



South African Revenue Service

BINDING CLASS RULING: BCR 078

DATE: 24 January 2022

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITIONS OF “GROSS INCOME” AND “TRADE”, 6quat(1) AND (1A)(a)(i), 10B, 11(a), READ WITH 23(g), 23H AND PARAGRAPHS 1 – DEFINITIONS OF “ASSET” AND “PROCEEDS”, 3 – DEFINITION OF “CAPITAL GAIN” AND 11 – DEFINITION OF “DISPOSAL” OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : EMPLOYEE SHARE INCENTIVE SCHEME – SHARES IN A FOREIGN COMPANY

Preamble

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

1. Summary

This ruling determines the income tax consequences of an employee share incentive scheme that holds shares in a foreign company.

2. Relevant tax laws

In this ruling references to sections are to sections of the Act and paragraphs are paragraphs of the Eighth Schedule to the Act applicable as at 20 September 2021. 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), – definitions of “gross income” and “trade”;
- section 6quat(1) and (1A)(a)(i);
- section 10B;
- section 11(a) read with section 23(g);
- section 23H;
- paragraph 1, – definitions of “asset” and “proceeds”;
- paragraph 3, – definition of “capital gain”; and
- paragraph 11, – definition of “disposal”.

3. Class

The class members to whom this ruling will apply are the applicants and the employees referred to in 4.

4. Parties to the proposed transaction

The applicants: Resident companies forming part of the same group of companies as defined in section 1(1)

The co-applicant: A trust to be created by the applicants in order to administer the share incentive scheme

Employees: Employees of the applicants participating in the share incentive scheme

5. Description of the proposed transaction

The applicants became a group of companies in terms of a merger agreement which was approved by the Competition Tribunal. The ultimate holding company of the applicants is Holdco, a public company incorporated and tax resident in a foreign jurisdiction (Country X), whose shares are listed on an exchange in Country X. The applicants propose to establish an employee share incentive scheme.

The purpose of the employee share incentive scheme will be to incentivise all the participating employees by affording them the opportunity to participate in the economic benefits and appreciation in value in the shares held by the co-applicant that will be driven by their endeavours. This will be achieved by the participating employees being entitled to on-going dividends and indirectly the capital appreciation of the scheme shares by virtue of being entitled to so-called milestone distributions and leaver distributions as defined in the scheme rules and trust deed.

A participating employee will be entitled to the following benefits in terms of the trust deed of the co-applicant:

- A proportionate share of 50% of any dividends received in respect of the scheme shares;
- Milestone distributions after an initial period of four years participation in the scheme and thereafter every five years of completed participation in the scheme. The milestone distributions will be determined in accordance with a formula that considers any appreciation in the value of the scheme shares held by the co-applicant at the relevant "Assessment Dates".
- Leaver distributions, being equivalent to milestone payments (and essentially determined on the same basis) payable to a participating employee that ceases employment with an applicant.

The applicants will make contributions to the co-applicant to enable it to purchase and acquire listed shares in Holdco.

The following proposed salient features of the trust deed of the co-applicant are relevant:

- Once the co-applicant acquires the shares in the ultimate holding company, with the approval of the South African Reserve Bank, the participating

employees will be allocated notional units in the co-applicant for no consideration.

- The participating employees employed by the applicants on the Closing Date, or who join within a period of 12 months of the Closing Date, will be allocated one unit each by the trustees. An employee who joins an applicant after the first anniversary of the Closing Date (i.e. after a period of 12 months after Closing Date) will similarly be entitled to one unit once the employee has been employed for 12 consecutive months by an applicant. The unit will entitle a participating employee to a portion of the dividend distributions and to so-called milestone distributions and leaver distributions via the co-applicant.
- In all instances, a participant, on ceasing employment with an applicant, will forfeit the unit awarded to him or her for no value. Any such unit may be reallocated to a future participant or cancelled by the trustees in their sole discretion. The benefits to be derived by an employee are dependent on the employee remaining in employment, with the result that the workforce is incentivised to not only render exemplary services so as to positively impact the value of the trust shares for their benefit, but also to stay in the employ of an applicant to continue to render those services so as to maximise the benefits that may be derived by workers over time.

The proposed transaction will be achieved by way of the following transaction steps:

- The applicants will make cash contributions to the co-applicant. The value of the contributions will be determined with reference to the number of participating employees on the Closing Date employed by each applicant and who remained participating employees on that date.
- The co-applicant will use the proceeds of the contributions to acquire shares in Holdco.
- The trustees of the co-applicant will allocate units in the co-applicant to the participating employees.
- The co-applicant will seek appointment as a Foreign Withholding Trust (FWT) by the Revenue Service of Country X with the result that it will be liable to deduct and account for the applicable Dividends Withholding Tax (DWT) on dividends received by the co-applicant from Holdco for the benefit of participating employees.
- The co-applicant will assume the withholding and reporting obligations under Country X's tax laws for dividends paid to its beneficiaries. Such an arrangement would avoid all the participating employees from having to individually apply for the DWT relief. Instead, the co-applicant would undertake to withhold the applicable DWT and remit same to Country X's Revenue Service. In addition, the participating employees will not be required to submit any tax returns to Country X's Revenue Service.
- The co-applicant will receive the gross foreign dividends that vest in the participating employees and would pass on the net amount (foreign dividend less the DWT at the applicable reduced rate that will be withheld by the co-applicant and paid to Country X's Revenue Service) to the participating employees. The co-applicant will annually issue a certificate to participating employees certifying the amount of Holdco dividends derived by them and the amount of DWT accounted for by the trust on their behalf.

6. Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that the co-applicant be duly approved as a FWT by Country X's Revenue Service and successfully enter into a withholding tax agreement with the revenue service in respect of the DWT obligations.

7. Ruling

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

- a) The contributions to be made by the applicants to the co-applicant will constitute expenditure deductible under section 11(a) read with section 23(g), subject to the application of section 23H.
- b) The contributions to be received by the co-applicant will not constitute its gross income.
- c) The receipt of the contributions will not result in a gain or a loss under paragraph 3 for the co-applicant.
- d) The certificate to be issued by the co-applicant evidencing the DWT paid to Country X's Revenue Service on behalf of participating employees will suffice as evidence of the payment of the dividend withholding tax proved to be payable for purposes of section 6quat(1A)(1)(a).

8. Period for which this ruling is valid

This binding class ruling is valid for a period of five years from 20 September 2021.