

HOLDING COMPANIES DON'T DEDUCT DIVIDENDS TAX: By Jonathan Hore

The Income Tax Act generally imposes withholding tax on dividends. However, the same Act provides certain provisions that actually prescribe the deduction of withholding tax on dividends declared from taxed dividends. Yes, that's right, dividends declared from taxed dividends are free from withholding tax if paid by what is known as investment companies. You might be asking yourself how that is possible. Well, this article seeks to explore and explain how investment companies are not required to deduct tax on such dividends and I will expand on that today. Throughout this article, words importing the masculine shall be deemed to include the feminine

Investment company

It is critical to note that the Income Tax Act is embedded with meanings of certain words or phrases that should be adopted in the context of interpreting provisions of the Act. This actually means the definition of words provided by the Act takes precedence over the ordinary meaning. Well, in this regard an investment company, in terms of the tax law means 'a company or trust engaged in the business of investing the pooled capital of shareholders in financial instruments (including shares, debentures and units) of other companies...' In essence, an investment company is technically a company whose business consists of investing in the equity of other companies or simply, any shareholding company qualifies as an investment company for tax purposes. Put in other words, a company which holds shares in any other company is regarded as an investment company, whether or not that company is resident in Botswana.

Enter dividends

Now, let us turn to the meaning of a dividend in terms of the Income Tax Act. Interestingly, the Act provides exclusions and conditions on what constitutes a 'dividend'. The Act specifically excludes, 'any distribution of profits by an investment company' from the definition of a dividend provided that such distribution is derived from taxed dividend income that accrued to that investment company. The tax which I refer to above is the withholding tax on dividends, which is now 10% as from 1 July 2021.

Let us pause for a second and try to comprehend the above paragraph. In simple terms, the Act does not consider dividends that are declared from dividend income that would have suffered tax at source as subject to withholding tax. For instance, HoldCo (Pty) Ltd could be a holding company which owns 100% of Sub (Pty) Ltd and that makes it an investment company. If Sub (Pty) Ltd declares a dividend of P10m to HoldCo, withholding tax will be deducted at 10%. However, if HoldCo then declares and distributes a dividend of P9m to its shareholders out of the P10m, such a distribution is excluded from the definition of taxable dividends. As stated above, it does not matter where the shareholders of HoldCo are based, i.e. the withholding tax does not apply even if the shareholders are resident outside Botswana.

Without derogation to the above, if HoldCo declares P15m to its shareholders, P10m from the dividends received from Sub (Pty) Ltd, the excess of P5m is subject to withholding tax as it would most likely be from the payer's retained earnings. What is not made explicit in the Act is whether the shareholders of HoldCo, if they are a company, must also not deduct withholding tax on subsequent declaration of the dividends to their shareholders. However,

my considered view is that no further tax must apply on such dividends as anything to the contrary would be tantamount to double taxation.

Let's summarise

Now, the obvious consequence from the above analogy would be that withholding tax does not apply on a distribution that is not in the ambit of the definition of a dividend. As provided by the Act, a subsequent declaration of dividends from profits derived from dividend income that would have suffered withholding tax 'shall be excluded' from the definition of a dividend as long as it is paid by an investment company.

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 about our 9 Tax e-books, send me a text on the cell number below.