

CROSS-BORDER TAXATION OF EMPLOYEE SHARE INCENTIVE SCHEMES

by

SARIKA BEZUIDENHOUT

**A dissertation submitted in part fulfilment of the
requirements for the degree**

LLM TAX LAW

in the

FACULTY OF LAW

at the

University of Pretoria

Supervisor: Dr T Legwaila

OCTOBER 2013

DECLARATION

I, Sarika Bezuidenhout, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other University.



.....
Sarika Bezuidenhout

30 October 2013

ABSTRACT

One way for employers to attract and retain the services of employees who are in a position to make a material contribution to the successful operation of the employer is to offer such selected employees the opportunity to participate in an employee share incentive scheme in terms of which they will receive certain benefits. Generally, a benefit derived from the participation in an employee share scheme is taxable as employment income where the granting of such benefit is linked to the employee's employment or in respect of services rendered by that employee to his employer.

Countries often have a different basis for the taxation of benefits derived from participation in an employee share incentive scheme. In South Africa, the benefits from the participation in an employee share incentive scheme are taxed at the time such benefit vests (i.e when the employee becomes unconditionally entitled thereto). However, in Belgium, the benefits are taxed upfront at the time it is granted. While in India, the benefits are only taxed at the time of transfer or allotment (exercise). Where employees receive employee share incentive scheme benefits in respect of services rendered in more than one country, double taxation could occur as a result of each country taxing the benefits a different manner. If two or more countries seek tax the benefit or a portion thereof they often follow different approaches to the allocation, timing and characterisation of income derived from participation in an employee share incentive scheme. This could result in the measures which aim to prevent double taxation, in DTA's as well as the South African domestic legislation, being ineffective.

This study compares the tax treatment of benefits derived from the participation in an employee share scheme in South Africa, Belgium and India which each follow a different approach to the taxation of benefits derived from the participation in an employee share scheme. It aims to illustrate the possibility of double taxation from a South African resident perspective where DTAs and the South African legislation are not effective in eliminating double taxation.

TABLE OF CONTENTS

DECLARATION	i
ABSTRACT	ii
CHAPTER 1: INTRODUCTION AND PROBLEM STATEMENT	1
1.1 Background	1
1.2 Research problem	3
1.2.1 Domestic tax legislation	4
1.2.2 Allocation of income	4
1.2.2.1 <i>Reward for past or future services</i>	4
1.2.2.2 <i>Place where services are rendered</i>	4
1.2.3 Timing of income	5
1.2.4 Character of income	5
1.3 Hypothesis and anticipated results	6
1.4 Definition of key terms	7
CHAPTER 2: WHAT ARE SHARE INCENTIVE SCHEMES, WHY DO EMPLOYERS HAVE THEM AND HOW DO THEY WORK	9
2.1 Background	9
2.2 Types of employee share schemes	10
CHAPTER 3: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN SOUTH AFRICA	12
3.1 Introduction	12
3.1.1 Resident	12
3.1.2 Source of income	13
3.2 Taxation of share incentive schemes	14
3.2.1 Gain made by the exercise of a right to acquire a marketable security	15
3.2.1.1 <i>Right to acquire a marketable security</i>	15
3.2.1.2 <i>Granted in respect of employment or holding of office</i>	16
3.2.1.3 <i>Valuation of the gain</i>	17
3.2.2 Amounts derived from a broad-based employee share plan	18
3.2.2.1 <i>Qualifying shares</i>	18
3.2.2.2 <i>Valuation of the gain</i>	19
3.2.3 Taxation of directors and employees on vesting of equity instruments.	19
3.2.3.1 <i>Granted in respect of employment or holding of office</i>	20
3.2.3.2 <i>Vesting of an equity instrument</i>	20

3.2.3.3	<i>Valuation of the gain</i>	22
3.2.4	Capital gains tax considerations	22
3.3	Summary	24
CHAPTER 4: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN BELGIUM		25
4.1	Introduction	25
4.1.1	Resident	25
4.1.2	Source of income	25
4.2	Taxation of share options	26
4.2.1	General	26
4.2.2	Income from employment	26
4.2.3	The Law of 26 March 1999	27
4.2.4	Valuation of the benefit	28
4.2.5	Capital gains tax considerations	29
4.3	Summary	30
CHAPTER 5: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN INDIA		31
5.1	Introduction	31
5.1.1	Residence	31
5.1.2	Source	32
5.2	Taxation of share options	32
5.2.1	General	32
5.2.2	Perquisite tax	33
5.2.3	Valuation of the benefit	33
5.2.4	Capital gains tax considerations	34
5.3	Summary	35
CHAPTER 6: CROSS-BORDER TAXATION		36
6.1	Double taxation	36
6.2	Elimination of double taxation	36
6.3	South Africa	36
6.3.1	Relief for South African residents	37
6.3.1.1	<i>Exemption for foreign employment income</i>	37
6.3.1.2	<i>Section 6quat rebate</i>	38
6.3.1.3	<i>Section 6quat deduction</i>	39
6.3.1.4	<i>Section 6quin rebate</i>	40
6.3.2	Relief for non-residents	40

6.3.3	Application to share options for services rendered	41
6.4	Belgium	43
6.4.1	Relief for Belgian residents	43
6.4.2	Relief for non-residents	44
6.4.3	Application to share options for services rendered	45
6.5	India	45
6.5.1	Relief for Indian residents	45
6.5.2	Relief for non-residents	46
6.5.3	Application to share options for services rendered	47
6.6	Double Taxation Agreements	47
6.6.1	OECD Model Tax Convention	47
6.6.2	Residency	48
6.6.3	Income from employment versus capital gains	48
6.6.3.1	<i>Income from employment</i>	49
6.6.3.2	<i>Capital Gains</i>	51
6.6.4	Method for the elimination of double taxation	52
CHAPTER 7: PRACTICAL DIFICULTIES OF CROSS-BORDER SHARE INCENTIVE SCHEMES		55
7.1	Allocation of the income	55
7.1.1	Reward for past or future services	56
7.1.2	Place where the services are rendered	56
7.1.3	Summary	58
7.1.4	Example 1	59
7.1.5	Problems identified with the elimination of double taxation	60
7.1.5.1	<i>Double taxation agreements</i>	60
7.1.5.2	<i>SAITA</i>	63
7.2	Timing of the income	64
7.2.1	Example 2	65
7.2.2	Problems Identified	66
7.2.2.1	<i>Double taxation agreements</i>	66
7.2.2.2	<i>SAITA</i>	68
7.3	Character of the income	69
7.3.1	Example 3	69
7.3.2	Problems identified	70
7.3.2.1	<i>Double taxation agreements</i>	70

