THE SOUTH AFRICAN TAX IMPLICATIONS OF BLACK ECONOMIC EMPOWERMENT TRANSACTIONS

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The South African Tax Implications of Black Economic Empowerment Transactions

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I would like to express my thanks to Professor Lindsay Mitchell, my supervisor, for his assistance and advice in the compilation and preparation for submission of this material. I would also like to extend my thanks to all authors of the relevant reference material referred to in this dissertation as, without their insight into this complex topic, the finalisation of this dissertation would not have been possible.
ABSTRACT

The aim of this dissertation is to research the existing South African income tax legislation that is available for use by various parties when conducting equity transactions aimed at compliance with the ownership element of the Black Economic Empowerment (BEE) scorecard and to suggest recommendations when possible to the Income Tax Act 58 of 1962 that may be necessary to encourage an increased focus on making a success of BEE within South Africa. To achieve this, existing income tax legislation applicable to each party in the transaction is considered separately as the tax consequence differ depending on whose perspective is being considered. This dissertation represents tax legislation applicable as at 8 January 2008, including all amendments up to this date.
DECLARATION

I hereby declare that this dissertation is entirely my own work.

____________________________________
Chanelle Kim Beukes
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<table>
<thead>
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<th>Term</th>
<th>Description</th>
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<tbody>
<tr>
<td>BBBEE</td>
<td>Broad Based Black Economic Empowerment</td>
</tr>
<tr>
<td>BEE</td>
<td>Black Economic Empowerment</td>
</tr>
<tr>
<td>BEE Act</td>
<td>Broad Based Black Economic Empowerment Act No 53 of 2003</td>
</tr>
<tr>
<td>CGT</td>
<td>Capital Gains Tax</td>
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<tr>
<td>DTI</td>
<td>Department of Trade and Industry</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>SAICA</td>
<td>South African Institute of Chartered Accountants</td>
</tr>
<tr>
<td>SANAS</td>
<td>South African National Accreditation System</td>
</tr>
<tr>
<td>SARS</td>
<td>South African Revenue Services</td>
</tr>
<tr>
<td>SPV</td>
<td>Special Purpose Vehicle</td>
</tr>
<tr>
<td>STC</td>
<td>Secondary Tax on Companies</td>
</tr>
<tr>
<td>The Codes</td>
<td>The Codes of Good Practice</td>
</tr>
<tr>
<td>The Act</td>
<td>Income Tax Act No 58 of 1962</td>
</tr>
</tbody>
</table>
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• Paragraph 11(2)(j) of Eighth Schedule
• Paragraph 12(2)(c) of Eighth Schedule
• Paragraph 20 of Eighth Schedule
• Paragraph 29(4) of Eighth Schedule
• Paragraph 42A of Eighth Schedule
CHAPTER 1
INTRODUCTION

Background to Black Economic Empowerment in South Africa

Black Economic Empowerment (BEE) is a process of transformation implemented and administered by the Department of Trade and Industry (DTI) on behalf of the South African Government. This process aims to contribute to the economic transformation of South Africa by reversing the economic damage caused by apartheid and thereby correcting past injustices to certain categories of South African citizens. The DTI defines BEE in its Strategy document as¹

‘an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country’s economy, as well as significant decreases in income inequalities’.

In the decades leading up to democracy, the Government of South Africa excluded certain people (African, Indian and Coloured people – collectively known as ‘Black people’) from participating in the country’s economy. This resulted in a financial, social and moral distortion between the majority of the country’s citizens and the ‘privileged class’ who were entitled to participate meaningfully in the economy.

A political and constitutional transformation took place in South Africa in 1994, however, various economic disparities that existed at this stage could not be corrected immediately. To minimise the economic gap that had developed between the previously-advantaged citizens of the country and those that had been unfairly treated, the Government entrusted the DTI to implement and oversee a process of socio-economic transformation referred to as ‘Black Economic Empowerment’. This process aims to accelerate the integration of all Black people (defined simply as South African citizens who belong to the African, Indian or Coloured race groups) into the South African economy, including women, people with disabilities, youth and people living in rural areas.

Implementation of Black Economic Empowerment

In 2003, the DTI released its Strategy Document entitled ‘A Strategy for Broad-Based Black Economic Empowerment’ which defined BEE and the transformation imperative. This was followed by the introduction of the Broad Based Black Economic

Empowerment Act 53 of 2003 (BEE Act) which was promulgated in January 2004. The BEE Act provides the legislative framework for BEE by defining the policy and outlining the mechanisms for regulation and measurement. The BEE Act refers to two primary mechanisms to ensure that the BEE strategies are effectively implemented, namely,

- the Codes of Good Practice, and
- Transformation Charters.

**Codes of Good Practice**

Section 9 of the BEE Act states that the Minister of Trade and Industry may, by notice in the Gazette, issue codes of good practice on BEE. The Codes of Good Practice (the Codes) were issued on 9 February 2007 and essentially provide the framework for the measurement of BEE across all sectors of the economy. According to the DTI, the intention behind the Codes is to

‘level the playing field for all entities operating within the South African economy by providing clear and comprehensive criteria for the measurement of broad-based BEE’.

The Codes are organised into various series, for example, Code 000 through to Code 900 and each Code is further broken down into various Statements.

Code 000 outlines the general principles of BEE. It sets out a generic scorecard that is an integral tool in measuring compliance with the envisaged BEE strategy and assessing an entity’s progress in achieving the pre-set BEE targets. The scorecard is divided into seven key elements with a different weighting or points allocation attaching to each element. As there are different levels of BEE recognition, the higher the score achieved on the scorecard, the greater the recognition level. For example, an entity that attains 100 points or more (made possible by the award of bonus points) will be regarded as a ‘Level One Contributor’ to BEE whereas a score below thirty points will categorise the entity as a ‘Non-Compliant Contributor’. The BEE recognition level is the recognition that a client receives when buying from a BEE compliant supplier, which in turn has an impact on the afore-mentioned clients BEE recognition levels. In this way, clients will prefer to interact and procure from entities with higher BEE status to increase their own BEE recognition levels. This then ensures that a drive to implement BEE strategies occurs across the supply chain.

The other Codes deal primarily with the measurement criteria for each of the seven elements of the generic scorecard.

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Transformation Charters

The background to Transformation Charters can be found in the following extract:4

‘By the beginning of 2004 when the BEE Act was promulgated, numerous sectors of the economy had drafted industry charters on BEE and transformation. Whilst some contained scorecards loosely based on the broad-based scorecard contained in the Strategy, others were merely written undertakings of commitment to transformation. In addition, several of these charters were drafted prior to the release of the Strategy and stakeholders therefore had little point of reference in terms of broad-based elements and weightings. Furthermore, it became evident that other pertinent issues surrounding the measurement of BEE needed to be addressed to further accelerate the transformation process.’

When the BEE Act was introduced, it became necessary to introduce guidelines around the status of both existing and new Transformation Charters. This is achieved by provisions contained in the BEE Act itself, including guidelines contained in Code 000 of the Codes. In summary, an industry can apply to have a Transformation Charter gazetted under section 9 or 12 of the BEE Act (certain rules apply as to whether this can be performed). Whether a Charter is gazetted under the BEE Act ultimately determines the status of the Charter when interacting with Government. For example, when a Charter is gazetted under section 9 of the BEE Act, Government will apply the Charter instead of the Codes when interacting with that industry. But when a Charter is not gazetted under the BEE Act, it remains unbinding on all parties and merely represents a document of intent for that specific industry.

Compliance with Black Economic Empowerment

Speaking at the Shanduka and BUSA BEE Briefing in March 2005, Trade and Industry Minister Mandisa Mphalwa made the following comment regarding BEE compliance:5

‘Black economic empowerment is a process. Nobody is expecting every enterprise in South Africa to be BEE compliant immediately, but government does expect every enterprise to immediately commence implementation of BEE with a view to becoming compliant over the next 10 years!’

Section 10 of the BEE Act stipulates that all organs of state and all public entities must apply the Codes when performing the following:

- Determining qualification criteria for the issuing of licenses, concessions or other authorisations in terms of any law.
- Developing and implementing a preferential procurement policy.
- Determining qualification criteria for the sale of state-owned enterprises.

• Developing criteria for entering into partnerships with the private sector.

This implies that all state bodies are bound by the Codes. An entity operating in the private sector will, however, only be required to apply the Codes if it wants to do business with state bodies. Yet it is still encouraged to apply the Codes in its interactions with other entities. Although compliance with a BEE strategy is not actually required by every entity in South Africa, a business providing goods or services to another business that is subject to BEE will generally find that it needs to comply to retain a meaningful link in the supply chain.

The implementation and monitoring of a chosen BEE strategy is thus a crucial consideration for all South African entities that wish to continue to operate in the country into the foreseeable future, whether or not they are bound to comply with the Codes.

BEE compliance is ultimately achieved by reference to the overall score that is obtained on the different elements of the generic scorecard referred to above. In terms of the Codes, the verification of this compliance is encouraged by the use of an accredited verification agency. The South African National Accreditation System (SANAS) is in the process of developing accreditation standards and of accrediting various verification agencies.

**Key elements of generic scorecard**

According to the Codes, there are six different scorecards that may apply to an entity, depending on turnover and certain other factors. The main difference between the scorecards effectively relates to the points weighting that is attached to each of the elements on it. For purposes of this dissertation, only the generic scorecard is referred to.

As already mentioned, the generic scorecard dealt with in Code 000 is broken down into seven key elements, each element having its own individual weighting attached to it. The seven key elements and their relevant weightings are as follows:

• Ownership (20 points).
• Management control (10 points).
• Skills development (15 points).
• Employment equity (15 points).
• Preferential procurement (20 points).
• Enterprise development (15 points).
Socio-economic development (5 points).

The development of a BEE strategy for an individual entity will involve the consideration of all of these elements but the significance that is attached to each element will vary from entity to entity. This is largely due to the fact that every entity has an individual business strategy for achieving success within its chosen field of operation. Its chosen BEE strategy should therefore complement and support the general business strategy. A BEE strategy can never be a ‘one-size fits all’ solution. Each entity will need to consider the above elements in this light and thereby arrive at a tailor-made solution that best aligns with its industry and operating culture.

For the purposes of this dissertation, the ownership element is the key consideration in that it is this element that has the primary affect on the tax implications that arise out of the implementation of a BEE strategy.

Ownership element

The ownership element of the BEE scorecard is measured in terms of Code 100 of the Codes of Good Practice. It is further broken down into a number of Statements, each Statement dealing with a different aspect of the ownership element and how it is measured. For example,

- Statement 102 deals with the recognition of the sale of assets, and
- Statement 103 deals with the recognition of equity equivalents for multinational companies.

The ownership element of BEE is measured using an ownership scorecard. The ownership scorecard has been set out in Table 1-1 below:

<table>
<thead>
<tr>
<th>Category</th>
<th>Ownership criteria</th>
<th>Weighting points</th>
<th>Compliance target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voting rights</td>
<td>Exercisable voting rights in the hands of Black people</td>
<td>3</td>
<td>25% + 1 vote</td>
</tr>
<tr>
<td></td>
<td>Exercisable voting rights in the hands of Black women</td>
<td>2</td>
<td>10%</td>
</tr>
<tr>
<td>Economic interest</td>
<td>Economic interest to which Black people are entitled</td>
<td>4</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Economic interest to which Black women are entitled</td>
<td>2</td>
<td>10%</td>
</tr>
</tbody>
</table>

6 Code 100 applies only to entities that do not meet the requirements of a qualifying small enterprise (QSE). A QSE is identified in Code 800 depending on the sector in which it operates, its total number of full-time employees and its total annual turnover. A separate scorecard applies to entities qualifying as a QSE, however, for the purposes of this dissertation, only the scorecard applying to non-QSE’s is dealt with as it is the more complex of the two.

7 Source: Code 100 Statement 100 of Codes of Good Practice.
<table>
<thead>
<tr>
<th>Category</th>
<th>Ownership criteria</th>
<th>Weighting points</th>
<th>Compliance target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic interest to which the following natural persons are entitled:</td>
<td>1 Black designated groups. Black participants in employee ownership schemes. Black beneficiaries of broad-based ownership schemes. Black participants in co-operatives.</td>
<td>1 2,5%</td>
<td></td>
</tr>
</tbody>
</table>

Realisation points

<table>
<thead>
<tr>
<th>Ownership fulfilment</th>
<th>1</th>
<th>Refer paragraph 17 of Code 100 Statement 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net equity interest</td>
<td>7</td>
<td>Refer paragraph 17 of Code 100 Statement 100</td>
</tr>
</tbody>
</table>

Bonus points

<table>
<thead>
<tr>
<th>Involvement in the ownership of the enterprise of:</th>
<th>3</th>
<th>Refer paragraph 18 of Code 100 Statement 100</th>
</tr>
</thead>
</table>

Each of the categories referred to above is defined and discussed in detail in Statement 100 of Code 100. These definitions and principles are key considerations when implementing a BEE equity strategy, however, they are not discussed in detail for the purposes of this dissertation.

