AN ANALYSIS OF THE REQUIREMENTS FOR THE IMPOSITION OF SECURITIES TRANSFER TAX WITH SPECIFIC FOCUS ON THE SECURITIES TRANSFER TAX CONSEQUENCES OF A REPURCHASE OF UNCERTIFICATED SHARES

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ABSTRACT

STT is imposed on every (i) occurrence of any 'transfer' event (ii) of a 'security' (iii) that results in a change in 'beneficial ownership' in that 'security', unless that 'transfer' event constitutes the issue of a security or the cancellation or redemption of a security of a company that is being wound up, liquidated, deregistered or finally terminated. However, the concept of 'beneficial ownership' is not defined in the STT Act and the intended scope and meaning of the concepts of a 'security' and a 'transfer' event are not necessarily clear from their definitions in the STT Act. This may result in practical difficulties.

This minor dissertation primarily seeks to investigate and clarify the practical scope and meaning of the requirements for the imposition of STT.

In this regard, the key finding arising from the research presented in this minor dissertation is that no STT will be imposed on a transaction involving an uncertificated share in the absence of registration of that share in the transferee's name in accordance with the requirements of the Companies Act, 2008, even if that transaction results in a 'change in beneficial ownership' in that share. This is due to the fact that the imposition of STT requires the transfer of a share, which will only occur upon compliance with certain procedural requirements contained in the Companies Act, 2008.

This minor dissertation also seeks to apply the requirements for the imposition of STT in the context of a share repurchase and determine whether the differing views regarding the mechanics of a share repurchase result in different STT outcomes.

There is currently no uniform tax treatment of a share repurchase and legal commentators and SARS have divergent views on the mechanics of a share repurchase. In particular, there is no certainty whether a repurchased share is cancelled in the shareholder's hands due to its repurchase, or whether it is re-acquired and cancelled by the repurchasing company. In the context of the STT Act, it is therefore unclear whether a repurchase consists of a single 'transfer' event or two 'transfer' events (that can potentially result in double STT).

In this regard, a further key finding is that, notwithstanding the inconsistency in views between legal commentators and SARS regarding the mechanics of a share repurchase, the requirements for the imposition of STT can be interpreted in such a way that both views result in a single STT charge on a share repurchase. However, as both interpretations result in practical anomalies, it is recommended that the mechanics and treatment of a share repurchase be clarified through definitive guidance or legislative amendments in order to provide certainty, and eliminate the perceived inconsistency, in the tax treatment of a share repurchase.

ABBREVIATIONS

CSD	-	Central Securities Depository
CGT	**-**	Capital Gains Tax
Companies Act, 1973	**-**	Companies Act No 61 of 1973
Companies Act, 2008	**-**	Companies Act No 71 of 2008
Income Tax Act	**-**	Income Tax Act No. 58 of 1962
JSE	-	Johannesburg Stock Exchange
SARS	**-**	South African Revenue Service
SARS CGT Guide	**-**	Comprehensive Guide to Capital Gains Tax
SARS Dividends Tax Guide	**-**	Comprehensive Guide to Dividends Tax
Strate	-	Share Transactions Totally Electronic
STT	**-**	Securities Transfer Tax
STT Act	**-**	Securities Transfer Tax Act No.25 of 2007
UK	**-**	United Kingdom
UST Act	**-**	Uncertificated Securities Tax Act No. 31 of 1998

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION

1.1 Background

Share transactions have become common-place in global commerce. According to a recent study conducted by the World Federation of Exchanges, the total number of trades conducted on international exchanges during 2016 amounted to approximately 20.2 billion, while the value of share trading worldwide during 2016 amounted to approximately USD 84.2 trillion.[1]

Therefore, taxing these transactions is an attractive source of revenue for revenue authorities globally. South Africa is no different and currently the transfer of securities is subject to securities transfer tax ('STT'), which was implemented from 1 July 2008 under the Securities Transfer Tax Act, No. 25 of 2007 ('STT Act').

However, taxation of these transactions is not a recent development in South Africa. With World War II drawing to a close, governments desperately needed money to settle debts and repair their economies. Amongst other measures, taxation was one of the preferred tools for achieving this objective.[2] However, the Legislature was aware that raising income tax rates would have had a negative socio-economic impact and, perhaps more importantly, unfavourable political consequences. Government therefore considered indirect ways of broadening the tax base to bolster revenue, resulting in a tax on the transfer of shares.

This was initially implemented in the form of Marketable Securities Tax imposed under the Marketable Securities Tax Act, No. 32 of 1948 ('MST Act'), which was payable by stockbrokers on behalf of clients in respect of purchases of marketable securities at a rate of 0,25% of the consideration. Some securities such as bonds were exempted, but marketable securities tax applied to share transactions.

Over the course of 1999 – 2001, the Johannesburg Stock Exchange ('JSE') implemented a decision to introduce a new 'paperless' system to deal with the settlement of share trades on the JSE (in other words, listed shares), namely Strate (Share Transactions Totally Electronic). This system provided for the dematerialisation of securities listed on the JSE in a Central Securities Depository ('CSD') and electronic settlement of trades *via* the Strate system. This resulted in a need for new tax legislation to accommodate paperless settlement of trades in shares listed on the JSE. In this regard, the Uncertificated Securities Tax Act, No. 31 of 1998 ('UST Act') replaced the Stamp Duties Act, No. 77 of 1968 ('Stamp Duties Act') as far as unlisted uncertificated securities were concerned and the MST Act as far as listed uncertificated securities were concerned[3] and provided for uncertificated securities tax on any issue or change in beneficial ownership of any listed securities at a rate of 0,25%. As the dematerialisation of a company's shares became a requirement for listing on the JSE,[4] a situation arose

[1] WFE Annual Statistics Guide 2016 available at https://www.world-exchanges.org/home/index.php/statistics/annual-statistics (last visited 18/01/2017).
[2] '*Second World War and its impact, 1939 – 1948'* available at http://www.sahistory.org.za/article/second-world-war-and-its-impact-1939-1948 (last visited 18/01/2018).
[3] *Explanatory Memorandum on the Uncertificated Securities Tax Bill*, 1998, 22.
[4] Vermaas, M.R. 2010. '*Reform of the law of uncertificated securities in South African company law'.* Acta Juridica, 101.

where transfers of listed securities were governed by the UST Act, while transfers of unlisted securities were governed by the Stamp Duties Act. As a result, the Legislature decided to consolidate the rules governing listed and unlisted securities so as to provide for the levying of a single tax in respect of any transfer of a security, whether it is listed or unlisted. Accordingly, the STT Act abolished UST[5] and replaced stamp duty insofar as it applied in respect of the transfer of securities,[6] with effect from 1 July 2008.

In terms of the STT Act,[7] STT is leviable on every 'transfer' of a 'security' issued by a company incorporated inside the Republic. The phrase 'transfer' is defined in section 1 of the STT Act so as to include various 'transfer' events that constitute the 'transfer' of a 'security', excluding the following:

- any of the listed 'transfer' events to the extent that it does not result in a change in beneficial ownership;
- the issue of a security; or
- a cancellation or redemption of a security if the company which issued the security is being wound up, liquidated or deregistered or its corporate existence is being finally terminated.

Accordingly, STT is imposed on the occurrence of any 'transfer' event of a 'security' that results in a change in 'beneficial ownership' of that security. From the above, the following three requirements, or 'triggers', for the imposition of STT can be identified:

- there must be a 'transfer' event in relation to a security;
- the 'transfer' event must result in a change in 'beneficial ownership' in that security; and
- the 'transfer' event must relate to a 'security' and result in a transfer of that 'security'.

1.2 Problem statement

As mentioned above, the STT Act provides for the payment of tax on any 'transfer' (as defined in the STT Act) of a 'security', such as a share in a company. In terms of this definition, a 'transfer' specifically excludes an event that does not result in a change in 'beneficial ownership' of the 'security'. However, the meaning, and application, of the concepts of a 'transfer', 'security' and 'beneficial ownership' for STT purposes aren't always clear and thus results in practical difficulties. By way of example: The Securities Transfer Tax Administration Act, No. 26 of 2007 ('STT Admin Act') requires STT to be paid and an electronic declaration to be submitted (i) in the case of the transfer of a listed share, by the 14th day of the month following the month when the STT became payable[8] or (ii) in the case of an unlisted share, within two months from the end of the month when the STT became payable[9] ('submission date').

[5] Section 11 of the STT Act.
[6] Section 25(1)(*a*) of the Revenue Laws Second Amendment Act No. 36 of 2007.
[7] Section 2 read with the definition of 'transfer' in section 1 of the STT Act.
[8] Section 3(1)(a) and (b) read with section 3(2) of the STT Admin Act.
[9] Section 3(1)(c) read with section 3(2) of the STT Admin Act.

The STT becomes payable upon the occurrence ('transfer date') of a 'transfer' of a 'security' that results in a change in 'beneficial ownership' of that 'security' and does not constitute any of the other exclusions from the definition of 'transfer' for STT purposes.[10] However, in the absence of an understanding of the meaning of the above phrases, the transfer date - and therefore also the submission date - cannot be accurately established.

This dissertation therefore primarily seeks to investigate and clarify the practical scope and meaning of the requirements for the imposition of STT as contained in the definition of a 'transfer' in the STT Act. This includes an investigation into:

- the scope and meaning of the various 'transfer' events listed in the definition of 'transfer',
- the scope and meaning of a 'change in beneficial ownership' as contemplated in the definition of 'transfer'; and
- the scope and meaning of the term 'security', as defined in the STT Act, and what would constitute the 'transfer' of that security, in the context of the definition of 'transfer' in the STT Act.

In addition, the dissertation seeks to apply the findings in respect of the above requirements to a share repurchase. Share repurchases occur on a regular basis and serve important commercial purposes. For that reason, it has been specifically recognised in the Companies Act, No. 71 of 2008.[11] Consequently, certainty as to the tax cost of a share repurchase is essential. In applying the requirements to a share repurchase, the dissertation will therefore compare the SARS approach as to mechanics of a share repurchase with the corporate law position as illustrated by the provisions of the Companies Act, 2008 and legal commentators. In this regard, the dissertation will consider whether the differing views result in different STT outcomes and whether the STT consequences of a share repurchase need to be clarified through legislative intervention.

1.3 Research Methodology

The research method followed is qualitative research of a doctrinal nature. The particular method will involve an analysis of domestic legislation, government publications, domestic case law and a study and review of literature and published articles relating to identified requirements for the imposition of STT.

Since South African courts are constitutionally obliged to prefer any reasonable interpretation of any legislation consistent with international law over any alternative interpretation, the interpretation of the term 'beneficial owner' also will include a consideration of the outcomes of prominent international cases dealing with the subject.

[10] Section 2(1) of the STT Act.
[11] Section 48 of the Companies Act, 2008.

Due to the fact that the concepts are of a technical interpretational nature, an empirical study will not be appropriate.

1.4 Limitations of scope

A 'security' is defined in section 1 of the STT Act as '*any share or depository receipt in a company or any member's interest in a close corporation*', but specifically excludes the debt portion in respect of a share linked to a debenture. The scope of the definition therefore includes a share in a company, but can also extend to a member's interest in a close corporation. As it has not been possible to register close corporations since 1 May 2011, close corporations have to a large extent become irrelevant and transactions involving close corporations have become increasingly infrequent. The scope of this minor dissertation will therefore not include a consideration of the scope and meaning of a transfer of a member's interest in a close corporation.

Furthermore, the consideration in Chapter 7 of the application of the conclusions in the chapters below to a share repurchase will specifically be confined to a consideration thereof in the context of a repurchase of 'uncertificated' shares.

1.5 Chapter overview and structure

This chapter introduced the research topic and highlighted the issues to be explored. It set out the objectives this dissertation aims to achieve within the boundaries of its scope and identified the requirements that must be met for the imposition of STT.

Chapter 2 investigates the scope and meaning of the first requirement for the imposition of STT, being a 'transfer' event relating to a security. The chapter therefore focusses on the definition of 'transfer' in section 1 of the STT Act and considers the variety of 'transfer' events that can potentially constitute a 'transfer' for STT purposes.

Chapter 3 and Chapter 4 deal with the second requirement for the imposition of STT, being a 'change in beneficial ownership'. Chapter 3 investigates the meaning of the concept 'beneficial ownership'. As the term is not defined for STT purposes and has not been firmly settled in a domestic context, Part A of Chapter 3 seeks to establish a basis for reliance on an international meaning of the term 'beneficial ownership' when interpreting the term in a South African context. On that basis it examines the relevant international case law in an effort to determine an appropriate international meaning of the term from a South African perspective. In Part B of Chapter 3, the chapter attempts to determine a domestic meaning of the term 'beneficial ownership', from the following sources:

- the common law and previous case law;
- the Companies Act, 2008;
- the JSE Equity Rules;

- current and repealed revenue legislation, including explanatory memoranda issued by National Treasury and Interpretation Notes issued by SARS.

Chapter 4 investigates the practical scope and meaning of a 'change in beneficial ownership' in a share, with particular focus on the extent to which (i) the granting of a 'beneficial interest' as contemplated in the Companies Act, 2008 will result in a 'change in beneficial ownership' and (ii) a change in 'beneficial ownership' requires compliance with any prescribed procedural requirements.

Chapter 5 investigates the scope and meaning of the third requirement for the imposition of STT. Firstly, it seeks to establish a clearer practical scope and meaning of the term 'security' as defined in section 1 of the STT Act, with due regard to the scope limitation set out in 1.4 above. In addition, it seeks to determine whether there are any specific requirements that must be complied with for a 'transfer of a share' to occur for STT purposes.

Chapter 6 attempts to formulate a practical delineation of the requirements for the imposition of STT from the conclusions drawn in the prior chapters.

Chapter 7 seeks to apply the requirements for the imposition of STT from the conclusions drawn in the prior chapters to a share repurchase, with specific reference to the mechanics of a share repurchase. In particular, Chapter 7 will examine the mechanics of a share repurchase under the Companies Act No. 61 of 1973 and Companies Act, 2008 from a corporate law perspective, compare it with SARS' apparently divergent approach to a share repurchase, comment on the difficulties in applying the requirements in the context of each of the divergent approaches and conclude on whether they result in different STT consequences. To achieve that purpose, the chapter will also investigate the mechanics of a share redemption and consider whether there is a basis for share redemptions and share repurchases to be treated similarly for tax purposes.

Chapter 8 sets out the conclusions drawn from the analysis in the preceding chapters.

CHAPTER 2: 'TRANSFER' EVENTS FOR STT PURPOSES

The first requirement for the imposition of STT is the '*transfer'* of a security that results in a change in 'beneficial ownership' of that security. Accordingly, this chapter considers the meaning of 'transfer' for STT purposes.

The term 'transfer' is defined in the STT Act so as to include any of the following 'transfer' events:[12]

- the 'transfer' of a security;
- the 'sale' of a security;
- the 'assignment' of a security;
- the 'cession' of a security;
- the 'cancellation' of a security;
- the 'redemption' of a security;
- the 'disposal in any other manner' of a security.

The various 'transfer' events listed above can all *potentially* result in a 'transfer' for STT purposes, provided they relate to a 'security' (as defined in the STT Act) and result in both a 'change in beneficial ownership' of that 'security and a transfer of that 'security'. The meaning of 'beneficial ownership' and 'change in beneficial ownership' is discussed in Chapter 3 and Chapter 4 respectively, while the scope and meaning of 'security' (and the transfer thereof) is discussed in Chapter 5.

As the ordinary scope and meaning of the particular 'transfer' events listed above doesn't form the bone of contention from an STT perspective, a detailed investigation into their commercial meanings fall outside the scope of this dissertation. Suffice to say that, to the extent that they may be contentious, the wide-ranging definition of 'transfer' in any event includes '*the disposal* [of a security] *in any other manner*' than the other listed 'transfer' events. While the phrase 'disposal in any other manner' is not defined in the STT Act, *Olivier* states that a 'disposal' is so widely defined for capital gains tax ('CGT') purposes that *'it bears no relation to what is commercially or even legally regarded as a disposal'*.[13] Based on the wide interpretation of the term 'disposal', any '*action or process of getting rid of*' a security in any manner should constitute a 'transfer' event for STT purposes.[14] The reference to 'disposal in any other manner' therefore effectively serves as a 'catch all' clause to ensure that any type of transaction, irrespective of its legal nature or classification, in terms whereof a person parts with, or 'gets rid of' a security, will constitute a 'transfer' event that could result in the imposition of STT.

[12] See the definition of 'transfer' in section 1 of the STT Act.
[13] Olivier, L. 2007. '*Determining a taxable capital gain or an assessed capital loss: some problems'*. Meditari Accountancy Research, 15 (1), 43.
[14] English Oxford Living Dictionaries available at https://en.oxforddictionaries.com/definition/disposal (last visited 18/01/2018).

CHAPTER 3: MEANING OF 'BENEFICIAL OWNERSHIP' FOR STT PURPOSES

The second requirement for the imposition of STT is that the 'transfer' event (as discussed under Chapter 2) must result in a 'change in "*beneficial ownership"*' in the security that is transferred. In order to determine the meaning of the phrase 'change in beneficial ownership', it is first necessary to determine the meaning of the term 'beneficial ownership'. Accordingly, this chapter investigates the meaning of the term 'beneficial ownership' for STT purposes, so as to assist in the determination of the meaning of the phrase 'change in beneficial ownership' in Chapter 4.

The phrase 'beneficial ownership' is however not defined in the STT Act. Therefore, its meaning in a domestic context must be determined in accordance with the established rules of interpretation and with reference to case law and other legislation in a tax law context. In particular, the principles of company law will also have to be considered to ascertain whether a change in 'beneficial ownership' takes place.[15]

The meaning of the term 'beneficial ownership' is particularly relevant from an international tax perspective, especially in the context of articles of the Double Tax Treaties ('DTA's') dealing with dividends, interest and royalties. This is the case, as these articles typically require a particular party to be the 'beneficial owner' of the dividend, interest or royalty under consideration in order to be entitled to the benefit of the applicable article (generally in the form of a reduced or zero rate of withholding tax).[16]

Accordingly, this chapter falls to be discussed in two parts:

- Part A examines the international tax meaning of the term 'beneficial ownership', in terms of international case law and the applicability thereof to South Africa in a domestic context.

- Part B attempts to glean a domestic meaning of the term 'beneficial ownership' from previous case law, company law, current and repealed legislation, explanatory memoranda issued by National Treasury and Interpretation Notes issued by SARS. It also proposes an interpretation of the term for purposes of the STT Act that appears to be consistent with previous jurisprudence, the Legislature and SARS' view on the subject, as well as the international case law considered in Part A.

