Dear Sir/Madam

CALL FOR COMMENT: INTERPRETATION NOTE: TAXATION OF DIRECTORS AND EMPLOYEES ON VESTING OF EQUITY INSTRUMENTS “(INTERPRETATION NOTE)”

We refer to your call for comment regarding the above-mentioned document that was placed on your website. Set out below please find SAICA’s comments, which have been provided by members of our National Tax Committee:

1. General

1.1 Overall, the draft interpretation appears to be very light and provides little or no guidance. It is for the most part a rework of the existing legislation. There are many practical difficulties when it comes to vesting of shares. We propose before finalizing this note SARS should liaise with large employers who have had section 8C shares vest to determine the issues and how they were dealt with, and then base the note on those practical issues, incorporating the legislation.

2. Paragraph 4.1

2.1 In paragraph 4.1 (a) of the Interpretation Note it is correctly stated that for section 8C to apply, the person must have acquired the equity instrument by virtue of “employment or office of a director of any company or from any person by arrangement with the person’s employer”.

2.2 The Interpretation Note however does not appear to give any guidance on the meaning of this phrase and potentially explaining any required causal link between the person’s employment and the equity instruments received.
2.3 Such guidance is needed as it happens in practice that a person is allocated a restricted equity instruments by their employers at the current market value of the equity instruments (price available to the general public). Will section 8C apply in such a case?

3. **Paragraph 4.4**

3.1 Page 4, Example 1 – Last sentence of Result: “The gain of R50…is included in X’s income…” and not “taxable income”.

4. **Paragraph 4.5**

4.1 Inclusion of a section 8C gain into the definition of 'gross income':

Should a section 8C gain be included in the 'gross income' definition and i.e. in terms of which specific subparagraph is it included into the 'gross income' definition? Kindly confirm whether this gain is included in terms of paragraph (n) of the 'gross income' definition?

4.2 Implications if the recipient of a section 8C gain is a non-resident for tax purposes:

Why is a section 8C gain included in 'income' in terms of this section (i.e. "a taxpayer must include in ...... his or her income ... any gain") but it is not specifically included in the definition of 'gross income'? If the gain is brought into 'income' (which is defined as 'gross income' less exempt income), can that gain still be apportioned to exclude the non-SA sourced portion of the gain which relates to services rendered outside of South Africa in the case of non-resident individuals?

4.3 Page 5, Part 4.5(a) – The heading should read “Inclusion in income”, and not “taxable income”.

4.4 Page 6, Example 3 – In the Result section, reference is made to Mrs Y. There is no Mrs Y in the facts, it should be Z instead.

5. **Paragraph 5**

5.1 Page 8, Example 5 – The example should be clarified. Did B pay R300 for the shares? If so, the result is correct. If B acquired them for no consideration, the gain should be R1000. As the example stands now it is ambiguous and unclear.

5.2 Page 8, Para 5.3 – This paragraph should be expanded to include the consequence of the employee disposal in the acquiring employer / share trust’s hands, i.e. paragraph’s 38 and 39 of the Eighth Schedule to the Act should be included.

6. **Items not dealt with in Interpretation Note: Guidance is needed on the following scenarios:**

6.1 Vesting of shares in employees who are on temporary or permanent overseas secondment at the time of vesting for more than 6 months – who is responsible for...
withholding employees’ tax? They are not earning any local remuneration from which to deduct tax. The legislation merely requires that we notify SARS in this instance. In what format must this notice take place? What will SARS’ likely response be? What must employers do in the meantime? Does the employer withhold the shares from the employee or should the employer transfer the shares?

6.2 Vesting of shares of former employees who have transferred permanently to another company within the group – Who is responsible for withholding the tax, the old employer or the new employer? Para 11A of the Fourth Schedule to the Income Tax Act No.58 of 1962 (“the Act”), states that the gain (i.e. the value of the shares to be included in the employee’s taxable income at vesting date) “will be deemed to be an amount of remuneration which is payable to that employee by the person by whom that right was granted or from whom that equity instrument was acquired, as the case may be” (emphasis added). Following on from this, the relevant “person” must deduct / withhold employee’s tax from any consideration paid/payable by him to the employee in respect of any equity instrument that has vested, unless the Commissioner has granted authority to the contrary.

For example, the “person” from the equity instrument was acquired is the employee share trust, as the shares are registered in the trust’s name during the restricted period. The trust obviously does not pay remuneration to employees, therefore the original employer, as representative employer of the trust, will be responsible to withhold/deduct tax from any consideration paid to the employees.

