

South Africa

Robert Gad, Andrea Coetzee, Hanneke Farrand,
Claire Speirs and Edwin Ellis
Edward Nathan Sonnenbergs

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GENERAL

1. Is it common for employees to be offered participation in an employee share plan?

Employee share plans are common in South Africa.

2. Is it lawful to offer participation in an employee share plan where the shares to be acquired are shares in a foreign parent company?

Employers can offer an employee share plan if both:

- The share scheme and the employees' participation are registered with the South African Reserve Bank (SARB).
- The company law requirements are met (see *Question 23*).

SHARE OPTION PLANS

3. Please list each type of share option plan operated in your jurisdiction (if more than one).

There are many variations on the basic share option plan. Plans typically involve the acquisition of shares by the employees directly or by a fund with the employees then becoming beneficiaries of the fund. The tax treatment of the rights acquired under the fund is similar to a direct purchase of shares by the employee.

4. In relation to the share option plan:

- What are the plan's main characteristics?
- Which types of company can offer the plan?
- Is this type of plan popular? If so, among which types of company is this plan particularly popular?

Share option plan

Main characteristics. Companies can grant employees options to acquire shares in the company or a company in the group. The granted options can be at a discounted exercise price (see *Question 5, Share option plan: Market value*) or with conditions (see *Question 6*).

Types of company. Any type of company can implement an option plan. However, private companies may not wish to dilute their

shareholding and certain considerations can make it impractical, such as:

- The additional administrative burden of a larger number of shareholders.
- Other shareholders issues, such as voting rights and the requirements of the shareholders agreement.

Public companies listed on the Johannesburg Stock Exchange (JSE) must comply with the JSE listing requirements (see *Question 5*).

Popularity. The option plan has traditionally been popular, but more recently other schemes, including more targeted forms of incentive, have been increasingly common due to tax, accounting and other developments.

5. In relation to the grant of share options under the plan:

- Can options be granted on a discretionary basis or must they be offered to all employees on the same terms?
- Is there a maximum value of shares over which options can be granted, either on a per-company or per-employee basis?
- Must the options have an exercise price equivalent to market value at the date of grant?
- What are the tax and social security obligations arising from the grant of the option?

Share option plan

Discretionary/all-employee. Companies can grant options on a discretionary basis and need not offer them to all employees on the same terms, provided this does not amount to unfair discrimination.

Maximum value of shares. There is no limit on the number of shares that can be used for an option plan. However, where the company is listed on the JSE, the JSE listing requirements require the scheme to specify both:

- The number of shares used for the scheme.
- The maximum number of shares that any one participant can acquire under the scheme.

These cannot be increased without shareholder approval.

Market value. The exercise price can be less than the market value of the shares at the date of grant. Where the shares acquired for the share option are newly issued shares, the company issuing the shares must be paid at least the par value of the shares.

If the company is listed on the JSE, the discount (if any) from the market value of the shares on the date of grant at which the options may be exercised must be determined in terms of a fixed mechanism for all participants. In practice, it is unlikely that the JSE will allow a discount in excess of 10% of the market value of the shares on the date of grant.

A company cannot give financial assistance for the purchase of, or subscription for, shares in itself (or, where the company is a subsidiary company, in its holding company) except in certain specific situations. These exceptions include:

- Financial assistance to trustees subscribing for or purchasing company shares to hold them for the benefit of company employees.
- Loans to employees (other than directors) enabling them to purchase or subscribe for company shares (or those of the holding company).
- Financial assistance where both:
 - the company's board is satisfied that after the transaction the company will be solvent; and
 - the assistance is sanctioned by a special resolution of the company members.

Tax/social security. Employees must include in (or deduct from) their income for income tax purposes, the gain or loss resulting from the vesting of options under an option plan. The gain or loss is calculated as the difference between the option price and the market value of the shares on the date on which any restrictions on the options end. Such restrictions include:

- Restrictions preventing the employee from freely disposing of the option or from disposing of the option other than at market value.
- Financial penalties for not complying with the terms of the option acquisition agreement.
- Restrictions where, if the share price falls, the agreement under which the option is acquired can be cancelled, or the option repurchased by the employer.
- Where the delivery of the shares is contingent on another event.