7.3.2.2	<i>SAITA</i>	71
7.3.3	Recommendations	72
CHAPTER 8: CONCLUSION		74
8.1	Allocation of Income	74
8.2	Timing of Income	75
8.3	Character of Income	75
8.4	Recommendations	76
References		77
Appendix 1		

CHAPTER 1: INTRODUCTION AND PROBLEM STATEMENT

1.1 Background

One way for employers to attract and retain the services of employees who are in a position to make a material contribution to the successful operation thereof is to offer them the opportunity to participate in an employee share incentive scheme in terms of which they will receive certain benefits.¹ These employee share incentive schemes exist in various forms and owe their origin to the recognition of the concept that the profits of a large entity are in a large measure due to its employees.² Therefore, employees are given an opportunity to share in the profits of their employer by participation in an employee share incentive scheme that will either provide them with an opportunity to benefit by acquiring shares in their employer, or, to receive other benefits linked to the employer's share performance.

Many multinational corporations employ a mobile workforce that render services all over the world. In many cases a single employee would work in various countries during the time of his employ. These mobile employees will often be granted the opportunity to participate, in one form or another, in an employee share incentive scheme in terms of which he will be awarded share options.

Difficulties arise in the taxation of share options awarded due to the participation in employee share incentive scheme where the services for which the share option is granted are rendered in more than one country. Most of the difficulties arise in the determination of the specific services to which the share option relates.³ This is due to the fact that the benefits derived from the participation in an employee share incentive scheme may be as a reward for previous performance or serve as an incentive for future performance.⁴

¹ These benefits will be referred to as share options and unless the context indicates otherwise will be understood to mean any benefit acquired by an employee as a result of his participation in an employee share incentive scheme including a share, an option to acquire a share and any other benefit which is linked directly or indirectly to a share.

² H Padamchand Khincha (2002) Taxation of Employee Stock Option Plans: International Principles. *Revenue Law Journal*. Vol 12 Iss 1, p145.

³ Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 2. *European Taxation*. October 2007, p467.

⁴ OECD (2012), 'R(20). Cross-border income tax issues arising from employee stock-option plans', in OECD, *Model Tax Convention on Income and on Capital 2010: Full Version*, OECD Publishing.

The contractual arrangements for qualification of the share benefits in terms of an employee share incentive scheme need to be considered in order to determine whether past or future services result in the share benefit being acquired. Where the contract specifies that the employee needs to be in the employ of the employer at the time that the share benefits are to be derived from participation in the employee share incentive scheme, it would suggest that the reward is for future services. On the other hand, where all employees who were employed in a certain period are able to participate in the employee share incentive scheme, and it is not possible for the employee to lose the share benefit or where the share benefit is calculated in accordance with the financial results of a previous year, the reward could be considered to be for previous performance.⁵

The income from share benefits is generally taxed at a different time to when the services for which the benefits are received are rendered. Most countries use the following times as the taxable event:

- when the benefit is granted;
- when the benefit irrevocably vests;
- when the benefit is exercised or disposed of;
- when the underlying asset acquired in terms of the benefit is sold.⁶

Therefore, consideration should be given to the tax treatment at the time of granting, vesting, exercise, or disposal and sale of any share option acquired in terms of an employee share incentive scheme.⁷

Where an individual acquires share options as a result of participation in an employee share incentive scheme, and the individual has rendered services in more than one country, multiple countries may seek to tax the income from that share benefit.

⁵ *Ibid.*

⁶ OECD (2005). The taxation of Employee Stock Options, *OECD Tax Policy Studies*. OECD Publishing. Available online at <http://www.sourceoecd.org/taxation/9264012486>.

⁷ AP de Koker *et al.* (2012) *Silke on South African Income Tax*. Retrieved May 20, 2012, from Lexis Nexis online database.

1.2 Research problem

In the light of the principles set out above, it is necessary to investigate the implications of income from share options for services rendered in more than one country.

When comparing the domestic tax treatment of income from share options in various countries (i.e where the services in respect of that share benefit was rendered in more than one country), there can be differences in *inter alia* the source, timing, and character of that income.⁸

The differences in the domestic tax treatment of income from share options could result in the same income being taxed twice. It could also result in the income not being taxed at all.⁹

In order to illustrate the difficulties created when cross-border services are rendered in respect of share benefits acquired in terms of an employee share scheme, a comparative study is conducted. This study focuses on the current domestic tax legislation of South Africa, Belgium, and India as well as the principles followed by the Organisation for Economic Co-operation and Development (hereinafter referred to as the "OECD"). Belgium and India have been included in the study as their domestic legislation differs in varying degrees from South Africa in respect of the source, timing, and to a lesser extent, the character of income from a share option. Furthermore, as South Africa has double taxation agreements (hereinafter referred to as 'DTA') with Belgium and India, it will be possible to illustrate that the unilateral¹⁰ and bilateral¹¹ relief available in South Africa may not be sufficient to eliminate double taxation and double non-taxation of income from share options awarded to the employee who has rendered services in India and/or Belgium.

⁸ Colon JM (2003) Double-Dipping: The Cross-Border Taxation of Stock Options *Rutgers Law Journal*, Vol. 35, p175. Available at SSRN: <http://ssrn.com/abstract=559221>.

