A critical analysis of the equality and fairness of the taxation of foreign dividends

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ABSTRACT

This study critically examines the equality and fairness of the taxation of foreign dividend income received by South African resident taxpayers, particularly in relation to the shareholding threshold stated in Section 10B(2)(a) of the Income Tax Act. The legislation currently allows for a full exemption from income tax for taxpayers who hold at least 10% of the equity shares and voting rights in a foreign company, while those who hold less than 10% are subject to income tax. Grounded in Adam Smith's (1776) canons of taxation, this research examines whether the taxation of taxpayers who hold less than 10% of equity shares and voting rights in foreign companies upholds the principle of equity as a fundamental element of a sound tax system.

Employing a qualitative, doctrinal legal research methodology within an interpretive paradigm, the study analyses relevant legislation, case law, academic literature, and tax frameworks in South Africa, the UK, and Ghana. Through comparative analysis, material differences in the treatment of foreign dividends are revealed: while the UK adopts a progressive, income-based approach, Ghana imposes a flat withholding tax, and South Africa's two-fold exemption structure disproportionately benefits higher-equity shareholders.

The study proposes reforming Section 10B(2)(a) to extend partial or tiered relief to taxpayers holding less than 10% equity shares, contingent upon adequate disclosure of foreign tax paid. It further recommends the establishment of enhanced cross-border information-sharing agreements to strike a balance between administrative efficiency and tax equity. These reforms aim to strengthen the coherence, fairness, and inclusivity of South Africa's international dividend tax policy, aligning it more closely with the global best practices and Adam Smith's principles of a sound tax system.

LIST OF ABBREVIATIONS AND ACRONYMS

The following abbreviations and acronyms were used in the study:

DTA	Double Tax Agreement
FDI	Foreign Direct Investment
FTCR	Foreign Tax Credit Relief
ITTOIA 2005	Trading and Other Income Act 2005
JSE	Johannesburg Stock Exchange
OECD	Organisation for Economic Co-operation and Development
PCOF	Portfolio Committee on Finance
REITs	Real Estate Investment Trusts
SARS	South African Revenue Service
The Income Tax Act	Income Tax Act No. 58 of 1962
UK	United Kingdom
WHT	Withholding Tax
MFN	Most Favoured Nation

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CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1 INTRODUCTION

The taxation of both local and foreign dividends significantly influences the tax contribution made by taxpayers to the state, as the applicable tax rates, exemptions, and participation thresholds determine whether dividend income is taxed at source or exempt from tax, which in turn affects the overall tax burden borne by taxpayers (Kubicová, 2015:15). Under the current South African tax system, resident taxpayers are subject to a 20% tax on local and foreign dividends received. This can either be through the dividend tax or under the regular income tax, where applicable exemptions may reduce the final amount to be taxed at a normal rate of 20% (Comprehensive Guide to Dividends Tax (Issue 5), 2021:7).

The 2011 amendment to the South African Income Tax Act No. 58 of 1962 (hereinafter referred to as the *Income Tax Act*) created a clear distinction between local and foreign dividends, now excluding foreign dividends from falling under the general dividend definition, subjecting them to the normal tax system instead of the dividends tax. However, both local and foreign dividends are included in the gross income of the resident taxpayer under Section 1, Paragraph (k) of the Income Tax Act. In contrast, the separation of foreign dividends from the general (local) dividend definition depicts specific criteria for exempting these dividends. The separation allows for full exemptions for local dividends under Section 10(1)(k) and full or partial exemptions under Section 10B for foreign dividends according to the Income Tax Act (South African Revenue Service (SARS), 2021:4). This aim ensures clarity and consistency in maintaining the effective tax rate on local and foreign dividends at or below 20%, as indicated below, while simultaneously fostering investment in local and foreign companies (Hsiung *et al.*, 2022:1).

A noteworthy exception, however, exists in the Act for resident taxpayers who receive foreign dividends from foreign companies that are not listed on the Johannesburg Stock Exchange (JSE) and where the resident holds at least 10% of the total equity shares and

voting rights as the dividend received will not be subject to any taxes in South Africa as indicated in the first bullet below:

- *Foreign Dividends from Non-JSE-Listed Companies (Total Equity Shares and Voting Rights ≥ 10%):* Similar to local dividends, these dividends are fully exempt under Section 10B(2)(a) of the Income Tax Act. A notable exception exists for dividends from non-JSE-listed companies where ownership of the total equity shares and voting rights is at least 10% or more. There is no dividend tax on these dividends. While the dividend is initially included in gross income, it is subsequently fully exempt, resulting in an effective tax rate of 0%; this is where issues of equity and fairness arise because neither dividends tax nor normal income tax is imposed on foreign dividend income where the taxpayer holds at least 10% or more of the total equity shares and voting rights.

In addition to the above, the Income Tax Act also outlines the tax treatment for other categories of dividends, which include foreign dividends from non-JSE-listed companies with less than 10% ownership, dividends from JSE-dual-listed companies, and local dividends. These categories are discussed below:

- *Foreign Dividends from Non-JSE-Listed Companies (Total Equity Shares and Voting Rights < 10%):* These dividends are included in gross income but receive a partial exemption under Section 10B(3)(b) of the Income Tax Act, effectively limiting the normal income tax rate to 20%. There is no dividend tax on these dividends.
- *Foreign Dividends from JSE-dual Listed Companies:* Dividends received from foreign companies listed on the JSE are also fully exempt from normal income tax under Section 10(1)(k) of the Income Tax Act. Similar to local dividends, these dividends are subject to a separate dividend tax of 20%.
- *Local dividends:* Cash dividends received from South African resident companies are fully exempt under Section 10(1)(k) of the Income Tax Act. However, these dividends remain subject to the separate dividend tax at a rate of 20%. This exemption, however, does not apply to local cash dividends received in annuities

(Section 10(2)(b)) and those falling under Section 10(1)(k)(i), such as distributions by Real Estate Investment Trusts (REITs), dividends linked to employee share schemes, dividends received by a company through cession, exercise of a trustee's discretionary power, share borrowing, or application against deductible financial payments. Additionally, dividends obtained as part of a dividend-stripping transaction are not exempt.

According to the above outline, local dividends received from South African resident companies are subject to dividend tax at a rate of 20% and qualify for full exemption under Section 10(1)(k) of the Income Tax Act. Similarly, foreign dividends received from foreign companies listed on the JSE or a comparable registered stock exchange also qualify for full exemption under Section 10B(2)(a). However, foreign dividends from non-JSE-listed foreign companies, where the taxpayer holds less than 10% of the total equity shares and voting rights, are subject to a 20% tax under the normal income tax. This imposition of a 20% tax rate on foreign dividends is accomplished through their inclusion in the taxpayer's gross income, followed by a ratio exemption pursuant to Section 10B(3). Conversely, dividends from foreign companies that are not listed on the JSE and where the resident holds at least 10% of the total equity shares and voting rights are subject to a 0% effective tax rate.

This afore-mentioned Section 10B(3) ratio exemption is achieved in the case of a resident company or closed corporation by exempting 7 out of 27 ($\frac{7}{27}$) of the foreign dividends that were included in the gross income, and by multiplying it by the normal tax at the fixed rate of 27%. For a natural person, a special trust, the estate of a deceased person, and an insolvent estate, the ratio exemption is achieved by exempting 25 out of 45 ($\frac{25}{45}$) of the foreign dividends that were included in the gross income, and by multiplying it by the normal tax at the maximum marginal tax rate of 45%. The ratio exemption aims to prevent the highest effective tax rate on taxable foreign dividends from exceeding the rate payable on local dividends, which is set at 20%, thus maintaining equity, fairness, and consistency (SARS, 2021:40).

Foreign dividends from foreign companies that are not listed on the JSE and where the resident holds at least 10% of the total equity shares and voting rights are included in gross income but receive a full exemption, making them fully exempt from taxation (Stiglingh *et al*., 2023:749). This interplay between the dividend tax, partial exemptions, and the treatment of foreign dividends underscores the complexity and importance of understanding whether dividend tax aligns with equity and/or fairness as a fundamental principle of a well-designed tax system.

The issue of equity in the tax system remains a significant concern, particularly in a country such as South Africa, which has high levels of income inequality, making it more challenging to design a tax system that ensures fairness and equity to generate sufficient revenue to support essential public services (Fall, 2022:3). This research study, therefore, aims to investigate equity as a fundamental principle of a well-designed tax system. It focuses specifically on how foreign dividend income is treated for South African residents who hold less than 10% equity shares and voting rights in foreign companies, compared to resident shareholders who own 10% or more of the equity shares and voting rights. A comparative analysis between South Africa, Ghana, and the United Kingdom (UK) tax systems is undertaken to gain insights into possible practices that enhance the equitable collection of revenue, as the two countries have tax systems similar to South Africa's.

South Africa was chosen as the principal jurisdiction for this study because the researcher is an ordinary resident of South Africa, a tax practitioner and lecturer, and is also familiar with its tax legislation. A comparative analysis can offer valuable insights into the procedures and practices that could be adopted and utilised to enhance the equitable collection of revenue by SARS (Fritz, 2017:11). Ghana and the UK have been chosen for comparative analysis with South Africa due to the common foundation of their legal systems and legislation in English law (Shomade, 2021). Moreover, the two jurisdictions operate under participation tax regimes and implement a progressive income tax system, meaning persons with higher incomes are subject to higher tax rates (Malik *et al*., 2021:15).

1.2 BACKGROUND AND MOTIVATION FOR THE STUDY

This study aims to investigate the equality and fairness of foreign dividend income received by South African residents with equity shares and voting rights as a principle of a sound and efficient tax system. The background of this study examines aspects related to the tax system in South Africa, including considerations for an efficient and effective tax system, as well as the implementation of resident-based taxation. It concludes with an analysis of tax inequality in foreign dividend income for South African residents. Identifying key principles and challenges that shape tax policies and administration is paramount, given their direct influence on the financial decisions and tax strategies of taxpayers.

1.3 TAX SYSTEM IN SOUTH AFRICA

According to Bejaković (2020:145), a sound tax system involves achieving efficiency, equity, and sustainable development. He further defines efficiency in the tax system as the ability to collect adequate public revenues. While efficiency relates to the ability to collect adequate public revenues, this study focuses on equity as the central principle against which the taxation of foreign dividends is examined. In the same vein, equity is understood as the analysis of the distribution of available resources to the public (Bejaković, 2020:137). Therefore, the importance of an efficient and effective tax system lies in ensuring that the government generates the necessary revenue to fund public services (Evans and Joseph, 2015:26). Conversely, Soyode and Oyedokun (2019:18) emphasise the fact that a well-designed tax system imposes taxes either through a progressive or proportional tax rate system. In this regard, the manner in which tax systems are designed and structured has direct implications for equality and fairness, as progressive and proportional tax regimes distribute the tax burden differently among taxpayers.

Tax systems vary by country, with some implementing progressive, regressive, and/or proportional tax systems. A progressive tax system is distinguished by a tax rate that increases in proportion to the taxpayer's taxable income (Weller and Rao, 2010:1). Conversely, a regressive tax system is one in which the tax rate decreases with an

increase in taxable income. On the other hand, a proportional tax system imposes a uniform flat tax rate on all taxpayers, irrespective of their income level (Weller and Rao, 2010:1).

In a progressive tax system, persons in higher income brackets pay a larger percentage of their earnings in taxes, which means that the person contributes a greater share of their earnings to government revenue (Weller and Rao, 2010). This approach is often seen as more equitable because it recognises that those with higher incomes possess a greater capacity to fulfil tax obligations (Regy, 2018:16). Additionally, a progressive tax system has the potential to mitigate income inequality and foster a more equitable distribution of wealth. This is the type of tax applicable in South Africa. A regressive tax system, however, is not applicable in South Africa.

