

16 JANUARY 2020

TAX & EXCHANGE CONTROL ALERT

IN THIS ISSUE >

Employee share schemes: Full bench confirms deductibility of employer contributions

In our [Tax & Exchange Control Alert](#) of 18 May 2018 we reported on a judgment in the Cape Town Tax Court dealing with the tax deductibility of employer contributions in relation to share incentive schemes.

FOR MORE INSIGHT INTO OUR
EXPERTISE AND SERVICES

CLICK HERE 

Employee share schemes: Full bench confirms deductibility of employer contributions

SARS appealed to a full bench of the Cape High Court. The judgment in that case was recently reported as *CSARS v Spur Group (Pty) Ltd* (A285/2019) (26 November 2019).

In our [Tax & Exchange Control Alert of 18 May 2018](#) we reported on a judgment in the Cape Town Tax Court dealing with the tax deductibility of employer contributions in relation to share incentive schemes.

In that case, the Tax Court had ruled against SARS. SARS appealed to a full bench of the Cape High Court. The judgment in that case was recently reported as *CSARS v Spur Group (Pty) Ltd* (A285/2019) (26 November 2019).

The majority of the judges in the High Court case dismissed the appeal and again found in favour of the taxpayer.

The facts are relatively complex, but are summarised in our [Tax & Exchange Control Alert](#) of 18 May 2018 referred to above.

The take-aways from the two judgments are the following:

- If a taxpayer establishes an employee share scheme to incentivise employees; and if the taxpayer uses a trust as the vehicle through which the scheme is implemented; and if the taxpayer makes a contribution (and not a loan) to the trust – then the taxpayer may be able to claim the amount of the contribution as an income tax deduction in terms of section 11(a) of the Income Tax Act 58 of 1962.
- However, the onus is on the taxpayer to show that there is a direct link between, on the one hand, the expenditure (the contribution) and, on the other hand, the benefits (i) accruing to the employees participating in the scheme, and (ii) accruing to the taxpayer in the form of happy employees who are willing to work hard to improve the profitability of the taxpayer. The taxpayer must also show that the employees in fact will benefit from the scheme.
- In the *Spur* case SARS issued additional assessments in 2014 and 2015, that is, more than 10 years after the scheme was initially devised and implemented. The case, in turn, reached the courts only in 2018. Fortunately, at the time of the hearing, the taxpayer still had witnesses on hand who could testify as to the operation and the effect of the scheme. It is critical that, when initially devising and implementing a scheme, the taxpayer has detailed contemporaneous documents setting out the purpose, operation and effect of the scheme, and that the taxpayer preserves those documents.
- It is also vital that comprehensive agreements between the parties involved in the scheme be drafted and signed. Courts will lend a lot of weight to the contents of the agreements. In the *Spur* case, for example, the taxpayer and the trust concluded a comprehensive “contribution agreement” which set out the purpose of the contribution and the scheme in great detail.
- Taxpayers should obtain advice from professionals such as lawyers and accountants when devising and implementing a scheme. It is apparent from the Tax Court and High Court judgments in the *Spur* case that the taxpayer had taken proper advice upfront.

Employee share schemes: Full bench confirms deductibility of employer contributions...*continued*

Taxpayers should ensure that all transactions comprised in the scheme are genuine and are implemented in accordance with their terms, and that they do not give rise to any notion that they are simulated, for example, that a contribution in substance is a loan.

It should be added that SARS had emphasised the role of other entities in the group who may coincidentally also have benefitted from the scheme. The majority of the judges dismissed SARS's arguments on this score. However, in a minority judgment, Judge Salie-Hlophe held that, effectively, the taxpayer had not disbursed the contribution; it was merely held in trust for the taxpayer. She held that "[t]he distance created by the various legal instruments in the formation of the trust, the contribution, the incentive scheme *et al* is a masquerade to appear as a section 11(a) expenditure" (at paragraph 11 of her judgment). Further on she added that "[t]he payment, *per se*, never left the family [ie the larger Spur group]" (paragraph 14 of her judgment).

Now, it was common cause between the taxpayer and SARS that "the scheme was legitimate and the transactions comprising it were neither simulated nor a sham" (paragraph 3 of the majority judgment). Accordingly, it may have been incorrect for Judge Salie-Hlophe to describe the parts of the scheme as a "masquerade".

Nevertheless, what the minority judgment does bring to light is that the taxpayers should ensure that all transactions comprised in the scheme are genuine and are implemented in accordance with their terms, and that they do not give rise to any notion that they are simulated, for example, that a contribution in substance is a loan.

Ben Strauss

CDH is a Level 1 BEE contributor – our clients will benefit by virtue of the recognition of 135% of their legal services spend with our firm for purposes of their own BEE scorecards.

OUR TEAM

For more information about our Tax & Exchange Control practice and services, please contact:



Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com



Mark Linington
Private Equity Sector Head
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com



Louis Botha
Senior Associate
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com



Gerhard Badenhorst
Director
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com



Jerome Brink
Senior Associate
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com



Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com



Varusha Moodaley
Senior Associate
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com



Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com



Louise Kotze
Associate
T +27 (0)11 562 1077
E louise.kotze@cdhlegal.com



Heinrich Louw
Director
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com



Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

©2020 8573/JAN

