BINDING CLASS RULING: BCR 060

DATE: 19 January 2018

ACT	**:**	**INCOME TAX ACT 58 OF 1962 (the Act)**
SECTION	**:**	**SECTIONS 1(1) – DEFINITIONS OF “CONNECTED PERSON” AND “GROSS INCOME”, 8C AND PARAGRAPHS 56 AND 80 OF THE EIGHTH SCHEDULE**
SUBJECT	**:**	**CONSEQUENCES OF AN EMPLOYEE SHARE TRUST DISPOSING OF THE UNDERLYING SHARES AND DISTRIBUTING THE NET PROCEEDS TO THE BENEFICIARIES**

1. Summary

This ruling determines the tax consequences for an employee share trust and its beneficiaries resulting from the disposal by the employee share trust of the underlying shares and the resulting distribution of the net proceeds to the beneficiaries.

2. Relevant tax laws

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

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 28 September 2017. 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) – definition of “gross income”;
- section 8C;
- paragraph 56; and
- paragraph 80 of the Eighth Schedule to the Act.

3. Class

The class members to whom this ruling will apply are the beneficiaries referred to in **4**.

4. Parties to the proposed transaction

The applicant:	An unlisted company, incorporated in and a resident of South Africa
The co-applicant:	A listed company, incorporated in and a resident of South Africa and the holding company of the applicant

The trust:	A trust, settled by the applicant, registered in and a resident of South Africa
The beneficiaries:	Qualifying employees who are permanent employees of the companies that form the group of which the co-applicant is the controlling company

5. Description of the proposed transaction

The applicant settled the trust for the benefit of the beneficiaries during 2012. From time to time the trustees allocate units to qualifying employees in accordance with their participation percentages at the commencement of a term. The allocation date is the date upon which an allocation of units is made.

A unit is defined as a vested right to receive a number of shares in a relevant tranche in accordance with a beneficiary's participation percentage on each delivery date (being each of the fifth, sixth and seventh anniversaries of the relevant allocation date) and to receive distributions declared and paid in respect of the shares.

The participation percentage of a beneficiary in respect of a specific tranche is the aggregate number of units which have been allocated to and are held by a beneficiary in respect of a tranche, in a specific term, divided by the total number of units which have been allocated to and are held by all beneficiaries in respect of that tranche during that term, expressed as a percentage.

The term, in relation to each tranche, is defined as a period commencing on the allocation date and terminating on the seventh anniversary of that date.

A tranche is defined as the pool of trust shares which have been acquired by the trustees at the commencement of each term and in respect of which units are allocated to qualifying employees during that term.

The trust deed provides for the dates upon which the relevant shares in a particular tranche, attributable to a beneficiary, will become deliverable to that beneficiary. In particular –

- 25% of the relevant shares are deliverable on the fifth anniversary of the allocation date;
- a further 25% of those shares on its sixth anniversary; and
- the balance of 50% on the seventh anniversary.

The settlement date means, in relation to each delivery date, the date occurring on the fourth business day after that delivery date.

The trust is funded by the employer companies through capital contributions which are used to acquire the shares in the co-applicant in respect of each tranche.

Beneficiaries acquire vested rights in respect of their units from the allocation date. A qualifying employee becomes a beneficiary once a "form of acceptance and adherence" has been completed.

To date all distributions in respect of the shares held by the trust (the trust shares) have been paid to beneficiaries on the basis that the dividends tax is borne by the beneficiaries.

In terms of the trust deed –

- ownership of the relevant trust shares is delivered to a beneficiary on each delivery date;
- a beneficiary is not entitled to dispose of the relevant shares so transferred for a period of seven days after the transfer of ownership by the trust to the beneficiary; and
- the trust may act as an agent to dispose of the shares after the seven day period. However, a beneficiary should then have timeously delivered a duly executed sale instruction.

The applicant considers that the difficulty with the current construction is that all shares are firstly transferred to a beneficiary and then sold on behalf of a beneficiary. This requires each beneficiary to have a central securities depository participant (CSDP) account in order to take transfer of the relevant shares and to sell them.