Alongside the progressive tax system, South Africa also employs a proportional tax system, creating what is known as a mixed tax system (Kalideen, 2019:2). As previously mentioned, a proportional tax system imposes a flat tax rate on all taxpayers, regardless of their income levels. This approach is often viewed as simpler and more transparent because it is easy to understand and administer (Pántya *et al.*, 2016:263). Conversely, it can be argued that a proportional tax system may be less equitable, as it does not take into account the taxpayer's ability to pay (Kalideen, 2019:59). Both progressive and proportional tax systems are applied in South Africa. A well-designed tax system in South Africa strives to balance equity, certainty, economy, and convenience while also considering the needs and interests of all members of society (Enyew, 2019:53188).

1.4 EFFICIENT, EFFECTIVE, AND EQUITABLE TAX SYSTEM

Building on the discussion above, Adam Smith (as cited by Fritz, 2017) outlines and recognises the four principles of a sound and efficient tax system, namely equity, certainty, economy, and convenience, which are accepted by South Africa and commonly referred to as "the canons of taxation" (Fritz, 2017:24). For purposes of this study, the terms sound and efficient tax system and well-designed tax system are used interchangeably. Regarding equity, Adam Smith (1776) states that every citizen of the

state should contribute, almost in proportion to their abilities, to the government's support. With certainty, Adam Smith (1776) indicates that taxes paid by subjects of the state should be certain (i.e., the time and amount must be clear). With the canon of economy, the taxes paid by the citizens of the state must be minimal for the contributor to pay but enough to give the government the resources needed (Dahms, 2017:87). Lastly, with the canon of convenience, taxes should be levied at the time or manner most convenient for the person who has to pay. This consideration underscores the importance of ensuring that taxes are fair and equitable for all taxpayers. In recent years, however, there has been a growing focus on equity challenges in the tax system, particularly in relation to income and wealth inequality. Achieving equity in the country's tax system poses a challenge due to various reasons, including high income inequality, a high unemployment rate, sluggish output growth, and environmental challenges that threaten the sustainability of economic progress (Organisation for Economic Co-operation and Development [OECD] Report, 2013:8).

According to Fritz (2017:25), equity implies one's ability to pay, and that those with comparable financial means ought to be treated equally and subject to the same tax burden. According to Bird and Zolt (2003:15), fairness and equity may vary from person to person, and tax scholars have generally defined fairness in terms of both horizontal and vertical equity. Vertical equity calls for appropriate variations among taxpayers in different income circumstances (Black *et al.*, 2022), while horizontal equity requires that those in comparable circumstances pay the same amount of taxes (Repetti and Ring, 2022:136).

According to Stoddard, citing a World Bank Report, South Africa is positioned as one of the most unequal nations worldwide in terms of income distribution (Stoddard, 2022). This means that the majority of the population earns very little, while a small minority earns a lot (Francis *et al.*, 2022:i). As a result, it is challenging to design a tax system that ensures fairness and equity while generating sufficient revenue for the government (Enyew, 2019:53191). When equity is not balanced correctly, it can lead to an unequal taxation scenario where taxpayers are not taxed equally, consequently resulting in

disparate contributions by taxpayers (Bryan, 2014:87). While Adam Smith's first canon of taxation is commonly referred to as the canon of equity, this study uses the term equality in the title to foreground concerns of horizontal equity and distributive fairness, which are examined within the broader framework of tax equity.

The impact of an inequitable tax system can be significant in terms of the revenue collected by the government (Bryan, 2014:84). It can lead to a decrease in public trust in the government, as taxpayers feel that they are being unfairly burdened. It can also exacerbate income inequality, as those already struggling financially are further burdened by high tax rates (Maag *et al.*, 2012:759). An unsustainable tax system can also reduce the government's capacity to provide crucial public services, such as healthcare, education, and infrastructure development (Evans and Joseph, 2015:49). Developing countries are faced with inequality, characterised by high unemployment rates and limited access to grants (Zandi *et al.*, 2022:119). South Africa is no exception, with a projected unemployment rate of 35.6% in 2023 (World Economic Forum, 2023). Given this economic challenge, South African residents face an increased burden of paying high taxes to fund government services (Sachs, 2021:21).

1.5 RESIDENT-BASED TAX

Accordingly, South Africa follows a resident-based tax system where residents are taxed on worldwide income (Stiglingh *et al.*, 2023:26). A person's classification as either a "resident" or a "non-resident" determines the type of income that will be subject to tax in South Africa (Hutchon and Kim, 2020:12). Resident taxpayers are liable for taxes on their worldwide income. In contrast, non-residents are only taxed on income sourced in South Africa. This distinction provides necessary context for the residence-based tax system, within which the taxation of foreign dividend income received by resident taxpayers is examined. In essence, all taxpayers, residents, and non-residents must pay taxes and contribute to the government's practice of collecting money to fund public services (Hutchon and Kim 2020:29).

The term resident is included in the definition of gross income in Section 1 of the South African Income Tax Act No. 58 of 1962. Gross income in relation to any year or period of assessment, in the case of any resident, is defined as the total amount, in cash or otherwise, received by or accrued to or in favour of such resident during such year or period of assessment, excluding receipts or accruals of a capital nature. To interpret the components of the gross income definition, reliance is placed on court cases since not all components of the gross income definition are explicitly defined in the Income Tax Act. The term "resident" serves an important role in establishing the jurisdiction where a taxpayer should pay taxes. The term "resident" encompasses both natural persons, referring to living, breathing human beings, and companies, representing entities distinct from natural persons. Two tests exist to ascertain the residency status of both a natural person and a company.

In the case of a natural person, the two tests encompass the "ordinarily residence" test and the "physical presence" test. Ordinarily residence is the initial test to consider when determining a taxpayer's residency. If the taxpayer fails to meet the requirements of ordinary residency, then the physical presence test is considered. The term ordinary resident is not defined in the Act, and therefore, to interpret the term "ordinary resident," reliance will be based on the court cases.

In the case of *CIR v. Kuttel (1992 (3) SA 242 (A) (54 SATC 298)*, the court determined that "ordinary residence" refers to the place where a person normally resides, disregarding temporary or occasional absences. Conversely, in the case of Cohen v. CIR 1946 AD 174 (13 SATC 362), "ordinarily residence" refers to a country where a person will naturally return to after their wanderings or their real home. When the taxpayer is not an ordinary resident, the physical presence test is considered the second test.

The requirements of the physical presence test are outlined in Section 1, Paragraph (a)(ii) of the Income Tax Act. A natural person will be considered a resident if they meet all the requirements of the physical presence test of being physically present in South Africa for:

i. more than 91 days in total during the current tax year, and
ii. more than 91 days in total for each of the past five tax years before the current tax year, and
iii. more than 915 days in total for the past five tax years before the current year of assessment.

A natural person who fulfils all of the physical presence test conditions will be considered a resident at the beginning of the first day of the relevant assessment year and will be taxed as such on worldwide income. Correspondingly, two tests are also considered when assessing a company's residency status. The first test examines whether the company is incorporated, established, or formed in South Africa. The second test evaluates whether the company is effectively managed in South Africa. The term "effective management" refers to where the company's management is located or where its routine operational activities are carried out.

According to Venter and Stiglingh (1998:382), there are two tax systems, namely the "residence-based" tax system and the "source-based" tax system. In the context of a residence-based tax system, the country will seek to tax all the income derived by the resident taxpayer, regardless of the source from which the income originates. The Katz Commission, cited by Venter and Stiglingh (1998:382), posits that the "source base" is a system where the country taxes income based on its origin, regardless of the taxpayer's residency status (Katz, 1997:1). In the case of South Africa, residents are subject to a resident-based tax system, whereby residents are liable to pay taxes on their worldwide income. However, where South Africa has a Double Tax Agreement (DTA) with other countries covered by the DTA, specific circumstances allow for relief from double taxation (SARS, 2024). For this purpose, the DTA can be regarded as part of a well-designed tax system that strives for equal treatment of all resident taxpayers, as it imposes an equitable tax burden on taxpayers.

1.6 TAX INEQUALITY IN FOREIGN DIVIDEND INCOME FOR SOUTH AFRICAN RESIDENTS

Resident taxpayers who do not benefit from the DTA, where their foreign dividend income (the focus of the study) is taxed in South Africa as well as in other foreign countries, or whose foreign dividend income is exempted from income taxation altogether, may not be treated equally. This is because the taxation of dividends can vary depending on the investor's residency status and the source of the income received. South African residents who receive foreign dividends from a company in which they hold at least 10% of the equity shares and voting rights in the foreign company declaring the dividend are exempt from tax, unlike taxpayers who receive dividends from local and foreign companies (Tarryn Spearman, 2013). A dividend is included in the taxpayer's gross income according to Section 1 Paragraph (k) of the Income Tax Act and, in some cases, qualifies for a full, partial, or no exemption. Section 1 of the Income Tax Act describes dividends as any amount transferred or applied by a resident company for the benefit of any person in relation to any of its shares. Similarly, this section of the Act defines foreign dividends as any amount paid or payable by a foreign company for a share in that company, provided the foreign company classifies it as a dividend or a similar payment for tax purposes.
The reason dividends qualify for an exemption is that they would have been taxed under dividend tax at 20% in the case of local dividends received from South African resident companies or foreign dividends received from a foreign company listed on the JSE. As a result, taxpayers receive a full exemption to avoid double taxation, as the dividend will be fully exempt (Stiglingh *et al.*, 2023:750).

As already alluded, dividends received from foreign companies that are not listed on the JSE and where the taxpayer does not hold at least 10% of the equity shares and voting rights in the foreign company qualify for the partial exemption of $\frac{25}{45}$ in the case of a natural person shareholder or $\frac{7}{27}$ in the case of a company shareholder. The net effect of the partial exemption in the case of a natural person and company shareholders is equivalent to the 20% dividend tax that resident taxpayers would have been taxed on in relation to the local dividends or foreign dividends of JSE foreign-listed companies. The 20% is in the form of normal tax, not dividend tax. For a taxpayer who only receives

dividend income, for instance, when income (gross income less exemption) is multiplied by a natural person's highest marginal tax rate of 45%, the net effect results in the taxpayer being subject to tax at a 20% rate. In the case of a company shareholder, the income will need to be multiplied by the corporate tax rate of 27% to arrive at the net effect of 20%.

Despite the extensive body of literature on international taxation, relatively limited scholarly attention has been devoted to the equity and fairness of tax benefits associated with foreign income, particularly foreign dividend income, and whether taxpayers derive these benefits equally. This is because taxpayers who receive foreign dividends from an unlisted JSE company where the resident holds at least 10% of the equity shares and voting rights in the foreign company qualify for the full exemption, which means the taxpayer will not be subject to any tax according to Section 10B(2)(a). Similarly, capital gain or loss is disregarded when a taxpayer disposes of equity shares in a foreign company, provided the resident holds at least 10% of the equity shares and voting rights in that company and has held the interest for at least 18 months prior to the disposal (Paragraph 64B of the 8th Schedule). Thus, if a taxpayer disposes of foreign equity shares in which they hold at least 10%, the gain is generally not taxable, except where the shares are foreign equity shares listed on the JSE and held for a minimum of three years. In that case, the shares are considered qualifying shares under Section 9C, and the proceeds from disposal are deemed to be capital.

In conclusion, it is likely that foreign dividend income received by resident taxpayers is not taxed uniformly, as resident shareholders holding 10% or more of the equity shares in foreign companies are fully exempt from paying taxes. In stark contrast, other resident shareholders are subject to income tax on foreign dividends or capital gains tax on the disposal of foreign equity shares. There are inequalities in the taxation of foreign dividend income. The study, therefore, aims to explore the equality of foreign investment income received by residents using Adam Smith’s (1776) canons of taxation as a benchmark. This study intends to examine the equality of foreign dividend income received by South

African residents who hold equity shares and voting rights in a South African company in comparison to other countries with similar tax systems, such as the UK and Ghana.