⁹ *Ibid.*

¹⁰ 'Unilateral relief' is the relief from double taxation provided by the country of residency.

¹¹ 'Bilateral relief' is the relief from double taxation provided in terms of a Double Tax Agreement.

1.2.1 Domestic tax legislation

The domestic tax treatment of income from share benefits varies from country to country. The differences are mainly in respect of:

- the source of the income (i.e. is the share benefit acquired as a reward for past or future services and where are the services rendered?).
- the timing of the income (i.e. at which point in time will the income be taxed?).
- the character of the income (i.e. is it income from employment or a capital gain?).

1.2.2 Allocation of income

Share options can be awarded under an employee share incentive scheme in respect of past or future services. The services for which the share options are rewarded can also be rendered in more than one country.

1.2.2.1 *Reward for past or future services*

It is sometimes difficult to determine the services to which the award of share options relate due the variability of the situations and conditions under which the share options are granted.¹²

The general guideline is that the share options should not be considered to relate to any services after the required period of employment which is necessary to acquire the irrevocable right to the share option. It should only be considered to relate to services rendered before the time when it was granted to the extent that the grant is conditional on the services having already been performed. In cases of doubt, the general assumption is that the award is primarily related to future services.¹³

1.2.2.2 *Place where services are rendered*

According to Rohatgi *Basic International Tax* (2005) 223,¹⁴ internationally, the source of income for services rendered or income from employment will be the place where the

¹² Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

¹³ *Ibid.*

¹⁴ Rohatgi R (2005) *Basic International Tax*, Richmond Law & Tax Limited.

services are performed, the place where the contract of employment is entered into or the place where payment is made.

Where the services are rendered in more than one country, the share options awarded in respect of such services should be proportionally attributed to the country in which the services were rendered.

Countries may use different formulas in order to determine the portion of the income which is sourced in it. For example, one country may use the calendar days physically spent in that country to attribute a portion of the income to it,¹⁵ where another country may use the days of work physically spent in that country.¹⁶

1.2.3 Timing of income

Countries consider different times to be the time at which the taxable event occurs. Generally the time of grant, vest, exercise or disposal of the share option and the time of sale of the underlying share is considered.¹⁷

Furthermore, the same country may also tax different parts of the share option at different times. For example, a country may tax one part of the option at the date of grant and another part when the underlying share is sold.

Difficulties can arise when the country in which the person is tax resident and the country in which the benefit is sourced do not tax the income from the share benefit at the same time and where they tax different portions of the income at different times.

1.2.4 Character of income

The share option which is granted in terms of an employee share scheme will constitute income from employment and will form part of the employee's remuneration¹⁸ Some commentators consider that the holding and subsequent exercise of the share option is

¹⁵ As is the case in South Africa and India.

¹⁶ As is the case in Belgium and according to the OECD MTC.

¹⁷ OECD (2005). The taxation of Employee Stock Options, *OECD Tax Policy Studies*. OECD Publishing. Available online at <http://www.sourceoecd.org/taxation/9264012486>.

¹⁸ Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 1 *European Taxation*. August/September 2007 p407.

an investment decision and that the gain realised as a result will constitute a capital gain.¹⁹ Others consider that no investment decision can be made until the share option has vested and, therefore, that a gain realised subsequent to the vesting of the share benefit will constitute a capital gain.²⁰ A further view is that any benefit derived from the share option, including a gain realised upon the sale of the underlying share, will be employment income as the employee acquired the shares solely because he was remunerated with the option.²¹

Where one country characterises the income from share option or part thereof as remuneration, and another country characterises it as capital, double taxation or double non-taxation could occur, and there could be difficulties in applying unilateral as well as bilateral relief.

1.3 Hypothesis and anticipated results

In order to address the possibility of double taxation or double non-taxation of income from share options, the application of unilateral as well bilateral relief should be examined.

For example, the South African domestic legislation provides for a credit in respect of foreign taxes payable by a South African resident for income from a source outside South Africa.²² Furthermore, South Africa is party to international tax treaties with more than 80 countries²³ that seek to eliminate double taxation and double non-taxation of income and prevent fiscal evasion.

By application of the domestic legislation and DTAs, this study seeks to determine whether the current provisions in South African legislation and DTAs effectively eliminates double taxation and double non-taxation of income from share option acquired

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ *Ibid.*

²² Sec 6quat of the SAITA.

²³ South African Revenue Service (2013) *Summary of all Treaties for the Avoidance of Double Taxation*. Accessed online on 26 September on the SARS website at <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf>.

by participation in an employee share incentive scheme where the employee renders services in more than one country.

It is anticipated that while the domestic legislation and DTAs may to some extent eliminate double taxation, there will be gaps which will result in part or all of the income being subject to double taxation.

1.4 Definition of key terms

The key terms for the purposes of this study are defined below.

‘Share option’ means, unless the contexts indicates otherwise, any benefit acquired by an employee as a result of his participation in an employee share incentive scheme and includes a share, an option to acquire a share and any other benefit which is linked directly or indirectly to a share.²⁴

‘Unilateral relief’ means the relief from double taxation provided by the country of residency.²⁵

‘Bilateral relief’ means the relief from double taxation provided in terms of a Double Tax Agreement.²⁶

‘Grant’ means the process by which an employee is given a share option.²⁷ In The Law Dictionary²⁸ explains it as ‘[s]omething given to a recipient, called the grantee, by an entity, called the grantor’ and says that ‘[a] grant is typically given for a specific reason’.

‘Vesting’ means the process by which the employee receives an irrevocable right to apply for and be issued the shares under the share option granted.²⁹ The Law

²⁴ The definition for purposes of this study incorporates various share based benefits which may be derived from the participation in a share incentive scheme.

²⁵ Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: SiberInk.

²⁶ *Ibid.*

²⁷ H Padamchand Khincha (2002) Taxation of Employee Stock Option Plans: International Principles. *Revenue Law Journal*. Vol 12 Iss 1 p145.

²⁸ Accessed online on 27 September 2013 at <http://thelawdictionary.org/grant-2/#ixzz2g4ryzqtj>.

