

INTERPRETATION NOTE: NO. 62

DATE: 30 March 2011

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)

SECTION : SECTIONS 8B, 10(1)(nC) AND 11(IA)

SUBJECT : BROAD-BASED EMPLOYEE SHARE PLAN

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 explains the tax consequences for an employee who participates in a broad-based employee share plan.

2. Background

In his 2004/05 Budget Speech, the Minister of Finance proposed the introduction of legislation which will allow a tax-free transfer of shares by an employer to employees in order to encourage broad-based employee participation in companies.

Section 8B was subsequently introduced into the Act by section 8(1) of the Revenue Laws Amendment Act No. 32 of 2004 and is applicable with effect from 26 October 2004. Section 8B deals with any “qualifying equity shares” acquired under a broad-based employee share plan approved on or after 26 October 2004. The aim is to encourage long-term empowerment of employees through the receipt of shares at less than market value without adverse tax consequences.

Section 11(IA) was introduced to permit a deduction for the person granting qualifying equity shares.

3. The law

The purpose of section 8B is to provide an exemption from income tax of certain gains which may accrue to an employee from a qualifying broad-based employee share plan. The exemption is limited to gains made upon the disposal of a “qualifying equity share” acquired under a “broad-based employee share plan”. Certain strict conditions must be met before the gains are exempt from income tax and capital gains tax.

In order to understand the provisions of section 8B, a few definitions are crucial. These definitions are part of the legislation quoted in the **Annexure** to this Note.

3.1 Broad-based employee share plan

A plan will qualify as a “broad-based employee share plan” if the requirements set out below are met.

3.1.1 Consideration

The equity shares in an employer or any other associated institution in relation to that employer must be offered to employees for free or at a minimum consideration, which does not exceed the par value of the shares, as required by the Companies Act, 2008.

3.1.2 Employees

Eligible employees are limited to employees who –

- do not participate in any other equity scheme associated with the employer; and
- are employed on a permanent basis and who have been employed on a permanent basis for a period of at least one year.

The plan must allow for at least 80% of the above employees to be entitled to participate in this scheme.

3.1.3 Shareholder rights

Employees who acquire qualifying equity shares must be entitled to all dividends and full voting rights in the shares offered to them under the broad-based share plan.

3.1.4 Restrictions

No restrictions or conditions other than those listed below may be imposed on the disposal of the shares acquired under the plan.

- (a) Restrictions imposed by legislation.
- (b) A right of any person to acquire the share from the employee or former employee at –
 - (i) the market value on the date of such acquisition, or
 - (ii) where the employee or former employee is or was guilty of misconduct or poor performance, at the lower of market value on the date of acquisition or market value on the date of grant.
- (c) Restrictions on the disposal of the equity shares by the employee or former employee within a period of five years (but not exceeding 5 years) from the date of grant.

3.2 Date of grant

The date of grant in relation to an equity share is the date on which the granting of the equity share is approved by the directors or any other person or body of persons with

comparable authority. This date is not necessarily the date when the ownership of the share is registered in the name of the employee.

3.3 Gain

A gain only occurs on disposal of either a qualifying equity share, or a right or interest in that share. The gain is the difference between –

- the amount received or accrued in respect of a disposal; and
- the consideration given by the employee for that share, right or interest.

Only amounts actually paid by the employee to acquire the share, right or interest may be considered. If the consideration is in any other form, for example services rendered or to be rendered, or accepting any restrictions or performing any actions, it may not be taken into account.

3.4 Market value

Market value is the price that could be obtained upon the sale of the equity share between a willing buyer and a willing seller dealing freely at arm's length in an open market.

3.5 Qualifying equity share

The following requirements must be met for a share to be a “qualifying equity share”:

- The share must be an “equity share”. An “equity share” is defined in section 1 to mean part of the issued share capital of a company, but excluding any portion thereof that does not carry any participation rights. Options to acquire shares and convertible financial instruments do not constitute qualifying equity shares.
- The equity share must be acquired by the employee under a broad-based employee share plan.
- The market value of the shares acquired may not exceed R50 000 during the current and previous four years of assessment. None of the shares acquired will be regarded as qualifying equity shares if an employee acquires shares where the market value exceeds the R50 000 limit, unless they are new shares acquired by virtue of shares already held.