1.7 PROBLEM STATEMENT

Examine the extent to which taxation of foreign dividend income among South African resident taxpayers aligns with equality as one of the four principles of a sound and efficient tax system. Given that foreign dividend income received by resident taxpayers who hold 10% or more of equity shares and voting rights in foreign companies is fully exempted from taxes, resident shareholders who hold less than 10% equity shares and voting rights in foreign companies are subject to income tax on foreign dividends and capital gains tax on the disposal of foreign equity shares. Elkinst (2006:81) opines that the better-off taxpayer should be subject to a lesser exemption and consequently be subject to a greater tax burden. However, the full exemption of foreign dividends under Section 10B of the Income Tax Act may give rise to inequalities. This is because resident shareholders who hold more than 10% equity shares and voting rights in foreign companies are typically higher-income taxpayers with the financial capacity to invest offshore. As a result, the application of section 10B may enable wealthier resident taxpayers to derive proportionately greater tax benefits from the full exemption when compared to those who invest less than 10% equity shares and voting rights in foreign companies. This outcome raises concerns regarding whether the foreign dividend full exemption operates equitably in substance and in accordance with the equality principle, thereby forming the basis of the research problem examined in this study.

This study, therefore, aims to examine the inequality in the taxation of foreign dividend income received by resident taxpayers who hold less than 10% equity shares and voting rights in foreign companies, compared to resident shareholders owning 10% or more equity shares and voting rights, using Adam Smith's (1776) canon of taxation (see 1.4 Efficient, effective and equitable tax system) as a benchmark.

1.8 RESEARCH OBJECTIVES

The primary research objective of the study is to:

- Examine the extent to which taxation of foreign dividend income among South African resident taxpayers aligns with equality as one of the four principles of a sound and efficient tax system, as outlined by Adam Smith (1776) (see Chapter 1).

The following secondary objectives are designed to support and achieve the overarching primary objective of the study:

- Investigate the equality and fairness of the tax exemption granted to South African tax residents on foreign dividend income, specifically by comparing resident holding at least 10% of the foreign company's equity shares and voting rights with those who hold less than 10%. This will be compared with how the UK and Ghana, which have similar tax systems, approach the exemptions of foreign dividend income received by their resident taxpayers (see Chapter 2).
- Developing possible strategies for modifying the South African tax system in relation to the participation exemption based on the study's findings (see Chapter 3).

1.9 RESEARCH DESIGN AND METHODOLOGY

1.9.1 Research Philosophy

The research paradigm is referred to as a set of consensuses regarding the understanding of problems, the perspective through which we perceive the world, and the approach we undertake in conducting research (Rahi, 2017:1). Research paradigms are important to a methodological framework, encompassing ontological and epistemological assumptions (Rehman and Alharthi, 2016:51). A relativistic stance was adopted in this study, recognising the subjective nature of reality, emphasising how social experiences shape individual perceptions, particularly when it comes to taxation (Botha and Greeff, 2022:2). Epistemology is integral to this study, seeking to comprehend the creation of knowledge. It acknowledges that interpretations can be both subjective and objective, particularly in tax legislation (Sri *et al.*, 2019:416).

The philosophical stance encompasses the three most commonly used perspectives (Kim 2003:9), namely positivism, interpretivism, and pragmatism. This study's underlying philosophy employed interpretivism due to its core belief in humans creating meaning. This perspective highlights the distinction between humans and physical phenomena, underscoring that humans possess the capacity to create and assign meaning to their experiences (Pandey, 2009:3). Such emphasis on the role of meaning-making is particularly aligned with the qualitative research method employed in this study. Noteworthy is that the researcher relied on literature gathered by other researchers who employed both positivist and interpretivist approaches.

1.9.2 Research Approach/Strategy

The analysis and interpretation of existing legal sources, including legislation, case law, and legal commentary, play a crucial role in doctrinal research (Knight & Ruddock, 2008:29). This study adopts a qualitative research methodology and, more specifically, a doctrinal research approach. Doctrinal research is concerned with the systematic process of identifying, analyzing, organizing, and synthesizing legal sources, including legislation, judicial decisions, and authoritative commentary, in order to ascertain and critically evaluate the state of the law on a particular issue (McKerchar, 2008:19). Although doctrinal research is often associated with positivist legal traditions, it does not merely involve the mechanical description of legal rules. Rather, doctrine must be evaluated contextually based on the nature and authority of its sources, whether legislation, case law, or interpretative commentary (Hutchinson & Duncan, 2012).

In this study, the doctrinal approach therefore includes a comparative dimension, enabling an evaluation of South Africa’s tax treatment of foreign dividend income alongside selected foreign jurisdictions. This methodological design ensures that the analysis remains grounded in authoritative legal sources while allowing for a critical assessment of equity and fairness within and across tax systems.

Therefore, the qualitative approach, combined with doctrinal legal research, was considered in this study. The study also adopted an inductive approach because it allows for the exploration and generation of new insights and ideas based on the examination of specific legal instances or legislation. Inductive reasoning also enables researchers to identify patterns, themes, and emerging concepts within the intricate network of legal sources, employing a bottom-up approach that progresses from specific cases to broader principles or ideas, facilitating navigation through the complexities of legal documents (Soiferman, 2010). The inductive technique was deemed appropriate since the study aims to compare, identify, and analyse similarities, differences, and trends in legal reasoning, interpretation, and application between South Africa, the UK, and Ghana.

1.9.3 Research Design

This study employed a qualitative research approach, aligned with an interpretive paradigm, to investigate the taxation of foreign dividend income among South African resident taxpayers, focusing on equality and fairness. This is one of the four principles of a sound and efficient tax system outlined by Adam Smith, and it is worth comparing this with the practices in the UK and Ghana. A qualitative methodology is essential when employing an interpretive approach as it allows for a deep understanding of the complexities and distinctions within legal and tax frameworks (Botha and Greeff, 2022:2). Qualitative research involves the collection and analysis of non-numerical data, such as case law, academic journals, and relevant scholarly literature, rather than statistical data. This approach is employed to obtain an in-depth understanding of complex issues and to develop insights, interpretations, or potential solutions grounded in contextual analysis (Bhandari, 2023).

This study employs a qualitative research methodology, as indicated above, primarily utilizing a doctrinal research approach. This method involves a systematic analysis of legislation, statutes, judicial decisions, and legal commentary to understand and interpret the existing legal framework (Hutchinson and Duncan, 2012:102; McKerchar, 2008:19).

To achieve the research objectives, a comparative research approach was integrated into the doctrinal analysis. This involves comparing how the UK and Ghana, which have similar tax systems, approach the exemptions of foreign dividend income received by their resident taxpayers (Shomade, 2021). Comparative law research examines both the similarities and differences in legal systems and their evolution over time, providing a broader understanding of how different jurisdictions address similar issues (Hutchinson, 2015:132).

By combining doctrinal and comparative research methodologies, this study aims to provide a comprehensive analysis of the tax exemption practices for foreign dividend income in South Africa and comparable jurisdictions, offering valuable insights into the fairness and/or equality of these tax policies.

Primary sources of information include the South African Income Tax Act, relevant case law from the UK and Ghana, and official government communications on tax policies. Secondary sources encompass a wide range of materials, including journals, online portals, books, newspapers, dissertations, legislation, and legal commentary. South Africa was selected as the primary jurisdiction due to the researcher's residency and professional expertise in its tax laws. The UK and Ghana were chosen for comparative analysis as both countries, like South Africa, have tax systems rooted in English law. This shared legal foundation provides a strong basis for comparative analysis while allowing for insights into the diverse ways in which taxation policies are applied across different economic contexts (Teixeira, 1996:71).

Tax systems are not only designed to generate revenue but also to reflect principles of fairness and equity (Duff, 2008:2). South Africa's unique taxation framework, particularly its treatment of foreign dividends and participation exemptions, makes it a compelling case study. Ghana and the UK, while operating under similar participation tax regimes, apply different approaches to foreign dividend taxation. Examining these three jurisdictions offers valuable insights into how taxation policies affect equity holders and revenue collection. This analysis is particularly relevant in assessing whether South

Africa's full exemption for significant foreign equity holders aligns with international best practices or creates disparities in tax treatment.

By drawing comparisons across these jurisdictions, this study aims to evaluate whether South Africa's policies promote equitable revenue collection and whether reforms could enhance tax equity and fairness (Ordower, 2006:16).

1.9.4 Data Collection

Data collection is a systematic process of identifying, gathering, and compiling information relevant to addressing the research objectives. For the purpose of this study, the process is encompassed within a qualitative doctrinal research framework. Accordingly, data collection does not involve empirical measurement or statistical or quantitative analysis. Instead, it entails the identification, examination, and interpretation of authoritative primary and secondary legal sources, including legislation, judicial decisions, double taxation agreements, and relevant academic literature (Hutchinson and Duncan, 2012). Therefore, the data collected provides the foundation upon which the doctrinal analysis undertaken in this study is based. This study did not involve human participants but rather utilised secondary data from published sources, including journals, online portals, books, newspapers, dissertations, legislation, case law, and legal commentary, to address the research objectives. The data is readily available to the public at large. However, ethical consideration was sought to ensure that all research regulations were not flawed.

1.9.5 Data Analysis

A doctrinal research methodology using inductive reasoning was employed to compare, identify, and analyse similarities, differences, and trends in legal reasoning, interpretation, and application between South Africa, the UK, and Ghana. The collected data undergo analysis in accordance with the methodology employed in doctrinal studies following these steps, namely compilation of facts and legal issues for study, literature review (searching for relevant literature), analysis (analyses of similarities, differences, and trends in legal reasoning, interpretation, and application between South Africa, the

UK, and Ghana regarding the treatment of foreign dividend income received by residents), conclusion and suggestions (incorporating relevant recommendations for the improvement of the tax system to enhance the equitable collection of revenue by SARS), and research reporting (reporting on library search, supported by accurate and reliable references) (Pradeep, 2019:99).

1.10 ETHICAL CONSIDERATIONS

The study adhered to an ethical protocol to safeguard against any potential harm to participants, and the researcher committed to addressing all ethical considerations throughout the study. The publicly available secondary data were utilised with proper citation and acknowledgement of the sources. An ethical clearance application was submitted to the Faculty of Economics and Management Science Research Ethics Committee (EMS-REC) to ensure compliance with the North-West University policy on academic integrity.

1.11 CHAPTER OUTLINE

1.11.1 CHAPTER 1: INTRODUCTION

Chapter 1 provides a comprehensive rationale for the research, elucidating the underlying motivations and justifications behind the foreign dividend income exemptions granted to South African resident taxpayers. It also presents a contextual background that outlines the criteria for determining residency status. This introduction is followed by a concise articulation of the problem statement, research question, and research objectives. Finally, a thorough examination of the philosophical foundations of the research design and methodology is undertaken.

1.11.2 CHAPTER 2 ARTICLE: ALIGNMENT OF FOREIGN DIVIDEND INCOME TAXATION WITH THE PRINCIPLE OF EQUALITY IN SOUTH AFRICA

This chapter examines the equality and fairness of the tax exemption applicable to foreign dividend income received by South African residents, with specific reference to the differential treatment of resident shareholders holding at least 10% of the equity shares and voting rights in a foreign company and those holding less than 10%. The analysis is

undertaken within the framework of equality as one of the four principles of a sound and efficient tax system, as articulated by Adam Smith (1776), and is informed by a comparative perspective drawn from the approaches adopted in the United Kingdom and Ghana. This chapter will further investigate the equality and fairness of the tax exemption granted to South African tax residents on foreign dividend income, specifically where the resident holds at least 10% of the foreign company's equity shares and voting rights. Lastly, the researcher will compare how the UK and Ghana, countries with similar tax systems to South Africa, approach participation exemptions of foreign dividend income received by their resident taxpayers.

1.11.3 CHAPTER 3: CONCLUSIONS AND RECOMMENDATIONS OF THE STUDY

Chapter 3 presents possible strategies and recommendations for modifying the South African tax system in relation to the participation exemption based on the study's findings.