²⁹ H Padamchand Khincha (2002) Taxation of Employee Stock Option Plans: International Principles. *Revenue Law Journal*. Vol 12 Iss 1 p145.

Dictionary³⁰ calls it the '[p]rocess where the authority privilege or right to interest or asset unconditionally passes to a body.'

'**Exercise**' means that the employee applies for the issue of the shares that have vested.³¹ According to The Law Dictionary³² it is '[t]he process of utilizing the rights granted an [option] buyer under the terms of a contract

³⁰ <http://thelawdictionary.org/vesting/#ixzz2g4sRurM9>.

³¹ *Ibid.*

³² Accessed online on 27 September 2013 at <http://thelawdictionary.org/exercise-2/#ixzz2g4silw1q>.

CHAPTER 2: WHAT ARE SHARE INCENTIVE SCHEMES, WHY DO EMPLOYERS HAVE THEM AND HOW DO THEY WORK

2.1 Background

Share incentive schemes have long been utilised as a form compensation for employees and executives. According to Nyelisani (2010), about 92 per cent of listed companies in the United Kingdom offer shares to their employees. Throughout Europe, it is expected that the number of employee share-ownership schemes will double over the next five to ten years. In the United States, the numbers are even higher and many executives are now only paid in shares.³³ There are various reasons for companies to use share incentive schemes as a way to compensate their employees. One of the reasons used to explain the use of share incentive schemes is that employees are seen as opportunistic agents that should be monitored by the shareholding owners of the company.³⁴

The main objectives sought by employers by utilising share incentive schemes, as identified by Brincker (2011), include:

- Enabling employees to participate in the growth of a company so that they will identify with the progress and prospects of the company.
- Trying to ensure that the growth achieved by employees in respect of their holding of shares in the company will be tax free.
- Trying to ensure that there will not be any fringe benefits tax to which the employee will be subjected to on the extension of credit or a soft loan; and
- Protecting the employees against the possibility of downside loss.³⁵

Furthermore, share incentive schemes are used to channel increases in remuneration through alternative compensation forms instead of through increases in salary. In most instances, the objective is to encourage good performance or to retain valued employees. In meeting this objective, a balance must be struck between attracting and

³³ Nyelisani TP (2010) *Employee Perceptions of share schemes*. Unpublished Master of Business Administration dissertation, University of Pretoria: Gordon Institute of Business Science.

³⁴ Poutsma E et al. (2012) Employee share ownership and profit sharing in different institutional contexts. *The International Journal of Human Resource Management* Vol 23 No 8 p1513.

³⁵ Brincker TE (2011). *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 3 March 2012 from the Lexis Nexis database.

retaining qualified and motivated employees and executives, and ensuring that compensation is not excessive or unjustified.³⁶

Typical incentive mechanisms include share based incentive schemes in terms of which participants acquire shares either free of charge or at a discounted rate on a date in the future. Alternatively, the scheme may grant employees an entitlement to shares or cash, calculated with reference to the appreciation in the market value of a company's shares during the vesting period.³⁷

2.2 Types of employee share schemes

Various types of share schemes are used by employers in order to achieve certain objectives. These include share option plans,³⁸ share purchase plans,³⁹ and phantom share plans.⁴⁰ Set out in the table below are some of the common awards that may form part of an employee share schemes.

Award	Description
Performance shares / Conditional shares	Shares granted subsequent to a vesting period, once performance conditions have been met.
Restricted shares	Shares are granted to the employee subject to restrictions. The restrictions are lifted after a vesting period once the award conditions have been met.
Restricted stock units	A promise to grant shares to employees at the end of a vesting period once the award conditions have been made.
Share appreciation rights	A right granted to an employee to receive a cash bonus or shares. The amount that the employee receives is

³⁶ Madden C (2013) *Employee Share Incentive Schemes*. Unpublished presentation, KPMG International.

³⁷ *Ibid.*

³⁸ A share option plan is a plan in terms of which employees are granted options to purchase shares at a discounted price at the end of a vesting period.

³⁹ A share purchase plan is a plan in terms of which employees are assisted by their employer to enable them to purchase shares in a company. These shares are generally offered at a discount to the market price of the shares.

⁴⁰ A phantom share plan is a plan that entails the granting of a right to an employee to receive a cash bonus, determined with reference to the increase in the company's share price over a vesting period.

	determined with reference to the increase in the value of the company's share price during a vesting period
Share options	An offer by an employer to an employee to acquire shares at a particular price by a particular date

CHAPTER 3: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN SOUTH AFRICA

3.1 Introduction

South Africa applies a resident based tax system.⁴¹ According to AP de Koker *et al* (2012) the resident basis of taxation adopted is described as a 'resident minus' system which means that receipts and accruals of income derived by 'residents' from all sources are subject to tax, but certain limited categories of income arising from activities undertaken outside the Republic are exempt from tax. Non-residents, on the other hand, will only be taxable on receipts and accruals of income derived from a source within the Republic, subject to certain exceptions.⁴²

3.1.1 Resident

In order to determine what income will be taxable in South Africa, it is necessary to distinguish between 'residents' and 'non-residents'.

The definition of 'resident' is set out in section 1 of the South African Income Tax Act⁴³ (hereinafter referred to as 'the SAITA'). A natural person will qualify as a resident where he:

- a) is ordinarily resident in South Africa; or
- b) has met the requirements of the physical presence test.

The question of whether a person is 'ordinarily resident' is one of fact.⁴⁴ Though there is no definition in the SAITA, the courts have interpreted the concept to mean the country to which a person would naturally and as a matter of course return from his wanderings.⁴⁵

⁴¹ South African Revenue Service (2009) *Guide on the residence basis of taxation for individuals 2008/09* Accessed online on 27 September on the SARS website at <http://196.37.40.40/home.asp?pid=4150&tid=65&s=pubs&show=1260>.

