

UNIVERSITY OF THE WITWATERSRAND
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**THE TAXATION OF EMPLOYEES ON THE VESTING OF EQUITY
INSTRUMENTS: A COMPARATIVE ANALYSIS BETWEEN SOUTH AFRICA,
AUSTRALIA AND SINGAPORE**

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Abstract

In South Africa, the tax rules governing employee share schemes provide that an employee, who receives shares in terms of the scheme, will have a tax liability as soon as, *inter alia*, all restrictions in relation to those shares are lifted, even though he/she may not have actually disposed of the shares at that particular point. This may leave the employee with a liquidity problem, should the employee not be able to dispose of the shares in order to settle the resultant tax liability. This research report considers the manner in which sections 8B and 8C of the Income Tax Act can be amended to resolve the aforementioned cash flow problems experienced by employees thereby making employee share schemes more attractive to employees. The tax laws of Australia and Singapore provide concessions that mitigate the cash flow constraints that arise when employees are required to settle the tax liabilities due upon the vesting of share awards.

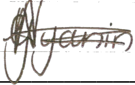
The question that is examined is whether improvements to sections 8B and 8C can be identified from a comparison of the respective Australian and Singaporean tax legislation.

It is submitted that the: (i) deferral of the tax liability to a later date or when the shares are disposed of; and (ii) tax exemption or reduction of gains derived from an employee share scheme, will not only ensure that the employee has cash to settle the accompanying tax liability, but will enable the employee to determine the most opportune time to dispose of the shares in order to be able to pay the related tax. Further, the introduction of a start-up company concession will contribute to South Africa being viewed as an attractive investment destination that allows businesses to be more competitive in recruiting and retaining talented employees.

Keywords: Employee Share Schemes; Section 8C; Section 8B; Cash flow constraints; Vesting; Tax Deferral Schemes; Deferred Taxing Point; Start-up concessions; Tax Concessions; Qualified Employee Equity-Based Remuneration Scheme; Equity Remuneration Incentive Schemes

Declaration

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.



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List of abbreviations

In this document, unless the context indicates otherwise –

A. Legislation and related material

South Africa

“**the Act**” means the Income Tax Act, 58 of 1962; and

“**the Companies Act**” means the Companies Act, 71 of 2008.

Australia

“**the ITAA 1997**” means the Income Tax Assessment Act, 38 of 1997; and

“**the 2009 EM**” means the Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009.

Singapore

“**the SITA**” means the Income Tax Act (Chapter 134) (Original Enactment: Ordinance 39 of 1947).

B. Other abbreviations

AAT	Administrative Appeals Tribunal
ATO	Australian Taxation Office
Div	Division
ERIS Scheme	Equity Remuneration Incentive Schemes
IRAS	Inland Revenue Authority of Singapore
QEEBR Scheme	Qualified Employee Equity-Based Remuneration Scheme
SARS	South African Revenue Service

1. Chapter 1: Introduction

1.1. Background

The Companies Act 71 of 2008 (“**Companies Act**”) defines an employee share scheme as a –

‘... scheme established by a company, whether by means of a trust or otherwise, for the purpose of offering participation therein solely to employees, officers and other persons closely involved in the business of the company or a subsidiary of the company, either –
(i) by means of the issue of shares in the company; or
(ii) by the grant of options for shares in the company...’¹

Employee share schemes are implemented by many companies for a number of purposes, such as to retain and incentivise employees, secure the long-term tenure of senior management, motivate employees to be more productive² and to ensure that the financial interests of the company and its employees are aligned.³

Although seemingly beneficial for both the company⁴ and its employees⁵, there are some disadvantages attendant to employee share schemes. For example:

- where there is minimal growth or a decline in the price of the company’s shares, the efficacy of the employee share scheme as a motivation tool may be diminished, as employees may view their efforts as not having the desired impact on the company’s performance; and⁶
- in South Africa, employee share schemes are subject to stringent tax laws⁷, which include any gain made on the vesting of equity instruments in the employee’s income.⁸

¹ In s 95(1)(c).

²Huddart, S., (1994) ‘Employee Stock Options’ *Journal of Accounting and Economics*. Available at <http://www.personal.psu.edu/sjh11/Papers/ESO.pdf> (last accessed on 20 September 2020 at 03:24am).

³ Werksmans (2005) *Employee share incentive schemes - a comparison of the old and newly promulgated income tax rules*. Available at https://www.saica.co.za/integritax/2005/1302_Employee_share_incentive_schemes_a_comparison_of_the_old_and_newly_promulgated_income_tax_rules.htm (last accessed on 11 July 2020 at 17:28pm).

⁴ For example, Employee Ownership Australia (2012) *The Advantages and Disadvantages of Employee Share Ownership for a Company and an Employee*, available at <https://employeeownership.com.au/the-advantages-and-disadvantage/> (last accessed on 10 August 2020 at 21:57pm), provides that an employee share scheme can relieve pressure on the cash flow of a business, motivate employees to be more productive and increase the company’s likelihood of survival, all of which are beneficial for the company.

⁵ An employee share scheme may compensate an employee for a low salary and increase the employee’s level of satisfaction with his or her job, according to Employee Ownership Australia (2012) *The Advantages and Disadvantages of Employee Share Ownership for a Company and an Employee*, available at <https://employeeownership.com.au/the-advantages-and-disadvantage/> (last accessed on 10 August 2020 at 21:57pm).

⁶ Dunford, B. B., Boudreau, J. W. & Boswell, W. R. (2002) ‘When stock options fail to motivate: Attribution and context effects on stock price expectancy’ (CAHRS Working Paper #02-04). Ithaca, NY: Cornell University, School of Industrial and Labor Relations, Center for Advanced Human Resource Studies. Available at <https://core.ac.uk/reader/144979790> (last accessed on 10 August 2020 at 22:13pm). For additional examples, see also Employee Ownership Australia (2012) *The Advantages and Disadvantages of Employee Share Ownership for a Company and an Employee*. Available at <https://employeeownership.com.au/the-advantages-and-disadvantage/> (last accessed on 10 August 2020 at 21:57pm).

⁷ Isaacman A, J., (2017) ‘Is tax legislation effectively discouraging employee share ownership?’, Master of Commerce thesis, Faculty of Commerce, Law and Management, University of Witwatersrand. Available at <http://wiredspace.wits.ac.za/jspui/bitstream/10539/24370/1/Allon%20Isaacman%20Research%20Report%20Final.pdf> (last accessed on 10 August 2020 at 14:32pm).

⁸ Section 8C(1)(a) of the Income Tax Act 58 of 1962.

- The gains arising will generally be taxed in the year that the equity instrument vests and not when the shares are sold, potentially resulting in cash-flow problems for the employee. Ordinarily, an employee may dispose of some of the shares in order to settle the employees' tax liability that arises upon vesting,⁹ however, it is likely that a cash flow challenge may arise where the employee is unable to dispose of the shares in the same year that the gain is realised. An example of one such instance is discussed below.¹⁰

On 4 May 2020, RCL Foods Limited (“**RCL**”), a South African food manufacturer, issued a circular to its shareholders¹¹ indicating its intention to repurchase approximately 14.5 million¹² of its shares (representing in aggregate 1.5% of the issued share capital of the company) from various individual shareholders (hereinafter referred to as the “**Sellers**”).

The Sellers¹³ were part of RCL's long-term employee share scheme referred to as the Conditional Share Plan (“**CSP**”), the aim of which was to incentivise RCL employees and encourage their long-term employment with the company.¹⁴ The mechanics of the CSP were such that the Sellers were awarded conditional shares in RCL on 1 March 2017, subject to specific performance conditions and a three-year vesting period.¹⁵ These conditional shares vested on 1 April 2020 and the Sellers received the commensurate number of ordinary shares in RCL.¹⁶

The transfer of the ordinary shares triggered a tax liability¹⁷ in the hands of the Sellers and as a result of a decline in RCL's share price, ‘*extremely limited free float, low trading volumes and lack of tradability*’¹⁸ the Sellers were unable to trade in these shares. In order to assist the Sellers to settle their tax liabilities, RCL proposed¹⁹ to repurchase the shares for

⁹ South African Revenue Service (2019) Binding Class Ruling 069 *Employee Share Ownership Plan*, p.5. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BCR-2018-10%20-%20BCR%20069%20Employee%20share%20ownership%20plan.pdf> (last accessed on 28 December 2020 at 11:39am).

¹⁰ Deloitte (2018) *Singapore Budget 2018 Feedback*. Available at <https://www2.deloitte.com/content/dam/Deloitte/sg/Documents/tax/sq-tax-singapore-budget-2018-feedback.pdf> (last accessed on 16 September 2020 at 23:07pm).

¹¹ RCL Foods Limited (2020) *Circular to Shareholders*. Available at https://rclfoods.com/wp-content/uploads/2020/05/RCL-FOODS-LTD-Circular_web.pdf (last accessed on 3 August 2020 at 22:46pm).

¹² RCL Foods Limited (2020) *Update regarding Specific Repurchase of Shares*. Available at <https://rclfoods.com/stock-exchange-news/update-regarding-specific-repurchase-of-shares/> (last accessed on 9 August 2020 at 20:30pm).

¹³ Two of the Sellers were RCL executive directors, Miles Dally and Robert Hilton Field.

¹⁴ RCL Foods Limited (2020) *Update regarding Specific Repurchase of Shares*, p.6. Available at <https://rclfoods.com/stock-exchange-news/update-regarding-specific-repurchase-of-shares/> (last accessed on 9 August 2020 at 20:30pm).

¹⁵ RCL Foods Limited (2020) *Update regarding Specific Repurchase of Shares*, p.8. Available at <https://rclfoods.com/stock-exchange-news/update-regarding-specific-repurchase-of-shares/> (last accessed on 9 August 2020 at 20:30pm).

¹⁶ RCL Foods Limited (2020) *Update regarding Specific Repurchase of Shares*, p.8. Available at <https://rclfoods.com/stock-exchange-news/update-regarding-specific-repurchase-of-shares/> (last accessed on 9 August 2020 at 20:30pm).

¹⁷ In accordance with s 8C of the Income Tax Act 58 of 1962.

¹⁸ Hasenfuss, M., (2020) ‘RCL does a dirty with exec plan’, *Financial Mail*, 2 April, p.43. Available at https://issuu.com/sundaytimesza/docs/fm_financialmail_02042020_rev1 (last accessed on 25 August at 15:49pm).

¹⁹ Over 55% of RCL's minority shareholders voted against the repurchase of the Sellers' shares on the basis that the repurchase provided the Sellers with the opportunity to exit their investments in RCL, despite the company's lack of liquidity. It was subsequently decided that RCL's majority shareholder, Remgro Limited, would purchase the Sellers' shares to ensure that the

approximately R149 million, which amount would be funded from the company's existing cash resources.²⁰

As mentioned above, the transfer of the ordinary shares to the Sellers triggered the provisions of s 8C(1)(a) read with para 11A(1) of the Fourth Schedule of the Income Tax Act, 58 of 1962 ("Act"), which subjects gains or losses made on the vesting of equity instruments, which were acquired by virtue of employment, to income tax and places an employees' tax withholding obligation on the employer²¹.

In recent times, numerous businesses have experienced cash flow constraints, reductions in turnover and declining share prices due to the novel coronavirus pandemic ("COVID-19")²², and accordingly employers have had to consider implementing several cost-saving measures to ensure business continuity, such as imposing temporary lay-offs, part-time work and even retrenchments.²³ For those companies that are experiencing cash flow constraints -

*'offering share-based incentive schemes to employees may in fact be a useful means of remunerating employees and boosting employee engagement and morale during this difficult time.'*²⁴

Employees may, however, opt not to participate in employee share schemes if the tax treatment is considered to be unfavourable.²⁵ This may be the case in South Africa, for instance, where an employee will be liable to pay tax at the time that an award granted in terms of an employee share scheme vests. The resulting tax is payable on the amount of the gain, which is, subject to certain exceptions, the amount by which the market value of the shares on the date of vesting exceeds the consideration paid by the employee,²⁶ regardless of whether the shares have been sold.²⁷ Employees of listed entities may find it easier to dispose of the publicly traded shares in order to crystallise the gain and pay the resulting tax

Sellers could settle their tax liabilities. See Crotty, A., (2020) 'RCL: Leaving it to Remgro to bail it out', *The Citizen*, 28 May. Available at <https://pressreader.com/article/282136408621872> (last accessed on 15 August at 21:39pm).

²⁰ RCL Foods Limited (2020) *Update regarding Specific Repurchase of Shares*, p.9. Available at <https://rclfoods.com/stock-exchange-news/update-regarding-specific-repurchase-of-shares/> (last accessed on 9 August 2020 at 20:30pm).

²¹ Paragraph 11A(1) of the Fourth Schedule to the Act deems any gain made upon the vesting of any equity instrument to be an amount of remuneration that is payable to the employee by the person by whom the right was granted or from whom the equity instrument was acquired. Employees' tax in respect of the gain must therefore be deducted.

²² McCann FitzGerald (2020) *COVID-19: Employee Share Plans – Impacts and Opportunities*. Available at <https://www.mccannfitzgerald.com/knowledge/pensions-incentives/covid-19-and-employee-share-incentive-schemes-impacts-and-opportunities> (last accessed on 10 August 2020 at 22:43pm).

²³ Truter, C., (2020) *COVID-19: Impact on businesses and investments in South Africa*. Available at <https://www.bowmanslaw.com/insights/mergers-and-acquisitions/covid-19-impact-on-businesses-and-investments-in-south-africa/#Employmentconsiderations> (last accessed on 16 August 2020 at 19:48pm).

²⁴ McCann FitzGerald (2020) *COVID-19: Employee Share Plans – Impacts and Opportunities*. Available at <https://www.mccannfitzgerald.com/knowledge/pensions-incentives/covid-19-and-employee-share-incentive-schemes-impacts-and-opportunities> (last accessed on 10 August 2020 at 22:43pm).

²⁵ Chartered Accountants Australia and New Zealand (2019) *Submission on Employee Share Schemes*. Available at <https://www.charteredaccountantsanz.com/-/media/7db140fd4fe440d699335d9dba719a41.ashx> (last accessed on 13 September 2020 at 20:35pm).

²⁶ In accordance with s 8C(2)(a)(i) and (ii) of the Act.

²⁷ Section 8C(1) read with s 8C(3) of the Act.

bill.²⁸ Conversely, employees of private companies (especially start-up businesses) may be unable to sell those shares, leaving them with a tax liability but no cash to pay.²⁹ This will create cash flow constraints for the employees, especially where the tax arising from the gains is substantial.³⁰

To alleviate potential cash flow problems, Australia offers favourable tax advantages (known as tax concessions³¹) for employees who participate in employee share schemes.³² These tax concessions range from a refund³³ of tax paid where an employee acquires shares and later forfeits them, to a start-up concession³⁴, where employees of start-up companies do not include the gain in their taxable income.³⁵ In addition, Australian tax legislation provides a number of tax deferral concessions³⁶ in terms of which employees may defer the time they are required to pay the tax in relation to their employee share scheme interests, to –

*'a future time when the outcomes of holding or exercising the [employee share scheme] interest are more certain, and when [they] are more likely (although not certain) to have some cash to pay the resulting tax bill.'*³⁷

Similarly, Singaporean tax legislation provides for a Qualified Employee Equity-Based Remuneration Scheme (“**QEEBR Scheme**”)³⁸, a tax deferral scheme where an employee can defer the payment of tax on a gain³⁹ arising from an employee share scheme for up to five years.⁴⁰ Taxes deferred in this manner will be subject to interest, chargeable at the average

²⁸ Kindrik Partners (2017) *Taxation of employee share schemes for startups*. Available at <https://kindrik.co.nz/blogs/taxation-of-employee-share-schemes-for-start-ups/> (last accessed on 1 September 2020 at 13:49pm).

²⁹ Andreyev Lawyers (n.d.) *ESS – Qualifying for 'deferral' of the taxable discount*. Available at <https://andreyev.com.au/2017/04/29/ess-qualifying-for-deferral-of-the-taxable-discount/> (last accessed on 21 September 2020 at 05:17am).

³⁰ Deloitte (2018) *Singapore Budget 2018 Feedback*. Available at <https://www2.deloitte.com/content/dam/Deloitte/sg/Documents/tax/sg-tax-singapore-budget-2018-feedback.pdf> (last accessed on 16 September 2020 at 23:07pm).

³¹ These tax concessions were introduced in terms of the Tax and Superannuation Laws Amendment (Employee Share Schemes) Act No. 105, 2015. Refer to Division 83A-5 of the Income Tax Assessment Act No. 38 of 1997.

³² In July 2015, the Australian Taxation Office amended the tax treatment of employee share schemes to make them more attractive to employees. See Australian Taxation Office (n.d.) *Key ESS changes in detail*. Available at <https://www.ato.gov.au/general/employee-share-schemes/in-detail/key-ess-changes-in-detail/> (last accessed on 22 August 2020 at 19:35pm).

³³ Division 83A-310 of the Income Tax Assessment Act No. 38 of 1997.

³⁴ Division 83A-30 of the Income Tax Assessment Act No. 38 of 1997.

³⁵ Muraca, J., Kellock, M & Clements, A., (2020) *Employee share plans in Australia: regulatory overview*. Available at [https://uk.practicallaw.thomsonreuters.com/1-513-1482?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/1-513-1482?transitionType=Default&contextData=(sc.Default)&firstPage=true) (last accessed on 22 August 2020 at 21:19pm).

³⁶ Section 83A-100 of the Income Tax Assessment Act No. 38 of 1997.

³⁷ Andreyev Lawyers (n.d.) *ESS – Qualifying for 'deferral' of the taxable discount*. Available at <https://andreyev.com.au/2017/04/29/ess-qualifying-for-deferral-of-the-taxable-discount/> (last accessed on 21 September 2020 at 05:17am).

³⁸ Inland Revenue Authority of Singapore *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.7. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³⁹ Inland Revenue Authority of Singapore *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.11. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

⁴⁰ Inland Revenue Authority of Singapore *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.11. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

prime rate.⁴¹ Other schemes that offer favourable tax treatment of gains from employee share schemes in Singapore, include the Equity Remuneration Incentive Schemes (“**ERIS Schemes**”) for start-up businesses, small and medium enterprises and all corporations respectively.⁴² It is important to note that, although the ERIS Schemes were phased out as of 31 December 2013, in order to ‘*rationalise the tax treatment of remuneration, regardless of form for employees*’⁴³, these schemes apply to gains accrued up to 31 December 2023.⁴⁴

The tax laws of Australia and Singapore were respectively identified for purposes of the comparative analysis in this research report, for the following reasons:

- although there are similarities⁴⁵ between the tax treatment of employee share schemes in South Africa, Australia and Singapore respectively, the South African legislation lacks a variety of concessions that mitigate the cash flow constraints that arise when employees are required to settle the tax liabilities due upon the vesting of share awards, as is the case in Australia and Singapore;
- the tax concessions provided by Australian legislation were introduced by the government in 2015 to address the concerns raised by stakeholders in relation to the tax treatment of employee share schemes. The Australian government conducted public consultations, sought advice from the Prime Minister’s Business Advisory Council and analysed the results of a study prepared by the Business Council of Australia in developing these reforms.⁴⁶ This active seeking of the opinions of interested and affected groups,⁴⁷ has assisted to align the tax legislation governing employee share schemes with the commercial realities of conducting business in Australia;⁴⁸ and

⁴¹ The rate of interest is based on averaging the prime rates of three designated Singapore banks as of April 15 each year according to Leng, C.Y., (2019) *International Stock Plans: The Practitioner’s Guide to Exporting Employee Equity (Singapore Guide)*, p.7. Available at <https://www.naspp.com/NASPPAttachmens/NASPP/80/8099278d-efef-4cb4-9db6-f2db94591ffa.pdf> (last accessed on 21 September 2020 at 06:16am).

⁴² See ss 13J, 13L and 13M of the Income Tax Act (Chapter 134) (Original Enactment: Ordinance 39 of 1947).

⁴³ Inland Revenue Authority of Singapore (n.d.) *Stock Options*. Available at [https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top:_Equity%20Remuneration%20Incentive%20Schemes%20\(ERIS\).plans%20granted%20by%20their%20employers.](https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top:_Equity%20Remuneration%20Incentive%20Schemes%20(ERIS).plans%20granted%20by%20their%20employers.) (last accessed on 21 September 2020 at 06:30am).

⁴⁴ Leng, C.Y., (2019) *International Stock Plans: The Practitioner’s Guide to Exporting Employee Equity (Singapore Guide)*, p.6. Available at <https://www.naspp.com/NASPPAttachmens/NASPP/80/8099278d-efef-4cb4-9db6-f2db94591ffa.pdf> (last accessed on 21 September 2020 at 06:16am).

⁴⁵ For example, the discount in relation to a share issued in terms of an employee share scheme is generally deemed to be the difference between the market value of the share and any consideration paid by the employee to acquire the share, in South Africa, Singapore and Australia respectively.

⁴⁶ Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015, p.6. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

⁴⁷ Organisation for Economic Co-operation and Development (n.d.) *Background Document on Public Consultation*, p.1. Available at <https://www.oecd.org/mena/governance/36785341.pdf> (last accessed on 24 January 2021 at 19:13pm).