Tax is only payable when all restrictions on the shares fall away. The employer must withhold the employee's resulting income tax liability (if any) from the employee's cash remuneration and pay it to the South African Revenue Service within seven days of the end of the month in which the option vested.

Resulting gains can also be subject to a:

- Skills development levy (SDL) of 1% (contributed by the employer).

- Unemployment insurance fund (UIF) contribution of 2% on the gain (of which half is contributed by the employer and half by the employee).

The employer withholds and pays the SDL and UIF contributions to the South African Revenue Service.

If employees subsequently dispose of the shares, they may be liable to capital gains tax or income tax, depending on their individual tax profile.

In certain limited circumstances, an option scheme can qualify for more favourable tax treatment as a broad-based employee share plan. These are narrowly defined and must meet the following criteria, among others:

- At least 80% of the permanent employees (who do not participate in any other scheme) are entitled to participate in the scheme.
- The market value of the shares acquired by a single employee in any given year and in the preceding four years, does not exceed ZAR50,000 (about US\$6,340).

If the option plan qualifies as a broad-based employee share plan:

- The employee is not subject to income tax on the acquisition or vesting of the options or shares.
- The employer may be entitled to a deduction from income tax of the market value of the shares granted to the employees, limited to an annual deduction of ZAR10,000 (about US\$1,270) per employee.

If the employee disposes of the shares within five years of acquisition (except in certain circumstances such as death or insolvency), the employee is subject to income tax on the difference between the proceeds and any amount paid for the shares.

6. In relation to the vesting of share options:

- **Can the company specify that the options are only exercisable if certain performance or time-based vesting conditions are met?**
 - **Is any tax or social security contributions payable when these performance or time-based vesting conditions are met?**
-

Share option plan

Exercisable only on conditions being met. The company can specify that the options are only exercisable if certain conditions are met. Generally, options are only exercisable if:

- The employee is still in the employment of the company or the group of companies after a certain time.
- The employee meets certain performance conditions.

Tax/social security. The employee's income tax liability for the options is generally only triggered when the vesting conditions are met (see Question 5, *Share option plan: Tax/social security*).

7. Do any tax or social security implications arise when the:

- Option is exercised?
- Shares are sold?

Share option plan

Tax/social security on exercise. Tax and social security liabilities arise when all restrictions, if any, on the option and/or the shares lapse. This generally coincides with the exercise of the option (provided the shares to be acquired are not subject to restrictions) (see *Question 5, Share option plan: Tax/social security*).

Tax/social security on sale. The employee must pay capital gains tax or income tax on the sale of the shares, depending on the tax profile of the relevant employee.

SHARE ACQUISITION OR PURCHASE PLANS**8. Please list each type of share acquisition or purchase plan operated in your jurisdiction (if more than one).**

There are only minor variations on the basic share acquisition or purchase plan.

9. In relation to the share acquisition or purchase plan:

- What are the plan's main characteristics?
- Which types of company can offer the plan?
- Is this type of plan popular? If so, among which types of company is this plan particularly popular?

Share purchase plan

Main characteristics. An offer is made to employees to purchase shares in a company in the group. The purchase price can be at a discount to the market value of the shares. The acquisition or retention of the shares may be subject to certain conditions, which usually include the continued employment of the employee in the group and may include performance requirements. The funding of the purchase is a key aspect and may include both benefits to and restrictions on the employee.

Types of company. Any type of company can implement a share purchase plan. However, as is the case with option plans, private companies may not wish to dilute their shareholding, and considerations such as the additional administrative burden of a larger number of shareholders and other shareholders issues, such as voting rights and the requirements of the shareholders agreement, may make it impractical.

As is the case with option plans, public companies listed on the JSE must comply with the JSE listing requirements (see *Question 5*).

Popularity. Share purchase plans have traditionally been popular, but recently there has been increased use of other schemes, including more targeted forms of incentive, due to tax, accounting and other developments.

