

# Tax treatment of share option and share incentive schemes

In recent years an increasing number of South Africans have become share owners. With interest rates at their lowest levels in thirty years many investors have turned to participation in the JSE either directly through share ownership or indirectly through collective investment schemes in an attempt to derive a return that beats inflation. The proliferation of broad-based employee share incentive arrangements has also contributed to share ownership among South Africans.

An employee may be subject to income tax when they acquire shares from their employer or from an employee share purchase trust set up by the employer. Any gain or loss on shares so acquired is determined in accordance with special rules contained in sections 8A, 8B and 8C. These rules are complex and a full discussion of them is will be provided on request. Employers will usually determine the gain or loss and deduct the required amount of employees' tax (PAYE). The gain or loss will be reflected on employee's tax certificate (IRP 5).

Set out below is a brief overview of sections 8A, 8B and 8C.

Shares or options acquired before 26 October 2004 (section 8A)  
Section 8A applies to shares or options acquired by an employee (including a director) from his or her employer before 26 October 2004. Any revenue gain determined under section 8A will be included in employee's income. Such a gain usually arises when the employee exercises an option to acquire shares from his or her employer and the price paid for the shares is less than the market price at the time of acquisition. When an employer does not allow an employee to sell the shares before a certain date, the employee can elect to delay the taxation of the gain until that date.

Once an employee have been subject to income tax under section 8A on the shares acquired from the employer a further gain or loss may arise when the shares are disposed. The capital or revenue nature of this further gain or loss is determined in the normal way; that is, shares held as capital assets will be subject to CGT, while shares held as trading stock will be subject to income tax in full. For CGT purposes the base cost of the shares will be the market value that was taken into account in determining the section 8A gain.

#### Example 2 – Shares acquired under section 8A

##### Facts:

On 1 October 2004, T was granted an option to acquire 1 000 shares in T's employer, ABC Ltd at a price of R1,00 per share when the market price was R1,50 per share. T paid 10 cents per share for the options. On 28 February 2009 T exercised the options when the market price was R5,00 per share, and on 30 June 2011 T sold the shares at R8,00 per share.

##### Result:

The following gains will arise in T's hands:

- 2009 year of assessment – an ordinary income gain under section 8A
- 2012 year of assessment – a capital gain.

These gains will be determined as follows:

##### Section 8A gain

Market value of shares at date option exercised (1 000 x R5) 5 000

Less: Cost of options 1 000 x 10 cents (100)

Cost of shares 1 000 x R1,00 (1 000)

Section 8A gain included in income 3 900

##### Capital gain

Proceeds 1 000 x R8,00 8 000

Less: Base cost 1 000 x R5,00 (5 000)

Capital gain 3 000

Note: The actual cost of the shares comprises the option cost of R100 and the purchase price of the shares of R1 000. These amounts are excluded from base cost, since they have been taken into account in determining the section 8A gain. It is simply the market price of the shares that was taken into account in determining the section 8A gain that constitutes the base cost. The market value taken into account is the same as the actual cost R1 100 plus the section 8A gain (R3 900) = R5 000.

#### Broad-based employee share plans (section 8B)

Section 8B applies to qualifying broad-based employee share plans when at least 80% of the employees in the company are entitled to participate. In order for an employee to qualify, the market value of the shares given to him or her in the current and immediately preceding four years of assessment must not exceed R50 000. If you hold a share acquired under such a plan for at least five years, the gain on disposal will be of a capital nature and subject to CGT. But if you dispose of the share within five years, any gain will be taxed as income in your hands, and section 9C, which deems shares held for at least three years to be on capital account, will not apply. This serves as an encouragement for you to hold your shares for at least five years. The benefits of section 8B do not apply if you were a member of any other employee share incentive scheme at the time you received the shares. In that case you will be taxed under section 8C.

#### Example 3 – Broad-based employee share incentive plan: Employee disposing of shares within five years

##### Facts:

On 5 January 2011, under a qualifying broad-based employee share incentive plan, Y received 2 500 shares in Y's employer, XYZ Ltd at no cost. The shares were trading at R1 each at the time they were awarded to Y. No restrictions apply to the shares, except that they may not be sold before 5 January 2014 unless an employee is retrenched or resigns. An employee who

resigns or is retrenched must sell the 2 500 shares back to XYZ Ltd for the market value of the shares on the last day of employment. XYZ Ltd appointed a trust to administer the shares under the plan.

Y resigned from XYZ Ltd on 21 December 2011. Under the plan rules Y sold the shares back to XYZ Ltd (through the trust) on 21 December 2011 at market value of R3 750 (R1,50 per share).

Result:

Y is not subject to tax upon the granting of the shares in the 2011 year of assessment.<sup>35</sup> In the 2012 year of assessment R3 750 will be taxed as ordinary income in Y's hands when the shares are sold back to XYZ Ltd and the company will withhold the appropriate amount of employees' tax.

Example 4 – Broad-based employee share incentive plan:  
Employee disposing of shares after five years

Facts:

The facts are the same as in Example 3, except that Y left XYZ Ltd on 30 June 2016 and sold the shares on 31 January 2017 in the open market for R4 500.

Result:

Since the shares have been held for more than five years they are no longer subject to a potential income inclusion under section 8B(1) and any proceeds will be of a capital nature under section 9C(2) upon their disposal.

The disposal in 2017 will thus result in a capital gain of R4 500 (proceeds R4 500 less base cost of nil).

Shares and options acquired on or after 26 October 2004  
(section 8C)

Section 8C replaced section 8A and applies to "equity instruments" (shares and options) acquired from an employer on or after 26 October 2004. A revenue gain or loss will arise when a share or option "vests" in you. Vesting will usually happen when you acquire the share with no restrictions, or when all restrictions are lifted. If you are restricted from disposing of the share, the revenue gain or loss will be

determined at the time when the restriction is lifted. This differs from section 8A in which the revenue gain was frozen at the time of acquisition of a share and on election deferred until the restriction ended.

Once you have been subject to income tax under section 8C on the shares acquired from your employer a further gain or loss may arise when you dispose of them. The capital or revenue nature of this further gain or loss is determined in the normal way; that is, shares held as capital assets will be subject to CGT, while shares held as trading stock will be subject to income tax in full. For CGT purposes the base cost of the shares will be the market value that was taken into account in determining the section 8C gain.