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TAX & EXCHANGE CONTROL ALERT

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Employee share schemes: Full bench confirms deductibility of employer contributions

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Employee share schemes: Full bench confirms deductibility of employer contributions

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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.

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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

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