CHAPTER 2: ARTICLE: ALIGNMENT OF FOREIGN DIVIDEND INCOME TAXATION WITH THE PRINCIPLE OF EQUALITY IN SOUTH AFRICA

2.1 INTRODUCTION TO CHAPTER 2

This chapter represents the article for this study. This article will be submitted for publication in a journal or conference proceedings. The chapter investigates the equality and fairness of the tax exemption granted to South African tax residents on foreign dividend income, specifically where they hold at least 10% of the foreign company's equity shares and voting rights. Lastly, the researcher compared how the UK and Ghana, countries with similar tax systems to South Africa, approach participation exemptions of foreign investment income received by their resident taxpayers.

2.2 HISTORY OF FOREIGN DIVIDENDS IN SOUTH AFRICA

The evolution of South Africa's tax system from a source-based to a residence-based system represents a pivotal transformation in the country's fiscal policy (Olivier, 2001:20). As outlined in the 2000 Budget Review by the Minister of Finance, this transition, effective from 1 January 2001, fundamentally redefined the taxation landscape for South African residents (Department of National Treasury, 2000:2). Under the previous source-based system, only income originating within the Republic was subject to taxation. However, beginning in 1997, provisions were introduced to incorporate the worldwide passive income of residents, including foreign dividends, as part of South Africa's tax base. This measure aimed to protect the tax base following the relaxation of exchange controls, marking a gradual shift towards the residence-based system (Department of National Treasury, 2000:2).

The residence-based tax system imposes tax obligations on individuals based on their residency rather than solely on the source of their income. For natural persons, residency is determined using two tests: the "ordinary residence" test and the "physical presence" test. The "ordinary residence" test, as elucidated in Cohen v. CIR and CIR v. Kuttel, establishes that an individual is "ordinarily resident" in the country they regard as their real home or principal residence. Schreiner JA, in Cohen v. CIR, described this as the

country to which one naturally and routinely returns (SATC 371). Similarly, in CIR v. Kuttel, Goldstone JA reaffirmed that "ordinary residence" refers to a person's principal residence, their real home (54 SATC 306). If the "ordinary residence" test fails, the "physical presence" test is applied, requiring a person to meet specific time-based criteria outlined in Section 1, Paragraph (a)(ii) of the Income Tax Act.

For companies, residency is determined based on whether the company is incorporated, established, or formed in South Africa or if it is "effectively managed" within the country. The concept of "effective management" refers to the process by which strategic decisions are made and routine operational activities are conducted.

This shift to a residence-based tax system, coupled with detailed residency criteria for individuals and companies, has had a profound impact on South African taxpayers, particularly in the context of foreign dividends. The evolution from taxing income based solely on source to a broader residence-based approach reflects the country's response to global economic integration and the need for a robust and adaptable fiscal policy.

The implementation of the residence-based system subjected South African taxpayers to taxation on their worldwide income, albeit with specific exclusions (Tshikovhi, 2018:1). This change had profound implications, particularly for resident taxpayers receiving foreign dividends. Therefore, it necessitated a thorough examination of the impacts and adjustments required to navigate the new tax regime effectively, given the evolution of tax on foreign dividends over the years from Section 9E to the now amended Section 1 of the Act.

Prior to the amendment of the gross income definition in Section 1 of the Act, Section 9E dealt extensively with the taxation of foreign dividends before it was entirely scrapped (repealed) (Department of National Treasury, 2004:50). Under Section 9E, foreign dividends received by South African residents were included in their gross income. To encourage taxpayers to invest in foreign shares and to reduce double taxation, Section 9E offered mechanisms for direct and indirect tax credits, known as Section 6quat

rebates, alongside specific exemptions. These exemptions included dividends from dual-listed foreign companies on the JSE Securities Exchange, dividends from previously taxed South African profits, unbundlings, and a ministerial exemption (Department of National Treasury, 2003:46).

For this reason, foreign dividends are included in gross income and taxed as ordinary revenue unless they meet the criteria for the participation exemption (Department of National Treasury, 2010:72). According to the Standing Committee on Finance (SCOF) Report (2010:24), the participation exemption, previously outlined in Section 10(1)(k)(ii) of the Act, applied an intricate system of indirect tax credits. If a resident shareholder held at least 10% of the equity in the foreign company declaring the dividend, they could claim both foreign corporate taxes paid as an indirect tax credit and the withholding tax (WHT) paid as a direct tax credit. Conversely, shareholders with less than 10% equity could only claim the indirect tax credit.

The disparity between taxpayers holding at least 10% of the equity share capital and those with less than 10% did not arise from Section 10B but rather from Section 10(1)(k)(ii) of the Act. The rationale behind this complex system, as discussed in the Portfolio Committee on Finance's (PCOF) comments on the Revenue Laws Amendment Bill of 2000, was that it would be challenging for portfolio investors (holding less than 10%) to obtain information on foreign taxes paid by the foreign company declaring the dividend, thereby complicating SARS's verification process. It was further noted that it is an internationally accepted principle that portfolio investors are not granted credit for foreign underlying tax (Department of National Treasury, 2000:8).

Moreover, Section 9E's complexity, which involved tracing historical profits to relevant foreign taxes, made the system burdensome. This complexity often discouraged the repatriation of dividends, as South African taxpayers delayed or avoided bringing foreign dividends back to the country to avoid additional tax burdens (Department of National Treasury, 2001:23). This situation highlighted the need for a more simplified taxation system for foreign dividends. The amendments to the definition of gross income and

foreign dividends in Section 1 and the introduction of Section 10B of the Act aimed to address this by encouraging the inflow of foreign dividends into South Africa (Department of National Treasury, 2003:72). This replacement further sought to remove the obstacles to dividend repatriation and create a more straightforward and administratively feasible framework for both taxpayers and SARS (Tax & Exchange Control Alert, 2021:06).

Moreover, Section 10B sought to simplify exemptions and align them with international standards. The transition from Section 9E with Section 10(1)(k)(ii) to the amended definitions in Section 1 and the introduction of Section 10B was motivated by the need to update the tax code, reduce administrative complexity, and ensure fair taxation of foreign dividends (Department of National Treasury, 2011:11). This change demonstrates South Africa's commitment to simplifying its tax system regarding foreign dividends and promoting the repatriation of foreign earnings by resident taxpayers. Section 10B offers a more straightforward and manageable framework, harmonising the tax treatment of foreign dividends with global practices while retaining specific exemptions for genuine equity investments. Consequently, this shift has reduced the administrative burden on taxpayers and SARS, creating a more favourable environment for foreign investment returns (Department of National Treasury, 2001:23).

While the intent for the introduction of Section 10B was noble, the effectiveness of the Section has continued to spark *contentious debate among scholars and policymakers, with some arguing that it has also created complexities and uncertainties* in the tax system. This is also seen in the 2019 court case between *ABC Proprietary Limited v Commissioner for the South African Revenue Services* (Taxpayer), wherein the courts sided with ABC Pty Ltd, determining that dividends received by a Dutch parent company from its South African subsidiary were exempt from South African dividends tax, highlighting the importance of adhering to the specific wording of the agreements.

In this case, the court conducted a detailed analysis of the South African tax treaties with the Netherlands, Sweden, and Kuwait, with a focus on the "Most Favoured Nation" (MFN) clauses. Notably, it emphasised a literal interpretation of the treaty language. The court

determined that the zero-rate dividend tax provision under the South Africa-Kuwait treaty, combined with the cascading effect of the Swedish MFN clause, conferred the same preferential treatment on Dutch residents despite the Dutch MFN clause being explicitly limited to future agreements. This judgment underscores the importance of precise treaty language in tax disputes and highlights how minor variations in wording can have significant legal and financial consequences (Cliffe Dekker Hofmeyr, 2019).

To further contextualise the court's decision and evaluate the fairness of South Africa's approach to foreign dividend taxation, the following table presents a comparative analysis of how dividend tax is applied in South Africa. The table outlines the rates and treaty implications, highlighting the nuances that contribute to the complexities of dividend taxation.

Table 2 - 1: Dividend Tax: South Africa		
Dividend Received	**Tax Implication**	**Tax Rate**
Local dividend from RSA company	**Normal Tax Implications:** Gross income (s1 par (k)) R1 000 000 Exemption (s 10(1)(k)) (R1 000 000) **Taxable income Rnil** **Normal Income Tax Liability/Implication:** Not applicable **Withholding Dividend Tax Implications:** R1 000 000 x 20% = R200 000	20%: dividend tax
Foreign dividend (JSE-listed foreign company) ***New Amendment*: This exemption does not apply if the foreign dividend is deductible (by the foreign company that paid it) in its calculation of its foreign taxable income.**	**Normal Tax Implications:** Gross income (s1 par (k) R1 000 000 Exemption s 10B(2)(a) (R1 000 000) **Taxable income Rnil** **Normal Income Tax Liability/Implication:** Not applicable **Withholding Dividend Tax Implications:** R1 000 000 x 20% = R200 000	20%: dividend tax
Foreign dividend (Participation exemption where the taxpayer owns at least 10% of the equity shares and voting rights in the foreign company) ***This exemption will also not apply if the foreign dividend is deductible (by the foreign company that paid it) in the calculation of its foreign taxable income.***	**Normal Tax Implications:** Gross income (s1 par (k) R1 000 000 Exemption s 10B(2)(a) (R1 000 000) **Taxable income Rnil** **Normal Income Tax Liability/Implication:** Not applicable **Withholding Dividend Tax Implications:** Not applicable	Not taxable (***This is the ISSUE***)

<table>
<tr>
<td>Foreign dividend (Ratio exemption on foreign dividends that are not otherwise exempt, for example, where the taxpayer owns less than 10% of the equity shares and voting rights in the foreign company)</td>
<td>
Normal Tax Implications:
Table 2 - 1 1
<table>
<tr><th></th><th>Company</th><th>Natural Person</th></tr>
<tr><td>Gross income (s1 par (k)</td><td>R1 000 000</td><td>R1 000 000</td></tr>
<tr><td>Exemption s 10B(3)</td><td>(R259 259)</td><td>(R555 556)</td></tr>
<tr><td>Taxable income</td><td>R740 741</td><td>R444 444</td></tr>
</table>
Normal Income Tax Liability/Implication:
<table>
<tr><th>Companies</th><th>Natural Persons</th></tr>
<tr><td>General corporate income tax: 27%</td><td>Progressive tax rates: Graduated with rates ranging from 18% to 45%.</td></tr>
<tr><td>Tax Liability:
R740 741 x 27% = R200 000</td><td>Tax Liability:
Natural person (R444 444 x 45% = R200 000</td></tr>
</table>
Withholding Dividend Tax Implications:
Not applicable
</td>
<td>20% on normal income</td>
</tr>
</table>

(Source: Author's own compilation)

Table 2-1 illustrates that all taxpayers are subject to a 20% tax rate on dividend income, regardless of whether the dividends are from local or foreign sources. However, an exception exists for foreign dividends where the taxpayer holds at least 10% of the foreign company's equity shares and voting rights. In such cases, these dividends are subject to a 0% effective tax rate. This exemption, which results in a 0% effective tax rate, raises concerns about the equality and fairness of the dividend tax, particularly in relation to its preferential treatment for certain taxpayers and its potential impact on broader tax equity.

2.3 EQUALITY AND FAIRNESS OF THE TAX EXEMPTION GRANTED TO SOUTH AFRICAN TAX RESIDENTS ON FOREIGN DIVIDEND INCOME

According to Vogel (1988:393), equity is an interpretive concept that does not necessarily provide a definitive stance on whether something is equitable. He further suggested that equity is better explained than strictly defined. Similarly, Dodge (2013) noted that the term "equity" in tax discussions is particularly unhelpful. Thus, for the purposes of this study, it is crucial to elucidate how equity is understood. This is because, according to Bird and Zolt (2003:15), the notions of fairness and equity differ among individuals.