⁴⁸ BDO Australia (2016) *Employee Share Schemes*. Available at <https://www.bdo.com.au/en-au/insights/tax/articles/employee-share-schemes> (last accessed on 24 January 2021 at 19:26pm).

- as mentioned above, the Singaporean legislation allows employees to defer the payment of tax on the gains derived from the vesting of share awards for up to five years in accordance with the QEEBR Scheme, subject to an interest charge.⁴⁹ Although this concession may assist to relieve the cash flow constraints faced by employees when required to settle the tax liability upon vesting, the interest charge may affect the attractiveness thereof.⁵⁰ This consideration is important, particularly for purposes of determining the extent to which the Singaporean legislation may be used as a guide for the enhancement of the South African tax legislation applicable to employee share schemes.

1.2. Aim of this research

Owing to factors such as COVID-19, employers may need to consider how changes to their businesses will affect the manner in which employees are remunerated and incentivised. It is submitted that where the tax laws of a country allow businesses to be more competitive in recruiting and retaining talented employees by offering tax concessions to participants of employee share schemes, such jurisdiction will, most likely, be viewed as an attractive investment destination.⁵¹

For the reasons mentioned above, this report will examine the ambit of ss 8B (which deals with broad-based employee share plans) and 8C of the Act and the manner in which these sections can be amended to make employee share schemes more attractive to employees. A comparative analysis of the South African, Australian and Singaporean tax provisions will be included in order to determine the extent to which the foreign legislation may be used as guidance to enhance the South African tax legislation governing employee share schemes.

1.3. Structure of this research

The structure of this report is as follows:

⁴⁹ Inland Revenue Authority of Singapore *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.11. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

⁵⁰ Deloitte (2013) *Global Rewards Update: Singapore — Phasing out the Equity Remuneration Incentive Scheme (ERIS)*. Available at <https://www.globalequity.org/geo/sites/default/files/Global%20Rewards%20Update%20-%20Singapore%20-%20March%202013.pdf> (last accessed on 24 January 2021 at 20:55pm).

⁵¹ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

Chapter 2 provides an overview of the relevant provisions of the Act that govern employee share schemes in a South African context. The ambit of ss 8B and 8C of the Act will be examined, specifically focusing on the timing of the tax event.

In Chapter 3, the tax legislation governing employee share schemes in Australia and Singapore, respectively, will be discussed. This chapter will analyse the mechanisms adopted by these jurisdictions to mitigate the potential cash flow problems that may arise for employees with regard to the settlement of the tax liability due upon the vesting of the share awards.

In chapter 4, the South African tax treatment of employee share schemes will be compared to that of Australia and Singapore respectively. In addition, this chapter will evaluate the manner in which the tax legislation governing employee share schemes in South Africa can be amended so as to encourage employee equity participation without resulting in a loss for the fiscus (i.e. the proposed recommendations will focus on, *inter alia*, tax deferral rather than the scrapping of the taxation of employee share schemes in its entirety).

Chapter 5 will summarise the findings of the research report and propose the areas requiring further research.

1.4. Research Method

This report constitutes legal research. The research method adopted is of a qualitative, interpretive nature, based on an extensive literature review and analysis of, *inter alia*, tax legislation, commentary on legislation, case law, journal articles, dissertations, electronic databases and resources.

1.5. Limitation of scope

This report will analyse country specific legislation governing employee share schemes, namely:

- ss 8B and 8C of the Act;
- Division 83A of the ITAA 1997; and
- ss 10(6), 13J, 13L and 13M of the SITA.

This research report will focus on generic tax issues that may affect employees and includes all the relevant South African, Australian and Singaporean legislation promulgated as at 31 December 2020. This research report will provide a high level analysis of the various tax concessions offered by these countries to employees who receive shares as part of an employee share scheme. This report will not discuss all types of performance-based incentive awards but will rather focus on equity-based incentives (i.e. employee share schemes). This report will also not consider the regulatory issues, such as corporate governance guidelines, employment law, exchange control etc., which are applicable to employee share schemes but not directly related to tax.

2. Chapter 2: South African tax legislation governing employee share schemes

2.1. Introduction

In South Africa, the taxation of employee share schemes is governed by the provisions of ss 8B and 8C of the Act.⁵² Section 8B includes any gain made on the disposal of a qualifying equity share in the income of a person, where the person disposes of such share within five years⁵³ after it was granted in terms of a 'broad-based employee share plan',⁵⁴ whereas s 8C includes any gains or losses made on the vesting of equity instruments, which were acquired by virtue of employment, in a taxpayer's income⁵⁵.

As a point of departure, this chapter will expand on the following, among others:

- In the context of s 8B -
 - the requirements for a broad-based employee share plan;
 - the inclusion of a gain in the income of the person where the shares are disposed within five years from the date of grant;
 - the exemption from income tax of any amount received by the person in the form of a qualifying equity share; and
 - the impact of s 8B on the employer including the employees' tax withholding obligation.

- In the context of s 8C -
 - the requirement for the equity instrument to be acquired by virtue of the employee's employment;
 - the difference between restricted and unrestricted equity instruments;
 - the vesting events in relation to equity instruments; and
 - impact of s 8C on the employer including the employees' tax withholding obligation.

⁵² Cridlan, D., Kennedy-Good, S., Vandeleur, A., Chavoos, M., Mathonsi, P., Lake, R. & Naidoo P., (2020) *Employee share plans in South Africa: regulatory overview*. Available at [https://uk.practicallaw.thomsonreuters.com/1-503-4810?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/1-503-4810?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1) (last accessed on 1 August 2020 at 13:38pm).

⁵³ Conversely, where the shares are disposed of after five years from their date of grant, the gain will be treated as a capital gain and subject to capital gains tax.

⁵⁴ South African Revenue Service Interpretation Note No. 62 (2011) *Broad-Based Employee Share Plan*, para 3. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁵⁵ Or by virtue of holding of any office of director. See ss 8C(1)(a) and 8C(1)(a)(i) of the Act.

2.2. Taxation of amounts derived from broad-based employee share plans - s 8B of the Income Tax Act

Section 8B was introduced into the Act, with effect from 26 October 2004, to encourage the broad-based participation of employees in share schemes by allowing the employer company to issue shares to its employees on a tax-free basis.⁵⁶ More specifically, this section was promulgated to ensure that the granting of shares to certain qualifying employees -

*'... at reduced or no cost (subject to a cap) will not be deemed as income for purposes of income tax if the shares are held for a prescribed period of time.'*⁵⁷

Prior to the promulgation of s 8B, the law was such that the issuance of employer-provided shares to an employee at a discount (or at a consideration less than market value) was a taxable fringe benefit⁵⁸ in the hands of the employee and accordingly subject to employees' tax.⁵⁹ The South African Revenue Service ("SARS") stated that the reason for the amendment to the fringe benefit tax treatment (i.e. promulgation of s 8B) of share schemes centred around the fact that such treatment -

*'... is especially problematic for low-income employees who cannot afford to pay tax on free or discounted shares without selling their stake. Special tax rules are accordingly required to promote long-term, broad-based employee empowerment by allowing employees to participate in the success of their employer with minimal tax cost.'*⁶⁰ (own emphasis)

As mentioned above and as a general rule, s 8B(1) of the Act provides for the inclusion of a gain made from the disposal of a qualifying equity share or any right or interest in that share, in the income of a person⁶¹ who disposes of that share within five years from the date of grant

⁵⁶ South African Revenue Service Interpretation Note No. 62 (2011) *Broad-Based Employee Share Plan*, para 2. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁵⁷ National Treasury (2004) *Budget Speech*, p.20. Available at <http://www.treasury.gov.za/documents/national%20budget/2004/speech/Speech.pdf> (last accessed on 28 December 2020 at 15:45pm).

⁵⁸ The fringe benefit was in the form of ordinary income.

⁵⁹ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁶⁰ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.6. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁶¹ As this section uses the term 'person' and not 'employee', this section will apply to ex-employees. See Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am) and South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2005*, p.6. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2005-01%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202005.pdf> (last accessed on 31 January 2021 at 15:48pm).

of that share.⁶² Such gain will accordingly be subject to employees' tax.⁶³ Conversely, where the person disposes of the qualifying equity share *after* five years from the date of grant, such gain will be of a capital nature and subject to capital gains tax in terms of the Eighth Schedule to the Act.⁶⁴

The date of grant of the equity shares is the date upon which the granting of the equity shares to the employee is approved by the directors of the employer company (or any other person with comparable authority). It is important to note that the date of grant is not necessarily the date where the equity shares are registered in the name of the employee.⁶⁵

The aforementioned general rule applies to any 'qualifying equity shares' acquired in terms of a 'broad-based employee share plan' approved by the directors of the company (or other persons with comparable authority⁶⁶).⁶⁷ For a share to be a 'qualifying equity share', three requirements must be met:

- Firstly, the share must be an 'equity share', which is defined in s 1 of the Act as any share other than a share that, neither as respects dividends nor returns of capital, carries any right to participate beyond a specified amount in a distribution. Stated differently, it is only where a limit is imposed, which is applicable both to dividends *and* returns of capital, that a share will not be an 'equity share'.⁶⁸ Accordingly, a share will still constitute an equity share where only the shareholder's right to dividends in respect of a share is restricted, and not the right to returns of capital and vice versa.⁶⁹
- Secondly, the equity share must be acquired in terms of a 'broad-based employee share plan', the definition of which is discussed in more detail below.

⁶² Sections 8B(1)(a), (b) and (c) provide that disposals that occur by virtue of (i) a qualifying equity share being exchanged for another equity share; and (ii) on the death or insolvency of the employee, will not result in the gain being included in the income of the employee.

⁶³ See para (d) of the definition of 'remuneration' in the Fourth Schedule to the Act read with para 11A(1)(b) of the Fourth Schedule to the Act.

⁶⁴ South African Revenue Service Interpretation Note No. 62 (2011) *Broad-Based Employee Share Plan*, p.8. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁶⁵ South African Revenue Service Interpretation Note No. 62 (2011) *Broad-Based Employee Share Plan*, para 3.2. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁶⁶ Section 8B(1) read with the definition of 'date of grant' in s 8B(3).

⁶⁷ Meissner, I., (2014) 'Special Report: Broad-Based Employee Share Plans' *Accountancy South Africa*. Available at <https://www.accountancysa.org.za/special-report-broad-based-employee-share-plans/> (last accessed on 28 December 2020 at 15:34pm).

⁶⁸ Lewis, A., (2013) *Preference shares constituting equity shares*. Available at <https://www.thesait.org.za/news/125684/Preference-shares-constituting-equity-shares.htm> (last accessed 30 January 2021 at 01:52am).

⁶⁹ Edward Nathan Sonnenbergs (2011) *Share incentive schemes vs. equity shares*. Available at https://www.saica.co.za/integritax/2011/1926_Share_incentive_schemes_vs._equity_shares.htm (last accessed on 31 January 2021 at 09:42am).

- And lastly, the market value⁷⁰ of the equity shares (as determined on the date of grant) acquired in the current and immediately preceding four years of assessment must not exceed R50 000 in aggregate. Should the market value of the equity shares exceed the R50 000 limit, such shares will fall outside the ambit of s 8B as they will not comply with the definition of ‘qualifying equity share’.⁷¹ It is interesting to note that when s 8B was introduced, the limit imposed on the market value of the shares was R9 000⁷² and applied over a three-year period.⁷³ In explaining the reasons for introducing this limit, SARS noted that:

‘The proposal is intended to be of greatest assistance to rank-and-file employees who earn an average of R50 000 to R70 000 per annum and was eventually pitched at 5 per cent of the SITE amount limitation.

Reasons for the low amount include:

- *It will limit abuse in the form of deferred compensation arrangements;*
- *It will limit the temptation to “cash-out” by resigning or entering into further schemes like the disposal of dividend rights;*
- *A deduction will be allowed to the employer hence the need to limit revenue exposure for the fiscus.’⁷⁴*

In order to qualify as a ‘broad-based employee share plan’, the following requirements must be met:

- the employee must acquire equity shares in the employer or a company that is an ‘associated institution’⁷⁵ in relation to the employer. The terms ‘employee’ and ‘employer’ are not defined in s 8B nor s 1 of the Act. They are, however, both widely

⁷⁰ In relation to an equity share, the market value is the arm’s length price that could be obtained upon the sale of the equity share, on the open market, between a willing buyer and a willing seller. In addition, the market value of any qualifying equity share acquired by virtue of holding any other qualifying equity share is excluded from this definition in accordance with s 8B(2A) of the Act.

⁷¹ See Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta’s Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am) and Bezuidenhout L, M., (2006) ‘Employee Share Incentive Schemes: An Integrated Approach’, Master of Commerce thesis, Commerce Faculty, University of Cape Town, p.51. Available at https://open.uct.ac.za/bitstream/handle/11427/5908/thesis_com_2006_bezuidenhout_l_m.pdf?sequence=1 (last accessed on 7 February 2021 at 00:21am).

⁷² This monetary cap was increased to R50 000 by s 10(1)(d) of the Revenue Laws Amendment Act 60 of 2008 following a review of the lack of usage of s 8B. See the South African Revenue Service (2008) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*, p.20. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2008-01%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202008.pdf> (last accessed on 7 February 2021 at 01:42am).

⁷³ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.7. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁷⁴ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.3. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

⁷⁵ An ‘associated institution’ is defined in para 1 of the Seventh Schedule to the Act to include, where the employer is a company, a company which is managed and controlled, directly or indirectly, by the same persons who manage and control the employer company. Alternatively, where the employer is not a company, any company which is managed and controlled by the employer or by any partnership of which the employer is a member.

defined⁷⁶ in para 1 of the Fourth Schedule to Act for purposes of that Schedule (i.e. a person that is deemed to be an employee or employer for purposes of the Fourth Schedule will not be an employee or employer for purposes of the other provisions of the Act).⁷⁷ Accordingly, the common law formulation of these terms, which provides that an employer-employee relationship is established by virtue of an employment contract, must be applied for purposes of s 8B.⁷⁸ More specifically:

*'A contract of employment is an agreement under which one person (the common law employee) works for another person (the employer) in exchange for remuneration.'*⁷⁹

- eligible employees of a broad-based employee share plan cannot participate in any other equity scheme of the employer (or any associated institution). As s 8B was introduced to provide an incentive for the broad-based equity participation of 'rank-and-file employees', the incentive would be compromised where employees who participated in, for instance, executive remuneration schemes, were also allowed to participate in a broad-based employee share plan;⁸⁰
- at least 80% of all employees who are employed on a permanent basis (including those that have been continuously employed on a permanent basis for at least one year) are entitled to participate. The purpose of this requirement is twofold: to (i) ensure that the share plan is 'fully broad-based'; and (ii) allow the employer to exclude, for example, temporary employees or those that are underperforming;⁸¹
- employees that acquire the equity shares have full voting rights and are entitled to all dividends (including foreign dividends) in relation to those shares. This is to ensure that the employees 'acquire a "real" ongoing equity interest' in the employer company;⁸² and

⁷⁶ Para 1 of the Fourth Schedule to the Act defines an employee as, *inter alia*, any natural person who receives remuneration or to whom remuneration accrues by reason of the rendering of services by such person to or on behalf of a labour broker. The definition of 'employer' appears in the same paragraph and means, *inter alia*, any person who pays remuneration.

⁷⁷ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

⁷⁸ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.6. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

⁷⁹ South African Revenue Service (2011) Interpretation Note No. 62 *Broad-Based Employee Share Plan*, p.3. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁸⁰ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.4. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

⁸¹ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.7. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁸² South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.7.

- no restrictions may be placed on the disposal of the equity shares, other than:
 - restrictions imposed by legislation;
 - a right of any other person to acquire the equity shares from the employee or former employee at market value on the date of acquisition (or where the employee was guilty of misconduct or poor performance, the shares may be acquired at the lower of market value on the date of acquisition or market value at the time the shares were acquired by the employee); and
 - restrictions on the disposal of the equity shares by the employee or former employee within a period of five years from the date that the equity shares were granted to the employee.

These restrictions were put in place to ensure that the employee's equity interest is not inadvertently undermined when providing the employer with some flexibility with respect to the share plan.⁸³

Tax implications on the award of qualifying equity shares

'Gross income' is defined in s 1 of the Act, in the case of a resident, as the total amount, in cash or otherwise, received by or accrued to or in favour of a resident, excluding receipts or accruals of a capital nature. This definition is extended to provide for certain specific inclusions, whether of a capital nature or not, and paragraph (c) of the definition specifically includes in a person's income:

'any amount, including a voluntary award, received or accrued in respect of services rendered or to be rendered, or any amount (other than an amount referred to in section ...8B or 8C) received or accrued in respect of any employment or the holding of any office.'

The '*amount referred to in section ...8B or 8C*' which is not included in gross income is the amount of the difference between the market value of the qualifying equity share or equity instrument (as the case may be) and the consideration paid by the employee.⁸⁴ Accordingly, para (c) includes only the value of the initial award of a qualifying equity share or equity instrument.

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁸³ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.8.

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

⁸⁴ Stiglingh M, Koekemoer AD. (2019) *Silke: First Touch to Tax 2020*. LexisNexis SA. Available at <http://search.ebscohost.com/login.aspx?direct=true&db=nlebk&AN=2350430&site=ehost-live&scope=site> (last accessed on 12 March 2021 at 21:46pm).

In order for an amount⁸⁵ to be included as 'gross income' under paragraph (c), there has to be a causal relationship between the amount received and the services rendered (or to be rendered).⁸⁶ Stated differently, there must be a direct link between the cause (the services rendered or to be rendered) and the result (the amount received). Where the amount is awarded in respect of services rendered (or to be rendered) or alternatively, in respect of any employment relationship, it will be taxable, irrespective of whether or not it is payable in terms of a contract of service.⁸⁷

There have been a number of court cases⁸⁸ which deal with the causal relationship between the circumstances that give rise to an amount, and the resulting tax treatment thereof. For instance, in *Stander v CIR* 1997 59 SATC 212, a manufacturer and distributor of motor vehicles marketed its products through franchise dealers who were required to furnish monthly financial reports to the manufacturer. The taxpayer, employed as a bookkeeper for a franchisee and in recognition of his standards of performance in financial management, was awarded a prize by the manufacturer consisting of a seven-day overseas holiday for himself and his wife. The taxpayer received no tickets in connection with the trip and was not permitted to convert the prize into cash, nor was the trip transferable to anyone else. The Commissioner for Inland Revenue subjected the value of the prize to income tax. The court found, *inter alia*, that the value of the prize was not subject to income tax as the trip was not received '*in respect of services rendered*'. More specifically, the court held:⁸⁹

"...That, as regards the further requirement of para (c) of the definition of 'gross income' that the trip must be 'in respect of services rendered', the fact that appellant's employment with Frank Vos Motors was a sine qua non of the receipt by him of the award sought to be taxed, was not sufficient to provide the necessary causal link between the services which he rendered to his employer and the obtaining of the award; those services did not constitute the causa causans of the award..."

...That appellant did not seek the prize by entering a competition - nor did he expect to receive anything from Delta for the work he performed for Frank Vos Motors; he merely performed his normal duties for which he was remunerated by his employer and the fact that these duties were performed in a manner which Delta considered to be excellent was what qualified him to receive the prize; the fact that these services were beneficial to Delta did not mean that the award he received was 'in respect of' services rendered."

Having regard to the principles set out above, the value of qualifying equity shares received by an employee will be included in the employee's gross income by virtue of: (i) para (c) of the

⁸⁵ In *WH Lategan v CIR* 1926 CPD 203, Watermeyer J held that '*...the word 'amount' must be given a wider meaning and must include not only money, but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.*'

⁸⁶ *Stander v CIR* 1997 59 SATC 212 at 220 and 221.

⁸⁷ See *CSARS v Kotze* 2002 64 SATC 447; *Verrinder Ltd v CIR* 1949 (2) SA 147 (T), 16 SATC 48; *ITC 689* (1949) 16 SATC 501; *ITC 938* (1960) 24 SATC 375; *ITC 1091* (1966) 28 SATC 224 and *ITC 1359* (1981) 44 SATC 165 at 166.

⁸⁸ See *CIR v Crown Mines Ltd* (1923) AD 121; *ITC 369* (1936) 9 SATC 310; *ITC 411* (1938) 10 SATC 238; *CIR v Shell Southern Africa Pension Fund (A)* 1983 46 SATC 1; *Stevens v CIR (A)* 2006 69 SATC 1.

⁸⁹ At 214.

definition of 'gross income', and (ii) the award being linked to services rendered (or to be rendered).

Section 10(1)(nC) of the Act, however, provides that any amount received by or accrued to any employee in the form of qualifying equity shares as defined in s 8B is exempt from normal tax in the hands of the employee. Accordingly, an employee who is awarded qualifying equity shares in accordance with a broad-based employee share plan will not be taxed on such an award at the time of acquisition.

