA of South Africa.

4.2.4 United States of America (USA)

Provisions regulating distributions by corporations are found in sections 301 to 318 of the Title 26 Internal Revenue Code (IRC) of the U.S. Code (Legal Information Institute, n.d.). "Dividend" is defined under section 316(a) as "any distribution of property made by a corporation to its shareholders". Property is defined under section 317(a) as "money, securities, and any other property except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock)". The value attributable to a dividend of property is the amount of money received if received in cash, otherwise the fair market value if other property is received (section 301(b)(1)).

The Code of Federal Regulations (CFR) is a codification of general and permanent rules and regulations published in the Federal Register by agencies of the federal government of the USA. Agencies like the Internal Revenue Service (IRS) promulgate regulations and rules specific to their subject area, which are divided into 50 broad subject areas that are updated on a regular basis. CFR Title 26 contains the regulations and rules published for internal revenue. Section 1.301-1(j) of CFR Title 26 states, in part, that if property is transferred by a corporation to a shareholder who is not a corporation, for an amount that is less than its fair market value in a sale or exchange, such a shareholder shall be treated as having received a distribution to which section 301 of the IRC Code applies. In such a case, the amount of the distribution shall be the difference between the amount paid by the shareholder for the property and its fair market value. The provision of services and the use of corporate-owned property have been held to be "property" for purposes of section 301 (*Ireland v United States* 621 F.2d 731, 735 (5th Cir. 1980)). Furthermore, it was also held by the American courts that the distribution of corporate earnings to or for the benefit of shareholders may constitute a dividend to the shareholder, notwithstanding that the formalities of a dividend declaration are not observed, not recorded in the accounting records of the entity, or even if some of the shareholders do not participate in the benefit distributed (*Paramount-Richards Theatres v Commissioner* 153 F.2d 602, 604 (5th Cir. 1946)).

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Distributions of other property like services and the private use of corporate assets, referred to as constructive dividends, have received much attention from the IRS, yet no official provisions or policies for determining the value of the deemed dividend exist (Kohla, 1974:1431). The American courts have developed principles that can be divided into two categories for determining the value of such a benefit distributed.

The two categories are:

- firstly, to value the benefit distributed equal to the cost of the asset; or
- secondly, the value equals the fair value of the asset or benefit conferred on the shareholder.

The first category of valuing the benefit equal to the cost of the asset is generally used by the courts when the ownership of the asset is transferred to the shareholder, or when the ownership cannot be ascertained and is subsequently presumed to be that of the shareholder. In the case of *Hessert v Commissioner* 20 T.C.M. 1119 (1961), the controlling shareholder caused the corporation to purchase a yacht that was used for business and private purposes. The purchase was recorded in the books of the corporation and the bill of sale was issued in the corporation's name. The controlling shareholder, however, requested that a Coast Guard certificate be issued in his name, with the result that he could then sell the yacht to a purchaser without any corporate action needed. In the said case, the shareholder also disposed of his own smaller personal yacht before causing the corporation to purchase a yacht, with the court establishing that he used the corporate yacht in the same manner and frequency as his prior personal yacht. These circumstances led to the courts suggesting that the shareholder represented himself as the owner and he also appeared as the owner due to the pattern of use. Thus the courts held that the acquisition cost of the yacht was a constructive dividend to the controlling shareholder. Circumstances of using a corporate asset that is similar in kind to a personal asset that is owned or previously owned do not in itself trigger a dividend to be equal the cost of the asset.