**Black Economic Empowerment implementation considerations**

Although this dissertation focuses on the income tax implications to various parties in certain BEE equity transactions, there are numerous other factors that need to be considered when implementing a BEE strategy. These factors include, but are not limited to, the following:

- The regulatory environment in which the entity operates.
- The accounting, tax and legal implications of conducting certain transactions.
- The overall business strategy that governs operations.
- Whether the needs of all key stakeholders have been considered (key stakeholders would generally include the Government, shareholders, employees and the wider business community).
- Whether the strategy implemented complies with the measurement requirements of the Codes.

An entity that wishes to implement a successful BEE strategy will need to consider all of these factors in light of its individual circumstances and thereby arrive at a strategy that is customised and in line with its individual business strategy and operating environment.
Although the income tax implications of transactions are not the only crucial consideration in implementing a successful BEE strategy, failure to properly consider the ultimate income tax consequences of achieving BEE compliance could be an expensive mistake for various parties to the transaction, either immediately on implementation or later on when, for example, shares are disposed of. On top of this, transactions focusing on the ownership element of the BEE scorecard (equity transactions) are increasing in complexity in that a far wider range of participants are being involved. These participants now extend not only to an external BEE partner but include the involvement of employees, management, customers and even community groups. This increase in the number of participants naturally increases the tax complexity of transactions, however, to date, there have been limited tax developments aimed at BEE transactions.

This dissertation researches the existing South African income tax legislation that is available for use by various parties when conducting equity transactions aimed at compliance with the ownership element of the BEE scorecard. Changes (or amendments) to the Income Tax Act 58 of 1962 (the Act) that may be necessary to encourage an increased focus on making a success of BEE within South African are also recommended. This dissertation represents tax legislation applicable as 8 January 2008, including all amendments up to this date. Accordingly, it does not take into account amendments as per the following legislation promulgated since this date:

- Revenue Laws Amendment Act 60 of 2008.8
- Revenue Laws Second Amendment Act 61 of 2008.9
- Taxation Laws Amendment Act 3 of 2008.10
- Taxation Laws Second Amendment Act 4 of 2008.11

**Chapter outline**

To identify the existing income tax legislation that is available when conducting a transaction aimed at the ownership element of a BEE strategy, it is necessary to separately consider each party to the transaction as the tax consequences differ depending on whose perspective is considered.

Chapter 2 deals with the tax implications that are applicable for employees when acquiring shares as part of a BEE transaction.

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8 Promulgated on the 8 January 2009 (Government Gazette No 31781).
9 Promulgated on the 8 January 2009 (Government Gazette No 31782).
10 Promulgated on the 22 July 2008 (Government Gazette No 31267).
11 Promulgated on the 3 July 2008 (Government Gazette No 31208).
In Chapter 3 the tax implications applicable to third parties when acquiring shares as part of a BEE transaction are considered.

Chapter 4 deals with the tax implications applicable to the target company itself when selling shares as part of a BEE transaction.

Finally, Chapter 5 concludes on the overall findings of this dissertation.
CHAPTER 2
TAX IMPLICATIONS TO EMPLOYEES

Background

In the spirit of true broad-based empowerment that is envisaged in the BEE Strategy document released by the DTI, recent BEE equity transactions have started to display a far wider empowerment strategy. This has materialised in a shift away from involving only third-party BEE partners and moving towards the increased involvement of existing employees to satisfy the ownership element of the BEE scorecard. This is due to the fact that many South African companies have realised that BEE is fast becoming a reality that can no longer be avoided and the best place to start is at home by creating vehicles to enable share ownership by employees. This chapter focuses on the tax implications that affect employees who are involved in the implementation of an entity’s BEE equity strategy.

The involvement of employees in an entity’s BEE equity strategy will typically involve the use of one or more share incentive schemes so as to place shares in the hands of qualifying employees. Share incentive schemes in themselves can be complex structures that often involve the use of a trust as a vehicle to hold or vest shares in the hands of employees. Once again, when establishing an employee share incentive scheme, there are a number of factors that an entity will need to consider in addition to the tax implications. This could include factors, for example,

- the potential accounting implications imposed by the International Financial Reporting Standards (IFRS),
- methods of financing the trust,
- whether new or existing shares are to be issued,
- the level of employees being granted shares, and
- the corresponding need to link awards to performance-related criteria.

As this chapter focuses on the tax implications to the employees themselves, the issues affecting the entity on the implementation of an employee share incentive scheme is not dealt with (it is dealt with in Chapter 4).

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When considering the tax implications to an employee of acquiring shares in an entity under a BEE equity transaction, there are two main categories of plans that have differing tax consequences, namely,

- broad-based employee share plans that meet the requirements of s 8B of the Act, and
- then all other share plans that will generally fall within s 8C of the Act.

Each of these are discussed in more detail below. Irrespective of the type of share incentive plan that is implemented, the dividends that are received by or accrue to employees for shares held in a local company will be exempt from normal tax in terms of s 10(1)(k)(i) of the Act.

**Broad-based employee share plans**

Traditionally, share schemes have aimed to incentivise and remunerate executive management of an organisation, however, this is not always of use when attempting to achieve a broad-based empowerment strategy that aims to place shares in the hands of a much larger category of employees. For this reason, s 8B and s 10(1)(nC) of the Act were introduced in 2004 and, although the incentives provided hereunder are still fairly limited, it is clearly a step in the right direction of introducing tax legislation to encourage the implementation of a broad-based BEE strategy that benefits the envisaged categories of South African citizens.

**Section 8B**

Section 8B was introduced with effect from 26 October 2004. Although it is actually a taxing provision in that it requires certain amounts to be included in the income of a person in a year of assessment on the disposal of qualifying shares, it also contains the definitions of

- a ‘qualifying equity share’, and
- a ‘broad-based employee share plan’,

both of which need to be considered when determining whether the *award* of qualifying shares to employees is exempt under s 10(1)(nC).

The provisions of the Act that are relevant to the taxing of these shares, both on the award and on ultimate disposal are discussed below.

Section 1 defines ‘gross income’ in relation to a resident to mean the total amount, in cash or otherwise, received by or accrued to or in favour of a resident, during a year or period of assessment but excluding receipts or accruals of a capital nature.

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13 Francis Newham, director at Cliffe Dekker Inc, 19 January 2006, ‘Broad-Based Employee Share Plans’
There are also some ‘special inclusions’ that are specifically included in the definition of ‘gross income’ in s 1, even if they are of a capital nature. Paragraph (c) of these special inclusions is relevant here. It includes in the definition of gross income

‘any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered or any amount . . . received or accrued in respect of or by virtue of any employment or the holding of any office . . .’.

Section 8B(1) includes in the income of a person for a year of assessment, notwithstanding s 9C (see below), a gain made by that person from the disposal of a qualifying equity share, that is disposed of within five years from the date of grant (certain exceptions apply). A gain is defined in s 8B(3) as the difference between the amount received or accrued on disposal and the consideration given.

Section 10(1)(nC) provides an exemption from normal tax for

‘any amount received by or accrued to that person in the form of a qualifying equity share contemplated in section 8B’.

It is thus necessary to further consider the definitions of a ‘qualifying equity share’ and a ‘broad-based employee share plan’ as contained in s 8B(3).

A ‘qualifying equity share’ is defined as a share that is acquired in terms of a broad-based employee share plan when the market value of all equity shares acquired (as determined on the grant date of each share) in the current year and the two immediately preceding years of assessment does not in aggregate exceed R9 000. What is not clear from this definition is what the tax treatment will be when the market value of all shares awarded exceeds the R9 000 threshold. It is submitted in Silke\textsuperscript{14}

‘that the phrase “does not in aggregate exceed R9 000” should preferably read “to the extent that it does not in aggregate exceed R9 000”’.

The result of adopting this interpretation would be that the exemption will apply to the first R9 000 worth of shares awarded and a value awarded in excess of it will not qualify for the exemption from normal tax. Yet it is not clear whether this is the interpretation that the South African Revenue Services (SARS) will take. This should ideally be clarified by an amendment to the existing legislation.

The definition of a ‘broad-based employee share plan’ is crucial to the understanding of these provisions. Its main requirements, all of which must be met, are summarised as follows:

\textsuperscript{14} Silke on South African Income Tax in § 4.73A.
- The employer must offer equity shares in itself or in a company that forms part of the same group of companies as it (the term ‘group of companies’ is defined in s 1) for a consideration that does not exceed the minimum consideration required by the Companies Act 61 of 1973. This implies that the shares must be awarded to an employee for no consideration or for a consideration that does not exceed the nominal value of the shares.

- The employee to whom shares are offered may not participate in another equity scheme of the employer or of a company in the same group of companies as the employer.

- At least 90% of the remaining permanent employees (having excluded those who already participate in another equity scheme) are entitled to participate (they do not necessarily have to participate but should be entitled to do so).

- The participants must be entitled to full dividend and voting rights for their shares held.

- There must be no restrictions imposed on the disposal of the shares, other than a restriction imposed by legislation, a right of any person to acquire those equity shares from the employee at market value, or a restriction on the disposal of shares for a period not exceeding five years from the date of grant (the ‘date of grant’ is defined as the date when the granting of the share is approved by the directors or other similar authority).

**Tax implications on award of shares**

Provided all of the requirements of a ‘qualifying equity share’ and a ‘broad-based employee share plan’ as described above are met, the award of shares to an employee will not result in him being taxed on this award. The value of shares received by the employee will fall into gross income in terms of para (c) of the definition of ‘gross income’ as the award is linked to services rendered or to be rendered. But then the exemption provided for in s 10(1)(nC) will result in the value of the award not being included in the employee’s income. The only exception to this is when the market value of shares awarded over the three-year period exceeds the R9 000 threshold as discussed above. It should also be noted that s 10(1)(nC) refers to any amount received or accrued

‘in the form of a qualifying equity share’.

This implies that should the employee rather receive cash to enable him to purchase a qualifying equity share, the exemption is unlikely to apply and the cash award will be included in income and taxed accordingly.

The only other consideration on the award of shares to an employee is whether this award constitutes a taxable fringe benefit for the purposes of the Seventh Schedule to the Act. Ordinarily, in terms of para 2(a) of the Seventh Schedule, when an employee acquires an asset
from his employer for no consideration or a consideration below market value, a taxable benefit arises. The value of this benefit is the difference between the market value and the consideration paid. The value is then included in the employee’s gross income in terms of para (i) of the definition of ‘gross income’. But the proviso to para 2(a) of the Seventh Schedule states that the ordinary rules will not apply to a qualifying equity share as contemplated in s 8B. This means that no taxable fringe benefit arises when an employer awards qualifying equity shares to an employee under a broad-based employee share plan. Similarly, an interest-free or low-interest loan granted to an employee to enable them to acquire a qualifying equity share is an excluded taxable benefit under para 2(f).

**Tax implications on disposal of shares**

The tax implications on the ultimate disposal of shares that meet the definitions contained in s 8B(3) become slightly more complicated. Two situations are envisaged, namely,

- when the shares are disposed of within five years from grant date, or
- when the shares are disposed of after the five-year period.

When the shares are disposed of within five years from grant date (certain exceptions apply on the death or insolvency of the employee or on exchange for another qualifying equity share), s 8B(1) applies and includes the gain made on the disposal in the person’s income for the relevant year of assessment, even if this gain is of a capital nature. This will apply even when the employee has left the employment of the employer who awarded the shares as the provisions of s 8B apply to a ‘person’ and not an ‘employee’. (Although the legislation does not cater for the intended tax treatment of a loss on the disposal of qualifying equity shares, this does not appear to be a material deficiency as the likelihood of a person disposing of the shares below the consideration that was paid for them (maximum of nominal value of shares) appears to be remote).

When, however, the shares are disposed of after the five-year period, s 8B(1) does not apply. The tax treatment of the shares will depend on whether the date of disposal occurred before or after 1 October 2007.

