

INTERPRETATION NOTE: NO. 55 (Issue 2)

DATE: 30 March 2011

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTION 8C AND 10(1)(nD), PARAGRAPH 11A OF THE FOURTH SCHEDULE AND PARAGRAPH 2(a) OF THE SEVENTH SCHEDULE
SUBJECT : TAXATION OF DIRECTORS AND EMPLOYEES ON VESTING OF EQUITY INSTRUMENTS

Preamble

In this Note –

- references to sections are to sections of the Act; and
- unless the context otherwise indicates, any word or expression in this Note bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides clarity on the tax implications of any gain made or loss incurred by any director or employee on the vesting of an equity instrument.

2. Background

Section 8C has been introduced to replace section 8A. Section 8C includes in a taxpayer's income any gains or losses made on the vesting of equity instruments, which were acquired by virtue of employment or the holding of any office of director, on or after 26 October 2004.

3. The law

For ease of reference, the relevant sections of the Act are quoted in the **Annexure**.

4. Application of the law – Income tax

Any gain or loss made by an employee as a result of the vesting of any equity instrument during any year of assessment must be included in or deducted from the income of the employee. Section 8C prescribes the requirements, circumstances, exclusions, valuation methodology as well as procedural matters relating to the inclusion or deduction of amounts that relate to the vesting of equity instruments in the hands of employees and holders of the office of director. Excluded from the operations of section 8C are “qualifying equity shares” acquired under a broad-based employee share plan contemplated in section 8B.

4.1 Application of section 8C

Section 8C applies to any person who acquired an equity instrument –

- (a) by virtue of employment or office of a director of any company or from any person by arrangement with the person's employer;
- (b) by virtue of the fact that the taxpayer already held restricted equity instruments (for example, as a result of a capitalisation issue or the unbundling of a company) [section 8C(1)(a)]; or
- (c) as a restricted equity instrument during the period of employment by or office of director of any company from –
 - (i) that company or any associated institution in relation to that company; or
 - (ii) any person employed by or that is a director of that company or any associated institution in relation to that company.

4.2 Nature of equity instruments and restricted equity instruments

It is important to distinguish between a restricted and an unrestricted equity instrument as it determines the timing of the taxable event.

- (a) The definition of an “**equity instrument**” in section 8C is very wide and includes –
 - (i) any share or part thereof in the equity share capital of a company or a member's interest in a company, which is a close corporation;
 - (ii) any non-equity share, such as a redeemable preference share;
 - (iii) an option to acquire such a share, part of a share or member's interest;
 - (iv) any other financial instrument that is convertible to a share, part of a share or member's interest; and
 - (v) any contractual right or obligation the value of which is determined directly or indirectly with reference to a share or member's interest, for example, a contingent or vested interest in a trust that holds shares.
- (b) If any of the following restrictions are placed on an equity instrument, the equity instrument will be a “**restricted equity instrument**”, as defined in section 8C:
 - (i) Any restriction (other than restrictions imposed by legislation) that prevents the taxpayer from freely disposing of the equity instrument at market value, for example, a requirement that the taxpayer must retain a share for a specified number of years or may only dispose of the share to a specified person.
 - (ii) A restriction whereby the taxpayer could either forfeit ownership of the equity instrument or the right to acquire ownership of the equity instrument, at a price other than at market value, for example, where the taxpayer is required to remain in employment for a period, failing which options to acquire shares are forfeited or shares already acquired must be resold to the employer at cost. This will include a restriction where the taxpayer may be subjected to financial penalties, for example, by the grantor of the shares, for not complying with the terms of the acquisition agreement.
 - (iii) A restriction granting any person a right to impose one of the restrictions contemplated in (i) or (ii) above, for example, an option by the employer to

impose an additional retention period before the shares may be disposed of.

- (iv) In the case of an option to acquire a share, if the share to be acquired is a restricted equity instrument the option will then also be a restricted equity instrument. For example, an option to acquire a share that may not be disposed of for a specified period.
- (v) In the case of any financial instrument which is convertible into a share or member's interest that is restricted, the financial instrument will be a restricted equity instrument. For example, convertible debentures that may only be converted into restricted shares.
- (vi) Any instrument that is linked to an undertaking by the employer, at the time of acquisition by the taxpayer, to either –
 - cancel the purchase transaction; or
 - repurchase the equity instrument at a price exceeding its market value, if the market value of the equity instrument declines after that acquisition, then the equity instrument so acquired will be a restricted equity instrument.
- (vii) If the equity instrument is not deliverable to the taxpayer until the happening of a future event, whether fixed or contingent. For example, where the share certificate is held by the employer until a loan granted to the taxpayer to acquire the equity instrument has been repaid, the equity instrument will be a restricted equity instrument.