[15] Schoon, AD. 2011. '*The tax effect of shares-for-future services'.* LLM Dissertation, University of Pretoria, 61.
[16] Helmer, G. 2012. '*Beneficial ownership – a looming disaster?'* available at https://www.pwc.com/sg/en/tax/tax-issue20120730.html (last visited 01/06/2017).

PART A: Meaning of the term 'beneficial ownership' in terms of international case law and applicability to South Africa

Section 233 of the Constitution[17] requires South African courts to prefer any reasonable interpretation of any legislation consistent with international law over any alternative interpretation that is inconsistent with international law. As DTA's are part of international law, any 'international meaning' of 'beneficial ownership' for purposes of double tax agreements in general (if one is ascertainable), will have to be considered and applied by South African courts. Whether the directive of section 233 of the Constitution regarding the application of an 'international meaning' of 'beneficial ownership' extends to a situation where a court is tasked with interpreting domestic legislation such as the STT Act, is less clear.[18] While the issue has not authoritatively been addressed, indications are that 'a more uniform international meaning' of 'beneficial ownership' may be preferred by our courts, for the sake of uniformity.[19]

On that basis, international case law has at least persuasive value in South African courts, even though South African courts are not bound thereby.[20] This has been the case in practice, as foreign judgments are often referred to and even quoted in South African courts.[21]

Although South Africa's characterisation of the concept of 'beneficial ownership' is not narrative, it appears to have similar elements to those of developed and developing nations. The similarities are indicative of an intended alignment with international tax norms and it is therefore submitted that, although international decisions only hold persuasive value in South Africa, it may be beneficial for South Africa to draw on the meaning of the concept from the domestic law of other countries as they can provide a useful framework for determining whether or not a recipient of an amount is the 'beneficial owner' thereof.[22] It has also been suggested that, as the approach of the Canadian courts (and other courts, as will be shown below) with regards to the concept of 'beneficial ownership' are considered rationally sound, South African courts could adopt a similar view, notwithstanding the fact that those cases dealt with the meaning of 'beneficial ownership' in the context of DTA's.[23]

A summary of the main findings and principles distilled from the relevant international case law is set out in Part A of Chapter 3 below. Note that a more detailed breakdown of the background facts, arguments presented and findings made in those cases is contained in Annexure A. The comments and conclusions set out in Part A of Chapter 3 below should therefore be read in conjunction with the relevant case summaries in Annexure A.

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[17] Constitution of the Republic of South Africa, 1996.
[18] De Koker, A.P. and Williams, R.C. Silke on International Tax (electronic version). LexisNexis, 9.13.
[19] Ibid.
[20] Kruger, D. 2012. *'Who is a Beneficial Owner?'*. Business Tax & Company Law Quarterly 3(1), 14. See also Engelbrecht, W.A. 2013. *'A Critical Analysis of the Meaning of Beneficial Owner of Dividend Income Received by a Discretionary Trust'.* M. Acc Dissertation, Stellenbosch University, 9.
[21] Koorowlay, T. 2013. '*The Commonalities or Divergence of the Meaning of Beneficial Owner in a Treaty (International) and Domestic Context'.* M. Com Dissertation, University of Cape Town, 66.
[22] *Koorowlay*, 64.
[23] Louw, H. 2012. '*Dividend tax and trusts – who needs to pay?'* available at https://www.moneyweb.co.za/archive/dividendtaxandtrusts/ (last visited 31/05/2017). See also *Engelbrecht*, 4.

3.1 Canadian case law

3.1.1 Prévost Car Inc. v Her Majesty The Queen[24]

In *Prévost*, the Court remarked as follows in determining the meaning of the term 'beneficial owner' for purposes of the Canada/Netherlands DTA:

- The 'beneficial owner' of a dividend is the person who:[25]
    - '*receives the dividends for his or her own use and enjoyment'*;
    - '*assumes the risk and control of the dividend*';
    - '*enjoys and assumes all the attributes of ownership'*;
    - '*is not accountable to anyone for how he or she deals with the dividend income*';
    - '*could do with the dividend what he or she desires'*.
- The shareholders of a corporation are not automatically the 'beneficial owners' of the assets or income earned by that corporation;[26]
- The shareholders of a corporation receiving a dividend will only be the 'beneficial owners' of that dividend to the extent that '*the corporation is a conduit … and has absolutely no discretion as to the use or application*' of the funds or has '*agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it*' with regard to the dividend.[27]

3.1.2 Velcro Canada Inc v The Queen[28]

In *Velcro*, the Court applied the so-called 'beneficial owners test' as enunciated in *Prévost* in determining the 'beneficial owner' of royalties for purposes of the Canada/Netherlands DTA. In terms thereof, the Court took into account the following factors:

- Who had possession of the payment;
- Who had the right to use and enjoyment of the payment;
- Who assumed economic risk in respect of the payment;
- Who had control of the payment.

[24] 2008 TCC 231.
[25] *Prévost*, paragraph 100.
[26] Ibid.
[27] Ibid.
[28] 2012 TCC 57.

The Court further found that to the extent that there was '*no predetermined or automatic flow through*' of the royalties to anyone other than the receiver of the royalty payment, it was barred from piercing the corporate veil and finding that anyone else was the 'beneficial owner' of the royalties, since it is only when there is *'"absolutely no discretion" that the Court take the draconian step of piercing the corporate veil'*.[29]

3.1.3 Conclusion on Canadian cases

In summary, it now appears to be settled law in Canada that the meaning of 'beneficial owner' of passive income receipts for DTA purposes, means the person who receives the passive income for his or her own enjoyment and who assumes the risk and control of the passive income derived by him or her, as this would indicate that the recipient is not accountable to anyone else for how the passive income is to be dealt with.[30]

As stated by *Arnold*, viewed together, the *Velcro* and *Prévost* cases appear to establish what has been termed a 'very low threshold' for 'beneficial ownership' for the purposes of Canadian tax treaties.[31] This is the case as these judgments practically only require a shareholder to have autonomy over *a portion* of an income stream in order for it to qualify as the 'beneficial owner' thereof. Nevertheless, the decisions make it clear that a holding company will be regarded as the 'beneficial owner' of its property or income, unless that holding company has absolutely no discretion to deal with that property or income on its own.[32]

3.2 Russian case law

Following the recent BEPS (base erosion and profit shifting) developments relating to 'beneficial ownership', Russia embarked on the implementation of so-called 'de-offshorization' laws (domestically known as the 'actual right to income rule') since 1 January 2015.[33] These laws essentially meant that a foreign company that receives income from Russia (for example, in the form of dividends, interest and royalties) may be refused the right to claim the lower rates of withholding tax provided for under DTA's, unless they are the 'beneficial owners' thereof (hereinafter referred to as the 'beneficial ownership concept'). While the legislative amendments introducing the 'actual right to income rule' only became effective in 2015, Russian courts have however been applying the beneficial owner concept even prior to this implementation date. Accordingly, these laws are merely a codification into its official legislative clarifications of pre-existing rules relating to the beneficial owner concept, as previously formulated by the Russian Ministry of Finance and applied by the Russian courts.[34]

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[29] *Velcro*, paragraph 52.
[30] *Kruger*, 14.
[31] Lang, M., Pistone, P. *et al*. 2013. '*Beneficial Ownership: Recent Trends'*. IBFD, 49
[32] Rossi, M. 2013. '*An Italian Perspective on the Concept of Beneficial*'. Tax Notes International, 72(12), 1151.
[33] See clauses 2 to 4 of Article 7 and clauses 1 to 1.4 of Article 312 of the Tax Code of the Russian Federation.
[34] Voronkova, A and Valitova, R. 2015. '*Russia: Introducing the beneficial owner concept as part of Russia's de-offshorisation initiatives*' available at http://www.internationaltaxreview.com/Article/3482221/Russia-Introducing-the-beneficial-owner-concept-as-part-of-Russias-de-offshorisation-initiatives.html (last visited 21/01/2018). See also Towers, S. 2017. 'Russia: Beneficial ownership case on capital gains' available at https://www.linkedin.com/pulse/russia-beneficial-ownership-case-capital-gains-steve-towers (last visited on 21/01/2017).

Russian cases decided on the basis of the beneficial owner concept (whether prior or subsequent to the promulgation of the 'actual right to income rule') turn on the same legal question as the Canadian cases (that is to say, who the 'beneficial owner' of the income is) and can therefore provide a valuable perspective on the subject.

3.2.1 ZAO Votek Mobile and OAO Sankt-Petersburg Telecom

In both the *ZAO Votek Mobile*[35] and *OAO Sankt-Petersburg Telecom*[36] cases, the Court ruled that the company receiving dividends from Russia was the 'beneficial owner' of the dividends, as the entire dividend amount was not on-distributed by that company to its shareholder. Additionally, it was found in the *OAO Sankt-Petersburg Telecom* case that the recipient of the dividend appeared to conduct its own business activities in its jurisdiction and was not interposed as a mere conduit.

3.2.2 Severstal PAO and OOO TD Petelino

In the cases of *Severstal PAO*[37] and *OOO TD Petelino*,[38] the Court ruled that companies which received the income (in the former instance, in the form of dividends and in the latter case, in the form of royalties) from Russia were 'conduit' companies and did not have an actual right to the income, since:

- payments were made soon after receiving funds from the Russian companies;
- the shares in the Russian subsidiaries were the companies' only asset and in *Severstal PAO's* case dividends on those shares made up 99% of its income;
- the companies themselves did not have the right to alienate their interests in the Russian subsidiaries, as their owners had the right to make that decision.

In *OOO TD Petelino's case*, the Court went so far as to disregard the intermediary company, notwithstanding the fact that it was entitled to royalty income under a valid sub-licensing agreement and ostensibly conducted genuine business operations in its jurisdiction.

3.2.3 Conclusion on Russian cases

It is evident that, similar to the Canadian courts, the Russian courts have focussed on whether the receiver of income (i) assumes any risk in respect of the income or underlying interest, (ii) has any discretion to determine the economic fate of the income so received or (iii) acts as a mere conduit for the income so received. However, in determining whether a company is simply a conduit, indications are that Russian courts are increasingly taking into account business substance factors such as the relevant company's level of presence, business purpose and functions in another jurisdiction.

[35] Ruling of the Nineteenth Arbitration Appeal Court of 5 June 2015 on Case No. A14-13723/ 2013.
[36] Decision of the Moscow Arbitration Court of 16 June 2015 on Case No. A40-187121/14.
[37] Decision of the Arbitration Court of the City of Moscow of 31 October 2016 on Case No. A40-113217/16-107-982.
[38] Decision of the Moscow Arbitration Court of 8 May 2015 on Case No. A40-12815/15.

3.3 UK case law

3.3.1 Indofood International Finance Limited v JP Morgan Chase Bank NA London Branch

Although not a tax case and involving the Indonesia/Mauritius DTA rather than a UK DTA, the UK Court of Appeal case of *Indofood International Finance Limited v JP Morgan Chase Bank NA London Branch*[39] specifically considered the international meaning of the term 'beneficial ownership'.

In its *dictum*, the Court held that '*the concept of beneficial ownership is incompatible with that of the formal owner who does not have the full privilege to directly benefit from the income'*.[40] The Court proceeded to find that a party receiving an interest payment would not be the 'beneficial owner' thereof under the following circumstances:[41]

- if it receives exactly the same amount of interest that it is liable to pay its investors;
- if it does not retain any margin of the interest and does not exercise any control over the interest it receives;
- it receives payment immediately before it is liable to pay its investors; and
- if an agreement obliges it to meet its obligations in respect of its investors solely from the interest it receives and prohibits it from settling its obligations from any other source of funds.

3.3.2 Conclusion and criticism against UK case law

If one has regard to only the facts of the case (which is dealt with in more detail in Annexure A) and the Court's eventual finding that the Dutch SPV's position would have equated to that of an '*administrator of income*' who derives no '*direct benefit*' from the income,[42] the question appeared to be simply whether or not the Dutch SPV would have constituted a mere conduit. Commentators agree that, on the facts of the case, the Court correctly found that the Dutch SPV would not have met the 'very low threshold' for 'beneficial ownership' that *Arnold* refers to in the context of the Canadian cases.[43]

However, the Court's references to a 'beneficial owner' having to have '*the full privilege to directly benefit from the income'*,[44] clearly creates a substantially higher threshold for 'beneficial ownership' than simply having to determine whether a party is a mere conduit. As a result, these references have been subjected to criticism from authors and scholars alike. *Baker* summarises the concerns as follows:[45]

[39] [2006] EWCA Civ 158.
[40] *Indofood*, paragraph 42.
[41] Stegmann, JB. 2016. '*Determining the impact of the 2014 OECD update to beneficial ownership in equity derivatives and financial instrument transactions*'. M. Com Dissertation, University of Pretoria, 18.
[42] *Indofood*, paragraph 44.
[43] *Silke on International Tax*, 46.39.
[44] *Indofood*, paragraph 42.
[45] Baker, P. '*Beneficial Ownership: After Indofood'*. GITC Review, (6)1, 24.

> *'The biggest difficulty with the case is not that it confirms that the proposed Dutch company would not have been the beneficial owner. The real difficulty is how far the judgment extends: what other arrangements would be held to fall foul of the BO limitation?'*

Koorowlay states that the reference to those comments is unfortunate and questionable, as it implies that a recipient will only qualify as a 'beneficial owner' if such recipient holds *all* the rights of ownership associated with such income.[46] Similarly, *Du Toit* and *Hattingh* state that the comments make the judgment a good example of a so-called '*geleentheidsbeslissing*' in that the decision may have been right on the facts, but gives rise to difficulties as far as the extrapolation of a more general yet workable principle is concerned.[47]

3.4 Concluding remarks on international case law in general

As is evident from the aforementioned case law, no universally accepted or globally recognised meaning has been established for the term 'beneficial ownership' yet.

As a point of departure, it appears that the 'beneficial owner' of an income stream or a share is to be found somewhere between the two extremities mentioned by *Baker* in his review of the *Indofood* case.[48] At one end of the spectrum is the person who is simply a nominee shareholder of a company. As established above, a mere nominee shareholder will not qualify as the 'beneficial owner' of income, as it will not be entitled to any economic benefit attaching to the income. At the other end of that spectrum, are persons who are eventually entitled to an economic benefit from that income, after ignoring one or more direct stakeholders ('ultimate shareholders'). In the ordinary course, the benefits derived by the ultimate shareholders are arguably too far removed from a share for the ultimate shareholders to constitute the 'beneficial owners' of that income. If this was not the case, it would result in an untenable situation and would beg the question:[49]

> *'If a company were to be denied the benefit of a treaty (due to it not being the beneficial owner) because the income received might ultimately be paid on to a third party, then when would any company ever be entitled to the benefit of the three central provisions of most tax treaties?'*

What can be condensed from the cases discussed above is that a party will not constitute the 'beneficial owner' of income to the extent that (i) it is an intermediary with absolutely no discretion with regards to the income it receives or (ii) the funds are pre-destined to automatically flow to a different person. On the other hand, it appears that a company receiving funds that has a properly constituted management that makes independent decisions regarding the distribution of its funds to its shareholders and

[46] *Koorowlay*, 38.
[47] *Silke on International Tax*, 9.13.
[48] *Baker*, 16.
[49] Ibid.

conducts its own income-generating business activities will constitute the 'beneficial owner' of the income so received.

According to *Meyer*, the focus is that the recipient of income operates *'in such a way as if it is independent and has operational and economical substance'*.[50] Accordingly, he is of the view that, '*in proving that a company is not merely an intermediary, one might need to prove that the company has a fixed place of business located in that country, is suitably staffed with managerial and operational employees and has suitable equipment and facilities available for conducting the primary operations of that business'*.[51] Likewise, *Van Bladel* reasons that '*beneficial ownership requires 100% legal ownership and a certain degree of economic risk'* in the income.[52] While recipients who adhere to the guidance of *Meyer* and *Van Bladel* will most likely comfortably satisfy the requirements for 'beneficial ownership', these guidelines lend themselves to the stricter approach to 'beneficial ownership' followed in the *Indofood* and recent Russian cases, rather than the lower threshold established by the Canadian cases.

In this regard, it must be noted that *Indofood* was heard by a civil court, argued by counsel who had no tax expertise and decided by judges who were not tax experts, without any representation from a revenue authority. On the other hand, the Canadian cases have been described as 'sound' decisions by local commentators[53] and were decided by a tax court.[54] Furthermore, the Russian legal system is based on the civil law model, while both the Canadian and South African legal system is based on the common law model and follows the *stare decisis* doctrine.[55] Decisions in common law countries generally carry more weight because of the style of judicial writing and English language materials are more easily accessible.[56] It is therefore submitted that the Canadian cases will arguably have a greater influence on a South African court saddled with the responsibility of determining the domestic meaning of the term 'beneficial ownership' than either *Indofood* or the more recent Russian cases.[57]

[50] Meyer, S.P. 2010. '*The meaning of 'beneficial ownership' and the use thereof for tax treaty shopping and tax avoidance'.* M. Com Dissertation, University of Pretoria, 55.
[51] Ibid.
[52] Van Bladel, M.L.L. 2013. '*Commentary on OECD Model tax convention: Revised proposals concerning the meaning of Beneficial Owner in articles 10, 11 and 12, 19*' available at https://www.oecd.org/ctp/treaties/BENOWNMLL_vanBladel.pdf (last visited 21/01/2018).
[53] *Kruger*, 1.
[54] Li, J. 2012. '*Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity'*. Comparative Research in Law & Political Economy Research Paper No. 4/2012, 204 - 205. With reference to Prévost, he states that "*Justice Rip is a highly respected tax expert in Canada. His decision was meticulously written, containing a detailed statement of facts, references to relevant Canadian, Dutch and OECD materials, a summary of the evidence given by four Dutch tax experts, and a careful analysis of the meaning of beneficial ownership under Canadian law. The decision was unanimously affirmed by a highly respected panel of appellate judges known for their tax expertise*."
[55] Kate T., Gauri S., Rupal Bansal *et al*. 2018. *Civil Law v Common Law'* available at https://www.diffen.com/difference/Civil_Law_vs_Common_Law (last visited 21/01/2018). Note in this regard that South Africa's law system can be classified as 'bijuridical' in that it follows a combination of both legal systems. Nevertheless, the Canadian and South African legal systems have a shared common law origin (see Jansen van Vuuren, J,P. 2013. '*A legal comparison between South African, Canadian and Australian workmen's compensation law*'. LLM dissertation, University of South Africa, 1 and 61).
[56] *Li*, 204.
[57] *Li*, 205.

