Employee share schemes: South African tax considerations

Employee share schemes have tax implications for employees as well as their employers. This article discusses the basic principles to consider. It also highlights some areas that often result in tax complexity in such schemes.

Companies often set up employee share schemes that incentivise and align key staff members with the company's broader objectives. As with any remuneration, these schemes have tax implications for the employer and employee.

This article provides a high-level overview of the South African tax rules for these awards. I also highlight some instances in which their application can be complex.

South African tax on employee share schemes

Section 8C of the Income Tax Act governs the tax implications for the recipient. Broadly, two aspects determine whether this provision applies:

- Did the person acquire an equity instrument(s)? This concept includes shares but is broader than that. It also includes options and contractual rights (for example, as a beneficiary of a trust) that derive their value i from shares.
- Did the person acquire these instruments from a relationship or arrangement to which section 8C applies? The provision applies where the person acquires the instruments by virtue of employment or holding office as director of a company or, in some instances, while employed or being a director of a company. The person should not necessarily acquire instruments from an employer; the provision also caters for arrangements involving other persons and instruments.

If section 8C applies to an instrument, the acquirer is taxed on the instrument's value upon vesting, as opposed to the grant or award date. This amount is taxed as income (rather than capital gains, which many assume in the case of shares). An instrument's vesting date depends on the instrument's terms and those of any arrangement affecting the instruments, for example, the acquisition agreement or shareholders agreements. An employer should generally withhold employees' tax in respect of the amount at the time of vesting.

Areas of potential complexity

The tax consequences of employee share schemes are often more complex if:

- A trust holds the instruments until vesting or the employee's right consists of an interest in a trust that owns shares. In these structures, it is often necessary to consider the transactions that occur in or flow through the trust, which is a taxpayer in its own right.
- Instruments are granted to or held by a related person, for example, a family trust, rather than the employee. These types of arrangements could be subject to various anti-avoidance rules.
- A group entity that does not employ the recipient makes the awards. For example, this introduces complexity in identifying the entity that should withhold employees' tax.
- The employee share scheme involves an international group.
- The employee who acquires the instrument is only temporarily in South Africa or moves abroad during the term of the award. In such cases, the interaction between section 8C and the relevant tax treaty comes into play.

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