The wording of paragraph 11A(2), appears to be flawed in that it limits the responsibility of withholding or deducting tax in respect of vesting shares to the original employer/issuing share trust. This is contrary to the intention of the legislation which requires the new employer to withhold the tax. We respectfully request that SARS clarifies their interpretation of the practical implications of this scenario.

6.3 The Interpretation Note should include guidance & examples to illustrate the application of section 10(1)(o) on the vesting of shares, i.e. if share awards were granted to an employee on 1 March 2006 restricted for a 3-year period, and then on 1 March 2007 he/she goes on a 2-year overseas secondment and then comes back to his/her SA employer on 1 March 2009. His/her shares vest on 28 February 2009. What happens in this scenario? There are 2 potential issues that arise in this scenario: 1) he/she was out of RSA for 2 years during the 3-year vesting period, therefore only 1/3rd of the vesting amount accrues in SA, and then 2) when the shares eventually do vest, he/she has no SA remuneration from which to deduct the tax.

6.4 Does SARS have a preference for which share price on vesting date must be used or do they leave this up to the employer to decide? As an example the employer could use the opening or closing share price, or an average for the day. Or is this up to the employer company? We request that this be clarified.

6.5 It is requested that the Interpretation Note must include comment on the subsequent disposal of the section 8C shares by the employee after vesting.
7. **General: Tax directives for amounts contemplated in sections 8A, 8B and 8C:**

7.1. Sections 8A, 8B and 8C of the Act include in a taxpayer’s income the gains made in respect of the exercise of rights to acquire marketable securities or gains made in terms of the vesting of equity instruments. Gains determined in terms of section 8C and 8C are specifically included in the definition of ‘remuneration’ for purposes of the Fourth Schedule.

7.2. Paragraph 11A(4) of the Fourth Schedule requires employers to ascertain from the Commissioner the amount to be deducted from gains due in respect of gains made in terms of sections 8A, 8B and 8C. The SARS Guide for Employers in respect of Employees’ Tax (EMP10) states further that those employers must apply for IRP3 tax directives to ascertain the amount of employees’ tax to be withheld.

7.3. Paragraph 9(1) of the Fourth Schedule provides for the application of the tax deduction tables, subject to subparagraphs 9(3), (4), (5) and paragraph 10, 11 and 12 of the Fourth Schedule. Paragraph 11A is, therefore, not excluded from the application of the tax deduction tables. Paragraph 11A simply requires that the employers must ‘ascertain from the Commissioner the amount to be deducted’ and not that a directive need to be applied for. Directives, as provided for in paragraph 11(a) and (b) in the Fourth Schedule aims to provide relief to taxpayers from hardship suffered.

7.4. We believe, therefore, that an employer will be able to apply the tax deduction tables to remuneration received in respect of gains made in terms of section 8A, B and C upon approval from the Commissioner.

7.5. In addition, certain practical problems are experienced if tax directives are to be applied for equity instruments. Some of these problems are listed below:

- Employees’ tax needs to be withheld from gains made in respect of the vesting of equity instruments as provided in section 8C and not on the individual exercise of shares as per section 8A. As vesting of equity instruments may take place simultaneously for a large number of employees, to process individual applications is time consuming and not practical. In addition, complex schemes would offer the employee the choice to exercise the number of shares or rights to account for the employees’ tax due on the vesting of the instrument. As such, this exercise is dependent on the employees’ tax due on the vesting and would require a tax rate to be calculated and applied.
- It is suggested that most employees that participate in the equity instruments as determined by section 8C is likely to have a marginal tax rate of 40%.
• Similarly, broad based share schemes could have a simultaneous
vesting of taxable shares due to, for example, the forced sale of
shares. In general, such schemes apply fairly low values per
individual and most of the employees of the company would have
been eligible to participate in the scheme.
• We believe that the SARS system would not be able to cater for multiple
applications on short notice.

7.6. We believe, therefore, that the requirement to apply for an individual
tax directive in respect of gains made on section 8A, 8B and 8C is only
stated in the EMP10 guide, and not the Act. We request that the
Commissioner would approve, per employer, a marginal tax rate to be
applied to gains without requesting an individual tax directive.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

M Hassan CA(SA)

PROJECT DIRECTOR: TAX

The South African Institute of Chartered Accountants