

BINDING CLASS RULING: BCR 025

DATE: 25 January 2011

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTIONS : SECTION 1 DEFINITION OF “GROSS INCOME” PARAGRAPH (i), SECTIONS 8A, 8C AND 10(1)(o)(ii)(C) AND PARAGRAPH 11A OF THE FOURTH SCHEDULE TO THE ACT
SUBJECT : INCOME TAX IMPLICATIONS FOR EMPLOYEES/SENIOR EXECUTIVES IN RELATION TO A SHARE OPTION PLAN/SHARE APPRECIATION RIGHTS PLAN

1. Summary

This ruling deals with the income tax implications for the employees/senior executives within a group of companies in relation to their respective participation in a share option plan/share appreciation rights plan created by a holding company, and the appropriate apportionment formula that must be used to determine the amount to be included in the income of the employees/senior executives. The ruling also provides guidance on the employer’s obligation to withhold employees’ tax.

2. Relevant tax laws

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling legislative references to sections and paragraphs are to sections of the Act and paragraphs of the Fourth Schedule to the Act, applicable as at 31 May 2010 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

The ruling has been requested under the provisions of –

- section 1 paragraph (i) of the definition of “gross income”;
- section 8A;
- section 8C;
- section 10(1)(o)(ii)(C); and
- paragraph 11A of the Fourth Schedule.

3. Class

The class members to whom this ruling applies are the Participants as described in point 4 below.

4. Parties to the transaction

The Applicant: A resident holding company

The Participants: Qualifying employees/senior executives of the Applicant and its subsidiaries (the Group) who are either “resident” as defined in section 1 (residents) or not resident (non-residents)

5. Description of the proposed transaction

The Applicant currently operates two long term incentive schemes, one scheme for the qualifying employees and the other scheme for the qualifying senior executives within the Group who will render services inside and outside South Africa.

Share option plan

The share option plan was established by the Applicant before 2000 for the benefit of qualifying employees within the Group to provide them with the opportunity to acquire an interest in the equity of the Applicant. The Participants were granted share options on a specific date and these options became exercisable as follows –

- no share options became exercisable prior to the second anniversary of the date of grant;
- after the second anniversary, 20% of the share options became exercisable;
- after the third anniversary, 20% of the share options became exercisable;
- after the fourth anniversary, 30% of the share options became exercisable; and
- the balance of the options may be exercised after the fifth anniversary of the date of grant.

It is a stipulation of the share option plan that options must be exercised within a 10 year period. Failure by a Participant to exercise the option will result in the option being forfeited. When an option is exercised, there is no restriction on the disposal of the underlying shares and those shares may immediately be disposed of or otherwise alienated. All options were granted before 2005.

Share appreciation rights plan

The Share Appreciation rights plan (SAR scheme) was established with effect from 2006 for the benefit of qualifying senior executives within the Group to provide them with the opportunity to acquire an interest in the equity of the Applicant. The Participants were granted rights which entitled them to a number of shares. The amount to be included in the income of a Participant is determined when the Participant exercises the right. The amount will be the difference between the value of the underlying share when the right is granted and when the right is exercised. A Participant is granted a number of these rights on a specific date (year 1) and these rights become exercisable as follows –

- no rights become exercisable prior to the second anniversary of the date of grant;
- between the second and the third year after the date of grant, 20% of the rights may be exercised;
- between the third and the fourth year after the date of grant, 20% of the rights may be exercised;
- between the fourth and the fifth year after the date of grant, 20% of the rights may be exercised; and
- the balance of the rights may be exercised after five years from the date of grant.

The rights must be exercised within a 10 year period. Failure by a Participant to exercise the right will result in the right being forfeited. The obligation of the Applicant to the Participants who have exercised their rights will be settled in the form of equity. However, in very limited exceptions the obligation may be settled in cash.

6. Conditions and assumptions

This ruling is not subject to any conditions and assumptions.

7. Ruling

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

- The non-resident Participants will be subject to normal tax in South Africa on South African source income, which will include any gain under sections 8A and 8C. The income which is attributable to a South African source will be deemed to have accrued or received evenly over the period if those services have been rendered inside and outside South Africa.

Expressed as a formula in cases to which the provisions of section 8A apply:

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of exercise}} \times \text{Section 8A gain}$$

or expressed as a formula in cases to which the provisions of section 8C apply:

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of vesting}} \times \text{Section 8C gain}$$

= The portion of the gain that will be deemed to be from a South African source and taxable in South Africa during the year of assessment in which a section 8A or section 8C event takes place.

- The resident Participants will be exempt from normal tax in South Africa to the extent that the provisions of section 10(1)(o)(ii)(C) apply and the gain under

either of the schemes spans a period to which those provisions apply. Remuneration received by or accrued to any resident Participant during any year of assessment in respect of services rendered by that Participant in more than one year of assessment will be deemed to have been received or to have accrued evenly over the period if those services have been rendered inside and outside South Africa.

Expressed as a formula in cases to which the provisions of section 8A apply:

$$\frac{\text{Total calendar days outside South Africa}}{\text{Total calendar days between date of grant and date of exercise}} \times \text{Section 8A gain}$$

or expressed as a formula in cases to which the provisions of section 8C apply:

$$\frac{\text{Total calendar days outside South Africa}}{\text{Total calendar days between date of grant and date of vesting}} \times \text{Section 8C gain}$$

= The portion of the gain that will be exempt under section 10(1)(o)(ii) during the year in which a section 8A or section 8C event takes place.

- Paragraph (i) of the definition of “gross income” in section 1 will be applicable to the rights under the SAR scheme acquired before 21 October 2008.
- The provisions of section 8C will be applicable to those rights acquired on or after 21 October 2008 by virtue of the provisions of paragraph (b) of “equity instrument” as defined in section 8C.
- The provisions of paragraph 11A of the Fourth Schedule to the Act will be applicable in respect of the gains made under sections 8A and 8C.

8. Period for which this ruling is valid

This binding class ruling will be valid for a period of five (5) years from 1 June 2010.

Issued by:

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