PART B: Meaning of the term 'beneficial ownership' in terms of South African domestic law

3.5 Common law

In the context of South African common law, the term 'beneficial ownership' is an inconvenient label that fits uncomfortably into the South African legal mould. This is mainly due to the fact that the term has its origins in English law of equity, which was never incorporated into South African domestic law.[58] It is on this basis that it was noted in *Braun v Blann and Botha NNO*[59] that *'[T]he English conception of an equitable ownership distinct from, but coexisting with, the legal ownership is foreign to our law'* and that *Borrowdale* stated that *'ownership of shares in South African law is completely distinct from, although frequently co-extensive with, the registered title to shares'*.[60]

The inconvenience of the label is well-illustrated by *Du Toit*, *Hattingh* and *Borrowdale*. *Du Toit* and *Hattingh* state that, generally speaking, 'things' are simply 'owned'; and a person can therefore not claim 'beneficial *ownership'* simultaneously and separately with another person's ownership of the same thing. Furthermore, they state that personal rights are typically not 'owned', but rather 'held'. Based on the fact that a share denotes a bundle of personal rights, it follows that such rights are 'held', rather than 'owned'.[61] *Borrowdale* describes the inconvenience created by the disjuncture of the 'ownership' of the rights which constitute the share (that is to say, 'beneficial ownership') and the ability to exercise or enforce those rights (that is to say, registered title of the share) as follows:[62]

> *'[A]n unsatisfactory position is created involving two sets of obligations neither of which can be identified with ownership: (1) the rights which the nominee possesses as against the company arising by virtue of his registration and which he alone can enforce; and (2) the rights of the owner against the nominee created by the agreement of agency between them. Since the shares consist of the rights in (1) and ownership is founded on the rights in (2), there exists in effect a separation of ownership from the subject-matter.'*

Therefore, in a domestic context, the reference to 'beneficial ownership' is actually a misnomer in that a person can be beneficially entitled to one or more of the benefits or rights comprising a share by virtue of 'holding' those rights or benefits, without having to be the *owner* thereof. In this regard it has been suggested that it may be more appropriate to refer to someone being the person that has 'the beneficial entitlement' to a dividend, interest or royalty payment, rather than being the 'beneficial owner' thereof.[63]

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[58] *Silke on International Tax*, 9.9.
[59] 1984 (2) SA 850 (A) at 859.
[60] Borrowdale, A. 1985. *'Transfer of proprietary rights in shares'*. Comparative and International Law Journal of Southern Africa 18(1), 37.
[61] *Silke on International Tax*, 9.9. The authors specifically state that the *'law concerns itself with the shareholder, and not the 'shareowner'.*
[62] *Borrowdale*, 40 and 44.
[63] *Silke on International Tax*, 9.9. The authors point out that similar labels are used internationally to denote 'beneficial ownership'. For example, Australian DTA's and United Kingdom legislation refer to the term 'beneficially entitled'. The same trend can be noticed from the following examples where foreign language terms denoting 'beneficial ownership' are directly translated into English: (i) German and SwissGerman - 'person entitled to have and use', (ii) Dutch and Flemish -'person ultimately entitled', (iii)

Nevertheless, a distinction is often drawn between the 'beneficial ownership' and registered ownership of a share by South African courts, especially in a corporate law context. In essence, this distinction recognises the fact that one party can be the registered owner of a share, while a different party can be entitled to the rights attaching to that share. Generally, the latter party is referred to as the 'beneficial owner' of the shares.[64] This distinction between registered ownership and 'beneficial ownership' of a share was first recognised by the Appellate Division in *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*,[65] where it was held that:[66]

> *'A nominee is an agent with limited authority: he holds shares in name only. He does this on behalf of his nominator or principal, from whom he takes his instructions; …. The principal, whose name does not appear on the register, is usually described as the 'beneficial owner'. This is not, juristically speaking, wholly accurate; but it is a convenient and well-understood label.'*

The principles enunciated in *Oakland Nominees* above were again confirmed in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others*,[67] where this distinction between registered ownership and 'beneficial ownership' of a share was described as follows:[68]

> *'Normally the person in whom the share vests is the registered shareholder in the books of the company and has issued to him a share certificate specifying the share, or shares, held by him. . . [I]n some instances, however, the registered shareholder may hold the shares as the nominee, i.e. agent, of another, generally described as the "owner" or "beneficial owner" of the shares. This fact does not appear on the company's register, as it is the policy of the law that a company should concern itself only with the registered owner of the shares [. . .] The term "beneficial owner" is, juristically speaking, not wholly accurate, but it is a convenient and well used label to denote the person in whom, as between himself and the registered shareholder, the benefit of the bundle of rights constituting the share vests.'*

Corbett JA, who delivered the judgment, went on to state reasons why a person will be considered to be a 'beneficial owner':[69]

> *'…There is no doubt, to my mind, that prior to the sale to Ocean the Harris brothers were, as alleged by them, the beneficial owners of the external securities registered in the name of Standard Bank Nominees and held by Standard Bank SEB. It was they who had provided the capital necessary for the acquisition of the shares; dividends declared on the shares were remitted to them; shareholders' rights, such*

French, SwissFrench, BelgiumFrench, CanadianFrench and Italian - 'real beneficiary', (iv) Swedish - 'has the right to' and (v) Japanese - 'beneficiary under a trust'.

[64] *ITC 1192* (1965) 35 SATC 213 (T), 217.
[65] 1976 (1) SA 441 (A).
[66] *Oakland Nominees*, 453.
[67] [1983] 1 All SA 145 (A).
[68] *Ocean Commodities (A)*, 152.
[69] Ibid.

> *as, for example, the right to vote at company meetings, were, it seems, exercised by the nominee company on instructions from the Harris brothers; and it was they who determined when and in what manner switches of external securities were to be made.*'

A similar reasoning was adopted in *May and Others v Reserve Bank of Zimbabwe*,[70] where the Court made the following *obiter* statement with regard to the ownership of the securities:[71]

> *'… I am of the opinion that the applicants were the owners of the securities, even though they were not registered in their names but as required by the law in this case in the names of nominees. The nominees did not pay for the securities; they could not dispose of the securities; they had to follow the instructions of the applicants in exercising any votes attaching to the shares; any dividends received had to be paid to the applicants and the applicants could change the nominees at any time.'*

This distinction was also recognised by the Supreme Court of Appeal in the context of a trust in *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd*.[72] In that case it had to be determined whether the respondent had the necessary *locus standi* to institute eviction proceedings in respect of leased premises which was registered in the Deeds Office in the respondent's name, in its capacity as 'the trustees for the time being of the Allan Gray Property Trust Collective Investment Scheme' ('scheme trust'). In finding that the respondent, as duly registered owner of the property and 'trustee' of the scheme trust, did in fact have the requisite legal standing to apply for an eviction order relating the leased premises, the Court ruled that the respondent held the 'bare ownership' (or 'legal ownership') of the scheme trust's assets, while the beneficiaries of the scheme trust (that is to say, the investors in the scheme) were the 'beneficial owners' thereof. In particular, the Court held (with reference to the trustee of a trust) that:[73]

> *'His title is usually described as 'bare ownership' ('nudum dominium') – sometimes also called 'legal ownership' – while 'beneficial ownership' ('utile dominium') is said to vest in the beneficiaries of the trust ... In short, the provisions of the Act and the Deed are, in my view, quite clear: upon registration in its name, qua trustee, the respondent became the 'legal owner' of the property and holds it in trust for the investors as 'beneficial owners'.*

Recently, the distinction between a 'nominee' and 'beneficial owner' of a share was re-affirmed in *Sino West Shipping Co. Limited v Nyk-Hinode Line Limited*[74],[75] again with reference to the *Oakland Nominees* case. In that case, application was made to the KwaZulu-Natal High Court to set aside the arrest of the vessel *MV Sino* West as security for damages arising from the sinking of the *MV Asian*

[70] [1985] 4 All SA 129 (ZH).
[71] *May*, 192 – 193.
[72] [2006] SCA 160 (RSA).
[73] *Yarram Trading*, paragraph 10.
[74] [2013] ZAKZDHC 7.
[75] *Sino West*, paragraph 55 and 60.

Forest. In terms of the Admiralty Jurisdiction Regulation Act[76] ('Admiralty Act'), to obtain security for contemplated or pending proceedings, a party must demonstrate that it has a claim against a ship which is an associated ship of the ship concerned.[77] The respondent averred that, at the time when its claim arose against the applicant, it was controlled by the same person who also controlled Sino West Shipping Company Limited ('CWS Co') at the time of the arrest of the *Sino West* vessel. Accordingly, the respondent alleged that the *Sino West* vessel was an associated ship of the *Asian Forest* vessel for purposes of the Admiralty Act.

The Court proceeded to find that, for purposes of the Admiralty Act, the same person 'controlled' the applicant and CWS Co - in the former case due to him effectively being the 'beneficial owner' of the applicant's shares and in the latter due to him being the nominee shareholder of the shares. More significantly, the Court noted in passing that the term 'beneficial ownership' is a label denoting the person in whom the benefit of the bundle of rights constituting a share vests.[78]

It is therefore evident that, at least for corporate law purposes, it has become an established practice to distinguish between the registered holder of a share on the one hand, and the 'beneficial owner' thereof on the other; and that the registered owner of a share is not necessarily the 'beneficial owner' of that share, and *vice versa*. However, it should be borne in mind that South African courts have thus far recognised this distinction mainly for purposes of developing procedural remedies in instances where public policy appears to have required the courts to do so.[79] On this basis, *Hattingh* notes that the cases mentioned above simply use the term 'beneficial ownership' as a label or 'practical descriptive concept', rather than recognising it as a legal notion with specific well-defined legal consequences.[80] This aligns with *Borrowdale's* view that:[81]

> *'… despite the inaccuracy of the term [beneficial ownership] and its association with the concept of equitable title in English law, it is nevertheless widely used in South African decisions to refer to the unregistered title to shares.'*

It is submitted that the same rings true in respect of the *obiter* remark regarding 'beneficial ownership' in *Sino West*. While the Court arguably intended to confirm the apparent meaning that was previously established in *Oakland Nominees* and *Ocean Commodities*, the judgment arguably does not significantly contribute to the further delineation of the definition or content of the term, other than possibly suggesting that one should also take into account whether a particular party can exercise

[76] Act No. 105 of 1983.
[77] Section 5(3) of the Admiralty Act.
[78] *Sino West*, paragraph 68.
[79] *Silke on International Tax*, 9.10. For example, in *Oakland Nominees* the Court found that that the 'beneficial owner' of stolen shares was procedurally entitled to directly enforce 'ownership' of its shares, and needed not engage his nominee to do so, in circumstances were a third person threatened the position by claiming title to those shares. Likewise, the Court ruled in *Ocean Commodities* that, procedurally, a beneficial owner's claim for delivery of shares is based on a cause of action that is analogous to that of *rei vindicatio*.
[80] Ibid.
[81] *Borrowdale*, 37 - 38.

'control' over a company when determining whether he is the 'beneficial owner' of that company's shares.

3.6 Companies Act, 2008

The distinction between a legal owner and 'beneficial owner' of a share is seemingly also recognised and regulated by the Companies Act, 2008. While the term 'beneficial ownership' is not defined therein, the Companies Act, 2008 requires the disclosure of any 'beneficial interest' held in respect of a share.[82] A 'beneficial interest' is defined as follows:

> ***'"beneficial interest"'**, when used in relation to a company's securities, means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to –*
>
> *(a) receive or participate in any distribution in respect of the company's securities;*
>
> *(b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company's securities; or*
>
> *(c) dispose or direct the disposition of the company's securities, or any part of a distribution in respect of the securities,*
>
> *but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act 45 of 2002).'*

Notably, the term 'beneficial interest' does not necessarily require *ownership* of rights in respect of shares, but simply the 'right' or 'entitlement' to one or more of the specific benefits prescribed in (a) – (c) above. *Prima facie*, the definition of 'beneficial interest' therefore appears to extend beyond a literal interpretation of the term 'beneficial ownership', in that a 'beneficial interest' does not necessarily require 'ownership' *per se* of any of the rights attaching to the share. Furthermore, it is ostensibly possible to have more than one beneficial interest holder in a share, while typically only a single 'beneficial owner' is recognised in respect of a share.[83] In this regard it is stated in *Henochsberg* that the *'beneficial holder of securities and holder of a beneficial interest are not the same*',[84] since the 'beneficial owner' of a share would be the holder of *all* the rights that could individually qualify as a beneficial interest in that share.[85] Likewise, *Rachlitz* states that the term 'beneficial interest' must be distinguished from the legal

[82] Section 56 of the Companies Act, 2008.
[83] Du Toit, C. 1999. *'Beneficial Ownership of Royalties in Bilateral Tax Treaties'*. IBFD Publications, 244.
[84] *Henochsberg on the Companies Act 71 of 2008*, 33.
[85] Delport, P. A. and Vorster, Q. 2017. Henochsberg on the Companies Act 71 of 2008 (electronic version). LexisNexis, 221.

concept of 'beneficial ownership' since '*there can be many persons who hold a beneficial interest in one and the same share'*.[86]

While the scope of the term 'beneficial interest' therefore extends beyond the scope of the term 'beneficial ownership', the concepts are not mutually exclusive and, as set out in Chapter 6, may overlap to the extent that a person acquires a beneficial interest in respect of all the rights that comprise a share.

3.7 JSE Equity Rules

Part of the regulatory framework that governs the JSE, is the JSE Equity Rules.[87] According to the JSE Equity Rules, a 'beneficial owner' of a security is a person whose securities are held in the name of a registered owner acting as a nominee for that person and in whom the benefits of the bundle of rights attaching to that share vest. The definition further states that these rights are '*typically evidenced by one or more of … (a) the right or entitlement to receive any dividend or interest payable in respect of those equity securities; (b) the right to exercise or cause to be exercised in the ordinary course of events, any or all of the voting, conversion, redemption or other rights attached to those equity securities; (c) the right to dispose or direct the disposition of those equity securities, or any part of a distribution in respect of those equity securities, and to have the benefit of the proceeds*.'[88]

3.8 SARS' interpretation of previous and current revenue legislation

Even though the STT Act as primary legislation alone must be interpreted in order to determine the meaning of 'beneficial ownership' for STT purposes, a court will give due consideration to the meaning of the phrase in other legislation that is administered by the Commissioner, any relevant explanatory memoranda[89] that accompanied amendments to such legislation and any relevant Interpretation Notes.[90] In addition, the legislative amendment history of the relevant tax legislation may provide additional insight and clarification on SARS' interpretation of the phrase 'beneficial ownership'.[91]

3.8.1 Income Tax Act

The legal distinction between registered ownership and 'beneficial ownership' of a share has recently also been acknowledged by SARS in the context of the Income Tax Act, resulting in the removal of the definition of 'shareholder' from the Income Tax Act. In the *Explanatory Memorandum on Taxation Laws*

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[86] Rachlitz, R. 2013. '*Disclosure of Ownership in South African Company Law*'. Stellenbosch Law Review 24(3), 412.
[87] JSE Equity Rules dated 28 April 2017, available at https://www.jse.co.za/content/JSERulesPoliciesandRegulationItems/EquitiesRules.pdf.
[88] *JSE Equity Rules*, 11.
[89] *CSARS v Bosch* [2014] ZASCA 171, paragraph 18. It is also now accepted law that one can rely on what is said in documents such as Explanatory Memoranda, issued when legislation is enacted, to ascertain the meaning of the relevant legislation. Thus in *Minister of Health v New Clicks SA (Pty) Ltd* 2006 (2) SA 311 (CC), Chaskalson CJ held as follows at paragraph 200 and 201: *'In S v Makwanyane and Another I had occasion to consider whether background material is admissible for the purpose of interpreting the Constitution. I concluded that: "where the background material is clear, is not in dispute, and is relevant to showing why particular provisions were or were not included in the Constitution, it can be taken into account by a Court in interpreting the Constitution". ... I have no reason to depart from that finding and … it is applicable to ascertaining the 'mischief' that a statute is aimed at where that would be relevant to its interpretation.'*
[90] See *CSARS v Marshall NO and Others* (2016) ZASCA 158, where the Court held at paragraph 33 that *'…Interpretation Notes, though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provision in question.'* See also *ITC 1893* 79 SATC 159 and *RTCC v CSARS* (VAT 1345) [2016] ZATC 5 (28 July 2016), where the Tax Court referred to SARS' Interpretation Note 59 and Interpretation Note 82 respectively.
[91] *Stegmann*, 21.

Amendment Bill, 2011 (‘the *2011 Explanatory Memorandum’*) that accompanied the removal of the definition of ‘shareholder’ from the Income Tax Act, it is indicated that the definition was removed because it created confusion by focussing on both the share register and ‘beneficial ownership’. In particular, it is acknowledged that the person named in the share register is not necessarily the ‘beneficial owner’ of the share and that ‘*the focus should always be on the beneficial owner of the share, not the registered owner*.’[92] In addition, SARS specifically states in Interpretation Note 67[93] dealing with the definition of ‘connected parties’ as defined in section 1(1) of the Income Tax Act, that a person who is a registered shareholder and acts in a nominee capacity would not be the ‘beneficial owner’.[94] Likewise, in Interpretation Note 43[95] dealing with section 9C of the Income Tax Act, SARS once again states that ‘*[G]iven that the Act is generally concerned only with beneficial ownership, the word “owner” must be taken as referring to the beneficial owner*’.[96]

However, none of these documents provide a definition for ‘beneficial owner’.

3.8.2 Dividends Tax

Prior to the introduction of dividends tax, the term ‘beneficial owner’ was not defined in the Income Tax Act. Thus, under the previous dividend taxing regime (that is to say, secondary tax on companies), a dividend was regarded as any amount distributed by a company to its ‘shareholder’. However, as set out above, the legal distinction between registered ownership and ‘beneficial ownership’ of a share resulted in the removal of the definition of ‘shareholder’ from the Income Tax Act.

The dividends tax regime subjects cash dividends paid by a South African company to dividends tax at the rate of 20%[97] and places the liability for the tax on the ‘beneficial owner’ of the dividend (unless an exemption applies).[98] As a result, the introduction of the dividends tax regime was accompanied by the insertion of a definition of the term ‘beneficial owner’ for dividends tax purposes. In terms thereof, the term means ‘*the person entitled to the benefit of the dividend attaching to the share*’.[99]

The Explanatory Memorandum that accompanied the introduction of section 64D provided no further explanation of the ‘beneficial owner’ definition in section 64D. In the *SARS Dividends Tax Guide*,[100] which was subsequently issued, also does not provide much more detail in respect of the statutory definition, other than referring to *dicta* in *Oakland Nominees* and *Prévost*. Nevertheless, it confirms that the term ‘beneficial owner’ should not be interpreted too widely or out of context and that not every person that benefits from the holding of a share will necessarily be the ‘beneficial owner’ of a dividend.[101]

[92] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011*, 35.
[93] Issue 3, dated 8 December 2017.
[94] SARS Interpretation Note 67, paragraph 3.5.4.
[95] Issue 5, dated 17 February 2014.
[96] SARS Interpretation Note 43, paragraph 4.3.3.
[97] Section 64E of the Income Tax Act.
[98] Ibid.
[99] Section 64D of the Income Tax Act.
[100] Issue 2, dated 12 October 2017.
[101] *SARS Dividends Tax Guide,* 39.

