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MoneyTalk

Another twist to the new dividend tax

Value Extraction Tax is part of the new dividend tax regime

AS part of the dividend tax reform process, a new tax to be known as Value Extraction Tax (VET) will come into effect.

The VET forms part of the new withholding tax on dividends regime which is set to replace the current secondary tax on companies (STC), and will most likely come into effect in 2011. It is not a new concept, as it essentially replaces the deemed dividend anti-avoidance rules found in the STC legislation, of which the debit shareholders loan is the most common.

Transactions affected by VET

There are four types of transactions that are affected by VET:

1. Financial assistance, which is in essence any loan or advance granted by the company to a connected person at an interest rate below a deemed market-related interest charge;
2. The release or waiver of any loan obligation owing by a connected per son to the company;
3. The settlement of any debt by the company where the debt is owed by a connected party to a third party; and
4. If the company ceases to be a South African tax resident.

Each transaction type will now be discussed in greater detail.

Financial assistance

Where there is financial assistance, the VET is calculated using the market-related interest of the financial assistance, less any interest paid. Where the financial assistance has been granted, the market related interest rate is deemed to be the average Repo rate plus 100 basis points.

The method of determining the VET when compared to the STC regime is more favourable for financial assistance transactions.

The main difference with the VET is that it is only the market-related interest that is subject to the tax, whereas with the STC regime, the entire loan amount is subject to STC. The other main difference is that under the STC regime, the financial assistance is deemed to be a dividend if the loan is not repaid by the end of the next financial year, whereas with the VET regime it will be payable from inception.

Waiver of loans and settlement of debts

For waiver of loans and settlement of debts owed by a connected party to a third party, the VET will be levied on the respective principal amounts.

Ceasing to be a resident

Where the company ceases to be a South African tax resident, the VET is determined on the day before it ceased to be a tax resident and is based on the difference between:

- the market value of all assets; and
- the liabilities plus all classes of issued share capital, including share premium.

Exemptions

There are a number of exemptions to the VET, with the most significant ones being where the value extraction is effected in favour of a South African tax resident company, all spheres of government, public benefit organisations (PBOs), pension funds, and medical aid funds.

There are further exemptions where the value extraction is in respect of financial assistance:

- where the financial assistance is granted for the provision of goods or services in the ordinary course of trade of the business carried on by the company;
- the company carries on the business of a money lender and the financial assistance arises in the ordinary course of business of the company; or
- the financial assistance is granted to an employee share incentive trust.

Where there are value extracted transactions effected by a company in favour of another company, and that company has more than 20% shareholding of the other company and the other company does not own any shares in the lender, then the value extraction transactions are also exempt.

Latest developments

It is proposed in the latest draft amendments to tax legislation that the VET will not apply in certain circumstances to financial assistance (for example loans) where that financial assistance was treated as a deemed dividend under the STC regime.

Payment of tax

The VET is payable by the company at the rate of 10%, and must be paid to SARS by the end of the month following the month in which the value extraction took place. Where the tax is not paid, the unpaid balance will attract interest and may be subject to the imposition of penalties.

Extracted & summarised from a Moneyweb publication by Grant Thornton tax department.

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