Any other equity instrument which does not fall into restricted status in terms of the categories mentioned above is an “**unrestricted equity instrument**”, as defined in section 8C.

4.3 Definitions

4.3.1 Consideration

In respect of an equity instrument it is any amount given or to be given by (otherwise than in the form of services rendered or to be rendered or anything done, to be done or not to be done) –

- (a) the taxpayer in respect of that equity instrument;
- (b) the taxpayer in respect of another restricted equity instrument which has been disposal by the taxpayer in exchange for that equity instrument; or
- (c) any other person in acquiring equity instrument at an arm's length or from a connected person in relation to that taxpayer. The actual amount paid by that person for the equity instrument will be ignored and is replaced by the amount which would have been paid by the taxpayer, who originally owned the equity instrument.

Excluding

The market value of an equity instrument given by the taxpayer in exchange for a new equity instrument acquired. For example, employee A acquired an equity instrument to the value of R100 and paid R50 as consideration on the date of grant. Later employee A receives a new equity instrument to the value of R200 in exchange for the equity instrument already held. The market value of the old equity instrument

(R100) will not be taken into account in determining the consideration. The employee has still only paid a consideration of R50.

Provided that:

Where a taxpayer acquired any marketable security (that is, security, stock, debenture, share, option or other interest capable of being sold in a share-market or exchange or otherwise) in exchange for any other right and that right so acquired constitutes an equity instrument, the consideration for that equity instrument will be the initial amount paid in acquisition of original marketable security. The equity instrument acquired is deemed to be acquired by virtue of employment, and the value, if the marketable security is disposed of, may not be taken into account in determining the consideration paid for the new equity instrument acquired.

4.3.2 Market value

Market value means in relation to an equity instrument –

- of a private company (referred to in the Companies Act, 1973), an amount determined in terms of a method of valuation prescribed in the rules relating to that equity instrument, which is used consistently and is regarded as a proxy for the market value of that equity instrument for the purpose of those rules; or
- of any other company, the price of which an instrument could be obtained between a willing buyer and a willing seller on the open market at arm's length.

4.4 The gain or loss to be included in the taxpayer's income

It is the vesting of an equity instrument that results in a gain or loss to be included in or deducted from the income of the taxpayer. Subject to certain exceptions discussed in **4.6**, the gain is the amount by which the market value on the date of vesting exceeds any consideration paid in respect of the equity instrument. Conversely, the loss is the amount by which the consideration paid exceeds that market value on the date of vesting.

4.5 Timing of taxable event in respect of equity instruments

The event that triggers taxation in the hands of the taxpayer is the vesting of an equity instrument. Unrestricted equity instruments vest when the employee acquires the instrument. Restricted equity instruments vest on the earlier of any of the following events:

- (a) All the relevant restrictions on an equity instrument cease to have effect.
- (b) Immediately after termination of –
 - (i) an option to acquire a restricted equity instrument; or
 - (ii) a financial instrument which is convertible into a restricted equity instrument.

This provision does not apply when exercising the option, or when converting the financial instrument, as the case may be.

- (c) Death of an employee provided all restrictions relating to that equity instrument are or may be lifted upon the taxpayer's death. The date of accrual is deemed to be the day immediately preceding the date of death.

- (d) At the time an equity instrument is disposed of to the employer at less than market value.
- (e) Immediately before disposal of the equity instrument by the taxpayer, except in the case of the following disposals:
- (i) The exchange of a restricted equity instrument to which section 8C applies, for another restricted equity instrument.
 - (ii) Any disposal of an equity instrument that constitutes a qualifying equity share as contemplated in section 8B.
 - (iii) The disposal of a restricted equity instrument to another person in terms of a transaction which is not an arm's length transaction.
 - (iv) The disposal of a restricted equity instrument to a connected person.
 - (v) The disposal is to the employer at less than the market value of the restricted equity instrument.