3.8.3 The UST Act

Previously, the UST Act provided for UST on every change in 'beneficial ownership' in uncertificated shares.[102] For purposes of the UST Act, 'beneficial ownership' in relation to a share was defined so as to include:

- the right or entitlement to receive dividends in respect of the share; and
- the right to exercise or cause to exercise any or all of the voting, conversion, redemption or other rights attaching to the share.

In addition, the term 'change in beneficial ownership' was defined so as to specifically include the cancellation or redemption of a share, but excluded the issue of a share.[103] In this regard the *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005* clarified that '*a change in beneficial ownership takes place whenever securities are cancelled or redeemed, and whenever there is any acquisition of any of the rights or entitlements attaching to a security*'.[104]

Since the UST Act was repealed and replaced by the STT Act, its provisions are now obsolete. The extent to which its definitions would carry any authority in the interpretation of the term 'beneficial ownership', or what would constitute a change therein, for STT purposes, is therefore questionable. As the Legislature specifically chose not to retain the definition and intended meaning of the definitions when repealing the UST Act,[105] it has to be anticipated that the aforementioned definitions may no longer correctly reflect the Legislature's intention or the law. Nevertheless, they could well serve as an appropriate point of departure when determining the meaning of these previously-defined concepts.[106]

3.9 Remarks on formulation of a domestic meaning of 'beneficial ownership'

Even though the distinction between legal ownership and 'beneficial ownership' of a share is recognised in both South African case law and legislation, there is currently no uniform statutory definition of a 'beneficial owner' of shares in South African domestic legislation.

In the absence of a statutory definition for STT purposes, regard must first and foremost be had to the ordinary grammatical meaning of the words.[107] The definition specifically includes the word 'ownership'. As a result of the definition used in the UST Act that referred to the 'right' or 'entitlement' to benefits of a shares not being retained in the STT Act, one is compelled to interpret the term as requiring 'ownership' of the share or the rights attaching thereto. In terms of the Companies Act, 2008, a person can only acquire 'ownership' of a share, or the rights attaching to that share, in accordance with the

[102] Section 2 of the UST Act.
[103] See the definition of 'change in beneficial ownership' in section 1 of the UST Act, which was introduced through section 127 of the Revenue Laws Amendment Act No. 31 of 2005.
[104] *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005*, 78.
[105] Note in this regard that the definition of 'change in beneficial ownership' originally formed part of an initial version of the Securities Transfer Tax Bill, but was not retained in subsequent versions of the Bill, or the STT Act.
[106] In this regard, the definition of 'beneficial ownership' in the UST Act appears to have been incorporated into the definition of 'beneficial interest' in the Companies Act, 2008.
[107] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA), paragraph 18.

relevant CSD's rules.[108] Practically, compliance with the CSD rules will therefore result in a person simultaneously acquiring ownership of both the share and the rights associated therewith. On that basis, the registered owner of the share will in effect always also be the 'beneficial owner' of a share, negating the long-acknowledged distinction between the two concepts.[109]

The domestic meaning of the term 'beneficial ownership' for STT purposes should therefore not be limited to the strict literal meaning set out above, but should rather be interpreted so as to include any person who has a right or entitlement to the benefits attaching to that share, unless that person is an intermediary or 'conduit' with absolutely no discretion with regards to the benefits of the share. This is based on the following reasoning:

- Even though regard must be had to the ordinary grammatical meaning of the phrase, regard must also be had to the purpose of the phrase, as well as the background and preparation of the STT Act.[110] In this regard, the *Explanatory Memorandum on the Securities Transfer Tax Bill, 2007* specifically stated that the *'concept of transfer relates to economic ownership, as opposed to the mere registration of a security as in the case of a share registered in the name of a nominee. For that reason transfer excludes any event that does not result in a change in beneficial ownership.'*[111] It is therefore evident that, in line with the purpose of the STT Act, the meaning of the phrase should not focus on the transfer of registered ownership, but rather economic ownership. Notwithstanding the reference to 'ownership', the concept of 'economic ownership' more closely resembles the notion of 'beneficial ownership' that has historically been recognised by South African courts. In terms thereof, the reference to 'ownership' is a misnomer and simply a convenient label to describe the person who is ultimately entitled to the benefits attaching to a share, as opposed to the registered owner thereof.[112]

- In addition, there is an apparent effort to align South Africa's domestic legislation as far as 'beneficial ownership' is concerned,[113] with the focus thereof being on the person who has a 'right' or 'entitlement' to the benefits attaching to a share. For example, in the context of the right to dividends, the Income Tax Act recognises the person who has an entitlement to the benefit of the dividend as the 'beneficial owner' thereof for dividends tax purposes. This largely correlates with the meaning of the term 'beneficial ownership' as enunciated in *Sino West*, save for the fact that *Sino West* focussed on the benefit of *all* the rights comprising a share and not only the right to dividends. Likewise, both the definition of 'beneficial ownership' in the repealed UST Act and the definition of 'beneficial interest' in the Companies Act, 2008 refer to 'rights' or 'entitlement' in relation to income or an asset.

[108] Section 37(9) and 53 of the Companies Act, 2008.
[109] See further in this regard 4.1 and 5.3 below.
[110] *Natal Joint Municipal Pension Fund,* 18. See also *Smyth v Investec Bank Limited* 2017 JDR 1709 (SCA), 12.
[111] *Explanatory Memorandum on the Securities Transfer Tax Bill*, 2007, 6.
[112] *Ocean Commodities (A)*, 152.
[113] *Koorowlay*, 60.

- There are also various indications in Explanatory Memoranda and Interpretation Notes that SARS will not view the registered owner of a share as the 'beneficial owner' of such shares, unless he benefits from the holding of that share.

- An approach to the interpretation of the term 'beneficial ownership' that focusses on an 'entitlement to benefits' rather than 'ownership' will adhere to the constitutional directive that South African courts should prefer a reasonable interpretation of legislation that is consistent with international law.

3.10 Conclusion on meaning of 'beneficial ownership' for STT purposes

In the absence of a statutory definition of 'beneficial ownership' for STT purposes, the following factors should be taken into account when interpreting the phrase in a domestic context:

- regard should be had for the ordinary grammatical meaning of the term 'beneficial ownership';

- the term must be read in the context of the overall scheme of the STT Act;

- regard should be had for the purpose of the relevant provision against the background to the production of the STT Act; and

- due regard should be had for appropriate international case law.

Based on the international case law discussed in Part A, neither a mere nominee shareholder, nor the ultimate shareholders, will in the ordinary course constitute the 'beneficial owner' of a share. Instead, they will rather delineate the spectrum within which the meaning of the term has to be determined. Based on the guidance provided by the Canadian cases in particular, such a determination should involve a South African court establishing whether the person alleging 'beneficial ownership' of a share (i) receives the income from the shares for his or her own enjoyment, (ii) assumes the risk and control of the share and (iii) is wholly accountable to anyone else for how the share is dealt with.

Taking into account (i) the above international meaning, (ii) the guidance provided by the various meanings in Part B that have been attributed to the phrase 'beneficial ownership' in a domestic context, (iii) the purpose of the STT Act of taxing only transfers of economic ownership and (iv) the fact there can typically be only a single 'beneficial owner' of a share, the 'beneficial owner' of a share for STT purposes should be that person whose right or entitlement to one or more of the benefits attaching to that share outweighs that of any other person.

CHAPTER 4: MEANING OF 'CHANGE IN BENEFICIAL OWNERSHIP' FOR STT PURPOSES

As set out in Chapter 3, the second requirement for the imposition of STT is that the 'transfer' event (as discussed under Chapter 2) must result in a '*change in beneficial ownership*' in the security that is transferred. Accordingly, this chapter considers the scope and meaning of the phrase 'change in beneficial ownership' for STT purposes, with specific reference to the findings regarding the meaning of 'beneficial ownership' in Chapter 3.

Previously, the term 'change in beneficial ownership' was defined for purposes of the UST Act and was intended to clarify that '*a change in beneficial ownership takes place whenever securities are cancelled or redeemed, and whenever there is any acquisition of any of the rights or entitlements attaching to a security*'.[114] Even though this definition was retained in an initial version of the STT Bill, it was ultimately not retained in the STT Act. As a result, there is currently no legislative meaning of the phrase 'change in beneficial ownership'. Nevertheless, the phrase clearly requires that a 'transfer' event relating to a 'security' must result in either (i) a different person becoming entitled to the majority of the benefits attaching to that security or, at least (ii) in the transferor no longer being entitled to the majority of the benefits attaching to that security.

4.1 Impact and relevance of the Companies Act, 2008

Practically, a person cannot become the legal owner[115] of a share,[116] or the rights associated with an uncertificated share,[117] in the absence of the debiting of the Securities Account of the transferor and the crediting of the Securities Account of that person. It is therefore evident that the same procedural requirement (that is to say, the debiting and crediting of the Securities Accounts of the transferor and transferee) applies in respect of both the acquisition of ownership of an uncertificated share and the acquisition of ownership of the rights associated with that uncertificated share.[118] As demonstrated in 3.9 above, the practical effect thereof is that ownership and registration of uncertificated shares cannot be separated[119] and that the person in whose name a share is registered will become (i) the legal owner of the share itself, as well as (ii) the legal owner of the rights associated with that share. From a legal perspective this appears to be an acceptable notion, as a share consists of '*a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interests in the company, its assets and dividends*';[120] and ownership of all those rights will result in ownership of the share itself.[121]

However, as concluded in Chapter 3, the 'beneficial owner' of a share is the person *entitled* to the benefits of the rights attaching to that share and not necessarily the legal owner thereof. Accordingly, while a legal transfer of an uncertificated share will *automatically* result in a change in ownership of the

[114] *Explanatory Memorandum on the Revenue Laws Amendment Bill*, 2005, 78.
[115] Or 'registered owner' or 'title holder'.
[116] Section 53(2) of the Companies Act, 2008.
[117] Section 37(9) of the Companies Act, 2008 read with Strate Rules 7.3.3.1 and 7.3.3.2.
[118] *Henochsberg on the Companies Act 71 of 2008,* 174 – 175.
[119] *Rachlitz*, 410.
[120] *Ocean Commodities (A),* 151.
[121] *Henochsberg on the Companies Act 71 of 2008*, 174 – 175. The authors state that the '*acquisition of the rights associated with a share equals ownership of the share because the rights (or rather the competencies in respect of the rights) that comprise the share is "ownership" of the share*'.

rights comprising the share due to registration of the share in the transferee's name in terms the Companies Act, 2008, such registration is not necessarily a requirement for a change in 'beneficial ownership to occur'. This is the case, as the granting of a beneficial interest can also result in a change in 'beneficial ownership', which only requires disclosure and not registration.[122] However, as concluded in Chapter 3, there can be more than one beneficial interest holder in a share, but only a single 'beneficial owner' of a share - being the person whose right or entitlement to one or more of the benefits attaching to that share outweighs that of any other person. Accordingly, only the conferral of a beneficial interest that entitles the beneficial interest holder to the benefit of the majority of the rights comprising that share, will result in a change in 'beneficial ownership' in respect of that share.

4.2 Conclusion

Since a 'change in beneficial ownership' is one of the requirements for the imposition of STT, this chapter considered what is meant by this phrase in light of the findings regarding the meaning of 'beneficial ownership' in Chapter 3. In addition, this chapter also considered whether registration in accordance with the Companies Act, 2008 is a requirement for a 'change in beneficial ownership' to occur.

As a point of departure, the registered owner of an uncertificated share will become both the legal owner and the 'beneficial owner' of that share immediately upon registration of that share in accordance with the rules of the CSD. Accordingly, registration in accordance with the Companies Act, 2008 is required for a 'change of beneficial ownership' to occur in this way. However, the granting of a beneficial interest in the majority of the rights attaching to that share, which does not require registration in accordance with the Companies Act, 2008, will also result in a 'change in beneficial ownership' in that share. It follows that, while any transfer of legal ownership of a share (or the rights attaching to that share) which requires the debiting and crediting of the parties' respective Securities Accounts in accordance with the Companies Act, 2008 will result in a 'change in beneficial ownership', such registration is not a requirement for a change in 'beneficial ownership' in a share.

This position aligns with both (i) the common law distinction referred to in 3.5 above between the registered owner and 'beneficial owner' of a share and (ii) the view highlighted in 3.5 above that a person can be beneficially entitled to one or more of the benefits or rights comprising a share without having to be the owner thereof.

[122] Section 56 of the Companies Act, 2008.

CHAPTER 5: MEANING OF 'TRANSFER OF SECURITY' FOR STT PURPOSES

The third requirement for the imposition of STT is that the 'transfer' event (as discussed under Chapter 2) must result in a 'change in beneficial ownership' in the security that is transferred (as discussed under Chapters 3 and 4) and result in a 'transfer' of a 'security'.

Accordingly, this chapter considers the scope and meaning of the term 'security', and what would constitute the 'transfer of a share', for STT purposes.

From a commercial perspective, the term 'security' usually refers to shares, but also includes '*debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company*'.[123] For STT purposes, a 'security' is defined as *'any share or depository receipt in a company or any member's interest in a close corporation'*, but specifically excludes the debt portion in respect of a share linked to a debenture.[124] According to the *Explanatory Memorandum on the Securities Transfer Tax Bill, 2007*, the definition of 'security' is intended to cover all shares in a company, depository receipts and all members' interests in a close corporation, but not debts or interests in collective investment schemes in the form of unit trusts.[125] It is therefore evident that the scope of the definition includes the ordinary concept of a 'share' and accordingly the word 'security' and the word 'share' will be used interchangeably in this chapter.

5.1 Meaning and legal nature of a 'share'

From the above, it is evident that any share (including an uncertificated share) will constitute a 'security' for STT purposes. The Companies Act, 2008 defines a 'share' as '*one of the units into which the proprietary interest in a profit company is divided*'.[126] Likewise, the Income Tax Act defines a 'share' in a company as '*any unit into which the proprietary interest in that company is divided*'.[127] While the term 'proprietary interest' is not defined in either the Companies Act, 2008 or the Income Tax Act, it is understood to mean any '*[a]dvantage, profit, right, or share held by the owner of a tangible or intangible asset or property with all associated rights*'.[128]

Authorities agree that no simple definition of a share can be derived from the common law[129] and that its *'various definitions emphasise a complex of characteristics which are peculiar to it*'.[130] In the English case of *Borland's Trustee v Steel Brothers & Co Ltd*[131] it was held in respect of the nature of a share that:

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[123] See the definition of 'security' in section 1 of the Companies Act, 2008. See also *Henochsberg on the Companies Act 71 of 2008*, 157.
[124] See the definition of 'security' in section 1 of the STT Act.
[125] *Explanatory Memorandum on the Securities Transfer Tax Bill, 2007*, 5.
[126] See the definition of 'security' in section 1 of the Companies Act, 2008.
[127] See the definition of 'share' in section 1(1) of the Income Tax Act.
[128] *SARS Guide to Dividends Tax*, 38.
[129] Pretorius J.T., Delport P.A., Havenga M. and Vermaas M.R. 1999. Hahlo's South African Company Law through the Cases, 6th Edition, Juta & Company, 150.
[130] *Cooper v Boyes NO* [1994] 2 All SA 475 (C), 448(2).
[131] [1901] 1 Ch 279.

> *'A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se … The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money settled … but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.'*

In a South African context it was similarly held in *Ocean Commodities (A)* that a '*share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends*'.[132] The legal nature of a share was subsequently described in *Cooper v Boyes* as follows:[133]

> *'The gist … is that a share represents an interest in a company that consists of a complex of personal rights which may, as an incorporeal moveable entity, be negotiated or otherwise disposed of. It is certainly not a consumable article, such as money, even though a money value can be placed on it. Nor can it, by any analogy, be likened to a debt which may give rise to a claim of some kind or another, even though the debt and related claim may eventuate in an award of money being made to the claimant in respect of such debt. The fact that the value of a share in a company may fluctuate for a great variety of reasons, or that it may be affected by all manner of eventualities which may befall the company … cannot change its essential nature. It cannot, by any stretch of the imagination, be converted from an interest or conglomerate of personal rights.'*

In *Letseng Diamonds Ltd v JCI Ltd; Trinity Management* (*Pty*) *Ltd v Investec Bank Ltd*[134] these personal rights were described as those rights that are fixed in the relevant company's documents of incorporation and which, in the normal course of events, afford the shareholder (i) the right to dividends when declared, (ii) the right to a return of capital on the winding-up of the company (or authorised reduction of capital) and (iii) the right to attend and vote at meetings of shareholders.[135]

The legal nature of a share is further regulated by section 35 of the Companies Act, 2008, which specifically provides that a share issued by a company is movable property which is transferable in any manner provided for, or recognised, by the Companies Act, 2008 or other legislation.[136] This classification as movable property is significant as, in the case of immovable property, a court cannot go behind the relevant register to determine the owner of the article. Accordingly, if a share was classified as immovable property, a court would have been bound by the company's share register when determining the owner of that share. Based on the fact that a share is statutorily recognised to be

[132] *Ocean Commodities (A)*, 152.
[133] *Cooper*, 488(2).
[134] 2007 (5) SA 564 (W).
[135] *Letseng Diamonds*, paragraph 17. See also *Henochsberg on the Companies Act 71 of 2008*, 157.
[136] Section 35(1) of the Companies Act, 2008.

of a movable nature, '*a Court can go behind the register to ascertain the identity of the true owner*' of a share.[137] A share's movable nature thus results in Courts, in determining 'beneficial ownership' of a share, being entitled to take into account parties with direct or indirect interests in a share beyond only those reflected in the company's share register.

In summary, a share is therefore an incorporeal movable representing a bundle of personal rights. These personal rights typically include the following rights of the shareholder:[138]

- the right to dividends when declared;
- the right to share in the 'surplus assets' of the company (if any), whether by way of an authorised return of capital or upon the winding-up of the company; and
- the right to attend and vote at general meetings of shareholders.

5.2 Distinction between a transfer of a 'share' and the rights comprising a 'share'

Under the common law a distinction is drawn between:[139]

- the transfer of the rights of which the share comprises, which can occur by way of cession and is not subject to any prescribed procedural corporate law requirements; and
- the transfer of the share (that is to say, the incorporeal movable) itself, which is simply the formal process by which the new owner of a share is recognised as such by the company and third parties by way of compliance with the prescribed procedural corporate law requirements for the transfer of a share.

