

BINDING CLASS RULING: BCR 086

DATE: 26 May 2023

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – PARAGRAPHS (c) AND (i) OF THE DEFINITION OF “GROSS INCOME”, 10(1)(nE) AND 19, PARAGRAPH 2 OF THE FOURTH SCHEDULE, PARAGRAPH 2(h) OF THE SEVENTH SCHEDULE AND PARAGRAPHS 12A AND 20(3)(b) OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : WAIVER OF DEBT BY AN EMPLOYER RELATING TO THE UNWINDING OF A SHARE PURCHASE SCHEME

Preamble

This binding class ruling is published with the consent of the applicant(s) to which it has been issued. It is binding between SARS and the applicant, any co-applicant(s) and the class members only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the tax consequences for the Participants (employees) of a share purchase scheme (Scheme) following the unwinding of the Scheme and the waiver of debt arising out of the Scheme.

2. Relevant tax laws

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Fourth, Seventh and Eighth Schedules to the Act applicable as at 14 December 2022. 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 –

- section 1(1) – paragraphs (c) and (i) of the definition of “gross income”;
- section 10(1)(nE);
- section 19;
- paragraph 2 of the Fourth Schedule;
- paragraph 2(h) of the Seventh Schedule;
- paragraph 12A; and
- paragraph 20(3)(b) of the Eighth Schedule.

3. Class

The class members to whom this ruling will apply are the employees referred to in 4.

4. Parties to the proposed transaction

The Applicant: A listed resident company

Participants: The qualifying employees of the applicant who participated in the Scheme and owe outstanding Scheme Debt due to the applicant

5. Description of the proposed transaction

In terms of an award under the Applicant's Scheme, Participants were offered debt in a particular amount, based on a multiple of the Participant's cost to company, grade, performance, retention- and attraction requirements and market benchmarks (Scheme Debt). The Scheme Debt was used to acquire ordinary shares in the Applicant (Scheme Shares). On acceptance of an award by a Participant: –

- the Scheme Shares were acquired at market value by the Applicant on behalf of the Participants;
- ownership in the Scheme Shares vested immediately in the Participant but the Scheme Shares were pledged and ceded to the Applicant as security for the Scheme Debt;
- the Scheme Shares could be disposed of or otherwise encumbered at any time provided the Scheme Debt had been repaid or would be repaid upon such disposal or other encumbrance in respect of such Scheme Shares; and
- the Applicant discharged the purchase price for the Scheme Shares on the Participant's behalf and the Scheme Debt became owing by the Participant to the Applicant.

The outstanding balance due on the Scheme Debt bears interest from time to time. Distributions in respect of the Scheme Shares are applied firstly to any accrued and unpaid interest on the Scheme Debt. The balance may be applied to settle any income tax liability and reduce the Scheme Debt. Any residual amounts are paid to the Participant.

In instances where the distributions on the Scheme Shares are insufficient to service the interest on the Scheme Debt, any unpaid interest is capitalised to the Scheme Debt.

Save for one Participant, over the period of the Scheme, the dividends which have accrued to the Participants in respect of the Scheme Shares have been insufficient to service the interest incurred on the Scheme Debt, which was used to acquire the Scheme Shares, with the result that at present there is unpaid interest included in the outstanding balance owing under the Scheme Debt.

The current market price of the Scheme Shares is significantly below the original purchase price that was paid for the Scheme Shares, and the Scheme Debt exceeds the current market price of the Scheme Shares.

It is the intention of the board of the Applicant to unwind the Scheme in its entirety. Following JSE approval to amend the rules of the Scheme, in order to give effect to the unwinding and cancellation of the Scheme without detriment to the Participants,

the following transaction steps will be followed to give effect to the proposed transaction:

- a) The Participants will sell their Scheme Shares in the market (or the Applicant will procure such sale on behalf of the Participants) and use the proceeds from the sale –
 - i) firstly, to repay any accrued but unpaid interest in respect of the Scheme Debt; and
 - ii) then the balance, to repay a portion of the capital outstanding under the Scheme Debt in an amount equivalent to such remaining sale proceeds.
- b) The Applicant will waive the outstanding capital balance of the Scheme Debt (after the payments contemplated above) owing by the Participants. As such, the Participants will be released from their obligation to make any payments in respect of the outstanding capital balance of the Scheme Debt.

For each Participant, the proceeds from the Scheme Shares will exceed the accrued but unpaid interest of the Scheme Debt and will cover a portion of the capital outstanding under the Scheme Debt.

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:

- a) The amount of outstanding capital in respect of Scheme Debt waived by the Applicant will be exempt from income tax in the hands of the Participants under section 10(1)(nE).
- b) The Applicant does not have an obligation to withhold any amount of employees' tax under paragraph 2 of the Fourth Schedule in respect of the waiver by the Applicant of the outstanding capital of the Scheme Debt.
- c) Section 19 and paragraph 12A will not apply to the waiver by the Applicant of the outstanding capital in respect of the Scheme Debt. However, the amount of outstanding capital waived by the Applicant will reduce the base cost of the Scheme Shares for each Participant under paragraph 20(3)(b) of the Eighth Schedule.

8. Period for which this ruling is valid

This binding class ruling is valid in respect of the year of assessment ending 28 February 2024.