Example 1 – Vesting of a restricted equity instrument

Facts:

X is employed by Company J and acquired shares in Company J for R100, when the shares had a value of R100. In terms of the agreement, X is not allowed to sell the shares for two years. After a period of two years the market value of the shares is R150.

Result:

Section 8C comes into operation because X acquired the shares by virtue of his employment with Company J. The shares in Company J are restricted equity instruments since there is a restriction imposed on the disposal of the shares. The shares will only vest in X after the two-year period, when the restriction expires. The gain of R50 (R150 – R100) is included in X's income in the year of assessment in which the shares vest in him.

Example 2 – Disposal of a restricted equity instrument to a connected person

Facts:

An employee, Y, is granted and accepts options to acquire 100 restricted equity shares from Company J by virtue of his employment with Company J, at R1 per share. The underlying shares may not be disposed of for five years. After three years, when the underlying shares have a market value of R4 per share, Y disposes of the options to his wife. After five years all restrictions fall away and his wife acquires the underlying shares at R1 per share when their market value is R7 per share.

Result:

The disposal of the option by Y to his wife is treated as a non-event for vesting purposes, as his wife is a connected person to Y. When all restrictions fall away and his wife becomes entitled to dispose of the shares, the gain of R6 per share made by his wife (R7 market value less R1 paid for the share) is deemed to be a gain made by Y. Y must account for income of R600 in his tax return, and Company J must withhold employees' tax from Y's remuneration.

Note:

Section 58(2) deems the restricted instrument to be donation at the time that it is deemed to vest for the purposes section 8C, if a person disposes such an instrument to a connected person. The value for donations tax is the fair market value of that instrument at that time, reduced by any amount of consideration in respect of that donation.

The same principle in **Example 2** applies where the original equity instrument was acquired by a person other than the taxpayer, for example, Y's wife acquires an equity instrument from Company J by virtue of his employment with Company J. The instrument is deemed to be originally acquired by Y, and disposed of by him to his wife in the same way as described in **Example 2** [section 8C(5)(b)].

An exception to the rules deeming disposals by other parties to accrue to the taxpayer is the situation where the taxpayer disposes of a restricted equity instrument to his employer for an amount less than the market value, and if the repurchase by the employer is in terms of a restriction imposed in respect of that equity instrument. In these circumstances, if the employer subsequently disposes of that equity share, no gain is deemed to be made by the taxpayer [section 8C(5)(c)].

4.6 Determination of a taxpayer's income

(a) Inclusion in income

In the circumstances described below, the amounts indicated must be included in a taxpayer's income –

- (i) if the restricted equity instrument is repurchased by the employer, the amount by which the sum received by or accrued to the taxpayer exceeds the sum of any consideration paid for that equity instrument [section 8C(2)(a)(i)(aa)];
- (ii) if the equity instrument is an option to acquire a share, or a financial instrument convertible into a share, which is disposed of by release, abandonment or which lapses, the amount by which the sum received by or accrued to the taxpayer exceeds the sum of any consideration paid for that equity instrument [section 8C(2)(a)(i)(bb)];
- (iii) if the taxpayer holds a restricted equity instrument, and a capital distribution as contemplated in paragraph 74 of the Eighth Schedule to the Act, other than a capital distribution of an equity instrument, is made in respect of that instrument, the amount of the capital distribution [section 8C(1A)]; or
- (iv) in any other case, the amount by which the market value at the date of vesting exceeds any consideration paid by the taxpayer in respect of that instrument [section 8C(2)(a)(ii)].

(b) Deduction from income

If the amount so calculated results in a loss to the taxpayer, the loss may be deducted from the taxpayer's income, notwithstanding the prohibition against such deductions contained in section 23(m) [section 8C(1)(a) and (2)(b)].

(c) Special circumstances

If a taxpayer exchanges one restricted equity instrument acquired from the employer for another restricted equity instrument from that employer, and in addition receives any payment in a form other than a restricted equity instrument, the additional payment must be included in the income of the taxpayer, and the "new" equity instrument so acquired is deemed to have been received by the taxpayer by virtue of his employment or office of director. However, the taxpayer may deduct any consideration attributable to that payment, for example, the amount paid for the "old" restricted equity instrument. If the result is a loss, the loss may be deducted from the taxpayer's income [section 8C(4)(a) and (b)].