**Disposals before 1 October 2007**

When the shares were disposed of prior to 1 October 2007 and held for at least five years, the normal capital versus revenue rules need to be considered in determining how this gain should be taxed. A detailed analysis of the difference between capital and revenue is not performed for
the purpose of this dissertation, but in simple terms, when it can be shown that the shares were sold in a scheme of profit making, the gain is likely to be revenue in nature and the full value included in gross income.\(^\text{15}\) When, however, it can be proved by the taxpayer that the gain is capital in nature, the amount to be taxed will be determined in accordance with the provisions of the Eighth Schedule to the Act, resulting in a lower tax liability.

The only exception to this will be when the provisions of s 9B are applicable to the disposal. Section 9B applies to listed shares held for a continuous period of at least five years prior to disposal and effectively treats the gain on disposal to be of a capital rather than a revenue nature, provided its provisions are elected by the taxpayer.

The tax treatment of qualifying equity shares disposed of after five years was considered a deficiency in the taxing of shares relating to broad-based employee share plans due to the uncertainty associated with the tax treatment on ultimate disposal. The Explanatory Memorandum to the Revenue Laws Amendment Bill, 2004 states that

\[\text{‘if the employee sells the shares after this five-year period, the employee’s gains will generally be capital in nature’.}\]

Although this will generally be the position, there is no certainty in this regard and the normal capital versus revenue rules as referred to above will need to be considered when the shares do not qualify for the relief provided in s 9B. Due to this uncertainty, the South African Institute of Charted Accountants (SAICA) expressed dissatisfaction with the existing tax treatment of qualifying equity shares in its submission to National Treasury by noting the following:\(^\text{16}\)

\[\text{‘Employees should have certainty as to the tax treatment of the proceeds arising from the sale of qualifying equity shares that fall within the scope of section 8B. This certainty could be provided by extending the provisions of section 9B.’}\]

SAICA proposed that the wording of s 9B, which applies only to listed shares held for at least five years prior to disposal, be amended so that it includes both listed shares and qualifying equity shares as defined in s 8B. The result of this proposal would be to provide certainty to taxpayers regarding the tax treatment of qualifying equity shares after the five-year period by deeming the disposal to be of a capital nature.

This certainty has now been awarded with the introduction of s 9C in the Revenue Laws Amendment Act, 35 of 2007. Its provisions apply to disposals of all ‘qualifying shares’ on or after 1 October 2007.

\(^{15}\) Principle established in Overseas Trust Corporation Ltd v CIR, 1926 AD 444, 2 SATC 71.

\(^{16}\) View expressed in SAICA’s Submission to National Treasury on ‘Broad-Based Employee Share Plans and Section 9B’, 11 July 2005, Available: [https://www.saica.co.za](https://www.saica.co.za).
Disposals after 1 October 2007

When the shares are disposed of on or after 1 October 2007 and provided s 8B(1) does not apply, the provisions of s 9C may be used to treat the gain or loss on disposal as capital in nature.

The general rule contained in s 9C is that the sale of ‘qualifying shares’ is deemed to be capital in nature.

‘Qualifying shares’ are defined as an equity share that has been disposed of by the taxpayer if they were held for a continuous period of at least three years prior to disposal. Specifically excluded are

- shares in a share block company,
- shares in an unlisted foreign company, or
- a hybrid equity instruments as contemplated in s 8E.

Section 9C also includes certain anti-avoidance rules. These are not considered for the purpose of this dissertation.

When the shares are disposed of on or after 1 October 2007 and the provisions of s 9C do not apply, the normal capital versus revenue rules discussed above need to be considered when determining the tax treatment of the disposal.

Recommendations

Francis Newham in an article written on broad-based employee share plans and BEE ownership in January 2006, states that the provisions relating to broad-based employee share plans17

‘constitute a simple and effective means for ensuring worker participation, albeit in a limited way, in a manner that is both tax effective for all concerned and should form an essential building block in any BEE structuring of a company with a significant labour-force or in any contemplated merger or take-over of such a company’.

A similar view was expressed by Deneys Reitz, the legal firm, in an article on broad-based plans appearing in Integritax:18

The tax concessions provided by section 8B of the Act are to be welcomed as a contribution by Government to the spread of economic interests amongst the wider group of ordinary employees, rather than the select few upon whom those benefits are currently and frequently bestowed. Admittedly the tax concessions are not particularly significant. But they are structured in such a way that by the simple expedient of periodical increases in the figures of R9 000 . . ., considerable tax benefits to both employer and employee can be secured. This will encourage even greater participation by black persons in business enterprises on a basis which is tax efficient for all parties.”

Despite these views and the fact that the introduction of these provisions are a step in the right direction by Government, the provisions of s 8B make it clear that there are onerous requirements that need to be met before a share plan can be classified as a ‘broad-based employee share plan’ and accordingly afford the beneficiary of the shares with favorable tax consequences in the form of an exemption when the shares are awarded. Combined with the fact that these incentives will often be applied only to lower-grade employees due to the restriction on linking in performance-related criteria, the value of the actual tax relief provided to the employee (R9 000 over a three-year period) is limited. The situation is not clear as to the treatment to be applied when the R9 000 threshold is exceeded.

These are criticisms that have been leveled at the tax provisions that have been introduced to encourage an employer to empower a larger category of employees when implementing BEE equity transactions. They also highlight some considerations that should be taken into account by the Government when amending the existing tax legislation.

The Budget Tax Proposals19 that form part of the National Budget Speech20 presented by Finance Minister, Trevor Manuel, on 21 February 2007, confirmed that Government is considering BEE transactions when amendments to tax legislation are introduced. A tax proposal included under the heading ‘Corporate Reorganisation and BEE Transactions’ related to broad-based share incentive schemes. It noted the following:21

‘In 2004, government introduced a tax incentive to facilitate broad-based share employee ownership. As a result, employees can now receive up to R9 000 worth of shares tax-free over a three year period (with companies eligible for up to R3 000 of deductions per annum). This incentive was partly driven by the need to have more broad-based schemes that would include rank-and-file employees. Unfortunately, usage of the incentive appears to be minimal. This incentive will accordingly be reviewed for possible change.’

Despite this proposal, there have been no amendments to these provisions.

Other share plans

Although it would generally be more beneficial from a tax perspective for an employee to receive the right to shares that meet the requirements contained in s 8B of the Act, this is not always the position, due largely to the fact that an employer can then not link these rights to a performance-related criteria.

Should an entity wish to combine encouraging an employee with the implementation of a BEE equity strategy, it may choose to award rights to shares that have various restrictions attached to them. In so doing, the share plan is likely to fail the requirements of a broad-based employee share plan as defined in s 8B. When a share plan that is implemented as part of a BEE equity strategy does not qualify for the broad-based tax incentives discussed above, the employee is likely to be taxed in terms of s 8C of the Act.

Section 8C

Section 8C was introduced with effect from 26 October 2004. It applies to an ‘equity instrument’ acquired on or after that date, other than by way of the exercise of a right granted before that date. Section 8C replaced the more favourable s 8A (still applicable to rights to marketable securities obtained before 26 October 2004). It suspends the determination of a gain or loss that must be included in, or deducted from, income until the equity instrument ‘vests’ in the taxpayer. As highlighted by an article appearing in Integritax in December 2004:

‘the cumulative effect of the [introduction of s 8C] . . . is to ensure that any tax advantages under future employee share incentive schemes of whatever description will cease, and that all gains or losses arising from the award of shares or options to employees will be treated as income, or losses, and taxed accordingly’.

The provisions of the Act that are relevant to the taxing of these instruments on the award, vesting and ultimate disposal are discussed below.

Section 8C(1), notwithstanding s 9B, s 9C and s 23(m), includes in the income, or deducts from the income of a taxpayer for a year of assessment a gain or loss made by him from the vesting of an equity instrument, if it was acquired by him either by virtue of his employment or directorship of a company or by virtue of another restricted equity instrument held by him for which this provision will apply upon its vesting. This implies that there must be a necessary causal link between the acquisition of the equity instrument and employment or the holding of

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office of director, irrespective of who the equity instrument is received from. This provision does not apply to a qualifying equity share contemplated in s 8B and to an equity instrument acquired in exchange for an equity instrument that had already vested.

A gain or loss is defined in s 8C(2) and is calculated as follows:

- For a disposal or a disposal by way of release, abandonment or lapse of an option or financial instrument, the difference between the amount received or accrued and the consideration paid for the instrument.
- In any other situation, the difference between the market value on the date of vesting and the consideration paid for the instrument.

Section 10(1)(nD) provides an exemption from normal tax for

‘any amount received by or accrued to that person which constitutes—
(i) an equity instrument contemplated in section 8C acquired by that person and in respect of which that section applies; or
(ii) consideration for the disposal of an equity instrument contemplated in subparagraph (i), which had not yet vested as contemplated in that section at the time of that acquisition or disposal’.

It is thus necessary to further consider the definition of an ‘equity instrument’ and when it is deemed to ‘vest’ for the purposes of s 8C.

An ‘equity instrument’ is defined in s 8C(7) as

- a share or part of a share in the equity share capital of a company, or
- a member’s interest in a close corporation,

and includes an option to acquire shares and another financial instrument that is convertible into shares.

In terms of s 8C(3), an equity instrument is deemed to vest on the following dates:

- For an unrestricted equity instrument, at the time of acquisition. An unrestricted equity instrument is defined as one that is not a restricted equity instrument (refer below).
- For a restricted equity instrument, at the earliest of the following:
  - When all the restrictions cease to exist.
  - Immediately before disposal (certain exceptions apply).
  - Immediately after termination of an option or convertible financial instrument (otherwise than by exercise or conversion).
  - Immediately before the death of the taxpayer, if all restrictions are lifted on his death.
  - At the time a disposal occurs in relation to disposals contemplated in s 8C(2)(a)(i) or s 8C(2)(b)(i).
A restricted equity instrument is an equity instrument

- that is subject to a restriction that prevents the taxpayer from freely disposing of it at its market value,
- that is subject to restrictions that could result in him forfeiting its ownership otherwise than at its market value,
- if a person has retained the right to impose the above restrictions,
- that is an option to acquire a restricted equity instrument,
- that is a financial instrument convertible into a restricted equity instrument,
- if the employer, associated institution or another person by arrangement has undertaken to cancel the transaction or repurchase it if there is a decline in its value, or
- that is not delivered to the taxpayer until the happening of a fixed or contingent event.

**Tax implications on award of instruments**

A primary objective of the introduction of s 8C into the Act is to ensure that the taxpayer is not subjected to tax when an equity instrument is awarded or acquired but rather when it vests (refer to discussion below). Provided an ‘equity instrument’ as defined in s 8C has been awarded to an employee and provided it has not yet vested as contemplated in that provision, the award of shares, options or similar instruments to him will not result in him being taxed on the award. Although the value of the shares, options or instruments received by the employee will generally fall into his gross income due to the requirements of para (c) of the definition of ‘gross income’ (refer to discussion on award of shares in relation to broad-based employee share plans above), the exemption provided for in s 10(1)(nD) will result in the value of the award not being included in his income.

There appears to be an oversight in the Act relating to the tax treatment on the award of equity instruments that vest immediately. This appears to be the situation as the value of the instruments will fall into gross income in terms of para (c) of the definition of ‘gross income’, but there is no exemption in terms of s 10(1)(nD) as the instruments would have immediately vested. The provisions of s 8C will also apply to bring the gain or loss on vesting into income on the date of the award. The result is that the same gain is being included in income twice. Although this does not appear to be the intention of the legislature, it is recommended that the legislation be amended to clarify that a gain included in income on the vesting of equity instruments as contemplated in s 8C should not again be included in gross income.
Similarly to shares awarded under a broad-based employee share plan, the award of equity instruments as contemplated in s 8C to employees will not constitute a taxable fringe benefit for the purposes of the Seventh Schedule to the Act. Unlike shares awarded under a broad-based employee share plan, the provision of an interest-free or low-interest loan by an employer to an employee to enable them to acquire equity instruments contemplated in s 8C is not an excluded taxable benefit under para 2(f). This type of loan will result in a taxable fringe benefit.

**Tax implications on vesting of instruments**

As pointed out above, one of the primary objectives of introducing s 8C into the Act, and the corresponding removal of s 8A, is to delay the taxing of equity instruments to the time when this instrument vests in the taxpayer instead of merely when it is awarded as this is likely to result in an increased taxable gain in the scenario of an appreciating share price. Section 8C also results in a gain or loss arising on the vesting of the equity instrument being taxed on revenue account, irrespective of whether the shares are actually held on capital account and notwithstanding the provisions of s 9B or s 9C.