The second category is usually applied in situations where the asset is available for personal use. The fair value of the benefit conferred has been determined to be either the fair rental value of the asset or cost of the benefit to the corporation in terms of the amount of the deductions, including depreciation, denied the corporation due to the personal use by the shareholder (Kohla, 1974:1431). Deductions of such benefits conferred on shareholders are denied in terms of section 274 if the corporation cannot provide evidence that the asset was primarily used for business purposes. The fair rental value will be used if the value is readily

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ascertainable (*Dole v Commissioner of Internal Revenue* 43 T.C. 697 (1965)). The principle that the value of the constructive dividend may equal the operating expenses and depreciation disallowed as deductions for the corporation was held by the court in *Estate of Runnels v Commissioner* 54 T.C. 762 (1970). However, in *Ashby v Commissioner* 50 T.C. 409 (1968), the courts held that the full value disallowed as a deduction for the corporation would in certain circumstances not be appropriate. This would be the case when the full amount is not deductible as the asset was not used primarily for business purposes, yet was used for some business purposes. In these circumstances an apportionment of the deduction disallowed based on the percentage used for personal purposes would be an appropriate determination of the value of the constructive dividend. Lastly, it was also held by the courts that constructive dividends are usually attributable due to the actual personal use of the asset but a constructive dividend can also be attributed to a shareholder based on the availability of the corporate asset for personal use (*Offshore Operations Trust v Commissioner* 32 T.C.M. 985 (1973)). This is due to the corporation being unable to use that asset in its business and thus a type of “standby status” or “available for use” value is added to the constructive dividend.

Guidance from Title 26 IRC dividends sections indicate that property also constitute dividends and property in turn include services and the use of corporate-owned property. This interpretation could be of assistance in interpreting what could be included in the ambit of “amount” for ITA purposes as “amount” includes property. Based on this guidance the granting of services and right of use of assets could be interpreted as being included in the ambit of the definition of “dividend”. Further guidance is also obtained from American courts who have paid attention to determining the value of what they classified as constructive dividends (services and use of corporate-owned property). Based on the above court cases it would seem that in order to determine the value of a dividend received by a person each case needs to be assessed on an individual case bases on the facts of each case. This is because the way the value is determined might not be appropriate in determining the fair value in those circumstances. Guidance on valuing the dividend in an American context could provide assistance for valuing the granting of services and the right of use of assets in respect of shares in a South African context.

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4.3 CONCLUSION

Section 64E(3)(b) of the ITA deems the amount of the dividend *in specie* to be equal to the market value of the asset on the date the dividend is deemed to be paid. The question that arises is what the market value of dividends *in specie* would be in the case of distributions in the form of the granting of services or the right of use of assets if such distributions constitute dividends in terms of the ITA.

Many similarities exist between the taxation treatments of the countries investigated in this research assignment when considering benefits received by shareholders due to their shareholding. In the case of Canada, Australia, and the USA, the value to be placed on such benefits is the fair market value, which indicates the value that the shareholder would have paid to a third party in an arm's-length transaction for the benefit. In the case of the UK, the value to be placed on the benefit is the actual cost to the company. This might reflect the fair value as the company might have incurred the cost in an arm's-length transaction with a third party. Guidance from the USA suggests that if ownership is transferred to the shareholder, the value for that benefit will be the cost of the asset as the substance of the benefit is the full value of the asset. The entity in essence bought the asset for the shareholder and not merely the right of use or usufruct by the shareholder. Further guidance from the USA is that the fair value can be determined based on the deductions denied the entity. The entity would not be able to deduct these expenses incurred to confer the benefit on the shareholder as they are not primarily used in the business and the production of income. Consequently, any cost incurred to provide the benefit will be denied; these could include the cost of the asset or wear-and-tear allowances. However, the value to be placed on a benefit using this method would most likely be much higher than the fair rental value to use the asset, thus guidance from the American courts indicate that the value for dividends tax would only be the portion used for private purposes. If the asset is made available for private use and is used in the business, only the percentage portion of private use should be deemed a dividend. The Canadian courts have held that in circumstances where the fair market value rent is not appropriate, the value of the benefit would be the income the corporation would have earned had the capital been employed productively.

