GRAY ISSUE

Dividend Withholding Tax increases to 15%

24 February 2012
Issue no. 128

During his recent budget speech, Minister of Finance Pravin Gordhan, announced that Dividend Withholding Tax (DWT) will be levied at a rate of 15% when it is implemented on 1 April 2012 (and not 10% as we stated previously – see Quarterly Commentary 4, 2011). This is an unforeseen increase on Secondary Tax on Companies (STC), which it is set to replace, and took us and most other stakeholders by surprise.

Gordhan explained that the increase in the tax rate will make up for some of the R1.9 billion in losses expected as a result of those groups who are exempt from the tax (see point 3). It is hoped that the introduction of DWT will improve the transparency and equity of our tax system, and ultimately align South African practices with international norms.

With DWT set at 10%, the transition from STC to DWT may have gone unnoticed since it merely involved a shift in the tax liability on a dividend distribution from the company paying the dividend to the investor receiving it. With DWT now set at 15% it will impact South African individuals, trusts, and non-residents, the latter where there is no or limited protection under a Double Taxation Agreement (see point 3).

1. What is Dividend Withholding Tax?

DWT is a 15% tax levied on investors receiving dividends declared and paid by South African resident companies or foreign companies listed on the JSE. Although DWT is a tax borne by investors, it is the responsibility of the companies paying the dividends, or where relevant, certain 'withholding agents', to withhold the tax and pay it to the South African Revenue Service (SARS) on behalf of the ultimate recipients.

Allan Gray Unit Trust Management (RF) Proprietary Limited and our investment platform, Allan Gray Investment Services Limited, are examples of 'withholding agents'. We must therefore pay the tax to SARS on behalf of our investors.

2. What does this mean for you?

a. The new dividends tax is a final withholding tax set at 15% on dividends paid

This means that if a dividend of R100 is paid, the recipient will receive R85 and SARS R15. The dividend income (R100 in the above example) will still be exempt from normal tax in the beneficiary's hands because the dividends tax does not influence the normal tax rules. The 15% will be the final tax payable on the dividend.

b. Taxation of distributed profits moves from company level to investor level

The difference between DWT and STC is that DWT is a tax levied on investors who receive dividends, whereas STC is a tax payable by the company declaring the dividend. The legal liability for tax on a dividend distribution therefore shifts from the company paying the dividend to the investor (also known as the 'beneficial owner') receiving it.

3. Some investors are exempt from DWT

Certain investors are exempt from DWT, including:

- South African resident companies or close corporations
- The South African government, provincial governments and municipalities
- Specified tax-exempt beneficiaries (e.g. public benefit organisations)
- Retirement funds and living annuity policyholders
- Endowment investment accounts allocated to the Company Policyholder Fund or the Untaxed Policyholder Fund

If you are a non-resident, the rate at which we will deduct DWT will be determined by the Double Taxation Agreement (DTA) that exists between South Africa and your country of residence. However, most DTAs only allow for a reduced tax rate if your investment is held in the name of a registered legal entity (e.g. a company) and you own a minimum percentage of share capital (typically between 10% and 25%) in the South African company declaring the dividend. For unit trust investors, these requirements are unlikely to apply.

Next steps

If you are an individual and resident in South Africa for tax purposes your investment account will attract DWT at the default rate of 15%. If you are exempt from DWT, you should have received a declaration form from us to complete. To ensure that you are taxed at the correct rate, please complete the declaration when it arrives, and send it back to us before 29 February 2012. The information that you provide will cover all future dividend distributions for your investment. If you believe you should be exempt from DWT and have not yet received a declaration from us, or to establish whether you are exempt from dividend withholding tax, kindly contact our Client Service Centre on 0860 000 654 or email us at info@allangray.co.za.

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Allan Gray Proprietary Limited is an authorised financial services provider.