When the taxpayer receives an unrestricted equity instrument, it is deemed to vest on its acquisition. Accordingly, the difference between the market value on the date of acquisition and the consideration paid for it will be included in, or deducted from, the taxpayer’s income on that date. (It has already been pointed out under the discussion regarding the tax implications on the award of instruments that, although this does not appear to be the intention of the legislature, there appears to be an oversight in the legislation regarding the tax treatment of an unrestricted equity instrument that vests immediately on acquisition in that the same gain could be taxed twice if the legislation is strictly applied.)

When, however, the taxpayer receives a restricted equity instrument, it is deemed not to vest until a later date, essentially once all restrictions have been lifted. Once again, the gain or loss to be included in, or deducted from, the income of the taxpayer on vesting is the difference between its market value on the date of vesting and the consideration paid for it.

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23 Paragraph 2(a)(iv) of the Seventh Schedule.
**Tax implications on disposal of instruments**

When equity instruments are disposed of prior to vesting, this disposal is effectively ignored for tax purposes. This is the situation irrespective of whether the disposal is considered revenue or capital in nature due to the application of s 10(1)(nD) or para 11(2)(j) of the Eighth Schedule.

When, however, the instrument is disposed of after vesting, similar considerations that apply to broad-based employee share plans also apply here.

- When the disposal occurs prior to 1 October 2007, s 9B may apply to deem the disposal to be capital in nature or, when s 9B does not apply, the normal capital versus revenue rules will need to be considered in determining how this gain should be taxed.

- When, however, the disposal occurs after 1 October 2007, s 9C may apply to deem the disposal to be capital in nature or, when s 9C does not apply, the normal capital versus revenue rules will need to be considered in determining how this gain should be taxed.

When the disposal occurs after vesting of an instrument held by the taxpayer on capital account, a capital gain or loss needs to be determined. This capital gain or loss will be calculated as the difference between

- the proceeds received on disposal, and
- the market value of the instrument at vesting date.\(^{24}\)

When the disposal occurs after vesting of an instrument held by the taxpayer on revenue account, a revenue gain or loss needs to be determined. The calculation of this gain or loss is not as simple as when the instrument is held on capital account as it would generally involve a change in intention on behalf of the taxpayer from

- holding the instrument on capital account to,
- holding it on revenue account,

in other words non-trading stock would be converted into trading stock.

For capital gains tax (CGT) purposes, the taxpayer is treated as having disposed of the instrument at market value on the date of the change in intention.\(^ {25}\) This market value will then be treated as the cost of the trading stock for normal tax purposes.\(^ {26}\) The net result is that the

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\(^{24}\) Paragraph 20(1)(h) of the Eighth Schedule deems the base cost of a vested equity instrument to be the market value that was used in calculating the s 8C gain or loss at the time of vesting.

\(^{25}\) Paragraph 12(2)(c) of the Eighth Schedule.

\(^{26}\) Section 22(3)(a)(ii) of the Act.
increase in market value up to the date of the change in intention is effectively treated as a capital gain and taxed in terms of the Eighth Schedule. A subsequent increase in the market value up to the date of disposal will be treated as a revenue gain and taxed in full.

Special rules apply to
- connected person transactions,
- non-arm’s length transactions, and
- swap arrangements,
however, these are not dealt with in this dissertation.

**Recommendations**

Section 8C is a complex taxing provision that was introduced with the aim of ensuring
- that no tax advantages arise under an employee share scheme, and
- that a gain or loss that results from the award of shares or options to an employee is taxed accordingly.

For this reason, the provision has no intention of encouraging an employer to award shares or options as part of the implementation of a broad-based BEE equity strategy and cannot be criticised for not including provisions to achieve this. Accordingly, there do not appear to be any specific recommendations relating to s 8C that can be made to assist or encourage an entity with regards to the implementation of a BEE equity strategy.

The main consideration with regards to implementing a BEE equity strategy that involves the award of shares to an employee that is linked to performance-related criteria, and therefore fails to qualify for the tax benefits contained in s 8B, lies in the hands of the employer. The involvement of an employee in an entity’s BEE equity strategy often results in a balancing act between
- safeguarding the interests of the business, that is achieved by awarding instruments linked to an employee’s performance, and
- potentially increasing the employee’s tax exposure by issuing instruments that meet the requirements of s 8C and therefore only result in the employee being taxed on the vesting of these instruments.

This needs to be carefully considered by an entity when implementing an employee-driven BEE strategy as it may result in the employee having to liquidate his shareholding to fund the resulting tax payable.
To implement a successful BEE strategy that also complies with Government’s broad-based BEE goals, all of the above factors need to be considered in light of the specific requirements of the Codes.

As already pointed out above, Code 100 deals with the measurement of the ownership element of broad-based BEE. It is further broken down into various statements.

Statement 100 is relevant to this dissertation. It is entitled ‘The General Ownership Scorecard and the Recognition of Ownership Arising from the Sale of Equity Instruments’. The objectives of this statement are set out in its para 4 and include the following:

- Specify the scorecard for the measurement of the ownership element of broad-based BEE (the ownership scorecard and its key elements have already been set out in Table 1-1 in Chapter 1).
- Define the key measurement principles associated with the ownership element of BEE.
- Specify the specific measurement principles applicable to trusts and other schemes.
- Specify the principles governing the treatment of various instruments, for example, options and debt instruments.
- Specify the various formulas to be applied when measuring various elements on the ownership scorecard, for example, the measurement of ‘Voting Rights’, ‘Economic Interest’ and ‘Realisation Points’.
- Define the approach to awarding bonus points under this statement.

These objectives highlight the fact that, to comply with the ownership element of the Codes and thereby earn points that contribute to an entity’s level of BEE recognition, it is necessary to consider whether a specific BEE equity transaction meets the requirements and guidelines as set out in Code 100. This would involve a careful analysis of the various definitions and measurement principles as contained in Statement 100 (This analysis will not, however, be performed for the purposes of this dissertation.) It should merely be noted that compliance with the Codes is a further significant consideration in the implementation of an entity’s BEE strategy.
CHAPTER 3
TAX IMPLICATIONS TO THIRD PARTIES

Background

This chapter focuses on the tax implications that affect various third parties, other than employees, who are involved in the acquisition of an interest in a BEE target company. Recent BEE equity transactions have displayed a far wider range of participants than the traditional BEE transactions that historically involved only an external BEE consortium.

In transactions that have been implemented in more recent years, the external participants have been extended to include

- clients,
- distributors, and
- the wider community.

An example of an empowerment deal that included all these relevant parties is the Nedbank Group Limited empowerment deal.27 This increase in the number of participants simultaneously results in an increase in the complexity of the tax implications that arise from the transaction. Despite the increase in the number and complexity of recent BEE equity transactions, there have still been limited developments to date in the realm of tax legislation aimed at these transactions. It should be noted that the existing tax implications that apply to BEE equity transactions are not unique to these transactions in that they affect any taxpayer that enters a similar type of equity transaction. Although the Act does not contain specific tax consequences for BEE transactions, there are certain provisions that are available that may either provide some relief or alternatively, may have adverse tax implications when implementing these transactions. These are discussed in more detail below.

Once again, when implementing a BEE equity transaction, there are a number of factors that third parties and the target company need to consider alongside the tax implications. These include

- the potential accounting implications that arise from IFRS on the implementation of various structures,
- the required period of lock-in of the BEE third party,

27 A summary of the proposed transaction is set out in Circular to Ordinary Shareholders of the Company, available on www.nebankgroup.co.za (downloaded on 24 January 2008).
• the availability of financiers to provide the necessary financing, the guarantees and security that may be required by the target company, and
• whether new or existing shares should be issued,
that are crucial to the successful implementation of a transaction for all the parties involved. All of these factors, together with the tax implications, should be taken into account when structuring a BEE equity transaction. Each factor will need to be considered in the light of the individual requirements of the third parties and the target company involved.

Share financing

One of the most crucial considerations for a third party investor when entering into a BEE equity transaction is the method of financing that will be employed to acquire the necessary interest in the target company. To facilitate the financing of the BEE interest and to cater for the various other factors that need to be considered on implementation of a BEE equity transaction, a number of complex structures are often put in place. But the key tax considerations that exist for third-party investors when financing a share purchase will generally remain the same. These are discussed in more detail below.

Deduction of expenditure

A key consideration for third party investors is whether the expenditure incurred on financing the acquisition of an interest in the target company will be tax deductible. As there is no specific provision within the Act that allows this deduction, the positive aspect of the general deduction formula contained in s 11(a) needs to be considered.

The starting point for the deduction of all expenditure in the Act is contained in the general deduction formula. It consists of

• s 11(a), commonly referred to as the positive test as it sets out what may be deducted, and
• s 23(g) which is referred to as the negative test and stipulates what may not be deducted.

These two provisions must be read together when determining whether an amount is deductible.28 A requirement of this formula is that for expenditure to be deductible, it must have been incurred in the production of the income.

The word ‘income’ is defined in s 1 and essentially equals ‘gross income’ (a defined term) less amounts that are exempt from normal tax in terms of section 10. From this definition, it follows

28 Port Elizabeth Electric Tramway Co Ltd v CIR 1936 CPD 241, 8 SATC 13.
that income does not include ‘local’ dividends because they are exempt from normal tax in terms of s 10(1)(k)(i) of the Act. Accordingly, interest and other financing costs incurred on a loan obtained to finance the acquisition of shares that produce exempt ‘local’ dividends does not meet the requirements of the general deduction formula, in that it has not been incurred in the ‘production of the income’. It will therefore not qualify as a deduction for tax purposes.

An exception to this general rule was dealt with in *CIR v Drakensberg Garden Hotel (Pty) Ltd*. 29 In this case, it was proved by the taxpayer that the shares had been acquired for the sole purpose of acquiring the business as there was no other means of acquiring it. Accordingly, the purpose of acquiring the shares had not been to produce exempt dividends. It is not clear whether the acquisition of an equity interest in a BEE target company to acquire a part of the business operations will be able to advance the argument from the Drakensberg Garden’s case. This has yet to be tested in the South African courts.

**Preference share funding**

On the assumption that financing costs incurred to acquire shares in a target company will not be tax deductible, their acquisition becomes expensive. It could result in a taxpayer exploring alternative means of funding, including the use of preference shares.

There are two common uses for preference shares in BEE-structuring transactions’

- The first involves the issue of preference shares to a third-party investor.
- The second involves the issue of preference shares to the target company itself.

**Scenario one**

This scenario involves the issue of preference shares to a third-party investor. It usually involves the following series of transactions:

- The BEE partners create a wholly-owned special purpose vehicle (SPV) with a notional share capital.
- An external financier, usually a bank, will ‘capitalise’ the SPV by subscribing for preference shares in it at a price equal to the value of the shares to be acquired in the target company. These preference shares are redeemable at a later date. The dividends declared on the preference shares match the anticipated dividend inflow from the investment in the target company.

29 1960 (2) SA 475 (A), 23 SATC 251.
• The SPV will use the funds received from the issue of the preference shares to acquire the required percentage interest in the target company.

• The dividends received by the SPV from the investment in the target company are used to service the preference shares.

The legal form of the preference share transaction is that the SPV is paying and the external financier is receiving a dividend as opposed to interest. In terms of IFRS, it is possible that the accounting records may reflect the substance of the transaction instead of its legal form. This could result in the dividend being treated as interest paid in the accounting records of the SPV. These considerations have, however, been ignored for the purposes of this dissertation.

**Tax implications to SPV**

Assuming that the SPV performs no other operations other than holding the investment in the target company, it would receive only local dividends that would be exempt from normal tax in terms of s 10(1)(k)(i) of the Act, thereby resulting in no income on which normal tax can be levied. With regards to the payment of the preference share dividends, secondary tax on companies (STC) is payable on the net amount of the dividend in terms of s 64B of the Act. But, the dividend received from the target company is offset against the dividend declared when calculating the ‘net amount’ on which STC is levied resulting in a reduced or nil STC liability. Accordingly, there are no major or adverse tax consequences to the SPV on the use of a preference share funding structure.

**Tax implications to external financier**

The financier would earn ‘local’ dividends from the SPV that are exempt from normal tax in terms of s 10(1)(k)(i) of the Act. Section 8E may, however, apply to convert the nature of the exempt dividend into taxable interest when its provisions are met.

