

November 2019

## Collective investment schemes in securities – Return of capital

**For income tax purposes, a collective investment scheme in securities (CISS) should distribute any income that it receives or accrues to it, to unit holders within 12 months in order for that CISS to avoid being taxed on the income. <sup>[1]</sup>**

The income streams that typically accrue to a CISS would be comprised of interest, dividends and profit arising from the sale of investments. A dividend is broadly defined in the Act as any distribution from a company to its shareholder, *other than a return of capital*.<sup>[2]</sup> There are instances where a CISS receives a distribution which is a return of capital; these distributions fall outside the definition of a dividend. Where the CISS holds the underlying share with a capital intention, the return of capital would not constitute gross income<sup>[3]</sup> and the CISS would not be subjected to tax on the receipt thereon. The CISS will therefore not be subject to tax where it receives a return of capital and does not distribute this amount within 12 months of receipt or accrual, and in this instance, the subsequent on-distribution will not be taxed in the hands of unit holders.

### **How do shareholders of listed companies know when they are the recipients of a return of capital?**

Listed companies are required to release a SENS<sup>[4]</sup> and/or a circular when any corporate action, such as a return of capital, is planned. The Act requires companies to inform its shareholders when it is returning capital to the shareholder by the time the distribution or payment is made.<sup>[5]</sup> Companies are therefore obligated to inform its shareholders that it has made a distribution which constitutes a return of capital.

### **Corporate actions – The (potential) tax liability is in the detail**

Certain corporate actions, such as an unbundling<sup>[6]</sup>, can result in the distribution of a dividend *in specie*, or a return of capital, to shareholders. If the SENS announcement is unclear with regard to the nature of the distribution that arises from the unbundling, the shareholder would have to seek clarity from the unbundling company with regard to the nature of the distribution. Any uncertainty could result in a tax liability for the CISS where it records the distribution as a return of capital, when in fact the distribution was a dividend.

There are additional complexities to consider:

- An unbundling results in the distribution of an asset (generally a share) by a company to its shareholder. As the shareholder is not receiving a cash distribution, the CISS in this instance may have to fund the distribution to the unit holder from an alternative source. This is particularly relevant where the unbundling represents a dividend *in specie* and the CISS is required to distribute the dividend to the unit holder within 12 months of receipt or accrual.
- Shareholders will have to be mindful of the base cost of the shares received in terms of an unbundling transaction. This is applicable to the shares which are held at the date of the unbundling as well as the base cost of the new shares which it receives as a result of the unbundling. The unit holder could be prejudiced where the base cost of shares are not accurately determined (in conjunction with the base cost of the units held) and the unit holder disposes of his/her units in a CISS after that unbundling.

### Conclusion

CISS's have to pay careful attention to the nature of receipts and accruals arising from the various investments it holds. Where the CISS inadvertently applies the incorrect treatment of an income receipt, there could be adverse tax consequences for both the CISS as well as the unit holders.

For more information, please contact:



**Yacoob Jaffar**  
Director  
Corporate Tax  
KPMG South Africa  
E: [yacoob.jaffar@kpmg.co.za](mailto:yacoob.jaffar@kpmg.co.za)



**Shaficque Narker**  
Senior Manager  
Corporate Tax  
KPMG South Africa  
E: [shaficque.narker@kpmg.co.za](mailto:shaficque.narker@kpmg.co.za)

<sup>1</sup> Section 25BA of the Income Tax Act No. 58 of 1962 (the Act)

<sup>2</sup> Definition of dividend in section 1 of the Act

<sup>3</sup> Definition of gross income in section 1 of the Act

<sup>4</sup> Stock Exchange News Service

<sup>5</sup> Paragraph 76(4) of the Eighth Schedule to the Act

<sup>6</sup> Broadly speaking, the term 'unbundling transaction' encapsulates a transaction in terms of which an 'unbundling company' transfers its (total) equity shareholding in an 'unbundled company' to its shareholders to enable the shareholders of a listed company or the group company shareholders of an unlisted company to acquire directly, by way of a distribution *in specie*, all the equity shares held by the listed or unlisted company.

---

---

---

---

---

[\[1\]](#) Section 25BA of the Income Tax Act No. 58 of 1962 (the **Act**)

[\[2\]](#) Definition of dividend in section 1 of the Act

[\[3\]](#) Definition of gross income in section 1 of the Act

[\[4\]](#) Stock Exchange News Service

[\[5\]](#) Paragraph 76(4) of the Eighth Schedule to the Act

[\[6\]](#) Broadly speaking, the term 'unbundling transaction' encapsulates a transaction in terms of which an 'unbundling company' transfers its (total) equity shareholding in an 'unbundled company' to its shareholders to enable the shareholders of a listed company or the group company shareholders of an unlisted company to acquire directly, by way of a distribution *in specie*, all the equity shares held by the listed or unlisted company.