CONTRIBUTED TAX CAPITAL – CTC

INTRODUCTION

For the first time we are seeing two disciplines in the accountant's office – The Tax and Secretarial functions merge.

Although the definition of **CONTRIBUTED TAX CAPITAL** (CTC) is really a ***tax concept*** and has nothing to do with company law it is really only the company secretary that has the necessary records to record and calculate CTC. We have been doing share buy backs without really understanding the tax consequences of keeping proper records of CTC. The record keeping is normally handled by the secretarial department but only from a company secretarial point of view without understanding the tax consequences. The time has come for tax people and secretarial people to work together to come up with the required information thus reducing risk. It is now obligatory to have this information on tap for the purposes of completing the IT14 tax return.

Any repayment of **CONTRIBUTED TAX CAPITAL** (CTC) to a shareholder is not a dividend.

CTC is a tax concept only. From a practical point of view the CTC may be the same as the share capital of a company and may very well be the case where smaller companies are concerned.

In terms of the Income Tax Act there are four parts to the definition of CTC.

PART 1 – NON RESIDENT COMPANY

If a non-resident company becomes a resident company in RSA on or after the 1st of January 2011 it's contributed tax capital will be calculated as follows;

The ***market value*** of all shares on the day before the company becomes resident	RX
Plus the consideration for new shares issued	RY
Total CTC	**RX+RY=CTC**

All the reserves realised and unrealised of the company immediately before it becomes resident in South Africa is effectively the starting point for CTC for income tax purposes and any repayment of these reserves is not a dividend.

A non-resident company can become a tax resident by moving its place of effective management to South Africa. This happens when one or more Directors manage the company from premises in South Africa.

PART 2 – OTHER COMPANIES

Untainted share capital plus the share premium or stated capital immediately before the 1st January 2011	XXX
Plus consideration received for share capital	XXX
Total CTC	**XXX**

Untainted share capital is pure share capital where money was paid into the company for shares that were issued. This could be share capital and share premium if the company is a pre-existing (company incorporated prior to 1 April 2011). ***Tainted share capital*** is where the share capital arose by way of a capitalisation issue. This is where shares are issued to shareholders which are supported by a transfer from reserves to share capital. If these reserves had been distributed to shareholders they would have constituted a dividend.

In order to calculate the CTC one needs to understand the concept of share capital in the old companies act as compared to the new act and one should be able to do a reconciliation between the share capital and the CTC.

PART 3 – REDUCTION OF CONTRIBUTED TAX CAPITAL

Section 46 of the Companies Act deals with this and there are some formalities that need to be complied with. The directors must determine what CTC is to be transferred to shareholders; they must actually resolve the amounts. The safest thing to do when a share buyback takes place besides doing the normal company law formalities is to take care of CTC calculation and to include the details in the resolutions.

EXAMPLE 1

Let us say a company has a share capital of R100,000 plus a share premium of R900,000 and retained income of R2 million. The directors resolve that they are going to pay an amount of R800,000 to shareholders. The CTC of this company is R1,000,000. If nothing is said the full amount of the R800,000 distributed to shareholders is a dividend and is subject to the dividend withholding tax. In this case the CTC remains the same.

Let's say that the directors resolve that of the R800,000, R300,000 is to be paid out of share premium and R500,000 out of reserves or retained income. This means that R300,000 is a reduction of CTC and is not a dividend and R500,000 is a dividend and is subject to the dividend withholding tax.

EXAMPLE 2

The share capital of the company is R50,000 being 1000 ordinary shares of R50 each and it has a retained income of R60,000 making the total share capital R110,000.

The company decides to buy back 10% of the shares by making a payment of R25,000 to shareholders. In this example because the company has determined that they are only buying back 10% this would make a pay-back to shareholders of R5,000 which is a capital reduction and a reduction of the balance of CTC. The balance of the payment of R20,000 has to come out of retained income and is therefore a dividend.

POINT 4 – PROVISO

Basically the proviso to the definition says that a shareholder cannot receive a distribution in a different proportion to the shares they hold for a particular class of shares. If they receive a higher amount to the proportion of the shares they hold then this will be classified as a dividend. It's best to explain this by way of example.

EXAMPLE 1

Let us say a company has a R100 worth of shares and the share premium is now R9,900 making the total share capital R10,000.

One of the shareholders, a 50% shareholder gets R6,000 as a distribution. As the shareholder is only a 50% shareholder they would only be entitled to R5,000 of the

share capital, therefore R1,000 of the repayment is a dividend. After this payment the CTC is reduced by R5,000. Later on the same company wishes to pay R6,000 to B who is now the only shareholder. As the CTC is R5000 one can only reduce the CTC by R5000, therefore R1000 is a dividend. This is for the purposes of illustration only as there are various company issues here.

EXAMPLE 2

A shareholder owns 10,000 ordinary shares in a company which amounts to 20% of the company. These shares have a cost of R100,000. The company buys back the shares for R450,000. What would the journal entry be for this transaction? The balance on the CTC account before the transaction is R1 million rand.

As only 20% of the shareholding is to be paid back only R200,000 will be a capital reduction reducing the CTC balance of R1million to R800,000. The balance of the distribution R250,000 will be a dividend.

This is in line with the proviso of the definition.

COMPLETING THE TAX RETURN

How many different classes of shares have been issued by the company?

Contributed Tax Capital

CCTIF01

Description of class of shares

Amount of contributed tax capital:

(a) Immediately before 1 January 2011; or

R

(b) Where the company became a resident since 1 January 2011

R

Add: Consideration received or accrued for the issue of shares by the company

R

Deduct: Amounts transferred to holders of shares

R

Deduct: Reduction as a result of the application of s42

R

Deduct: Reduction as a result of the application of s44

R

Deduct: Reduction as a result of the application of s46

R

Balance of contributed tax capital at the end of the year of assessment

R

Shares

COSHR01

Do 5 or fewer people (related parties to be considered as one) hold more than 50% ownership of the company? Y ☐ N ☐

Was there any change in shareholder's interest during the year of assessment (excluding listed companies)? Y ☐ N ☐

Did the company convert par value shares to no par value shares during the year of assessment? Y ☐ N ☐

If Yes, specify the value

R

The ITR14 asks a question **did the company convert par value shares to no par value shares.**

If you answered yes to the question it then says *specify the value.*

I would assume that this is the value of the class converted.