10. In relation to the initial acquisition or purchase of shares:

- Can entitlement to acquire shares be awarded on a discretionary basis or must it be offered to all employees on the same terms?
- Is there a maximum value of shares that can be awarded under the plan, either on a per-company or per-employee basis?
- Must employees pay for the shares and, if so, are there any rules governing the price?
- Is any tax or social security contributions payable when the shares are awarded?

Share purchase plan

Discretionary/all-employee. As with option plans, purchase plans can be offered to employees on a discretionary basis and need not be offered to all employees on the same terms, provided this does not amount to unfair discrimination.

Maximum value of shares. There is no limit on the number of shares that can be used for a purchase plan. However, purchase plans are subject to the same JSE listing requirements as option plans (see *Question 5*).

Payment of shares and price. The same rules concerning the price on exercise, and against financial assistance, apply to share purchase plans as for share option plans (see *Question 5, Share option plan: Market value*).

Tax/social security. Share purchase plans are treated in the same way as share option plans for tax and social security contribution purposes (see *Question 5, Share option plan: Tax/social security*).

11. In relation to the vesting of share acquisition or purchase awards:

- Can the company award the shares subject to restrictions that are only removed when performance or time-based vesting conditions are met?
- Is any tax or social security contributions payable when these performance or time-based vesting conditions are met?

Share purchase plan

Restrictions removed only on conditions being met. The company can award the shares subject to restrictions that are only removed when performance or time-based vesting conditions are met. A failure to fulfil the conditions can then result in the acquisition agreement either not coming into effect or ceasing to have effect.

Alternatively, payment for and delivery of the shares may be conditional on the employee's fulfilment of conditions. If so, if the employee fails to fulfil the conditions, the acquisition agreement is cancelled or the shares are repurchased by the company.

Tax/social security. The employee's income tax liability is generally only triggered when the shares become unrestricted, as with option plans (see *Question 5, Share option plan: Tax/social security*). This usually only occurs when all performance and/or time-based vesting conditions are met.

12. What are the tax and social security implications when the shares are sold?

Share purchase plan

The employee must pay capital gains tax or income tax on the sale of the shares, depending on the employee's tax profile.

PHANTOM OR CASH-SETTLED SHARE PLANS

13. Please list each type of phantom or cash-settled share plan operated in your jurisdiction (if more than one).

There are only minor variations on the basic phantom or cash-settled share plan (also known as a share appreciation right plan, a cash-settled option plan or a bonus plan).

14. In relation to the phantom or cash-settled share plan:

- What are the plan's main characteristics?
 - Which types of company can offer the plan?
 - Is this type of plan popular? If so, among which types of company is this plan particularly popular?
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Phantom or cash-settled plan

Main characteristics. A phantom share plan grants an employee a right to receive a certain amount in cash at a certain time. This right is generally subject to the employee's continued employment and may include performance criteria.

Types of company. Any type of company can offer a phantom plan.

Popularity. The phantom plan has become increasingly popular, due to various factors including:

- Simplicity.
- The avoidance of any shareholder and related administrative issues.
- No securities regulatory compliance requirements.
- Employees' receipt of cash as opposed to an equity holding.
- An overall tax treatment that is potentially more favourable than the traditional option or purchase plan.

15. In relation to the grant of phantom or cash-settled awards:

- Can the awards be granted on a discretionary basis or must they be offered to all employees on the same terms?
 - Is there a maximum award value that can be granted under the plan, either on a per-company or per-employee basis?
 - Is any tax or social security contributions payable when the award is made?
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Phantom or cash-settled plan

Discretionary/all-employee. Awards can be granted on a discretionary basis and need not be offered to all employees on the same terms, provided this does not amount to unfair discrimination.

Maximum value of awards. There is no maximum value for awards.

Tax/social security. The taxation regime covering shares and options, which postpones the tax event until the shares or option become unrestricted (see *Question 5, Share option plan: Tax/social security*) has recently been broadened to potentially include an award of a phantom right. This expansion has caused various complexities in its application to phantom schemes and in certain instances gives rise to anomalies and potential double-tax exposures. The tax implications of each individual scheme must therefore be carefully considered.