The matter is further considered to be complicated by a rights issue by the co-applicant during 2017. It was decided by the trustees and the board of directors of the co-applicant that the beneficiaries should benefit from it.

This is to be effected in the following manner:

- The trust is currently the registered holder of the shares in the co-applicant and entitled to exercise its rights in respect of the rights issue.
- The applicant will advance a loan to the trust to enable it to exercise its rights under the rights issue (the rights issue loan).
- It will attract interest at the official rate of interest for tax purposes (currently 7.75%).
- The trust will be obliged to repay the capital and accrued interest. The applicant may however waive a portion of the loan.

After the rights issue the trust will hold approximately 0.5% of the total issued share capital of the co-applicant.

<u>The proposed transaction</u>

The following two transactions are proposed –

- a revised mechanism to deal with the conferral of benefits by the trust on beneficiaries on delivery date and settlement date; and
- arrangements concerning the treatment of the proposed rights issue loan as well as the shares acquired by the trust pursuant to the rights issue (the rights issue shares).

Revised unwinding mechanism

In terms of the proposed revised unwinding mechanism, both the trust shares and the rights issue shares will become deliverable to a beneficiary in accordance with the already-mentioned 25/25/50 methodology in years five, six and seven.

A beneficiary must indicate prior to section 8C vesting whether or not the trust shares must be delivered to him or her or sold for his or her benefit.

If the beneficiary's shares are to be transferred, it will be done on the delivery date. If a beneficiary does not pay cash to settle the costs of transfer and the resultant tax liability, a number of the beneficiary's shares will be sold to cover that liability out of the proceeds.

If no election has been made by a beneficiary or a beneficiary has delivered a sale instruction, the trust will, whilst it is still the registered shareholder, sell all of the shares for the benefit of the beneficiary. The proceeds less costs and taxes for which the beneficiary is liable, will be paid to the beneficiary on the settlement date, to allow the trust sufficient time to sell the shares and to collect the proceeds.

Rights issue shares

A beneficiary will not be entitled to elect to take transfer of the rights issue shares. Those shares will be sold by the trust for the benefit of beneficiaries, who will become entitled to the sale proceeds. However, two liabilities will arise in this context, namely –

- the income tax liability under section 8C; and
- a proportionate amount to enable the trust to settle at least a portion of the rights issue loan and accrued interest, depending on whether or not a portion of the loan is waived. Set-off will apply to the obligation of the trust to pay the proceeds from disposal of the rights issue shares, and the obligation of the beneficiary to pay the income tax and the beneficiary's contribution amount. In this regard, the trust deed provides that each beneficiary shall become obliged to make a contribution to the trust on the settlement date, which will be calculated by reference to the outstanding loan amount in respect of the beneficiary's rights issue shares.

6. Conditions and assumptions

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

7. Ruling

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

a) The market value for purposes of section 8C(2)(*a*)(ii) is the amount which will be received by each beneficiary on the settlement date.

b) All direct costs payable by each beneficiary relating to the disposal of the trust shares and the rights issue shares linked to the units, must be taken into account in determining the gain under section 8C(2)(*a*)(ii).

c) Paragraph 80(2A) will not apply to the transaction. Under the provisions of paragraph 80(2), if the trust derives any capital gains from the disposal of the trust shares and rights issue shares, those gains will not be taxable in the trust.

d) The amount contributed by each beneficiary to the trust to enable the trust to repay a portion of the rights issue loan will form part of the consideration payable by that beneficiary in respect of that equity instrument.

e) The contributions received by the trust from each beneficiary relating to the rights issue shares will not be included in the gross income of the trust.

f) To the extent that the aggregate of the beneficiary's contribution amounts are insufficient and the balance of the rights issue loan is waived by the applicant, the provisions of paragraph 56 will not apply.

8. Period for which this ruling is valid

This binding class ruling is valid for a period of five years from 28 September 2017.

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