3.6 Employer and employee

Neither the word “employee” nor the word “employer” is defined for the purpose of section 8B. These words are also not defined in section 1. When interpreting section 8B, these words must be given their ordinary meaning. In terms of the common law, the relationship between an employee and an employer arises out of a contract of employment. A contract of employment is an agreement under which one person (the common law employee) works for another person (the employer) in exchange for remuneration.

4. Application of the law

4.1 Acquisition of qualifying equity shares

Employees may acquire any qualifying equity share at no cost or for a consideration below the par value. The total value of all qualifying equity shares acquired under a broad-based scheme may not exceed a total market value of R50 000 during a five year period consisting of the current and four previous years of assessment. All requirements of a “broad-based employee share plan” must be met before an equity share may be regarded as a qualifying equity share.

Example 1 – Qualifying equity shares

Facts:

ABC Ltd has 15 million authorised shares, 7.5 million of which were approved and issued at a par value of R1 each. ABC Ltd decides to grant 25 000 shares to each of the permanent employees on 7 March 2009, at par value. The market value of the shares at the date of grant was R2 each. No restrictions apply to these shares, but if an employee leaves ABC Ltd before 7 March 2014, the employee must sell all 25 000 shares back to the company at the market value of the share as at the date of acquisition. Employees have full dividend and voting rights.

Result:

The employees are not taxed on the market value of the shares received from ABC Ltd. The shares granted to the employees are qualifying equity shares, because –

- they have been acquired by employees in terms of a “broad-based employee share plan”; and
- The total market value of the shares acquired by the employees does not exceed R50 000.

Note:

- (a) Qualifying equity shares acquired, at no consideration or for a consideration below market value, are not included as taxable benefits under proviso (iii) of paragraph 2(a) of the Seventh Schedule to the Act.
- (b) The market value of a qualifying equity share received by or accrued to a person on the date of grant is exempt in the hands of that person under section 10(1)(nC).

4.2 Acquisition of deemed qualifying equity shares

In certain circumstances, shares acquired by employees already in possession of qualifying equity shares are deemed to be qualifying equity shares. These are broadly –

- the acquisition of equity shares as a result of the disposal of qualifying equity shares already held; or
- the acquisition of equity shares by virtue of equity shares already held.

The tax consequences of these transactions are discussed more fully below.

4.2.1 Acquisition of equity shares as a result of the disposal of qualifying equity shares

The following occurs where an employee acquires new equity shares in exchange for the disposal of qualifying equity share already held:

- The other equity share received in exchange is deemed to be a qualifying equity share (“new equity share”).
- The date on which the new equity share is deemed to have been received is the date of grant of the original qualifying equity share disposed of in exchange (“original equity share”).
- The consideration for which the new equity share is deemed to have been acquired is an amount equal to the consideration given for the original equity share.
- No amount is included in the person’s income by section 8B as a result of the person having disposed of the original equity share.

The new equity share acquired as a result of the disposal of the original equity share is deemed to be a qualifying equity share acquired on the same date and for the same consideration as the original equity share.

The shares so acquired are deemed to be qualifying equity shares even if the market value of the shares received in exchange exceeds R50 000 during the permitted time period.

Example 2 – Acquisition of equity shares as a result of the disposal of qualifying equity shares

Facts:

Sally is an employee of Subco Limited. Subco Limited and Otherco Limited are subsidiaries of Holdco Limited. On 1 March 2010, Subco Limited granted 5 000 qualifying equity shares to Sally at R1 per share. The total market value of the shares at the time of their acquisition was R50 000.

On 1 March 2011, Holdco Limited decides to rationalise its business by closing down Subco Limited and transferring all of its employees to Otherco. Due to the rationalisation, employees of Subco are required to dispose of their Subco shares and in return, they receive equity shares in Otherco with a market value totalling R75 000.

Result:

The shares that Sally receives from Otherco Limited are deemed to be qualifying equity shares, despite the market value of the new shares acquired being in excess of R50 000. They are deemed to have been acquired by Sally on 1 March 2010. No amount is included in Sally’s income as a result of the disposal of the original qualifying equity shares, despite the fact that they were disposed of within 5 years from the date of grant. The R5 000 that Sally paid for the original Subco Limited shares is deemed to be a consideration paid for the new shares in Otherco Limited.