Example 3 – Exchange of restricted equity share instrument for another equity instrument*Facts:*

An employee of Company J, Z, acquires 100 shares, being restricted equity instruments, at a price of R2 per share from her employer. Z may not sell the shares until a period of three years has expired. After two years, Company J is acquired in a takeover by Company K. The original Company J shares acquired by Z are exchanged for 100 shares in Company K, with a market value of R3 per share. The balance of the restriction applicable to the old shares applies to the newly acquired shares. After another one year, when the restriction falls away and Z is entitled to dispose of the new shares, the market value is R8 per share.

Result:

The shares originally acquired are restricted equity instruments. As the new restricted equity instruments were acquired in exchange for the old shares, the new shares are deemed to have been acquired by virtue of Z's employment, and section 8C applies to any vesting.

No amount is required to be included in income when the exchange of shares takes place, as no vesting has occurred.

When the shares eventually vest, Z must include in her income the gain made of R6 per share (R8 market value at vesting less R2 paid for the original equity instruments).

Example 4 – Cash received upon exchange of restricted equity instrument*Facts:*

The circumstances are the same as in Example 3, except that the market value of the shares received in exchange is R1 per share; and in addition to the new equity shares, Z receives R120 in cash. Nothing is paid for the new shares.

Result:

The additional payment of R120 in cash is included as a gain in the taxpayer's income in the year of exchange. No consideration may be deducted from the income, as nothing was paid for the new shares.

Upon vesting, the gain to be included in Z's income will be R6 per share (R8 market value at vesting less R2 paid for the original equity instruments).

5. Application of the law – Employees' tax

5.1 Deduction upon vesting

(a) Any gain made upon the vesting of any equity instrument as contemplated in section 8C is deemed to be an amount of remuneration that is payable to the employee by the person by whom the right was granted or from whom the equity instrument was acquired, under paragraph 11A(1) of the Fourth Schedule to the Act.

(b) Employee' tax in respect of the gain must be deducted or withheld by the person who granted the right to the employee, or from whom the equity instrument was acquired, from –

- (i) any consideration paid or payable to the employee in respect of the disposal of vested equity shares; or
- (ii) any cash remuneration paid or payable by that person to the employee from the amount of the gain made on the vesting of the equity instrument.

The employer must ascertain from the Commissioner the amount of employees' tax which must be deducted from the amount of the gain made on the vesting of the equity instrument. Therefore, a tax directive application must be submitted to SARS. Employees' tax must be deducted during the year of assessment in which the gain has arisen as a result of the vesting of the equity instrument.

(c) In the circumstances where the equity instrument was granted by or acquired from an associated institution in relation to the employer, and that associated institution is unable to deduct or withhold employees' tax on the gain (due to the amount required to be deducted exceeding the remuneration from which the withholding must be made), then both –

- the person who granted the right to acquire the equity instrument, or from whom the equity instrument was acquired; and
- the employee's employer,

are jointly and severally liable for an amount equal to the amount of employees' tax attributable to the gain. If this occurs, the employees' tax to be deducted or withheld must be aggregated over the year of assessment during which the gain is made. The local SARS office must immediately be notified of this fact.

In the case where the remainder of the year of assessment is insufficient to deduct or withhold the employees' tax due in respect of the gain, or where such a deduction may cause the employee undue hardship, the local SARS office must be approached for guidance.

- (d) An employee may make a gain under a transaction which the employer or the person who granted the right or from whom the equity instrument was acquired, was not a party to. In such cases, the employee must immediately inform these parties of the fact that a gain has been made, and the amount of the gain. Any employee who fails to perform this duty will be guilty of an offence, and may be criminally prosecuted.

5.2 Acquisition from an associated institution

An associated institution and the employer are deemed to be jointly and severally liable for an amount equal to the amount of employees' tax attributable to that gain where –

- (a) the equity instrument was granted to the employee by an “associated institution” in relation to the employer (as defined in the Seventh Schedule to the Act) of that employee; and
- (b) that associated institution is unable to deduct or withhold employees' tax in respect of the gain, due to the amount required to be deducted exceeding the remuneration from which the withholding must be made.

The employee must inform his or her employer and the associated institution that gains have been made in respect of such equity instruments and the amount of the gain must be disclosed to the employer and the associated institution.

