TAX BITES

Singing the praises of the broad-based share scheme

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The introduction of section 8B ensures employers will secure greater benefits than previously possible

THE 2004 budget review, published by the National Treasury, announced the introduction of tax laws to encourage broad-based employee equity participation.

As a result, section 8B was introduced into the Income Tax Act, 1962, by way of section 8(1) of the Revenue Laws Amendment Act, 2004. Under the general principles of the act, an employee who receives shares from an employer at less than the market value thereof is subjected to income tax so as to protect the tax base from tax avoidance by disguising salary benefits. Section 8B was introduced into the act to encourage broad-based equity participation.

For an employer to derive the benefits contained in section 8B, it must be shown that the share scheme falls into the definition of "broad-based employee share plan", contained in section 8B(3).

The definition of "broad-based employee share plan" requires that the equity shares in the employer or a company that is regarded as an associated institution in relation to the employer under the provisions of the seventh schedule to the act, are acquired by employees of the employer for a consideration which does not exceed the minimum consideration required by the Companies Act, 1973.

It is further required that employees who participate in any other share scheme of that employer, or of a company that is an associated institution in relation to that employer, are not entitled to participate in the arrangement and at least 80% of all other employees, who are employed by that employer on a permanent basis on the date of grant, and who have been continuously employed on a full-time basis for at least one year, are entitled to participate.

Also, it is required that employees who acquire the shares under the broad-based scheme are entitled to all dividends and full voting rights in relation to the equity shares issued.

Finally, it is a requirement that no restrictions are imposed on the disposal of the equity shares, other than a restriction that may be imposed by law. Alternatively, another permissible restriction is the right of any person to acquire those equity shares from the employee or former employee, who acquired the equity shares as required under the broad-based scheme, in the case where the employee or former employee is or was guilty of misconduct or poor performance, at the lower of market value on the date on which the equity share was granted, or the market value on the date of acquisition by that employer, or in any other case, at market value on the date of acquisition by the said person.

The section allows the employer to impose a restriction in terms of which the employee or former employee, who acquired the shares under the broad-based scheme, may not sell the shares for a period which may not extend beyond five years from the date the shares were granted to the employee.

Where the employer can show the share scheme put in place complies with the specific conditions contained in the definition of "broad-based employee share plan", the provisions of section 8B will apply to that share scheme. There are a number of benefits that flow from share schemes that qualify as broad-based share schemes, regulated under section 8B, and these will be dealt with below.

When section 8B was initially introduced, employers instituting a broad-based equity plan, as defined in section 8B, qualified for a deduction, limited to a maximum of R9 000 over a period of three years, in respect of the shares allotted to employees.

The South African Revenue Service usually does not allow a deduction for expenses where, for example, shares are awarded to employees as a benefit linked to services rendered.

As a result, a specific provision was introduced, namely, section 11(1A) of the act, which specifically provides that where the share scheme falls into section 8B, the employer qualifies for a deduction limited to the maximum of R9 000 over a period of three years in respect of the shares allotted to employees.

Because little use was made of section 8B, the authorities deemed it appropriate to increase the limit to an amount of R50 000 over a period of five years. The amendment was introduced by way of the Revenue Laws Amendment Act No. 60 of 2008, which took effect on February 21 last year and applies in respect of qualifying equity shares granted to taxpayers on or after that date.

The fact that the employer company can deduct the amount of R50 000 over a period of five years reduces the after-tax cost of the incentive made available to employees.

Section 8B contains an incentive to employees so that they are taxed on a beneficial basis, where they dispose of the shares received under the broad-based share scheme, after a period of five years has elapsed. If the shares are held for five years or more, capital gains tax will become payable by the employees, with the result that tax may be payable at a maximum rate of 10%, as opposed to the benefit arising on the sale of the shares attracting normal income tax, which could be up to 40%.

At the time section 8B was introduced, paragraph (a)(iii) of the seventh schedule was amended to provide that the allotment of shares for no consideration to employees, under a broad-based share scheme, will not constitute a fringe benefit.

When the monetary limit was increased to R50 000 over five years, the National Treasury indicated that the provisions of the section are now more aligned with the provisions of the Black Economic Empowerment codes in that a five-year time horizon is also contained in those codes.

The amendments introduced to section 8B last year also allow an employer to acquire the shares from an underperforming employee at the market value at the time the shares were granted to the employee.

The increase in the monetary limit from R9 000 over three years to R50 000 over five years should encourage employers to utilise the provisions of section 8B, in that employers will secure a greater deduction than what was previously possible under this section when it was first introduced. In light of the current depressed price of many shares, it may be opportune to consider introducing a broad-based share scheme sooner rather than later.

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