⁴² AP de Koker *et al.* (2012) *Silke on South African Income Tax*. Retrieved on 20 May 2012, from Lexis Nexis online database.

⁴³ Act 58 of 1962.

⁴⁴ Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

⁴⁵ *Cohen v CIR* 13 SATC 362, *CIR v Kuttel* 54 SATC 298.

The physical presence test requires that a person be physically present in South Africa in the year of assessment under consideration as well as the preceding five years of assessment for more than 91 days in each year and more than 915 days in aggregate over the preceding five years.⁴⁶

The definition of 'resident' expressly excludes:

*any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation.*⁴⁷

A 'non-resident' will be a natural person who does not meet the criteria as set out in the definition of 'resident' in section 1 of the SAITA.

3.1.2 Source of income

Even though 'source of income' is set out in section 9 of the SAITA, this definition does not address the 'source' of income derived from employment. Therefore, it is necessary to look at case law to determine the 'source' of employment income.

The leading case on the meaning of 'source' is *CIR v Lever Bros & Unilever Ltd*⁴⁸ where it was held that 'source' means 'originating cause'.

Once the nature of the income and its originating cause have been determined, it is then necessary to locate the cause i.e. is it within South Africa or not? It is noteworthy that the source of the income can often be located in more than one jurisdiction. To date, there is no basis to support an argument to apportion the source of income between various locations. Rather, it is necessary in these circumstances to determine the sole, main or dominant source of the income.⁴⁹

⁴⁶ Para (ii) of the definition of 'resident' in sec 1 of the SAITA.

⁴⁷ Definition of 'resident' in sec 1 of the SAITA.

⁴⁸ 1946 AD 441.

⁴⁹ *CIR v Black* 1957 AD.

Applying the *Lever Brothers* test⁵⁰ the originating cause for income from services rendered under South African domestic law is the services rendered and the source is located where the services are rendered.

3.2 Taxation of share incentive schemes

The South African Revenue Service (hereinafter referred to as “SARS”) have in recent years tightened the regulation of employee share incentive schemes in order to protect the tax base against the tax avoidance of disguised salary benefits.⁵¹

The taxation of share benefits from the participation in employee share incentive schemes is regulated by the SITA. In this regard, the provisions of the SITA fall into two broad categories:

- Provisions of the definition of ‘gross income’, as defined in section 1 of the SITA, in particular paragraphs (c) and (i) of the definition, which includes income received as a result of employment or holding of an office in an individual’s ‘gross income’.
- Provisions of sections 8A, 8B and 8C of the SITA dealing with the taxation of gains arising on the exercise of rights to acquire marketable securities.
- Provisions of the Eighth Schedule to the SITA which governs the determination of capital gains.

This section seeks to tax the gain made by an employee when the right to acquire shares are exercised where such rights were granted prior to 26 October 2004.⁵² As the exercise of the right may take place long after the right was granted, section 8A is still applicable in limited cases.

Section 8B is applicable to the disposal of certain qualifying equity shares granted on or after 26 October 2004 to an employee in accordance with an employer’s broad-based employee share plan.⁵³ By allowing an employee to participate in the success of their

⁵⁰ *CIR v Lever Bros & Unilever Ltd* 1946 AD 441.

⁵¹ National Treasury (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004* Pretoria: South African Revenue Service.

⁵² Sec 8A(1)(a) of the SITA.

⁵³ Sec 8B(1).

employer at a minimal tax cost, the aim is to promote long-term, broad based employee empowerment.⁵⁴

Section 8C is applicable to the vesting of certain equity instruments, granted to a director or employee on or after 26 October 2004.⁵⁵

Consideration should also be given to the possible capital gains tax consequences upon disposal of certain awards granted in terms of a share incentive scheme. The provisions of the Eighth Schedule to the SAITA will apply and should be used to determine any capital gain which may arise.

Specific awards granted in terms of a share incentive schemes must be looked at on a case by case basis in order to determine the correct tax treatment thereof.

3.2.1 Gain made by the exercise of a right to acquire a marketable security

In terms of section 8A(1)⁵⁶ of the SAITA, any gain made by the exercise of a right to acquire a marketable security⁵⁷ which was obtained before 26 October 2004 as a director or in respect of services rendered as an employee must be included in that person's income for the year. Paragraph (i) of the definition of 'gross income'⁵⁸ in section 1 of the SAITA, specifically includes 'any amount required to be included in the taxpayer's income under section 8A'

3.2.1.1 Right to acquire a marketable security

For section 8A to apply, a director or employee must have been granted a 'right' to acquire a marketable security. This 'right' includes more than just the right to acquire shares as contemplated in the case of an option to acquire shares and would include a

⁵⁴ National Treasury (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004* Pretoria: South African Revenue Service.

⁵⁵ Sec 8C(1).

⁵⁶ Sec 8A(1) of the SAITA.

⁵⁷ Defined in sec 8A as 'any security, debenture, share, option or other interest capable of being sold in a share-market or exchange or otherwise.'

⁵⁸ Sec 1 of the SAITA.

simple offer to sell or purchase shares.⁵⁹ In *SIR v Kirsch*⁶⁰ the court considered that section 8A applied in circumstances other than the granting of ‘options’. The taxpayer argued that the section did not apply to cases where a director acquired shares ‘by way of outright purchase and not an option’. The court disagreed with the taxpayer’s argument that the word ‘right’ was to be interpreted as a legally enforceable right only thereby limiting the application of the section to ‘share options’. It held that there is ‘no reason whatever why the legislature, when it dealt with this very type of commercial activity where ‘right’ rarely means option, should have intended to limit the operation of s 8A to rights in the strict sense of options’.⁶¹

The right granted must be to acquire a ‘marketable security’. Per the definition ‘marketable security’ in section 8A(10), the application of section 8A will be limited to the right to acquire shares and similar instruments and will not be applicable to a right to acquire other assets, such as land or inventory. These rights will be taxable under the provisions of the SITA which relates to fringe benefits.⁶²

3.2.1.2 Granted in respect of employment or holding of office

Section 8A will only apply where the right to acquire a marketable security was granted to the taxpayer by the holding of office as a director of a company or in respect of services rendered or to be rendered by him as an employee to an employer.⁶³ In *Income Tax Case No 1493*⁶⁴ it was held by the court that there has to be a causal link between the granting of the right and the holding of the position of director or former director and the future or past rendering of services as an employee to an employer.⁶⁵ The court stated that:

The mere fact that the taxpayer who obtains the right to acquire shares is a director or past director or an employee is not conclusive. The right must be given to the

⁵⁹ AP de Koker et al. (2012) Silke on South African Income Tax. Retrieved May 20, 2012, from Lexis Nexis online database.