The Australian treatment deems dividends paid out of an amount other than profit to be deemed as paid out of profits. Dividends are the distribution of a shareholder's share in an entity's profits, thus the deeming of distributions of an amount other than profits to be from profits brings the benefit within the general meaning of a dividend. Benefits received by shareholders that are not paid out of profits may thus still be taxed as dividends, which

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prevents shareholders from avoiding this liability. This is consistent with the ITA, the Companies Act, and the IFRS as the distributions are no longer required to be paid out of profits. Australian provisions also provide that if a non-cash business benefit is not convertible to cash, it is deemed as if it were convertible to cash, and any restrictions or prevention of converting the benefit to cash will also be disregarded when valuing the benefit. This view was also held by the South African courts in *C:SARS v Brummeria Renaissance (Pty) Ltd & Others* 69 SATC 205.

Of notable importance is that the American courts held that distributions to or for the benefit of a shareholder may constitute a dividend whether or not formalities like dividend declaration by the board or actual accounting of the dividends are observed by the entity. This also provides a kind of anti-avoidance provision as distributions will not be excluded from dividends tax by way of not declaring the dividend, or any other formality. This is, however, in contrast to the Companies Act and IFRIC 17, which require the declaration of a distribution for it to constitute a distribution or dividend.

Guidance from other countries to determine the value of the benefit received by the shareholder is summarised in Table 4.1. In all circumstances, any consideration paid by the shareholder must be deducted from the value of the benefit.

Table 4.1: Summary of determination of benefit value per country

Country	**Determination of benefit value**
Canada	Fair market value or rate of return method if fair market value not appropriate.
UK	Cost of expenses incurred on behalf of the shareholder.
Australia	Non-cash benefits valued at arm's-length value.
USA	Two categories: • Cost: When the shareholder receives ownership or ownership cannot be determined. • Fair value: Fair rental value if readily available, or cost to the corporation in terms of the amount of deductions denied multiplied by the percentage of personal use.

Source: Compiled by author

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In addition to the value of benefits discussed, the granting of a service or the right of use of an asset as a dividend would also require consideration of the timing of when the dividends are deemed to have been paid. Section 64E(2)(b) deems a dividend *in specie* to be paid on the earlier of the date on which the dividend is paid or becomes due and payable. Dividends declared by a company are generally due on the date on which they are declared. This is due to the fact that declaring a dividend creates a debt owed by the company to the beneficial owner and such a debt arises from a formal act performed by a company (*Boyd v CIR* 17 SATC 366, 1951:377). "Payable" can have different meanings (*CIR v Janke* 4 SATC 269, 1930:276). In the context of benefits received by beneficial owners, other than cash, uncertainty could exist as to when these are considered due and payable or paid. The right of use of assets could be provided over an extended period and guidance is thus sought of when the benefit is deemed paid. *ITC 1688* (1999) 62 SATC 478 (N) provides some principles on the date of payment, one of which is the date on which the resolution is passed. In *C:SARS v Scribante Construction* (Pty) Ltd (2000) 62 SATC 443, as no formal resolution was passed, the date of the payment of the dividend was deemed when the accounting entry was made.

Guidance from international practice is provided by the Australian Taxation Ruling 96/6 (1996), which states that the facts of each case must be considered, but guidance is given that this would most likely be when there are no more steps required in order to become entitled to the benefit. Further guidance from the USA that could be applied is that if the asset is available for use, a type of "standby charge" might apply. Thus, in circumstances where the asset is not being used and is available for use in the ordinary business of the entity, no dividends tax would be levied. The opposite also applies where if the entity cannot use the asset for business purposes, a "standby charge" benefit still accrues to the shareholder and will be taxed as dividends. If this guidance is applied in a South African context dividends tax could be levied once the beneficial owner is entitled to the benefit even if the asset is not used by the beneficial owner, but cannot be used by the company. In *CIR v Janke* 4 SATC 269, 1930:276 it was held that payable sometimes used to mean "payable immediately" or "actually due and presently demandable". This agrees with the guidance obtained from international practices. The granting of a right of use of assets will be due and payable for dividends tax purposes when the beneficial owner is entitled and can demand the use of the asset.