It is also important to consider whether the award of the shares may constitute a taxable fringe benefit in accordance with the provisions of the Seventh Schedule to the Act. The value of such a benefit is included in the gross income of a person in terms of paragraph (i) of the gross income definition. Where an employee acquires an asset⁹⁰ from his employer for no consideration or a consideration below market value, a taxable benefit generally arises.⁹¹ Paragraph (iii) of the proviso to paragraph 2(a) of the Seventh Schedule to the Act specifically excludes qualifying equity shares as contemplated in s 8B from constituting a taxable benefit. Qualifying equity shares are, therefore, not subject to the provisions of the Seventh Schedule to the Act and are not taxed as fringe benefits. In addition, loans granted by employers to employees enabling them to acquire qualifying equity shares are not deemed to be taxable benefits in terms of para 2(f) of the Seventh Schedule to the Act.

Tax implications of the disposal of qualifying equity shares

The tax implications of the disposal of qualifying equity shares are dependent on the timing of the disposal. As mentioned above, where a qualifying equity share is disposed⁹² of within five years from date of grant, the gain is included in the income of the employee and employees' tax will need to be withheld, whereas if the disposal occurs after five years from the date of grant, the gain will be deemed to be of a capital nature and subject to capital gains tax. These two scenarios are discussed in more detail below.

Section 8B(1) of the Act applies to include any gain, made on the disposal of a qualifying equity share, in the income of an employee where such share is disposed of within five years

⁹⁰ Consisting of any goods, commodity, financial instrument or property of any nature (other than money). See para 2(a) of the Seventh Schedule to the Act.

⁹¹ See para 2(a) of the Seventh Schedule to the Act. The value of such taxable benefit is included in the employee's gross income in terms of para (i) of the definition of 'gross income' in s 1 of the Act.

⁹² This refers to an outright disposal and not a disposal as envisioned in subsecs (2), (2A) or (2B) of s 8B, discussed in more detail below.

from the date of grant. This general rule does not apply where a qualifying equity share is exchanged for another equity share and, on the death, or insolvency of the employee.⁹³

In South Africa, where an employer pays or becomes liable to pay remuneration (as defined)⁹⁴ to an employee, the employer is required to withhold employees' tax from such remuneration and pay it over to SARS.⁹⁵ Paragraph (d) of the definition of 'remuneration' in para 1 of the Fourth Schedule to the Act includes any gain (as determined in s 8B(3) of the Act) made from the disposal of a qualifying equity share in the remuneration of the employee. Such a gain is the difference between the amount received by or accrued by the employee from that disposal and the consideration given by the employee for that share, right or interest in that share.⁹⁶ Services rendered are excluded from 'consideration' in the definition of a 'gain'.⁹⁷ Accordingly, only amounts actually paid by the employee to acquire the qualifying equity shares will be considered in determining the gain arising on disposal.⁹⁸

Of particular importance to this report is subparagraph 2 of para 11A of the Fourth Schedule to the Act, which provides that employees' tax, in respect of the amount of the remuneration, must be withheld or deducted,⁹⁹ by either the person who granted the qualifying equity share to the employee or from whom the share was acquired,¹⁰⁰ from either –

- any consideration paid or payable to the employee in respect of the disposal of the qualifying equity shares; or
- any cash remuneration paid or payable to the employee after that qualifying equity share has been disposed of.

⁹³ Such disposals will not result in the gain being included in the income of the employee. See s 8B(1)(a), (b) and (c) of the Act.

⁹⁴ Remuneration is broadly defined in para 1 of the Fourth Schedule to mean, *inter alia*, any amount of income which is paid or is payable to any person by way of any salary, leave pay, overtime pay, bonus, commission, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered.

⁹⁵ Paragraph 2(1) of the Fourth Schedule to the Act. In addition, the South African Revenue Service *Guide for Employers in respect of Employees' Tax (2021 Tax Year)*, para 7.1, provides that three elements are required before the deduction of employees' tax, namely, 'an **employer** paying **remuneration** to an **employee**.' Available at <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/PAYE-GEN-01-G15%20-%20Guide%20for%20Employers%20iro%20Employees%20Tax%20for%202021%20-%20External%20Guide.pdf> (last accessed on 30 December 2020 at 14:15pm).

⁹⁶ See definition of 'gain' in s 8B (3) of the Act.

⁹⁷ See definition of 'gain' in s 8B (3) of the Act.

⁹⁸ South African Revenue Service (2011) Interpretation Note No. 62 *Broad-Based Employee Share Plan*, para 3.3. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-62%20-%20Broad%20Based%20Employee%20Share%20Plan.pdf> (last accessed on 28 December 2020 at 12:30pm).

⁹⁹ The South African Revenue Service (2021) *Guide for Employers in respect of Employees' Tax (2021 Tax Year)*, para 12.1, provides that an employer must calculate the employees' tax to be deducted from the gain made by an employee on the disposal of a qualifying equity share, in the same manner as tax on an annual payment (i.e. bonus). Available at <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/PAYE-GEN-01-G15%20-%20Guide%20for%20Employers%20iro%20Employees%20Tax%20for%202021%20-%20External%20Guide.pdf> (last accessed on 30 December 2020 at 14:15pm).

¹⁰⁰ The effect of this is that persons 'by whom the right was granted or from whom the equity instrument or qualifying equity share that gave rise to the gain or amount was acquired, are therefore considered to be employers and must deduct employee's tax from the remuneration payable by them to that employee during that year of assessment'. See South African Revenue Service (2017) *Explanatory Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2017*, p.28. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2017-02%20-%20Explanatory%20Memorandum%20on%20TALAB%2028%20of%202017%20introduced%20on%2025%20October%202017.pdf> (last accessed on 14 February 2021 at 18:27pm).

The employees' tax liability will only arise to the extent that the employee exercises his/her right to dispose of the qualifying equity share. Accordingly, a participant of a broad-based employee share plan who disposes of a qualifying equity share should not find himself/herself in a position where he/she is not able to settle the accompanying tax liability. This may not be the case where the employee disposes of the qualifying equity shares for a consideration which is less than the employees' tax liability - this, however, is within the employee's control and he/she can choose not to dispose of the shares, should that be the case. It is interesting to note, at this juncture, that s 8B does not cater for a position where the disposal of the qualifying equity share results in a loss.¹⁰¹

As mentioned above, where a qualifying equity share is disposed of after five years from the date of grant, the gain will be deemed to be of a capital nature. Section 9C of the Act provides a general rule which deems the proceeds of shares held for a period of at least three years, to be capital in nature and subject to capital gains tax, which is governed by the provisions of the Eighth Schedule to the Act.¹⁰² Section 8B applies, notwithstanding s 9C, which means that as soon as five years from the date of grant have elapsed, s 8B will stop applying to a qualifying equity share (i.e. the gain will not be included in the employees' income)¹⁰³. Instead, s 9C will automatically apply and as per the general rule, the proceeds of the shares will be capital in nature.¹⁰⁴

In accordance with the provisions of the Eighth Schedule to the Act, a capital gain arises where the proceeds received in respect of a disposal of an asset exceed the base cost thereof.¹⁰⁵ A natural person is entitled to an annual exclusion of R40 000 on the sum of capital gains arising in a year of assessment.¹⁰⁶ From the remaining balance of capital gains, 40%¹⁰⁷ is included in the person's taxable income and taxed at a marginal tax rate of between 18% and 45%.¹⁰⁸ Accordingly, an employee who disposes of the qualifying equity share after five years from the date of grant will be subject to an effective tax rate of between 0% and 18% on capital gains.

¹⁰¹ Beukes C, K., (n.d.) 'The South African tax implications of Black Economic Empowerment Transactions', p.13. Master of Accountancy dissertation, School of Accounting, University of KwaZulu-Natal. Available at https://researchspace.ukzn.ac.za/bitstream/handle/10413/10435/Beukes_Chanelle_Kim_%5B20_%5D.pdf?sequence=1&isAllowed=y (last accessed on 27 February 2020 at 13:37pm).

¹⁰² Conversely, where a qualifying equity share has been held for over three years, but less than five years, the proceeds will not be capital in nature (i.e. the provisions of s 8B(1) will apply). See Haupt, P., (2018) *Notes on South African Income Tax*, 37th edn., p.397, H & H Publications, South Africa.

¹⁰³ See s 8B(1) of the Act.

¹⁰⁴ See s 9C(2) of the Act.

¹⁰⁵ Paragraph 3(a) of the Eighth Schedule to the Act.

¹⁰⁶ Paragraph 5(1) of the Eighth Schedule to the Act.

¹⁰⁷ Paragraph 10(1)(a) of the Eighth Schedule to the Act.

¹⁰⁸ South African Revenue Service (2021) *Rates of Tax for Individuals*. Available at <https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Rates%20of%20Tax%20for%20Individuals.aspx> (last accessed on 12 March 2021 at 22:49pm).

Accordingly, it is more tax efficient for an employee to dispose of the qualifying equity shares after five years from the date of grant.¹⁰⁹

It is possible for an employee to dispose of already held qualifying equity shares in exchange for new equity shares in the employer company.¹¹⁰ This may occur where, for instance, an employee holds qualifying equity shares in an employer company, hereinafter referred to as ABC Pty Ltd, and such employer company is amalgamated with its holding company, DEF Pty Ltd. As a result of the amalgamation, the employee's qualifying equity shares in ABC Pty Ltd will be disposed of in exchange for shares in DEF Pty Ltd. Where this occurs, s 8B(2) of the Act deems the new equity shares (i.e. shares in DEF Pty Ltd) to be qualifying equity shares (as defined) which were acquired by the employee on the same date and for the same consideration as the qualifying equity shares previously acquired (i.e. shares in ABC Pty Ltd).

As a result of certain corporate actions such as an unbundling or issue of capitalisation shares, an employee may acquire an equity share by virtue of an already held qualifying equity share.¹¹¹ In this case, the newly acquired equity share will be deemed by s 8B(2A) to be a qualifying equity share which was acquired by the employee on the date of grant of the original qualifying equity share.

As mentioned above, the shares acquired in terms of subsections (2) and (2A) of s 8B are deemed to be qualifying equity shares notwithstanding that the newly acquired qualifying equity shares may result in the employee's total shareholding exceeding the R50 000 limit during the previous five years.¹¹² The value of the newly acquired equity shares will, therefore, not be taken into account when determining whether the R50 000 limit has been exceeded.

In addition to disposing of qualifying equity shares, an employee may dispose of a right or interest in relation to such share.¹¹³ Section 8B(2B) of the Act provides that the acquisition cost that is attributable to that right or interest must be calculated:

¹⁰⁹ This is in line with the legislature's intention to encourage long term ownership. See South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.2. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

¹¹⁰ Paragraph 11(2)(m) of the Eighth Schedule to the Act provides that there is no disposal 'by a person where that person exchanges a qualifying equity share for another qualifying equity share as contemplated in section 8B(2)'.

¹¹¹ National Treasury (2005) *Revenue Laws Amendment Bill, 2005, Batch Four*, p.4. Available at <http://www.treasury.gov.za/divisions/tfsie/tax/legislation/proposed/2005/Draft%20Revenue%20Laws%20Amendment%20Bill.%20Batch%20Four%20-%20for%20comment%20by%2021%20September%202005.pdf> (last accessed on 28 February 2021 at 10:08am).

¹¹² Haupt, P., (2018) *Notes on South African Income Tax*, 37th edn., p.396, H & H Publications, South Africa.

¹¹³ The disposal of such right or interest within five years from the date of grant will also constitute a gain that must be included in the employee's income.

“in accordance with the ratio that the amount received for the disposal of that right or interest bears to the market value of that qualifying equity share immediately before that disposal.”

There are other sections of the Act which apply to broad-based employee share plans, namely ss 11(A), 25 and 56(1)(k)(i). Section 11(A) provides that the employer may claim a deduction of an amount equal to the market value of any qualifying equity share granted to an employee, as determined on the date of grant, less any consideration given by that employee for that qualifying equity share. Such deduction may not exceed, in any year of assessment, an amount of R10 000 in respect of all qualifying equity shares granted to a single employee. It is important to note that s 11(A) applies *in lieu* of any other deduction, which means that a taxpayer may not deduct the market value of the shares under another section, for example under s 11(a) of the Act.¹¹⁴

Where an employee who holds qualifying equity shares dies, s 25, which applies to the deceased estate or the heirs of the deceased, does not apply in respect of amounts received or accrued from the disposal of any qualifying equity share after the date of the death of the employee.

Furthermore, s 56(1)(k)(i) of the Act exempts the gain which must be included in the income of the employee from donations tax.

2.3. Taxation of employees on the vesting of equity instruments - s 8C of the Income Tax Act

As was the case with s 8B, s 8C was introduced into the Act with effect from 26 October 2004. The main purpose for the promulgation of this section was to replace s 8A which included in the taxpayer's income, any gain made by the exercise, cession or release of any right to acquire any marketable security to the extent that the right was obtained by the taxpayer as a director or in respect of services rendered by him/her as an employee.¹¹⁵

SARS notes this motivation for introducing s 8C –

‘The existing section 8A...has failed to keep pace with the myriad of equity-based incentives developed for top management. While these provisions cover any right to acquire a marketable

¹¹⁴ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

¹¹⁵ Section 8A applies to all rights which were acquired by a director or employee before 26 October 2004. See *ITC 1856* (2011) 74 SATC 76 which confirmed, practically, how the gains made under a share incentive scheme prior to 26 October 2004 were taxable under s 8A and that gains made after that date were taxable under s 8C of the Act.

*security, the nature of the regime is such that its application is often unclear once top management enters into schemes that involve share rights beyond simple share options.*¹¹⁶

Section 8C of the Act subjects gains or losses¹¹⁷ made by employees on the vesting of equity instruments to income tax¹¹⁸ and places an employees' tax withholding obligation on the employer¹¹⁹. The time of the tax event under s 8C depends on whether the equity instrument is unrestricted or restricted. A gain on an 'unrestricted equity instrument' is taxed at the time that it is acquired or awarded, whereas a gain on a 'restricted equity instrument' is only taxed when the instrument 'vests' being, *inter alia*, the earlier of disposal or the lifting of restrictions.¹²⁰ The taxable gain is equal to the discount in the acquisition price (relative to market value).

In addition, SARS notes that s 8C is applicable '*only when an employee effectively cashes out the employee's stake in the employer.*'¹²¹ It is important to note that s 8C does not apply in respect of equity instruments which were acquired by the exercise or conversion of, or in exchange for the disposal of any other equity instrument that has already vested.¹²² Qualifying equity shares acquired under a broad-based employee share plan contemplated in s 8B are also excluded from the operation of s 8C. The provisions of s 8C that are applicable to the taxation, award, vesting and disposal of equity instruments are discussed in further detail below.¹²³

Taxation of equity instruments

The ambit of s 8C is wide, as it applies to an 'equity instrument' which is defined in s 8C(7) to include a share in a company or a member's interest in a close corporation and an option to acquire, or a financial instrument that is convertible into, a share or member's interest. This definition also includes a contractual right or obligation, the value of which is determined with reference to a share or member's interest. The requirement of a contractual right or obligation was introduced in 2008, to target instances where share schemes, for instance, involved a

¹¹⁶ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.10. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹¹⁷ Section 8C(1)(a) of the Act allows a deduction in respect of losses incurred when an equity instrument vests.

¹¹⁸ See s 8C(1)(a) of the Act.

¹¹⁹ See para 11A(1) of the Fourth Schedule to the Act.

¹²⁰ Section 8C(3)(a) and (b) of the Act.

¹²¹ South African Revenue Service (2011) Interpretation Note No. 55 *Taxation of Directors and Employees on Vesting of Equity Instruments*, p.10. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-55%20-%20Taxation%20Directors%20Employees%20Vesting%20Equity%20Instruments.pdf> (last accessed on 30 December 2020 at 09:18am). Also see *Bosch and Another v Commissioner for South African Revenue Service* (2012) 75 SATC 1.

¹²² See s 8C(1)(b)(i) of the Act.

¹²³ Section 8C(1)(b)(ii) of the Act.

trust and the taxpayer would obtain a right to the value of the shares held in trust, without any direct right to the shares themselves.¹²⁴

As stated above, s 8C(1)(a) provides for the inclusion of a gain or loss in the income of a taxpayer which arises on the vesting of an equity instrument. This section applies to equity instruments where they are acquired in three instances, namely, (i) by virtue of employment or the office of directorship or from any person by arrangement with the taxpayer's employer; (ii) by virtue of another restricted equity instrument held by the taxpayer; or (iii) as a restricted equity instrument during the taxpayer's term of employment or office of directorship.¹²⁵

Paragraph (i) of s8C(1)(a) requires either a causal link with employment or that the equity instrument is acquired by arrangement with the employer. Stated differently, the causal link with employment suggests that s 8C applies to only those equity instruments that were acquired 'by virtue of employment'.¹²⁶ The term 'employment' is not defined in the Act, and the ordinary meaning would therefore apply.¹²⁷

Where for example, a share incentive trust holds the shares on behalf of the employee, the shares cannot be said to have been held 'by virtue of employment', as the trust itself cannot be employed by the employer.¹²⁸ Section 8C(5), however, widens the application of s 8C and provides that, where a restricted equity instrument is disposed of to any person (i.e., trust)¹²⁹ that is a 'connected person'¹³⁰ in relation to the employee, or where the person¹³¹ (i.e., trust) acquires the equity instrument by virtue of the employee's employment or office of director,¹³² the provisions of s 8C must be applied *mutatis mutandis* to the shares held by the person (i.e., trust) and any gain or loss must be attributed to the employee.¹³³

The reference to 'by virtue of employment' is significant when considering the application of s 8C. The matter of causation has been considered by the courts on a number of occasions¹³⁴,

¹²⁴ South African Revenue Service (2008) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008*, p.23. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2008-01%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202008.pdf> (last accessed on 7 February 2021 at 01:42am).

¹²⁵ Section 8C(1)(a)(i), (ii) and (iii) of the Act.

¹²⁶ Cliffe Dekker Hofmeyr (2012) *Share Scheme Ruling*. Available at https://www.saica.co.za/integritax/2012/2029_Share_scheme_ruling.htm (last accessed at 30 December 2020 at 13:56pm).

¹²⁷ See discussion of the common law definition of an employment contract, in the context of s 8B, above.

¹²⁸ Van der Spuy, P., (2020) *Trustees as shareholders or directors in a company*. Available at <https://www.iol.co.za/personal-finance/trustees-as-shareholders-or-directors-in-a-company-47837183> (last accessed 12 March 2021 at 23:06pm).

¹²⁹ The definition of 'person' in s 1 of the Act includes a trust.

¹³⁰ As defined in s 1 of the Act.

¹³¹ That is not necessarily a 'connected person'.

¹³² For example, where a spouse receives an equity instrument by virtue of the other spouse's employment or the office of director. In this instance, s 8C(5)(b) provides that any dealings in relation to the equity instrument will be ascribed to the employed spouse.

¹³³ Section 8C(5)(a) and (b) of the Act.

¹³⁴ See *ST v COT* (1973) 35 SATC 99; *CIR v Shell Southern Africa Pension Fund* (1983) 46 SATC 1; *Stander v CIR* (1997) 59 SATC 212; *CSARS v Kotze* (2002) 64 SATC 447; *Stevens v C:SARS* (2006) 69 SATC 1.

perhaps most famously by Innes CJ in *CIR v Crown Mines Ltd*¹³⁵ where he held that a tax could not be imposed ‘...in respect of a particular subject matter, unless it had a direct relationship to that matter’. This view was confirmed, in the context of past employment, in *R v CIR*¹³⁶, where the High Court of Southern Rhodesia found that a causal relationship between a purported gift and services rendered meant that an amount was taxable.

Whether such a causal relationship needs to be direct is often an important consideration.¹³⁷ The Fiscal Appeal Court (Rhodesia) considered this question in *ST v COT*¹³⁸ noting that the Black’s Law Dictionary defines ‘by virtue of’ to mean ‘by force of’, ‘by authority of’, ‘by reason of’, ‘because of’, ‘through’ or ‘in pursuance of’ and went on to find that:

*‘Each of these definitions suggests that there must be a direct link between the cause and the result.’*¹³⁹

On the basis of the above principles, it is apparent that there needs to be a direct link between the services or employment and the amount received, and that such a link would not exist where the services or employment are a ‘mere background factor’¹⁴⁰.

The provisions of s 8C(1)(a) will also apply where an employer arranges with another company to issue equity instruments to its employees.

Paragraph (ii) of s 8C(1)(a) applies where an employee receives equity shares by virtue of holding other equity instruments which are restricted for s 8C purposes. This could occur, for instance, as a result of a corporate action (such as an unbundling transaction) or a capitalisation issue.¹⁴¹

Paragraph (iii) of s 8C(1)(a) does not require a causal link between employment and the acquisition of the restricted equity instrument, as is the case with part (i). In this regard, s 8C(1)(a) will apply to a restricted equity instrument that is acquired from the employer company or any associated institution¹⁴² in relation to the employer company and/or a co-employee or a director of the aforementioned employer company associated institution. As it

¹³⁵ 1923 AD 121.

¹³⁶ (1949) 16 SATC 151.

¹³⁷ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta’s Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

¹³⁸ (1973) 35 SATC 99.

¹³⁹ At p.100.

¹⁴⁰ See *ITC 1790* (2004) 67 SATC 221 where the court noted, at 228, that ‘the employment with or the services rendered by the appellant to S could not be regarded as a mere background factor for the purposes in making the ex gratia payment by S.’

