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Postal: P O Box 504899 Gaborone
Physical: Commerce Park, Plot 49, Unit 2
Telephone: 393 9435 / 71 81 58 36
website: www.aupracontax.co.bw

SHAREHOLDERS TO SOON PAY TAX AT 29.8%: By Jonathan Hore

Last week, I wrote an article based on the fact that the dividends tax may, effective 1 July 2021, soon be 10%, up from the current 7.5%. Based on that, I want to demonstrate that shareholders' effective tax will rise from the current 27.85% to 29.8% and provide useful insights at the end. The analogy below assumes that the 10% dividends tax increase proposed by the Minister of Finance & Economic Development, Hon Dr T Matsheka on 1 February 2021 will be passed by the legislature. Throughout this article, words importing the masculine shall be deemed to include the feminine.

10% or 29.8%?

It is easy to believe that shareholders suffer tax at 7.5% which will or may, effective 1 July 2021, increase to 10%. Well, no-one should be blamed for thinking that way as that is how it looks on paper, i.e. shareholders pay tax at the mentioned tax rates. But there is what we call the effective tax rate, which looks at the total tax cost per each Pula that a taxpayer earns. This is what I will analyse in detail below.

Shareholders tax to be 29.8%

It is critical to state that shareholders withdraw dividends from taxed income, which tax is borne by the company they own. Companies are subject to, in the majority of cases, tax at 22%. This leaves 78%, which is monies which can be distributed to shareholders. An accounting lingo, those reserves are referred to as retained earnings. Now, when shareholders need to reward themselves from those reserves, they pay an additional tax of 7.5% (before 1.07.21) or 10% (after 1.07.21). Effectively, the shareholders will part with income tax at an effective rate of 29.8%, as enunciated below.

To illustrate how the effective tax becomes 29.8%, let us assume that a company makes a net profit before tax of P10m, which for convenience, will be regarded as its taxable income. The shareholders, through the company, will first part with corporate tax of P2.2m. This leaves P7.8m as retained earnings. Assuming that all the retained earnings are distributed as dividends, that will result in another tax of P780 000, being 10% of P7.8m after 1 July. If we do the maths, we see how much the shareholder pays to the taxman. Well, it sums up to P2 980 000 (P2.2m + P0.78m) out of P10m, which translates to an effective tax rate of 29.8%.

Other better options

Well, for listed and bigger organisations, the dividend option appears to be the only feasible way shareholders can be rewarded for their investment in companies. However, there are other options, especially for owner-managed companies where the shareholders work for their companies, as analysed below:

- **Bonus:** Owner-managed companies may opt for bigger bonuses instead of dividends as they can enter into employment contracts with their companies. In the extreme cases, the bonuses massively reduce the tax bills, especially if we assume that the full profits are declared as a bonus. Using the P10m profits per the example above, if a shareholder gets the said P10m as a bonus, he pays PAYE of P 2 469 400 (after

01.07.21), against P2 980 000 payable by a shareholder who withdraws a dividend. The bonus results in the shareholder making tax savings of P 510 600.

- **A higher salary:** A shareholder who gets a handsome salary from his company can make the same tax savings stated above.
- **Interest:** Interest-earning instruments are much better than dividends in a number of ways. Dividends are not automatically paid to shareholders but interest, just like salaries and 13th cheques, are payable whether or not the company makes profit. Dividends are subject to approval by the board and depend on the financial position of the company. There is however now a limit of the interest payable to shareholders.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax whatsapp group or know more about our 8 Tax e-books, send me a text on the number below.