Section 8E is an anti-avoidance provision introduced into the Act to prevent a taxpayer from disguising a debt instrument as equity and thereby achieving a minimal or nil tax liability. Section 8E(2) states that

“any dividend declared by a company on a hybrid equity instrument which is declared on or after the date that the share becomes a hybrid equity instrument, shall for the purposes of this Act be deemed in relation to the recipient thereof only to be an amount of interest received by him from a source within the Republic”.

Section 8E(1) defines a ‘hybrid equity instrument’. In simple terms it means a redeemable preference share (or any other share in certain situations) that either
the relevant company is obliged to redeem within three years from the date of issue, or
the holder has the option to redeem the shares within three years, or
a right of disposal that may be exercised within three years from the date of issue.\textsuperscript{30}

If the provisions of s 8E(2) apply, the dividends declared on the preference shares are deemed to be interest in relation to the recipient of them. This means that the tax consequences for the issuing company are not affected in that the dividend paid is still a dividend. It

• does not then qualify for a normal tax deduction, and
• is subject to STC.

But the recipient of the dividend is deemed to receive taxable interest rather than a tax-free ‘local’ dividend.

In the scenario referred to above, when the SPV is the issuer and the external financier is the holder of the preference shares, the application of s 8E would apply to the financier, but have no adverse tax implications to the SPV. In practice, this increased cost may be passed onto the SPV, and ultimately, the BEE investor, through an increased coupon rate on the preference shares to take into account the after-tax return on the dividends.\textsuperscript{31}

\textit{Scenario two}

This scenario involves the issue of preference shares to the target company itself. It is similar to the one described above with the main difference being that the target company itself, as opposed to a third party, finances the transaction by subscribing for the redeemable preference shares in the SPV. Once the SPV has sufficient funds, the target company redeems the preference shares, thereby leaving the SPV as an unencumbered holder of the target company’s shares.

This scenario effectively results in a cross-issue of shares as the target company issues shares in itself in exchange for redeemable preference shares in the SPV. The legal form of the transaction and tax implications to the SPV remain the same as described under scenario one above, however, the tax implications to the target company are different to those described for the external financier. Although the tax consequences to the target company that arise on BEE transactions are discussed only in Chapter 4, for purposes of completion, they are dealt with in this part of the dissertation.

\textsuperscript{30} ‘Date of issue’ and ‘right of disposal’ are also defined terms within s 8E(1).
\textsuperscript{31} Part four of an eight-part series of articles on the tax implications of BEE transactions appearing in \textit{The Mercury}, Brigitte Keirby-Smith, July 2006.
The tax implications on the cross-issue of shares is governed by the provisions of s 24B(2) of the Act and, in simple terms, the company that issues its own shares in exchange for the issue of shares by another company will receive a zero base cost (or s 11(a) deduction in the newly-issued shares acquired. The result is that the target company will eventually recognise a gain for tax purposes on the full value of the redeemable preference shares at the time of redemption. As noted in the Explanatory Memorandum to the Revenue Laws Amendment Bill, 2007:

‘this result is seemingly problematic because the redemption of the preference shares is said to be economically akin to the return of principal on a loan (which should not, as a theoretical matter, give rise to tax)’.

Accordingly, an amendment to s 24B of the Act has been introduced in the form of the addition of s 24B(2A) and s 24B(2B). This amendment effectively aims to by providing an exception to the zero base cost (or s 11(a) expenditure) rule in a specific set of circumstances. To obtain this relief, the following must apply:

- The operating company (target company) must issue ordinary shares in exchange for the issue of redeemable preference shares by another company (BEE investor or SPV).
- The preference shares must be held for a period of not less than five years.
- The preference shares must be redeemed.

When all of the above apply, the expenditure incurred by the target company for the acquisition of the preference shares is deemed to be the lesser of

- the amount received or accrued on redemption, or
- the market value on the date of acquisition (as opposed to zero when the above factors do not apply).

This amendment was introduced specifically to cater for BEE transactions to but will apply to a similar transaction of this nature.

**Hybrid debt instruments**

A further exposure for BEE investors may arise when a ‘hybrid debt instrument’ is used as part of the BEE equity transaction. This would typically involve the issue of debt instruments by the target company to the BEE investor or a SPV that are convertible into equity shares at a later date.

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33 Section 39 of Revenue Laws Amendment Act 35 of 2007.
34 Explanatory Memorandum on Revenue Laws Amendment Bill, 2007, at 25.
The anti-avoidance provisions that may result are contained in s 8F. It effectively disallows a tax deduction for the interest incurred on the hybrid debt instrument. It also deems the interest incurred to be a dividend subject to STC when the instrument can, at the option of the holder or the issuer, be converted into an equity share within three years from the date of its issue.³⁶ Although this provision actually applies to the target company and not the BEE investor itself, the risk once again exists that the target company will pass on this cost to the BEE investor through a reduced interest rate to ensure that the after-tax cost of the interest is achieved.³⁷

**Corporate restructuring**

Sections 41 to 47 of the Act contain the so-called corporate restructuring rules aimed to provide tax relief when companies undergo different forms of restructuring. This tax relief is effectively achieved by deferring the normal tax and capital gains tax implications that would ordinarily arise on the transfer or disposal of assets that form part of the restructuring process, provided certain requirements are met.

Once again, the tax provisions that could apply to these types of transactions are not unique to BEE equity structuring and could apply to a similar transaction of this nature.

It should be noted that, apart from income tax, there are also exemptions from other types of taxes when the corporate restructuring rules are used, for example, value-added tax. As this dissertation deals primarily with the income tax consequences that arise from structuring of BEE equity transactions, these other taxes are not discussed.

The Budget Tax Proposals³⁸ included a number of proposals relating to the amendment of the corporate restructuring rules to facilitate the structuring of BEE transactions and to eliminate³⁹ ‘undue compliance and enforcement burdens’.

The majority of the amendments were included in the Revenue Laws Amendment Act 35 of 2007, and included, for example, the repeal of s 43 for ‘share-for-share transactions’. This amendment, together with those relevant to BEE transactions, is discussed in more detail below.

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³⁶ The terms ‘date of issue’ and ‘hybrid debt instrument’ are defined in s 8F(1).
According to an article appearing in *Accountancy SA* in June 2004, share-for-share transactions and amalgamation transactions are the most commonly used restructuring methods when structuring a BEE equity transaction and accordingly have been analysed in more detail than the other types of methods.

**Asset-for-share transactions**

Section 43 of the Act contained the provisions relating to ‘share-for-share transactions’, however, this provision has been repealed by the Revenue Laws Amendment Act 35 of 2007, effective for all transactions entered into on or after 1 January 2007. The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007 included the following comment on the reason for the repeal:

‘Two sets of rollover provisions exist that are mainly intended to address the transfer of appreciated items to an acquiring company in exchange for the issue of shares by the acquiring company. In the case of a company formation, the transferor transfers appreciated non-share assets to an acquiring company in exchange for the acquiring company’s issue of shares. In the case of a share-for-share transaction, the transferor transfers a significant shareholder stake in a target company to an acquiring company in exchange for the acquiring company’s shares. Both sets of provisions allow for tax-free rollovers, but the price of this deferred gain is duplication of that gain at two levels.

‘No reason exists to have a duplicate set of provisions for two comparable sets of transactions that essentially achieve the same results. The reason for a second set of rules for share-for-share transactions was mainly to ensure that the target company transferred did not mainly consist of financial instruments. With the financial instrument provisions removed, little reason exists for the special rules associated with share-for-share transactions.

‘The share-for-share rollover regime will be repealed. All transfers of appreciated assets (including shares) will receive rollover relief under the revised section 42.’

It is therefore necessary to consider the revised provisions of s 42 of the Act that now apply to ‘asset-for-share transactions’ and will include tax relief in relation to the old ‘share-for-share transactions’ and the old ‘company formation transactions’. Both these types of transactions become applicable when structuring a BEE equity transaction.

Section 42(1) of the Act contains the provisions relating to ‘asset-for-share transactions’ and defines such a transaction as follows:

‘[A]ny transaction –

(a) in terms of which a person disposes of an asset (other than . . . a restraint of trade or personal goodwill), the market value of which is equal to or exceed–

(i) in the case of an asset held as a capital asset, the base cost of that asset on the date of disposal; or

(ii) in the case of an asset held as trading stock, the amount taken into account in respect of that asset in terms of section 11 (a) or 22 (1) or (2),

to a company which is a resident, in exchange for an equity share or shares of that company and that person–

(aa) at the close of the date on which that asset is disposed of, holds a qualifying interest in that company; or


– As amended by s 53 of Revenue Laws Amendment Act 35 of 2007.
(bb) is a natural person who will be engaged on a full-time basis in the business of that company of rendering any service;

(b) as a result of which that company acquires that asset from that person—
(i) as a capital asset or as trading stock, when that person holds it as a capital asset; or
(ii) as trading stock, when that person holds it as trading stock; and

(c) in respect of which that person and that company have jointly elected that this section applies."

In the absence of s 42, tax implications could when assets (including shares) are exchanged for shares in another company.

- When the shares are held as trading stock, normal tax would arise on the inclusion in the transferor’s gross income of the market value of the received shares.\(^43\)
- When the shares are held as capital assets, an exchange of shares for new shares would ordinarily constitute a disposal of the original shares for purposes of the Eighth Schedule and the transferor would become liable for CGT at the time of the disposal.

But when the transaction complies with the provisions of s 42, relief could be obtained by deferring the possible normal tax and capital gains tax implications to a later date when they are ultimately disposed of by the transferee company. For this to be achieved, there are a number of requirements that need to be met. These can be summarised as follows:

- The person disposing of the asset (transferor) must be a natural person or company (including a close corporation) but not a trust (other than a special trust).
- The company acquiring the asset (transferee) must be a resident as defined for tax purposes.\(^44\)
- The transferor must receive ‘equity shares’ as defined in s 41 in the transferee company. This will include shares that entitle the transferor to participate beyond a specified or fixed amount, for example, ordinary shares or participating preference shares. When the transferor receives a consideration other than equity shares, part-disposal rules will come into play.\(^45\)
- The asset disposed of may not constitute personal goodwill or a restraint of trade but includes all other assets as defined in the definition of an ‘asset’ in para 1 of the Eighth Schedule.
- The market value of the asset must equal or exceed its base cost on the date of disposal when it is held as a capital asset or the trading stock value when it is held as trading stock. The intention behind this requirement is that the asset be disposed of at a gain and thereby attract a potential tax liability.
- The transferee must acquire the asset either

\(^{43}\) Based on the principle established in Lace Proprietary Mines Ltd v CIR 1938 AD 267, 9 SATC 349.

\(^{44}\) Refer to the definition of a ‘resident’ in s 1 of the Act.
• as trading stock if it was originally held as trading stock by the transferor, or
• as a capital asset or trading stock if it was originally held as a capital asset by the
transferor.

In other words, the only situation not permitted is for the transferee to acquire the asset as
a capital asset when it was originally held as trading stock by the transferor as this would
result in a reduced tax liability on the ultimate disposal by the transferee.

• Subsequent to the disposal of the target shares, the transferor must hold a ‘qualifying
interest’ in the transferee or be a natural person who is engaged to work on a full-time
basis in the business of the transferee of rendering any service (aimed at incorporated
professional partnerships). 46 A qualifying interest equates to the following:

  • When the transferee is a listed company or will become listed within twelve months,
an interest in it.
  • When the transferee and the transferor form part of the same group of companies (as
defined in s 41), an interest in it.
  • When the transferee is not a listed company or will not become listed within twelve
months, 20% or more of its equity shares and voting rights.

• The parties must jointly elect that the provisions of s 42 will apply to the transaction.

45 Silke on South African Income Tax in § 24.154D.
46 Silke on South African Income Tax in § 14.8.3.
This type of transaction, ignoring the scenario whereby the transferor is a natural person engaged to work on a full-time basis in the business, is illustrated diagrammatically as follows.

Figure 3-1

There are numerous ways in which the relief provided for in s 42 could be used when structuring a BEE equity transaction. A common scenario involves the situation where an existing shareholder transfers its shares in a target company in exchange for shares in a new company established for the purposes of the BEE transaction. This is illustrated diagrammatically as follows:

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47 Based on a diagram in Silke on South African Income Tax in § 24.154C.
In the above scenario,

- the existing shareholder is considered the transferor, and
- the new company is considered the transferee

for the purposes of determining the tax relief contained in s 42 of the Act, provided all of the other requirements of the provision as discussed above have been met. The tax consequences to both of these entities on the transaction envisaged above are discussed below.

**Tax consequences to transferor**

The tax consequences to the transferor on the transfer of shares in the target company are determined based on the provisions of s 42(2)(a) and depends on whether the shares were held as capital assets or as trading stock prior to their transfer.

