

BINDING CLASS RULING: BCR 031

Some guidance contained in this ruling is affected by subsequent law changes. Refer to paragraph (ii) of the proviso to section 10(1)(k)(i).

DATE: 14 October 2011

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1, DEFINITION OF “GROSS INCOME”, 8C AND 10(1)(k)(i)
SUBJECT : INCOME DISTRIBUTED BY A DISCRETIONARY TRUST AND BENEFIT UNITS ALLOCATED TO BENEFICIARIES BY VIRTUE OF EMPLOYMENT

1. Summary

This ruling deals with the question as to whether –

- dividends received and distributed by a trust will retain its nature as dividends in the hands of the beneficiaries of the trust; and
- beneficial units allocated to beneficiaries will constitute equity instruments in their hands.

2. Relevant tax laws

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling legislative references to sections are to sections of the Act applicable as at 1 January 2011 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 1, definition of “gross income”;
- section 8C; and
- section 10(1)(k)(i).

3. Class

The class members to whom this ruling will apply will be the employees as described in point 4 below.

4. Parties to the proposed transaction

The Applicant: A holding company together with its subsidiaries, which form a group of companies (the Group)

The Trust: A discretionary trust established by the Group

The Employees: A specific group of permanent employees of the Group (also to be known as the beneficiaries of the Trust)

5. Description of the proposed transaction

The Trust has been established to enable the Employees to participate in a broad-based black economic empowerment initiative of the Applicant.

One of the objectives of the Trust is to acquire ordinary shares (the shares) in two companies within the Group. Both these two companies are public companies duly incorporated under the Companies Act, No. 61 of 1973. These shares will vest in the Trust and will at all times remain under the control of the trustees save for those circumstances when the shares will be used as security. These shares will not vest in the Employees.

A further object of the Trust is to hold and administer the “trust funds”. The trust funds comprise all assets administered by the trustees of the Trust, except for the shares acquired in the two companies. The trust funds comprise the following –

- a donation;
- any other donation as may from time to time be made to the Trust;
- other assets, shareholdings or investments – movable or immovable, corporeal or incorporeal – which the trustees may acquire on behalf of the Trust, but not limited to shares; and
- interest, dividends or accruals to the Trust of whatever nature.

The trustees are empowered to apply and allocate the trust funds in the discretion of the trustees for the benefit of the Employees to achieve the following objectives of the Trust –

- the broad-based black economic empowerment of the Employees;
- the improvement of the lives and standard of living of the Employees;

- the educational needs of the Employees and their immediate families or other dependents, as identified by the trustees from time to time;
- the initiation and development of projects to promote the employment, health, recreation, mental- and spiritual welfare and general well-being of the Employees;
- the provision of urgent relief and/or medical care to Employees in times of unforeseen hardship; and
- such further purposes which the trustees in their sole and unfettered discretion may deem ancillary and supplementary to the objects detailed.

The trustees may exercise their discretion to vest in the Employees the dividends – ordinary or special – declared by the two companies, which accrue to the Trust, being the owner of the shares. The Trust Deed enables the trustees to deal with these dividends as follows –

- 20% of the cash dividends may be utilized by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as listed above;
- the remaining 80% of the cash dividends may be used exclusively for repayment of the loans incurred to acquire the shares in the two companies;
- once the loans have been settled in full, the remaining 80% of all the cash dividends declared by the two companies and accruing to the Trust may be utilised by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as set out above; and
- any non-cash dividends declared by the two companies and accruing to the Trust may be utilised by the trustees in their absolute discretion in order to satisfy the objectives of the Trust as set out above.

The Employees will also participate in the Trust by way of Beneficial Units which will be determined and allocated to them as the Beneficiaries in the Trust within 6 months of the year-end of the Trust. The allocation method will result in a floating variable pool of the Employees eligible for Beneficial Units on an annual basis. They will share equally in the number of Beneficial Units to be allocated annually. The Beneficial Units will be determined in accordance with the formula:

$$A = B/C$$

in which –

- A means an amount of Beneficial Units to be allocated to each Employee;
- B means an amount equal to the total portion of cash dividends received by the Trust that will be utilised for repayment by the Trust of the loans incurred to purchase the shares in each financial year; and
- C means the number of Employees on the first day of the Trust's financial year to which the debt repayments in B above relate.

The Trust Deed provides that the Beneficial Units can only be valued as follows –

- the trustees will determine the price at which the Beneficial Units will be re-purchased in their sole and absolute discretion, taking into account the trust funds available for the re-purchase of the Beneficial Units on the relevant re-purchase date;
- the trustees are entitled to use such method of calculating the value of the Beneficial Units to be re-purchased at such date as they may deem fit and reasonable in their sole and absolute discretion at the time of the re-purchase of the Beneficial Units; and
- the trustees are entitled to put such measures in place relating to the payment of the re-purchase price of the Beneficial Units as they may deem fit and reasonable in their sole and absolute discretion.

The number of Beneficial Units will be the same as the value of the dividend amounts that will be used to repay the loans. If an Employee resigns or retires from a company within the Group he or she will be paid an amount based on the discretion of the trustees (re-purchase of the Beneficial Units). Whilst the number of Beneficial Units is equal to the dividends which could be vested in the Employees, the amount paid to Employees does not represent an amount equal to dividends which could not be vested. The re-purchase price is based on the trust funds available for the re-purchase of Beneficial Units. The value of the Beneficial Units are taxable in the hands of the Employees in the year in which the re-purchase value accrues to them.

6. Conditions and assumptions

This ruling is made subject to the conditions and assumptions that –

- the trustees' discretion in terms of Trust Deed is in no way linked to the performance of the Employees and cannot result in the payment of any form of remuneration or bonus to the said Employees;

- the vesting of the dividends in the Employees and the distribution thereof will not result in the settlement of an obligation of the Group in respect of the employment or services rendered by the Employees; and
- the re-purchase price of the Beneficial Units will in no way be linked to the value of the shares.

7. Ruling

The ruling made in connection with the proposed transaction is as follows:

- Any distribution made by the trustees of the Trust to the Beneficiaries (Employees) will, if the distribution is made within the same year of assessment in which the dividend was received by or accrued to the Trust, retain the character of a dividend in the hands of the Beneficiaries (Employees).
- Such distributions will be exempt in the hands of the Beneficiaries (Employees) under section 10(1)(k)(i).
- The Beneficial Units will not constitute equity instruments as defined in section 8C in the hands of the Beneficiaries (Employees).

8. Period for which this ruling is valid

This binding class ruling is valid for a period of five (5) years as from January 2011.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**