¹⁴¹ See discussion in relation to s 8B(2A) above. The same principle will apply in the context of s 8C(1)(a)(ii) of the Act.

¹⁴² See definition of ‘associated institution’ in the s 8B discussion above.

may be difficult to discern whether an employee acquired a restricted equity instrument directly from an employer or from a co-employee or director, this subsection was introduced as an anti-avoidance mechanism that targets instances of collusion.¹⁴³

It should be noted that there are certain sections of the Act that do not apply where s 8C finds application. More specifically, s 8C applies notwithstanding s 9C, meaning that the proceeds received on the disposal of any equity instrument will not be deemed to be capital in nature, irrespective of the number of years that it had been held. In addition, s 23(m), which disallows the deduction of amounts relating to employment does not prohibit the deduction of a loss arising in respect of s 8C.

Section 8C(2) of the Act deals with the gain to be included in, or the loss to be deducted from, the income of a taxpayer upon the vesting of an equity instrument. In the context of gains, the general principle is that the gain to be included in an employee's income upon the vesting of an equity instrument, is the amount by which the market value (on the date of vesting) exceeds any consideration paid by the employee for the equity instrument.¹⁴⁴ There are instances where the employee may be compelled to sell the equity instrument for less than market value.¹⁴⁵ For instance, where the equity instrument is –

- repurchased by the employer or an associated institution for less than the market value;¹⁴⁶ or
- disposed by way of release, abandonment or lapse of an option to acquire a share or financial instrument convertible into a share,¹⁴⁷

the gain to be included in income is the amount received or accrued less the consideration paid by the employee for that equity instrument.

It is interesting to note that, unlike s 8B, a loss made on the vesting of an equity instrument is deductible for income tax purposes.¹⁴⁸ The general rule applicable to losses is that the loss to be deducted from the income of the employee upon the vesting of an equity instrument, is the amount by which the consideration paid by the employee for the equity instrument exceeds

¹⁴³ South African Revenue Service (2010) *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010*, p.18. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2010-01%20-%20Explanatory%20Memorandum%20Taxation%20Laws%20Amendment%20Bill%202010.pdf> (last accessed on 3 March 2021 at 01:58am).

¹⁴⁴ Section 8C(2)(a)(ii) of the Act.

¹⁴⁵ See discussion on the definition of 'restricted equity instrument' below.

¹⁴⁶ Section 8C(2)(a)(i)(aa) read with s 8C(5)(c) of the Act.

¹⁴⁷ Section 8C(2)(a)(i)(bb) of the Act.

¹⁴⁸ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

the market value of the equity instrument at the time of vesting. Where the equity instrument is –

- repurchased by the employer or an associated institution for less than the market value;¹⁴⁹ or
- disposed by way of release, abandonment or lapse of an option to acquire a share or financial instrument convertible into a share,¹⁵⁰

the loss to be deducted from income is the amount received or accrued less the consideration paid by the employee for that equity instrument.

The concepts of ‘consideration’ and ‘market value’ are crucial for purposes of determining the gain or loss to be included in an employee’s income. Generally, the consideration for an equity instrument is, *inter alia*, the amount given (or to be given) by the employee for the acquisition of the equity instrument. As with s 8B, services provided by the employee cannot form part of the consideration. This is to ensure that the award of the shares is not treated as a deferred salary benefit (i.e. so that the employer cannot argue that the employee “pays” for the shares by rendering services to the company).¹⁵¹ Accordingly, only amounts actually paid by the employee to acquire the equity instrument will be deemed to be consideration.

Where an equity instrument is disposed of by an employee in exchange for a restricted equity instrument, the consideration will be any amount given by the employee for the restricted equity instrument, which amount must be reduced by the gain or loss determined in terms of s 8C(4)(b) of the Act. Section 8C(4)(b) provides that where the amount received in respect of a disposed restricted equity instrument (i.e. instrument A) includes payment other than a restricted equity instrument (i.e. instrument B), such payment (less any consideration given for instrument A attributable to that payment) must be deemed to be a gain or loss which must be included or deducted from the income of the employee, in the year of assessment in which instrument A is disposed, and not when instrument B is disposed of.¹⁵² This sub-section is, however, subject to a proviso that where an equity instrument is exchanged for any other equity instrument, the market value of the equity instrument given in exchange will not be taken into account in determining the consideration in respect of the acquired equity instrument.

¹⁴⁹ Section 8C(2)(b)(i)(aa) read with s 8C(5)(c) of the Act.

¹⁵⁰ Section 8C(2)(b)(i)(bb) of the Act.

¹⁵¹ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.13. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁵² Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

Where an equity instrument is acquired by a person in the circumstances set out in s 8C(5)(a) and (b) (discussed above), the consideration will be deemed to be amount which would have been paid by the employee who originally held the equity instrument - the actual amount paid by that person (i.e. trust in earlier example) for the equity instrument is disregarded.

The market value of an equity instrument is the arm's length price that could be obtained upon the sale of the equity instrument, on the open market, between a willing buyer and a willing seller.¹⁵³ Where the equity instrument is a share in a private company, however, the market value is an amount determined in terms of a method of valuation as prescribed by the rules relating to the equity instrument. Such valuation method must be used consistently to determine, for instance, the consideration for the acquisition of the equity instrument.¹⁵⁴

A distinction is made, in s 8C, between a restricted and unrestricted equity instrument, and as mentioned above, the time of the tax event depends on this distinction, which is discussed below. An equity instrument will be restricted to the extent that any of the following restrictions are placed thereon, namely:¹⁵⁵

- a) any restriction (other than one imposed by legislation) that prevents the employee from freely disposing of the instrument at market value. This will include, for example, a scenario where an employee is prohibited from disposing the equity instrument for a certain period or until his/her employment terminates;¹⁵⁶
- b) any restriction that could result in the employee forfeiting ownership or the right to acquire ownership of that equity instrument otherwise than at market value. A forfeiture would include an instance where the employee is required to sell the equity instrument back to the employer at cost, should the employee's employment be terminated before a certain date;¹⁵⁷
- c) a restriction which could result in the employee being penalised financially in any manner for not complying with the terms of the agreement for the acquisition of that equity instrument. This will include where an employee will forfeit, for example, his/her bonus should the equity instrument be disposed of within a certain period;¹⁵⁸

¹⁵³ Paragraph (b) of the definition of 'market value' in s 8C(7) of the Act.

¹⁵⁴ Paragraph (a) of the definition of 'market value' in s 8C(7) of the Act.

¹⁵⁵ Definition of 'restricted equity instrument' in s 8C(7) of the Act.

¹⁵⁶ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.12. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁵⁷ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

¹⁵⁸ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.12.

- d) where any person has retained the right to impose a restriction contemplated in a) or b) above. This scenario may arise, for instance, where a shareholder of the employer company has the option to acquire the equity instrument at cost where that the employee leaves the employ of the company;¹⁵⁹
- e) which is an option to acquire a restricted equity instrument. Stated differently, an option that can only be converted into a restricted equity instrument will be deemed to be a restricted equity instrument;¹⁶⁰
- f) where the equity instrument to which a financial instrument can be converted will be restricted. The principle in relation to this restriction is essentially the same as discussed in e) above;¹⁶¹
- g) where there is an undertaking to cancel the transaction or repurchase the equity instrument at a price exceeding market value if there is a decline in the value of the equity instrument; or
- h) where the equity instrument is not deliverable until the happening of an event, whether fixed or contingent.

Any equity instrument that is not subject to the restrictions discussed above, will be considered to be an 'unrestricted equity instrument'.¹⁶²

Tax implications on the award of equity instruments

The value of an equity instrument received by an employee will be included in the employee's gross income by virtue of: (i) para (c) of the definition of 'gross income', and (ii) the award being linked to employment or the office of director (refer to discussion above on the tax implications on the award of qualifying equity shares in the context of s 8B). Section 10(1)(nD) of the Act, however, provides that any amount received by or accrued to any employee that

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁵⁹ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.12.

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁶⁰ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.12.

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁶¹ South African Revenue Service (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004*, p.12.

Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2004-02%20-%20%20Explanatory%20Memorandum%20Revenue%20Laws%20Amendment%20Bill%202004.pdf> (last accessed on 28 December 2020 at 13:13pm).

¹⁶² South African Revenue Service (2011) Interpretation Note No. 55 *Taxation of Directors and Employees on Vesting of Equity Instruments*, p.3. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-55%20-%20Taxation%20Directors%20Employees%20Vesting%20Equity%20Instruments.pdf> last accessed on 30 December 2020 at 09:18am).

constitutes (i) an equity instrument contemplated in s 8C acquired by the employee, or (ii) consideration for the disposal of an equity instrument, which has not vested (at the time of the acquisition or disposal of the equity instrument), is exempt from tax in the hands of the employee. Accordingly, the value of the award will not be included in the employee's income and, essentially, the tax event is deferred to the date that the instrument vests.

As with s 8B, equity instruments acquired at a reduced or no cost do not constitute taxable benefits. As a result, a benefit which arises by virtue of the acquisition of an equity instrument will not be taxed in accordance with para 2(a)(iv) of the Seventh Schedule. In contrast to the treatment in terms of s 8B, where an employer¹⁶³ grants a low-interest or interest-free loan to an employee to acquire an equity instrument, the benefit, subject to certain exclusions,¹⁶⁴ will be deemed to be a taxable benefit in accordance with the provisions of para 2(f) of the Seventh Schedule to the Act.

Tax implications on the vesting of equity instruments

The taxation of an equity instrument in the hands of the employee is triggered by the vesting of the equity instrument. Accordingly, it is the vesting of the equity instrument that will result in a gain being included, or a loss being deducted from, the income of the employee.

As mentioned above, an unrestricted equity instrument is deemed to vest at the time of acquisition (i.e. on the date it is awarded).¹⁶⁵ The gain to be included (subject to certain exceptions discussed above) in the income of an employee who is awarded such an equity instrument is the amount by which the market value of the instrument exceeds the cost incurred for the acquisition thereof. In like manner, the loss to be deducted from the income of the employee who received an unrestricted equity instrument will be the amount by which the consideration provided exceeds the market value of the instrument.¹⁶⁶ Where an employee pays no consideration for the unrestricted equity instrument, the gain will be equal to any value attributable to such instrument.¹⁶⁷

¹⁶³ This section will also apply where any other person by arrangement with the employer or alternatively an associated institution in relation to the employer extends the loan to the employee.

¹⁶⁴ Paragraph 2(f) of the Seventh Schedule applies where (i) no interest is payable by the employee or (ii) where the interest on the loan that is charged is lower than the official rate of interest. Accordingly, where a rate of interest equal to or above the official rate of interest is levied on the loan, such loan will not constitute a taxable fringe benefit.

¹⁶⁵ Section 8C(3)(a) of the Act.

¹⁶⁶ Section 8C(2)(b)(ii) of the Act.

¹⁶⁷ Section 8C(2)(a)(ii) of the Act.

With reference to restricted equity instruments, the date of vesting occurs (i) when all the restrictions cease to exist or have effect; (ii) when the instrument is disposed of; or (iii) immediately:

- before the employee disposes of the instrument (other than a disposal contemplated in ss 8C (4), (5)(a), (b) or (c));
- after an option or a convertible financial instrument terminates (other than through the exercise or conversion thereof); or
- before the taxpayer dies to the extent that all the restrictions are or may be lifted on or after death.¹⁶⁸

Similar to the exemption provided for gains arising in respect of s 8B, s 56(1)(k)(i) of the Act exempts any gain which must be included in the income of an employee in respect of s 8C from donations tax.

As mentioned above, an employer is required to withhold employees' tax from any remuneration paid to an employee.¹⁶⁹ Paragraph (e) of the definition of 'remuneration' in para 1 of the Fourth Schedule to the Act includes any amount which is required to be included in the income of the employee by virtue of s 8C.

Paragraph 11A(1)(c) of the Fourth Schedule to the Act provides that where the remuneration of an employee includes an amount referred to in s 8C which is required to be included in the income of the employee, the person from whom the equity instrument was acquired is deemed to be the employer. Once again, of particular importance to this report is subparagraph 2(b) of para 11A of the Fourth Schedule to the Act, which provides that employees' tax must be withheld from any cash remuneration paid or payable to the employee after that equity instrument has vested (and not when it is disposed, as is the case with s 8B).¹⁷⁰

Ordinarily, an employee may dispose of some of the shares in order to settle the employees' tax liability that arises upon vesting, however, it is likely that a cash flow challenge may arise where the employee is unable to dispose of the shares in the same year that the instrument vests. This has been a concern for some commentators even before the section was promulgated. For instance, the South African Institute of Chartered Accountants argued that an employee should be allowed to defer payment of the employees' tax to the year in which

¹⁶⁸ Section 8C(3) of the Act.

¹⁶⁹ Paragraph 2(1) of the Fourth Schedule to the Act.

¹⁷⁰ Paragraph 11A(4) provides that the employer must ascertain from SARS the amount of employees' tax to be deducted or withheld.

the shares are actually disposed of.¹⁷¹ As an alternative, they proposed the gain should be taxed on the basis of 'payment and delivery' (i.e. the gain is only taxed once the shares have been delivered).¹⁷² SARS and National Treasury did not share this concern, as is evident from their response to representations made on the 2004 Revenue Laws Amendment Bill:

*'These comments are not accepted. Once the restrictions have been lifted the employee has full control over the shares and it is appropriate to tax at that point in time. The employee can sell the shares in order to pay the tax.'*¹⁷³

It is very interesting to note that SARS and National Treasury did not foresee a situation where an employee is unable to dispose of the shares in order to settle the tax liability. Notwithstanding the above, SARS and National Treasury alluded to the fact that should a taxpayer be allowed to defer the payment of the employees' tax to the point when the shares are disposed, a deemed interest charge should be imposed.¹⁷⁴

Unlike broad-based employee share plans, a specific deduction is not provided to an employer for the award of equity instruments to its employees. The issue of such shares is also not allowed as a deduction in terms of s 11(a) of the Act, as no expenditure has been incurred.¹⁷⁵

Tax implications of the disposal of equity instruments

The tax implications of the disposal of an equity instrument are dependent on whether the instrument is disposed of before or after vesting.

Where an equity instrument is disposed of prior to vesting, the provisions of para 64C of the Eighth Schedule to the Act, which provides that a person must disregard a capital gain or loss which arises upon the disposal of a restricted equity instrument in a manner contemplated in ss 8C(4)(a), (5a) or (c), will apply. Sections 5(a) and (c) were discussed above. Section 8C(4)(a) finds application where an employee disposes of a restricted equity instrument for an

¹⁷¹ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.11. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

¹⁷² SAICA also noted that countries such as the United Kingdom, Germany and the United States all tax on this basis.

¹⁷³ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.11. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

¹⁷⁴ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p.11. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

¹⁷⁵ See *Commissioner for South African Revenue Service v Labat Africa Ltd* 74 SATC 1.

amount which consists of another restricted equity instrument in the employer company.¹⁷⁶ In this instance, the gain arising on disposal will not be subject to capital gains tax, but will be covered by the provisions of s 8C.¹⁷⁷ As mentioned above, the disposal of an equity instrument is a vesting event in terms of s 8C(3)(b)(iii). Accordingly, where none of ss 8C(4)(a), (5a) or (c) apply, the equity instrument will vest on disposal and be subject to the provisions of s 8C.

Where the equity instrument is disposed of after the vesting thereof and the gain or loss has been included or deducted from the employee's income, the nature of the shares determines the tax treatment. Where the shares had been held for a period of at least three years prior to disposal, s 9C will apply (see discussion above in the context of s 8B) resulting in a capital gain or loss which will be subject to capital gains tax.¹⁷⁸ In order to avoid double taxation under s 8C (on vesting of the equity instrument) and the Eighth Schedule (i.e. on disposal of the equity instrument), para 20(1)(h)(i) of the Eighth Schedule to the Act deems the base cost of an equity instrument, the vesting of which resulted in a gain or loss being included or deducted from an employee's income, to be the market value of the equity instrument that was taken into account in determining the amount of that gain or loss.

2.4. Conclusion

In this chapter, the legislative framework that governs the requirements, tax implications and ancillary matters that are applicable to share incentive schemes in South Africa was analysed.

In the context of s 8B, it is submitted that, as the employees' tax liability only arises to the extent that the employee exercises his/her right to dispose of the qualifying equity share, a participant of a broad-based employee share plan should not find himself/herself in a position where he/she are not able to settle the tax liability.

In contrast, where s 8C applies, the employee will have a tax liability as soon as, *inter alia*, all restrictions in relation to those shares are lifted, even though he/she may not have actually disposed of the equity instrument at that particular point. This may leave the employee with a liquidity problem, should the employee not be able to dispose of the shares in order to settle the tax liability.

¹⁷⁶ In this instance, the new restricted equity instrument will be deemed to have been acquired by virtue of the employee's employment.

¹⁷⁷ Davis, D., Olivier, L., & Urquhart, G., (2020) *Juta's Income Tax Commentary*. Available at <https://0-jutastat-juta-co-za.innopac.wits.ac.za/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (last accessed on 30 January 2021 at 01:32am).

¹⁷⁸ Where the employee trades in shares, the employee may be taxed on revenue account. The tax consequences applicable thereto are not dealt with in this report.

As share prices rise and fall, it is submitted that s 8C is not aligned to the commercial realities of conducting business in South Africa, as it fails to take into account the risks attendant upon these share schemes.¹⁷⁹ In Chapter 3, the tax legislation governing employee share schemes in Australia and Singapore, respectively, will be discussed. This chapter will analyse the mechanisms adopted by these jurisdictions to mitigate the potential cash flow problems that may arise for employees with regard to the settlement of their tax liabilities due upon the vesting of the share awards.

¹⁷⁹ Foster, D., (2016) *Taxing Executive Share Incentives: The Rules Need to Change*. Available at <https://www.thesait.org.za/news/308092/Taxing-Executive-Share-Incentives-The-Rules-Need-to-Change.htm> (last accessed on 7 March 2021 at 11:26am).

3. Chapter 3: Analysis of the tax legislation applicable to employee share schemes in Australia and Singapore

3.1. Introduction

International research has indicated, *inter alia*, that employee share schemes are widely used by companies to attract and retain staff.¹⁸⁰ In addition, it has been noted that companies in which employees are provided with a financial share in the company are more productive than those that do not.¹⁸¹ As mentioned above, it is submitted that where the tax laws of a country allow businesses to be more competitive in recruiting and retaining employees by offering tax concessions to participants of employee share schemes, such jurisdiction will, most likely, be viewed as an attractive investment destination.¹⁸²

This chapter will discuss the tax legislation governing employee share schemes in Australia and Singapore, respectively, with particular reference to the mechanisms available to mitigate the potential cash flow problems that may arise for employees when they are required to settle the tax liabilities due upon the vesting of share awards. More specifically, this chapter will, expand on the following, among others:

- In the context of Australian tax law:
 - the tax concessions available to employees who participate in employee share schemes, namely, (i) the exemption concession in terms of which employees who have participated in a taxed-upfront scheme may reduce their taxable income by up to \$1,000; (ii) tax deferral concessions where employees may defer the payment of the tax in relation to their employee share scheme interests to a future time; and (iii) the start-up concession, where employees of certain small start-up companies do not include the discount on a share award in their taxable income;
 - a refund of tax paid where an employee forfeits shares;
 - the capital gains tax treatment of share awards; and
 - the deduction for the employer and the tax withholding requirements.

¹⁸⁰ O'Connell, A., (n.d.) *Employee share ownership plans – a comparative report*. Available at https://law.unimelb.edu.au/_data/assets/pdf_file/0007/1709764/45-Comparative_ESOP_Report_-_final_32.pdf (last accessed on 13 March 2021 at 11:52am).

¹⁸¹ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.11. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

¹⁸² The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.11. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

- In the context of Singaporean tax law:
 - the Equity Remuneration Incentive Schemes which provide a tax exemption for employees of start-up businesses, small and medium enterprises and all corporations respectively;
 - the Qualified Employee Equity-Based Remuneration Scheme which is a tax deferral scheme where an employee can defer the payment of tax on a gain arising from an employee share scheme for up to five years;
 - the capital gains tax treatment of share awards; and
 - the deduction available to the employer.

3.2. Tax legislation applicable to employee share schemes in Australia

In Australia, the taxation of employee share schemes is governed by the provisions of Division 83A (“**Div 83A**”) of the Income Tax Assessment Act 38 of 1997 (“**ITAA 1997**”).¹⁸³ The objectives of Div 83A are enumerated in subsection 5 and include, *inter alia*, ensuring that the benefits provided to employees in terms of employee share schemes are taxed at the employee’s marginal tax rates (and not as a fringe benefit)¹⁸⁴ and providing tax concessions to encourage employees to participate in these schemes.¹⁸⁵

An employee share scheme is defined in Div 83A-10(2) of the ITAA 1997 as a scheme in terms of which an ‘ESS interest’ is provided to the employees¹⁸⁶ of a company, by virtue of their employment. An ‘ESS interest’ is defined as a beneficial interest in a share in the company or a right¹⁸⁷ to acquire such beneficial interest.¹⁸⁸ An individual will be deemed to have a ‘beneficial interest’ in a share where such employee derives an ‘economic benefit’ from the share. Such beneficial interest will be present even where, for example, the employee is not the legal owner of the share.¹⁸⁹ For purposes of this discussion, a share granted to an employee in terms of an employee share scheme will be referred to as an “**ESS interest**”.