In this regard, the authors of *Henochsberg* conclude that '*apart from the transfer of the share itself, the shareholder can also transfer particular right/s (comprising the share) … which is not the transfer of the share itself*.'[140] This distinction appears to be rooted in the 'disjuncture' expressed by *Borrowdale* between 'beneficial ownership' of a share (i.e. the entitlement to the rights against the company) and the registered title to that share (i.e. the ability to exercise or enforce those rights against the company).[141] Furthermore, it aligns with the view set out in 5.3 below that the process of legally transferring a share is not a single act, but consists of a series of steps, which includes the registration of the transfer in accordance with the Companies Act, 2008.[142]

[137] Vermaas, M.R. 1995. '*Aspekte van die Dematerialisasie van Genoteerde Aandele in die Suid-Afrikaanse Reg'.* PhD Dissertation, University of South Africa, 22. See also *Ocean Commodities*, 181 – 182.
[138] *Hahlo's South African Company Law through the Cases*, 154.
[139] *Henochsberg on the Companies Act 71 of 2008*, 160.
[140] Ibid.
[141] *Borrowdale*, 40.
[142] *Inland Property Development Corporation v Cilliers* 1973 (3) SA 245 (A), 251C-D.

This view was endorsed by the High Court in *Tigon Limited v Bestyet Investments (Proprietary) Limited*,[143] where it was held that:[144]

> *'It seems … that a distinction (not always recognised) may be drawn between the share itself, which is an incorporeal moveable entity, and the bundle of personal rights to which it gives rise.'*

The relevance of this view in the context of the STT Act is highlighted by the fact that any right or entitlement to receive any distribution from a company, which is one of the rights that a share comprises of, was specifically removed from the definition of 'security' for STT purposes with effect from 1 April 2012.[145] In the explanatory memorandum accompanying that amendment, it was stated that such dividend cessions would no longer be subject to STT based on the fact that a dividend cession is an income right that is '*totally independent of the underlying shares*' and is '*no longer viewed as part of the security*'.[146] This reinforces the view that the transfer of the personal rights making up a share (that is to say, (i) the right to dividends when declared, (ii) the right to share in the 'surplus assets' of the company and (iii) the right to attend and vote at general meetings) can be transferred separately from the underlying share by means of a mere cession that doesn't necessarily constitute the transfer of a 'security' for STT purposes.

5.3 Requirements for the 'transfer of a share'

In *Smuts v Booyens; Markplaas (Edms) Bpk en 'n ander v Booyens*[147] the Court emphasised that the basis for shareholding in a company is derived from legislation and held that the provisions of the Companies Act, 1973 should be the point of departure in determining whether the shares in a private company could be transferred.[148] In *Inland Property Development Corporation (Pty) Ltd v Cilliers*,[149] the Court also held that:

> *'In regard to shares, the word 'transfer' in its full and technical sense, is not a single act but consists of a series of steps, namely an agreement to transfer, the execution of a deed of transfer and, finally, the registration of the transfer.'*

According to *Vermaas*, the process of transferring a share (including the rights and obligations attaching to that share) is not limited to the aforementioned three steps in practice, though they are the most important ones.[150] She further states that the entering into a purchase agreement in respect of a share will not, in itself, be sufficient to effect transfer of ownership of a share.[151]

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[143] [2015] JOL 33667 (N).
[144] *Tigon*, 15.
[145] Section 145(1)(c) of the Taxation Laws Amendment Act No. 24 of 2011.
[146] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2011*, 172 - 173.
[147] [2001] 3 All SA 536 (A).
[148] *Smuts*, paragraph 7.
[149] 1973 (3) SA 245 (A), 251C-D.
[150] *Vermaas (1995)*, 83.
[151] *Vermaas (1995)*, 93 – 94.

Based on the above, the legal 'transfer' of a share (which will include the rights and obligations attaching to that share) will entail at least the following three events:

- the entering into a sale and purchase agreement by the parties in terms whereof the share is ceded;
- performance of the obligations in terms of that agreement; and
- registration of the transfer so as to effect the change of membership in the company.

In the context of the third event listed above, the effect of the *Smuts* judgment is that the 'registration of the transfer so as to effect the change of membership in the company' has to occur in accordance with any statutory requirements specified in the Companies Act, 2008 to result in a legal 'transfer' of the share 'in its full and technical sense'. This view is supported by the following:

- According to the preamble to the Companies Act, 2008, one of its purposes is '*to define the relationships between companies and their respective shareholders or members and directors'*; and
- Part E of Chapter 2[152] deals with what is termed 'Securities registration and transfer', and consists of provisions dealing with the registration and transfer of certificated shares, uncertificated shares and beneficial interests in shares.

As set out in 5.2 above, there is a distinction between the transfer of a share and a transfer of the rights comprising the share. This distinction is illustrated by the fact that, under the common law, no formalities are required in that the rights pass by way of cession,[153] while the transfer of legal ownership of a share requires the registration of the share in accordance with the requirements of the relevant Companies Act.[154] In this regard, full title to the shares is conferred only by registration of transfer but, as between the transferor and transferee, 'beneficial ownership' passes under the ordinary principles of cession independently of and prior to registration.[155]

In the context of uncertificated shares this distinction becomes less pronounced. This is the case, as the transfer of 'ownership' of an uncertificated share and the transfer of 'rights associated with' an uncertificated share are effectively subject to the same procedural requirement. In this regard:

- the transfer of 'ownership' of an uncertificated share is subject to '*debiting the account in the uncertificated securities register from which the transfer is effected and crediting the account in*

[152] Part E of Chapter 2 of the Companies Act, 2008 consisting of sections 49 to 56.
[153] *Henochsberg on the Companies Act 71 of 2008*, 160.
[154] In respect of certificated shares, section 103(1) and (2) of the Companies Act, 1973 required, and section 51(5) and (6) of the Companies Act, 2008 requires, that every transfer must be entered into the company's register. In respect of uncertificated shares, section 91A(4) of the Companies Act, 1973 required, and section 53(1) and section 53(2) of the Companies Act, 2008 requires, that every share is entered into the company's uncertificated securities register in accordance with the relevant CSD.
[155] Havenga, M., Esser, IM., *et al.* 2012. Corporate Business Administration (Revision service 19), 17-2.

the uncertificated securities register to which the transfer is effected' in accordance with the rules of a CSD;[156] and

- the transfer of 'rights associated with' an uncertificated share occurs as 'determined in accordance with the rules of the CSD',[157] with the relevant CSD rules providing that the transfer of ownership of rights associated with a security[158] is also effected by the debiting of the Securities Account of the transferor and crediting the Securities Account of the transferee.[159]

The practical effect thereof is that where legal ownership of the entire bundle of the rights comprising an uncertificated share is transferred simultaneously, registration in accordance with the Companies Act, 2008 will be required – and upon such registration occurring, transfer of the uncertificated share itself will effectively also occur. Therefore, even though the rights associated with an uncertificated share in themselves do not constitute an uncertificated share, a simultaneous acquisition of all of them in accordance with the requirements of the Companies Act, 2008 will effectively result in an acquisition of the uncertificated share itself.[160] On the other hand, should the cession of the rights associated with the uncertificated share not be registered as required, the registered holder will still own the rights associated with the share but as the nominee for the new beneficial holder[161] – and this will not constitute the transfer of the share itself.

It follows that, in the absence of compliance with the procedural requirements in the Companies Act, 2008, no legal 'transfer' in the 'full and technical sense' of a share will occur.

5.4 Conclusion

This chapter considered the scope and meaning of the term 'security', as well as the requirements for effecting a 'transfer of a share', as a requirement for the imposition of STT.

The legal 'transfer' of a share usually entails three events, the last of which is the registration of the transfer so as to effect the change of membership. As the basis for shareholding in a company is derived from corporate law legislation, the requirements prescribed by the Companies Act, 2008 must be satisfied to effect the legal transfer of a share. In the context of uncertificated shares, the Companies Act, 2008 provides that:

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[156] Section 53(2) of the Companies Act, 2008.
[157] Section 37(9) of the Companies Act, 2008.
[158] In this regard, 'transfer' is defined in the CSD Rules as '*the transfer of Uncertificated Securities or an interest in Uncertificated Securities by debiting the account in the Uncertificated Securities Register from which the transfer is effected and crediting the account in the Uncertificated Securities Register to which the transfer is effected in accordance with the Strate Rules, and in respect of Securities issued in terms of the Companies Act, in the manner provided for in Part E of Chapter 2 of that Act*'.
[159] Strate Rules 7.3.3.1 and 7.3.3.2.
[160] That will be the case, as registration of the new shareholder in the company's CSD register constitutes the formal process by which the new owner of a share is recognised as such by the company and third parties. See in this regard *Henochsberg on the Companies Act 71 of 2008*, 174 – 175, where it is stated that the '*acquisition of the rights associated with a share equals ownership of the share because the rights (or rather the competencies in respect of the rights) that comprise the share is "ownership" of the share*'.
[161] *Henochsberg on the Companies Act 71 of 2008*, 175.

- the transfer of uncertificated securities may be effected only in accordance with the rules of the relevant CSD;[162]

- a person acquires the rights associated with an uncertificated share as determined in accordance with the rules of the CSD;[163] and

- a person can only acquire ownership of a security upon debiting the account in the uncertificated securities register from which the transfer is effected and crediting the account in the uncertificated securities register to which the transfer is effected in accordance with the rules of the relevant CSD.[164]

On this basis, compliance with the procedures as set out in the relevant CSD rules is effectively elevated to a requirement for the legal transfer of ownership of an uncertificated share under the Companies Act, 2008.

While a share is defined as comprising of a bundle of personal rights, a distinction can be drawn between (i) the rights comprising that share and (ii) the share itself. Those rights will therefore not constitute a 'security' for STT purposes. In addition, the transfer of those rights occurs through cession without any procedural formalities. As no transfer in the full and technical sense can occur in the absence of compliance with the registration requirements in the Companies Act, 2008, a transfer of those rights will also not constitute the 'transfer of a share'. Nevertheless, the transfer of *all* the rights comprising the share *may* effectively result in a transfer of the share itself to the extent that the transaction requires the same procedural requirements as the transfer of a share.

It follows that, save for the situation described directly above, only a change in registered title holder of a share in accordance with the procedural requirements of the Companies Act, 2008 will result in a 'transfer' of a 'share' for STT purposes.

In light of the findings in this chapter and in the preceding four chapters, it now falls to consider the practical application of, and interplay between, the requirements for the imposition of STT.

[162] Section 53(1) of the Companies Act, 2008.
[163] Section 37(9)(a)(ii) of the Companies Act, 2008.
[164] Section 53(2) of the Companies Act, 2008.

CHAPTER 6: PRACTICAL DELINEATION OF THE REQUIREMENTS FOR THE IMPOSITION OF STT

As set out in Chapter 1, STT will be imposed on the occurrence of any 'transfer' event of a 'security' that results in a change in 'beneficial ownership' and transfer of that security, unless that 'transfer' event is the issue of a security or the cancellation or redemption of a security of a company that is being wound up, liquidated, deregistered or finally terminated.

Based on the findings in Chapters 2, 3, 4 and 5 above, STT will, practically, only be levied on a transaction concerning a share to the extent that:

- there is a disposal or other alienation of that share (see Chapter 2); **and**
- subsequent to the transaction, someone else's right or entitlement to the benefits (such as the voting rights, the right to receive dividends or the right to share in the surplus assets upon liquidation of the company) attaching to that share outweighs the transferor's, or any other person's, right or entitlement to those benefits (see Chapter 3 and Chapter 4); **and**
- all the corporate law requirements (such as those prescribed by the Companies Act, 2008) for the transfer of title to that share has been met (see Chapter 5).

In many instances, the disposal of the personal rights comprising a share will result in a change in 'beneficial ownership' of that share (for example, where the rights comprising the share are ceded or where a conferral of a beneficial interest to third party occurs). As illustrated in 4.1 and 5.3 above, such a transfer of the personal rights comprising a share will not necessarily require the debiting and crediting of the transferor and transferee's respective CSD accounts; and will therefore not constitute the 'transfer' of the 'share' itself (unless the underlying share is debited and credited in the transferor and transferee's respective CSD accounts). This is the case, as the transfer of a 'share' will only occur upon compliance with the relevant requirements contained in the Companies Act, 2008, (as opposed to the transfer of the rights comprising the share, which has no formal procedural requirements and can occur by means of a mere cession). Accordingly, instances may arise where a transaction results in a 'change in beneficial ownership', but does not constitute the 'transfer of a share' since the relevant procedural requirements contained in the Companies Act, 2008 have not been met. It follows that the main consideration in ascertaining whether a particular 'transfer' event results in the imposition of STT is not whether a 'change in beneficial ownership' has occurred, but rather whether the prescribed procedural requirements for the transfer of a share (currently the debiting and crediting of the transferor and transferee's respective CSD accounts) were satisfied in order for the transaction to constitute the 'transfer of a security'.

The interaction between the relevant requirements are illustrated in further detail below:

Description	**Transfer event** *(Chapter 2)*	**Change in beneficial ownership** *(Chapters 3 & 4)*	**Transfer of a share** *(Chapter 5)*	**STT**
X sells a share and all the rights attaching thereto to Y and the share is registered in Y's name in accordance with the CSD Rules	✓	✓	✓	✓
X cedes all the rights attaching to a share to Y and transfer of the rights are registered in accordance with the Companies Act, 2008	✓	✓	✓	✓
X cedes all the rights attaching to a share to Y and the beneficial interest is disclosed in terms of the Companies Act, 2008, but no registration occurs in terms of the Companies Act, 2008	✓	✓	×	×
X grants a beneficial interest in the majority of the rights attaching to a share to Y and the beneficial interest is disclosed in terms of the Companies Act, 2008, but no registration occurs in terms of the Companies Act, 2008	✓	✓	×	×
X grants a beneficial interest in the minority of the rights attaching to a share to Y, but no beneficial interest is disclosed and no registration occurs in terms of the Companies Act, 2008	✓	×	×	×

CHAPTER 7: STT CONSEQUENCES OF A REPURCHASE OF UNCERTIFICATED SHARES

From a commercial perspective, one of the issues to be taken into account by a repurchasing company is the STT consequences of the transaction.[165] However, notwithstanding the fact that share repurchases have become an increasingly popular tool to use as part of restructurings and acquisitions in South Africa due to their usefulness in achieving the various commercial objectives set out under 7.1 below, uncertainty still exists around the tax treatment thereof. This uncertainty stems from the fact that, even though share repurchases are specifically recognised by the Companies Act, 2008[166] and the Income Tax Act,[167] no revenue legislation contains special provisions that comprehensively deal with the tax consequences of a share repurchase.

This uncertainty is illustrated by *Brincker*, who states that particular tax treatments of a share repurchase could theoretically even result in STT being payable twice on a repurchase.[168] This view is based on the fact that both a 'sale' (or any 'disposal in any other manner') and a 'cancellation' that does not occur as a result of the liquidation of the company will qualify as 'transfer' events that may give rise to STT.

Chapter 7 will therefore examine and compare the treatment of a share repurchase from both a corporate law perspective and the SARS perspective, seeking to determine the STT consequences of each approach with reference to the STT requirements as discussed in the prior chapters and considering whether they result in different STT consequences.

7.1 Relevance of share repurchases and historical development thereof in South Africa

This sub-chapter will briefly set out the commercial relevance of share repurchases in both a global and domestic context. In addition, it will provide a brief overview of the historical development of share repurchases in South Africa, in order to provide background and context when considering and comparing the treatment of a share repurchase from a corporate law perspective and the SARS perspective in 7.2 below.

In recent times, share repurchases have become common-place in global commerce. This has been a direct result of the fact that they can readily be utilised as a way of unlocking the investment made by a shareholder who no longer wishes to be involved in the company, a means by which a company can rid itself of a dissident shareholder or a means to facilitate or implement share-based compensation schemes.[169] In a South African context, share repurchases have also increasingly been utilised to achieve the following objectives:[170]

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[165] Brincker, E. 2010. The taxation principles of interest and other financial transactions, UA – 1.
[166] See paragraph (a)(iii)(aa) of the definition of 'distribution' in section 1 and section 48 of the Companies Act, 2008.
[167] The definition of 'dividend' in section 1(1) of the Income Tax Act provides, *inter alia*, that *'**"dividend"** means any amount transferred or applied by a company … in respect of any share in that company, whether that amount is transferred or applied … as consideration for the acquisition of any share in that company …*'.
[168] *Brincker*, UA – 7.
[169] Siddle, A.M., 2006. '*Share Repurchases in South Africa: Reasons and Returns'.* M.Com Dissertation, University of Cape Town, 36 – 44.
[170] *Siddle*, 75.

- the enhancement of a company's earnings per share;
- the enhancement of a company's net assets per share;
- creating, maximising or enhancing value for shareholders;
- enabling or facilitating the exit of a disinvesting shareholder; and
- facilitating the introduction of a BEE participant.