⁶⁰ 40 SATC 95.

⁶¹ *Ibid.*

⁶² AP de Koker et al. (2012) Silke on South African Income Tax. Retrieved May 20, 2012, from Lexis Nexis online database.

⁶³ Sec 8A(1).

⁶⁴ 53 SATC 187(T).

⁶⁵ This position was previously held in *SIR v Kirsch* 40 SATC 95.

director qua director and to the employee because of the services he has rendered or will render to his employer.

Therefore, where a director or an employee is granted a right to acquire a marketable security for any other reason than for holding the office of director or rendering services as an employee, section 8A will not find application. This would be, for example, where a shareholder who also happens to be a director is granted the right to acquire a marketable security in his capacity as shareholder and not as a result of holding the office of a director.⁶⁶

3.2.1.3 Valuation of the gain

The director or employee is deemed to have made a gain for purposes of section 8A when, at the time of the exercise of the right, the market value of the marketable security exceeds the consideration given by him for the right or the granting of the right.⁶⁷ For this purpose, the market value of the marketable security is taken to be the sum that a person having the right freely to dispose of the security might reasonably expect to obtain for it in a sale on the open market.⁶⁸

Section 8A(1)(b) provides for an exception to the above in circumstances where a right to acquire a marketable security has been exercised but a restriction is placed on the disposal thereof. The restriction must have been placed in the year of assessment in which the exercise takes place. Where this is the case, the individual may elect, by informing the Commissioner for SARS in writing, to defer the taxation of the gain to the year of assessment during which he becomes entitled to dispose of the marketable security.⁶⁹

The employee is prevented from avoiding tax where the gain is made by another person.⁷⁰ Where the individual has ceded the right to acquire a marketable security and the cession was not at arm's length, the gain will still be included in his taxable income.⁷¹ The same will apply where the gain is made by a relative of the employee and where the

⁶⁶ *ITC 1493 53 SATC 187(T).*

⁶⁷ Sec 8A(2)(a) and sec 8A(3)(a).

⁶⁸ Proviso to sec 8A(2)(a).

⁶⁹ Sec 8A(1)(b).

⁷⁰ Haupt, P. (2012) *Notes on South African Income Tax* Cape Town: H & H Publishing.

⁷¹ Sec 8A(6).

right was obtained by another person due to the employee's holding of office or rendering of services.⁷²

3.2.2 Amounts derived from a broad-based employee share plan

Section 8B was introduced in order to promote long term, broad-based employee empowerment by allowing employees to participate in the success of their employment with minimal tax cost by allowing for the tax-free treatment of 'qualifying shares' acquired by employees, even though the shares may be acquired without cost or at a discount.⁷³

3.2.2.1 Qualifying shares

The 'qualifying shares' are shares that are acquired in terms of a broad based employee share plan where the market value of all such shares acquired over a period of five years is, in aggregate, less than R50 000.

For a share plan to qualify as a 'broad-based employee share plan' the following conditions must be met:

- The employer must offer the shares to the employees for no consideration or at par value;
- Employees may not participate in the broad-based employee share plan if they participate in any other equity share plan;
- The employer must offer the plan to at least 80 per cent of those other employees who have been permanent employee on a full-time basis for at least one year;
- The employees must receive full voting rights and be entitled to all dividends;
- The plan may not have any restrictions on disposal other than restrictions imposed by legislation, a right to acquire the shares at market value and a restriction on the employee to not dispose of the share for a period of five years.

Market value in relation to an equity share is the price which could be obtained upon the sale of that equity share between a willing buyer and a willing seller dealing freely at

⁷² Sec 8A(6)(a) and sec 8A(6)(b)(ii).

⁷³ National Treasury (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004* Pretoria: South African Revenue Service.

arm's length in an open market and without having regard to any restrictions imposed in respect of that equity share.⁷⁴

3.2.2.2 Valuation of the gain

Where an employee is granted a qualifying equity share in terms of a broad-based employee share plan, any gain made by the employee from the disposal of that qualifying equity share will only be included in the employee's taxable income if the disposal is made within five years from the date of grant of that qualifying equity share.⁷⁵ If, however, the equity share is disposed of more than five years from the date that it was granted, the gain will be subject to capital gains tax, but the initial grant of the qualifying equity share will be tax-free.⁷⁶

3.2.3 Taxation of directors and employees on vesting of equity instruments.

Section 8C of the SAITA was introduced from 26 October 2004 and was an attempt by SARS to curb the tax benefits enjoyed by employees participating in share incentive schemes.⁷⁷ According to the Explanatory Memorandum on the Revenue Laws Amendment Bill 2004⁷⁸ any advantages associated with employee share incentive schemes conflicts with the concept of vertical equity. It states that:

Employees (especially top management) should not be allowed to obtain tax advantaged fringe benefits when rank and file employees are fully subject to tax at ordinary rates on their cash salaries.

It seeks to effectively tax employees and directors on gains made in respect of the vesting of an equity instrument received from their employer by virtue of their employment or holding of office.⁷⁹

⁷⁴ Sec 8B(3).

⁷⁵ Sec 8B(1).

⁷⁶ Sec 10(1)(nC).

⁷⁷ Jonas S (2012) A Critical Analysis of the tax Efficiency of Share Incentive Schemes in Relation to Employees in South Africa. Unpublished MComm Dissertation, University of Stellenbosh.