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Based on international practice, the granting of services or the right of use of an asset would constitute a “dividend” for tax purposes. International practice also provides evidence of specific inclusion provisions to tax the private use of business assets or other benefits received by shareholders in their capacity as shareholders. These provisions could be argued as punitive provisions as the legislator intends to prevent shareholders from using their influence as shareholders to avoid the taxing of distribution by masking the true nature of the transaction, when in fact the substance is that of a dividend. The substance of the transaction is thus important to conclude whether a transaction constitutes a dividend for purposes of the ITA.

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CHAPTER 5
CONCLUSION

This study investigated whether the granting of services or the right of use of assets constitutes a dividend as defined in the ITA. This was done by investigating the intention of the legislator by investigating the tax amendments of the definition of "dividend" and the ordinary English meaning of the words contained in the definition.

The definition of "dividend" in section 1(1) of the ITA is interpreted broadly to prevent avoidance of dividends tax (Mazansky, 2012:172). Beneficial owners could structure distributions to avoid their liability for dividends tax. The inclusion of fringe benefits awarded instead of cash salaries in the Seventh Schedule could indicate the legislators intention to tax benefits received in lieu of cash dividends in the same manner as benefits received in lieu of remuneration. Based on these findings the benefits included in the ambit of "taxable benefits" in section 2 of the Seventh Schedule to the ITA could indicate what the legislator intended to fall within the ambit of dividends *in specie* for ITA purposes.

The amendments to the definition of "dividend" in the ITA resulted in the current definition, which does not require that dividends be paid out of any profits. This was due to the enactment of the new Companies Act during 2008, which removed the capital maintenance rules with respect to distributions and introduced the solvency and liquidity test. This means that companies are now able to distribute profits by various means, provided they meet the solvency and liquidity requirements in order to be compliant with the Companies Act. The history of the definition could indicate that the intention of the legislator was to include distributions of benefits such as the granting of services or the right of use of assets as dividends *in specie* due to the previous definition of a dividend referring to the distribution of an asset including a benefit or advantage measurable in terms of money. The word "amount" in the definition of "dividend" has been considered by South African courts and has been held to have a wide meaning that not only includes cash but also the value of every form of property as long as the property can be valued in money. The term "transferred or applied" broadens the scope of the definition of "dividend" even further as payments of debts, on behalf of a shareholder, owed by the shareholder to a third party, are also brought within the scope of the definition.

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Based on the meaning in terms of the ITA, guidance was also obtained from:

- the explanatory guides from SARS in respect of donations in kind;
- the Companies Act;
- the IFRS; and
- the international practices of selected countries.

5.1 GUIDANCE BASED ON DONATIONS IN KIND

For purposes of section 18A of the ITA, no deduction will be allowed for donations *in kind* consisting of fiduciary rights, usufruct or other similar rights, and for donations of services (SARS, 2016). Based on this guidance, "in kind" distribution could be construed as excluding the right of use of assets and services granted if applied in the context of dividends *in specie*. Dividends tax is the tax of any distribution by an entity to a beneficial owner by virtue of shareholding, while donations are a gratuitous distribution. It is submitted that the reason for not allowing donations of services and the right of use of assets is to regulate the deductions for the purposes of section 18A. In the context of dividends the deduction is not submitted as the focus, but rather, the inclusion for the beneficial owner. Conclusive guidance is as result not obtained from the aforementioned meaning of "in kind" when applying the interpretation in the context of donations to that of "in specie" as used in the dividends tax provisions.

5.2 GUIDANCE BASED ON COMPANIES ACT COMPARISON

A comparison between the Companies Act's definition of "distribution" and the ITA's definition of "dividend" indicated that similarities exist but that the Acts are not aligned in the context of distributions. Some uncertainty exists whether the same meaning of "distribution" as defined in the Companies Act can be attributed to the meaning contained in subsection (a) of the definition of "dividend" contained in the ITA. This is due to a possible circular reference being created when comparing the two definitions as the definition of "distribution", refers to a dividend, while the definition of "dividend" refers to a distribution. Uncertainty also exists whether the word "distribution", as contained in the definition of "dividend" in the ITA, would encompass all the subsections as defined under the definition of "distribution" in the Companies Act. A recommendation to clarify these uncertainties would be to align both acts. Guidance obtained from the Companies Act confirms that the substance of the transaction should be considered and not merely the legal form, which aligns with the substance over form doctrine in tax. Any wealth that causes an outflow from the entity for the benefit of the

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shareholder (positive impact on the shareholder's wealth) will be considered a distribution for purposes of the Companies Act. With inference to the Companies Act's interpretation, the same should be applied to the interpretation of a "dividend" for ITA purposes as the phrase "for the benefit or on behalf of" is used within the definition, which is similar to that used in the Companies Act's definition of "distribution".