4.2.2 Acquisition of equity shares as a result of qualifying equity shares already held

An equity share acquired by a person as a result of any qualifying equity share already held by that person is deemed to be a qualifying equity share. The equity share received is further deemed to have been received on the date of grant of the original equity share held by that person. The limit of R50 000 does not apply in these circumstances.

Example 3 – Acquisition of equity shares as a result of holding qualifying equity shares

Facts:

Bafana is an employee of M Limited. M Limited is a subsidiary of P Limited. On 1 March 2005, P Limited granted to Bafana 1 000 qualifying equity shares at R1 per share. The total market value of the shares at the time of their acquisition was R40 000.

On 1 March 2009, P Limited decided to unbundle its interests in M Limited. As a result of the unbundling, and by virtue of the shares already held by him, Bafana received shares in M Limited with a total market value of R60 000.

Result:

Bafana is deemed to have acquired qualifying equity shares from P Limited on the date of grant (that is, 1 March 2005). The total market value of all the qualifying shares held is R100 000 (R40 000 + R60 000). However, only the market value of the original qualifying equity shares received (that is, R40 000) is considered in determining whether the limit of R50 000 has been exceeded (even though the total market value of all shares acquired is more than R50 000).

4.3 Taxation of the gain on disposal of qualifying equity shares

The gain made from the disposal of a qualifying equity share, or the disposal of any right or interest in a qualifying equity share, must be included in the income of the person who disposes of that share, if the share is disposed of by that person within five years from the date of grant of that share. However, a disposal is not considered to be made –

- where a qualifying equity share is exchanged for another qualifying equity share (see 4.2);
- on the death of that person (see 4.4); or
- on the insolvency of that person.

4.3.1 Disposal of any qualifying equity share or any right or interest within five years

Any gain made from the disposal of any qualifying equity share, or the disposal of a right or interest in a qualifying equity share, within five years from the date of grant must be included in the income of the taxpayer.

Example 4 – Calculation of gain when a disposal occurs within five years

Facts:

The facts are the same as Example 1. Lesego, an employee of ABC Ltd, resigns from her employment on 1 August 2009. Under the terms of the plan, her shares must be sold back to the company at the market value determined at the date that she acquired the shares, in this case R50 000 (that is, 25 000 shares at R2 per share).

Result:

The proceeds from the disposal of the shares constitute income in Lesego's hands, since the shares were disposed within five years from the date of grant of the shares. The gain on the disposal of the shares is calculated as the proceeds of R50 000 less the R25 000 consideration paid for the shares (that is, 25 000 shares at R1 per share). The gain of R25 000 must therefore be included in Lesego's income.

Note:

- (a) Any gain made from the disposal of a qualifying equity share acquired under a broad-based employee share plan is deemed to be an amount of remuneration payable to the employee by the person by whom the right was granted or from whom the qualifying equity share was acquired, under paragraph 11A(1) of the Fourth Schedule to the Act.
- (b) Employees' 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 qualifying equity instrument was acquired, from—
 - (i) any consideration paid or payable to the employee in respect of the disposal of qualifying equity shares; or
 - (ii) any cash remuneration paid or payable by that person to the employee after that qualifying equity share has been disposed of.

It is not necessary to apply for a tax directive to ascertain the employees' tax to be deducted or withheld from gains made by the disposal of qualifying equity shares.

- (c) In the circumstances where the qualifying equity share 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 share, or from whom the equity share 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 qualifying equity share 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.

4.3.2 Disposal of any qualifying equity share or any right or interest after five years

Section 8B does not include the gain in income where a person disposes of a qualifying equity share after the period of five years from the date of grant. The gain will be regarded as being of a capital nature due to the provisions of section 9C, and will therefore be subject to capital gains tax (CGT). Detailed information relating to CGT can be found in the Comprehensive Guide to CGT available on the SARS website www.sars.gov.za.

4.3.3 Disposal of any rights or interest in a qualifying equity share

The disposal of any rights or interest in a qualifying equity share, for example, voting rights or the right to receive dividends, within five years from the date the qualifying equity share was granted, constitutes a gain that must be included in the taxpayer's income.

The gain is calculated as the proceeds received or accrued as a result of the disposal of the right or interest, less a *pro rata* portion of the cost incurred on acquisition of such qualifying equity share.

The portion of the cost attributable to the disposed rights or interest must be calculated based on the ratio that the amount received or accrued upon disposal of that right or interest bears to the market value of the qualifying equity share at the time of the disposal of the right.