In principle, employees are subject to income tax on the cash amount received under the award, on the date on which they become unconditionally entitled. The employer must withhold the employee's tax liability from the employee's salary and pay it to the South African Revenue Services within seven days of the end of the month in which the employee became unconditionally entitled to the award. The award may also be subject to SDL and UIF contributions, which the employer withholds and pays to the South African Revenue Service.

16. In relation to the vesting of phantom or cash-settled awards:

- Can the awards be made to vest only where performance or time-based vesting conditions are met?
 - Is any tax or social security contributions payable when these performance or time-based vesting conditions are met?
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Phantom or cash-settled plan

Award vested only on conditions being met. The vesting of the award can be made subject to performance or time-based vesting conditions.

Tax/social security. Employees are subject to income tax at their marginal rate on the award on the date on which they become unconditionally entitled to them.

17. What are the tax and social security implications when the award is paid out?

Phantom or cash-settled plan

The payment under the award does not normally give rise to any additional income tax liability as income tax is already incurred when the award becomes unconditional. However, the legislation is not entirely clear in this regard (see *Question 24*).

GUIDELINES

18. Are there any institutional, shareholder, market or other guidelines that apply to any of the above plans, and which types of companies are subject to them? What are their principal terms?

There are no general guidelines that apply to the above plans.

EMPLOYEE REPRESENTATIVES

19. Is consultation or agreement with, or notification to, employee representative bodies required before an employee share plan can be launched?

An employer may be required to consult and reach consensus with a workplace forum (if one has been established under the Labour Relations Act 1955) before implementing certain proposals relating to incentive plans, depending on the nature of the plan and the number of employees participating in the plans.

EXCHANGE CONTROL

20. Do exchange control regulations prevent employees sending money from your jurisdiction to another to purchase shares under an employee share plan?

South African resident employees must have approval from the SARB to send money outside South Africa to purchase shares under an employee share plan. Application for approval can be made through an authorised dealer at a South African bank and must be accompanied by a tax clearance certificate for the employee obtained from the South African Revenue Service, indicating that the employee's tax affairs are in order. The amount an employee can remit from South Africa is limited to the employee's lifelong foreign investment allowance of ZAR2 million (about US\$254,000). This also applies if a South African employer company rather than the employee pays for the shares.

21. Do exchange control regulations permit employees to repatriate proceeds derived from selling shares in another jurisdiction?

Employees can retain proceeds from selling shares in another jurisdiction, provided the share scheme and the South African

employees' participation are recorded with the SARB and approval is obtained for the remittance of any funds abroad (see *Question 20*).

INTERNATIONALLY MOBILE EMPLOYEES

22. What is the tax position when:

- An employee who is resident in your jurisdiction at the time of grant of a share plan award leaves your jurisdiction before any taxable event affecting the award takes place?
- An employee is sent to your jurisdiction holding share plan awards granted to him before he is resident in your jurisdiction?

Resident employee

Natural persons are subject to income tax in South Africa in respect of their worldwide income where they are resident for South African tax purposes. Non-South African residents are subject to South African income tax in respect of their South African source income.

If an employee is a South African resident for South African income tax purposes at the time of the grant of a share plan award but ceases to be present in South Africa before income tax in respect of the award is triggered, various considerations determine the South African tax position, including:

- Whether the employee ceases to be a resident for South African tax purposes.
- Whether the award is derived from a South African source.
- Whether any taxable gain in respect of the award is attributable to services rendered in or outside South Africa, as the portion of the gain relating to services rendered outside of South Africa may be exempt from South African income tax.
- The application of any double taxation agreement between South Africa and the country to which the employee relocates.
- South African capital gains tax rules relating to deemed disposals on cessation of residence.