As previously noted, Adam Smith (1776) defines equity as the principle that every citizen should contribute to the state's support in proportion to their economic abilities. Scholars on the ability-to-pay principle also established that taxpayers with the same income levels, who are residents or citizens of a country, should be taxed equally, irrespective of where their income originates (Kaufman, 1997:153). Similarly, Dodge (2013:9) posited that equity in taxation requires that taxpayers in comparable situations be taxed equally. Before examining whether the full exemption granted to South African tax residents on foreign dividend income, specifically when the resident holds at least 10% of the foreign company's equity shares and voting rights, is equitable, it is essential to understand the concept of equity.

Given that this study focuses on international transactions, specifically foreign dividends, it is important to consider equity within the international landscape. According to Musgrave (1963:15-16), the principle of international equity aims to achieve fair and equitable taxation among countries, ensuring that each country receives a fair share of tax revenues from international transactions.

In South Africa, international equity is achieved through DTAs with other foreign countries. These agreements aim to prevent double taxation and establish guidelines for taxing income earned from foreign sources. While South Africa taxes its residents on worldwide income, the presence of a DTA means that a South African resident receiving income from a foreign country will be taxed by the country where the income originates, rather than in South Africa (Michael *et al.*, 2014:31).

Exemptions and tax credits further support international equity. For example, South African taxpayers may be eligible for exemptions on foreign income or receive tax credits for taxes paid to foreign countries, thereby ensuring fair treatment across countries. These foreign tax credits aim to mitigate the issue of international double taxation; however, these credits are capped at the amount of South African taxes that are owed on income earned from foreign countries (Hines, 2007:2). According to Musgrave and Musgrave (1980:571), interindividual equity in the national context necessitates South Africa, as the resident country, to provide limited tax credits for foreign income taxes.

As tax policies on foreign investment income affect both international and national tax treatment, it is also important to consider interindividual equity. Musgrave (1963:vii) posits that interindividual equity is concerned with the fairness of tax treatment among taxpayers within the same country. It addresses the need for taxpayers with similar economic capacities to be taxed equally.

To this end, South African resident taxpayers who hold less than 10% of the foreign company's equity shares and voting rights are taxed at the same rate of 20% as domestic investors. However, resident taxpayers who hold at least 10% of the foreign company’s

equity shares and voting rights are not taxed on foreign dividends, suggesting that there needs to be fairness in tax treatment among these two foreign investors. This is, therefore, contradictory to interindividual equity and the ability-to-pay theory.

In his book, Hentschel (2021:21) explains the ability-to-pay principle as an equal assessment of taxpayers based on their tax liability, considering their financial capacity. In South Africa, both local and foreign dividends are subject to a 20% tax rate. This approach aligns with the ability-to-pay principle, which posits that a taxpayer's capacity to pay taxes should not be influenced by the origin of their income.

Despite this, resident taxpayers who hold at least 10% of the foreign company's equity shares and voting rights receive a more favourable tax treatment when compared to other foreign investors who hold less than 10% of the foreign company's equity shares and voting rights. Shome (2021:4) asserts that equity in taxation involves ensuring that taxpayers with the same financial capacity should be treated equally, a concept known as horizontal equity. Additionally, it requires that taxpayers with differing income levels be treated differently, reflecting the principle of vertical equity.

Vertical equity demands suitable differences among taxpayers based on their varying income levels (Duclos, 2006:2). In contrast, horizontal equity stipulates that individuals in similar financial situations should pay the same amount in taxes (Repetti and Ring, 2022:136). The rationale behind inequality, as previously mentioned, stems from the fact that it would be challenging for foreign investors (holding less than 10%) to obtain information on the foreign taxes paid by the foreign company declaring the dividend, thereby complicating the verification process for SARS. While this is noted as an internationally accepted principle, it reflects inequalities amongst taxpayers with similar foreign dividend income, thereby displaying redistributive equity as a classical horizontal inequity (Wagstaff *et al.*, 1999:74). Hentschel (2021:22) contends that the principle of horizontal equity requires taxpayers with similar financial means to share an equal tax burden. This principle is endorsed by Elkins (2006:43) as widely recognised and pivotal in defining a 'sound tax' system.

The favourable tax treatment of resident taxpayers who hold at least 10% of the foreign company's equity shares and voting rights raises significant questions about equity and fairness. This preferential treatment conflicts with principles of interindividual equity and the ability-to-pay theory, creating disparities between taxpayers with similar economic capacities. Addressing these inequities will be crucial for ensuring a fair and just tax system in South Africa that is aligned with both national and international standards. To this end, it is important to consider how other countries with tax systems similar to South Africa's, such as the UK and Ghana, tax foreign dividends received by their resident taxpayers.

2.4 TAXATION OF DIVIDEND INCOME FOR THE UNITED KINGDOM RESIDENT TAXPAYERS

The taxation framework for dividends in the UK reflects a nuanced interplay between historical developments, policy reforms, and the UK's broader economic context. This intricate system is shaped by changing economic conditions and government policies. Section 13 of Chapter 3 of the UK Income Tax Act 2007 provides that individual taxpayers, referred to as natural persons in South Africa, are liable for income tax on the dividends they receive (Income Tax Act 2007 (UK), s 13). Similarly, corporations, which align with the concept of companies in South African law, are taxed on their dividend income under Section 1305 of Chapter 1 of the UK Corporation Tax Act 2009.

The taxation of dividends in the UK has undergone significant changes, reflecting shifts in fiscal policy and economic priorities (Bell and Jenkinson, 2002:1). Initially, the UK imposed taxes on dividends at the company level, resulting in double taxation when shareholders were taxed again on their personal income. This is because the initial focus was primarily on revenue generation, with less distinction between local and foreign dividends. This prompted reforms aimed at mitigating such burdens. The imputation tax credit system was subsequently introduced to address the issue of double taxation (McClure *et al.*, 2018:496). However, a significant shift occurred with the introduction of the Dividend Tax Allowance in 2016, which established a tax-free threshold, followed by

progressively higher rates for higher earners (HM Revenue & Customs, 2015). Critics, such as Greg Smith (2013:5), argue that the system disproportionately benefits higher-income individuals, disadvantaging those with lower earnings. This highlights the need for ongoing evaluations of the equity of the tax system, particularly when compared to systems like South Africa's, which reflects different fiscal priorities.

Examining the interconnection between policy design, equity, and economic impacts is crucial for assessing the effectiveness of the United Kingdom's dividend taxation regime. Empirical evidence indicates that dividend tax structures influence foreign investment holdings, which in turn has implications for both domestic and cross-border investment decisions that policymakers must take into account (Mishra & Ratti, 2014:219). However, Leibfritz *et al.*, (1997:30) argue that determining how responsive FDI is to taxation presents considerable challenges. One key issue is that multinational corporations often shift taxable income, rather than actual investments, to jurisdictions with favourable tax rates, potentially reducing the impact of tax rates on investment decisions (Mishra & Ratti, 2014:219). Another factor is that governments with higher tax rates often compensate businesses through indirect incentives such as grants, worker training, and infrastructure improvements. Furthermore, the complexity of calculating effective tax rates compels companies to allocate resources to navigating tax systems rather than focusing on productive activities. This suggests that a comprehensive approach to tax policy, considering both direct taxes and indirect incentives, is necessary to optimise the impact on investment and economic growth.

The UK's approach to dividend taxation has undergone significant evolution, shaped by shifting economic and political priorities. With the expansion of globalisation, the complexities surrounding foreign dividends necessitated more nuanced tax strategies, prompting distinct policy adaptations for various types of dividends. Notably, the UK introduced an imputation tax credit system designed to mitigate double taxation. However, this approach faced criticism, with Pike *et al.,* (2012:11) questioning its effectiveness in addressing economic disparities. Recent discussions have increasingly

focused on re-evaluating the fairness of these tax structures, balancing the need for fiscal revenue with the equitable treatment of diverse income sources (Pike *et al.,* 2012:14).

Recent legislative changes in the UK's dividend taxation framework carry significant implications for equity and economic outcomes. The shift towards a more progressive tax structure has heightened scrutiny of the taxation of both domestic and foreign dividends, particularly impacting individual residents and corporations. These amendments aim to address imbalances in tax burdens by closing loopholes that disproportionately benefit higher earners while increasing revenue for public goods. Regulations governing foreign dividends seek to align the taxation of overseas investment returns with domestic standards, ostensibly promoting greater fairness within the fiscal system (Egger *et al.,* 2015:6).

2.4.1 Current Dividend Tax Policies and Framework in the United Kingdom

Recent changes in the UK's dividend tax policies have sparked extensive debates regarding their equity and economic impact. It was then crucial that the existing framework be revised to address these inequities and foster a more balanced economic landscape (Jones & Hickey, 2025). Furthermore, the lack of substantial evidence supporting the economic benefits of current policies suggested that they may disproportionately benefit certain demographics, exacerbating the gap in perceived fairness (Pike *et al*., 2012:14). For this reason, the study aims to evaluate how dividend income is taxed in the UK, which has undergone significant reforms in dividend taxation, and compare it with the South African tax system.

Before the implementation of the dividend allowance in Part 4 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005), most dividend income, along with other forms of distribution, was subject to income tax. Under Chapter 3 of Part 4 ITTOIA 2005, recipients of dividends were entitled to a tax credit equal to one-ninth of the dividend amount. This credit could be used to offset the recipient's tax liability on their dividend income for the relevant tax year.

Egger *et al.*, (2015:5) and PwC (2024) explain that UK-resident companies are generally exempt from corporation tax on both foreign and domestic dividends, provided specific, broadly defined criteria are satisfied. For instance, one condition is that the recipient resident company must have control over the dividend-paying company. When foreign-source dividends do not qualify for exemption, double tax relief (DTR) is typically applicable. Due to the comprehensive nature of the exemption, it is rare for UK companies to be taxed on local dividends. However, in instances where UK dividends are taxed, DTR does not apply.

A similar approach is followed in South Africa, where local dividends are exempt from company-level taxation (with no WHT), as outlined in Section 64F of the Income Tax Act. However, a key distinction arises with foreign dividends. Unlike the UK, where companies are generally not taxed on both local and foreign dividends, South African companies are subject to tax on foreign dividends. Building on this foundation, the next section will focus on natural persons (individuals) to analyse how they are taxed on both local and foreign dividends.

As detailed by The International Investor (2024), UK residents are required to pay income tax on dividends from both local and foreign sources unless these shares are held in tax-advantaged accounts such as Individual Savings Accounts (ISAs) or Self-Invested Personal Pensions (SIPPs). While the tax rates and allowances for foreign and local dividends are the same, foreign dividends are declared on the SA106 (foreign pages) section of a self-assessment tax return, counting towards the total dividend income.

Complications often arise with foreign dividends due to the WHT levied by other foreign countries. In these cases, the gross dividend income is subject to UK taxation, which may result in double taxation. Theoretically, this issue is mitigated by double taxation agreements (DTAs) between the UK and many other countries, which limit the WHT that foreign authorities can charge on dividends paid to UK residents (Dentons, 2026).

To address this, His Majesty's Revenue & Customs (HMRC) offers Foreign Tax Credit Relief (FTCR), which allows taxpayers to offset UK tax liability by the smaller of the foreign WHT already paid or the UK tax due on the income. For instance, if 15% WHT is withheld by a foreign country and the applicable UK tax rate is 7.5%, a credit of 7.5% can be claimed as being the smallest. Conversely, if the UK tax rate is 38.1%, the offset is limited to the 15% already withheld by the foreign country. This mechanism ensures that the same income is not taxed more than once or excessively in both jurisdictions, ensuring that the taxpayer ultimately pays the equivalent tax amount they would have owed had they received the dividends locally in the UK. As a result, the application of FTCR prevents double taxation by effectively adjusting the foreign WHT against the UK tax liability, allowing taxpayers to avoid paying more than the tax they would have paid on local dividends in the UK (The International Investor, 2024).