This means that, for example, upon an employee resigning from a previous employer within the same group but still retains restricted equity instruments in the previous employer which is an associated institution in relation with that employer, he or she must inform the current employer about any gain made from the vesting of that equity instruments from the previous employer.

Example 5 – Acquisition from an associated institution

Facts:

B is employed by Company J. Company K is the holding company of Company J, and is an associated institution, as defined. B acquires 100 restricted equity instruments for R300 in Company K by virtue of his employment with Company J. B may not dispose of those instruments for three years. The market value on the date of acquisition was R300. When the instruments vest after three years, the market value is R1 000. There is no cash paid by Company K to B.

Result:

Company K is deemed to pay an amount of remuneration to B, being equivalent to the amount of the gain of R700 (R1 000 market value at vesting less R300 market value at acquisition). As Company K does not pay remuneration to B, Company J is deemed to be jointly and severally liable together with Company K for the deduction of employees' tax on the gain.

In some cases, employee's (residents) who were awarded with restricted equity instruments are seconded overseas for a certain period before the restriction ceases. Where the vesting occurs upon return to the Republic or while overseas, the provision of section 10(1)(o)(ii) will apply. The gain made will be deemed to have accrued evenly over the period of services rendered. This means that the gain will be apportioned evenly according to the period relating to services rendered outside the

Republic that qualifies (section 10(1)(o)(ii) exemption) and the period relating to services rendered in the Republic. The portion of a gain that relates to services rendered in the Republic will be included in the taxpayer's income and be taxed accordingly.

Persons who are not residents are taxed on their receipts or accruals from sources, within or deemed to be within the Republic. If a person ceased to be a resident, that person is subjected to immediate deemed disposal of all the assets (that is, restricted and unrestricted equity instrument) for capital gains tax purposes. However, paragraph 12(2)(a)(iii) of the Eighth Schedule to the Act exempts unvested equity instruments, because these instruments will only be subjected to ordinary gain or loss when vesting takes place. Immediately when a restricted equity instrument vests, the gain or loss made upon vesting must be apportioned. The portion relating to the period of service rendered while in the Republic will be subjected to tax in the Republic.

5.3 Disposal of restricted equity instruments to the employer

An employee, who disposes of an equity instrument to his or her employer in terms of a restriction imposed by the employer, and for an amount less than the market value of that equity instrument, must include the amount received, less any consideration paid for the equity instrument, in his or her income. This amount is also deemed to be an amount of remuneration paid by the employer to the employee, and is subject to the deduction of employees' tax.

5.4 General

An employee that fails to inform his or her employer that he or she has made any gain on the vesting of any equity instrument, is guilty of an offence and is liable on conviction to a fine not exceeding R2 000 in terms of paragraph 11A(7) of the Fourth Schedule to the Act.

An amount received or accrued from the vesting of any equity instrument must be disclosed under code 3718, and code 3768 in respect of foreign services income, on the IRP 5 certificate.

6. Conclusion

Section 8C will apply to every vesting of an equity instrument acquired by virtue of employment or the holding of an office on or after 26 October 2004. It is important in the case of restricted equity instruments to note that the valuation and taxing event is delayed until such time as all restrictions are lifted or are no longer applicable. This section seeks to trigger taxation only when an employee effectively cashes out the employee's stake in the employer and the taxation under this section seeks further to preserve ordinary treatment for growth-related salary as opposed to artificial characterisation as capital.

Legal and Policy

SOUTH AFRICAN REVENUE SERVICE

Date of first issue: 31 March 2010

Annexure – The law

Section 8C – Taxation of directors and employees on vesting of equity instruments.

(1) (a) Notwithstanding section 9B, 9C and section 23(m), a taxpayer must include in or deduct from his or her income for a year of assessment any gain or loss determined in terms of subsection (2) in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by that taxpayer—

- (i) by virtue of his or her employment or office of director of any company or from any person by arrangement with the taxpayer's employer;
- (ii) by virtue of any restricted equity instrument held by that taxpayer in respect of which this section will apply upon vesting thereof; or
- (iii) as a restricted equity instrument during the period of his or her employment by or office of director of any company from—
 - (aa) that company or any associated institution in relation to that company; or
 - (bb) any person employed by or that is a director of—
 - (A) that company; or
 - (B) any associated institution in relation to that company.

