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TAX ALERT

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ADJUSTMENT OF ENERGY SAVINGS TAX INCENTIVE

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AMENDMENTS TO THE TAX TREATMENT OF DISPOSALS BY INCENTIVE TRUSTS

The Bill proposes to make five amendments to the Eighth Schedule of the Act in order to 'clarify' the tax treatment of disposals by incentive trusts.

Generally, where an employer establishes a trust to hold certain shares for future distribution to its employees as part of a share incentive scheme, the scheme is structured in such a manner that there are no capital gains or losses for the trust upon distribution.

In this regard, reliance is usually placed on paragraph 11(2)(j) of the Eighth Schedule of the Income Tax Act, No 58 of 1962 (Act), which provides that:

> "(2) There is no disposal of an asset:
>
> …
>
> (j) which constitutes an equity instrument contemplated in section 8C, which has not yet vested as contemplated in that section…"

However, according to the explanatory memorandum to the Taxation Laws Amendment Bill 2015 (Bill), it is indicated that "paragraph 11(2)(j) of the Eighth Schedule has been misinterpreted to mean that there is no disposal event at all by the trust in respect of an equity instrument".

Accordingly, the Bill proposes to make five amendments to the Eighth Schedule of the Act in order to 'clarify' the tax treatment of disposals by incentive trusts.

Firstly, it is proposed that paragraph 11(2)(j) of the Eighth Schedule be deleted.

Secondly, a new paragraph 13(1)(a)(iiB) will be inserted to deal with the time of disposal of equity instruments by trusts:

> "13(1) The time of disposal of an asset by means of:
>
> (a) a change of ownership effected or to be effected from one person to another because of an event, act forbearance or by operation of law is, in the case of:
>
> …
>
> *(iiB) the granting by a trust to a beneficiary of an equity instrument contemplated in section 8C, the time that equity instrument vests in that beneficiary as contemplated in that section…"*

The granting of an equity instrument by a trust will constitute a 'disposal', but the 'time of disposal', and therefore any capital gains tax effect, is postponed until such time as the equity instrument vests.

Accordingly, the granting of an equity instrument by a trust will constitute a 'disposal', but the 'time of disposal', and therefore any capital gains tax effect, is postponed until such time as the equity instrument vests.

Thirdly, a new paragraph 64C will be inserted to deal with instances where an employee exchanges an equity instrument that has not yet vested for another instrument, as contemplated in s8C(4)(a) of the Act, or where the employee disposes of the equity instrument to a connected party as contemplated in s8C(5)(a) of the Act. In these circumstances any capital gain or loss must be disregarded, because the tax consequences will be rolled over to the new instrument, or the connected party.

Fourthly, an amendment will be introduced to paragraph 80(1) of the Eighth Schedule, which will effectively exclude the disposal

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AMENDMENTS TO THE TAX TREATMENT OF DISPOSALS BY INCENTIVE TRUSTS

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Gains resulting from a share exchange or forfeiture in terms of s8C(4)(a) or s8C(5)(c) respectively will also be excluded from the operation of paragraph 80(2) of the Eighth Schedule of the Act.

by a trust of a s8C equity instrument to an employee beneficiary from the flow-through principle, and capital gains or losses will not be attributed to the employee.

However, the flow-through principle as contained in paragraph 80(2) will still apply where the trust disposes of the shares and then makes a cash distribution of any capital gain to the employee.

Lastly, a new paragraph 80(2A) will be inserted in the Eighth Schedule of the Act, which will exclude the operation of paragraph 80(2) as mentioned above to the extent that the capital gain is distributed to the employee by reason of the vesting of an equity instrument in that employee in terms of s8C of the Act. Gains resulting from a share exchange or forfeiture in terms of s8C(4)(a) or s8C(5)(c) respectively will also be excluded from the operation of paragraph 80(2) of the Eighth Schedule of the Act.

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ADJUSTMENT OF ENERGY SAVINGS TAX INCENTIVE

The energy efficiency savings tax incentive was implemented in November 2013, following the promulgation into law of s12L of the Income Tax, No 58 of 1962 (Act).

In recent years, the South African energy landscape has undergone significant changes with the introduction of a number of private and public sector renewable energy projects.

In order to ensure the commercial viability of the renewable energy projects, Government introduced an energy efficiency program which provides for qualifying tax allowances so as to assist and encourage taxpayers to reduce their energy footprint.

In particular, the energy efficiency savings tax incentive was implemented in November 2013, following the promulgation into law of s12L of the Income Tax, No 58 of 1962 (Act). Section 12L of the Act was introduced mainly to encourage the uptake of energy efficiency measures that result in improvements in energy use and which contribute towards reductions in greenhouse gasses.

Section 12L provides a qualifying taxpayer with an allowance for implementing technology resulting in measured and verified energy efficiency savings. Subject to certain compliance and registration requirements being met, the allowance under s12L is calculated at 45 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.

The potential difficulty with s12L in its current form is that a taxpayer would essentially only receive a once-off benefit in their first year of assessment, unless continuous energy efficiency processes are put in place year-on-year. The costs incurred could possibly outweigh any benefits under s12L after the first year of assessment in which the allowance is claimed, which is mainly due to the calculation of the baseline from which energy efficient savings is measured. Furthermore, since the introduction of the incentive, the rate of 45 cents per kilowatt hour has not been adjusted and is therefore deemed insufficient to incentivise energy efficiency projects.

The promulgation of the proposed amendment is likely to ensure that the substantial investment and compliance costs, relating to the uptake of energy efficiency projects, are commercially viable thereby assisting and encouraging taxpayers to reduce their energy footprints.

In order to address the aforementioned anomaly, the recently published Taxation Laws Amendment Bill 29 of 2015, which was tabled in Parliament on 27 October 2015 - which is likely to be promulgated in its current form - makes a welcome proposal to adjust the amount of the allowance to be claimed by qualifying taxpayers. In particular, it is proposed that the amount of the allowance to be claimed by qualifying taxpayers, in respect of energy efficiency savings, be increased from 45 cents per kilowatt hour to 95 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.

The promulgation of the proposed amendment is likely to ensure that the substantial investment and compliance costs, relating to the uptake of energy efficiency projects, are commercially viable thereby assisting and encouraging taxpayers to reduce their energy footprints.

The amendment is deemed to come into operation on 1 March 2015 and applies in respect of years of assessment commencing on or after that date.

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