Since 6 April 2016, the dividend allowance, which replaced the Dividend Tax Credit, introduced a tax-free allowance of £5 000 on dividend income. This allowance has gradually decreased, dropping to £500 in the 2024/25 tax year, following a reduction from £1 000 in the previous 2023/24 tax year. Dividends, both local and foreign, falling within this £500 allowance are exempt from tax. However, any dividend income exceeding this threshold is subject to tax at the following specific rates for UK individual residents (notably, the UK and Wales share the same national income tax rates, whereas Scotland follows a different structure with its own set of income tax rates and bands):

Table 2 - 2: United Kingdom income tax and dividend tax rates

Taxable income band £	**National income tax rates**	**Dividend tax rates**
1–37 700	20%	8.75%
37 701–125 140	40%	33.75%
125 141+	45%	39.35%

(Source: His Majesty's Revenue and Customs. 2024. Dividend tax rates)

According to the Low Incomes Tax Reform Group (2024), any dividend income exceeding the dividend allowance of £500 for the 2024/25 tax year is subject to taxation. Additionally, if the combined dividend income in excess of £500 and other income exceeds the personal allowance of £12 570, the taxable amount will be subject to the applicable UK tax rates based on the individual's income band. To contextualise these provisions, the following example illustrates how the UK's tax system applies in practice when determining a taxpayer's taxable income and corresponding tax liability:

Example 1:

In the 2024/25 tax year (year of assessment), Chris, a UK resident, has an annual salary of £9 000, savings income of £1 200, and dividend income of £30 000. This is how his taxes will be calculated while considering allowances, rates, and bands:

Step 1: Allocate the personal allowance (£12,570)

Chris's salary of £9 000 is fully covered by the personal allowance, leaving £3 570 of the allowance to be applied to other income sources.

Step 2: Savings Income

The starting rate for savings (0%) applies to £1 200, as Chris's non-savings income is less than £17 570. All savings income is, therefore, tax-free.

Step 3: Dividend Income

The first £500 of the dividend income benefits from the dividend allowance and is taxed at 0%. The remaining £29 500 of dividend income will first use up the remaining £3 570 of the personal allowance, leaving £25 930 subject to taxation.

Dividend tax liability:

£25,930 falls within the basic rate band (£37 700 cap) and is taxed at 8.75%, resulting in a tax liability of £2 268.88.

(Source: Author's own compilation)

The example above illustrates the structured approach of the UK dividend tax system, where dividend income exceeding the £500 tax-free allowance is progressively taxed based on an individual's income bracket. This reinforces a key distinction between the UK's approach and South Africa's system, where significant foreign dividend holdings (at least 10% equity shares and voting rights in a foreign company) are fully exempt from tax.

From a comparative perspective, this highlights a crucial disparity in the equitable taxation of foreign dividend income. In the UK, all dividend recipients, regardless of their ownership percentage, are subject to taxation beyond the exemption threshold, ensuring a broader tax base and a more balanced approach to revenue collection. In contrast, South Africa's current framework provides a differentiated tax treatment, where individuals holding at least 10% of a foreign company are exempt from tax, while those holding less than 10% are taxed. *This raises concerns regarding equity and fairness, key aspects aligned with the research objectives.*

One of the primary objectives of this study is to assess whether South Africa's dividend tax policy is equitable and/or fair, specifically where the resident holds at least 10% of the foreign company's equity shares and voting rights, when compared with the UK. The example provided demonstrates that the UK's structured dividend tax system ensures progressivity and inclusivity, whereas South Africa's policy may inadvertently create an uneven tax burden. This finding highlights the need for potential policy reform in South Africa, particularly regarding the taxation of significant foreign equity holders, to promote equity, fairness, and revenue mobilisation.

The table below illustrates the tax treatment of the different dividends received by UK residents. It compares the treatment of local dividends, dividends from foreign-listed companies, or from a foreign company in which the taxpayer holds a minority equity share and voting rights.

This demonstrates that the UK maintains a consistent and equitable approach to dividend taxation. The same principles of progressivity and fairness apply irrespective of the taxpayer's shareholding or the dividend's origin.

Table 2 - 3: Dividend Tax: United Kingdom		
Dividend Received	**Tax Implication**	**Tax Rate**
Local dividend from UK company	**Normal Tax Implications:** Gross income £1 000 000 Exemption (£1 000 000) **Taxable income £nil** **Normal Income Tax Liability/Implication:** Not applicable **Dividend Tax Implications:** **Dividend tax rates with a tax-free allowance of £500 on dividend income graduating with rates ranging from 8.75% to 39.35%** £1 000 000 - £500 = £999 500 x 39.35% = £393 303	Graduating rates range from 8.75% to 39.35%: dividend tax
Foreign dividend from the London Stock Exchange (LSE) listed foreign company	**Normal Tax Implications:** Gross income £1 000 000 Exemption (£1 000 000) **Taxable income £nil** **Normal Income Tax Liability/Implication:** Not applicable **Dividend Tax Implications:** **Dividend tax rates with a tax-free allowance of £500 on dividend income graduating with rates ranging from 8.75% to 39.35%** £1 000 000 - £500 = £999 500 x 39.35% = £393 303	Graduating rates range from 8.75% to 39.35%: dividend tax

Foreign dividend (Participation exemption where the taxpayer owns at least a certain percentage of the equity shares and voting rights in the foreign company)	**Normal Tax Implications:** Gross income £1 000 000 Exemption (£1 000 000) **Taxable income £nil** **Normal Income Tax Liability/Implication:** Not applicable **Dividend Tax Implications:** **Dividend tax rates with a tax-free allowance of £500 on dividend income graduating with rates ranging from 8.75% to 39.35%** £1 000 000 - £500 = £999 500 x 39.35% = £393 303	Graduating rates range from 8.75% to 39.35%: dividend tax

(Source: Author's own compilation)

The differential tax treatment of individual residents and corporations in the UK plays a critical role in addressing key concerns related to equity and economic efficiency. The current system aims to maintain a consistent approach to taxing both local and foreign dividends. Specifically, when foreign dividends are taxed, the system seeks to ensure that taxpayers do not pay more than they would if the dividends were from local companies (His Majesty's Revenue and Customs, 2024). Historically, however, the UK tax system favoured local dividends through tax credits, while foreign dividends were subject to more complex tax treatment, which sometimes resulted in double taxation for UK residents. This created significant equity issues, especially as wealth accumulation among higher-income individuals through investments continued to grow. Wallace and Alm (2004:3) highlight such concerns, questioning whether the tax system equitably distributes benefits among different social groups. This critique emphasises the need for fairness in the distribution of tax burdens, prompting policymakers to reassess the tax framework to foster a more equitable economic landscape.

The distribution of tax burdens within society often raises fundamental issues of equity and fairness, leading to important questions about who should ultimately bear the cost of taxation. In the UK, the current approach to dividend taxation appears to align both local and foreign dividends within a progressive taxation framework, marking a shift toward a more equitable treatment of dividends as the tax system evolves.

A comparative analysis between the United Kingdom and South Africa reveals significant differences in their approaches to taxing foreign dividends. In the United Kingdom, foreign dividends received by residents are integrated into the progressive income tax framework and taxed according to the taxpayer's overall income position, subject to relief mechanisms aimed at mitigating double taxation. By contrast, South Africa adopts a withholding tax model for foreign dividends, coupled with full or partial exemptions based on the level of shareholding and voting rights. These differing approaches reflect distinct policy choices and economic priorities, as well as the structural challenges each jurisdiction faces in balancing revenue collection, investment competitiveness, and fairness in the taxation of cross-border dividend income.

Cummins and Hubbard (1994:123) emphasise the critical role of taxation in influencing FDI decisions, underscoring the necessity of carefully designed tax policies that avoid discouraging beneficial economic activity. Addressing the complex issues surrounding dividend taxation requires ongoing reassessment of tax frameworks to ensure they promote both fairness and efficiency. This is particularly important when comparing the UK's approach to other systems, such as South Africa's, as these differences in tax treatment reflect broader economic priorities and structural realities.

This study not only highlights the complexities of the dividend taxation systems in both South Africa and the UK but also lays the foundation for future discussions and potential reforms. Policymakers must consider the historical context of dividend taxation in conjunction with current economic conditions, recognising that existing frameworks may disproportionately affect certain groups of taxpayers. Future research should focus on exploring the effects of potential policy changes on investor behaviour and economic growth, contributing to the development of a more inclusive and efficient tax system.

2.5 TAXATION OF DIVIDEND INCOME FOR GHANIAN RESIDENT TAXPAYERS

Historically, in Ghana, the 1966 Income Tax Decree (N.L.C.D. 78) established comprehensive rules governing the taxation of dividends. Mills (1977) highlights that dividends were explicitly categorised as taxable income under Paragraph 5(c) of the Decree. This framework required companies to deduct taxes on dividends paid to shareholders at rates corresponding to the corporate tax rate applied to the assessed income of the company paying the dividends. The tax deduction was credited to shareholders to avoid double taxation by both the company and the shareholder on the same amount. Within the Ghanaian regime, this mechanism applies to both resident and non-resident shareholders. However, non-resident shareholders are generally subject to final withholding tax on dividends, with relief available under applicable double taxation agreements. This distinction is important for comparative purposes, as it reflects how Ghana balances the prevention of economic double taxation with the taxation of cross-border dividend flows. Mills' (1997) analysis illustrates that the system intended to

streamline tax liabilities between corporations and their shareholders by integrating dividend taxation into corporate tax payments.

Furthermore, it is stated that companies were mandated to provide shareholders with certificates specifying the gross dividend, the amount of tax deducted, and the net dividend paid. This administrative approach facilitated transparency and compliance, as shareholders could claim tax credits for deductions made by the company.
The pre-1975 system faced several criticisms. Another notable critique highlighted by Mills (1977) is the inequitable impact on different income groups. While the system aimed to benefit smaller investors by reducing their effective tax burden, it predominantly favoured high-income earners whose marginal tax rates exceeded corporate tax rates. Consequently, the system's equity objectives were undermined, prompting calls for reform.

In response to these challenges, the Income Tax (Amendment) Decree of 1975 (N.R.C.D. 343) introduced a blanket exemption for dividends from income tax. This reform sought to simplify taxation and incentivise investments, particularly among small and medium-income earners. However, the exemption was met with mixed reactions. Proponents argued that it eliminated administrative complexities and promoted equity, while critics contended that it exacerbated revenue shortfalls and disproportionately benefited wealthier shareholders. To this end, the English court case (the highest appellate court in the UK) was considered by the Revenue Department, specifically the "*Hamilton v. Commissioners of Inland Revenue*" case.

In *Hamilton v. Commissioners of Inland Revenue, a* shareholder argued that when determining the amount deductible from dividends, the company should not simply apply the tax rate paid on its profits to the dividends distributed. Instead, the company should proportionally allocate the actual income tax it has paid among its shareholders. Essentially, the shareholder contended that dividends should not be subject to an additional, separate deduction; instead, shareholders should directly bear the tax already paid by the company.

The House of Lords decisively rejected this argument, maintaining that corporate tax on a company's profits and the tax deducted from shareholder dividends are entirely distinct. They asserted that a company's tax obligations were its own and could not be deemed payments on behalf of shareholders (Neumann v IRC [1934] AC 215 (HL)). Lord Justice Romer emphasised this principle, noting the fallacy of equating a company with its shareholders. He emphasised that a company and its shareholders are separate legal entities, each with its own distinct tax liabilities.

The court made the following observation:

"*Further, it seems to me that there is a fallacy lying at the very root of the argument. It treats the company not as a separate legal entity but as merely being equivalent to the aggregate body of its shareholders, and treats the company when it pays tax to the Crown as paying tax on behalf of its shareholders. It has, however, frequently in recent days been pointed out by the Courts, . . . that a company is one taxpayer and that each individual shareholder is another and a separate taxpayer, on whose behalf the company deducts a tax when it pays a dividend, but on whose behalf it is not paying the tax when it pays its own tax to the Crown*."

The evolution of dividend taxation in Ghana prior to the introduction of the Dividend WHT reveals a dynamic interplay between policy objectives and practical outcomes, particularly in contexts where corporate and individual tax obligations intersect.

