DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

WITHHOLDING EMPLOYEES' TAX IN RESPECT OF AN INCENTIVE SCHEME

The South African Revenue Service (SARS) recently released Binding Private Ruling 117 in which it had to be considered whether, and by whom, employees' tax had to be withheld in respect of certain share options granted to employees in circumstances where the employer and the person granting the share options are not the same person.

A foreign non-resident holding company and its local resident subsidiary wanted to implement two incentive schemes for the benefit of directors and employees of the subsidiary. The holding company would issue options to the relevant employees and directors that would entitle them to acquire shares in the holding company for no consideration. The exercising of the options would be subject to certain conditions.

SARS ruled that employees' tax need not be withheld in terms of paragraph 11A of the 4th Schedule to the Income Tax Act, No 58 of 1962 (Act) at the time the option is granted, but employees' tax will however have to be withheld when the option vests in terms of section 8C.

Essentially, section 8C(3) of the Act provides that an option will vest at the earliest of when the restrictions on the exercise or disposal of the option cease to have effect, or when the option lapses.

In respect of who would be liable for withholding the employees' tax at the time of vesting, SARS ruled that the holding company and the subsidiary would be jointly and severally liable for withholding employees' tax in terms of paragraph 11A of the Fourth Schedule of the Act if there is a gain in terms of section 8C of the Act.

Where the option is to be cash settled, the holding company and subsidiary will also be jointly and severally liable to withhold employees' tax, but only in respect of the vesting of the option in terms of section 8C of the Act and not in respect of the cash amount paid.

Heinrich Louw

IN THIS ISSUE

THE TAX TREATMENT OF A FOREIGN TESTAMENTARY AND DISCRETIONARY TRUST

SARS recently released Binding Private Ruling 116 (BPR116) in which it dealt with the income tax consequences for a resident beneficiary (beneficiary) of an amount to be received as a distribution from a non-resident discretionary testamentary trust (foreign trust A) and the subsequent donation of that amount by the beneficiary to another trust that is also a non-resident (foreign trust B).

The facts, more specifically, were as follows:

- Trust A holds all the shares in a non-resident company.
- During the 2010 calendar year, foreign trust A received a dividend from the non-resident company that foreign trust A did not immediately distribute to its beneficiaries.
- It was proposed that foreign trust A will in due course distribute (distribution) an amount equal to the amount of the dividend to the beneficiary.
- It is also proposed that the beneficiary will immediately on receipt of the distribution, donate the said amount to foreign trust B.

On the assumption that the dividend received by foreign trust A constituted a foreign dividend in terms of the now repealed section 10(1)(k)(ii)(dd) of the Income Tax Act, No 58 of 1962 (Act), SARS ruled that the amount of the distribution will not be included in the beneficiary's income under section 25B(2A) of the Act.

Section 25B(2A) deals specifically with income of a non-resident discretionary ownership trust and is premised on the view that income received by or accrued to a trust changes its character if not distributed during the year of assessment in which it is received or accrued. It provides that where a resident beneficiary acquires a vested right to any amount representing capital of a non-resident trust, that amount must be included in the income of the beneficiary if the capital arose from receipts and accruals of such trust which would have constituted income if the trust had been a resident in any previous year of assessment during which that resident beneficiary had a contingent right to that amount.

The requirements for section 25B(2A) to apply are as follows:

- The resident beneficiary of a non-resident trust must have acquired a vested right to an amount representing capital.
- The capital must have arisen from receipts and accruals of the trust:
    - which would have constituted income if the trust had been a resident; and
    - in any previous year of assessment during which that resident had a contingent right to that amount;
- The amount must not have been subject to tax in South Africa in terms of the Act.

On the facts of the ruling, the amount of the distribution received by the beneficiary would not have constituted income in the hands of foreign trust A because the distribution constituted an exempt foreign dividend. On this basis, the provisions of section 25B(2A) do not apply and as such the beneficiary will not be liable to tax on the distribution received from the trustees.

As indicated above, section 10(1)(k)(ii) of the Act has been repealed. The exemption of foreign dividends is now dealt with under the newly introduced section 10B of the Act which became fully operative on 1 April 2012.

The second issue which SARS was asked to consider was whether the subsequent donation by the beneficiary to foreign trust B would attract any donations tax, more particularly whether such donation will be exempt in terms of section 56(1)(g)(ii) of the Act.

Section 56(1)(g)(ii) provides an exemption in respect of a donation of any right in property situated outside South Africa that was acquired by the donor:

- by inheritance from a person who at the date of his death was not ordinarily resident in the Republic; or
- by a donation, if at the date of the donation the donor was a person other than a company not ordinarily resident in South Africa.

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SARS ruled that, assuming that the donation consists of a right in property situated outside South Africa, the donation would be exempt from donations tax under section 56(1)(g)(ii) of the Act.

Although it is not entirely clear from the ruling, it would appear that SARS regarded the distribution from foreign trust A (which as mentioned above is a testamentary discretionary trust) to the beneficiary as an inheritance from a person who at the date of his death was not ordinarily resident in South Africa. It is arguable, however, whether the exercise of a discretion by the trustees of a testamentary discretionary trust to award property to a beneficiary of that trust qualifies as an acquisition by the beneficiary by way of inheritance.

However, if one appreciates that assets acquired by the trustees from the testator and founder of a testamentary trust are acquired not for the benefit of the trustees but for the benefit of a particular beneficiary or beneficiaries, then it could be argued that the distribution thereof to a beneficiary is ultimately acquired by inheritance. Also, although the trustees exercise a discretion, such discretion is not totally unfettered. It is to be exercised in accordance with the parameters laid down in the will or trust deed and the selection of a beneficiary is from a group of named or ascertainable beneficiaries. In the context of a testamentary trust, a general power of appointment conferred on the trustees, that is a power to select a beneficiary not limited to certain persons or a class of persons, constitutes a delegation of the testator's power of testation, which is not allowed.

On this basis it is submitted that a distribution by the trustees of a testamentary trust to a beneficiary, either named or ascertainable from the will, can be regarded as an 'inheritance' from the testator and founder of the trust.

If, on the other hand, the distribution by the trustees to the beneficiary is considered to be a donation, then the exemption under section 56(1)(g)(ii) of the Act will likewise apply. It seems that this view is supported by the exemption contained in section 56(1)(l) of the Act which exempts from donations tax donations of property if such property is disposed of under and in pursuance of any trust. By implication, it could be argued that the legislature regards the distribution of property by a trustee to a beneficiary as a donation.

Nevertheless, it is difficult to categorise a distribution by a trustee to a beneficiary named in the trust as a donation. It is well recognised that for a disposal to be regarded as a donation it must be gratuitous, motivated by pure liberality or disinterested benevolence. The exercise of a discretion by a trustee seems to lack such motivation but is rather in pursuance of an obligation imposed on the trustee under the will or trust deed.

Overall, the ruling seems consistent with established principles and is to be welcomed by the taxpayer.

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