

BINDING PRIVATE RULING: BPR 199

DATE: 20 July 2015

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 8C(7), DEFINITION OF “RESTRICTED EQUITY INSTRUMENT” AND 10(1)(k)(i)
SUBJECT : EXEMPTION FROM INCOME TAX OF DIVIDENDS RECEIVED BY VIRTUE OF RESTRICTED EQUITY INSTRUMENTS

1. Summary

This ruling deals with whether the participation rights held by beneficiaries of an incentive trust are restricted equity instruments and, accordingly, whether the dividends they will receive by virtue of those rights are to be taxed as income or as dividends.

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 No. 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 20 February 2015, and 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 the provisions of –

- section 8C(7), definition of “restricted equity instrument”; and
- section 10(1)(k)(i).

3. Parties to the proposed transaction

The Applicant: An incentive trust formed for directors of a private company and which is a resident of South Africa

Beneficiaries: Directors and certain employees of the private company, and otherwise eligible individuals (qualifying employees)

4. Description of the proposed transaction

The Applicant was formed to purchase shares in the company for the benefit of its Beneficiaries. The Applicant acquired, and currently holds, ordinary shares in that company.

The Applicant was established prior to 26 October 2004 and the first Beneficiaries accepted their entitlements under the trust deed prior to that date. Subsequently, more Beneficiaries were added under the provisions of the trust deed.

Beneficiaries hold their interests on a proportional basis. Those interests are represented by participation units.

A participation unit entitles the Beneficiary to, amongst others, a portion of the dividends received by the Applicant. It does not entitle the Beneficiary to receive any of the shares held by the Applicant.

The qualifying employees had to satisfy certain requirements in terms of criteria set out in the Trust Deed, to become Beneficiaries of the Applicant. The Initial Beneficiaries had to make cash contributions (nominal amount) to the Applicant to acquire participation rights to the income and capital of the Applicant.

The participation units are subject to the following restrictions:–

- If a Beneficiary ceased to be a Beneficiary, the relevant Beneficiary will be deemed to have offered his or her participation units for sale to parties specified in the Trust Deed and the Offerees shall be entitled (but not obliged) to purchase the relevant Beneficiary's interest on the basis set out in the Trust Deed.
- The purchase price to be paid will be an amount equal to the fair market value, which will be agreed or determined in accordance with the Trust Deed. The parties will seek to agree on a fair market value, failing which, after 10 days, the fair market value will be determined with reference to the ultimate underlying investments in which the shares, held by the Applicant, are invested.
- None of the deemed offerrees is obliged to purchase a participation interest so offered.
- No Beneficiary may dispose of a participation interest without the permission of the board of directors of the company, who may not unreasonably withhold its permission.

The Applicant is anticipating receiving a dividend distribution. The dividend will further be distributed by the Applicant to all the Beneficiaries in proportion to their respective Trust Ratios.

5. Conditions and assumptions

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

6. Ruling

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

- The participation rights held by the Beneficiaries are considered to be "restricted equity instruments", as defined in section 8C(7).
- The dividends vested by the Applicant in the Beneficiaries are exempt from income tax in the hands of the Beneficiaries under section 10(1)(k)(i).

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 5 years from 20 February 2015.

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