4 AUGUST 2017

TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

FURTHER AMENDMENTS RELATING TO SHARE INCENTIVE TRUSTS

In 2015, several amendments were made to the Income Tax Act, No 58 of 1962 (Act) relating to the tax treatment of share incentive schemes. These amendments caused a substantial amount of uncertainty, specifically in respect of the disposal of shares by the incentive trust.

CLIFFE DEKKER HOFMEYR

FURTHER AMENDMENTS RELATING TO SHARE INCENTIVE TRUSTS

These amendments caused a substantial amount of uncertainty, specifically in respect of the disposal of shares by the incentive trust.

In 2015, several amendments were made to the Income Tax Act, No 58 of 1962 (Act) relating to the tax treatment of share incentive schemes. These amendments caused a substantial amount of uncertainty, specifically in respect of the disposal of shares by the incentive trust.

Capital gain if allowed to arise would result in double taxation since the employee would be taxed on a capital gain which is already reflected in the s8C income gain.

For some time, the following view was held:

> Under paragraph 11(1)(d) the vesting of an interest in an asset of a trust in a beneficiary is a disposal. The word 'vesting' is used in paragraph 11(1)(d) in the common law sense of unconditional entitlement. It does not mean a vesting as contemplated in s8C which occurs when all restrictions on the disposal of the share are lifted. If the common law vesting in an employee of a share by a share incentive trust precedes the vesting under s8C, paragraph 11(2)(j) prevents a disposal at the time of the common law vesting. When all restrictions are lifted on the share it vests under s8C but this event is not a disposal. It will therefore be observed that from the trust's perspective, there is no disposal of the share either at the time of the common law vesting or at the time of the s8C vesting. Paragraph 11(2)(j) thus prevents any capital gain from arising in the trust and being attributed to the employee under paragraph 80(1). Such a capital gain if allowed to arise would result in double taxation since the employee would be taxed on a capital gain which is already reflected in the s8C income gain. (SARS Capital Gains Tax Guide: Issue 4 – December 2011).

In the Explanatory Memorandum to the 2015 Taxation Laws Amendment Bill, it was indicated that:

> There is an anomaly in the interaction between taxation of share incentive trusts in s8C and time of disposal as well as attribution of capital gains to beneficiaries in the 8th schedule. It has come to our attention that paragraph 11(2)(j) of the 8th schedule has been misinterpreted to mean that there is no disposal event at all by a trust in respect of an equity instrument.

Inter alia, the following amendments were made:

- "...the deletion of paragraph 11(2)(j) of the 8th schedule. The reason for the deletion of this paragraph is to correct the misinterpretation that there is no disposal event at all by a trust";
- "...insertion of new paragraph 13(1)(a)(iiB) of the 8th schedule which deals with the time of disposal of an equity instrument by the trust to the qualifying employee beneficiary. The intention of this provision is to ensure that the granting of the restricted instrument by a trust to a qualifying employee beneficiary constitutes a time of disposal event. The capital gains tax implications are deferred and/or postponed until such time the equity instrument is free from restrictions and vests in the hands of a qualifying employee beneficiary for purposes of s8C";

CLIFFE DEKKER HOFMEYR

FURTHER AMENDMENTS RELATING TO SHARE INCENTIVE TRUSTS

CONTINUED

The question that arose is, if the incentive trust disposes of a share, whether to a beneficiary employee or other party, there is a disposal by the incentive trust subject to capital gains tax.

- "... insertion of new paragraph 64C of the 8th schedule, which makes provision to disregard any capital gain or capital loss determined in respect of disposal of the restricted instrument by a taxpayer to a connected person as contemplated in subsection (4)(a), (5)(a) or (5)(c) of s8C";
- "... amendment changes paragraph 80(1) of the 8th schedule to clarify that any gain as a result of this transaction will remain taxable in the trust and will not be attributed to the qualifying employee beneficiary. However, where a qualifying employee beneficiary becomes entitled to a cash amount instead of shares, the qualifying employee beneficiary will have a s8C gain (on the basis that the beneficial interest in the trust is a s8C equity instrument). Where the trust then dispose of shares and vests the profit in the hands of the employee, the capital gain will be attributed to the employee in terms of paragraph 80(2)"
- "...insertion of new paragraph 80(2A) of the 8th schedule which clarifies that where the trust dispose of shares and vests the profit in the hands of qualifying employee beneficiary, then the provisions of paragraph 80(2) will not apply if such amount is to be taken into account in the hands of qualifying employee beneficiary for purposes of s8C"

The question that arose is, if the incentive trust disposes of a share, whether to a beneficiary employee or other party, there is a disposal by the incentive trust subject to capital gains tax. Further, whether any gain realised would be taxable in the incentive trust, or whether the gain would flow through to the beneficiary employee and would be taxable in his or her hands. This in addition to the beneficiary employee being liable for income tax in terms of s8C of the Act.