Example 5 – Apportionment when disposing of a right or interest

Facts:

Ms V acquired qualifying equity shares for R40 000 (R2 per share x 20 000 shares). The shares had a market value of R50 000 on the date of grant. Ms V sold her voting rights in the qualifying equity shares on the 15 May 2008, for R25 500. Immediately before the disposal of the voting right, the qualifying equity share had a market value of R78 000.

Result:

The amount of the consideration permitted to be deducted from the disposal proceeds of a right or interest in qualifying equity shares will be apportioned based on the consideration received, against the market value of the share as follows:

	Acquisition cost	x	$\frac{\text{Consideration received}}{\text{Market value of qualifying equity shares}}$
=	R40 000	x	$\frac{\text{R25 500}}{\text{R78 000}}$
=	R13 077		

The acquisition cost attributable to the voting right is R13 077. Ms V will be taxed on the gain of R12 423 (that is, R25 500 – R13 077) made on the sale of the voting right. The acquisition cost attributable to the balance of the qualifying equity share (including the remaining rights or interest in the qualifying equity share) is an amount of R26 923 (that is, R40 000 – R13 077).

Note: In this example, the R50 000 market value of the shares on date of grant has no bearing on the calculation of the attributable cost.

4.4 Death of the taxpayer – Section 25

A disposal is deemed to be made by the taxpayer to his or her estate when a taxpayer dies. Section 8B(1)(b) deems that, even if a disposal is made within the five year period, no gain is deemed to be made by such a disposal.

However, the provisions of section 25 deem that –

- if the amount would have been income in the hands of the taxpayer had the disposal taken place before the taxpayer died; and
 - there is an ascertainable heir or legatee for that amount,
- the amount is deemed to be income of that heir or legatee.

However, as death is generally considered to be a no-fault disposal, and the intention was not to tax the estate or the heir or legatee on the disposal, section 8B(4) provides that section 25 does not apply to amounts received or accrued from such disposal after the date of death.

Therefore neither the estate, nor the ascertained heir or legatee is subject to a section 8B gain on the disposal of a qualifying equity share, even if the disposal takes place within five years of receipt of that share. There may, however, be a capital gain.

4.5 Deduction under of Section 11(IA)

Section 11(IA) permits an employer a deduction of an amount equal to the market value of qualifying equity shares granted to employees, less any consideration paid by the employees for those shares.

The deduction may not, in any year of assessment, in aggregate exceed R10 000 for a single employee. Any amount in excess of R10 000 may be carried forward to the following year of assessment. Deductions that may have been permitted under any other provision of the Act are prohibited.

Only the employer is entitled to claim the deduction, even though the shares may have been granted by an associated institution in relation to that employer. The associated institution is not entitled to a deduction under this section.

Example 6 – Deduction for employers for shares granted in terms of section 8B

Facts:

XYZ Ltd sold 1 000 equity shares (each share having a par value of R1) to each of its employees for R1 per share. The equity shares were qualifying equity shares. The market value of each share on the date of grant was R45.

Results:

XYZ Ltd is entitled to a deduction in the determination of its taxable income of R35 000, being the market value of the qualifying equity shares issued to employees (R45 000 [1 000 shares at R45 per share]) less the consideration paid by the employees for those shares (R10 000). The deduction is limited to R10 000 per employee per year. The excess deduction of R25 000 (R35 000 less R10 000) can be carried forward to the subsequent year of assessment.

5. Conclusion

It is important to ensure that all the requirements of section 8B are met before a scheme becomes eligible as a broad-based employee share plan. Should all the requirements not be met, it could result in an under-deduction of employees' tax, with all the resultant legal consequences.

Annexure – The law

Section 8B – Taxation of amount derived from broad-based employee share plan

(1) Notwithstanding section 9C, there must be included in the income of a person for a year of assessment any gain made by that person during that year from the disposal of any qualifying equity share or any right or interest in a qualifying equity share, which is disposed of by that person within five years from the date of grant of that qualifying equity share, otherwise than—

- (a) in exchange for another qualifying equity share as contemplated in subsection (2);
- (b) on the death of that person; or
- (c) on the insolvency of that person.

(2) If a person disposes of a qualifying equity share in exchange solely for any other equity share in that employer or any company that is an associated institution as defined in the Seventh Schedule in relation to that employer, that other equity share acquired in exchange is deemed to be—

- (a) a qualifying equity share which was acquired by that person on the date of grant of the qualifying equity share disposed of in exchange; and
- (b) acquired for a consideration equal to any consideration given for the qualifying equity share disposed of in exchange.