2.5.1 Current Dividend Tax Policies and Framework in Ghana

The taxation of dividends in Ghana presents a complex landscape, particularly when distinguishing between local and foreign dividends. Local dividends are subject to a WHT of 8% for both residents and non-residents, while foreign dividends may be subject to higher rates depending on the tax treaties between Ghana and other countries (PwC, 2024; First Schedule, Paragraph 8(1)(b)(i) of the 2015 Income Tax Act). However, local dividends paid by a resident company to another resident company are exempt from WHT if the receiving company holds at least 25% of the voting rights, either directly or indirectly, in the paying company.

This exemption is cited in the Ghana Revenue Authority's guidelines and Section 59(3) of the 2015 Income Tax Act, which stipulates that no WHT is levied under such

circumstances, effectively relieving the receiving company from further taxation on the dividend. In contrast, this exemption does not extend to dividends distributed by resident companies involved in petroleum operations, whether currently or in the past, nor does it apply to individuals who are partners in partnerships engaged in such petroleum activities.

Despite of local dividends either being subject to WHT of 8% or an exemption in the case where the dividends are paid by a resident company to another resident company that owns at least 25% of the voting powers, foreign dividends are taxed differently from local dividends. Dividends received by resident companies and individuals from foreign companies are taxable as assessable foreign income. Section 112 of the 2015 Income Tax Act defines assessable foreign income as "*foreign source income included in the assessable income of a resident person for a year of assessment from employment, business or investment of the resident person as the case requires.*"

Consequently, resident individuals must include foreign dividends in their assessable income, which is taxed at a progressive rate ranging from 5% to 25%. Similarly, for resident companies, foreign dividends are incorporated into their assessable income and taxed at the applicable corporate income tax rate (Ghana Tax Guide, 2021). Section 112 of the 2015 Income Tax Act provides that resident taxpayers in Ghana, including both individuals and companies but excluding partnerships, can claim a tax credit for income taxes paid to a foreign country, provided the foreign-sourced income is included in their taxable income in Ghana. This provision ensures that taxes paid on foreign dividends qualify for a credit to mitigate double taxation. However, the credit cannot exceed the average Ghanaian income tax rate applicable to the taxpayer's taxable foreign income for the assessment year (Ghana Tax Guide, 2021). This approach aligns with the tax credit systems in South Africa and the UK.

The table below presents the tax treatment of the local and foreign dividends received by Ghanaian residents. It shows the distinctions between dividends derived from local

companies, foreign-listed entities, and foreign companies by comparing resident taxpayers holding less than 10|% of the equity shares and voting rights with those holding 10% or more. For the purposes of this table, all monetary amounts are expressed in Ghanaian Cedi (GH₵), which is the official currency of Ghana.

Table 2 - 4: Dividend Tax: Ghana

<table>
<tr><th>Dividend Received</th><th>Tax Implication</th><th>Tax Rate</th></tr>
<tr><td>Local dividend from a Ghanaian company</td><td>Normal Tax Implications:
Gross income GH₵1 000 000
Exemption (GH₵1 000 000)
Taxable income GH₵nil

Normal Income Tax Liability/Implication:
Not applicable

Withholding Dividend Tax Implications:
GH₵1 000 000 x 8% = GH₵80 000</td><td>8%: dividend tax</td></tr>
<tr><td>Foreign dividend from the Ghana Stock Exchange (GSE) listed foreign company</td><td>Normal Tax Implications:
Gross income GH₵1 000 000
Exemption (GH₵1 000 000)
Taxable income GH₵nil

Normal Income Tax Liability/Implication:
Not applicable

Withholding Dividend Tax Implications:
GH₵1 000 000 x 8% = GH₵80 000</td><td>8%: dividend tax</td></tr>
<tr><td>Foreign dividend (Participation exemption where the taxpayer owns at least a certain percentage of the equity shares and voting rights in the foreign company)</td><td>Normal Tax Implications:
Company Natural Person
Gross income GH₵1 000 000 GH₵1 000 000
Taxable/Assessable income GH₵1 000 000 GH₵1 000 000

Normal Income Tax Liability/Implication:
<table><tr><th>Companies</th><th>Natural Persons</th></tr><tr><td>General corporate income tax: 25%</td><td>Progressive tax rates: Graduated with rates ranging from 0% to 25%.</td></tr><tr><td>Tax Liability:</td><td>Tax Liability:</td></tr></table></td><td>25% on assessable/normal income</td></tr>
</table>

	GH₵1 000 000 x 25% = GH₵250 000	GH₵100 000 x 25% = GH₵250 000	
	Withholding Dividend Tax Implications: Not applicable		

(Source: Author's own compilation)

Based on the above, it is evident that the current tax system applies different rates to local and foreign dividends, with local dividends subject to an 8% WHT and foreign dividends taxed based on whether the recipient is a company or an individual. Companies pay corporate tax on foreign dividends, while individuals are taxed at progressive rates. This difference raises concerns about fairness, particularly for smaller investors who may not have the financial capacity to bear the same tax burdens as larger entities. These challenges resonate with issues identified in studies on revenue management, such as those in Ghana's petroleum sector, which underscore the importance of inclusive economic growth and equitable wealth distribution (Simpson, 2015:1316). Although the taxation of foreign dividends aims to ensure fairness, it can unintentionally discourage foreign investment by placing greater financial strain on international stakeholders (Boadway, 1992:73).

Such disparities in taxation can exacerbate income inequality, ultimately undermining the fundamental objectives of a fair tax system. Thus, continuous assessments of tax policies are crucial to ensure they foster equity and support the long-term economic prosperity of all citizens rather than perpetuating existing disparities (Mosley and Chiripanhura, 2016:918). Empirical research in countries like Pakistan demonstrates that financial leverage and corporate tax rates significantly influence companies' dividend payout decisions, which, in turn, affect investment behaviour (Kanwal *et al.*, 2017:76). Thus, equitable and strategic dividend taxation not only incentivises investment but also plays a critical role in driving sustained economic growth within a nation.

When analysing equity in the context of dividend taxation, Ghana's system presents a distinct set of challenges and advantages compared to those of South Africa. Ghana has implemented a relatively simple tax system on dividends, marked by reforms aimed at aligning tax policy with economic growth and social equity. Both local and foreign dividends are taxed uniformly, with an 8% WHT applied to local dividends and corporate or progressive tax rates applied to companies and individuals, respectively, for foreign dividends. In contrast, South Africa's more complex system incorporates a 20% WHT,

along with full and partial exemptions designed to balance equity with economic incentives. These complexities can create disparities in how different income groups experience taxation, with evidence suggesting that they may exacerbate inequality in South Africa (Mosley and Abdulai, 2016:10). Consequently, while both countries seek fiscal equity, Ghana's more straightforward approach may provide a more equitable tax environment in terms of its impact on investment.

2.6 DISCUSSION OF FINDINGS

The taxation of dividends in South Africa, the UK, and Ghana reflects distinct approaches shaped by the unique tax systems and policy objectives of each country. South Africa's tax treatment of dividends is characterised by a complex tax system that seeks to balance international competitiveness with fairness. Local dividends, whether from resident or dual-listed companies, are largely exempt from income tax under Section 10 of the Income Tax Act, with a 20% dividend tax applied separately. However, foreign dividends from non-JSE-listed companies are fully exempt from tax if the shareholder holds at least 10% of the total equity shares and voting rights. In comparison, dividends from shareholders who hold less than 10% of the total equity shares and voting rights are partially exempt, leading to a differential tax treatment that may raise concerns about equity. This dual-layered exemption system, particularly in relation to foreign dividend income, highlights a conflict between promoting investment and ensuring a fair tax burden across different taxpayers.

In the UK, the tax treatment of dividends is similarly designed to encourage investment while mitigating the risk of double taxation. UK residents are taxed on both local and foreign dividends, following uniform progressive tax rates on dividend income, with a reduced tax-free allowance. This further enhances the tax advantages for UK investors.

Ghana's dividend taxation framework, in contrast, is marked by a more complex distinction between local and foreign dividends. Local dividends are generally subject to an 8% WHT, with notable exemptions for resident companies holding substantial equity

of at least 25% in the resident company paying the dividend. However, foreign dividends are subject to a more stringent taxation regime, where they are treated as assessable foreign income and taxed at progressive rates. This progressive approach, with rates ranging from 5% to 25%, aligns with Ghana's broader tax philosophy of targeting higher-income individuals and entities while offering some relief through tax credits for foreign taxes paid. The potential for double taxation on foreign dividends is mitigated by the provision for tax credits, though the caps on such credits ensure that the relief does not exceed the average domestic tax rate, preserving the integrity of Ghana's tax base.

All three countries demonstrate a commitment to preventing double taxation through tax credits. South Africa's partial exemptions for foreign dividends and dividend tax on local and foreign sources serve to simplify the tax process. However, the system's complexity for shareholders who hold less than 10% of the total equity shares and voting rights may raise issues of fairness. The UK's use of FTCR and the dividend allowance offers a more direct approach to mitigating double taxation while ensuring that investors benefit from a predictable and transparent tax regime. Ghana's progressive tax rates on foreign dividends, alongside tax credits, reflect an attempt to harmonise global tax obligations with national revenue needs. However, the complexities of foreign taxation and credits may create challenges for residents with substantial foreign income.

In summary, the taxation of dividends in these three countries highlights a broader trend of striking a balance between investor incentives, international tax obligations, and fairness in the tax system. While each country's approach is tailored to its economic and fiscal context, they all face similar challenges in addressing equity concerns, particularly regarding the taxation of foreign dividends. As global investment continues to expand and tax policies evolve, these nations may need to refine their dividend tax systems further to ensure both competitiveness and fairness. The comparative analysis of these tax regimes reveals the nuanced interplay between promoting investment, protecting tax bases, and preventing undue tax burdens on individuals and companies across borders.

2.7 SUMMARY OF THE CHAPTER

This chapter explored the taxation of foreign dividend income for South African residents, with a particular focus on the principle of equity, one of the four fundamental principles of a fair and efficient tax system as outlined by Adam Smith (1776). Through a comparative analysis of South Africa, the UK, and Ghana, the study examines whether South Africa's tax treatment of foreign dividends aligns with international best practices as articulated in OECD guidance, particularly in relation to neutrality, the avoidance of double taxation, and equitable treatment of cross-border dividend income (OECD, 2018:79).

The chapter began with a historical overview of dividend taxation in each of the three jurisdictions, followed by an in-depth discussion of their current approaches to taxing foreign dividends. Additionally, it provides a comparative summary of how each jurisdiction taxes local dividends, foreign dividends from listed companies, and foreign dividends from unlisted companies.

Finally, Chapter 3 presents the overall summary, conclusions, and recommendations based on the findings of this study.

CHAPTER 3: CONCLUSIONS AND RECOMMENDATIONS OF THE STUDY

3.1 INTRODUCTION

In the previous chapter, the taxation of foreign dividend income for South African residents was examined, with a focus on the principle of equality as one of the foundational pillars of a sound and efficient tax system, as articulated by Adam Smith (1776). The analysis provided an in-depth examination of the fairness of South Africa's tax exemption on foreign dividend income, particularly in cases where residents hold at least 10% of a foreign company's equity shares and voting rights. Additionally, a comparative analysis was conducted on how similar tax systems, such as those in the UK and Ghana, address participation exemptions for foreign investment income.

Building on these findings, this chapter will focus on providing strategies and recommendations aimed at enhancing the South African tax system's participation exemptions for foreign dividends. Based on the insights gained from the analysis, this chapter proposes legislative reforms that could ensure a fairer and more equitable approach to taxing foreign dividends in South Africa, particularly for taxpayers with varying equity shares and voting rights (equity ownership). By considering both the advantages and disadvantages identified in Chapter 2, this chapter offers practical recommendations that align with global best practices and enhance the efficiency and fairness of South Africa's tax policy on foreign dividend income.