(b) This section does not apply in respect of any equity instrument which—

- (i) was acquired by the exercise or conversion of, or in exchange for the disposal of, any other equity instrument where this section applied in respect of the vesting of that other equity instrument before that exercise, conversion or exchange; or
- (ii) constitutes a qualifying equity share contemplated in section 8B.

(1A) If a capital distribution as contemplated in paragraph 74 of the Eighth Schedule, other than a capital distribution of an equity instrument, is received by or accrues to a taxpayer in respect of a restricted equity instrument, the taxpayer must include the amount of the capital distribution in his or her income for the year of assessment during which the amount is received or accrues.

(2) (a) The gain to be included in the income of a taxpayer—

- (i) in the case of—
 - (aa) a disposal contemplated in subsection (5)(c); or
 - (bb) a disposal by way of release, abandonment or lapse of an option or financial instrument contemplated in paragraph (a) or (b) of the definition of "equity instrument",
 is the amount received or accrued in respect of that disposal which exceeds the sum of any consideration in respect of that equity instrument; or
- (ii) in any other case, is the amount by which the market value of the equity instrument determined at the time that it vests in that taxpayer exceeds the sum of any consideration in respect of that equity instrument.

(b) The loss to be deducted from the income of a taxpayer—

- (i) in the case of—
 - (aa) a disposal contemplated in subsection (5)(c); or
 - (bb) a disposal by way of release, abandonment or lapse of an option or financial instrument contemplated in paragraph (a) or (b) of the definition of "equity instrument",
 is the amount by which the sum of any consideration in respect of that equity instrument exceeds the amount received or accrued in respect of that disposal; or
- (ii) in any other case, is the amount by which the consideration in respect of the equity instrument exceeds the market value of that equity instrument determined at the time that it vests in that taxpayer.

(3) An equity instrument acquired by a taxpayer is deemed for the purposes of this section to vest in that taxpayer—

- (a) in the case of the acquisition of an unrestricted equity instrument, at the time of that acquisition; or
- (b) in the case of the acquisition of a restricted equity instrument, at the earliest of—
 - (i) when all the restrictions, which result in that equity instrument being a restricted equity instrument, cease to have effect;
 - (ii) immediately before that taxpayer disposes of that restricted equity instrument, other than a disposal contemplated in subsection (4) or (5)(a), (b) or (c);
 - (iii) immediately after that equity instrument, which is an option contemplated in paragraph (a) of the definition of “equity instrument” or a financial instrument contemplated in paragraph (b) of that definition, terminates (otherwise than by the exercise or conversion of that equity instrument);
 - (iv) immediately before that taxpayer dies, if all the restrictions relating to that equity instrument are or may be lifted on or after death; and
 - (v) the time a disposal contemplated in subsection (2)(a)(i) or (b)(i) occurs.

(4) (a) If a taxpayer disposes of a restricted equity instrument which was acquired in the manner contemplated in subsection (1) for an amount which consists of or includes any other restricted equity instrument in the employer of the taxpayer or an associated institution in relation to the employer, that other restricted equity instrument acquired in exchange is deemed to be acquired by that taxpayer by virtue of his or her employment or office of director of any company.

- (b) If the amount received or accrued in respect of the restricted equity instrument which is disposed of as contemplated in paragraph (a) includes any payment in a form other than restricted equity instruments, that payment less any consideration attributable to that payment must be deemed to be a gain or loss which must be included in or deducted from the income of the taxpayer in the year of assessment during which that restricted equity instrument is so disposed of.

(5) (a) If a restricted equity instrument which was acquired by a taxpayer in the manner contemplated in subsection (1) is disposed of by that taxpayer to any person—

- (i) otherwise than by or under a disposal made in terms of a transaction at arm’s length; or
- (ii) who is a connected person in relation to that taxpayer,
the provisions of subsection (2), (3) and (4) apply *mutatis mutandis* in the determination of any gain or loss made by that person as if that person had been the taxpayer, and that gain or loss is for purposes of subsection (1) deemed to be made by that taxpayer in respect of the vesting of that equity instrument.
- (b) If an equity instrument was acquired by any person other than the taxpayer by virtue of the taxpayer’s employment or office of director, that equity instrument must, for purposes of this section, be deemed to have been so acquired by that taxpayer and disposed of to that person in the manner contemplated in paragraph (a).
- (c) Paragraph (a) does not apply where a taxpayer disposes of any restricted equity instrument (including by way of forfeiture, lapse or cancellation) to his or her employer, an associated institution or other person by arrangement with the employer in terms of a restriction imposed in relation to that equity instrument for an amount which is less than the market value of that restricted equity instrument.