5.3 GUIDANCE BASED ON THE IFRS COMPARISON

A comparison between the IFRS and the ITA revealed that no definition of "dividend" is contained within the IFRS. However, the IFRS include specific guidance on how to account for non-cash assets distributed to owners as contained in IFRIC 17. For a dividend to fall within the scope of IFRIC 17, one of the requirements would be that the definition of an "asset" has to be met. The definitions of "asset" in the ITA and in the IFRS contain similarities as neither the ITA nor the IFRS require physical form. The meanings of what constitutes a dividend in both the IFRS and the ITA are aligned based on the findings. Guidance obtained from the IFRS and IFRIC 17 indicates that no restrictions are placed on the interpretation of what would constitute a distribution of a non-cash asset as long as it is nothing is received in return. The guidance obtained from the Conceptual Framework shows that the granting of services or the right of use of assets could be considered assets as defined and could thus fall within the scope of IFRIC 17. However in order to account for a distribution for IFRS purposes there has to be a previously recognised asset that needs to be derecognised for the distribution. Based on these findings, it is inconclusive whether or not the granting of services or the right of use of assets would fall within the scope of IFRIC 17. No guidance was thus obtained when comparing the meaning of "dividend" in terms of the IFRS with the meaning of "dividend" in terms of the ITA, with specific reference to the granting of services or the right of use of assets.

5.4 GUIDANCE BASED ON INTERNATIONAL PRACTICES

The findings from investigating international practices indicated that the granting of services and the right of use of assets constitute dividends in Australia, the UK, and the USA, while in Canada they are taxed as shareholder benefits included in the shareholders taxable income. Canadian legislation includes provisions for tax benefits received by shareholders, which specifically include provisions for taxing the use of a motor vehicle for private purposes by a shareholder. The value of the motor vehicle benefit conferred on the shareholder is determined based on the provisions for taxable amounts to be included from

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employment. From a Canadian context, a link is made between dividends tax and employees' tax for determining the value of the motor vehicle benefit. This could indicate that from a South African perspective guidance can be obtained for the value to be attributed for tax purposes to the granting of services and the right of use of assets form the Seventh Schedule. Canadian academics have interpreted "shareholder benefits" broadly and have included the right of use of various corporate assets and gifts to shareholders or their relatives. The UK legislation deems certain expenses paid by an entity on behalf of a shareholder as a distribution for dividends tax purposes. Australian legislation deems non-cash benefits (a right, benefit, privilege, service, or facility) received by a shareholder to be treated the same as if it were received in cash. This is because it is submitted that the legislator's intention is that the meaning of "other property" as contained in the definition of "dividend" would include non-cash benefits. In the USA, distributions of other property like services and the private use of corporate assets, referred to as constructive dividends, have received much attention from the IRS, yet no official provisions or policies for determining the value of the deemed dividends exist (Kohla, 1974:1431). Dividends include the distribution of property and the American courts have held that property includes the provision of services and the use of corporate-owned property. Based on international practices, the granting of a service or the right of use of an asset to a shareholder will be taxed as dividends. International guidance was also obtained on how to value the right of the benefit received by the shareholder, taking into consideration the specific facts of each case.