3.2 SUMMARY OF FINDINGS ON FOREIGN DIVIDEND TAXATION

In contemporary debates regarding international taxation, particularly the treatment of foreign dividends associated with equity shares and voting rights, disparities across jurisdictions reveal a complex and often inconsistent landscape. This study analyses South Africa, the UK, and Ghana, where notable differences in dividend tax treatment and participation exemptions emerge.

South Africa's participation exemption, applicable to taxpayers holding less than 10% of a foreign company's total equity shares and voting rights, subjects foreign dividends to a 20% tax rate under normal income tax provisions. This taxation is implemented by including the foreign dividends in the taxpayer's gross income, with partial relief provided through a ratio-based exemption in terms of Section 10B(3) of the Income Tax Act. Conversely, foreign dividends from companies not listed on the JSE, where the South African resident holds at least 10% of the total equity shares and voting rights, benefit from a 0% effective tax rate. This creates contradictions, as these dividends remain entirely tax-free (non-taxable), thereby challenging the principles of equality and equitable tax treatment within the tax system.

In contrast, the UK employs a tiered dividend tax system with progressive rates influenced by specific thresholds, whereas Ghana adopts a comparatively lower WHT rate. These findings highlight significant differences in tax liabilities for investors across these jurisdictions, particularly when considering the treatment of foreign dividends. Notably, Ghana's streamlined approach presents a more favourable outcome for taxpayers than those in South Africa and the UK, which raises questions about the fairness and competitiveness of the South African tax system on dividends.

Consequently, this analysis highlights the importance of harmonising tax policies to ensure equitable treatment of investors. It is proposed that South Africa refine its legislative framework to provide clearer, more transparent definitions surrounding participation exemptions and their applicability. By addressing the current inconsistencies, South Africa can align its tax policies with international best practices, thereby fostering fairness and efficiency in its treatment of foreign dividend income.

3.3 SUMMARY OF FINDINGS ON THE COMPARATIVE ANALYSIS OF TAXATION FRAMEWORKS

An important aspect of this study is understanding how the three jurisdictions approach the taxation of foreign dividends. The analysis of South Africa, the UK, and Ghana has revealed notable differences in tax treatment, exemptions, and overall policy frameworks. These variations highlight key considerations related to tax equity, efficiency, and international competitiveness.

The following table provides a concise comparative summary of the findings, outlining how each jurisdiction applies taxation principles to dividend income across different categories. This summary provides a foundation for evaluating potential policy reforms in the South African tax system to enhance equity, fairness, and alignment with global best practices. The headings distinguish between foreign dividends received from foreign companies irrespective of the level of shareholding, including listed foreign companies, and foreign dividends that qualify for a full exemption specifically due to the resident taxpayer meeting a prescribed ownership threshold in the foreign company.

Table 3 - 1: Comparative analysis of dividend tax

Country	**Local Dividends**	**Foreign Dividends of Foreign Companies, Including Listed Foreign Companies**	**Foreign Dividends (Full Exemption based on Ownership)**
South Africa	Exempt from normal tax but subject to 20% withholding tax.	Subject to 20% withholding tax on foreign-listed companies and 20% on normal income through a partial exemption on the foreign dividend.	Zero percent effective tax rate on South African residents who hold at least 10% of the total equity shares and voting rights on foreign dividends
United Kingdom	Exempt from normal tax but subject to dividend	Exempt from normal tax but subject to dividend	Exempt from normal tax but subject to dividend

	tax rates ranging from 8.75% to 39.35%.	tax rates ranging from 8.75% to 39.35%.	tax rates ranging from 8.75% to 39.35%.
Ghana	Exempt from normal tax but subject to 8% withholding tax.	Progressive tax rates range from 0% to 25% on assessable/normal income.	Progressive tax rates range from 0% to 25% on assessable/normal income.

(Source: Author's own compilation)

Based on a comparative analysis of dividend taxation frameworks in South Africa, the UK, and Ghana, notable disparities are revealed that prompt critical questions about equity and fairness, particularly regarding the treatment of foreign dividends in South Africa. South Africa's full exemption, which exempts taxpayers owning at least 10% of the total equity shares and voting rights from taxes on foreign dividends, demonstrates a significant divergence in tax policy. Scholars contend that tax policies should not challenge the principle of equitable tax treatment (Keen *et al.*, 2019:2).

Conversely, the UK employs a structured tax framework that applies progressive rates to dividends based on income brackets. This approach, as Aaberge *et al.,* (2018:20) contend, emphasises fairness by incorporating gradation into the taxation of dividends. Meanwhile, Ghana adopts a simplified model, imposing a flat 8% WHT on foreign dividends. Although straightforward, this system has been criticised as potentially regressive, disproportionately affecting taxpayers with lower incomes. It is worth noting that the three countries all strive to promote a commitment to preventing double taxation through tax credits on foreign dividends.

In light of these findings, it is proposed that South Africa revise its full exemption criteria to better align with principles of equity and fairness. Specifically, refining the exemption to balance the inclusivity of smaller shareholders while maintaining competitiveness could draw inspiration from the UK's progressive framework and Ghana's straightforward tax regime. Such revisions would enhance the equality of South Africa's tax system and address criticisms of its current structure.

The full exemption provides a significant advantage to investors who hold at least 10% of foreign equity shares and voting rights, exempting them from taxes on foreign dividend income. This policy, as highlighted in the OECD Report (2018:40), arguably favours wealthier investors, raising concerns about its alignment with the principles of horizontal equity. Scholars contend that such disparities underscore unequal treatment of economically similar activities, thereby challenging the equity of the tax framework.

To address these inequities, it is proposed that policymakers reconsider the current structure of the exemption. Revising foreign dividend tax policies to harmonise rates and reduce disparities could enhance fairness and better align with international best practices. A comparative table of findings emphasises the need for reforms, illustrating how these inequities undermine equitable taxation principles. This analysis advocates for a more balanced framework that supports fairness while maintaining competitiveness in the global tax landscape.

3.4 STRATEGIES AND RECOMMENDATIONS FOR FUTURE TAX POLICY

The complexities surrounding the taxation of foreign dividends highlight the need for substantial legislative reforms and greater international consistency to ensure equity and fairness across different jurisdictions. A comparative analysis of South Africa, the UK, and Ghana reveals significant disparities in the tax treatment of foreign dividends. Legislative reforms should therefore focus on clarifying and refining the criteria for full exemption based on ownership thresholds, in order to enhance equity and ensure that relief measures do not disproportionately favour wealthier investors.

Achieving consistency in the taxation of foreign dividends could be approached in two ways. As previously noted, the rationale behind South Africa's complex system, as outlined in the PCOF's commentary on the Revenue Laws Amendment Bill of 2000, was the difficulty for portfolio investors (those holding less than 10%) in accessing information on foreign taxes paid by foreign companies declaring dividends. This made the verification

process for SARS more challenging. However, the study highlights that all three countries under review share a common goal, namely to ensure fairness and equity in their taxation of dividend income. Each country seeks to apply consistent tax rates across taxpayers or to treat foreign and local dividends similarly. Notably, policymakers in each jurisdiction took into account the dynamic nature of economic conditions and government policies when making decisions about how taxes should be levied.

In South Africa, although the taxation of dividends has evolved, concerns persist regarding the treatment of foreign dividends received by taxpayers who own at least 10% of the equity shares and voting rights in a foreign company, particularly when compared to those owning less than 10%. To address this inequality, it is recommended that the following steps be taken:

3.4.1 Amendment of Section 10B(2)(a) of the Income Tax Act

Section 10B(2)(a) should be revised to include both taxpayers who own at least 10% of the equity shares and voting rights in a foreign company, as well as those who own less than 10%. However, for taxpayers owning less than 10%, the responsibility should lie with them to obtain the necessary information regarding foreign taxes paid by the foreign company declaring the dividend. This would simplify the complex verification process for SARS.

Furthermore, SARS should establish information-sharing agreements with tax authorities in jurisdictions where South African taxpayers hold substantial foreign shareholdings. These agreements would enable seamless verification of foreign dividends, ensuring compliance with tax regulations, mitigating tax avoidance, and promoting equitable treatment of foreign dividend income.

If the taxpayer is unable to provide this evidence, and there is no information-sharing agreement between South Africa and the foreign country, Section 10B(3) should apply,

resulting in the taxpayer being taxed at a rate of 20% instead of 0%. In other words, Section 10B(3) should be read in conjunction with Section 10B(2)(a). While this recommendation does not entirely eliminate existing inequality, it places the onus on the taxpayer, offering them the option to benefit from the lower tax rate or face a higher rate if they fail to provide the required documentation.

3.4.2 Alternative Approaches

Alternatively, Section 10B(3) could be repealed entirely, thereby exempting all foreign dividend income from taxation in South Africa. However, considering the fiscal challenges facing the South African government, this approach may not be financially viable. A more pragmatic alternative would be to subject all foreign dividends to a standard 20% tax rate unless the dividend is already taxed in South Africa, either through foreign company listings, Controlled Foreign Company (CFC) rules, or the residency status of the foreign entity in terms of Section 9 of the Act.

Another potential reform would be the introduction of a tiered tax system that takes into account the percentage of ownership in the foreign company. Under this system, taxpayers holding less than 10% of the equity shares and voting rights may be taxed at a reduced rate compared to local dividend taxpayers, thereby incentivising foreign investment while ensuring that all foreign dividends contribute to the national tax base.

These recommendations aim to strike a balance between tax equity, revenue generation, and investment attractiveness, ensuring that South Africa's foreign dividend tax regime remains both competitive and aligned with international best practices.

3.5 LIMITATIONS AND FUTURE RESEARCH

This study is subject to several limitations related to its scope and context, which are outlined as follows:

- The study does not provide a comprehensive analysis of dividend taxation as a whole. Instead, it focuses specifically on the taxation of dividends within the selected country, excluding consideration of DTA between nations.
- The concept of equality, as advanced by Adam Smith (1776) and subsequently interpreted by other scholars, was adopted as the framework for this study.
- The research is limited to examining the equity and fairness of dividend taxation in three countries, which may not fully represent international best practices. Furthermore, this study does not address the broader fairness of South Africa's tax system as a whole.

3.6 CONCLUSION

In conclusion, the findings of this study underscore the need for a comprehensive evaluation of the fairness and equity of South Africa's foreign dividend taxation framework, particularly in relation to the exemption provided to taxpayers owning at least 10% of equity shares and voting rights in foreign companies. The analysis reveals a clear disparity between South Africa's full exemption for larger investors, the progressive framework of the UK, and the straightforward approach adopted by Ghana. These findings directly address the primary objective of this study, which sought to examine the extent to which the taxation of foreign dividend income among South African resident taxpayers aligns with the principle of equality, as outlined by Adam Smith (1776).

The secondary objectives of the study, namely investigating the equality and fairness of South Africa's tax exemption compared to similar systems in the UK and Ghana, have highlighted the broader implications of South Africa's approach. While the UK incorporates a progressive tax system, which ensures a more equitable distribution of tax burdens, South Africa's policy raises concerns about horizontal equity, favouring wealthier investors and potentially perpetuating economic disparities. Ghana's simpler flat tax model, although easy to administer, poses its own fairness challenges, particularly for lower-income taxpayers. These international comparisons offer valuable insights into how South Africa could refine its tax policies to achieve a more equitable and fair taxation system.

Based on these findings, the study has made the case for revising South Africa's dividend tax exemption criteria to align more closely with principles of equity and fairness. By considering modifications to Sections 10B(2)(a) and 10B(3), integrating elements from the UK's progressive system and Ghana's straightforward approach, South Africa could create a tax regime that promotes inclusivity while maintaining competitiveness. The proposed adjustments would contribute to a more equitable tax system, addressing criticisms of the current framework and ensuring that tax burdens are more fairly distributed across all taxpayers.

In summary, the study's objectives have been met by critically examining the foreign dividend taxation policies of South Africa, the UK, and Ghana, with the aim of improving the equity of South Africa's tax system. By addressing the disparities identified in the findings, South Africa can move towards a more equitable and fair tax system that is better aligned with international best practices while ensuring the equitable treatment of all taxpayers.

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