When the shares in the target company were held as capital assets prior to transfer, the transferor is deemed

- to have disposed of the shares at an amount equal to the base cost on the date of disposal, and
to have acquired the equity shares in the new company for a cost equal to the base cost as determined under para 20 of the Eighth Schedule.

The result is that no capital gain arises on the transfer of the shares as it is effectively deferred until the date when the shares in the new company are ultimately disposed of.

When the shares in the target company were held as trading stock prior to transfer, the transferor is deemed

- to have disposed of them at an amount equal to the cost as determined under the provisions of s 11(a) or s 22(1) or (2), and
- to have acquired the equity shares in the new company for a cost equal to this same amount.

The result is that no income tax arises on the transfer of the shares as it is effectively deferred until the date when the shares in the new company are ultimately disposed of.

The above provisions apply, irrespective of whether the transferor acquires the equity shares in the new company as capital assets or trading stock and irrespective of the actual selling price.

But if an asset is sold for less than its market value, donations tax may become payable.

It should also be noted that when the market value of the shares in the target company is less than either the base cost or the amount determined in terms of s 11(a) or s 22(1) or (2), depending on whether the shares are held as capital assets or trading stock respectively, s 42 cannot apply to the disposal.

Section 42(5) and (6) also contains certain anti-avoidance rules that apply when the shares in the new company are disposed of subsequent to the asset-for-share transaction.

Section 42(5) deems the shares to be disposed of as trading stock (and the gain to therefore be taxed in full) if more than 50% of the market value of all shares transferred by the transferor to the transferee were treated as trading stock and the new shares are disposed of by the transferor within eighteen months after the transaction. When this occurs, the amount that is treated as having being received or accrued on the disposal of trading stock is limited to the market value of the shares at the beginning of the eighteen-month period. This deeming rule does not apply in certain instances, for example, when the disposal occurs due to death or in terms of a transaction contemplated in s 45, 46 or 47 of the Act.

Section 42(6) contains the anti-avoidance rules dealing with the situation when the transferor
ceases to hold a qualifying interest in the transferee, or

ceases to be engaged on a full-time basis

within eighteen months after the transaction. In these instances, the transferor is deemed to have disposed of all of the shares in the transferee that are still held on this date at their market value at the beginning of the eighteen-month period.

All the shares that are still actually held are then deemed to be reacquired at a cost equal to the same market value. Once again, this deeming rule will not apply in certain instances, for example, when the disposal occurs due to death or in terms of a transaction contemplated in s 45, 46 or 47 of the Act.

**Tax consequences to transferee**

The tax consequences to the transferee on the transfer of shares in the target company are determined from the provisions of s 42(2)(b). In essence, the transferor and transferee are deemed to be one and the same person with regards to the tax treatment that arises with regards to these shares. This is summarised as follows:

- When the shares were held by the transferor as capital assets and are then also acquired by the transferee as capital assets, the date of acquisition, amount and date of expenditure allowable in terms of para 20 of the Eighth Schedule and any valuations as contemplated in para 29(4) of the Eighth Schedule remain the same in the hands of the transferee.

- When the shares were held by the transferor as trading stock and are then also acquired by the transferee as trading stock, the date of acquisition, the amount and date of expenditure incurred in terms of s 11(a) or 22(1) or (2) remain the same in the hands of the transferee.

- When the shares were held by the transferor as capital assets and are then acquired by the transferee as trading stock, the date of acquisition, amount and date of expenditure allowable in terms of para 20 of the Eighth Schedule and any valuations as contemplated in para 29(4) of the Eighth Schedule must be treated as the amount to be taken into account by the transferee for the purposes of s 11(a) or 22(1) or (2).

The result of the above provisions is that the normal tax or capital gain in relation to shares held as trading stock or capital assets respectively will be determined only when the shares are ultimately disposed of by the transferee. When determining the amount to be included in taxable income on disposal date, the same calculation and information that would have applied to the transferor (in the absence of s 42) will apply also to the transferee, thereby merely deferring the calculation to a later date.
Section 42(7) also contains anti-avoidance rules that apply when the shares in the target company are disposed of by the transferee within eighteen months of the asset-for-share transaction. When this occurs and the shares are held as capital assets, a portion of the capital gain, calculated as the difference between

- the market value of the shares at the beginning of the eighteen-month period, and
- the base cost of those shares,

may not be set off against an assessed loss or capital loss of the transferee. Instead it is recognised immediately as a capital gain.

Similarly, when the shares are disposed of within eighteen months but are held as trading stock, a portion of the profit, calculated as the difference between

- the market value of the shares at the beginning of the eighteen-month period, and
- the original cost of those shares,

may not be set off against an assessed loss of the transferee. Instead it is recognised immediately in taxable income. When, however, the trading stock is of the same kind or same equivalent quality as that regularly and continuously sold by the transferee, these anti-avoidance rules will not apply.

**Amalgamation transactions**

Section 44 of the Act contained the provisions relating to ‘amalgamation transactions’ and defines this transaction as follows:

‘[A]ny transaction—

(a) in terms of which any company (hereinafter referred to as the “amalgamated company”) disposes of all of its assets (other than assets it elects to use to settled any debts incurred by it in the ordinary course of its trade) to another company (hereinafter referred to as the “resultant company”) which is a resident, by means of an amalgamation, conversion or merger; and

(b) as a result of which that amalgamated company’s existence will be terminated:

‘Provided that the provisions of this section will not apply to a disposal of an asset by an amalgamated company to a resultant company when that resultant company and the person contemplated in subsection (6) form part of the same group of companies immediately before and after that disposal, if that amalgamated company, resultant company and person jointly so elect.’

As with asset-for-share transactions, tax implications could arise for the above transaction in the absence of s 44. But when the transaction complies with the provisions of s 44, relief could be obtained by deferring the possible normal tax and capital gains tax implications that may arise on the disposal to a later date when the asset is ultimately disposed of by the resultant company. For this to be achieved, there are a number of requirements that need to be met. These requirements are summarised as follows:
• The person disposing of the asset (amalgamated company) must be a company (including a close corporation).

• The person acquiring the asset (resultant company) must be a company (including a close corporation) and a resident as defined for tax purposes.

• The amalgamated company must dispose of all of its assets other than those that it elects to use to settle debts incurred in the ordinary course of its trade.

• The amalgamated company must either receive ‘equity shares’ as defined in s 44(1) (a slightly wider definition than contemplated in s 42) in the resultant company in exchange for the assets disposed of or the resultant company must assume a debt of the amalgamated company, or both. This implies that the amalgamated company can dispose of its asset and reduce its value by debts that the resultant company will assume on its behalf.

• The resultant company must acquire the assets as the same type of asset as the amalgamated company was disposing of, for example, capital assets must be acquired as capital assets and trading stock as trading stock.

• Within six months after the transaction date, the steps as detailed in s 41(4) must have been taken to liquidate, wind up or deregister the amalgamated company. These steps include, for example, lodging various resolutions with the Registrar of Companies and providing certain information to SARS.

• Section 44 will not apply when the resultant company holds at least 70% of the equity shares in the amalgamated company immediately before the transaction.

• The relief provided by s 44 is mandatory unless the resultant company and the shareholder of the amalgamated company form part of the same group of companies and all parties (including the amalgamated company) elect that the provision does not apply.
This type of transaction is illustrated diagrammatically as follows: 48

Figure 3-4

When structuring a BEE equity transaction, s 44 would primarily be used to move operating assets out of a target company and into a new company in which a BEE partner could obtain an interest.

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48 Based on a diagram in *Silke on South African Income Tax* in § 24.154E.
This is illustrated diagrammatically as follows:

**Figure 3-5**

<table>
<thead>
<tr>
<th>Before transaction</th>
<th>After transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing shareholder</td>
<td>Existing shareholder holds 100% of the equity shares in the target company.</td>
</tr>
<tr>
<td>Target company</td>
<td>Target company (wound up, liquidated or deregistered)</td>
</tr>
<tr>
<td></td>
<td>New company</td>
</tr>
<tr>
<td></td>
<td>Existing shareholder</td>
</tr>
<tr>
<td></td>
<td>BEE shareholder</td>
</tr>
<tr>
<td></td>
<td>Existing shareholder now holds a portion of the equity shares in the new company as it received these shares as a distribution <em>in specie</em> from the target company. A new BEE shareholder has also acquired an interest in the new company.</td>
</tr>
</tbody>
</table>

In the above scenario, the target company is considered to be the ‘amalgamated company’ (as it is disposing of its assets and liabilities) and the new company will be considered the ‘resultant company’ for the purposes of determining the tax relief contained in s 44 of the Act, provided all of the other requirements of the provision as discussed above have been met. The tax consequences to both of these entities, and the existing shareholders of the amalgamated company, on the transaction envisaged above are discussed in detail below.

**Tax consequences to amalgamated company**

Although the tax consequences to the target company that arise on BEE transactions are discussed only in Chapter 4, for purposes of completion, they are dealt with in this part of the dissertation.

The tax consequences to the amalgamated company on the disposal of assets are determined based on the provisions of s 44(2) and (3) and depend on the type of asset being transferred.
When the asset is a capital asset, the amalgamated company is deemed to have disposed of it at an amount equal to its base cost on the date of disposal. The result is that no capital gain arises on the transfer of the asset as it is effectively deferred until the date when the asset is disposed of by the resultant company.

When the asset is trading stock, the amalgamated company is deemed to have disposed of it at an amount equal to its cost as determined under the provisions of s 11(a), s 22(1) or s 22(2). The result is that no income tax arises on the transfer of the asset as it is effectively deferred until the date when the trading stock is disposed of by the resultant company.

When the assets are ‘allowance assets’ as defined in s 41(1), the amalgamated company is deemed not to have recovered or recouped any portion of that allowance in the year of disposal. The result is that no normal tax arises on the transfer of these assets and any further allowances or potential recoupments are merely carried over from the amalgamated company to the resultant company.

There are also rules dealing with the transfer of s 24C allowances, but these are not dealt with as part of this dissertation.

The above rules apply irrespective of the actual selling price. But if an asset is sold for less than its market value, donations tax may become payable.

Another consideration from the amalgamated company’s perspective is the tax treatment of the dividend in specie that is distributed to the shareholders on liquidation, deregistration or winding up. In terms of s 44(8) and (9), when an amalgamated company disposes of shares in the resultant company that were acquired as part of an amalgamation transaction to a shareholder of the amalgamated company as part of the amalgamation transaction, this disposal is

- disregarded for purposes of determining the taxable income or assessed loss of the amalgamated company, and
- deemed not to be a dividend for purposes of STC.

The result is that no liability arises for normal tax, capital gains tax or STC on the distribution of the dividend in specie.

The anti-avoidance rules built into the provisions of s 44 deal with only the subsequent actions of the resultant company or the shareholders of the amalgamated company but not the amalgamated company itself.
**Tax consequences to resultant company**

The tax consequences to the resultant company are similar to those applicable to the transferee on the transfer of assets under an asset-for-share transaction. Section 44(2) and (3) deal with the tax consequences to the resultant company in an amalgamation transaction and are summarised as follows:

- For capital assets, the date of acquisition, amount and date of expenditure allowable in terms of para 20 of the Eighth Schedule and any valuations as contemplated in para 29(4) of the Eighth Schedule remain the same in the hands of the resultant company.
- For trading stock, the date of acquisition, amount and date of expenditure incurred in terms of s 11(a) or 22(1) or (2) remain the same in the hands of the resultant company.
- For an allowance asset, the resultant company continues to claim the same allowance amount that the amalgamated company was entitled to and will also be deemed to have recovered or recouped the previous allowances when necessary.
- There are also rules dealing with the transfer of s 24C allowances, but these are not dealt with as part of this dissertation.

The result of the above provision is that the normal tax or a capital gain in relation to an asset transferred as part of an amalgamation transaction will be determined only when the asset is ultimately disposed of by the resultant company. When determining the amount to be included in taxable income on disposal date, the same calculation and information that would have applied to the amalgamated company (in the absence of s 44) will also apply to the resultant company, thereby merely deferring the calculation to a later date.

Section 44(5) does contain anti-avoidance rules that apply when an asset acquired as part of an amalgamation transaction is disposed of by the resultant company within eighteen months after the date of the transaction. Simply, when this occurs, a portion of the gain or recoupment (limited to a set amount), whether capital or revenue in nature, cannot be set off against an assessed loss but must instead be recognised immediately. This is a similar anti-avoidance provision that applies to the transferee in an asset-for-share transaction.

