

Unforeseen preference share amendments included in tax bill

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The 2019 Taxation Laws Amendment Bill (TLAB) was tabled with the Medium Term Budget Policy Statement on 30 October 2019.



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The TLAB contains a significant amendment to the definition of "hybrid equity instrument" in section 8E of the Income Tax Act, which will deem any distributions made within three years of the date of issue of a preference share to be treated as normal income and fully taxable in the holder's hands.

More specifically, the TLAB will treat a preference share as a "hybrid equity instrument" if

“ the issuer of that share is obliged to redeem that share or to distribute an amount determined with reference to the issue price of that share ... within a period of three years from the date of issue. ”

The previous draft version of the TLAB issued in July 2019 was worded very differently, in effect only contemplating distributions constituting returns of capital made within three years from the date of issue being recharacterised as normal income in the holder's hands. The logic behind this was clear - Treasury did not want an artificial redemption to be done within three years by returning capital without an actual redemption of the shares, whether in whole or in part.

This final version of the TLAB, however, contemplates something completely different. The proposed wording is wide enough to effectively taint any distribution made within three years (even if paid as a dividend) that is calculated as a yield on the issue price (as would clearly be the case with any preference share coupon). National Treasury has not communicated any policy reason for such a fundamental change.

Webber Wentzel intends engaging with both National Treasury and SARS immediately to address this, as the consequences for the preference share market will clearly be dire - particularly given the effective date of this amendment being for years of assessment ending on or after 21 July 2019.

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