

*SOUTH AFRICAN REVENUE SERVICE*

**BINDING CLASS RULING: BCR 014**

DATE: 19 January 2010

**ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 8C, 10(1)(nE), 11(a), 23(m) AND 24J(2) AND PARAGRAPHS 1, 20(1)(g) AND (h), AND 76 OF THE EIGHTH SCHEDULE TO THE ACT**  
**SUBJECT : DEDUCTIBILITY OF INTEREST INCURRED IN RESPECT OF A LOAN ENTERED INTO TO PURCHASE RESTRICTED EQUITY INSTRUMENTS IN A SHARE PURCHASE SCHEME**

**1. Summary**

This ruling deals with the deductibility of interest incurred on a loan to acquire restricted equity instruments as part of a share incentive scheme.

**2. Relevant tax laws**

This is a binding class ruling issued in accordance with section 76R of the Act.

In this ruling legislative references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 22 July 2009 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 8C;
- section 10(1)(nE);
- section 11(a);
- sections 23(m);
- section 24J(2); and
- paragraphs 1, 20(1)(g) and (h), and 76 of the Eighth Schedule.

### 3. **Class**

The class members to whom this ruling will apply will be the Employees as described in point 4 below.

### 4. **Parties to the proposed transaction**

The Applicant: A listed company which is the controlling group company of a “group of companies” as defined in section 1

The Employees: Selected employees within the group of companies (who are the beneficiaries of a Share Purchase Trust) also referred to as the Participants

### 5. **Description of the proposed transaction**

The Applicant set up a Share Purchase Trust (the Trust) during 2005 which was established for the benefit of the Employees.

The market value of the Applicant’s shares has dropped significantly subsequent to the Employees acquiring the shares in terms of the Share Incentive Scheme (the Scheme) leading to an intention to wind up the Scheme.

The Trust Deed regulating the Scheme makes provision for the following:

- Participants would be granted options to acquire shares or offered shares to be acquired in the Applicant at a strike price or purchase price equal to the weighted average value per ordinary share, determined over a period of five (5) trading days on the JSE on the option date or the offer date, as the case may be.
- Where a Participant accepts an option or the offer to purchase shares, the option or the right must be exercised by written notice given by the Participant and delivered to the secretary of the Applicant within two (2) business days of the option date or the offer date, as the case may be. The option or the right, if not previously exercised, will lapse prior to the exercise thereof if the employment of the Participant is terminated for any reason whatsoever, including ill health, retirement, retrenchment or death.
- On the day on which a Participant exercises an option or right, the Participant will be deemed to have purchased from the Trust and the Trust will be deemed to have sold to the Participant that number of shares in respect of which the option or the offer to acquire such right was exercised on the following terms –
  - The shares will be acquired by the Participant at a price (strike price or purchase price, as the case may be), being the price per

share payable by a Participant in terms of the Scheme, which will be the fair market value thereof as at the option date or offer date, as the case may be;

- On the delivery date, those shares will be issued or transferred and delivered to the trustees for the benefit of the Participant against payment by the Trust on behalf of the Participant;
- Ownership of, and the risk and benefit in those shares, including voting rights, the right to dividends and other benefits attaching to those shares, will only pass to the Participant on the delivery date, being the first business day after the day on which the Participant exercises his/her right;
- Against delivery of those shares to the Participant, he/she will be deemed to have pledged those shares to the trustees;
- There will be no restriction on the sale of those shares by any Participant provided that on disposal of any of those shares, the Participant will be required to discharge his/her share debt in respect of those shares. The share debt will be paid for by the Participant no later than the expiry date, being within a period of ten years from the option date or the offer date, as the case may be;
- If the total amount of the share debt is not paid on the expiry date and remains unpaid for a period of 21 days after receipt of the proceeds from the sale of those shares (selling price) by the Participant, the trustees will be entitled to cancel the said sale in respect of those shares concerned. The trustees will recover all damages, suffered by the trust in consequence of the said cancellation, from the Participant. In that event, the trustees shall be entitled to retain all amounts paid by the Participant in reduction of his/her share debt.

Since 2005 the Employees were granted options or have received offers to acquire shares. The Employees exercised their options or accepted these offers, as the case may be, which resulted in shares being transferred to them. They funded the purchase price of those shares (that is, the market value of those shares at the time) out of loans advanced to them by the Trust. The share debt attracts interest at the average cost of group debt to the company over the period concerned, depending on the cost of debt for the month, which is a market related rate.

During 2006 and 2007, capital distributions were made to the Participants in respect of their shares so acquired.

## **6. Conditions and assumption**

This ruling is not subject to any conditions and assumption.

## **7. Ruling**

The ruling made in connection with the proposed transaction is as follows:

- Section 10(1)(nE) will not be applicable to the proposed transaction as the shares are restricted equity instruments as envisaged in paragraph (b)(ii) of the definition of 'restricted equity instrument' in section 8C(7).
- The definition of 'consideration' in section 8C(7) refers to the purchase price of the shares. The said definition does not include any interest incurred in respect of any loan obtained by the Employee to finance the purchase price of those shares.
- The interest incurred in respect of the loan obtained to acquire those shares in the Applicant is not deductible under section 11(a) or 24J(2) in determining the Employees' taxable income as a result of the application of section 23(m).
- One third of the interest expense incurred as provided for in paragraph 20(1)(g) of the Eighth Schedule cannot be added to the base cost of those shares, in determining the Employee's capital gains tax liability, as the interest expense was incurred prior to the vesting date for purposes of section 8C which date is the date on which the base cost of the equity instrument is determined under paragraph 20(1)(h).
- The capital distributions received after valuation date but before 01 October 2007 will not be included in the income of the Employees under section 8C(1A), but will be added to proceeds in calculating their capital gains tax liability on disposal of those shares as provided for in paragraph 76(2)(b) of the Eight Schedule.

## **8. Period for which this ruling is valid**

This binding class ruling, issued in September 2009, is valid in respect of the proposed winding up of the Scheme.

Issued by:

**Legal and Policy Division: Advance Tax Rulings**  
**SOUTH AFRICAN REVENUE SERVICE**