**Tax consequences to shareholders of amalgamated company**

The shareholders of the amalgamated company will receive equity shares in the resultant company as a dividend *in specie* when the amalgamated company is wound up, liquidated or deregistered. The receipts of ‘local’ dividends are exempt from normal tax in terms of
s 10(1)(k)(i). The receipt of foreign dividends may be exempt if one of the exemptions in s 10(1)(k)(ii) applies. When the shareholder is a company, the receipt of the dividend *in specie* will not be considered a dividend for purposes of determining the ‘net amount’ for STC purposes (s 44(9)), thereby resulting in an STC liability to the shareholder if this dividend is eventually on-declared.

Section 44(6) contains rules dealing with the position when a shareholder of an amalgamated company disposes of equity shares in the amalgamated company in return for equity shares in the resultant company. These provisions are virtually identical to those contained in s 42 and are not dealt with again in this dissertation.

**Intra-group transactions**

Section 45 of the Act contains the provisions relating to ‘intra-group transactions’. It is also commonly used as part of the structuring of BEE equity transactions. Section 45 applies when an asset is disposed of by one company to another resident company and both companies form part of the same ‘group of companies’ as defined.

As with asset-for-share transactions and amalgamation transactions, tax implications would arise on the disposal of assets in the absence of s 45. But s 45 provides relief for these types of transactions when conducted in a group of companies by deferring possible tax consequences that would ordinarily arise on disposal. The main requirements of this provision, however, are not dealt with in detail.

The provision contains certain anti-avoidance rules dealing with the situation where the companies cease to form part of the same group of companies. These rules have, however, recently been amended by the Revenue Laws Amendment Act 35 of 2007. Prior to the amendments, there was no time limit as to when this ‘de-grouping’ could occur. But as from 1 January 2009, a new six-year time limit has been introduced.\(^49\) The effect of this amendment is that when the transferor company and transferee company become severed (in that they no longer form part of the same group of companies as defined) during the six years after the transaction took place, a deemed sale and repurchase arises in the hands of the transferee company, thereby resulting in normal tax or capital gains tax implications, depending on the type of assets. This deemed sale and repurchase occurs at the market value on the date that the companies cease to form part of the same group. When, however, the group severance only

\(^49\) Section 56 of Revenue Laws Amendment Act 35 of 2007.
occurs after the six-year time limit has elapsed, no deemed sale and repurchase occurs and there are no undue or burdensome tax consequences that will arise.

Section 45(5) also contains similar anti-avoidance rules as are described under the asset-for-share and amalgamation transactions above relating to the set-off of profits and losses when assets subjected to the intra-group rules are disposed of by the transfectee company within eighteen months.

Section 45 is a commonly used provision of the Act when structuring BEE equity transactions. The recent amendments to the de-grouping charge will serve only to increase its popularity in these types of transactions.

**Unbundling transactions**

Section 46 provides tax relief for the commonly referred to ‘unbundling transactions’, effectively dealing with the situation whereby a qualifying shareholder acquires certain shares as a distribution *in specie* on the unbundling of a company. The effect of s 46, which applies unless an election is made otherwise, is to transfer the shares at their base cost and deem them to be the same shares in the hands of the shareholder, thereby resulting in no capital gain or loss in the hands of the company. The receipt of the new shares by the shareholder is also deemed not to be a dividend. The tax consequences are deferred until the shares are ultimately disposed of by the shareholder.

**Liquidation, winding-up or deregistration**

Section 47 contains the provisions that provide tax relief when a resident company transfers all of its assets to its resident company shareholders in anticipation of, or in the course of liquidation, winding up or deregistration, provided that the parties jointly elect that this provision applies. Similarly to s 42, 44, 45 and 46, the tax consequences that attach themselves to the applicable assets will also be transferred to the shareholders along with the assets themselves, thereby resulting in no immediate tax arising in the hands of the company that is being liquidated, wound up or deregistered.

**Other considerations**

Although the tax implications surrounding both the methods of financing a BEE transaction and the various restructuring possibilities are often crucial considerations from a tax perspective,
there are other considerations, including recent amendments introduced by the Revenue Laws Amendment Act 35 of 2007 that need to be factored in when structuring a BEE transaction. These are dealt with below.

**Share buy-backs of listed shares**

The following commentary in the Budget Tax Proposals 2007 / 2008 highlights the reason for this recent amendment to the Act: ⁵⁰

‘BEE restructurings of listed shares frequently involve a two-step transaction. Shares are first purchased from the public before transfer to BEE partners pursuant to a forced sale via section 311 of the Companies Act (1973). Many of those parties forced to sell their listed shares (especially management) then repurchase identical listed shares on the market from non-BEE participants. At issue is the tax triggered on the forced sale for those parties who simply use sale proceeds to repurchase identical shares. It is proposed that these parties be free from tax to the extent that timely repurchases leave them in the same economic position as before.’

This proposal resulted in the insertion of para 42A into the Eighth Schedule of the Act. ⁵¹ It operates to defer a capital gain realised on the sale of listed shares by a person provided certain requirements are met. These include

- the fact that the sale must have been pursuant to a court order under section 311 of the Companies Act 61 of 1973, and
- the taxpayer must then acquire a share of the same kind and of the same or equivalent quality within ninety days after the initial disposal.

To the extent that these rules apply,

- the shares disposed of in terms of the forced sale are deemed to be sold at cost (therefore no gain arises at disposal date), and
- a gain that would have arisen in the absence of this provision is effectively deferred until the date that the new shares are eventually disposed of.

Although it is unlikely to be a major criticism due to the low likelihood of it applying, this amendment deals only with the situation where shares are held as capital assets. It does not cater for shares held as trading stock. Despite this, it is still a welcome amendment, especially to management of an organisation whom are not considered ‘Black’ for the purposes of the Codes and accordingly will often be required to sell their listed shares when the organisation undergoes BEE equity restructuring.

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**Connected person sales of depreciable property**

The following commentary in the Budget Tax Proposals 2007 / 8 highlights the reason for this amendment to the Act.  

‘As a practical matter, the majority of BEE transactions involve BEE entities that obtain a 26-30 per cent shareholding with the pre-existing company shareholder retaining a 70-74 per cent shareholding. These situations largely receive relief through the intra-group rules discussed above. At issue are situations when BEE partners (especially with assistance of outsider investors) obtain ownership levels nearing 50 per cent. In these situations, the transfer of depreciable assets to the BEE entity often becomes subject to certain anti-avoidance rules that prevent the BEE entity from depreciating newly obtained assets at currently existing market values. While the general need for these avoidance rules is accepted, it is proposed that these anti-avoidance rules accommodate situations when avoidance is unlikely to the driver.’

This amendment was introduced by the creation of a new regime contained in s 23J of the Act. This new regime  

‘eliminates all of the scattered depreciable property connected person regimes in favour of a single regime under one new section’.

The result of this new regime is that a ‘connected person’ purchaser of a ‘depreciable asset’ will be entitled to a higher depreciable tax cost than was previously permitted. Although aimed at assisting the structuring of BEE transactions, this relief applies to all taxpayers who meet its requirements.

**CGT**

CGT adds complexity to BEE transactions and should be considered at all levels of the corporate structure as each entity is assessed separately for tax purposes. It may happen that CGT is suffered in multiple layers of the corporate structure as the disposal of shares in a subsidiary will generally attract CGT and then the disposal of the holding company’s shares (which includes the value of the subsidiary’s shares already subjected to STC) will generally also attract CGT. This factor needs to be considered when structuring a BEE transaction to avoid unnecessary tax costs.

**STC**

STC is a tax on the declaration of all dividends (both ordinary and preference). It is a further cost that needs to be taken into account when determining the optimum BEE structure and the cost of funding.

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51 Inserted by s 75 of Revenue Laws Amendment Act 35 of 2007.
Recommendations

The above discussion confirms that a number of recent amendments introduced by the Revenue Laws Amendment Act 35 of 2007 have introduced legislation aimed at assisting in the structuring of BEE transactions. As with other provisions of the Act that impact on BEE transactions, these amendments, although aimed at BEE transactions, do not apply uniquely to these transactions. They affect any transaction that meets the requirements of the relevant provision. These amendments are a step in the right direction and are a sign of Government’s increasing commitment to ensure the success of broad-based BEE. Yet there is still room for improvement in this regard.

A shortfall of South African tax legislation is the lack of tax incentives surrounding the financing of BEE transactions. An article entitled ‘Driving Private Equity’ in the December 2006 / January 2007 issue of Accountancy SA highlighted this issue in the following extracts:54

‘Another critical issue regarding the low level of Venture Capital in South Africa is that, unlike in America, there are not tax incentives. In the States, Venture Capital is a tax write-off and one must ask why that isn’t the case here.’

‘He [Johan Van Wyk – partner at Actis] points out that there are as yet no tax incentives around this type of funding (provision of private equity funding to empowerment companies due to the high cost of traditional funding sources) for either the investor or the companies.’

‘With the lack of clarity around tax matters and no specific incentives for capital raising, Segal [Malcolm Segal – chairperson of SAVCA and Executive Director or Sasfin Holdings Ltd] sees a lot of room for development.’

The comments above highlight some of the market concerns regarding the lack of tax incentives that surround capital investment into empowerment transactions in South Africa. Although, recent tax amendments have introduced provisions aimed to ensure that BEE restructurings do not encounter undue additional tax costs that could undermine necessary financing’, there has still been no amendments to date that deal with incentives directly related to the financing of the transaction itself. This is an area that needs careful consideration by Government when considering future tax amendments aimed at increasing the number and quality of BEE equity restructuring in South Africa.

54 ‘Driving Private Equity’, various authors, Accountancy SA, December 2006, at 17–25.
Link to Code 100

As mentioned in Chapter 2, all the above factors need to be considered in light of the measurement principles contained in Code 100 to implement a successful and effective BEE strategy.

CHAPTER 4
TAX IMPLICATIONS TO TARGET COMPANIES

Background

The final party to be considered in the analysis of the income-tax complications of BEE transactions is the target company whose business or assets form the driving force behind the proposed transaction. Although a large portion of the tax exposure or additional tax costs are often passed on to the BEE investor when possible, the target company may also be exposed to complex tax risks that require careful consideration before finalising a BEE transaction. These risks and the considerations that should be taken into account by the target company are discussed in this chapter. (It should be noted that some of the tax implications to the target company have already been dealt with in previous chapters. For purposes of completeness they are not dealt with again in this chapter.)

Deduction of BEE advisory costs

Costs borne by the target company when implementing a BEE equity transaction include the fees of the numerous consultants that are usually called upon to advise on all the different implications (for example, accounting, tax and legal fees) that attach themselves to the various restructuring methods that can possibly be used. These include fees for services provided by attorneys, tax advisers, business consultants, accountants, auditors and the like. Their services are necessary due to the variations in the type and complexity of transactions that are being implemented across the business community in South Africa in recent times, all of which contain associated advantages, disadvantages and variations on risk. This is further exacerbated by the fact that each organisation has its own individual needs and long-term goals making it impossible to merely implement a ‘one-type-fits-all’ BEE solution. For this reason, the likelihood of a BEE transaction being conducted and implemented without the incurral of professional advisory costs is unusual.

There is no specific provision of the Act that provides a tax deduction for these types of costs. The provisions of the general deduction formula will therefore need to be considered when determining whether they will be deductible from income.

The general deduction formula allows a deduction for

- expenditure,
actually incurred,
during the year of assessment,
in the production of the income,
excluding expenditure of a capital nature, and
excluding expenditure to the extent that it is not laid out or expended for the purpose of trade.

The important considerations when determining whether BEE advisory costs are deductible under this formula are the terms

- ‘in the production of the income’, and
- ‘not of a capital nature’.

The term ‘in the production of the income’ has been considered in numerous court cases. The principles flowing from these judgments is that for an amount to be deductible under the general deduction formula, it is necessary to establish the purpose of the event that caused the expenditure. When this act was performed with the purpose of earning ‘income’ as defined (irrespective of the year of assessment when the income is earned) and provided the expenditure is so closely linked to the act that it can be regarded as part of the cost of performing it, then the expenditure attendant upon the act is deductible.

The term ‘not of a capital nature’ has also been considered in many court cases. A detailed analysis of whether an amount is capital or revenue in nature is not necessary for the purposes of this dissertation. The relevant essence of these judgments in relation to BEE advisory costs is that

- revenue expenditure is related to the cost of performing the income-earning operations, whereas
- capital expenditure is related to the cost of establishing or improving the income-earning structure of the business.

