**BINDING CLASS RULING: BCR 051**

DATE: 16 February 2016

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| **ACT** | **:** | **INCOME TAX ACT NO. 58 OF 1962 (the Act)** |
| **SECTION** | **:** | **SECTIONS 8C, 10(1)(*k*), 25B, AND 64F(1)(*l*)** |
| **SUBJECT** | **:** | **TAXATION OF EMPLOYEES PARTICIPATING IN A PERPETUITY EMPLOYEE SHARE INCENTIVE SCHEME** |

## 1. Summary

This ruling determines the taxability of dividends accruing to a trust that will, in turn, distribute those dividends to its beneficiaries pursuant to an employee share incentive scheme.

## 2. Relevant tax laws

This is a binding class ruling issued in accordance with section 78(2) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 5 October 2015. Unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of –

- section 8C;
- section 10(1)(*k*);
- section 25B; and
- section 64F(1)(*l*).

## 3. Class Members

The class members to whom this ruling will apply are the Beneficiaries of the Co-Applicant.

## 4. Parties to the proposed transaction

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| The Applicant: | An unlisted company, incorporated in and a resident of South Africa |
| The Co-Applicant: | A trust, founded by the Applicant, registered in and a resident of South Africa |
| The Beneficiaries: | Qualifying employees who are permanent employees of the Applicant within the Applicant’s lower employment grades |

## 5. Description of the proposed transaction

The Applicant intends to establish an employee share ownership plan (ESOP) and founded the Co-Applicant for that purpose.

The Applicant will contribute an amount to the Co-Applicant to enable the Co-Applicant's trustees (trustees) to subscribe for a separate class of ordinary shares (scheme shares) in the Applicant.

The scheme shares will rank *pari passu* with the ordinary shares of the Applicant with regards to voting rights, participation in the capital and income of the Applicant as well as other share related matters. The sole distinction between the ordinary shares and the scheme shares is that the dividends of the scheme shares must be determined and paid, based on a formula which requires a percentage of the free cash flow determined for that financial year to be distributed as a dividend.

The distributable income (if any) will be paid to the Beneficiaries who were qualifying employees on the last day of the financial year to which the distributable income relates, in equal amounts (by dividing the distributable income by the number of Beneficiaries receiving distributable income). The trustees will ensure that the distributable income will always be paid to the Beneficiaries within the same financial year as the receipt thereof.

Persons who cease to be qualifying employees will cease to be regarded as Beneficiaries or to have any rights under the ESOP.

The trustees will be entitled to vote the scheme shares on behalf of the Beneficiaries at all shareholders meetings. Each recognised workers union will be entitled to appoint, remove or replace one trustee and one additional trustee for every completed 25% of the Beneficiaries who are members of such union. The Applicant will appoint one trustee fewer than the number of trustees appointed by the recognised unions. One independent trustee will also be appointed by the majority of the trustees.

It is intended that the ESOP will exist for an indefinite period. In this regard the Co-Applicant's trust deed determines that the Co-Applicant will endure in perpetuity, unless it is terminated on the occurrence of any one of the following events –

- the Applicant terminates its corporate existence;
- there are no Beneficiaries left; or
- the Applicant exercises its rights as against the Co-Applicant in terms of a "come along" arrangement, if a third party offers to buy all of the ordinary shares in the Applicant.

If the Co-Applicant is terminated for any one of those reasons, the Applicant will repurchase the scheme shares from the Co-Applicant at market value. Upon termination of the Co-Applicant, before the Co-Applicant is deregistered, the trustees will realise the Co-Applicant's assets, discharge the Co-Applicant's liabilities and distribute any surplus to the Beneficiaries in equal portions in the same financial year that the Co-Applicant's assets are realised. If there are no Beneficiaries left, any surplus will be paid to a public benefit organisation in the same financial year that the Co-Applicant's assets are realised. The public benefit organisation will be decided upon by the trustees.

The scheme shares must remain in the Co-Applicant and the Co-Applicant's trust deed provides that neither the Co-Applicant nor the trustees will –

- be entitled to divest the Co-Applicant of the scheme shares, except in terms of the termination provision as mentioned above; or
- enter into any agreement in respect of the manner in which any votes attached to any scheme shares will be exercised; or
- purport to agree, whether or not subject to any suspensive or resolutive condition, to do any of the aforegoing.

Beneficiaries will not be entitled to dispose of, cede or encumber any or all of their rights acquired under the Co-Applicant's trust deed.

## 6. Conditions and assumptions

This binding class ruling is not subject to any additional conditions and assumptions.

## 7. Ruling

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

- The dividends to be received by the Co-Applicant and distributed to the Beneficiaries within the same financial year the dividends were received will not be included in the income of the Co-Applicant under section 25B(1).
- The dividends to be distributed by the Co-Applicant to the Beneficiaries will not be exempt from normal tax under section 10(1)(*k*), as proviso (*ii*) to section 10(1)(*k*)(i) will apply.
- The dividends to be received by the Co-Applicant and distributed to the Beneficiaries will be exempt from dividends tax under section 64F(1)(*l*).

## 8. Period for which this ruling is valid

This binding class ruling is valid for the duration of the share incentive scheme, subject to reconfirmation thereof every 5 years from the date of the ruling.

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