⁷⁸ National Treasury (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004* Pretoria: South African Revenue Service.

⁷⁹ Muller TC (2009) A Critical Analysis of Section 8C: Taxation of Directors and Employees on Vesting of Equity Instruments. Unpublished MComm Dissertation, University of Pretoria.

Importantly, section 8C includes the gain or loss in the employee's 'income' rather than his 'gross income', as is the case with section 8A. The inclusion in 'income', which refers to the income after exempt income has been deducted, means that there cannot be an argument that the gain or loss should be apportioned to the extent that non taxable income (for example dividends) is received in respect of the equity instrument.⁸⁰

3.2.3.1 *Granted in respect of employment or holding of office*

In order for section 8C to apply, an equity instrument must have been granted to the employee by virtue of his employment or holding of office of director. It would also apply where the equity instrument is acquired from any other person by arrangement with the taxpayer's employer.⁸¹ Various cases note that there must be a causal link between the granting of the right and the holding of the position of director and the future or past rendering of services as an employee to an employer.⁸²

Where the taxpayer acquires an equity instrument for any other reason,⁸³ the provisions of section 8C will not apply.

3.2.3.2 *Vesting of an equity instrument*

Section 8C seeks to tax a gain made by an employee from the vesting of an 'equity instrument'.⁸⁴

An equity instrument will 'vest' when the employee obtains an irrevocable right thereto. The section specifies when vesting will take place. However, in order to determine when the equity instrument vests it is necessary to distinguish between 'restricted equity instruments' and 'unrestricted equity instruments' as contemplated in this section.

⁸⁰ Brincker TE (2011). *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 3 March 2012 from the Lexis Nexis database.

⁸¹ With effect from 8 November 2005.

⁸² *SIR v Kirsch* 40 SATC 95; *ITC 1493* 53 SATC 187.

⁸³ For instance where the equity instrument is acquired in the employee's capacity as shareholder.

⁸⁴ 'Equity instruments' as defined in sec 8C(6) include an option to acquire a share, part of a share or member's interest; any financial instrument that is convertible to a share or member's interest; and any contractual right or obligation the value of which is determined directly or indirectly with reference to a share or member's interest.

An 'unrestricted equity instrument' is any equity instrument which is not a 'restricted equity instrument'.⁸⁵ On the other hand, a 'restricted equity instrument' is an equity instrument upon which one or more restrictions are placed. Brincker (2011)⁸⁶ summarises the possible restrictions and restricted equity instruments as follows:

- Restrictions on the disposal of the equity instrument, whether this be a restriction on the disposal of the equity instrument at market value or a penalty which may be imposed for non compliance with the terms of agreement for the acquisition of the equity instrument;
- Forfeiture restrictions in terms of which the employee forfeits ownership or the right to acquire ownership of the equity instrument otherwise than at market value;
- Rights to impose restrictions on disposal or forfeiture restrictions;
- Options to acquire a restricted equity instrument will also be deemed to be a restricted equity instrument;
- Similar to options, a financial instrument which can be converted to a restricted equity instrument will be deemed to be a restricted equity instrument.
- Employee escape clauses which aim to protect the employee against a drop in share price;
- Deferral of delivery of the equity instrument to the employee until the happening of a certain event or fulfilment of a certain condition.

In the case of an 'unrestricted equity instrument' vesting will be at the time it is acquired. The word 'acquisition' is not defined in the SAITA but, according to Du Plessis (2005),⁸⁷ it includes any form of acquiring ownership or possession.

In the case of a 'restricted equity instrument' vesting will take place at the earlier of:

- When all restrictions are lifted and the participant has an unconditional right to the underlying shares.
- Immediately before the taxpayer disposes of a restricted equity instrument.
- Immediately after an option or a financial instrument terminates.

⁸⁵ Sec 8C(6).

⁸⁶ Brincker TE (2011). *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 3 March 2012 from the Lexis Nexis database.

⁸⁷ Du Plessis I (2005) Section 8C of the Income Tax Act: A discussion. *Stellenbosch Law Review* Vol.1 p 104.

- Immediately before a taxpayer dies, if all the restrictions relating to that equity instrument are or may be lifted on or after death.⁸⁸

3.2.3.3 Valuation of the gain

The gain to be included in the employee's income upon the vesting of an equity instrument will be the market value of the equity instrument on the date of vesting less any consideration given by employee in order to acquire the equity instrument.⁸⁹

A roll-over relief is provided where an employee exchanges a restricted equity instrument granted by his employer for another restricted equity instrument. In this case, the new instrument is deemed to have been acquired as a result of employment and any gain arising will be taxed when that equity instrument vests.⁹⁰ This prevents employees from arguing that the original equity instrument is a consideration given in respect of the subsequent restricted equity instrument.⁹¹

3.2.4 Capital gains tax considerations

South Africa does not have a separate capital gains tax.⁹² It is regarded as a tax on income and, therefore, taxable capital gains are included in a person's taxable income and subject to normal tax.⁹³

A person's taxable capital gain or loss upon the disposal of an asset is determined by deducting the base cost from the proceeds.⁹⁴

⁸⁸ Sec 8C(3)(b).

⁸⁹ Sec 8C(2)(a)(ii).

⁹⁰ Sec 8C(4)(a) of the SAITA.

⁹¹ Du Plessis I (2005) Section 8C of the Income Tax Act: A discussion. *Stellenbosch Law Review* Vol.1 p 104.

⁹² Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

⁹³ Sec 26A of the SAITA.

⁹⁴ Paras 3 to 10 of the Eighth Schedule to the SAITA.