A share repurchase may be defined as '*a transaction entered into between a company and one or more of its shareholders in terms of which it is agreed that the company will take back their shares in return for an agreed consideration, to be paid by the company to the shareholders concerned*'.[171]

Under the Companies Act, 1973 there was initially a complete bar on share repurchases. In this regard, the Companies Act, 1973 provided that a company could neither hold, nor acquire, its own shares, even if permitted to do so by its Memorandum of Association or Articles of Association.[172] This prohibition stemmed from the strict capital maintenance rules contained within the Companies Act, 1973 and served a twofold purpose:

- it protected the company's creditors by preventing what would have amounted to an unlawful reduction of the company's capital. In this regard, our courts had held that persons who give credit to the company was entitled to rely upon the issued share capital of the debtor company for payment of their claims and that shareholders should therefore not be allowed to subsequently withdraw their capital investment;[173] and
- it protected the company's shareholders by preventing the company from 'trafficking in its own shares'[174].[175] This was the case, as directors might have used a share buy-back to maintain themselves in control, to manipulate voting power or to buy out inconvenient shareholders.[176]

In contrast, this rule against a company purchasing its own shares was rejected in most jurisdictions in the United States of America. In addition, by 1989 the strict capital maintenance rules had also been either relaxed or abolished in Canada, the United Kingdom, Australia and New Zealand.[177] After identifying the commercial advantages that the ability to repurchase its own shares held for companies trading in those jurisdictions, South African corporate law took an about-turn in respect of the ability of

[171] Blackman *et al*. 2017. Commentary on the Companies Act (electronic version). Juta, 5-43.
[172] Gondwe, R. D. 2015. **'***Incomplete Company Law Reform: The Treasury Shares Question in South Africa'.* M.Com Dissertation, University of Cape Town, 1.
[173] *Cohen NO v Segal* 1970 (3) SA 702 (W), 705-706. See also *The Unisec Group Ltd v Sage Holdings Ltd* 1986 (3) SA 259 (T), 264-265.
[174] The phrase 'trafficking in its own shares' typically referred to instances where a company not only repurchased its shares, but traded in the treasury shares thus acquired for purposes of making a profit.
[175] *Commentary on the Companies Act*, 5-23.
[176] Mtwebana, K. F. 2005. '*Towards a More Flexible Structure of the Share Capital: A comparison of the company law of South Africa and Switzerland with regard to current debates and developments in the EU*'. LLM Dissertation, University of Cape Town, 11 – 12.
[177] *Siddle*, 2.

a company to acquire its own shares in 1999, with the promulgation into law of the Companies Amendment Act, No. 37 of 1999 ('1999 amendment'). In this regard, the *Memorandum on the Objects of the Companies Amendment Bill, 1999*, specifically stated that:

> *'[T]he principles of capital maintenance have undergone significant changes in almost all countries. The modern notion of capital maintenance is that companies may reduce capital, including the acquisition of their own shares, but subject to solvency and liquidity criteria. This has the advantage of affording protection to creditors whilst at the same time giving flexibility to companies to achieve sound commercial objectives. These aspects of flexibility and achievement of sound commercial objectives have become extremely important since South Africa's re-entry into the global markets.'*

After implementation of the 1999 amendment, section 85 of the Companies Act, 1973 conferred the right to companies to acquire or purchase their own shares under certain circumstances.[178] The introduction of these provisions signalled a new dawn for the capital maintenance rule in South Africa as it, for the first time, allowed companies to acquire their own shares.[179]

In 2011, the Companies Act, 2008 introduced an overhaul of what was considered a largely out-dated company law regime. As part of this process, the specific recognition of share repurchases in the Companies Act, 1973 was retained.[180] Apart from specifically allowing a company to repurchase its own shares, the Companies Act, 2008 also provides for a subsidiary to hold so-called treasury shares in its holding company.[181]

7.2 Mechanics of a share repurchase

As set out in 5.3 above, the basis for shareholding in a company is derived from the provisions of the Companies Act, 2008. Therefore, in the absence of tax legislation providing for a particular treatment of a share repurchase for tax purposes, the general provisions of the tax Acts must be applied with due regard to (i) the legal mechanics of a share repurchase and (ii) the extent to which it results in the transfer of the rights pertaining to a share.

In 7.2.1 and 7.2.2 below, the treatment of a share repurchase is considered from a corporate law and SARS perspective respectively. As highlighted earlier in Chapter 7, the difference in these approaches could potentially result in differing STT consequences.[182]

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[178] Viljoen, A. J. 2011. '*Acquisition of Securities: Section 48 of the Companies Act 71 of 2008'.* LLM Dissertation, University of Pretoria, 11.
[179] *Gondwe*, 6.
[180] Ibid.
[181] Section 48(2)(b) of the Companies Act, 2008.
[182] Note that, from a tax perspective, the different approaches not only complicates the STT consequences of a share repurchase, but will also affect the CGT consequences of a share repurchase. For example, under the Corporate Law Position, a shareholder disposing of a repurchased share could realise a capital gain as a result of the repurchase, while such a capital loss will be disregarded in terms of paragraph 39(1) of the 8th Schedule to the Income Tax Act under the SARS Position. Furthermore, under the SARS position paragraph 38 of the 8th Schedule to the Income Tax Act will apply where a shareholder disposing of a repurchased share and the repurchasing company are connected persons in relation to each other, while it will

7.2.1 Corporate Law Position

Companies Act, 1973

As set out earlier, the Companies Act, 1973 was amended in 1999 to permit the repurchase by a company of its own shares. The amended section 85 of the Companies Act, 1973 allowed the repurchase by a company of its own shares, provided the company's Articles of Association authorised repurchases and that approval was obtained by way of special resolution.[183] In this regard, section 85(1) provided that a company could approve the acquisition of its own shares, while section 85(8) specifically provided that repurchased shares '*shall be cancelled as issued shares and restored to the status of authorised shares forthwith*.'

This raised the question as to whether the repurchased shares can be said to have been 'acquired' by the repurchasing company at any stage. In this regard, *Blackman* stated that, strictly speaking, the company does not 'purchase' or 'buy' its shares, as a company cannot acquire rights against itself; and since the rights against the company are extinguished, the company does not purchase anything.[184] Likewise, *Cassim* stated that a company cannot have 'ownership' or a proprietary interest in itself, or legal rights and powers derived from itself.[185]

Blackman illustrated the point as follows:[186]

> *'[A] share is a bundle of rights. Where a company buys its own shares, one of these rights will be a right of action against itself. Obviously, the company cannot be the owner of a claim against itself. . . . How can one acquire a right against oneself? To state the proposition is to demonstrate the absurdity.'*

According to *Henochsberg*, the rights comprising a share only come into existence if it is capable of being exercised against the company.[187] As a company cannot sue itself for performance,[188] a share will cease to exist immediately when it is repurchased, because the conglomerate of rights comprising that share will not be capable of being exercised against the company at that stage. Section 85 therefore ensured that a company was unable to trade in its own shares by insisting that repurchased shares were cancelled as issued shares.[189]

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not apply in terms of the Corporate Law Position. However, a detailed consideration of all the potential tax uncertainties arising from share repurchase falls outside the scope of this dissertation. Accordingly, the consideration in this dissertation is limited to the perceived STT uncertainty arising from the differing approaches to a share repurchase.

[183] Section 85(1) of the Companies Act, 1973.

[184] *Commentary on the Companies Act*, 5-41.

[185] Cassim, F.H.I. 2003. '*The repurchase by a company of its own shares: The concept of treasury shares'.* SALJ 120(1), 137.

[186] *Commentary on the Companies Act*, 5-43.

[187] *Henochsberg on the Companies Act 71 of 2008*, 159.

[188] Van der Merwe, C.P. 2015. '*Reconsidering Distributions: A Critical Analysis of the Regulation of Distributions to Shareholders in the Companies Act of 2008, with Special Reference to the Solvency and Liquidity Requirement'.* LLM Dissertation, University of Stellenbosch, 24. See also Van der Linde, K. 2009. '*The regulation of distributions to shareholders in the Companies Act 2008*'. TSAR (3), 488.

[189] *Commentary on the Companies Act*, 5-41.

Accordingly, under the Companies Act, 1973, where a share was repurchased by a company from one of its shareholders:

- the repurchasing company never became the owner of, or entitled to exercise, the rights comprising that shares; and
- the repurchased share was never transferred to that repurchasing company, but cancelled by virtue of the repurchase transaction.

Stated differently, a company repurchasing its own shares never acquired the share itself, but rather an authorised, but unissued, version of that share.

Companies Act, 2008

The Companies Act, 2008 specifically recognises a repurchase by a company of its own shares and, similar to section 85 of the Companies Act, 1973, section 48 of the Companies Act, 2008 provides that a company can 'acquire' its own shares. In this regard, section 35 provides that a repurchased share will '*have the same status as shares that have been authorised but not issued*'.[190] As only issued shares have rights associated with it,[191] a share should automatically cease to exist immediately when it is repurchased. The question that arises is whether the provisions in the Companies Act, 2008 dealing with a share repurchase constituted a departure from the approach under the Companies Act, 1973, (in terms whereof a repurchased share was never transferred to the repurchasing company and that repurchasing company never became the owner of, or entitled to exercise, the rights comprising that share).

In this regard, both section 85(8) of the Companies Act, 1973 and section 35(5) of the Companies Act, 2008 refers to shares being 'acquired' by the repurchasing company, while only section 85(5) of the Companies Act, 1973 refers to the shares having to be 'cancelled'. However, commentators are generally in agreement that the mechanics of a share repurchase under the Companies Act, 2008 does not differ from a share repurchase under the Companies Act, 1973. In particular, the view is held that a company remains unable to 'acquire' and hold its own shares, as a company cannot hold or exercise rights against itself;[192] and that the reference to 'acquire' in the context of a share repurchase is therefore a 'misnomer'.[193] In this regard, *Henochsberg* states that, although the ordinary legal meaning of the word 'acquire' means 'obtaining the ownership of', a company cannot own shares in itself.[194] The term 'acquisition' should therefore simply be understood to include any instance where a shareholder relinquishes rights in respect of a share to the company.[195]

[190] Section 35(4) of the Companies Act, 2008.
[191] Ibid.
[192] *Van der Merwe*, 24 and *Van der Linde*, 488.
[193] Jooste, R. 2009. '*Issues relating to the regulation of 'distributions' by the 2008 Companies Act: notes'.* SALJ 126(4), 636.
[194] *Henochsberg on the Companies Act 71 of 2008*, 208(3).
[195] *Van der Linde*, 488.

7.2.2 SARS Position

Companies Act, 1973

The view that a company was unable to 'acquire' and hold its own shares under the Companies Act, 1973, used to be expressly supported by SARS. In its *Explanatory Memorandum on the Revenue Laws Amendment Bill, 1999* that dealt with the tax related amendments necessitated by the 1999 amendment to the Companies Act, 1973, it was specifically stated that:

> '*In terms of these new provisions a company will be able to buy back its own shares which was not allowed under the previous provisions of that Act. The company acquiring its own shares, will, however, not transfer such shares into its own name, but the shares so acquired must be cancelled as issued shares and restored to the status of authorised shares*.'
>
> *(Own underlining)*

Companies Act, 2008

However, in contrast to its view under the Companies Act, 1973, SARS is of the view that, under the Companies Act, 2008, a repurchasing company acquires the repurchased share from its shareholder, and immediately thereafter the company cancels that share. In this regard, SARS states in the *SARS CGT Guide*[196]:[197]

> *'When a company buys back its own shares it acquires an asset which is held for an instant before being disposed of through cancellation or extinction … On the question of cancellation or extinction of a share so bought back, under section 35(5) of the Companies Act 71 of 2008 shares of a company that have been issued and subsequently acquired by that company have the same status as shares that have been authorised but not issued. Under s 35(4) of the same Act an authorised share of a company has no rights associated with it until it has been issued. It follows that when a company acquires its own shares any rights in those shares are immediately extinguished by merger or confusio.'*

Curiously, the *SARS CGT Guide* specifically acknowledges that '*under South African law a company cannot hold rights against itself*', yet it maintains that '*a company that buys back its own shares (which comprise a bundle of rights) immediately disposes of them by merger*'.[198] While the basis for the statement is unclear, SARS' view appears to be that a repurchasing company acquires its issued shares for a moment in time, to be cancelled immediately upon re-acquisition through '*merger or confusio*', which restores it to the status of authorised but unissued shares. This is based on SARS' view that

[196] Issue 6, dated 13 December 2017.
[197] *SARS CGT Guide*, 91 and 385.
[198] *SARS CGT Guide*, 91.

there is a difference in the wording between the Companies Act, 2008 and Companies Act, 1973 in relation to share repurchases.[199] In this regard, *Seligson* states the following:

> *'The new Companies Act retains provisions authorising share buy-backs, but in a substantially different form … As the following analysis of the requirements imposed in section 46 is intended to show, the buy-back provisions of the new Act in its original form differ in material respects from those applicable under the current Act.'*[200]

He proceeds to state that there '*are a number of departures in the new Act from the buy-back provisions of the current statute that are noteworthy and call for comment*'. [201]

SARS' current view therefore appears to be that a share repurchase consists of two distinct 'transfer' events, namely a sale by the shareholder and a cancellation by the repurchasing company.

7.3 Comparison between share redemption and share repurchase

The nature of a redemption of redeemable shares from a tax perspective was considered in *ITC 1859*,[202] where it was held that '*the redemption of shares results in the extinction and not in a transfer of the rights embodied in the shares to the company redeeming them, or to any other person'*.[203] The Court therefore found that a 'redemption' of a preference share does not involve a disposal of the preference share for CGT purposes by the preference shareholder *'to'* the redeeming company. By extension, a redeeming company does not 'acquire' its own preference shares in the process of redeeming the shares - and the process will only involve a single disposal event.

An interesting issue that arises is to what extent a share repurchase and a redemption of preference shares can be said to be similar, or even identical, in nature. Should they be similar in nature, the authority of *ITC 1859* could lend support to the Corporate Law Position that a share repurchase consists of only a disposal of the repurchased share by the shareholder and no commensurate acquisition of the repurchased share by the repurchasing company; and thus only a single 'transfer' event for STT purposes.

In order to establish whether it would be appropriate to apply the decision in *ITC 1859* to a share repurchase, it must be determined to what extent a redemption and a share repurchase are similar in nature. Before one can consider whether there is a distinction between a share repurchase and redemption from a *tax* perspective (see 7.3.2. below), it should first be ascertained whether there is a distinction from a legal perspective (see 7.3.1 below).

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[199] *SARS CGT Guide*, 385 - 386.
[200] Seligson, M. 2011. '*Share Buy-backs under the Companies Acts, The Devil is in the Detail!*', Business Tax & Company Law Quarterly 2(1), 8
[201] *Seligson*, 14. However, these 'differences' and 'departures' mainly consist of mere procedural changes, for example the type of authorisation that is required and the fact that the solvency and liquidity test that must now be applied.
[202] 74 SATC 213.
[203] *ITC 1859*, paragraph 26.

7.3.1 Is there a distinction between a share repurchase and redemption from a legal perspective?

According to *Blackman*, redeemable preference shares usually have more in common with long-term debt than equity and their redemption is therefore qualitatively different from a repurchase of ordinary shares.[204] He is therefore of the view that there is a legal distinction between 'redemptions' and 'repurchases' of shares, even though '*both the terms refer to the taking back by a company of shares issued by it and, in return, the payment by the company of money or assets to the shareholder or shareholders concerned*'.[205] He distinguishes a 'redemption' from a share repurchase as follows:[206]

> *'The distinction between redemptions and repurchases (or buy-backs) thus turns on whether the company takes back its shares in accordance with rights attaching to the shares themselves (redemptions), or in accordance with a separate contract entered into between it and the shareholders concerned (repurchases or buy-backs).'*

This view was supported under the Companies Act, 1973 by the fact that it contained separate provisions governing share repurchases and the redemption of redeemable preference shares.[207]

While the Companies Act, 2008 does not contain provisions that specifically govern redeemable shares, but rather various provisions that refer to redeemable shares and securities,[208] the provisions dealing with share repurchases specifically does not apply to the *'redemption by the company of any redeemable securities in accordance with the terms and conditions of those securities'*.[209]

Accordingly, it appears that the distinction that was recognised under the Companies Act, 1973 was retained under the Companies Act, 2008.[210] Nevertheless, it seems that the function of the distinction is simply to determine whether a transaction must be authorised in terms of the procedural requirements of section 46 or section 48 of the Companies Act, 2008. Accordingly, this distinction arguably does not extend to the actual legal mechanics of the transactions.

7.3.2 Is there a distinction between a share repurchase and redemption from a tax perspective?

As highlighted in 7.3 above, it was held in *ITC 1859* that, similar to the Corporate Law Position in respect of a share repurchase set out in 7.2.1 above, a 'redemption' of a preference share does not involve a disposal of the preference share from the preference shareholder 'to' the redeeming company for tax purposes. However, the Court specifically declined to make a finding on whether a redemption and a

[204] *Commentary on the Companies Act*, 5-43.
[205] Ibid.
[206] Ibid.
[207] Section 85 and 98 of the Companies Act, 1973.
[208] Van Niekerk, J. 2016. '*Some observations regarding share redemptions under the Companies Act 71 of 2008*'. SA Mercantile Law Journal, 28(1), 132. See, for example, sections 37(5)*(b)*, 43(3), 48(1)*(b)* and 48(3)*(b)* of the Companies Act, 2008.
[209] Section 48(1)(b) of the Companies Act, 2008.
[210] *Van Niekerk*, 133 and Chong, S. J. 2013. '*The tax issues of various aspects of the Companies Act 71 of 2008*', LLM Dissertation, University of Pretoria, 49.

repurchase where similar in nature,[211] notwithstanding the fact that SARS argued that a redemption was 'a kind of buy-back'. [212]

SARS appears to have accepted the views expressed in *ITC 1859*, as it did not appeal the judgment and specifically refers thereto in the *SARS CGT Guide*.[213] However, SARS makes it clear that, in its view, the judgment only applies to the redemption of preference shares and cautions taxpayers against seeking to extend the application of the principles enunciated in *ITC 1859* to share repurchases.[214] According to SARS, even if a share repurchase and a redemption of preference shares were similar in nature, the principles will in any event no longer apply, since:[215]

- *ITC 1859* was decided under the Companies Act, 1973 and, in SARS' view, there is a difference in the wording between the Companies Act, 2008 and Companies Act 1973 in relation to share repurchases; and

- paragraph 11(2)(b) of the 8th Schedule to the Income Tax Act would be rendered pointless if a company did not acquire its own shares in terms of a share repurchase.

However, as set out in 7.2.1 above, commentators are generally in agreement that the mechanics of a share repurchase under the Companies Act, 2008 does not differ from one under the Companies Act, 1973.[216] Furthermore, paragraph 11(2)(b) simply disregards the event of the shares being cancelled as a disposal and does not provide that is a non-disposal *for the company*. It bears to be noted that paragraph 11(2)(b) formed part of the 8th Schedule since the inception of CGT on 1 October 2001, at which stage the Companies Act, 1973 was in force. In terms of the Companies Act, 1973, a company was entitled to convert its stated share capital from no par value into share capital consisting of par value shares and simultaneously cancel any excess share capital that was not taken up as part of the conversion by means of a special resolution.[217] Accordingly, the reference to the cancellation of shares in paragraph 11(2)(b) does not exclusively cater for the cancellation of shares as a result of a repurchase, but also used to cater for the cancellation of excess share capital under section 75(4)(b) of the Companies Act, 1973.

7.3.3 Concluding remarks

Based on (i) the fact that the distinction between share redemptions and share repurchases arguably does not extend to their legal mechanics and (ii) SARS' unpersuasive reasoning above, *ITC 1859* could well apply in the context of a share repurchase. However, in light of the findings in 7.6 below, it is unnecessary to finally conclude on the matter from an STT perspective.

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[211] *ITC 1859*, paragraph 23.
[212] *ITC 1859*, paragraphs 13, 20 and 21.
[213] *SARS CGT Guide*, 385.
[214] Ibid.
[215] *SARS CGT Guide*, 385 – 386.
[216] It can even be argued that the provisions of the Companies Act, 1973 were more supportive of the view that a company acquires *and* cancels its own shares than the provisions of the Companies Act, 2008, as only the Companies Act, 1973 refers to the shares also having to be 'cancelled' after being 'acquired'.
[217] Section 75(1)(g) and (h) of the Companies Act, 1973. See also section 75(4)(b) of the Companies Act, 1973.