Non-resident employee

If a non-South African resident employee acquires an award under an incentive plan and then relocates to South Africa, various considerations determine the South African tax position, including:

- The employee's tax residency.
- The source of the award.
- Whether any taxable gain in respect of the award is attributable to services rendered in or outside South Africa, as the portion of the gain relating to services rendered outside of South Africa may be exempt from South African income tax.
- The application of any double taxation agreement between South Africa and the country from which the employee relocates.
- South African capital gains tax rules relating to deemed disposals on acquisition of residence.

PROSPECTUS REQUIREMENTS AND OTHER CONSENTS OR FILINGS

23. For the offer of and participation in an employee share plan:

- What prospectus requirements (if any) must be completed and by when? What exemptions (if any) are available?
- What other regulatory consents or filings (if any) must be completed and by when? What exemptions (if any) are available?

Prospectus requirements

Share option and share purchase plans fall under the securities regulatory regime, although this does not apply to phantom plans. If the shares acquired under the plan are shares in a South African company, a prospectus is not required as long as the plan constitutes an employee share scheme (*section 144A, Companies Act 1973*). An employee share scheme is a scheme offering participation solely to bona fide employees of the company or its subsidiaries, either through a sale of shares in the company or the grant of options (whether or not using a trust). If this is the case, the company must:

- Appoint a compliance officer to be accountable to the directors of the company.
- State in its annual financial statements the number of specified shares that it has allotted during the financial year for the employee incentive plan.

The compliance officer is responsible for, among other things, the administration of the scheme and for providing a statement to employees receiving an offer of shares under the scheme containing:

- Full particulars of the nature of the transaction, including its risks.
- Information relating to the company, its latest financial statements, the general nature of its business, and its profit history over the previous three years.
- Full particulars of any material changes to this information.

If the company in which the shares are to be acquired is not a South African company, the securities regulatory position is uncertain and careful consideration must be given to the issue.

Other regulatory consents or filings

Foreign incentive plans operating in South Africa under which South African residents are granted awards, must be recorded with the SARB.

DEVELOPMENTS AND REFORM

24. Please briefly summarise:

- The main trends and developments relating to employee share plans over the last year.
- Any official proposals for reform of the law on employee share plans.

Trends and developments

South African company law is in the process of being completely overhauled. The new Companies Act will come into operation not earlier than 8 April 2010. Once in force, the new Act will introduce greater certainty for companies operating employee incentive schemes in South Africa, particularly for non-South African companies. The uncertainty concerning whether or not a prospectus is required (*see Question 23*) will be remedied by expressly providing that an offer made under an employee share scheme (which will expressly include schemes operated by foreign companies) is not an offer to the public. For a scheme to fall within the definition of employee share scheme, it must satisfy certain specified requirements similar to those summarised in *Question 23*.

The new Act also amends the prohibition against financial assistance to allow a company board of directors to authorise the company to provide financial assistance under an employee share scheme (which is not required for this purpose to be operated through a trust) without shareholders' approval, if both:

- The board is satisfied that immediately after providing the financial assistance the company will be solvent.
- The terms under which the financial assistance is given are fair and reasonable to the company.

Reform proposals

The regime dealing with share options and share purchases has been expanded to include other contractual benefits (*see Question 15, Phantom or cash settled plan: Tax/social security*) and there are practical difficulties that require further legislation.

CONTRIBUTOR DETAILS

Robert Gad, Andrea Coetzee, Hanneke Farrand

Claire Speirs and Edwin Ellis

Edward Nathan Sonnenbergs

T +27 21 410 2500

F +27 21 410 2555

E rgad@ens.co.za

acoetzee@ens.co.za

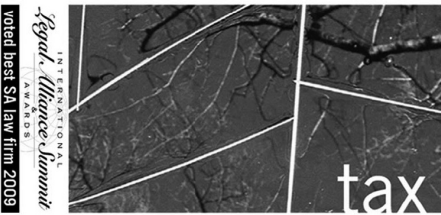
hfarrand@ens.co.za

cspeirs@ens.co.za

eellis@ens.co.za

W www.ens.co.za

edward nathan
sonnenbergs



johannesburg +2711 269 7600
cape town +2721 410 2500
stellenbosch +2721 808 6620
durban +2731 301 9340
problemsolved.co.za