¹⁸³ Div 83A applies to ESS interests acquired after 30 June 2009. In June 2015, Div 83A was amended by the Tax and Superannuation (Employee Share Schemes) Act No. 105 of 2015. This report focuses on law applicable to employee share schemes as at 1 July 2015.

¹⁸⁴ Div 83A-5 read with paras (h) and (ha) of the definition of ‘fringe benefit’ in s 136(1) of the Fringe Benefits Tax Assessment Act 39 of 1986.

¹⁸⁵ Div 83A-5(b) and (c) of the ITAA 1997.

¹⁸⁶ This includes past, current or prospective employees and their associates.

¹⁸⁷ There are a number of cases which deal with the question of whether a particular right is a ‘right to acquire a share’ for purposes of the rules dealing with employee share schemes. These cases include *Fraunschiel v Federal Commissioner of Taxation* (1989) 20 ATR 955, *Federal Commissioner of Taxation v McWilliam* (2012) 204 FCR 478, *Fowler v Federal Commissioner of Taxation* (2013) 212 FCR 149, *Davies v Deputy Commissioner of Taxation* (2015) 234 FCR 93 and *Re Van and Federal Commissioner of Taxation* (2002) 51 ATR 1153. The rights to acquire shares are not considered in this report.

¹⁸⁸ Div 83A-10(1) of the ITAA 1997.

¹⁸⁹ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.65.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

The general rule is that a taxpayer's assessable income includes any discount given on ESS interests acquired in terms of an employee share scheme.¹⁹⁰ The discount is the difference between the market value of the ESS interest and the consideration paid by the employee.¹⁹¹ In accordance with Div 83A-315(1) of the ITAA 1997, the ordinary meaning of market value must be used to determine the value of the share, however, in some cases the ordinary meaning may be affected by statutory rules.¹⁹²

Typically, there are two types of employee share schemes which employees can participate in, namely, those where the discount is taxed-upfront or, alternatively, taxed at a deferred point.¹⁹³ Depending on the type of employee share scheme, an employee may be entitled to: (i) a reduction of the amount included in his/her assessable income; or (ii) defer the taxing of the discount to a later date.¹⁹⁴

Taxed-upfront schemes

Subdivision 83A-B of the ITAA 1997 governs instances where the discount given on the acquisition of an ESS interest is included in an employee's assessable income at the time when the ESS interest is awarded. In South Africa, this is similar to the position when an unrestricted equity instrument is awarded to an employee (see discussion in chapter 2). An employee will be taxed on the value of the discount in the year in which the ESS interest is awarded in terms of a taxed-upfront scheme, where certain requirements for concessional tax treatment are met (hereinafter referred to as the "**General Requirements**"), namely:¹⁹⁵

- the ESS interest must be issued to the employee by the employer company or a holding company¹⁹⁶ of the employer. Stated differently, the employee must be employed by the company offering the scheme (or its holding company) at the time the interest is acquired;¹⁹⁷

¹⁹⁰ Division 83A-25(1) of the ITAA 1997.

¹⁹¹ Australian Taxation Office (2020) *Terms we use*. Available at <https://www.ato.gov.au/General/Employee-share-schemes/ESS-basics/Terms-we-use/> (last accessed on 13 March 2021 at 12:59pm).

¹⁹² See subdivision 960-S of the ITAA 1997 and O'Connell, A., (n.d.) *Employee share ownership plans – a comparative report*, p.7. Available at https://law.unimelb.edu.au/_data/assets/pdf_file/0007/1709764/45-Comparative_ESOP_Report_-_final_32.pdf (last accessed on 13 March 2021 at 11:52am).

¹⁹³ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.7. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

¹⁹⁴ Div 83A-1 of the ITAA 1997.

¹⁹⁵ Div 83A-25 of the ITAA 1997.

¹⁹⁶ A holding company is defined in s 9 of the Corporations Act 50 of 2001 as '...in relation to a body corporate, means a body corporate of which the first body corporate is a subsidiary.'

¹⁹⁷ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.29. Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

- the ESS interest must be an ordinary share¹⁹⁸ (i.e. preference shares are excluded from the operation of this division owing to the fact that there is less risk associated with these types of shares. For instance, preference shares may rank ahead of ordinary shares in the event of a company's liquidation);¹⁹⁹
- the ESS interest may not be disposed of for a period of three years unless the employee leaves the employ of the company.²⁰⁰ This requirement was included to ensure the employee is prohibited from disposing of the ESS interest immediately after claiming the concessional tax treatment;²⁰¹
- the predominant business of the employer company cannot be the buying or selling of shares;²⁰² and
- immediately after the acquisition of the ESS interest, the employee cannot hold a beneficial interest in more than 10% of the shares in the company or control more than 10% of the voting rights.²⁰³ This is to ensure that the benefits of the employee share scheme are spread widely amongst the employees (with no one single employee holding significant ownership in the company).²⁰⁴

An employee who acquires an ESS interest in terms of a taxed-upfront scheme may reduce the amount included in their taxable income (i.e. discount) by up to \$1,000 where, in addition to the abovementioned General Requirements the following requirements are met:

- the employee's adjusted taxable income²⁰⁵ for the year does not exceed \$180 000;²⁰⁶
- the employee share scheme is made available to at least 75% of the employer company's permanent employees (who are Australian residents);²⁰⁷ and

¹⁹⁸ Div 83A-45(2) of the ITAA 1997.

¹⁹⁹ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.29.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²⁰⁰ Div 83A-45(5) of the ITAA 1997.

²⁰¹ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.31. Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am). With reference to the start-up concession discussed below, a taxpayer may request the Commissioner to reduce the minimum holding period. Such a request may be granted where, *inter alia*, employees are required to dispose of their interests, for instance, where there is an initial public offering of the company. See Div 83A-45(5)(a) of the ITAA 1997.

²⁰² Div 83A-45(3) of the ITAA 1997.

²⁰³ Div 83A-45(6) of the ITAA 1997.

²⁰⁴ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.31.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²⁰⁵ Div 83A-35(2)(b) provides that an employee's taxable income after adjustments for the year is the sum of their:

- a) taxable income (including the total amount of all employee share scheme discounts);
- b) reportable fringe benefits total (if any);
- c) reportable superannuation contributions (if any); and
- d) total net investment loss.

²⁰⁶ Div 83A-35(1) and (2) of the ITAA 1997.

²⁰⁷ The permanent employees must have completed at least three years of service with the employer company. See Div 83A-35(6) of the ITAA 1997.

- there is no risk of the employee forfeiting the ESS interest (hereinafter referred to as the “**real risk of forfeiture**”) in terms of the conditions of the scheme.²⁰⁸ An ESS interest is deemed to be at a real risk of being forfeited where it could be concluded that there is a chance that the employee may forfeit the ESS interest, other than by way of disposal or lapse of the interest. This concept of forfeiture is discussed in further detail on page 45 below.

It is important to note that the \$1,000 limit has not been increased since 1997.²⁰⁹ Whilst it is possible, in certain instances, that the value of the discount may be absorbed by this reduction limit (due to the market value of the shares at the time of grant being a nominal amount), it is submitted that the taxed-upfront option may be more attractive to employees where the tax reduction limit takes into account to the time value of money.²¹⁰ It is further submitted that more employees would benefit from this concession if there was no limit with reference to the employee’s adjusted taxable income.²¹¹

Tax-deferred schemes

The taxation of ESS interests awarded in terms of tax-deferred schemes is governed by the provisions of Div 83A-C of the ITAA 1997. Where there is a real risk that the employee may forfeit the ESS interests granted in terms of an employee share scheme, the employee may defer the instance of tax to a later date (hereinafter referred to as the “**deferred taxing point**”).²¹² Stated differently, where an ESS interest (i) is acquired at a discount in terms of an employee share scheme, (ii) is subject to a real risk of forfeiture or acquired in terms of a salary sacrifice arrangement; and (iii) complies with a number of other requirements (discussed below), an employee may delay the inclusion of the discount in their taxable income to a deferred taxing point. Unlike with taxed-upfront schemes, the discount in relation

²⁰⁸ Division 83A-35(7) of the ITAA 1997. In addition, Div 83A-105(3) provides that a real risk arises under the conditions of the scheme where the employee would forfeit or lose the ESS interest (other than by disposing of it or in the case of rights to acquire shares, by exercising the right or allowing it to lapse).

²⁰⁹ Graw, S., (2016), Taxing Employee Share Schemes (ESS). Paper presented at the ATTA 2016 Conference – University of New South Wales, James Cook University. Available at https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Graw_Taxing-Employee-Share-Schemes.pdf (last accessed on 11 March 2021 at 22:00pm).

²¹⁰ Graw, S., (2016), Taxing Employee Share Schemes (ESS). Paper presented at the ATTA 2016 Conference – University of New South Wales, James Cook University. Available at https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Graw_Taxing-Employee-Share-Schemes.pdf (last accessed on 11 March 2021 at 22:00pm).

²¹¹ Graw, S., (2016), Taxing Employee Share Schemes (ESS). Paper presented at the ATTA 2016 Conference – University of New South Wales, James Cook University. Available at https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Graw_Taxing-Employee-Share-Schemes.pdf (last accessed on 11 March 2021 at 22:00pm).

²¹² Div 83A-100 of the ITAA 1997.

to tax-deferred schemes is the difference between the market value of the share at the deferred taxing point and the cost base²¹³ of the share.²¹⁴

As mentioned above, there are two instances in which the tax liability may be deferred to a later date, namely, where employees have acquired ESS interests, (i) in terms of a salary sacrifice arrangement; or (ii) there is a real risk that the employee may forfeit such interest under the conditions of the scheme.²¹⁵ Where the employee and the employee share scheme comply with specific requirements, the discount will not be included in the employee's income at the time of the award of the ESS interest. Instead, it will be taxed in the year that the deferred taxing point occurs.

Firstly, Div 83A-105 defines a salary sacrifice arrangement as one where an employee acquires a share (i) in return for a reduction in salary that would not have happened otherwise; or (ii) as part of the employee's remuneration package, in circumstances '*where it is reasonable to conclude that the employee's salary or wages would be greater if the ESS interest was not part of that package.*' Where an ESS interest is acquired as part of such an arrangement, Div 83A-105(2) and (4) of the ITAA 1997, provide that the following requirements must be met for tax deferral:

- at least 75% of the employer company's permanent employees (who are Australian residents)²¹⁶ must be entitled to acquire the ESS interest: (i) in terms of the employee share scheme; or (ii) in their employer company or a holding company of the employer in terms of another employee share scheme. This requirement will hereinafter be referred to as the "**broad availability condition**";²¹⁷
- there is a real risk of forfeiture of the ESS interest (other than, *inter alia*, through a disposal) under the terms of the scheme;²¹⁸
- at the time of acquiring the ESS interest –
 - the discount must be equal to the market value thereof²¹⁹ - i.e. the employee must receive the interest for no consideration;²²⁰

²¹³ In accordance with Div 110-25(2) of the ITAA 1997, the cost base on an asset consists of five elements, namely: (i) the acquisition cost; (ii) the incidental costs of acquiring or the asset; (iii) the costs of owning the asset; (iv) the costs associated with increasing or preserving the value of the asset; and (v) the cost to preserve or defend the owner's title or rights to the asset.

²¹⁴ Div 83A-110(1) of the ITAA 1997.

²¹⁵ Div 83A-100 of the ITAA 1997.

²¹⁶ The permanent employees must have completed at least three years of service with the employer company.

²¹⁷ Div 83A-105(2) of the ITAA 1997.

²¹⁸ Div 83A-105(3)(a) of the ITAA 1997.

²¹⁹ Div 83A-105(4)(b)(i) of the ITAA 1997.

²²⁰ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.43.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

- the scheme rules must expressly state that deferred taxation will apply to the scheme;²²¹ and
- the total market value of the ESS interest acquired by the employee must not exceed \$5,000 per annum.²²² This requirement was included in order to provide a concession to low- and middle-income employees.²²³

The second instance where tax deferral is possible is where an ESS interest is at a real risk of forfeiture.²²⁴ According to the Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 (“**2009 EM**”) that introduced this requirement, an ESS interest will be deemed to be at a real risk of forfeiture where:²²⁵

‘... a reasonable person would consider that there is a real risk that the employee would lose or forfeit the interest or never receive it, other than by selling or exercising it, by intentionally taking no action to realise the benefit, or through the market value of the ESS interest falling to nil.’

In this instance, the word ‘real’ refers to something that is ‘*more than a mere possibility*’.²²⁶ In other words, a risk will not be deemed to be ‘real’ where a reasonable person would disregard it on the basis that it is highly unlikely to occur.²²⁷ In the recent case of *Gennai and Commissioner of Taxation*²²⁸, the Administrative Appeals Tribunal (“**AAT**”) was asked to determine the meaning of what constitutes ‘a real risk’ that the taxpayer will forfeit the ESS interest in terms of the conditions of the employee share scheme. The AAT provided that, in order to determine whether there is such a real risk, one must have regard to the terms of the employee share scheme, particularly those that deal with the forfeiture or loss of the interest.²²⁹

As is evident from the *Gennai* case, the question of whether there is a real risk of forfeiture will depend on the facts and circumstances of each case.²³⁰ There are, however, a number

²²¹ Div 83A-105(4)(b)(iii) of the ITAA 1997.

²²² Div 83A-105(4)(c) of the ITAA 1997.

²²³ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.45.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²²⁴ The test of ‘real risk of forfeiture’ is also a requirement that is applicable to taxed upfront schemes where the employee may be eligible for the reduction of the discount. See above discussion on page 43.

²²⁵ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.30.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²²⁶ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.35.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²²⁷ In *Overseas Tankship (UK) Ltd v The Miller Steamship Co Pty Ltd (The Wagon Mound (No 2))* (1966) UKPC 1; [1967] 1 AC 617, it was held that the words ‘real risk’ are defined in Butterworth’s Concise Australian Legal Dictionary as being ‘one that a reasonable person would not brush aside as being far-fetched or fanciful.’

²²⁸ (2020) AATA 4667.

²²⁹ *Gennai v FC of T 2020 ATC 10-556; [2020] AATA 4667* at para 62.

²³⁰ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.38.

of tests for measuring whether such a risk exists. For instance, there is a real risk of forfeiture where an employee is legally compelled to transfer the ESS interest back to the issuer company.²³¹ There is also a real risk of forfeiture where a share is subject to a ‘*meaningful performance hurdle*’ or, alternatively, where a minimum term of employment is not complied with.²³² In addition, there will be a real risk of forfeiture where the share is subject to forfeiture when the employment ceases, except for when the employee is a ‘good leaver’ (e.g. employment terminates as a result of the employee being ill or the company being sold).²³³ There will be no real risk of forfeiture where the share is forfeited due to an act entirely within the employee’s control, for example where there is gross misconduct or the employee commits fraud.²³⁴

Where taxation on an ESS interest is deferred in terms of either a salary sacrifice or where there is a real risk of forfeiture, the difference between the market value of the ESS interest and the cost base will be included in assessable income of the employee at the deferred taxing point.²³⁵ Of particular importance to this report is the deferred taxing point in the case of shares,²³⁶ which is the earliest of when: (i) there is no real risk of forfeiture of the ESS interests;²³⁷ (ii) there is no genuine restriction preventing the employee from disposing the interest;²³⁸ (iii) the employment ceases; or (iv) fifteen years have lapsed from the date of acquiring the interest.²³⁹ The rationale for not allowing employees to defer the tax for an unlimited period was noted in the 2009 EM:²⁴⁰

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²³¹ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.35.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²³² The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.36.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²³³ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.37.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²³⁴ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.38.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²³⁵ Div 83A-110(1) of the ITAA 1997.

²³⁶ The deferred taxing point depends on whether the ESS interest is a share or right to acquire a share. In the case of a right to acquire a share, it is the earliest of when: (i) the employment in respect of which the right was acquired ceases; (ii) fifteen years after the right was acquired; or (iii) there are no genuine restrictions on disposal of the right or restrictions on exercising the right and disposing of the share. See Div 83A-120 of the ITAA 1997.

²³⁷ Div 83A-120(4)(a) of the ITAA 1997.

²³⁸ Div 83A-120(4)(b) of the ITAA 1997. The 2009 EM provides, at page 46, that a genuine restriction that prevents the disposal of an ESS interest includes a condition of the scheme that contractually prevents the disposal of the shares. A disposal restriction that can be lifted in the case of, for example, financial hardship, will be considered a genuine restriction. It is important to note that a disposal restriction that is subject to manipulation will not be considered a genuine restriction.

²³⁹ Div 83A-115 of the ITAA 1997.

²⁴⁰ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.46.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

'The deferral period is limited by the ESS deferred taxing points to ensure fairness, continue to align the interests of the employer and employee, and preserve the integrity of the tax system by preventing unlimited deferral of tax on employment remuneration.'

It is important to note that the restrictions covered by the deferred taxing points are only those that existed when the employee acquired the ESS interest. Where subsequent restrictions are placed on the ESS interests after acquisition, those are not taken into account when determining the deferred taxing point.²⁴¹

Start-up company concession

In 2015, the Australian government introduced reforms to, *inter alia*, encourage entrepreneurship and support the growth of early-stage businesses through assisting start-up companies to be more competitive in attracting and retaining employees.²⁴² These reforms culminated in a start-up company concession which introduced an incentive for small start-up businesses to utilise employee share schemes.²⁴³

Where certain requirements are met by the start-up employer company and the employee share scheme, the discount acquired on ESS interest will not be included in the employee's assessable income upfront.²⁴⁴ Instead, the employee will pay capital gains tax when the ESS interest is disposed of.²⁴⁵ In other words, the discount on the ESS interest is not treated as income, but as part of an asset for capital gains tax purposes. The capital gains tax treatment of ESS interests is discussed below. Importantly, employees that are eligible for the small start-up concession, cannot access any of the other tax concessions discussed above.²⁴⁶

In order to access the start-up company concession, the following requirements must be complied with:

²⁴¹ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.48.

Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²⁴² The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.4. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁴³ The concession is contained in Div 83A-33 of the ITAA 1997.

²⁴⁴ Div 83A-33(1) of the ITAA 1997.

²⁴⁵ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.20. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁴⁶ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.20. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

- General Requirements. As mentioned above, these requirements include that the ESS interest, which must be an ordinary share, may not be disposed for a period of at least three years and cannot entitled the employee to more than 10% of the voting rights in the employer company. See the full list of the requirements on page 42 above;²⁴⁷
- broad availability condition.²⁴⁸ As mentioned above, this condition requires that the employee share scheme must be made available to at least 75% of the company's permanent employees who have completed three years of service. In certain instances, companies that have recently been formed may not be able to meet this requirement.²⁴⁹ For instance, a company that was formed in 2020 will not have employees that have completed three years of service. The Australian Taxation Office²⁵⁰ (“ATO”) released Interpretative Decision 2003/24 which indicated that shares acquired by an employee in terms of an employee share scheme will be qualifying shares where the employer has no permanent employees;²⁵¹
- the employer start-up company, which must be an Australian resident taxpayer company,²⁵² cannot be listed on a stock exchange.²⁵³ Listed companies cannot benefit from this concession on the basis that such a company will have more access to capital and therefore be able to attract and retain employees much easier than an unlisted entity;²⁵⁴
- the employer start-up company must have been incorporated for less than ten years and must have a turnover of not more than \$50 million;²⁵⁵ and
- the discount on the ESS interest cannot exceed 15% of the market value of the interest on the date of acquisition.²⁵⁶ In other words, this concession only applies in instances

²⁴⁷ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.20. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁴⁸ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.21. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁴⁹ Graw, S., (2016), Taxing Employee Share Schemes (ESS). Paper presented at the ATTA 2016 Conference – University of New South Wales, James Cook University. Available at https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Graw_Taxing-Employee-Share-Schemes.pdf (last accessed on 11 March 2021 at 22:00pm).

²⁴⁹ Div 83A-100 of the ITAA 1997.

²⁵⁰ Australian Taxation Office Interpretative Decision 2003/24 ‘Employee share scheme: Permanent Employees requirement for Qualifying Shares’. Available at <https://www.ato.gov.au/law/view/document?Mode=type&TOC=%2205%3AATO%20interpretative%20decisions%3AB%20year%3A2003%3A1-99%3A%230024%23ATO%20ID%202003%2F24%20-%20Employee%20share%20scheme%26c%20Permanent%20Employees%20requirement%20for%20Qualifying%20Shares%3B%22&DOCID=%22AID%2FAID200324%2F00001%22> (last accessed on 16 March 2021 at 12:25pm).

²⁵¹ The Interpretative Decision applied to an equivalent provision provided by Division 13A of Part III of the ITAA 1936 which was repealed by the Tax Law Amendment (2009 Budget Measures No. 2) Act 2009 (133 of 2009), which introduced Div 83A.

²⁵² Div 83A-33(6) of the ITAA 1997.

²⁵³ Div 83A-33(2) of the ITAA 1997.

