



South African Revenue Service

BINDING CLASS RULING: BCR 072

DATE: 7 August 2020

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTION 11(a), READ WITH SECTIONS 23(g), 23H(1)(ii) AND THE DEFINITION OF “REMUNERATION” IN PARAGRAPH 1 AND PARAGRAPH 2 OF THE FOURTH SCHEDULE TO THE ACT AND PARAGRAPH 2(f), READ WITH PARAGRAPHS 4 AND 16(1)(b) OF THE SEVENTH SCHEDULE TO THE ACT
SUBJECT : DEDUCTIBILITY OF EMPLOYMENT RELATED EXPENDITURE, INCURRED AS PART OF A B-BBEE OWNERSHIP TRANSACTION AND THE PAYE TREATMENT OF INTEREST-FREE LOAN TO A SHARE TRUST

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 deductibility of contributions by employer companies (class members) to fund an employees’ trust to enable the trust to participate as a part shareholder of a newly established black-owned and controlled property entity (B-BBEE company). The ruling also confirms that the advance of an interest-free loan by the listed holding company (listco) of the applicant and class members to a managers’ trust destined to hold a percentage of the B-BBEE company, would not constitute a taxable benefit, with the effect that no PAYE withholding obligation would arise in respect thereof.

2. Relevant tax laws

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Fourth and Seventh Schedules to the Act, applicable as at 24 April 2020. 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 11(a), read with section 23(g);
- section 23H(1)(ii);
- paragraph 1 of the Fourth Schedule – definition of “remuneration”;
- paragraph 2 of the Fourth Schedule; and
- paragraph 2(f) read with paragraphs 4 and 16(1)(b) of the Seventh Schedule.

3. Class

The class members to whom this ruling will apply are the Employer companies referred to in 4.

4. Parties to the proposed transaction

Applicant: A private company and a resident

Employer companies: The group companies that employ the participating employees and managers and who are, together with the applicant, wholly-owned subsidiaries of listco, forming a group of companies

Listco: A holding company of the applicant and class members and listed on the JSE

5. Description of the proposed transaction

The group is in the process of implementing a B-BBEE transaction in terms of which immovable property, previously owned by the group, is transferred to the B-BBEE company. The shareholders of this entity include the employees' trust and the managers' trust, as well as members of the broader public who are black. The B-BBEE points earned by the group will contribute to the B-BBEE status of the applicant and each group company, including the employer companies. It is important to note that the B-BBEE status of the group prior to the transaction is already at the maximum level, due to previous equity-based B-BBEE transactions. However, this status is at risk, mainly due to uncertainty relating to the mandated investment by black shareholders who may sell the equity at any time. Therefore, the group seeks a more sustainable solution to ensure that the group remains black-owned.

The objects of both the employees' trust and managers' trust comprise the creation of an employee incentive scheme, as well as the implementation of the B-BBEE transaction. These objects are set out in the various founding documents and may be summarised as the incentivising of employees of group companies by affording them the opportunity to become beneficiaries of trusts that participate in the equity of the B-BBEE entity, thereby contributing to the sustained unencumbered B-BBEE ownership profile of the group.

Neither the managers' trust nor the employees' trust will be "connected persons" as defined by section 1(1) in relation to the applicant, any employer company, or listco.

Listco does not have any employees – all the South African based employees within the group are employed by the employer companies. It is intended that the employees' trust be funded directly by contributions from the employer companies, whilst listco will make an interest-free loan available to the managers' trust and invoice each employer company for its proportional share (the recovery amount). Each recovery amount is calculated with reference to the number of participatory units to be offered to the employees of each employer company, proportional to total units available to employees of the group. Units are allocated to employees in proportion to the national economically active population targets published by the Department of Labour.

Although the recovery amount for each employer company is calculated using employment-related criteria, each employer company also benefits from the more robust BEE credentials achieved in consequence of the B-BBEE transaction in which the trust plays an essential part. For each employer company, the recovery amount serves a dual purpose. On the one hand, the implementation of the B-BBEE transaction is facilitated and, on the other hand, the employees are incentivised. These two purposes are achieved equally. Therefore, 50% of the recovery amount relates to the staff incentive and 50% relates to the B-BBEE status, of each employer company.

The participating employees and managers will be taxed on the value of the shares in the B-BBEE company under section 8C, upon vesting, as governed by the scheme rules. Listco will not claim a deduction in relation to the expenditure it incurs and will also not include the recovery amounts in its gross income. The tax consequences for the employees, managers and listco fall outside the scope of this binding class ruling.

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) Fifty percent (50%) of each employer company's recovery amount is not deductible, because it relates to the implementation of the B-BBEE transaction and is capital in nature. However, fifty percent (50%) of each employer company's recovery amount relates to incentivising employees and will be deductible in terms of section 11(a), read with section 23(g). Section 23H(1) will apply to this portion, with the effect that that amount must be deducted proportionally over the period for which staff is incentivised.
- b) The advance by listco of an interest-free loan to the managers' trust does not result in a taxable benefit contemplated under paragraph 2 of the Seventh Schedule and in consequence there is no PAYE withholding obligation in the hands of the employer companies in relation to the beneficiaries of the managers' trust.

8. Period for which this ruling is valid

This binding class ruling is valid for a period of three years from 24 April 2020.