

**BINDING PRIVATE RULING: BPR 312**

DATE: 6 November 2018

**ACT : INCOME TAX ACT 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 1(1) – DEFINITION OF “GROSS INCOME”; 11(a) READ WITH 23(g); 11(cA); 11(nA) AND 23H**  
**SUBJECT : TAX IMPLICATIONS OF THE VARIATION OF EMPLOYMENT CONTRACTS**

***Preamble***

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

**1. Summary**

This ruling determines the tax consequences of payments made pursuant to the cancellation of a profit share agreement entered into between an employer and certain of its employees.

**2. Relevant tax laws**

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 17 September 2018. 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 (cB) and (d) of the definition of “gross income”;
- section 11(a) read with section 23(g);
- section 11(cA);
- section 11(nA); and
- section 23H.

**3. Parties to the proposed transaction**

The applicant: A resident company

First co-applicant: A resident company which is a 100% held subsidiary of the applicant

- Second co-applicant: A resident company which is a 100% held subsidiary of the applicant
- Third co-applicants: Mr X and all other employees who will receive cancellation payments
- Restraint Nominees: Third co-applicants who will additionally receive restraint of trade payments
- Other employees: Employees who will receive predetermined payments pursuant to the cancellation agreement, but who are not co-applicants, not parties to the cancellation agreement, but who will accept the benefits offered to them

#### **4. Description of the proposed transaction**

The applicant and Mr X previously entered into an employment agreement which included a profit share arrangement between them. Mr X was entitled to nominate and did nominate certain employees to benefit from the profit share arrangement on certain terms.

The parties have agreed to terminate the profit share arrangement by way of a cancellation agreement which will be entered into between the applicant and the co-applicants who benefited from it.

The cancellation agreement will provide, amongst others, that –

- the first and second co-applicant will pay predetermined cancellation fees to the affected third co-applicants as compensation for the cancellation of the profit share arrangement, and also make the payments to the other employees;
- a retained cash portion will be left with the applicant as security for the due compliance with his obligations by Mr X to be released on 31 August 2021. Should Mr X's employment be terminated on the grounds of dismissible conduct, the cash portion will be forfeited;
- the third co-applicants will continue to be employed by the first and second co-applicants;
- the cancellation agreement will also provide for restraint of trade agreements to be entered into by the applicant and the first and second co-applicants with the restraint nominees, and restraint payments to be made to the restraint nominees.

#### **5. Conditions and assumptions**

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

**6. Ruling**

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

- a) The cancellation fees and the payments to the other employees will be deductible by the first and second co-applicants under section 11(a) read with section 23(g).
- b) The retained cash portion will be subject to section 23H.
- c) The cancellation fee and retained cash portion will be included in the gross income of each of the third co-applicants under paragraph (d) of the definition of "gross income".
- d) To the extent that any amount of the retained cash portion is forfeited by Mr X, such forfeited amounts may be deducted by him under section 11(nA) in the relevant year of assessment during which the forfeited amount is refunded by him.
- e) The restraint payments will be included in the gross income of the Restraint Nominees under paragraph (cB) of the definition of "gross income".
- f) The restraint payments will be deductible by the first and second co-applicants under section 11(cA).
- g) No ruling is made on the apportionment between the first and second co-applicants of the cancellation fee mentioned in a) and the restraint payments mentioned in f).

**7. Period for which this ruling is valid**

This binding private ruling is valid for five years from 17 September 2018.

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SOUTH AFRICAN REVENUE SERVICE**