²⁵⁴ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.21. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁵⁵ Div 83A-33(3) and (4) of the ITAA 1997.

²⁵⁶ Div 83A-33(5)(a) of the ITAA 1997.

where a small discount is provided to employees. This is to ensure that the concession is not open to abuse through disguised salary arrangements.²⁵⁷

Refund of income tax paid where ESS interests are forfeited

Div 83A-310 of the ITAA 1997 allows an employee to claim a refund²⁵⁸ of the tax paid, in certain instances, where the interests are forfeited after the employee has been taxed on the discount.²⁵⁹ Such instances include where the employee had no other option but to forfeit the interest (for instance where the employee does not satisfy a performance condition linked to the ESS interest)²⁶⁰ or alternatively, where the employment ceased and the interest was forfeited as a result.²⁶¹ Under these circumstances, the forfeited ESS interest will be treated as though it was not acquired²⁶² and the employee may claim the refund by amending their tax assessment.²⁶³ In addition, there is no time limit within which the refund may be claimed.²⁶⁴

It is interesting to note that where the employee share scheme includes a condition which protects the employee against any decline in the market value of the interest, such employee will not be able to claim the refund (unless the employee leaves the employ of the company).²⁶⁵

Capital gains tax on disposal of ESS interests

In most instances, ESS interests are exempt from capital gains tax until the discount on the interest has been taxed.²⁶⁶ This is owing to the recognition by Australian tax law that the

²⁵⁷ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.23. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁵⁸ The refund also applies where an employee chooses not to exercise a right (to acquire shares) which subsequently lapses. See Div 83A-310(2)(b) of the ITAA 1997.

²⁵⁹ There are different rules, depending on when the ESS interest was acquired. For purposes of this report, we will only look at the rules applicable to ESS interests acquired after 1 July 2015. The discussion and references to the 2009 EM in this report relate to those rules that were not amended by the reforms introduced on 1 July 2015. See Australian Taxation Office (2020) *ESS interests acquired after 30 June 2009*. Available at https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Restrictions-and-forfeiture/Lapsed-and-forfeited-employee-share-scheme-interests/?page=2#ESS_interests_acquired_from_1_160_July_2015 (last accessed on 16 March 2021 at 15:06pm).

²⁶⁰ Allens Arthur Robinson (2010) *Employee Share Schemes – What you Need to Know about the New Tax Rules*, p.14. Available at <https://data.allens.com.au/pubs/pdf/tax/paptaxmay10.pdf> (last accessed on 17 April 2021 at 22:39pm).

²⁶¹ Div 83A-310(1)(c) read with 310(2)(a) of the ITAA 1997.

²⁶² Div 83A-310 (1) of the ITAA 1997.

²⁶³ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.18. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁶⁴ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.18. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

²⁶⁵ Div 83A-310(1)(c)(ii) of the ITAA 1997.

²⁶⁶ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.50. Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

shares awarded in terms of an employee scheme are both a component of an employee's remuneration package as well as a capital asset (i.e. an investment).²⁶⁷ In the context of tax-deferred schemes, where an employee disposes of an ESS interest *within* 30 days after the earliest deferred taxing point (see discussion above), the time of the disposal will be deemed to be the deferred taxing point.²⁶⁸ Accordingly, the discount on the ESS interest will be taxed as income. Where, however, the ESS interest is disposed of *after* 30 days of the earliest deferred taxing point and a gain is realised, such will be subject to capital gains tax.²⁶⁹

Div 83A-30 of the ITAA 1997 provides that where the discount is taxed upfront, the ESS interest will be deemed to have been acquired for its market value (rather than its discounted value) at the date of acquisition. This is similar to the treatment in terms of South African law where the market value of the equity instrument at the vesting date is deemed to be the base cost (see discussion in chapter 2). On the other hand, Div 83A-125 notes that for ESS interests where the tax has been deferred, the ESS interest will be deemed to have been reacquired at its market value immediately after the deferred taxing point. The implication of this is that the cost base of the ESS interest will be the market value thereof and the acquisition date thereof will be reset, which is relevant when applying the capital gains tax discount afforded by Div 115 of the ITAA 1997.²⁷⁰ In accordance with Div 115-25(1) of the ITAA 1997, an individual²⁷¹ who holds an asset longer than 12 months may discount 50% of the gain where certain requirements are met.²⁷² Stated differently, such an individual will be subject to capital gains tax on only 50% of the gain.²⁷³

Deduction for the employer and withholding obligations

An employer may claim a deduction where the company issues ESS interests to employees in terms of a taxed-upfront scheme that meets the requirements for eligibility for the \$1,000

²⁶⁷ Australian Taxation Office (2020) *Edited private advice – Employee Share Schemes*. Available at <https://www.ato.gov.au/law/view/document?src=rs&pit=20210318000000&arc=false&start=31&pageSize=10&total=201&num=8&docid=EV%2F1051775005901&dc=false&styp=find&df=49&df=68&df=96&df=98&tm=and-basic-division%2083A> (last accessed on 18 March 2021 at 02:09am).

²⁶⁸ Div 83A-120(3) of the ITAA 1997.

²⁶⁹ O'Connell, A., (n.d.) *Employee share ownership plans – a comparative report*, p.9. Available at [https://law.unimelb.edu.au/_data/assets/pdf_file/0007/1709764/45-Comparative ESOP Report - final 32.pdf](https://law.unimelb.edu.au/_data/assets/pdf_file/0007/1709764/45-Comparative_ESOP_Report_-_final_32.pdf) (last accessed on 13 March 2021 at 11:52am).

²⁷⁰ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p52. Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

²⁷¹ Or a small business.

²⁷² The requirements are set out in Div 115-A(5) – (34) of the ITAA 1997. These requirements are not discussed as part of this report.

²⁷³ See *Mangat and Commissioner of Taxation* (2018) AATA 3012 where the taxpayer was found not to be entitled to a capital gain discount in relation to the cancellation of shares that were granted in terms of an employee share scheme. The court affirmed the position that whether the taxpayer is entitled to the capital gain discount depends on the date of acquisition of the ESS interest and whether the interest was acquired at least 12 months before the cancellation of shares.

reduction.²⁷⁴ The deduction is limited to the amount of the concession (i.e. maximum of \$1,000).²⁷⁵

An employer who issues ESS interests to an employee is required to withhold tax only when the employee has not provided the employer with his/her tax file number by the end of the relevant year of assessment.²⁷⁶ Accordingly, where an employee does not provide the tax file number, the employer must withhold tax from the employee's salary and pay this over to the ATO.²⁷⁷ The withholding tax is calculated on the discount that the employee must include in his/her assessable income.²⁷⁸

There are a number of reporting obligations that the employer needs to comply with. For instance, the employer must provide the employee with information relating to the ESS interests, such as, the number of interests acquired, the acquisition date and price, as well as the market value of the interests.²⁷⁹

3.3. Tax legislation applicable to employee share schemes in Singapore

In Singapore, the taxation of employee share schemes is governed by the provisions of s 10(6) of the Income Tax Act (Chapter 134) (Original Enactment: Ordinance 39 of 1947) ("**SITA**").²⁸⁰ This section provides that where an employee is awarded a share by virtue of his/her employment in Singapore, any gain – which is based on the difference between the market value²⁸¹ of the share less any consideration paid for the share – will be deemed to be income. This income will be taxable in the year in which the share is awarded unless there is a moratorium placed on the disposal of the share – then tax will be levied on the date when the moratorium is lifted. A moratorium refers to the period of time within which an employee is not allowed to dispose of shares granted in terms of an employee share scheme.²⁸²

²⁷⁴ Div 83A-205(1) of the ITAA 1997.

²⁷⁵ Div 83A-205(3) of the ITAA 1997. The deduction is available irrespective of whether the employee's adjusted taxable income is \$180 000 or less, in accordance with Div 83A-205(2) of the ITAA 1997.

²⁷⁶ See ss14-155(1) and (3) in Schedule 1 to the Tax Administration Act, 1 of 1953. The employee will be required to include the discount in his/her tax return.

²⁷⁷ Australian Taxation Office (2021) *ESS – Reporting requirements for employers*. Available at https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Employer-reporting-requirements/ESS---Reporting-requirements-for-employers/?page=1#TFN_withholding_for_ESS (last accessed on 18 April 2021 at 17:42pm).

²⁷⁸ The rate of withholding is the highest individual marginal tax rate plus the Medicare levy. See Australian Taxation Office (2020) *Tax file number (TFN) declarations*. Available at <https://www.ato.gov.au/rates/fortnightly-tax-table/?page=2#:~:text=If%20the%20employee%20has%20not,we%20tell%20you%20not%20to>. (last accessed on 16 March at 20:58pm).

²⁷⁹ See Australian Taxation Office (2021) *ESS – Reporting requirements for employers*. Available at <https://www.ato.gov.au/General/Employee-share-schemes/In-detail/Employer-reporting-requirements/ESS---Reporting-requirements-for-employers/> (last accessed on 18 April 2021 at 17:42pm).

²⁸⁰ Section 10(6)(a) and (b) of the SITA. This applies to shares awarded after 1 January 2003.

²⁸¹ Where the market value of the shares of an unlisted entity is unknown, the net asset value of the shares will be used instead.

²⁸² See Inland Revenue Authority of Singapore *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.3. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome-e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

In Singapore, an employee share ownership plan is a plan in terms of which an employee is granted shares in an employer company or its holding company, while the employee is exercising employment in Singapore.²⁸³ For purposes of this report, these plans will hereinafter simply be referred to as employee share schemes.

Typically, employees can participate in employee share schemes (i) which provide tax incentives for the gains derived (referred to as Equity Remuneration Incentive Schemes); and (ii) where the payment of the tax on the gains may be deferred to a later date (referred to as the Qualified Employee Equity-Based Remuneration Scheme).²⁸⁴

Equity Remuneration Incentive Schemes

As mentioned above, the Equity Remuneration Incentive Schemes (“**ERIS Schemes**”) provide a tax incentive for employees who are participants of employee share schemes. These incentives take the form of an exemption from tax of an amount which ranges between 25% and 75% of the gains derived from employee share schemes.²⁸⁵ The exemptions are applicable to three types of ERIS Schemes, namely those that apply to (i) small and medium enterprises (“**SMEs**”), (ii) all corporations; and (iii) start-up companies. It is important to note that the ERIS schemes were phased out as of 31 December 2013, in order to rationalise the tax treatment of employee share schemes.²⁸⁶ Although employees were no longer able to claim the tax incentives as of 1 January 2014, employees who were granted shares prior to 31 December 2013 will continue to enjoy the exemptions until 31 December 2023.²⁸⁷ Each of these ERIS Schemes is discussed below.

In order to encourage entrepreneurship, the ERIS Schemes for SMEs was introduced to provide a tax exemption for employees of ‘*high tech entrepreneurial companies*’.²⁸⁸ The

²⁸³ Singaporean law also makes provision for employee share option plans where options to acquire shares at a future date are awarded to employees. See Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.2. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm). This report will only deal with the laws applicable to employee share ownership plans.

²⁸⁴ Inland Revenue Authority of Singapore (n.d.) *Stock Options*. Available at [https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,Equity%20Remuneration%20Incentive%20Schemes%20\(ERIS\),plans%20granted%20by%20their%20employers](https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,Equity%20Remuneration%20Incentive%20Schemes%20(ERIS),plans%20granted%20by%20their%20employers) (last accessed on 21 September 2020 at 06:30am).

²⁸⁵ Sections 13J, 13L and 13M of the SITA.

²⁸⁶ Singapore Ministry of Finance *Budget Speech 2013*. Available at https://www.mof.gov.sg/docs/default-source/default-document-library/singapore-budget/budget-archives/2013/fy2013_budget_statement.pdf (last accessed 20 March 2021 at 10:11am).

²⁸⁷ Singapore Ministry of Finance *Budget Speech 2013*. Available at https://www.mof.gov.sg/docs/default-source/default-document-library/singapore-budget/budget-archives/2013/fy2013_budget_statement.pdf (last accessed 20 March 2021 at 10:11am).

²⁸⁸ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.3. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm). Please note that the scheme was not only introduced for SMES in the high technology

exemption applies to 50% of the gains²⁸⁹ derived from an employee share scheme, which is available over a period of ten years, subject to certain requirements.²⁹⁰ More specifically, s 13J(1) of the SITA provides that where a 'qualifying employee', who acquires a share in a 'qualifying company' in terms of an employee share scheme, derives any gain from a share granted between 1 January 2002 to 31 December 2013, 50% of such gain shall be exempt from tax.

In order to qualify for the exemption, the employee must:²⁹¹

- be employed by a qualifying company;
- not hold more than 25% of the shares and voting rights in the qualifying company; and
- be committed to work at least 30 hours a week for the qualifying company. Where the employee is committed to work less than that number of hours, at least 75% of his/her total working time²⁹² per week must be for the qualifying company.

A 'qualifying company' is defined in s13(J)(10) of the SITA as a company incorporated in Singapore which carries on business in Singapore and has gross assets not exceeding \$100 million. A parent company of the employer company can also be a 'qualifying company' for purposes of s 13(J). In other words, an employee may claim the tax exemption where the shares acquired are shares in the parent company of the employer company.²⁹³

In addition to the above requirements, the tax exemption only applies to cumulative gains of the employee which do not exceed \$10 million over a ten year period.²⁹⁴ Furthermore, s 13J will not apply where the gain arises as a result of the employee's employment terminating due to his misconduct (i.e. where the employee is a 'bad leaver').²⁹⁵ Importantly, as mentioned above, these gains, which are subject to a minimum holding period (discussed below), must be derived before 31 December 2023.²⁹⁶

sector, but is available for SMEs in all sectors. See Parliament of Australia (n.d.) *Appendix F – Employee Share Plans in other countries*, p.256. Available at https://www.aph.gov.au/parliamentary_business/committees/house_of_representatives_committees?url=ewr/eso/report/appendixf.pdf (last accessed on 22 March 2021 at 21:37pm).

²⁸⁹ The tax exemption applies to gains from ordinary shares only. Accordingly, the exemption will not apply to, for example, preference shares.

²⁹⁰ Section 13J of the SITA.

²⁹¹ See definition of 'qualifying employee' in s 13J(10) of the SITA. The requirements must be complied with at the time of the grant of the share.

²⁹² Section 13J(1) defines the 'total working time' is as the total period of time the employee spends as an employee for all his employers.

²⁹³ See Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.7. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

²⁹⁴ Section 13J(3)(a) and (b) of the SITA.

²⁹⁵ Section 13J(3)(c) of the SITA.

²⁹⁶ Section 13J(9A) of the SITA.

The tax exemption provided in s 13J will only apply after the expiry of a minimum holding period, which is dependent on whether the share was acquired at a discount or at market value. This period is known as the vesting period.²⁹⁷ The rule here is that where the employee acquired the share at, or more than, market value, the employee may not dispose of the share within six months from the date of grant. Conversely, where the employee acquired the share at a discount to market value (at the time of acquisition), the employee may not dispose of the share within one year from the date of the grant.²⁹⁸

The purpose of the ERIS Scheme for all corporations was to encourage employees of companies that do not qualify for the tax exemption provided by the ERIS Scheme for SMEs to participate in employee share schemes. The exemption, which applies to employees of a company incorporated in Singapore or a branch of a foreign entity which is registered in Singapore, allows employees to claim an exemption on the first \$2,000 of the gains plus a further exemption of 25% on the remaining gains. This exemption is subject to certain requirements, which are discussed below.

Section 13L of the SITA provides that where a 'qualifying employee', who acquires a share in a 'qualifying company' in terms of an employee share scheme, derives any gain from a share granted between 1 January 2002 to 31 December 2013, the first \$2,000 of such gain plus 25% of any gain exceeding \$2,000 shall be exempt from tax. In order to qualify for the exemption, the employee must: (i) be employed by a qualifying company (which is defined, for purposes of s 13L, as a company incorporated in Singapore which carries on business in Singapore); and (ii) not hold more than 25% of the shares and voting rights in the qualifying company. Another requirement, which is only applicable to this ERIS Scheme for all corporations, is that the qualifying company must offer the employee share scheme to at least 25% of its employees.²⁹⁹ This 25% requirement is determined in accordance with the ratio that the total number of employees to whom shares are offered in terms of the employee share scheme bears to the total number of employees³⁰⁰ as at 31 December³⁰¹ of that year.

²⁹⁷ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.10. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

²⁹⁸ See definition of 'minimum holding period' in s13J(10) of the SITA. These vesting periods are prescribed by the rules of the Singapore Exchange. In addition, the minimum holding period applies to all ERIS Schemes.

²⁹⁹ See definition of 'relevant percentage requirement' in s 13L(5) of the SITA. This requirement applies to shares granted on or after 16 February 2008.

³⁰⁰ In determining the total number of employees, part time employees, full time employees with less than one year service and contract employees are not included. See definition of 'specified formula' in s 13L(5) of the ITA.

³⁰¹ The 25% requirement is determined at the end of each calendar year.

In addition to the above requirements, the tax exemption only applies to cumulative gains of the employee which do not exceed \$1 million over a ten year period.³⁰² Furthermore, s13L will also not apply where the employee is a ‘bad leaver’.³⁰³ Importantly, as mentioned above, these gains, which are also subject to the same minimum holding period applicable to s 13J (as discussed above), must be derived before 31 December 2023.³⁰⁴

It is possible for a company’s employee share scheme to meet the requirements of both ss 13J and 13L respectively.³⁰⁵ In this regard, s 13J(6) of the SITA provides that the employer company must opt for one of the ERIS Schemes to apply to the gains derived from the employee share scheme. It is important to note, however, that where a company has opted for the ERIS Scheme for SMEs, such employer may switch to the ERIS Scheme for all corporations to the extent that: (i) the market value of the company’s assets exceeds the \$100 million threshold; and (ii) the company complies with all the other requirements of s 13L.³⁰⁶ Notwithstanding the above, a company that first opted for the ERIS Scheme for all corporations may not switch to the ERIS Scheme for SMEs even where all the requirements have been met.³⁰⁷

As is the case with the Australian start-up company concession, the ERIS Scheme for start-ups companies was initiated to ‘*improve the attractiveness of equity-based compensation tools for new start-up companies*’ by providing an exemption that applies to 75% of the gains derived from an employee share scheme, which is available over a period of ten years, subject to certain requirements.³⁰⁸ More specifically, s 13M(1) of the SITA provides that where a ‘qualifying employee’, who acquires a share in a ‘qualifying company’ in terms of an employee share scheme, derives any gain from a share granted between 16 February 2008 to 15 February 2013, 75% of such gain shall be exempt from tax. In order to be classified as a ‘qualifying employee’, the employee must (as is the case with the ERIS Schemes for SMEs) comply with the following requirements:³⁰⁹

- be employed by a ‘qualifying company’ (see below definition);

³⁰² Section 13L(3)(a) and (b) of the SITA.

³⁰³ Section 13L(3)(c) of the SITA.

³⁰⁴ Section 13L(3A) of the SITA.

³⁰⁵ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.16. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³⁰⁶ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.16. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³⁰⁷ Section 13L(8) of the SITA.

³⁰⁸ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.3. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³⁰⁹ See definition of ‘qualifying employee’ in s 13J(10) of the SITA. The requirements must be complied with at the time of the grant of the share.

- not hold more than 25% of the shares and voting rights in the qualifying company; and
- be committed to work at least 30 hours a week for the qualifying company. Where the employee is committed to work less than that number of hours, at least 75% of his/her total working time per week must be for the qualifying company.

In this instance, a qualifying company is defined in s 13(M)(7) of the SITA as a company incorporated in Singapore which carries on business in Singapore and has gross assets not exceeding \$100 million. An added requirement (which does not feature in the ERIS Schemes for SMEs) is that the qualifying company must have been incorporated for three years or less and must have its total share capital held by no more than 20 shareholders, all of whom are individuals, and at least one of whom is an individual who holds at least 10% of the total number of issued ordinary shares in the company.

In addition to the above requirements, the tax exemption only applies to cumulative gains of the employee which do not exceed \$10 million over a ten year period.³¹⁰ Furthermore, s13M will also not apply where the employee is a 'bad leaver'.³¹¹ Importantly, as mentioned above, these gains, which are also subject to the same minimum holding period applicable to ss 13J and 13L (as discussed above), must be derived before 31 December 2023.³¹²

In light of the above ERIS Schemes, it is important to note that the basis of taxing gains from employee share schemes as set out in s 10(6) of the SITA (as discussed above) is not amended by the ERIS Schemes.³¹³ Where a share is granted to the employee at a discount (i.e. where the consideration payable for the share is less than the market value thereof), the ERIS Scheme tax exemptions are only applicable to the gain less any discount enjoyed by the employee when the shares are awarded.³¹⁴

An employee may apply to defer the tax payable on gains (after taking into account the exemptions provided by the ERIS Schemes) for up to five years, subject to complying with the requirements of the tax deferral scheme known as the Qualified Employee Equity-Based Remuneration Scheme.³¹⁵

³¹⁰ Section 13M(3)(a) and (b) of the SITA.

³¹¹ Section 13M(3)(c) of the SITA.

³¹² Section 13M(5A) of the SITA.