5.5 OVERALL CONCLUSION

The study found that even if a benefit received by a beneficial owner by virtue of equity shares held does not have the legal or common form of a dividend, or the legal formalities have not been observed, the benefit could still constitute a dividend for ITA purposes. Even though the Companies Act of 2008 and the IFRS require the dividend to be declared, the courts in the USA have held that a benefit distributed to a shareholder would constitute a dividend even if the legal formalities were not observed. It is submitted that the same treatment should be applied in the South African context as beneficial owners could mask a dividend by not performing the legal formalities of declaration in order to avoid dividends tax, specifically in the case of the granting of services or the right of use of assets. In *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR* (1996 A) 58 SATC 229, the court acknowledged that a taxpayer has the right to arrange his or her affairs in such a manner as to obtain the most favourable tax position. However, if the taxpayer is involved in a disguised transaction, the

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courts will investigate the facts surrounding the transaction and will ignore the disguise to focus on the true intention of the taxpayer. In *C:SARS v NWK Ltd* [2011] 73 SATC 55, the courts further held that the commercial sense of the transaction must be examined in order to ascertain its real substance and purpose. When applied in the context of dividends, it would mean that if the true purpose of a benefit granted to a beneficial owner was to extract wealth in lieu of cash dividends from an entity, then the substance of the transaction is a dividend.

The broad interpretation of the meaning of "dividend" in the ITA does not prohibit the granting of services or the right of use of assets from constituting dividends. The intention of the legislator could thus be interpreted, based on the specific wording, history of the provision and context, that such benefits could constitute dividends. The comparison with the Companies Act and the IFRS also attaches a broad interpretation of what could constitute a dividend. Based on international practices, the granting of a service or the right of use of an asset by an entity to its shareholders would constitute a dividend. From the above, the granting of a service or the right of use of an asset to a beneficial owner by virtue of a share could constitute a dividend for purposes of the ITA.

In summary, the findings in respect of the research objectives of this study are as follows:

i) Does the granting of services or the right of use of assets constitute a dividend *in specie* for ITA purposes?

The study found that based on the wording used in the definition of "dividend" in the ITA, the intention of the legislator and guidance obtained from the Companies Act, and international practices, the granting of services and the right of use of an asset to a beneficial owner would constitute a dividend *in specie* for ITA purposes.

ii) Does the meaning of "dividend" in the Companies Act and the IFRS provide guidance on whether the granting of services or the right of use of assets constitute a dividend in specie for ITA purposes?

Guidance was obtained from the meaning of "dividend" in the Companies Act. When considering whether or not any benefit received by a shareholder in his or her capacity as a shareholder constitutes a dividend for tax purposes, the inquiry into the substance of the transaction is important and not its legal form. The granting of a service or the right of use of an asset to a shareholder in respect

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of the shareholder's shareholding could thus be considered a distribution for Companies Act purposes and by inference a dividend for ITA purposes.

Whether or not the distribution of services would constitute a distribution of a non-cash asset for IFRS purposes is inconclusive. In order to account for a distribution for IFRS purposes there has to be a previously recognised asset that needs to be derecognised for the distribution. No guidance was thus obtained when comparing the meaning of "dividend" in terms of the the IFRS with the meaning of "dividend" in terms of the ITA, with specific reference to the granting of services or the right of use of assets

The study found that the meaning of "dividend" in the ITA does not align with the meaning contained in the Companies Act due to a possible circular reference. It is submitted that the legislature erred in not aligning the two Acts. Alignment of these two legislations with regards to company distributions would ensure certainty in the specific treatment of a distribution by a company under both legislations.

iii) Does international practices in the context of taxing shareholder benefits provide tax guidance on whether the granting of services or the right of use of assets constitute a dividend in specie for tax purposes internationally?

Based on international practices, the granting of a service or the right of use of an asset to a shareholder will be taxed as dividends. Guidance on the market value of the granting of a service or the right of use of an asset constituting a dividend was also obtained from international practices.

5.6 AREAS FOR FURTHER RESEARCH

This study did not include an investigation of a dividend *in specie* distributed as contributed tax capital in which case such a dividend would not be classified as a dividend as defined in the ITA. Future research could consider the classification of a dividend *in specie* as contributed tax capital as another means of not subjecting a dividend *in specie* to dividends tax.

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