DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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IN THIS ISSUE

CONSIDERATION RECEIVED FOR THE SURRENDER OF A RIGHT TO ACQUIRE SHARES UNDER SECTION 8C

The South African Revenue Service (SARS) issued Binding Private Ruling 147 (ruling) on 14 May 2013. It deals with the tax treatment of compensation received by an employee for the surrender of a right to acquire shares under s8C of the Income Tax Act, No 58 of 1962 (Act).

The applicant in the ruling was the chief executive officer and managing director of a company (seller). The seller sold its business to another company (purchaser) including all its assets and liabilities as a going concern. The purchaser extended an offer of employment to the applicant, which offer contemplated that the business would be transferred to a new company (Newco), and that the applicant would be appointed chief executive officer of Newco. In terms of the offer, the applicant would also receive an equity share in Newco, which would be transferred to him following an uninterrupted 5 year employment period.

However, after the applicant accepted the offer, the applicant was informed that parts of Newco's business would be sold to another company. Such a disposal would have the effect of decreasing the value of the applicant’s right to receive shares in Newco after 5 years.

The purchaser therefore agreed to compensate the applicant for surrendering his right to acquire shares in Newco. The compensation would be a cash amount equal to the value of the equity shares in Newco that the applicant had the right to receive in 5 years, at the time of the disposal of parts of Newco's business. The compensation would be paid from the proceeds of the sale of parts of Newco's business.

Section 8C(1) of the Act provides *inter alia* that any gain or loss made due to the vesting of an equity instrument acquired by virtue of a taxpayer's employment, must be included in the taxpayer's income for the relevant year of assessment.

SARS ruled that the compensation received by the applicant for surrendering his right to acquire an equity stake in Newco would be a gain to be included in the Applicant's income in terms of s8C(1) of the Act.

Unfortunately SARS did not elaborate on the actual operation of s8C, which could have shed some light on the inner-workings of this deceptively complicated piece of legislation.

For instance, SARS did not specifically indicate how it is that the applicant's right to receive shares in Newco constitutes an equity instrument. It is assumed that SARS viewed the applicant's right as falling within paragraph (c) of the definition of 'equity instrument' in s8C(7) of the Act, being a 'contractual right or obligation the value of which is determined directly or indirectly with reference to a share'.

The specifics of how the applicant's right 'vested' for purposes of s8C of the Act was also not discussed. In this regard it submitted that the applicant’s 'equity instrument' would vest in terms of s8C(3)(b)(ii) of the Act, which provides that vesting occurs in respect of a restricted equity instrument 'immediately before that taxpayer disposes of that restricted equity instrument'.

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ALLOWANCES UNDER SECTION 11(E) – ASSETS FORMING PART OF A SALE AND LEASEBACK ARRANGEMENT

The South African Revenue Service (SARS) issued Binding Private Ruling 145 (ruling) on 8 May 2013. The ruling deals with the tax treatment of assets forming part of a sale and leaseback arrangement, with specific reference to the write-off period of these assets in terms of s11(e) of the Income Tax Act, No 58 of 1962 (Act).

The applicant in the ruling is a company incorporated in and a resident of South Africa, who intends to provide financing to another company (company) by way of a sale and leaseback arrangement (arrangement). In terms of the arrangement, the applicant will purchase plant and machinery from the company. The purchase price of the assets is to be determined through a valuation conducted by an independent third party. The assets are currently used in a process of manufacture by the company. It is assumed that the company has been claiming allowances in terms of s12C of the Act in respect of the assets.

Immediately after the sale of the assets, the applicant will lease back the specified assets to the company for a period of 7 years. Also, the company will have right to repurchase the assets from the applicant within a period of 30 days after the termination of the lease at market value.

The critical issues to be established by the ruling for purposes of the proposed transaction was:

- whether the applicant would be entitled to claim a deduction under s11(e) of the Act; and
- what the write-off periods for the specified assets would be.

Generally, the Act allows a taxpayer to deduct from its taxable income any expenditure or losses actually incurred in the production of income, except expenditure and losses of a capital nature. Section 11(e) of the Act however provides *inter alia* for a taxpayer to deduct from its taxable income a reasonable sum representing the amount by which the value of any machinery or plant, used for the purposes of the taxpayer's trade, has diminished by reason of wear and tear or depreciation during the year of assessment.

In light of the aforementioned and based on the facts of the proposed transaction, SARS ruled that the applicant may deduct a wear and tear allowance in respect of the specified assets which form part of the sale and leaseback arrangement over each individual asset's expected useful life.

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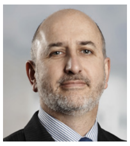

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