During 2016, certain amendments were made to s8C and s10(1)(k) of the Act. These amendments focused on avoidance schemes where the value of relevant restricted equity instruments are eroded by certain distributions prior to vesting. These amendments did not clear up the uncertainties mentioned above.

Some of the issues came under consideration in Binding Private Ruling No 261. In that matter, an incentive trust repurchased certain units (being restricted equity instruments) from beneficiary employees. In order to fund the repurchase, the incentive trust sold the underlying scheme shares.

SARS made it clear that the sale of the scheme shares was, in fact, a disposal for capital gains tax purposes. However, SARS also indicated that any gain would not be subject of capital gains tax in the hands of the incentive trust – suggesting that paragraph 80(2) of the 8th Schedule would apply, and that paragraph 80(2A) would not apply.

The repurchase would, however, cause the units to vest, and the beneficiary employees would be subject to tax in terms of s8C of the Act.

The ruling did not state unequivocally whether employee beneficiaries would be subject to both capital gains tax in terms of paragraph 80(2) of the 8th Schedule as well as income tax under s8C.

CLIFFE DEKKER HOFMEYR

FURTHER AMENDMENTS RELATING TO SHARE INCENTIVE TRUSTS

CONTINUED

The 2017 draft Taxation Laws Amendment Bills have now been released, in which it is proposed that further changes will be made to the Act to clarify the position on the taxation of share-based incentive schemes.

The 2017 draft Taxation Laws Amendment Bills have now been released, in which it is proposed that further changes will be made to the Act to clarify the position on the taxation of share-based incentive schemes.

According to the draft Explanatory Memorandum, the proposed amendments focus mainly on the potential overlapping of paragraph 80(2A) of the 8th Schedule and s8C(1A) of the Act. The concern appears to be that in certain circumstances, an amount can be subject to tax in terms of s8C(1A) of the Act, as well as paragraph 80(2A) of the 8th Schedule.

Unfortunately this is a slightly different issue from the concern as to whether, under typical circumstances, there is both a capital gain upon disposal by the incentive trust of any shares, and taxation under s8C(1), and whether the capital gain will have to be accounted for by the incentive trust of the beneficiary employee. The correct position is still not being spelt out unambiguously in the Explanatory Memorandum.

However, when one has regard to the actual proposed amendments, the following is noted:

- section 80(2A) will be deleted; and
- a new paragraph 64E will be inserted into the 8th Schedule:

  "Where a capital gain is determined in respect of the disposal of an asset by a trust and a trust beneficiary has a vested right to an amount derived from that capital gain, that trust must disregard so much of that capital gain as is equal to that amount if that amount must in terms of s8C be:

  (a) included in the income of that trust beneficiary as an amount received or accrued in respect of a restricted equity instrument; or

  (b) taken into account in determining the gain or loss in the hands of that trust beneficiary in respect of the vesting of a restricted equity instrument."

- Paragraph 80(2) of the 8th Schedule is made subject paragraph 64E.

The proposed amendments could, therefore, alleviate some of the concerns.

The amendments are proposed to be effective from 1 March 2017.

Heinrich Louw

CHAMBERS GLOBAL 2011 - 2017 ranks our Tax and Exchange Control practice in Band 2: Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2017 in Band 1: Tax.

Mark Linington ranked by CHAMBERS GLOBAL 2017 in Band 1: Tax.

Ludwig Smith ranked by CHAMBERS GLOBAL 2017 in Band 3: Tax.

TOP RANKED GLOBAL CHAMBERS AND PARTNERS 2017

CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Tax and 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

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

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

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

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

Mareli Treurnicht
Director
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com

Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com

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

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

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

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

Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com

Nandipha Mzizi
Candidate Attorney
T +27 (0)11 562 1741
E nandipha.mzizi@cdhlegal.com

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

CLIFFE DEKKER HOFMEYR