(6) If a person who acquires a restricted equity instrument from the taxpayer as contemplated in subsection (5), disposes of that restricted equity instrument to any other person in the manner contemplated in subsection (5)(a)(i) or to a connected person in relation to the taxpayer, subsection (5) applies in respect of that other person as if he or she had acquired that restricted equity instrument directly from that taxpayer.

(7) For the purposes of this section, unless the context otherwise indicates—

“**associated institution**” means an associated institution as contemplated in paragraph 1 of the Seventh Schedule;

“consideration” in respect of an equity instrument means any amount given or to be given (otherwise than in the form of services rendered or to be rendered or anything done, to be done or not to be done)—

- (a) by the taxpayer in respect of that equity instrument,
- (b) by the taxpayer in respect of any other restricted equity instrument which had been disposed of by that taxpayer in exchange for that equity instrument, reduced by any amount attributable to the gain or loss determined in terms of subsection (4)(b); or
- (c) by any person contemplated in subsection (5)(a) or (b) in respect of that restricted equity instrument to the extent that the amount does not exceed the amount the taxpayer would have been disposed of by him or her, but does not include any amount given or to be given by that person to the taxpayer to acquire that restricted equity instrument:

Provided that where a taxpayer acquires—

- (a) an equity instrument in exchange for any other equity instrument, as contemplated in subsection (4)(a), the market value of the equity instrument, as contemplated in subsection (4)(a), the market value of the equity instrument given in exchange must not be taken into account in determining the consideration in respect of the equity instrument so acquired; or
- (b) a right to acquire any marketable security in exchange for any other such right, as contemplated in section 8A(5), and the right so acquired constitutes an equity instrument acquired in the manner contemplated in subsection (1), the consideration for that equity instrument must be determined as if it was acquired in the manner contemplated in subsection (4)(a);

“employer” means an employer as contemplated in paragraph 1 of the Seventh Schedule;

“equity instrument” means a share or part thereof in the equity share capital of a company or a member’s interest in a company which is a close corporation, and includes—

- (a) an option to acquire such a share, part of a share or member’s interest; and
- (b) any other financial instrument that is convertible to a share, part of a share or member’s interest; and
- (c) any contractual right or obligation the value of which is determined directly or indirectly with reference to a share or member’s interest;

“market value” in relation to an equity instrument—

- (a) of a private company contemplated in section 20 of the Companies Act, 1973 (Act No. 61 of 1973), or a company that would be regarded as a private company if it were incorporated under that Act, means an amount determined as its value in terms of a method of valuation—
 - (i) prescribed in the rules relating to the acquisition and disposal of that equity instrument;
 - (ii) which is regarded as a proxy for the market value of that equity instrument for the purposes of those rules; and
 - (iii) used consistently to determine both the consideration for the acquisition of that equity instrument and the price of the equity instrument repurchased from the taxpayer after it has vested in that taxpayer; or
- (b) of any other company, means the price which could be obtained upon the sale of that equity instrument between a willing buyer and a willing seller dealing freely at arm’s length in an open market and, in the case of a restricted equity instrument, had the restriction to which that equity instrument is subject not existed;

“restricted equity instrument” in relation to a taxpayer means an equity instrument—

- (a) which is subject to any restriction (other than a restriction imposed by legislation) that prevents the taxpayer from freely disposing of that equity instrument at market value;
- (b) which is subject to any restriction that could result in the taxpayer—
 - (i) forfeiting ownership or the right to acquire ownership of that equity instrument otherwise than at market value; or
 - (ii) being penalised financially in any other manner for not complying with the terms of the agreement for the acquisition of that equity instrument;
- (c) if any person has retained the right to impose a restriction contemplated in paragraph (a) or (b) on the disposal of that equity instrument;
- (d) which is an option contemplated in paragraph (a) of the definition of “equity instrument” and where the equity instrument can be acquired in terms of that option will be a restricted equity instrument;
- (e) which is a financial instrument contemplated in paragraph (b) of the definition of “equity instrument” and where the equity instrument to which that financial instrument can be converted will be a restricted equity instrument;
- (f) if the employer, associated institution in relation to the employer or other person by the arrangement with the employer has at the time of acquisition by the taxpayer of the equity instrument undertaken to—
 - (i) cancel the transaction under which that taxpayer acquired the equity instrument; or
 - (ii) repurchase that equity instrument from that taxpayer at a price exceeding its market value on the date of repurchase, if there is a decline in the value of the equity instrument after that acquisition; or
- (g) which is not deliverable to the taxpayer until the happening of an event, whether fixed or contingent, and

“**unrestricted equity instrument**” means an equity instrument which is not restricted equity instrument.

