

TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

RULING ON UNITISED INCENTIVE SCHEME DOES NOT PROVIDE MUCH CLARITY

An employee incentive scheme that is commonly used works as follows: A company forms a trust. The company funds the trust, and the trust then uses the funds to buy shares in the company. The employees of the company are given units in the trust, usually free of charge. The units entitle the employees to receive distributions from the trust on the underlying shares. The employees forfeit their units in certain circumstances and may generally not dispose of their units. The trust may "repurchase" the units from the employees in certain circumstances.

CUSTOMS AND EXCISE HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment.

RULING ON UNITISED INCENTIVE SCHEME DOES NOT PROVIDE MUCH CLARITY

Section 8C of the Income Tax Act states that if an employee acquires a restricted equity instrument by virtue of her employment, she must pay income tax (and not capital gains tax (CGT)) when the instrument vests.

SARS ruled: the proceeds received by the trust on the disposal of the shares accrue to the trust, which must calculate any capital gain or capital loss arising on the disposal.



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Section 8C of the Income Tax Act, No 58 of 1962 (Act) generally applies to such schemes. Put simply, that provision states that, if an employee acquires a restricted equity instrument by virtue of her employment, she must pay income tax (and not capital gains tax (CGT)) when the instrument vests.

An equity instrument includes not only a share but also a unit in a trust as indicated above.

An instrument will be restricted if the employee may not freely dispose of the instrument, or forfeits it when the employee leaves the employment of the company within a specified period or is dismissed for cause.

An instrument vests when the restrictions that apply to the instrument come to an end.

The income tax is determined on the difference between the amount (if any) paid by the employee to acquire the instrument and the market value of the instrument at the time it vests.

The company or the trust must withhold employees’ tax (PAYE) on the amounts accruing to the employees.

The application of s8C of the Act is generally relatively clear in schemes such as the one described above.

What is not always clear is the interaction between s8C of the Act and the incidence of tax in the hands of the trust.

A scheme similar to the one described above was the subject of Binding Private Ruling No 261 (Ruling), issued by the South African Revenue Service (SARS) on 30 January 2017. The trust repurchased the units of the employees. However, to fund the repurchase price, the trust had to sell some of the shares in the company.

SARS ruled as follows:

- The proceeds received by the trust on the disposal of the shares accrue to the trust, which must calculate any capital gain or capital loss arising on the disposal.
- For CGT purposes the trust must reduce the base cost of the shares by the amount of the contributions made by the relevant companies to enable the trust to acquire the shares. This must be done under paragraph 20(3)(b) of the Eighth Schedule to the Act (Eighth Schedule) which states, among other things, that a taxpayer must reduce the cost of an asset by any amount that has been paid by any other person.

RULING ON UNITISED INCENTIVE SCHEME DOES NOT PROVIDE MUCH CLARITY

CONTINUED

The Ruling suggests that paragraph 80(2) of the Eighth Schedule will apply in respect of any gains realised on the disposal of the shares, and must be disregarded by the trust where the gains are vested in the beneficiaries.



- If the trust realises any capital gains on the disposal, those gains will not be taxable in the trust under paragraph 80(2) of the Eighth Schedule. Paragraph 80(2A) of the Eighth Schedule will not apply.
- As the repurchase of the units results in vesting, s8C of the Act will apply and any gain determined in respect of the vesting is subject to employees' tax, which the trust must withhold.

Paragraph 80(2) of the Eighth Schedule essentially provides that, where a trust realises a capital gain on the disposal of an asset, and the beneficiary has a vested interest in the capital gain but not in the asset, the beneficiary (and not the trust) must account for CGT.

Paragraph 80(2A) of the Eighth Schedule applies where a beneficiary of the trust holds an equity instrument to which s8C of the Act applies. The provision states that, in that case, paragraph 80(2) of the Eighth Schedule does not apply in respect of a capital gain that is vested in the beneficiary by reason of (i) the vesting of that equity instrument in the beneficiary, or (ii) the

disposal of that equity instrument under s8C(4)(a) and s8C(5)(c) of the Act.

In this regard, the Ruling suggests that paragraph 80(2) of the Eighth Schedule will apply in respect of any gains realised on the disposal of the shares, and must be disregarded by the trust where the gains are vested in the beneficiaries. However, the Ruling is silent as to whether any such gains must be taken into account for purposes of calculating the beneficiaries' aggregate capital gains or losses. The Ruling does not explicitly state whether the beneficiaries should account for CGT.

It is possible that SARS is saying that there is no CGT at all, and that the only tax that arises is income tax in the hands of the beneficiaries on the repurchase of the units under s8C of the Act.

Unfortunately, the Ruling does not provide certainty on the interplay between CGT and income tax in schemes such as that described above. Generally, that issue is a vexed one and greater clarity from SARS or the legislature would be very welcome.

Ben Strauss

CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

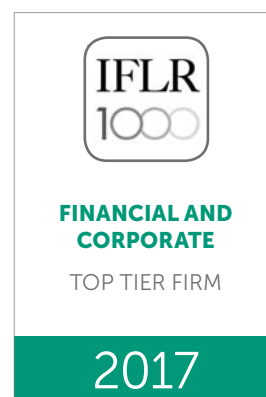
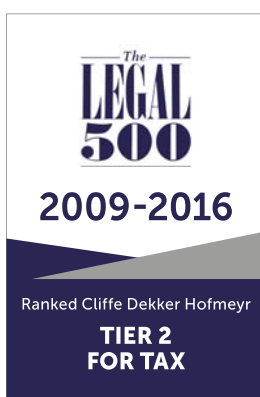
In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.



This week's selected highlights in the Customs and Excise environment:

- 1 Amendment of the following Schedules to the Customs and Excise Act, No 91 of 1964 (Act), as a consequence of the publication of the environmental levy on imported and locally manufactured tyres as announced by the Minister of Finance in his Budget Review on 24 February 2016 (with effect from 1 Feb 2017):
 - 1.1 Part 1 of Schedule No. 1;
 - 1.2 Part 3E of Schedule No. 1;
 - 1.3 Part 1 of Schedule No. 3;
 - 1.4 Part 5 of Schedule No. 4;
 - 1.5 Part 4 of Schedule No. 6; and
 - 1.6 Schedule No. 8.The levy is R2.30/kg net.
- 2 Amendment to Rule 54F to the Act to provide for the environmental levy on tyres as announced by the Minister of Finance in his Budget Review on 24 February 2016 (with effect from 1 Feb 2017).
- 3 Amendment of Part 3D of Schedule No. 1 to include hybrid vehicles under the environmental levy on carbon dioxide (CO₂) emissions of motor vehicles (with effect from 27 Jan 2017).

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