³¹³ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.13. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³¹⁴ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.13. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³¹⁵ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.4. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

Qualified Employee Equity-Based Remuneration Scheme

The gains derived by an employee from an employee share scheme are subject to tax in the year of assessment in which the share is awarded, or where there are restrictions imposed on the shares, the tax charge arises when the restrictions are lifted.³¹⁶ Typically, the employee is required to pay the tax within one month after the gain has been assessed.³¹⁷ In order to ease the cash flow constraints that may arise where an employee is unable to dispose of the shares to settle the tax liability³¹⁸, the Qualified Employee Equity-Based Remuneration Scheme (“**QEEBR Scheme**”) was introduced in 1999.³¹⁹

In terms of the QEEBR Scheme, employees who are granted shares in terms of an employee share scheme may defer (for a period calculated from the first of January in the year of assessment in which the gains are assessed) the tax payable on the gains for a period of up to five years, subject to an interest charge. The rate of interest is based on the average prime rate of three designated Singapore banks as at 15 April each year and the simple interest rate method is used to calculate the interest charge. The following requirements must be met for tax deferral:

- the shares granted in terms of the employee share scheme must be restricted and subject to the same minimum holding period (discussed above in the context of ERIS Schemes);
- the employee must be employed in Singapore at the time of grant of the shares;
- the shares must be awarded to the employee company by his/her employer company or an associated company of the employer;
- the tax on the gains, which cannot be less than \$200, cannot be paid by the employer on behalf of the employee; and
- the employee cannot, *inter alia*, be bankrupt or a delinquent taxpayer based on the revenue authority’s records.³²⁰

³¹⁶ Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.4. Available at https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

³¹⁷ Leng, C.Y., (2019) *International Stock Plans: The Practitioner’s Guide to Exporting Employee Equity (Singapore Guide)*, p.5. Available at <https://www.naspp.com/NASPPAttachments/NASPP/80/8099278d-efef-4cb4-9db6-f2db94591ffa.pdf> (last accessed on 21 September 2020 at 06:16am).

³¹⁸ Where a taxpayer does not wish to apply for the tax deferral, the employee may arrange to pay the tax via instalments. See Inland Revenue Authority of Singapore (n.d.) *Individuals*. Available at <https://www.iras.gov.sg/IRASHome/Quick-Links/Payments/Individuals/> (last accessed on 21 March 2021 at 17:22pm).

³¹⁹ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.8. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³²⁰ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), pp.8 - 10. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

The amount of deferred tax and interest will become payable immediately where the employee; (i) becomes bankrupt; or (ii) passes away.³²¹ Where the employee sells the shares upon which the tax deferral is granted, the deferral will not be terminated.³²²

It is interesting to note the QEEBR Scheme is not widely used in Singapore owing to the applicable interest charge.³²³ In order to assist employees with mitigating the liquidity issues that may arise when they are required to settle the tax liability due upon the exercise of share awards, Deloitte Singapore recommended the following proposals to make the QEEBR more attractive:

- the interest charge should apply from the fourth year of tax deferral (i.e. no interest should be levied for the first three years of deferral); or alternatively,
- the rate of interest should be lower than the average prime rate.

Having regard to the phasing out of the ERIS Schemes as of 1 January 2024, employees will need to determine if it is tax-efficient for them to participate in employee share schemes where the only available concession is the QEEBR Scheme.³²⁴

Capital gains tax on disposal of shares

It is interesting to note that capital gains are not taxable in Singapore.³²⁵ Accordingly, where an employee disposes of shares granted in terms of an employee share scheme, any gain realised will not be taxable. Where an employee is, however, considered to be a share dealer, any gains will be considered of a revenue nature and will therefore be taxable.³²⁶

³²¹ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.11. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³²² Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.11. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³²³ Deloitte (2018) *Singapore Budget 2018 Feedback*, p.37. Available at <https://www2.deloitte.com/content/dam/Deloitte/sg/Documents/tax/sg-tax-singapore-budget-2018-feedback.pdf> (last accessed on 16 September 2020 at 23:07pm).

³²⁴ Deloitte (2013) *Global Rewards Update: Singapore — Phasing out the Equity Remuneration Incentive Scheme (ERIS)*. Available at <https://www.globalequity.org/geo/sites/default/files/Global%20Rewards%20Update%20-%20Singapore%20-%20March%202013.pdf> (last accessed on 24 January 2021 at 20:55pm).

³²⁵ Inland Revenue Authority of Singapore (n.d.) *Gains from Sale of Property, Shares and Financial Instruments*. Available at <https://www.iras.gov.sg/irashome/Individuals/Locals/Working-Out-Your-Taxes/What-is-Taxable-What-is-Not/Gains-from-Sale-of-Property--Shares-and-Financial-Instruments/> (last accessed on 21 March 2021 at 18:07pm).

³²⁶ Inland Revenue Authority of Singapore (n.d.) *Gains from Sale of Property, Shares and Financial Instruments*. Available at <https://www.iras.gov.sg/irashome/Individuals/Locals/Working-Out-Your-Taxes/What-is-Taxable-What-is-Not/Gains-from-Sale-of-Property--Shares-and-Financial-Instruments/> (last accessed on 21 March 2021 at 18:07pm).

Deduction for the employer and the employees' tax withholding requirements

An employer may not claim a deduction for any cost borne for the employee share scheme or any shares awarded as part thereof.³²⁷ In addition, the employer company is not required to withhold tax from the income of the employee,³²⁸ and accordingly, the employee must declare the gain derived from the employee share scheme in his/her tax return.³²⁹

There are, however, a number of reporting obligations that the employer needs to comply with.³³⁰ For instance, the employer must provide the employee with an annual return of remuneration, which provides all the details of the gains, in the prescribed format.³³¹

3.4. Conclusion

In this chapter, the legislative framework that governs the requirements, tax implications and ancillary matters that are applicable to share incentive schemes in Australia and Singapore respectively was analysed. This analysis indicated that these respective jurisdictions recognise the potential cash flow problems that may arise for employees when they are required to settle the tax due upon the vesting of their share awards. Such recognition is evident from the mechanisms afforded by each jurisdiction to assist employees with these potential liquidity problems.

For instance, in the context of the Australian tax legislation, an employee who has participated in a taxed-upfront scheme may reduce his/her taxable income by up to \$1,000 or claim a refund of the tax paid where the shares are forfeited. Alternatively, the employee may defer the payment of the tax in relation to his/her employee share scheme interests until they have cash to settle the tax liability. Singapore also provides a tax deferral scheme, which is subject

³²⁷ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.5. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³²⁸ Unless the employer company is a participant of the Auto-Inclusion Scheme, which allows employers to submit the income information of their employees to the IRAS electronically. See Inland Revenue Authority (n.d.) *Tax Filing for Employees of AIS Employers*. Available at <https://www.iras.gov.sg/IRASHome/Individuals/Locals/Getting-it-right/Other-Services/Tax-Filing-for-Employees-of-AIS-Employers/> (last accessed on 19 April 2021 at 21:25pm).

³²⁹ Inland Revenue Authority of Singapore (n.d.) *Stock Options*. Available at [https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,%20Equity%20Remuneration%20Incentive%20Schemes%20\(ERIS\),plans%20granted%20by%20their%20employers](https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,%20Equity%20Remuneration%20Incentive%20Schemes%20(ERIS),plans%20granted%20by%20their%20employers) (last accessed on 21 September 2020 at 06:30am).

³³⁰ Inland Revenue Authority of Singapore (n.d.) *Stock Options*. Available at [https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,%20Equity%20Remuneration%20Incentive%20Schemes%20\(ERIS\),plans%20granted%20by%20their%20employers](https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,%20Equity%20Remuneration%20Incentive%20Schemes%20(ERIS),plans%20granted%20by%20their%20employers) (last accessed on 21 September 2020 at 06:30am).

³³¹ Where the company submits salary data electronically it may provide the return in any format. See Inland Revenue Authority of Singapore (2013) *Equity Remuneration Incentive Scheme (ERIS)* (Second Edition), p.18. Available at https://www.iras.gov.sg/iras/home/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ERIS_2013-04-26.pdf (last accessed on 23 January 2021 at 23:25pm).

to an interest charge and employees may claim a tax exemption of up to 75% of the gains derived from employee share schemes, depending on the applicable ERIS Scheme.

In addition, it is submitted that the start-up company concessions offered in both jurisdictions ensure that the local start-up companies are more competitive by encouraging the local development of ideas, which ultimately contributes to a country's economic growth.

Accordingly, it is submitted that, the tax legislation of these foreign jurisdictions is more aware of the risks attendant to employee share schemes. In Chapter 4, the South African tax treatment of employee share schemes will be compared to that of Australia and Singapore respectively. Recommendations to resolve the aforementioned cash flow problems for employees thereby making employee share schemes more attractive to employees will also be provided.

4. Chapter 4: Comparative analysis of the tax legislation applicable to employee share schemes in South Africa, Australia and Singapore respectively and recommendations to make employee share schemes more attractive to employees

4.1. Introduction

The analysis of the Australian and Singaporean tax legislation in chapter 3 indicates that the tax laws applicable to employee share schemes recognise the cash constraints that employees face where they are unable to dispose of the share awards in order to settle the tax liability, while the South African legislation does not.

Notwithstanding this observation, there are some key similarities between the foreign legislation and South Africa which can be dealt with under the following headings:

- taxing point for shares granted in terms of an employee share scheme;
- tax implications on the award of shares;
- tax concessions for employee share schemes;
- availability of broad-based employee share ownership;
- start-up company concession;
- capital gains tax on disposal of shares; and
- deductions for the employer.

In undertaking the comparison of the applicable tax regimes, the differences in the fundamental design features of each were considered. Accordingly, this research report does not attempt to undertake a detailed analysis of the design features of the employee share scheme tax rules applicable in Australia and Singapore respectively. Instead, this research report attempts to provide a high level analysis of the various tax concessions offered by these countries to employees who receive shares as part of an employee share scheme.

	South Africa	Australia	Singapore
Taxing point for shares granted in terms of an employee share scheme	<p>Section 8B</p> <p>A gain made from the disposal of a qualifying equity share is included in the income of a person who disposes of that share within five years from the date of grant of that share. The employees' tax liability only arises to the extent that the employee exercises his/her right to dispose of the share.³³² Stated differently, the incidence of tax occurs at the point where the share is disposed of and not at date of grant.</p> <p>Section 8C</p> <p>Any gains or losses made on the vesting of equity instruments, which were acquired by</p>	<p>Taxed-upfront scheme</p> <p>An employee will be taxed on the value of the discount in the year in which the ESS interest is awarded in terms of a taxed-upfront scheme, where certain requirements for concessional tax treatment are met.³³⁴</p> <p>Further, an employee who has participated in a taxed-upfront scheme may reduce his/her taxable income by up to \$1,000.³³⁵</p> <p>Tax-deferred scheme</p> <p>Where an employee is a participant of a tax-deferred scheme, such employee may defer the instance of tax to a later date.³³⁶</p>	<p>Where an employee is awarded a share by virtue of his/her employment in Singapore, any gain will be deemed to be income and taxable in the year in which the share is awarded unless there is a moratorium placed on the disposal of the share – then tax will be levied on the date when the moratorium is lifted.³³⁷</p> <p>QEEBR</p> <p>Employees may defer the instance of tax to a later date, subject to an interest charge.³³⁸</p> <p>ERIS Schemes</p> <p>Employees may claim a tax exemption of the gains derived from employee share</p>

³³² Section 8B(1) read with para (d) of the definition of 'remuneration' and para 11A(1)(b) of the Fourth Schedule to the Act.

³³⁴ Subdivision 83A-B of the ITAA 1997.

³³⁵ Div 83A-35 of the ITAA 1997.

³³⁶ Div 83A-C of the ITAA 1997.

³³⁷ Section 10(6) of the SITA.

³³⁸ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.8. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

	virtue of employment, are included in a taxpayer's income. A gain on an 'unrestricted equity instrument' is taxed at the time that it is acquired, whereas a gain on a 'restricted equity instrument' is only taxed when the instrument vests. ³³³		schemes, depending on the applicable ERIS Scheme. ³³⁹
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As can be observed from the above comparison, the taxing point of shares awarded in terms of an employee share scheme in Singapore is identical to the s 8C treatment of shares in a South African context, in that any gains derived from the shares will be taxed on award unless there is a restriction placed on the share (at which point, the gain will be taxed when the restrictions are lifted). In contrast, the taxing point in Australia is identical to the s 8C treatment of unrestricted shares in South Africa, in that any gains will be taxed on award. These similarities lend support to the contention that the foreign legislation may be used as a basis to guide the enhancement of the South African legislation, and in particular s 8C of the Act, as a s 8B equivalent is not available in both Singapore and Australia.

	South Africa	Australia	Singapore
<i>Tax implications on the award of shares</i>	An employee who is awarded shares in terms of an employee share scheme or broad-based employee share plan will not be taxed on such an award at the time of acquisition. This is due to the exemptions	The general rule is that a taxpayer's assessable income includes any discount given on ESS interests acquired in terms of an employee share scheme. Depending on the type of employee share scheme, an employee may be entitled to:	The general rule is that a taxpayer's income includes any gain derived in terms of an employee share scheme. Depending on the type of employee share scheme, an employee may be entitled to: (i) a tax

³³³ Section 8C(1) read with sub-section (3)(a) and (b) of the Act.

³³⁹ Sections 13J, 13L and 13M of the SITA.

	<p>from normal tax provided in ss 10(1)(nC) and 10(1)(nD) of the Act respectively.³⁴⁰</p> <p>It is important to note, however, that a gain on an equity instrument may be taxable at this point to the extent that it has 'vested'.</p>	<p>(i) a reduction of the amount included in his/her assessable income; or (ii) defer the taxing of the discount to a later date.³⁴¹</p>	<p>exemption; or (ii) defer the taxing of the discount to a later date.³⁴²</p>
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As can be deduced from the above analysis, although the default position in both Australia and Singapore is that a gain derived in terms of an employee share scheme will be included in the employee's income, the employee has a choice as to *when* the taxing of this gain will occur. Both jurisdictions, in addition, provide the employee with either a reduction of the gain (i.e. Australia) or a tax exemption on a portion of the gain (i.e. Singapore).

In contrast, where an equity instrument 'vests' at the time of acquisition (as is the case with an unrestricted instrument) in South Africa, the gain will be included in the employee's income and he/she will be taxed at that point. Of importance is the fact that the South African employee does not have a choice as to the timing of that tax where s 8C applies. In addition, there is no option for the employee to reduce the tax payable or claim a tax exemption. It is only in the case of s 8B that the employee can 'defer' the instance of tax to the point when he/she exercises his/her right to dispose of the qualifying equity share.

³⁴⁰ Read with para (c) of the definition of 'gross income' in s1.

³⁴¹ Div 83A-1 and 83A-25(1) of the ITAA 1997.

³⁴² Sections 10(6), 13J, 13L and 13M of the SITA.

	South Africa	Australia	Singapore
Tax concessions for employee share schemes	In the context of s 8B, the employees' tax liability only arises to the extent that the employee exercises his/her right to dispose of the qualifying equity share. Accordingly, the incidence of tax occurs at the point where the share is disposed of and not at date of grant. ³⁴³	The tax concessions available to employees include: <ul style="list-style-type: none"> • the reduction concession where employees may reduce the gain included in their taxable income by up to \$1,000;³⁴⁴ • tax deferral concessions where employees may defer tax liability for up to fifteen years;³⁴⁵ • the start-up concession, where employees of start-up companies do not include the discount in their taxable income,³⁴⁶ and • a refund of tax paid where an employee forfeits shares.³⁴⁷ 	The tax concessions available to employees include: <ul style="list-style-type: none"> • the ERIS Schemes which provide a tax exemption between 25% and 75% of the gains derived from an employee share scheme for employees of start-up businesses, small and medium enterprises and all corporations respectively;³⁴⁸ and • the QEEBR Scheme where an employee can defer the payment of tax on a gain arising from an employee share scheme for up to five years, subject to an interest charge.³⁴⁹

³⁴³ Section 8B read with subparagraph 2 of para 11A of the Fourth Schedule to the Act.

³⁴⁴ Div 83A-35 of the ITAA 1997.

³⁴⁵ Div 83A-C of the ITAA 1997.

³⁴⁶ Div 83A-33 of the ITAA 1997.

³⁴⁷ Div 83A-310 of the ITAA 1997.

³⁴⁸ Sections 13J, 13L and 13M of the SITA.

³⁴⁹ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.8. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

As can be observed from the above comparison, there are more tax concessions available in Australia and Singapore as compared to South Africa. More specifically, Australia and Singapore each offer concessions that assist employees to mitigate the cash flow constraints that may arise where they are unable to dispose of the shares in order to crystallise the gain and pay the resulting tax bill. From a South African context, the concession, which is provided only in terms of s 8B, allows the employee to be taxed once the shares are disposed and not when they are granted. Accordingly, where an employee is a participant of an employee share scheme that does not comply with the requirements of s 8B (i.e. s 8C), such employee will not have access to the concession. In contrast, the Australian and Singaporean tax legislations afford employees with more options to mitigate the cash flow constraints (subject to the requirements being met) and favourable tax treatment of gains from employee share schemes.

	South Africa	Australia	Singapore
Tax provisions relating to broad-based employee share ownership	Section 8B requires, <i>inter alia</i> , that at least 80% of all employees who are employed on a permanent basis (including those that have been continuously employed on a permanent basis for at least one year) must be entitled to participate in the employee share plan. ³⁵⁰	In order for an employee to: <ul style="list-style-type: none"> • reduce the amount included in their taxable income by up to \$1,000, the employee share scheme must, <i>inter alia</i>, be made available to at least 75% of the employer company's permanent employees (who are Australian residents);³⁵¹ • to claim the start-up concession, the employee share scheme must, <i>inter alia</i>, 	In order for an employee to claim an exemption on the first \$2,000 of the gains plus a further exemption of 25% on the remaining gains (i.e. tax exemption afforded to participants of the ERIS Scheme for all corporations), the qualifying company must, <i>inter alia</i> , offer the employee share scheme to at least 25% of its employees. ³⁵⁴

³⁵⁰ See definition of 'broad-based employee share plan' in s 8B(3) of the Act.

³⁵¹ See Div 83A-35(6) of the ITAA 1997.

³⁵⁴ Section 13L of the SITA.

		<p>be made available to at least 75% of the employer company's permanent employees (who are Australian residents);³⁵² and</p> <ul style="list-style-type: none"> • defer the payment of tax to a later date, at least 75% of the employer company's permanent employees (who are Australian residents) must be entitled to acquire the ESS interest: (i) in terms of the employee share scheme; or (ii) in their employer company or a holding company of the employer in terms of another employee share scheme.³⁵³ 	
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As can be observed from the above comparison, in South Africa, Australia and Singapore respectively, access to certain tax concessions requires that the employee share scheme be broad-based and open to all employees (and not only executives or senior management). Accordingly, the broad availability and participation of employees in share schemes is encouraged in each of these countries by providing the employee with access to tax concessions.

³⁵² Div 83A-33 of the ITAA 1997.

³⁵³ Div 83A-105(2) of the ITAA 1997.

	South Africa	Australia	Singapore
Start-up company concession	Not available.	Where certain requirements are met by the start-up employer company and the employee share scheme, the discount acquired on ESS interest will not be included in the employee's assessable income upfront. ³⁵⁵ Instead, the employee will pay capital gains tax when the ESS interest is disposed of. ³⁵⁶	Subject to certain requirements, where an employee, who acquires a share in a start-up company terms of an employee share scheme, derives any gain from such share, 75% of such gain shall be exempt from tax. ³⁵⁷

As noted in the above comparison, South Africa does not have an employee share scheme targeted specifically for start-up companies. Although Australia and Singapore both provide a concession for employees of start-up companies, these concessions differ (both in terms of requirements and relief provided). For instance, the requirements applicable in Australia appear to be more onerous (see discussion on page 47 above) than those applicable in Singapore (see discussion on page 55 above). In addition, while Australia does not tax the employee of a start-up company on the discount on date of grant, Singapore allows an upfront tax exemption on the gain derived from an employee share scheme. Despite these differences, it is submitted that the start-up company concessions offered in both jurisdictions encourage entrepreneurship and support the growth of early-stage businesses through assisting start-up companies to be more competitive in attracting and retaining employees.

³⁵⁵ Div 83A-33(1) of the ITAA 1997.

³⁵⁶ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.20. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

³⁵⁷ Section 13M of the SITA.

	South Africa	Australia	Singapore
Capital gains tax on disposal of shares	<p>Section 8B</p> <p>Where a share is disposed of after five years from the date of grant, the gain will be deemed to be of a capital nature and subject to capital gains tax.³⁵⁸</p> <p>Section 8C</p> <p>The tax implications of the disposal of an equity instrument are dependent on whether the instrument is disposed of before or after vesting. Where an equity instrument is disposed of prior to vesting, the gain arising on disposal will not be subject to capital gains tax, but will be covered by the provisions of s 8C.³⁵⁹</p> <p>Where the equity instrument is disposed of after the vesting thereof and the shares had</p>	<p>Where an ESS interest is disposed within 30 days of the earliest deferred taxing point, the difference between the market value and the base cost will be included in the employee's income. Where the disposal occurs after the 30 days of the earliest deferred taxing point, the gain on disposal will be deemed to be of a capital nature and subject to capital gains tax.³⁶¹</p> <p>In certain instances, the employee will pay capital gains tax on 50% of the gain only.³⁶²</p>	<p>Capital gains are not taxable in Singapore. Where an employee disposes of the shares, any gain realised will not be taxable. Where the employee is considered a share dealer, any gains will be considered of a revenue nature and will therefore be taxable.³⁶³</p>

³⁵⁸ Section 8B(1) read with s 9C of the Act.