(2A) If a person acquires any equity share by virtue of any qualifying equity share held by that person, that other equity share so acquired is deemed to be a qualifying equity share which was acquired by that person on the date of grant of the qualifying equity share so held by that person.

(2B) If a person disposes of any right or interest in a qualifying equity share, the amount of consideration incurred in respect of the acquisition of that qualifying equity share that is attributable to that right or interest must be determined in accordance with the ratio that the amount received for the disposal of that right or interest bears to the market value of that qualifying equity share immediately before that disposal

(3) For the purposes of this section—

“broad-based employee share plan” of an employer means a plan in terms of which—

- (a) equity shares in that employer, or in a company that is an associated institution as defined in the Seventh Schedule in relation to the employer, are acquired by employees of that employer, for consideration which does not exceed the minimum consideration required by the Companies Act, 1973 (Act No. 61 of 1973);
- (b) employees who participate in any other equity scheme of that employer or of a company that is an associated institution as defined in the Seventh Schedule in relation to that employer are not entitled to participate and where at least 80 per cent of all other employees who are employed by that employer on a permanent basis on the date of grant (and who have continuously been so employed on a full-time basis for at least one year) are entitled to participate;
- (c) the employee who acquire the equity shares as contemplated in paragraph (a) are entitled to all dividends and full voting rights in relation to those equity shares; and
- (d) no restrictions have been imposed in respect of the disposal of those equity shares, other than—
 - (i) a restriction imposed by legislation;
 - (ii) a right of any person to acquire those equity shares from the employee or former employee who acquired the equity shares as contemplated in paragraph (a)—

- (aa) in the case where the employee or former employee is or was guilty of misconduct or poor performance, at the lower of market value on the date of grant or market value on the date of acquisition by that employer; or
- (bb) in any other case, at market value on the date of acquisition by that person; or
- (iii) a restriction in terms of which the employee or former employee who acquired the equity shares as contemplated in paragraph (a) may not dispose of those equity shares for a period, which may not extend beyond five years from the date of grant;

“date of grant” in relation to an equity share means the date on which the granting of that equity share is approved by the directors or some other person or body of persons with comparable authority conferred under or by virtue of the memorandum and articles of association of the employer company;

“gain” in relation to the disposal by a person of a qualifying equity share or a right or interest in a qualifying equity share, means the amount by which any amount received or accrued to that person from that disposal exceeds the consideration given by him or her for that qualifying equity share, right or interest (otherwise than in the form of services rendered or to be rendered or anything done or to be done or not to be done);

“market value” in relation to an equity share means the price which could be obtained upon the sale of that equity share between a willing buyer and a willing seller dealing freely at arm’s length in an open market and without having regard to any restrictions imposed in respect of that equity share;

“qualifying equity share” in relation to a person means an equity share acquired in a year of assessment in terms of a broad-based employee share plan, where the market value of all equity shares (as determined on the relevant date of grant of each equity share and excluding the market value of any qualifying equity shares acquired in the circumstances contemplated in subsection (2A)), which were acquired by that person in terms of that plan in that year and the four immediately preceding years of assessment, does not in aggregate exceed R50 000.

(4) The provisions of section 25 do not apply in respect of any amount received or accrued from the disposal of any qualifying equity share after the date of death of the person contemplated in subsection (1).

Section 10(1)(nC) – Exemptions

(nC) any amount received by or accrued to that person in the form of a qualifying equity share contemplated in section 8B

Section 11(IA) of the Income Tax Act allows for deduction from income

(IA) an amount equal to the market value of any qualifying equity share granted to an employee of that person as contemplated in section 8B, as determined on the date of grant as defined in that section less any consideration given by that employee for that qualifying equity share, which applies *in lieu* of any other deduction which may otherwise be allowed to that person or any other person in respect of the granting of that share: Provided that the deduction under this paragraph may not during any year of assessment in aggregate exceed R10 000 in respect of all qualifying equity shares granted to a single employee and so much as exceeds that amount may be carried forward to the immediately succeeding year of assessment and that excess is deemed to be the market value of qualifying equity shares granted to the relevant employee during that immediately succeeding year for purposes of this paragraph;