Section 10(1)(nD) – Exemptions

- any amount received by or accrued to that person which constitutes—
- (i) an equity instrument contemplated in section 8C acquired by that person and in respect of which that section applies; or
 - (ii) consideration for the disposal of an equity instrument contemplated in subparagraph (i), which had not yet vested as contemplated in that section at the time of that acquisition or disposal;

Paragraph 1 of the Fourth Schedule – Definitions

“**remuneration**” means

- (e) any gain determined in terms of section 8C which is required to be included in the income of that person;

Paragraph 11A of the Fourth Schedule – Remuneration of an employee

(1) Where by virtue of the provisions of paragraph (b), (d) or (e) of the definition of “remuneration” in paragraph 1, the remuneration of an employee includes—

- (a) any gain made by the exercise, cession or release of any right to acquire any marketable security as contemplated in section 8A;
- (b) any gain made from the disposal of any qualifying equity share as contemplated in section 8B; or
- (c) any gain made are a result of the vesting of any equity instrument as contemplated in section 8C,

the amount of that gain must for the purposes of this Schedule be deemed to be an amount of remuneration which is payable to that employee by the employer by whom that right was granted, or from whom that equity instrument or qualifying equity share was acquired, as the case may be.

(2) Employees' tax in respect of the amount of remuneration contemplated in subparagraph (1) must, unless the Commissioner has granted authority to the contrary, be deducted or withheld by that employer from any consideration paid or payable by him or her to that employee in respect of the cession or release of that right or the disposal of that equity instrument or qualifying equity share, as the case may be, or from any cash remuneration paid or payable by that employer to that employee after that right has to the knowledge of that employer been exercised, ceded or released or that equity instrument has to the knowledge of that employer vested or that qualifying equity share has to the knowledge of that employer been disposed of.

Provided that where that person—

- (i) is an "associated institution", as defined in paragraph 1 of the Seventh Schedule, in relation to any employer who pays or is liable to pay to that employee any amount by way of remuneration during the year of assessment during which the gain contemplated in subparagraph (1) arises; and
- (ii) is or will be unable, for the reason described in subparagraph (5), to deduct or withhold the amount of employees' tax or part of it in respect of that gain during that year of assessment,

that person and that employer must deduct or withhold from the remuneration payable by them to that employee during that year of assessment an aggregate amount equal to the employee's tax payable in respect of that gain shall be jointly and severally liable for that employee's tax.

(3) The provisions of this Schedule apply in relation to the amount of employees' tax deducted or withheld under subparagraph (2) as though that amount had been deducted or withheld from the amount of the gain referred to in subparagraph (1).

(4) Before deducting or withholding employees tax under subparagraph (2) in respect of remuneration contemplated in subparagraph (1)(a) or (c), the employer must ascertain from the Commissioner the amount to be so deducted or withheld.

(5) If that employer is, by reason of the fact that the amount to be deducted or withheld by way of employees' tax exceeds the amount from which the deduction or withholding is to be made, unable to deduct or withhold the full amount of employees' tax during the year of assessment during which the gain arises, he or she must immediately notify the Commissioner of the fact.

(6) Where an employee has under any transaction to which the employer is not a party made any gain or an employee has disposed of any qualifying equity share as contemplated in subparagraph (1), that employee must immediately inform the employer thereof and of the amount of that gain.

(7) Any employee who without just cause shown by him or her fails to comply with the provisions of subparagraph (6), shall be guilty of an offence and liable on conviction to a fine not exceeding R2 000.

Proviso (iv) of paragraph 2(a) of the Seventh Schedule to the Act provides that no taxable benefit will arise in terms of paragraph 2(a) in respect of –

- (iv) any equity instrument as contemplated in section 8C