The question that arises with regards to BEE advisory costs is whether expenditure incurred in assisting with the enacting of structural changes (in the form of restructuring or the disposal of equity shares) that are required to comply with the requirements of the Codes (and thereby the BEE Act) will be deductible under the general deduction formula.

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56 See, for example, *Port Elizabeth Electric Tramway Co Ltd v CIR*, 1936 CPD 241, 8 SATC 13, *CIR v Genn & Co (Pty) Ltd*, 1955 (3) SA 293 (A), 20 SATC 113 and *Sub-Nigel Ltd v CIR*, 1948 (4) SA 580 (A), 15 SATC 381.
57 Principle established in *New State Areas Ltd v CIR*, 1946 AD 610, 14 SATC 155.
Although this question has not yet been tested in the South African courts, a similar principle was dealt with in a Supreme Court of Appeal case decided in 2003. The judgment in this case held that expenditure incurred in complying with the ‘Sullivan Code’, a movement that originated in the United States of America and aimed to achieve
- the non-segregation of races in the workplace,
- equal and fair employment,
- equal pay, and
- increasing the quality of employees’ lives,
satisfied the general deduction formula in that it was incurred in the production of the income and was not of a capital nature.

In this case, the company who incurred the expenditure was a subsidiary of an American company. It had been instructed by its parent company to incur expenses necessary to comply with the Sullivan Code. The court held that if the subsidiary had not incurred the necessary expenses, the American parent company may have closed it down or sold off its business. The loss of the company’s status in relation to the American parent company also could have resulted in a loss of future income. In this way, the court was able to link the requirement to incur the expenditure to the requirement that it must have been incurred to produce the income as required in s 11(a).

With regards to the capital or revenue nature of the same expenditure, the court held that it had not been incurred to protect the company’s income-earning structure and that it was similar in nature to insurance premiums. Accordingly, it was held to be of a revenue nature and therefore deductible.

Although the Sullivan Code and the Codes of Good Practice are entirely different legislative elements, the principles advocated by both are similar. In this way, and based on the decision in the case referred to above, there may be an argument for a company that incurs expenditure in implementing actions required by the Codes (including advisory costs incurred in implementing a successful BEE equity restructuring to facilitate Black ownership) that this expenditure, if not incurred, would result in a loss of future income. This can be substantiated by the fact that a company that does not comply with the BEE principles in the nearby future will eventually fall out of the supply chain (refer to the discussion in Chapter 1). It could then lose its right to future trade. Although this is the intention behind the BEE Act and the Codes, it would still need to be

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confirmed by a superior court. And as this issue has not yet been tested in the South African courts, there is no authority in this regard.

A more onerous consideration is whether BEE advisory costs are of a capital nature. Although the Warner Lambert case held that ‘social responsibility expenditure’ paid periodically was akin to the payment of insurance premiums, this was decided on the specific facts of that case. It is more likely that BEE advisory costs, that are usually once-off or irregular costs, will be considered to be of a capital nature as they can be linked to the cost of establishing or improving the income-earning structure of the business.

Despite the decision in the Warner Lambert case, it appears that expenditure incurred on various BEE advisory costs in relation to equity restructuring is likely to be of a capital nature and thereby not deductible when determining taxable income. When this cost represents a substantial expense for a target company, it may deter a smaller company from moving towards implementing these types of transactions and thereby defeat the intention of the Codes and the BEE Act. For this reason, Government should give consideration to possibly introducing a specific tax deduction for these and similar costs incurred when complying with the Codes (refer below).

Share plans

Broad-based employee share plans

Broad-based employee share plans were discussed in Chapter 2 from the perspective of the employee who is awarded shares under this type of plan. It is now necessary to consider the specific tax deductions that may be available to the employer under these types of plans.

Section 11(lA) was introduced into the Act along with s 8B and s 10(1)(nC). It also applies to qualifying equity shares acquired on or after 26 October 2004. An extract from Silke on South African Income Tax provides some insight into this provision.59

the market value R10, the employer may deduct R10 multiplied by the number of shares granted to the employee, but the deduction in the year of grant is limited to R3 000 for each employee.

‘This deduction is in lieu of any other deduction which may otherwise be allowed to that person or any other person in respect of the granting of such shares.’

As with the incentives provided under s 8B in relation to an employee, the incentives contained in s 11(I/A) for an employer setting up a broad-based employee share plan are still limited and, accordingly, have not resulted in the anticipated usage of these plans.\textsuperscript{60} For this reason, the incentives provided to both employers and employees under broad-based employee share plans should be reviewed for possible change.

\textit{Other share plans}

Due to the limited tax incentives available to an employer under a broad-based employee share plan, these plans are often not used in practice. It then becomes necessary to consider whether a tax deduction for the employer can be obtained for other types of share plans through another provision of the Act. This question has been dealt with in an article by Brigitte Keirby-Smith appearing in \textit{The Mercury} in 2007. The following was noted in this article:\textsuperscript{61}

\begin{quote}
‘Broadly speaking, through proper structuring of employee share schemes and the use of appropriate employee share trusts, the company can achieve a tax deduction under the general deduction formula of section 11(a), to the extent it incurs expenditure for the purpose of incentivising employees through the ownership of shares. This may be achieved through the issue of shares or alternatively the grant of share options to qualifying employees. When the shares or options are “restricted” in any way and the employees’ rights to unconditional ownership are deferred, the provisions of section 23H should be considered on the basis that the benefit to the company from incentivising its employees is enjoyed over the vesting period. This section overrides an immediate deduction under section 11(a) and effectively “spreads” the expense over the period the benefit is derived. In this regard, the specific terms and conditions of each share scheme should be reviewed in arriving at the appropriate tax treatment for the company.’
\end{quote}

The above quotation identifies the fact that, when motivating an employee, a deduction may be available under the general deduction formula (with the possibility that this may need to be spread over the period that the benefit from the employee is derived). But the question of whether this deduction will be available when issuing shares to clients or suppliers as part of a true broad-based BEE strategy remains unanswered. This would need to be considered in view of the facts of each individual entity’s strategy and long-terms business plan. This should be a further possible incentive that Government should consider introducing if it wishes to encourage the use of truly broad-based BEE restructuring.

\textsuperscript{60} As noted in Budget Tax Proposals 2007 / 2008.

\textsuperscript{61} Part six of an eight-part series of articles on the tax implications of BEE transactions appearing in \textit{The Mercury}, Brigitte Keirby-Smith, July 2006.
Corporate restructuring

The corporate restructuring rules, including the tax implications to the target company on the use of them, have been discussed in Chapter 3. They are not dealt with again in this chapter.

Other considerations

Cross-issue of shares

The tax provisions governing the cross-issue of shares in BEE transactions, including the tax implications to the target company on the use of them, have been discussed in Chapter 3. They are not dealt with again in this chapter.

Assets sold for an unquantified amount

BEE transactions may result in the sale of certain assets at selling prices that cannot be quantified at the date of sale. This may result when, for example, the selling price is based on a formula that takes into account future profits, that are not quantifiable at the date of sale. This may occur in a BEE transaction when assets, or even a portion of the assets associated with a targeted division of the company, are sold out of the target company and into a new company established for the purpose of allowing a new BEE shareholder to acquire an interest in it.

Section 24M of the Act contains provisions dealing with this type of transaction. It provides as follows:

‘(1) If a person during any year of assessment disposes of an asset for consideration which consists of or includes an amount which cannot be quantified in that year of assessment, so much of that consideration as—
(a) cannot be quantified in that year must for purposes of this Act be deemed not to have been accrued to that person in that year; and
(b) becomes quantifiable during any subsequent year of assessment must for purposes of this Act be deemed to have been accrued to that person from that disposal in that subsequent year.’

The provisions above effectively result in tax relief by deferring the tax consequences, including any recoveries or recoupments, associated with the unquantified portion of the selling price of the relevant assets.

These provisions can be used by a target company to achieve tax relief when structuring a BEE transaction that involves the sale of assets into another company.
Shares sold for an amount that is not due and payable

Some BEE transactions involving small and medium businesses may also involve the sale of shares when the proceeds are determined with reference to the company’s future profits. Although this is intended to protect the purchaser, it would ordinarily result in immediate tax consequences in the hands of the seller. But when s 24N applies, these consequences are deferred until a later date.

Section 24N of the Act provides as follows:

‘(1) When a person (hereinafter referred to as “the seller”) during a year of assessment disposes of equity shares to any other person (hereinafter referred to as “the purchaser”) in the circumstances contemplated in subsection (2), any quantified or quantifiable amount payable by the purchaser to the seller must--

(a) to the extent that it is not due and payable to the seller during that year, be deemed for purposes of this Act -

(i) not to have been accrued to the seller in that year; and

(ii) not to have been incurred by the purchaser during that year; and

(b) to the extent that it becomes due and payable to the seller in any subsequent year of assessment, be deemed for purposes of this Act--

(i) to have been accrued to the seller during that subsequent year; and

(ii) to have been incurred by the purchaser during that subsequent year.’

Section 24N(1) applies when all of the following conditions are met:

- More than 25% of the amount payable for the shares becomes due and payable by the purchaser after the end of the year of assessment of the seller and the amount payable is based on future profits of the company.
- The value of the equity shares in the company that have been disposed of exceeds 25% of the total value of equity shares of the company.
- The purchaser and seller are not connected persons in relation to each other after that disposal.
- The purchaser is obliged to return the equity shares to the seller in the event of failure by the purchaser to pay an amount that is due.
- The amount is not payable by the purchaser to the seller in terms of a financial instrument that is payable on demand and that is readily tradeable in the open market.

The purpose of this provision is to allow taxpayers to sell a meaningful stake in a company without being subject to immediate tax if substantial proceeds are deferred until a later year.

This aims to promote the sale of businesses supported by seller self-financing.

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In summary, s 24N will assist when the need for a deferred cash settlement based on profit participation is vital to their success.

Recommendations

Some possible recommendations for Government when considering the amendment of tax legislation going forward have already been dealt with under the relevant headings above. In summary these include

- a specific tax deduction for BEE advisory or consulting costs,
- increased incentives to an employer for the granting of shares under a broad-based employee share plan, and
- new incentives to an employer for the granting of shares to qualifying clients and suppliers as part of a BEE equity restructuring process.

These amendments, if implemented, would encourage the implementation of BEE strategies across South Africa and would do so in a manner that incorporates the true spirit of broad-based BEE as envisaged in the BEE Strategy document.

Link to Code 100

As mentioned in Chapters 2 and 3, all the above factors always need to be considered in light of the measurement principles contained in Code 100 to implement a successful and effective BEE strategy.

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64 Part seven of an eight-part series of articles on the tax implications of BEE transactions appearing in The Mercury, Brigitte Keirby-Smith, July 2006.
CHAPTER 5
CONCLUSION

Fourteen years on from the introduction of democracy in South Africa, the true spirit of broad-based BEE encompasses principles that few can dispute to be worthy based on the political history of the country and the injustices served on its people. These principles were first formalised in the BEE Strategy document. It identifies the following four key principles that underpin the Government’s BEE strategy:

- BEE is broad-based, implying that BEE should not simply be for the advantage of a small minority but instead, should aim to accelerate the quality of life and well-being of Black people, women, people with disabilities, youth and people living in rural areas.
- BEE must be an inclusive process to be truly successful. BEE should be taken seriously by all sectors of the economy and not limited to those enterprises that either derive income from Government procurement or are regulated by Government.
- BEE is associated with good governance. The quality of corporate boards and governance should be improved so that BEE is associated only with the highest standards.
- BEE must be part of South Africa’s growth strategy to be truly successful with wealth accumulation coming from both existing and newly-created economic activity.

To achieve the principles enunciated above, Government need to introduce incentives that will encourage all sectors of the economy to implement successful-BEE strategies that contribute to economic growth and similarly cater for all South African citizens, thereby contributing to both new wealth accumulation and the redistribution of existing wealth.

One of the most common methods of encouraging organisations is usually in the form of various tax incentives that encourage these entities to implement and maintain strategies that achieve Government’s goals.

Despite Government’s increased commitment to achieving broad-based BEE in South Africa, this dissertation identifies the fact that, to date, there have been limited tax incentives introduced to encourage these types of transactions and even when these incentives do exist, for example, in broad-based employee share plans, the actual incentives currently in place are too low to encourage the required usage.

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With this in mind and in conclusion, it is safe to say that more tax incentives are definitely needed from Government to encourage and facilitate BEE-equity transactions aimed at compliance with the ownership element of the BEE scorecard.