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DIVIDENDS TAX TO SOON BE 5% OR 10%: By Jonathan Hore

Withholding tax (WHT) on dividends is set to either be 5% or 10%, effective 1 July 2021, following the budget proposals made by the Minister of Finance and Economic Development, Hon Dr T Matsheka on 1 February 2021. The Minister proposed an increase in WHT on dividends from 7.5% to 10% as one of the ways to assist government with revenue generation. I will show you why the WHT on dividends will, in most cases, either be 5% or 10% below as well as how you can declare dividends without cash and pay tax at 7.5%. Throughout this article, words importing the masculine shall be deemed to include the feminine.

Tax on dividends

Dividends are currently subject to tax at 7.5% withholding tax for both resident and non-resident shareholders. The increase to 10% will equally apply to both residents and non-residents of Botswana. The WHT is a final tax for residents, which means that once the WHT has been deducted by a dividend-paying company, no further tax shall be levied on such dividends in the shareholder's hands.

It is important to note that the increase will not impact some non-resident shareholders depending on the terms of the Double Taxation Avoidance Agreement (DTAA) Botswana has with particular countries. This is why I stated above that the WHT will either be 5% or 10%. However, dividends payable to local shareholders will invariably be subject to WHT at 10% as from July this year. The 10% will also apply to shareholders domiciled in countries with which Botswana does not have a Double Taxation Avoidance Agreement with or where the DTAA does not vary the WHT rate.

Enter the 5%

Whilst the Minister proposed to increase the WHT from 7.5% to 10%, there are some DTAAs which bring that rate to a maximum of 5% provided that the shareholder is non-resident and holds at least 25% shares in the Botswana company. What that means is that whilst the general rate per local legislation will be 10%, that rate will be reduced to 5% by the applicable DTAAs. Countries with such DTAAs include, among others, UK & Northern Ireland, Seychelles, Ireland, Mauritius and Zimbabwe. Currently, the shareholders resident in such countries are subject to the WHT at 5% and that will not be impacted by the proposal made by the Minister. Shareholders based in South Africa will be taxed at 10%.

Paying dividends now

It must be acknowledged that companies have the liberty of paying dividends before 1 July 2021 and make use of the 7.5% rate whilst it is still available. For the record, dividend declarations must be preceded by a solvency test to establish whether a paying company will afford its obligations after paying the dividends. If the company has enough retained earnings and passes the solvency test, then it can declare and pay the dividends now, paying the tax at 7.5%. But what will happen if the company does not have enough cash reserves, especially in this COVID era? This is where shareholders' loans and dividends in specie come in.

Loans & dividends in specie

Some companies may want to declare dividends but may not have sufficient cash. This calls for alternative payment methods if a company wants to make use of the 7.5% whilst it is still available. A company can declare a dividend, pass it through a shareholder's loan account and that transaction is regarded as payment in terms of the Income Tax Act. This is so as the dividend will first sit in a liability account called dividend payable. When a journal is passed to extinguish the dividend payable to a shareholder's loan account, it extinguishes the dividend payable account, immediately triggering the WHT. The other alternative is to pay the shareholders through goods or services, but that also triggers the WHT in the same manner that a cash dividend does. Companies can still make use of the 7.5% rate, if their financial positions allow them to.