³⁵⁹ Section 8C read with para 64C of the Eighth Schedule to the Act.

³⁶¹ Div 83A-120(3) of the ITAA 1997.

³⁶² Div 115-A(5) – (34) of the ITAA 1997.

³⁶³ Inland Revenue Authority of Singapore (n.d.) *Gains from Sale of Property, Shares and Financial Instruments*. Available at <https://www.iras.gov.sg/irashome/Individuals/Locals/Working-Out-Your-Taxes/What-is-Taxable-What-is-Not/Gains-from-Sale-of-Property--Shares-and-Financial-Instruments/> (last accessed on 21 March 2021 at 18:07pm).

	been held for a period of at least three years prior to disposal, the gain arising on disposal will be subject to capital gains tax. ³⁶⁰		
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While capital gains are not taxable in Singapore, the capital gains tax implications of the disposal of a share granted in terms of an employee share scheme are dependent on the timing of the disposal, both in South Africa and Australia. It is submitted that the Australian provision that allows an individual who holds the shares for longer than 12 months, to discount 50% of the gain where certain requirements are met, provides an additional concession for Australian employees.

	South Africa	Australia	Singapore
<i>Deduction for the employer</i>	The employer may claim a deduction of an amount equal to the market value of shares granted to an employee less any consideration given by that employee. Such deduction may not exceed, in any year of assessment, an amount of R10 000 in respect of all shares granted to a single	An employer may claim a deduction where shares are issued in terms of a taxed-upfront scheme that meets the reduction concession requirement. The deduction is limited to the amount of the concession (i.e. maximum of \$1,000). ³⁶⁵	An employer may not claim a deduction for any cost borne, whether directly or indirectly, for the employee share scheme or any shares awarded as part thereof. ³⁶⁶

³⁶⁰ Section 8C read with s 9C.

³⁶⁵ Div 83A-205(3) of the ITAA 1997

³⁶⁶ Inland Revenue Authority of Singapore (2013) *Tax Treatment of Employee Stock Options and Other Forms of Employee Share Ownership Plans* (Second Edition), p.5. Available at https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_IIT_ESOP_2013-6-24.pdf (last accessed on 16 September 2020 at 22:07pm).

³⁶⁶ Inland Revenue Authority of Singapore (n.d.) *Stock Options*. Available at [https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,Equity%20Remuneration%20Incentive%20Schemes%20\(ERIS\),plans%20granted%20by%20their%20employers](https://www.iras.gov.sg/IRASHome/Individuals/Foreigners/Working-out-your-taxes/What-is-Taxable-What-is-Not/Stock-Options/#:~:text=Back%20to%20top-,Equity%20Remuneration%20Incentive%20Schemes%20(ERIS),plans%20granted%20by%20their%20employers) (last accessed on 21 September 2020 at 06:30am).

	employee. The deduction is only available in the context of s 8B. ³⁶⁴		
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As indicated in the above comparison, South Africa (from a s 8B perspective only) and Australia both provide a limited deduction to the employer who grants shares to an employee at a discount to market value. Employers in Singapore may not claim a deduction for the shares granted in terms of an employee share scheme, which is identical to the position in South Africa from a s 8C perspective. It is submitted that, in certain instances, this may discourage employers from granting shares to employees in terms of an employee share scheme.³⁶⁷

³⁶⁴ Section 11(A) of the Act.

³⁶⁷ The Parliament of the Commonwealth of Australia (2009) *Explanatory Memorandum to Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, p.21. Available at <https://www.legislation.gov.au/Details/C2009B00206/Explanatory%20Memorandum/Text> (last accessed on 13 March 2021 at 10:17am).

4.2. Recommendations

A number of jurisdictions have recognised the importance of employee share schemes when retaining and incentivising employees, securing the long-term tenure of senior management, and aligning the financial interests of the company and its employees.³⁶⁸ In light of this recognition, many jurisdictions have included concessions and/or incentives in their respective tax systems to make employee share schemes more attractive to employees and employers alike. For instance, jurisdictions such as Australia, Singapore, the United States of America,³⁶⁹ United Kingdom,³⁷⁰ New Zealand³⁷¹ and Germany³⁷² all allow for the incidence of tax, where shares are acquired in terms of an employee share scheme, to be deferred until the employee disposes of his shares. In addition, most of these jurisdictions allow the employer to claim a deduction for the costs of the employee share scheme.³⁷³

Owing to factors such as COVID-19 and the need for employers to consider how changes to their businesses will affect the manner in which employees are remunerated and incentivised, it is important that the tax rules applicable to employee share schemes '*do not raise unintended barriers to their use*.'³⁷⁴ In the context of s 8B of the Act, it is submitted that, as the employees' tax liability will only arise where the employee exercises his/her right to dispose of the qualifying equity share, a participant of a broad-based employee share plan should not find themselves in a position where they are not able to settle the tax liability. On the other hand, where s 8C applies, the employee will have a tax liability as soon as, *inter alia*, all restrictions in relation to those shares are lifted, even though he/she may not have actually disposed of the equity instrument at that particular point. This may leave the employee with a liquidity problem, should the employee not be able to dispose of the shares in order to settle the tax liability. In light of the above, the recommendations set out in this chapter relate only to s 8C of the Act.

As the ambit of s 8C does not create an incentive for employees to participate in these schemes, it is submitted that the below recommendations may assist to ensure that an optimal balance is struck between encouraging employee equity participation and ensuring that there is no loss to the fiscus (i.e. the proposed recommendations focus on, *inter alia*, tax deferral

³⁶⁸Huddart, S., (1994) 'Employee Stock Options' *Journal of Accounting and Economics*. Available at <http://www.personal.psu.edu/sjh11/Papers/ESO.pdf> (last accessed on 20 September 2020 at 03:24am).

³⁶⁹ See s 422 of the United States Code, 2006 Edition, Supplement 4, Title 26 – Internal Revenue Code.

³⁷⁰ See Income Tax (Earnings and Pensions) Act 2003 (UK) c 1, pt 7 ch 6.

³⁷¹ See the changes introduced by the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018.

³⁷² See proposed s 19a to the German Income Tax Act (Einkommensteuergesetz, EStG).

³⁷³ Australia, United States of America, United Kingdom and New Zealand all allows the employer to claim a deduction for the costs borne by it in administering an employee share scheme.

³⁷⁴ New Zealand Inland Revenue (2016) *Regulatory Impact Statement - Taxation of Employee Share Schemes*, p.2. Available at <https://www.treasury.govt.nz/sites/default/files/2017-01/ris-ird-tes-apr17.pdf> (last accessed on 25 March 2021 at 22:09pm).

rather than the scrapping of the taxation of employee share schemes in its entirety). The report has identified the following recommendations, which are discussed in more detail below:

- deferral of employees' tax liability to (i) a deferred taxing point; or (ii) date of disposal;
- tax exemption or reduction of the gains derived from an employee share scheme; and
- the introduction of a start-up concession.

Deferral of employees' tax liability to deferred taxing point or date of disposal

In the context of s 8C, the employee must have the option to delay the inclusion of the gain (which is equal to the discount in the acquisition price, relative to market value) in their taxable income to a deferred taxing point, as is the case with the tax-deferred schemes available in Australia. More specifically, the employee should be allowed to defer the tax liability until the earlier of (i) the employment ceasing; or (ii) a prescribed number of years after the date of grant, for instance, five years as is the case with the QEEBR Scheme in Singapore.

Alternatively, the employee must be provided with the option to defer the incidence of employees' tax to the point where the employee disposes of the equity instrument and not at the point where the instrument has 'vested' (for instance where the restrictions applicable to that share have ceased), as is the case in the context of s 8B of the Act. Stated differently, the employees' tax liability should only arise to the extent that the employee exercises his/her right to dispose of the equity instrument.

These options will not only ensure that the employee has cash to settle the accompanying tax liability, but will enable the employee to determine the most opportune time to dispose of the shares in order to be able to pay the related tax.

As an alternative to the above tax deferral options, SARS and National Treasury may consider imposing an interest charge when an employee elects to defer the employees' tax liability to a deferred taxing point or date of disposal, as was contemplated in 2004.³⁷⁵ It is important to note, however, that the rate of interest should not deter employees from utilising the concession.³⁷⁶

³⁷⁵ South African Revenue Service (2004) *Responses to written representations by organisations to the Portfolio Committee on Finance and Select Committee on Finance on the Revenue Laws Amendment Bill No, 22 of 2004*, p11. Available at <https://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2004-02%20-%20Response%20Document%20Revenue%20Laws%20Amendment%20Bill.pdf> (last accessed on 7 February 2021 at 01:47am).

Tax exemption or reduction of the gains derived from an employee share scheme

Where, for instance, an employee does not meet the requirements for tax deferral or opts not to defer the employees' tax to a deferred taxing point or on date of disposal, a tax exemption of the gain can be afforded to the employee. Provided that certain requirements are met, the employee should be able to exempt a portion of the gain from tax, as is the case with the ERIS Schemes in Singapore. The tax exemption can be made subject to a number of requirements, for instance, such as those that are applicable to the ERIS Scheme for all corporations, namely that:

- the employee must be employed by a South African company which carries on business in South Africa;
- the employee cannot hold more than, for instance, 25% of the shares and voting rights in the employer company; and
- the employer company must offer the employee share scheme to, for example, at least 25% of its employees.

It is submitted that the effect of a reduction of the gain included in an employee's taxable income by up to \$1,000 as provided in Australia, is identical to that of the tax exemption discussed above. Accordingly, the reduction concession will be deemed to be akin to the tax exemption for purposes of these recommendations. It is important to note, however, that any reduction amount must take into account to the time value of money.

As is the case with the tax-deferral options, the tax exemption or reduction will provide some relief to an employee who has cash flow problems as a result of not being able to settle the employees' tax liability due upon the vesting of share awards.

Start-up company concession

In order to encourage local innovation and allow businesses to be more competitive in recruiting and retaining talented employees by offering tax concessions to participants of employee share schemes, the introduction of a start-up company concession should be considered. This concession should allow employees of qualifying start-up companies to not include the discount of the share in their taxable income at the date of grant, as is the case with the start-up company concession available in Australia.

The start-up company concession tax exemption can be made subject to a number of requirements, for instance, such as those that are applicable to the start-up company concession in Australia:

- the equity instrument granted to the employee, which must be an ordinary share, may not be disposed for a period of at least three years and cannot entitle the employee to more than, for example, 10% of the voting rights in the employer company;
- the employee share scheme must be made available to at least 75% of the company's permanent employees who have completed the prescribed years of service;
- the employer start-up company, which must be a South African resident taxpayer company, cannot be listed on a stock exchange;
- the employer start-up company must have been incorporated for less than ten years and must have a turnover of not more than, for example, R20 million;³⁷⁷ and
- the discount on the equity instrument cannot exceed, for example, 15% of the market value of the interest on the date of acquisition.

As mentioned above, Australia allows an employee to claim a refund of the tax paid, in certain instances, where the interests are forfeited after the employee has been taxed on the discount. The recommendations identified above specifically apply to assist employees that may have a liquidity problem where they are able to dispose of the shares in order to settle the tax liability. Accordingly, as the refund is claimed after the tax has been settled, this concession is not considered as a recommendation for purposes of this research report.

4.3. Conclusion

In this chapter, the South African tax treatment of employee share schemes was compared to that of Australia and Singapore respectively. As can be observed from this comparison:

- the taxing point of shares scheme in Singapore is identical to the s 8C treatment of shares in a South African context, in that any gains will be taxed on award unless there is a restriction placed on the share. In contrast, the taxing point in Australia is identical to the s 8C treatment of unrestricted shares in South Africa (i.e. gains are taxed on award);
- although the default position in both Australia and Singapore is that a gain derived in terms of an employee share scheme will be included in the employee's income, the employee has a choice as to *when* the taxing of this gain will occur. In contrast, the

³⁷⁷ The turnover criteria used to determine qualifying entities for the Small Business Corporation incentive can be used as a basis. See s 12E of the Act.

South African employee does not have a choice as to the timing of that tax, particularly, where s 8C applies;

- there are more tax concessions available in Australia and Singapore as compared to South Africa. More specifically, Australia and Singapore each offer concessions that assist employees to mitigate the cash flow constraints that may arise where they are unable to dispose of the shares in order to crystallise the gain and pay the resulting tax bill. From a South African context, the concession, which is provided only in terms of s 8B, allows the employee to be taxed once the shares are disposed and not when they are granted;
- In South Africa, Australia and Singapore respectively, access to certain tax concessions requires that the employee share scheme be broad-based and open to all employees;
- South Africa does not have an employee share scheme concession targeted specifically for start-up companies. Although Australia and Singapore both provide a concession for employees of start-up companies, these concessions differ (both in terms of requirements and relief provided);
- the capital gains tax implications of the disposal of a share granted in terms of an employee share scheme are dependent on the timing of the disposal, both in South Africa and Australia. It is submitted that the Australian provision that allows an individual who holds the shares for longer than 12 months, to discount 50% of the gain where certain requirements are met, provides an additional concession for Australian employees; and
- South Africa (from a s 8B perspective only) and Australia both provide a limited deduction to the employer who grants shares to an employee at a discount to market value, whereas employers in Singapore may not claim a deduction for the shares granted in terms of an employee share scheme, which is identical to the position in South Africa from a s 8C perspective.

This analysis indicated that both Australia and Singapore recognise that share awards can be unaffordable to employees who experience cash flow issues as a result of the timing of the payment of tax.³⁷⁸ In addition, the start-up company concessions offered in both jurisdictions ensure that the local start-up companies are more competitive by encouraging the local development of ideas, which ultimately contributes to a country's economic growth. These

³⁷⁸ The Parliament of the Commonwealth of Australia (2015) *Explanatory Memorandum to Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, p.31. Available at <https://www.legislation.gov.au/Details/C2015B00037/Explanatory%20Memorandum/Text> (last accessed on 23 August 2020 at 19:45pm).

factors led to the conclusion that the South African tax legislation applicable to employee share schemes does not create an incentive for employees to participate in these schemes as compared to Australia and Singapore.

In addition, recommendations to resolve the cash flow problems for employees and make employee share schemes more attractive to employees were provided. These recommendations included:

- the deferral of employees' tax liability to a deferred taxing point or on the date of disposal,
- the gains derived from an employee share scheme be exempt from tax or reduced; and
- the introduction of a start-up concession.

It is submitted that the aforementioned recommendations will not only ensure that the employee has cash to settle the accompanying tax liability, but will enable the employee to determine the most opportune time to dispose of the shares in order to be able to pay the related tax. In addition, the recommendations will allow South African businesses to be more competitive in recruiting and retaining talented employees, but will assist to stimulate the growth of start-up companies. This will ultimately contribute to the country's economic growth.

5. Chapter 5: Conclusion

In South Africa, the tax rules governing employee share schemes provide that an employee, who receives shares in terms of the scheme, will have a tax liability as soon as, *inter alia*, all restrictions in relation to those shares are lifted, even though he/she may not have actually disposed of the shares at that particular point. This may leave the employee with a liquidity problem, should the employee not be able to dispose of the shares in order to settle the tax liability. This report sought to examine the ambit of ss 8B and 8C of the Act and the manner in which these sections could be amended to resolve the aforementioned cash flow problems for employees thereby making employee share schemes more attractive to employees. This was achieved through a comparison of the applicable South African, Australian and Singaporean tax provisions in order to determine the extent to which the foreign legislation may be used as guidance to enhance the South African tax legislation governing employee share schemes. In this regard, consideration was given to legislation, case law and other authorities relating to employee share schemes in each jurisdiction.

The introductory chapter of this research report introduced the background, the research statement, sub-statements identified and the research methods used. A discussion of the reasons that companies implement employee share schemes was provided together with the advantages and disadvantages linked to these schemes. In addition, this chapter discussed the significance of the research, in light of unprecedented economic harm experienced by companies due to COVID-19, and the option for companies that are experiencing cash flow constraints to offer share-based incentive schemes to their employees.

Chapter 2 contained an analysis of ss 8B and 8C of the Act, specifically focusing on the time of the tax event. This analysis included a discussion of the legislative framework that governs the requirements, tax implications of the award and disposal of qualifying equity shares and equity instruments and ancillary matters that are applicable to share incentive schemes in South Africa. The analysis led to the conclusion that s 8C is not aligned to the commercial realities of conducting business in South Africa, as it fails to take into account the risk of a liquidity problem, should the employee not be able to dispose of the shares in order to settle the tax liability. Furthermore, it was concluded that s 8B does not suffer the same fate as the employees' tax liability only arises to the extent that the employee exercises his/her right to dispose of the qualifying equity share.

In chapter 3, the tax legislation governing employee share schemes in Australia and Singapore respectively was examined, with particular focus to the mechanisms provided to

mitigate the cash flow issues for employees with regard to the settlement of their tax liabilities due upon the vesting of the share awards. This analysis indicated that these respective jurisdictions recognise the potential cash flow problems that may arise for employees when they are required to settle the tax due upon the vesting of their share awards by affording the employees with a number of tax concessions. For instance, in Australia, an employee who has participated in a taxed-upfront scheme may reduce his/her taxable income by up to \$1,000 or claim a refund of the tax paid where the shares are forfeited. Alternatively, the employee may defer the payment of the tax in relation to his/her employee share scheme interests until they have cash to settle the tax liability. Singapore also provides a tax deferral scheme, which is subject to an interest charge and employees may claim a tax exemption of the gains derived from employee share schemes, depending on the applicable scheme. In addition, the start-up company concessions offered in both jurisdictions ensure that the local start-up companies are more competitive by encouraging the local development of ideas, which ultimately contributes to a country's economic growth. This analysis led to the conclusion that the tax legislation of these foreign jurisdictions is more aware of the risks attendant to employee share schemes.

In chapter 4, the South African tax treatment of employee share schemes was compared to that of Australia and Singapore respectively. This comparison led to a number of conclusions, namely that:

- the taxing point of shares in Singapore is identical to the s 8C treatment of restricted shares (i.e. gains are taxed on award unless there is a restriction placed on the share), while the taxing point in Australia is identical to the s 8C treatment of unrestricted shares (i.e. gains are taxed on award);
- in Australia and Singapore, the employee has a choice as to *when* the taxing of a gain derived in terms of an employee share scheme will occur, whereas the South African employee does not have a choice as to the timing of that tax, particularly, where s 8C applies;
- there are more tax concessions available in Australia and Singapore as compared to South Africa. In South Africa, the only concession available to employees is provided by in terms of s 8B, where the employee is taxed once the shares are disposed and not when they are granted;
- in all the jurisdictions, access to certain tax concessions requires that the employee share scheme be broad-based and open to all employees;
- South Africa does not have an employee share scheme concession targeted specifically for start-up companies, as is the case in h Australia and Singapore;

- Both Australia and South Africa determine the capital gains tax implications of the disposal of a share granted in terms of an employee share scheme based on the timing of the disposal of such share; and
- South Africa (from a s 8B perspective only) and Australia provide a limited deduction to the employer who grants shares to an employee in terms of an employee share scheme, whereas such deduction is not available in Singapore and where s 8C applies.

This analysis indicated that both Australia and Singapore recognise that share awards can be unaffordable to employees who experience cash flow issues as a result of the timing of the payment of tax. These factors led to the conclusion that the South African tax legislation applicable to employee share schemes does not create an incentive for employees to participate in these schemes as compared to Australia and Singapore.

In addition, recommendations to resolve the cash flow problems for employees and make employee share schemes more attractive to employees were provided. These recommendations include the deferral of employees' tax liability to a deferred taxing point or on the date of disposal, the tax exemption or reduction of gains derived from an employee share scheme and the introduction of a start-up concession.

It is submitted that the aforementioned recommendations will not only ensure that the employee has cash to settle the accompanying tax liability, but will enable the employee to determine the most opportune time to dispose of the shares in order to be able to pay the related tax. In addition, the recommendations will allow South African businesses to be more competitive in recruiting and retaining talented employees, which will assist to stimulate the growth of start-up companies. This will ultimately contribute to the country's economic growth.

Areas requiring further research

A comparative study of the tax concessions provided in African countries, such as Ghana, Botswana and Malawi, and other developed countries, like the United States of America, United Kingdom, New Zealand and Germany, was not dealt with in this research report and can be focused on in the future. This comparative study may include an analysis of, *inter alia*,

- the prevalence of employee share schemes and the forms they take;
- the tax treatment of these employee share schemes;
- the effect of tax concessions on the uptake of employee share schemes;

- determining how long it takes for employees to sell shares in order to settle the tax liability; and
- where interest is charged for tax deferral, what rate is considered to be equitable from the perspectives of the taxpayers and revenue authorities respectively.

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