7.4 Practical treatment of share repurchases under the Companies Act, 2008

The Companies Act, 2008 provides that a shareholder will only cease to have the rights associated with a share (i) in the case of certificated shares, when the re-acquisition is entered into the company's register,[218] or, in the case of uncertificated shares, as determined 'in accordance with' the rules of the CSD.[219] Thus, a shareholder will only cease to be the owner of a repurchased share once the re-acquisition is entered into the company's register, or the requirements of the relevant CSD has been complied with.

As set out in 5.3 above, the Strate Rules provide that the 'transfer of ownership' in any securities in a Securities Account must be effected by debiting of the Securities Account or Segregated Depository Account from which the transfer is effected and crediting the Securities Account or Segregated Depository Account to which the transfer is effected, as the case may be, in accordance with the Financial Markets Act, 2012,[220] Companies Act, 2008, Strate Rules and Strate Directives.[221] However, the Strate Rules do not specifically cater for a share repurchase. The Strate system operates on a 'debit-for-a-credit system' and therefore a valid trade cannot be registered if there is no disposal entry and commensurate acquisition entry. Practically, to deal with this system functionality, participants report and submit repurchases to Strate in the form of transfers (that is to say, in the form of instructions to debit the shareholder's account and credit the repurchasing company's account). This creates the impression that the CSD rules require share repurchases to be treated in the way envisaged by SARS.

However, it is submitted that the reference to the rules of the CSD in section 37(9) of the Companies Act, 2008 does not intend to elevate the procedural rules of CSD's themselves to substantive legislation, or at least not law affecting the legal nature of transactions.[222] This is based on the fact that:

- Strate simply acts on instructions from participants and is not privy to the underlying *causa* of the transactions that are being registered. Strate's treatment of a transaction should therefore not be an appropriate measure of the nature of the transaction that is registered;

- the purpose of the reference to the CSD Rules in the provisions of the Companies Act, 2008 is simply to allow the CSD to determine the specific holding and transfer model for uncertificated shares, as this allows for flexibility to ensure that the procedural requirements adapt to the practical realities of global and domestic business developments financial markets;[223]

- each CSD can determine their own rules, depending on their particular system functionalities. While Strate currently does not have specific rules for effecting a repurchase, another CSD may well have. If CSD's rules in general are elevated to law, it would result in an untenable situation

[218] In the case of certificated shares.
[219] Section 37(9)(b) of the Companies Act, 2008.
[220] Act No. 19 of 2012.
[221] Strate Rule 6.2.1.8 read with Strate Rule 7.3.3.1.
[222] Note, however, in the context of the transfer of ownership of an uncertificated share, the procedural requirements in the relevant Strate Rules are similar to the legislative requirements set out in section 53(2) of the Companies Act, 2008 (that is to say, the requirement that the transferor and transferee's relevant CSD accounts must be debited and credited respectively).
[223] *Vermaas (2010)*, 101.

where the legal mechanics of share repurchases are treated differently, depending on which CSD processes the trade;

- section 37(9) of the Companies Act, 2008 only requires that registration or cessation of the rights attaching to the share must occur 'in accordance with' a CSD's rules. Accordingly, it only requires compliance with those procedural rules (whatever they may be), rather than elevating them to law that affects the nature of a transaction. Therefore, where a CSD's rules require a procedure to comply with the relevant CSD's systems functionality, it does not affect the legal nature of the transaction or change the common law principle that a company cannot exercise rights against itself.

Nevertheless, *compliance* with the procedural rules of CSD's regulating the transfer of uncertificated shares is now a statutory requirement to prove ownership of an uncertificated share, or legal transfer thereof.[224] The effect thereof is that the CSD register at any given moment reflects the owner of the uncertificated share and the rights attaching thereto. The purpose of the reference to the CSD rules is therefore simply a way to ensure that any procedural requirements for the registration of a trade that are prescribed by a particular CSD have to be followed in order to become the legal owner of an uncertificated share. However, whatever those procedures are, they should not affect the legal nature of the underlying transaction that is processed by the relevant CSD.

7.5 Application of STT requirements in the context of a share repurchase of uncertificated shares

As set out above, uncertainty exists around the mechanics of a share repurchase. On the one hand, the Corporate Law Position, which aligns with the judgment in *ITC 1859* in the context of a share redemption, dictates that a company repurchasing its own shares never acquires the share itself and therefore involves only a single 'transfer' event. On the other hand, the SARS Position is that a share repurchase consists of two distinct 'transfer' events, namely a sale by the shareholder and a cancellation by the repurchasing company.

It is preferable that share repurchases be treated in a uniform manner for corporate law and tax law purposes. More specifically, it is preferable that transactions are at least treated in a consistent manner for tax purposes (for instance in determining both the CGT and STT consequences of a transaction). Nevertheless, and irrespective of which approach correctly reflects the mechanics of a share repurchase, it is generally agreed that STT should be levied on a share repurchase only once.[225] However, this result should be based on, and supported by, a proper application of the provisions of the STT Act to a share repurchase.

[224] See Chapter 5 dealing with the meaning of 'security'. Stated differently, one cannot claim to be the owner of an uncertificated share if one was a purchaser in terms of a failed trade in terms of the CSD's rules.
[225] *Brincker*, UA – 7.

As illustrated in Chapter 1, there are essentially three requirements that have to be met before STT will be imposed on a transaction:

- There must be a 'transfer' event in relation to a 'security' (see Chapter 2);
- The 'transfer' event must result in a change in 'beneficial ownership' in that security (see Chapter 3 and Chapter 4); and
- The 'transfer' event must relate to a 'security' and result in a 'transfer of the security' (see Chapter 5).

The application of these requirements in the context of a share repurchase in terms of both the SARS Position and the Corporate Law Position is illustrated below.

7.5.1 SARS Position (Two 'transfer' events)

'Transfer' Event 1: Disposal by shareholder to repurchasing company	
'Transfer' event	✓ The repurchase by the company from its shareholder will constitute a 'sale', or at least a 'disposal in any other manner'.
Transfer of a 'share'	✓ A person ceases to have the rights associated with any particular securities as determined in accordance with the CSD Rules.[226] As the share will be registered in the company's name, as required by the CSD Rules, the disposal by the shareholder will constitute the transfer of a 'share'.
'Change in beneficial ownership'	✓ As the company will, for an instant, acquire all the rights attaching to the repurchased share and therefore momentarily become the beneficial owner of the repurchased share, the disposal will result in a change in beneficial ownership.

[226] Section 37(9)(b)(ii) of the Companies Act, 2008.

'Transfer' Event 2: Cancellation by the repurchasing company	
'Transfer' event	✓ The cancellation of the repurchased share by the repurchasing company will constitute a 'cancellation' other in the process of winding-up, liquidation, deregistration or termination of the company's corporate existence.
Transfer of a 'share'	× As the share will not be registered in the company's name, the cancellation arguably not constitute the transfer of a 'share'.
'Change in beneficial ownership'	✓ As the company will cease to be entitled to the benefits attaching to the repurchased share upon cancellation, the disposal will result in a change in beneficial ownership.

Based on the above application of the definition of 'transfer', STT will only be levied on the disposal of the repurchased share by the shareholder to the company and not on the cancellation of the share by the repurchasing company. While this results in the desired outcome of a single levy of STT on the share repurchase, the following difficulties arise:

- it renders the inclusion of the cancellation of a share other than in the process of winding-up, liquidation, deregistration or termination of the company's corporate existence in the definition of 'transfer' pointless, as that 'transfer' event does not result in STT; and

- it does not accord with the view of legal commentators and arguably the court in *ITC 1859* as far as the mechanics of a share repurchase are concerned and infringes the principle that a company cannot own or exercise rights against itself, even momentarily.

Admittedly, in the absence of the repurchased share being registered in the company's own name pursuant to the CSD Rules, no 'transfer of a share' will occur. However, as set out above, the CSD Rules are purely procedural requirements that are subject to change and which may differ from exchange to exchange. The relevant CSD Rules should therefore not affect the legal nature of a transaction and thus not provide a legal basis for the mechanics of a share repurchase as envisaged by SARS.

7.5.2 Corporate Law Position (Single 'transfer' event)

'Transfer' Event: Cancellation of share as a result of disposal by shareholder	
'Transfer' event	✓ The disposal of the repurchased share by the shareholder will constitute either a 'sale', 'cancellation' or at least a 'disposal in any other manner'.
Transfer of a 'share'	✓ A person ceases to have the rights associated with any particular securities as determined in accordance with the CSD Rules.[227] As the share will be registered in the company's name, as required by the CSD Rules, the disposal by the shareholder will constitute the transfer of a 'share'. The repurchase will constitute the transfer of a share, as the share will be registered in the repurchasing company's CSD account.
'Change in beneficial ownership'	✓ The repurchase will result in a 'change in beneficial ownership' in the repurchased share, as the shareholder will no longer be the beneficial owner of the repurchased share subsequent to the repurchase

Based on the above application of the definition of 'transfer', the Corporate Law Position will also result in the desired outcome of a single levy of STT on a share repurchase. While this approach aligns with the legal mechanics of a share repurchase as well as that of a share redemption, it results in the following difficulties:

- in terms the CSD Rules, the repurchased share still needs to be registered in the repurchasing company's name. On the one hand, the procedural requirement in the CSD Rules must be complied with in order for the transfer to constitute the transfer of a 'share' (and be subject to STT). However, on the other hand, compliance with the procedural requirement results in the repurchasing company becoming the registered owner of its own share and creates a strong impression that the repurchasing company still acquires the repurchased share momentarily. This is however primarily the result of the CSD Rules not specifically catering for share

[227] Section 37(9)(b)(ii) of the Companies Act, 2008.

repurchases and the procedure by default reverting to the requirements for a sale of a share. In this regard it must be borne in mind that, as set out above, the CSD Rules are purely procedural requirements and should not affect the legal nature of a transaction; and

- it will result in the untenable situation where SARS (correctly or incorrectly) treats a share repurchase differently for CGT and STT purposes.

7.6 Conclusion

There are currently two differing views in respect of the mechanics of a repurchase. In terms of the Corporate Law Position, a company repurchasing its own shares never acquires the share itself and thus involves only a single 'transfer' event. On the other hand, the SARS position is that a share repurchase consists of two distinct 'transfer' events, namely a sale by the shareholder and a cancellation by the repurchasing company.

In *ITC 1859*, the Tax Court specifically found that a share redemption must be treated consistent with the Corporate Law Position for tax purposes. Therefore, to the extent that a share redemption and a share repurchase are similar in nature, a share repurchase should be treated in accordance with the Corporate Law Position. While there is a technical distinction between a share repurchase and share redemption for company law purposes, their mechanics are arguably similar in nature since a share redemption is effectively a specific type of repurchase.

Nevertheless, both the Corporate Law Position and SARS Position result in a single STT charge on a share repurchase and the divergence in views is therefore arguably not critical in the context of STT. However, as set out under 7.5.1 and 7.5.2, both interpretations give rise to some practical anomalies and difficulties. In addition, it would be preferable, for the sake of legal certainty, if the tax treatment of a transaction aligned with the legal nature of that transaction.

It is therefore recommended that the mechanics of a share repurchase be clarified through legislative amendments to the 8th Schedule to the Income Tax Act, the STT Act and the Companies Act, 2008. Furthermore, it is recommended that CSD Rules be reconsidered so as to provide for a separate procedure for the registration of a share repurchase, with due regard to the legal nature thereof. Alternatively, the provisions of the Companies Act should clarify the legal mechanics of a share repurchase and confirm that the CSD Rules are purely procedural and has no bearing on the legal nature of a share repurchase.

CHAPTER 8: CONCLUSION

STT will be imposed on every occurrence of any 'transfer' event of a 'security' that results in a change in 'beneficial ownership' in that 'security', unless that 'transfer' event constitutes the issue of a security or the cancellation or redemption of a security of a company that is being wound up, liquidated, deregistered or finally terminated.

Based on the charging provision in the STT Act read with the definition of 'transfer' in the STT Act, there are essentially three requirements that have to be satisfied before STT will be imposed on a transaction:

- there must be a 'transfer' event in relation to a security;
- the 'transfer' event must result in a change in 'beneficial ownership' in that security; and
- the 'transfer' event must relate to a 'security' and constitute the transfer of that security.

However, the concept of 'beneficial ownership' is not defined in the STT Act. Likewise, the intended scope, meaning and application of the concepts of a 'transfer', 'security' and 'beneficial ownership' for STT purposes aren't always clear, resulting in practical difficulties. Accordingly, this dissertation primarily sought to identify, investigate and clarify the practical scope and meaning of the requirements for the imposition of STT. In addition, the dissertation seeks to apply these findings to a transaction that occur on a regular basis and serve important commercial purposes, being a share repurchase.

The first requirement that must be satisfied for the imposition of STT is that a 'transfer' event in relation to a security must occur. The definition of 'transfer' for STT purposes is cast extremely wide and any form of disposal or alienation of a 'security' by the holder thereof will constitute a 'transfer' event that can potentially result in the imposition of STT. However, such a disposal or alienation will only result in STT if the second and third requirements below are also met.

The second requirement that must be satisfied for the imposition of STT is that the 'transfer' event must result in a 'change in beneficial ownership' in the security that the 'transfer' event relates to. South African common law has long recognised a distinction between the 'beneficial owner' of a share and the registered owner thereof. The registered owner is the person who appears in the share register of the company, is a member of the company and can enforce its rights as member against the company. The so-called 'beneficial owner', on the other hand, does not appear in the share register, but is entitled to benefits flowing from the share. This distinction has recently also been acknowledged in the context of the Income Tax Act, particularly in the context of dividends tax and in determining whether a 'connected person' relationship exists between taxpayers.

The term 'beneficial ownership' is however not defined in the STT Act and has not been authoritatively interpreted by a South African court. In this regard, the Constitution requires South African courts to prefer any reasonable interpretation of legislation (such as the STT Act) that is consistent with international law. Accordingly, international case law dealing with the concept of 'beneficial ownership'

will, at least, have persuasive value in South African courts. As indicated in Part A of Chapter 3, there is currently no universally accepted definition of the term 'beneficial ownership'. Nevertheless, based on the relevant international case law, it will be appropriate for a South African court tasked with establishing the domestic meaning of 'beneficial ownership', as a point of departure, to consider whether the entity claiming 'beneficial ownership' of the share is a 'mere conduit' or whether it (i) receives the income from the shares for its own enjoyment, (ii) assumes the risk and control of the shares and (iii) is not wholly accountable to anyone else for how the shares are dealt with.

In the absence of a statutory definition of 'beneficial ownership' for STT purposes and regard being had for (i) the ordinary grammatical meaning of the term 'beneficial ownership', (ii) the context of the overall scheme of the STT Act, (iii) the purpose of the provision against the background to the production of the STT Act and (vi) appropriate international case law, the term 'beneficial ownership' should include any person who has a right or entitlement to the benefits attaching to that share, unless that person is an intermediary or 'conduit' with absolutely no discretion with regards to the benefits of the share. On that basis, Chapter 3 concludes that the 'beneficial owner' of a share will be the person whose right or entitlement to the benefits attaching to that share outweighs those of any other person.

Therefore, in order for a 'change in beneficial ownership' to occur, a 'transfer' event relating to a share must result in either (i) a different person being entitled to the majority of the benefits attaching to that share or, at least (ii) in the transferor no longer being entitled to the majority of the benefits attaching to that share. Practically, there are no prescribed procedural requirements (such as registration in accordance with the Companies Act, 2008) that must satisfied in order for a 'change in beneficial ownership' to occur. Furthermore, it is concluded that a 'beneficial interest' as envisaged in the Companies Act, 2008 does not necessarily equate to 'beneficial ownership' of a share, since there can be more than one 'beneficial interest holder' of a share, but only a single 'beneficial owner' of a share. Nevertheless, these concepts are not mutually exclusive, since the granting of a beneficial interest in a share that amounts to a right or entitlement to the majority of the benefits attaching to that share, will result in a 'change in beneficial ownership' in that share.

The third requirement that must be satisfied for the imposition of STT is that the 'transfer' event must relate to a 'security' and constitute the 'transfer of a security'. The definition of 'security' in the STT Act includes the ordinary notion of a share in a company. As set out in Chapter 5, a share is an incorporeal movable consisting of a bundle of personal rights. This bundle of rights comprise of, *inter alia*, (i) the right to dividends when declared, (ii) the right to share in the 'surplus assets' of the company (if any) whether by way of an authorised return of capital or upon the winding-up of the company and (iii) the right to attend and vote at general meetings of shareholders. These rights are capable of being transferred (either individually or collectively) independently from the share itself. Accordingly, a share exists apart from the rights that it comprises. This notion is supported by the fact that South African courts have consistently recognised that ownership of shares is at times distinct from the registered title to shares. The state of affairs in this regard is best illustrated by *Borrowdale's* 'unsatisfactory position', in terms whereof two sets of obligations are created where the registered owner of a share is not also

the ‘beneficial owner’ thereof. These obligations involve (i) the rights comprising the share which the registered title holder possesses as against the company by virtue of his registration and which he alone can enforce and (ii) the rights of entitlement to the benefits of the rights comprising the share of the ‘beneficial owner’ against the registered title holder created by the agreement between them.

It is on this basis that the common law distinguishes between:

- the transfer of particular rights comprising the share, which usually equates to the transfer of ‘beneficial ownership, or least of a ‘beneficial interest’; and

- the transfer of title of the share, which equates to a transfer of the share itself.

Practically, the transfer of rights comprising a share can be effected by means of a cession without compliance with any formal procedural requirements. However, in order to effect the transfer of registered title of a share, the procedural requirements prescribed in the Companies Act, 2008, must be complied with. Accordingly, Chapter 5 concludes that no ‘transfer’ of a ‘share’ can occur for STT purposes in the absence of all the corporate law requirements for the transfer of title to that share having been met.

Chapter 6 concludes that the practical requirement for the imposition of STT on the transfer of a share will, based on the above findings, effectively amount to the following:

- there must be any kind of disposal or other alienation of that share;

- subsequent to the transaction, someone else’s right or entitlement to the benefits (such as the voting right, the right to receive dividends or the right to share in the surplus assets upon liquidation of the company) attaching to that share must outweigh the transferor’s, or any other person’s, right or entitlement to those benefits; and

- all the prescribed procedural requirements (such as the procedural requirements relating to registration prescribed in the Companies Act, 2008) for the transfer of that share must be met.

