

BINDING PRIVATE RULING: BPR 103

DATE: 20 May 2011

ACT : **INCOME TAX ACT, NO. 58 OF 1962 (the Act)**
SECTION : **SECTION 1, DEFINITION OF “GROSS INCOME” AND SECTIONS 11(a), 23(g), 8C, 55 AND 58**
SUBJECT : **SHARE INCENTIVE SCHEME**

1. Summary

This ruling deals with the income tax consequences for companies within a group that will make payments to participating employees to enable those employees to acquire shares in the group's holding company.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling legislative references to sections are to sections of the Act applicable as at 07 December 2010 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, paragraph (c) of the definition of “gross income”;
- section 8C;
- section 11(a) read with section 23(g); and
- sections 55 and 58.

3. Parties to the proposed transaction

The Applicants: Two private companies, incorporated in South Africa

The Co-Applicant: A public company incorporated in South Africa and holding company of the Applicants

Participating Employees: Eligible employees of the Applicants

4. Description of the proposed transaction

The Co-Applicant wishes to implement a share incentive scheme (the Scheme) for the benefit of the Participating Employees of the Applicants. All current and future permanent employees of the Applicants, who are not already participating in a long-term incentive scheme being operated by the Co-Applicant, will be eligible to participate in the Scheme to be established.

A trust (the Trust) will be established to administer the Scheme.

Various commercial and other benefits will arise from the proposed transaction, mainly to incentivise Participating Employees, but also to extend equity ownership to Participating Employees which will accelerate transformation.

Upon inception of the Scheme, Participating Employees will constitute beneficiaries of the Trust and the Co-Applicant will issue a special class of unlisted shares ("A" Shares) to the Trust, which will constitute 10% of the total issued shares of the Co-Applicant. The "A" Shares will have a subscription (par) value of R0.01 each. The Co-Applicant will loan the subscription price to the Trust on an interest-free basis.

The Participating Employees will thus have rights to the capital and income of the Trust in respect of the "A" Shares (explained below).

In effect, the Participating Employees will participate in the growth of the "A" Shares from allocation date to vesting date and will accordingly be taxed under section 8C.

The Co-Applicant will issue the "A" Shares to the Trust. This consideration of R0.01 (par value) will not be the market value, since the "A" Shares will carry full voting rights for the period as well as a dividend (10% of dividends declared on ordinary shares of the Co-Applicant).

The difference between market value of the ordinary shares on commencement date and the par value of the "A" Shares will be deemed to be a notional loan, which will carry interest equal to 80% of prime. This is the first hypothetical cash flow.

For the avoidance of doubt, the notional loan will not constitute an actual loan between the Co-Applicant and the Trust, but shall merely constitute a mechanism which is used to calculate the number of ordinary shares to be issued by the Co-Applicant to the Trust which will be subscribed for by the Participating Employees.

A notional dividend will also be attributed to each "A" Share held by the Trust, equal to 90% of the dividend declared by the Co-Applicant in respect of each ordinary share. The notional dividend will be applied "notionally", in reduction of the notional loan. This is the second hypothetical cash flow.

The dividend to be paid in respect of the "A" Shares will be paid to the Trust, which will in turn distribute such dividend to the Participating Employees. Apart from the subscription at R0.01 per "A" Share, the dividend to be paid will be the only actual cash flow.

On the vesting dates in years 7 and 8, each of the Applicants will pay a certain amount, based on the value created, to the Participating Employees.

The Participating Employees will utilise these payments to acquire ordinary shares. The Participating Employees will recognise the amount received from the Applicants as taxable remuneration in their hands. The number of ordinary shares, to which the Participating Employees will be entitled to, will be based on the difference between the value of the equivalent number of ordinary shares, using the market value at the end of the transaction term, and the value of the notional loan at the end of the term.

The amount paid by each Applicant, and received by the Participating Employees, will be arrived at by using a formula that calculates the number of ordinary shares in the Co-Applicant that the Participating Employees will be entitled to and obliged to subscribe for.

At the end of the term, the "A" Shares will be redeemed for an amount equal to the subscription value (par value), equal to 50% after 7 years and 50% after 8 years, thereby settling the subscription loan to the Trust.

In addition, the notional loan will be deemed to be discharged on the delivery dates through the repurchase of all of the "A" Shares in issue by the Co-Applicant. Following the vesting dates, the Participating Employees can elect to retain the ordinary shares by taking delivery thereof, or that the ordinary shares are sold by the trustees (upon instruction from an independent broker) and receive a distribution in cash. The Trust will therefore act as agent and dispose of the ordinary shares on behalf of the Participating Employees.

In order to ensure that the Participating Employees will have sufficient funds to acquire the ordinary shares, no employees' tax will be withheld

from the amount to be paid by the Applicants to the Participating Employees at the time of payment thereof. In terms of paragraph 2(1) of the Fourth Schedule to the Act the consent of the Commissioner will be obtained for this arrangement. Each Participating Employee will then make a payment of an amount equal to the employees' tax to the applicable Applicant immediately after the Participating Employee has acquired the ordinary shares. It is envisaged that this will be funded from the proceeds of the sale of some of the ordinary shares. The applicable Applicant will then effect payment of the employees' tax due to the South African Revenue Service within the prescribed period under paragraph 2(1) of the Fourth Schedule.

5. Conditions and assumptions

This ruling is not subject to any conditions and assumptions.

6. Ruling

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

- The proposed expenditure for the Applicants in respect of the payment to the Participating Employees at the end of the terms, will qualify for a deduction under the provisions of section 11(a), read with section 23(g).
- The amounts paid or accrued to the Participating Employees will be included into the gross income of the Participating Employees by virtue of section 8C, read with paragraph (n) of the definition of "gross income" in section 1.
- There will be no further inclusion of the same amount under paragraph (c) of the definition of "gross income" in section 1.
- The Applicants must ascertain the amount of employees' tax to be withheld from the Participating Employees, as contemplated in paragraph 11A(4) of the Fourth Schedule to the Act, when the "A" Shares vests.
- The issuing of the "A" Shares will not constitute a donation made by the Co-Applicant as envisaged in sections 55 and 58.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of eight (8) years as from the implementation date of the Scheme.

Issued by:

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