Chapter 7 seeks to apply the STT requirements considered in the preceding chapters to a common commercial transaction; a share repurchase. The fact that the legal mechanics of a share repurchase has not been authoritatively settled, results in potential uncertainties regarding the STT treatment of a share repurchase. Commentators are generally in agreement that, from a legal perspective, the reference to ‘acquire’ in the context of a share repurchase is a ‘misnomer’, as a company is unable to ‘acquire’ and hold its own shares. Accordingly, from a corporate law perspective, a share repurchase involves only a single ‘transfer’ event for STT purposes. On the other hand, and in contrast to its initial view under the Companies Act, 1973, SARS is of the view that a share repurchase consists of two distinct ‘transfer’ events, namely an acquisition by the repurchasing company of the repurchased share from its shareholder for a moment in time and a subsequent cancellation of that repurchased share by the repurchasing company immediately thereafter.

In addition, SARS distinguishes a share repurchase from share redemption (the mechanics of which has been settled from a tax perspective). This distinction further aggravates the uncertainty with regards to the STT treatment of a share repurchase, as it prevents the tax principles that apply in respect of a share redemption from being applied in the context of a share repurchase. However, based on the finding below, it is unnecessary to definitively conclude on the similarities between a share repurchase and redemption from a tax perspective. Nevertheless, Chapter 7 highlights that there is potentially no difference in the legal mechanics of a share repurchase and redemption, since the distinction between the transactions in terms of the Companies Act, 2008 appear to be purely formalistic in nature.

Chapter 7 primarily concludes that, notwithstanding the inconsistency between the corporate law position and the SARS position in respect of the mechanics and treatment of a share repurchase, the requirements for the imposition of STT can be interpreted in such a way that both views result in a single STT charge on a share repurchase. However, both interpretations result in varying degrees of practical anomalies and difficulties. Due to these anomalies, as well as SARS' unpersuasive reasons for (i) its departure from its previous view in respect of the mechanics of a share repurchase and (ii) distinguishing between a share repurchase and a share redemption, Chapter 7 recommends that the mechanics and treatment of a share repurchase should be clarified through definitive guidance or legislative amendments. These can include one or more of the following measures:

- amendments to the STT Act that clarify the STT consequences of a share repurchase;
- amendments to the Companies Act, 2008 that clarify the legal mechanics of a share repurchase;
- amendments to the 8th Schedule to the Income Tax Act that clarify the CGT consequences of a share repurchase;
- amendments to the CSD Rules so as to provide for a separate procedural treatment of a share repurchase that takes its legal nature into account;
- An Interpretation Note that clarifies all the tax consequences of a share repurchase, with specific reference to the basis for any departure from the tax consequences of a share redemption.

Any combination of the aforementioned measures will provide more certainty on the STT analysis of a share repurchase and eliminate the perceived inconsistency in the tax treatment of a share repurchase.

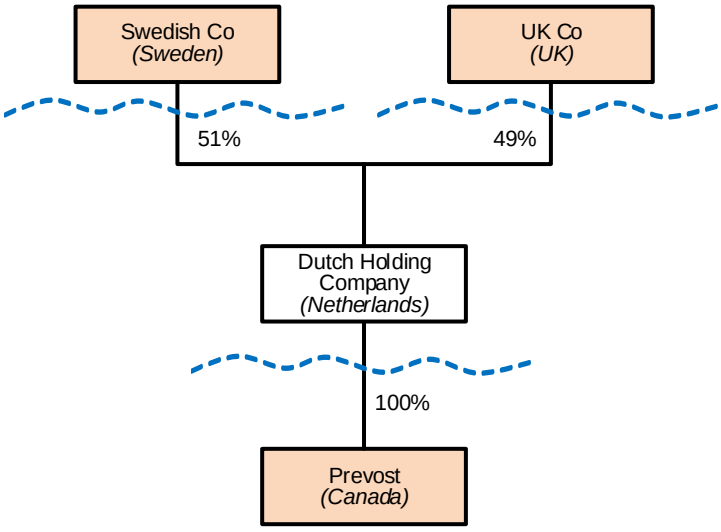
ANNEXURE A: INTERNATIONAL CASE LAW SUMMARIES

This annexure sets out a more detailed summary of the background facts, arguments presented and findings made in the international case law referred to in Part A of Chapter 3. It is therefore recommended that the comments and conclusions in Part A of Chapter 3 be considered in the context of the more detailed case summaries below.

Prévost Car Inc. v Her Majesty The Queen

In *Prévost Car Inc. v Her Majesty The Queen*,[228] a Swedish company ('Swedish Co') and UK company ('UK Co') (collectively referred to as 'the shareholders') acquired the shares of a Canadian car manufacturing company ('Prévost'), which they held *via* a Dutch holding company that had no physical office or employees in the Netherlands and held no assets other than the interest in Prévost. The shareholders entered into a dividend policy in terms whereof at least 80% of Prévost's net profit retained after tax would be distributed to them, subject to the larger group's capital requirements ('dividend policy'). The Tax Court of Canada ('TCC') was called upon to determine whether dividends paid by Prévost to the Dutch holding company were subject to Canadian withholding tax at the domestic statutory rate of 25%,[229] or the reduced rate of 6% (later 5%) pursuant to the Canada/Netherlands DTA. This question depended exclusively on whether or not the Dutch holding company was the 'beneficial owner' of the dividend.

The relevant corporate structure of the Prévost group at that stage was as follows:



In determining the meaning of the term 'beneficial owner' for purposes of the Canada/Netherlands DTA, the TCC made the following remarks:

[228] 2008 TCC 231.
[229] The Canadian Revenue Authority claimed that dividend tax should have been withheld at a rate of only 15%, which it argued was a concession on its part.

- The 'beneficial owner' of a dividend is the person who:[230]
    - '*receives the dividends for his or her own use and enjoyment'*;
    - '*assumes the risk and control of the dividend*';
    - '*enjoys and assumes all the attributes of ownership'*;
    - '*is not accountable to anyone for how he or she deals with the dividend income*';
    - '*could do with the dividend what he or she desires'*.
- The shareholders of a corporation are not automatically the 'beneficial owners' of the assets or income earned by that corporation;[231]
- The shareholders of a corporation receiving a dividend will only be the 'beneficial owners' of that dividend to the extent that '*the corporation is a conduit … and has absolutely no discretion as to the use or application*' of the funds or has '*agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it*' with regard to the dividend.[232]

The TCC proceeded to find that the Dutch holding company, and not UK CO or Swedish Co, was the 'beneficial owner' of the dividend, dismissing the Canadian Revenue Authority's main contention that the Dutch holding company acted as a mere 'conduit' or 'funnel' for the dividends. In support of its decision, the Court found that the dividends received from Prévost was not *ab inito* destined for Swedish Co and UK Co (that is to say, there was no predetermined or automatic flow of the dividend from Prévost to the shareholders *via* the Dutch holding company), as (i) the Dutch holding company was not a party to (and therefore not bound by) the shareholders agreement that established the dividend policy, (ii) its Deed of Incorporation did not obligate it to declare dividends to the shareholders and (iii) the dividends first had to be on-declared by the Dutch holding company's board and approved by its shareholders before it was paid to the shareholders.[233] Accordingly, the Court held that:[234]

> *'PHB.V[235] was the registered owner of Prévost shares. It paid for the shares. It owned the shares for itself. When dividends are received by PHB.V in respect of shares it owns, the dividends are the property of PHB.V. Until such time as the management board declares an interim dividend and the dividend is approved by the shareholders, the monies represented by the dividend continue to be property of, and is owned solely by, PHB.V. The dividends are an asset of PHB.V and are*

[230] *Prévost*, paragraph 100.
[231] Ibid.
[232] Ibid.
[233] In this regard, it bears to be mentioned that Prévost and the Dutch holding company's board of directors consisted of the same persons and the Dutch holding company's shareholders were the same parties who entered into the dividend policy with Prévost.
[234] *Prévost*, paragraph 105.
[235] Being the 'Dutch holding company'

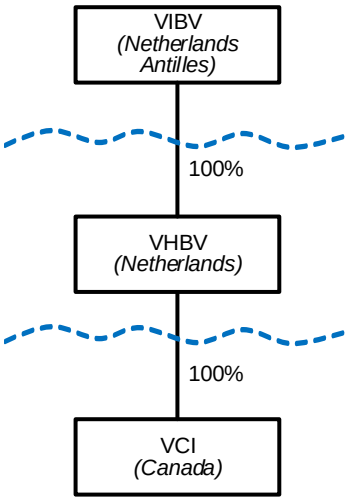
available to its creditors, if any. No other person other than PHB.V has an interest in the dividends received from Prévost. PHB.V can use the dividends as it wishes and is not accountable to its shareholders except by virtue of the laws of the Netherlands. Volvo[236] and Henlys[237] only obtain a right to dividends that are properly declared and paid by PHB.V.'

Velcro Canada Inc v The Queen

In *Velcro Canada Inc v The Queen*,[238] the TCC had to determine whether royalties paid by a Canadian company to a Dutch holding company were subject to Canadian withholding tax at the domestic statutory rate of 25%, or the reduced rate of 10% pursuant to the Canada/Netherlands DTA. This question depended exclusively on whether or not the Dutch holding company was the' beneficial owner' of the royalty payment.

In that case, Velcro Canada Inc, a Canadian resident company ('VCI') paid royalties to Velcro Industries BV, a Dutch resident company ('VIBV'), for the use of the Velcro brand and fastener technology in Canada pursuant to a Licence Agreement entered into in 1987. At that stage, VCI withheld and remitted tax on the royalty payments to VIBV at the reduced rate of 10%, based on the fact that VIBV was a Dutch resident and Article 12(2) of the Canada/Netherlands DTA applied. However, during 1995 the larger Velcro group embarked on a restructure in terms whereof VIBV became a resident of Netherlands Antilles. As no treaty existed between Canada and the Netherlands Antilles, any royalties paid by VCI to VIBV would be subject to withholding tax at the domestic statutory rate of 25% in Canada. Accordingly, VIBV assigned its rights and obligations under the License Agreement to Velcro Holdings BV, a Dutch resident company ('VHBV'). In consideration, VHBV agreed to pay VIBV an arm's length percentage of the net royalties received from VCI within 30 days of receipt thereof. As a result, any future royalty payments by VCI pursuant to the License Agreement (now made to VHBV) would continue to be subject to withholding tax at the reduced rate of 10% pursuant to the Canada/Netherlands DTA.[239] The relevant corporate structure of the Velcro group at that stage is set out in the diagram on the following page.

[236] Being 'Swedish Co'.
[237] Being 'UK Co'.
[238] 2012 TCC 57.
[239] Tax was withheld at the reduced rate of 10% pursuant to the Canada/Netherlands DTA until December 1998, when the royalty rate was reduced to 0%.



In determining whether VHBV was the 'beneficial owner' of the royalty payments, as submitted by VCI, the Court applied the so-called 'beneficial owners test' as enunciated in *Prévost* and took into account the following factors:

- who had possession of the payment;
- who had the right to use and enjoyment of the payment;
- who assumed economic risk in respect of the payment;
- who had control of the payment.

Based on these factors, the Court found that VHBV was the 'beneficial owner' of the royalties, for the following reasons:

'Possession' and 'use and enjoyment'

- VHBV owned the account wherein the royalties were deposited;
- VHBV was entitled to the interest on the royalties;
- VHBV's cash flow statements showed that the royalty payments were not segregated from, but were co-mingled with, VHBV's other monies;
- in terms of the License Agreement, VHBV was in no way prevented from using the royalties;
- VHBV utilised its funds (a portion of which was made up of the royalties) on an operational basis as it saw fit.

‘Risk’ and ‘control’

- VHBV assumed the risk of currency fluctuations in that the royalties were received in Canadian Dollars and then converted into US or Dutch currency;

- the royalties were at risk of seizure to satisfy VHBV’s creditors, without preference to VIBV’s claim;

- no agreement indemnified VHBV against any risks and/or exposure arising from the royalty payments.

The Court further found that VHBV simply had certain contractual obligations with respect to monies it contractually owed to VIBV. It held that, since VHBV had a semblance of discretion (as limited as it might have been) with regards to the royalties, there was ‘*no predetermined or automatic flow through*’ of the royalties to VIBV. This, the Court held, barred it from piercing the corporate veil and finding that VIBV was the ‘beneficial owner’ of the royalties, as it is only when there is *“‘absolutely no discretion” that the Court take the draconian step of piercing the corporate veil’*.[240]

Accordingly, it was found, with reference to the *Prévost* case, that since the agreement did not automatically pass on dividends or royalties to VIBV, without any discretion on the part of VHBV, VIBV’s beneficial rights cannot be said to ‘*shift the beneficial ownership of the payment over to the third party’*.[241]

ZAO Votek Mobile and OAO Sankt-Petersburg Telecom

In the *ZAO Votek Mobile*[242] and *OAO Sankt-Petersburg Telecom*[243] cases, the Russian Tax Inspectorate contended that two Russian subsidiaries of a Swedish company which paid dividends to their Swedish parent company were not entitled to apply the reduced rate provided for in the Russian/Swedish treaty in respect of their obligation to withhold dividends tax, on the basis that the Swedish company was not the ‘beneficial owner’ of the dividend.

In both cases, the Court ruled that the Swedish company was the ‘beneficial owner’ of the dividends, as the entire amount of the dividends was not on-distributed by the Swedish company to its shareholder. Additionally, in the *OAO Sankt-Petersburg Telecom* case, there was sufficient evidence indicating that the Swedish company:

[240] *Velcro*, paragraph 52.
[241] *Kruger*, 13.
[242] Ruling of the Nineteenth Arbitration Appeal Court of 5 June 2015 on Case No. A14-13723/ 2013.
[243] Decision of the Moscow Arbitration Court of 16 June 2015 on Case No. A40-187121/14.

- conducted its own business activities, in respect of which it received income and incurred certain expenses;

- used the income received from its Russian subsidiary in its financing and investment activities;

- had management that made independent decisions regarding the distribution of dividends to its shareholders.

Severstal PAO and OOO TD Petelino

Conversely, in the cases of *Severstal PAO*[244] and *OOO TD Petelino*,[245] the Courts ruled in favour of the Tax Inspectorate's argument that the reduced rate of withholding tax provided for in the Russian/Cyprus treaty could not be applied due to the fact that the Cypriot companies which received the income (in the former instance, in the form of dividends and in the latter case, in the form of royalties) from Russia were 'conduit' companies and did not have an actual right to the income.

In *Severstal PAO*, the Court's ruling was based on the fact that:

- the Cypriot companies made dividend payments soon after receiving dividends from the Russian company;

- the shares in the Russian company were the Cypriot companies' only asset and dividends on those shares made up 99% of their income;

- the Cypriot companies themselves did not have the right to alienate their interests in the Russian company, as the BVI-registered owners of the Cypriot companies had the right to make that decision.

In *OOO TD Petelino*, the Court went so far as to find that a Bermudian company, who was the owner of a trademark, was the 'beneficial owner' of royalties paid by a Russian company to a Cypriot intermediary company in respect of that trade mark pursuant to a sub-licensing agreement, notwithstanding the fact that the Cypriot intermediary company ostensibly conducted genuine business operations in Cyprus.

[244] Decision of the Arbitration Court of the City of Moscow of 31 October 2016 on Case No. A40-113217/16-107-982.
[245] Decision of the Moscow Arbitration Court of 8 May 2015 on Case No. A40-12815/15.

Indofood International Finance Limited v JP Morgan Chase Bank NA London Branch[246]

The case involved a dispute between an Indonesian company, Indofood International Finance Limited ('Indofood') and J.P. Morgan (who acted on behalf of various financers) regarding the termination of loan notes and was heard in the UK by virtue of a UK governing law clause in the loan notes at issue.

In that case, PT Indofood Sukses Makmur TBK ('PTISM') needed to obtain financing and decided to do so *via* a Mauritian subsidiary, namely Indofood. In terms of the funding structure, Indofood acquired interest-bearing funding from various financers in the form of loan notes and on-lent the funds to PTISM on an interest-bearing basis. Typically, interest payments by PTISM would have been subject to withholding tax on interest at a rate of 20% in Indonesia. However, in terms of the Indonesia/Mauritius DTA the withholding tax on the interest payments terms of the loan with Indofood was subject to a reduced rate of 10%. Interest payments by Indofood to the various financers were not subject to any withholding tax.

In terms of the loan agreements, Indofood had the option to settle the loans in full if the tax rate on interest should ever be increased, *unless reasonable measures could be taken* to avoid the increased tax rate.

Subsequently, Indonesia revoked its DTA with Mauritius, resulting in the interest repayment by PTISM to Indofood being subject to Indonesian withholding tax at the rate of 20% (instead of the reduced rate of 10%). Indofood accordingly sought to exercise its right to early redemption of the loans. The various lenders, however, disputed Indofood's right on the basis that a reasonable measure existed to avoid the increased tax rate. According to the lenders, this measure simply entailed the interposition of a Dutch company (the 'Dutch SPV') between PTISM and Indofood, the novation to the Dutch SPV of the loan notes owed by Indofood and the assignment to the Dutch SPV of ownership of the debt owed by PTISM to Indofood. Simply put, the Dutch SPV would be incorporated and simply step into the shoes of Indofood; and the parties would qualify for a reduced withholding tax rate on interest of 10% in terms of the Netherlands/Indonesia DTA. Indofood took the view that the proposal would likely not succeed and continued to seek redemption of the loan notes, resulting in the ensuing litigation.

In order for PTISM to qualify for the reduced rate in terms of Article 11.2 of the Indonesia/Netherlands DTA, the Dutch SPV would have had to be the 'beneficial owner' of the interest payable by PTISM. Accordingly, the Court (amongst other things) had to determine whether the Dutch SPV would have constituted the 'beneficial owner' of the interest.

In its *dictum*, the Court held, with reference to a statement by the Director General of Income Tax in Indonesia, that '*the concept of beneficial ownership is incompatible with that of the formal owner who does not have the full privilege to directly benefit from the income'*.[247]

[246] [2006] EWCA Civ 158.
[247] *Indofood*, paragraph 42.

Considering that the same rights and obligations that applied to Indofood would *mutatis mutandis* apply to the Dutch SPV in terms of the proposed 'reasonable measure', the Court proceeded to find that the Dutch SPV would not be the 'beneficial owner' of the interest paid by PTISM,[248] for the following reasons:[249]

- the Dutch SPV would have received exactly the same amount of interest that it would have been liable to pay to the investors;
- the Dutch SPV would not have retained any margin of the interest and would not have exercised any control over the funds it would receive;
- the Dutch SPV would have received payment only 1 day before it was liable to pay the investors; and
- the loan agreement would have obliged the Dutch SPV to meet its interest obligations solely from the funds received from PTISM and prohibited the Dutch SPV from settling the interest from any other source of funds.

[248] In this regard, the Indonesian Tax Authority indicated that it would not recognize the Dutch SPV as the 'beneficial owner' of the interest.
[249] Stegmann, JB. 2016. '*Determining the impact of the 2014 OECD update to beneficial ownership in equity derivatives and financial instrument transactions*'. M. Com Dissertation, University of Pretoria, 18.

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