The proceeds are equal to the total amount received by or accrued to the person in respect of the disposal⁹⁵ and the base cost is equal to the expenditure incurred in acquiring the asset.⁹⁶

The disposal of an equity instrument will not have any Capital Gains Tax (hereinafter referred to as “CGT”) consequences prior to the date of vesting.⁹⁷ Paragraph 11(2)(j) of the Eighth Schedule to the SITA provides that there is no disposal of an equity instrument contemplated in section 8C of the SITA which has not yet vested.⁹⁸

Furthermore, an equity instrument is deemed to have vested immediately prior to disposal⁹⁹ thereby making it an unlikely scenario that disposal should take place prior to vesting.¹⁰⁰

A distinction is made between the base cost of a gain determined in accordance with section 8A and section 8C. The base cost of an ‘equity instrument’ will be the market value of the ‘equity instrument’ on the date that it has vested.¹⁰¹ No consideration is given to the price paid by the employee for the equity instrument in the first place. On the other hand, the base cost of a ‘marketable security’ will be the market value or the amount received by the employee.¹⁰²

In the case of the vesting of a restricted option to acquire a restricted share, the market value of the option will generally be the difference between the market value of the share acquired at exercise, and the strike price paid by the employee. This amount is included in the employee’s income. When the unrestricted share is then disposed of, its base cost is equal to any amount actually paid on exercise of the option plus the section 8C taxable value of the option.¹⁰³

⁹⁵ Para 35(1) of the Eighth Schedule to the SITA.

⁹⁶ Para 20(1)(a)

⁹⁷ Bincker TE (2011) *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 8 September 2013 from the Lexis Nexis database.

⁹⁸ Para 11(2)(j) of the Eighth Schedule to the SITA.

⁹⁹ Sec 8C(3)(b)(ii) and sec 8C(3)(b)(v).

¹⁰⁰ Bincker TE (2011) *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 8 September 2013 from the Lexis Nexis database.

¹⁰¹ Para 20(1)(h) of the Eighth Schedule to the SITA.

¹⁰² *Ibid.*

¹⁰³ Paras 20(1)(c)(ix), 20(1)(h) and 58 of the Eighth Schedule to the SITA.

3.3 Summary

Summarised below is the tax treatment of share options in the context of South African tax law.

Gain	Time of tax event	Gain to be included	Maximum effective rate of tax applicable
Section 8A gain	Exercise	Difference between the market value at the time of exercise and the value of the consideration given by the employee	40 per cent
Section 8B gain	Disposal	None	Not applicable
Section 8C gain	Vesting	Difference between the market value at the time of vesting and the value of the consideration given by the employee	40 per cent
Capital gain	Disposal	Difference between the proceeds received in respect of the disposal and the market value used in order to calculate the gain in terms of section 8A or section 8C.	13.32 per cent

CHAPTER 4: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN BELGIUM

4.1 Introduction

In principle, a Belgian resident individual is taxable in Belgium on his worldwide income even if part of the income was derived outside of Belgium.¹⁰⁴ Non-residents, on the other hand are, in general, only taxed on income 'derived' in Belgium.¹⁰⁵

4.1.1 Resident

In accordance with article 2 of the Belgian Income Tax Code¹⁰⁶ (hereinafter referred to as 'the BITC'), any individual who has his 'residence' or his 'centre of economic interests' in Belgium is tax resident in Belgium.¹⁰⁷

The Belgian Supreme Court has held that 'residence' refers to the factual place of residence, the centre of a person's social and professional interests, and is necessarily characterized by a certain degree of permanence.¹⁰⁸ The law does not provide for a minimum duration.

A person's 'centre of economic interests' is the location from where the person's property is administered regardless of where the property is located.¹⁰⁹ The 'centre of economic interests' is mostly difficult to determine and, therefore, the tax administration usually looks at the 'residence' as the determining factor.¹¹⁰

Where a person is registered in the civil register of a Belgian municipality, he is deemed to be resident until proven otherwise.¹¹¹

¹⁰⁴ Art. 5 and 183 of the BITC.

¹⁰⁵ Art 228 °1 of the BITC.

¹⁰⁶ 1992.

¹⁰⁷ Art 2 of the BITC.

¹⁰⁸ Supreme Court 15 November 1990 *F.J.F.* 1991 70.

¹⁰⁹ Supreme Court 7 February 1979 *Bulletin der Belastingen* 611 2713.

¹¹⁰ T. Gernay, Belgium - Individual Taxation, Country Analyses IBFD database (accessed 19 Nov. 2012).

¹¹¹ Art 2 of the BITC.

4.1.2 Source of income

The term 'source' is not defined in the Belgian tax law. However, the law contains source rules to determine if income derived by a Belgian resident qualifies for unilateral relief and source rules to determine when income derived by a non resident is taxable in Belgium.¹¹² Generally, income will be foreign sourced if it arises in a location outside of Belgium.¹¹³

4.2 Taxation of share options

4.2.1 General

Included in the taxable income of an individual is 'earned income'¹¹⁴ which consists of employment income, business income and professional income from discontinued activities, and pension income.¹¹⁵

Taxable remuneration is defined in article 30 of the BITC as the remuneration of employees and remuneration of company directors regardless of the identity of the payer, its denomination and the way in which it is determined or attributed. Remuneration will include all compensation obtained by an employee from his employment with his employer and specifically includes benefits of any nature resulting from the employee's activities in service of the employer.¹¹⁶ The same principles apply for company directors.¹¹⁷

4.2.2 Income from employment

Any benefit granted by an employer to an employee is assumed to constitute taxable income unless it can be proven that the benefit would have been granted, irrespective of

¹¹² Schoolvliet E (2005), Source and Residence: A New Configuration of their principles – Belgium, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

¹¹³ *Ibid.*

¹¹⁴ *Beroepsinkomsten or revenus professionnels.*

¹¹⁵ Art 23 of the BITC.

¹¹⁶ Art 31 of the BITC.

¹¹⁷ *Ibid.*

the employment relationship.¹¹⁸ Where an employee is rewarded benefit in kind by his employer, there is a rebuttable presumption that the benefit was provided in respect of employment.¹¹⁹

Therefore, share options granted by an employer will, in principle, be included in an employee's remuneration where it was obtained by reason of the employee's activities in service of the employer.

4.2.3 The Law of 26 March 1999

In terms of the Law of 26 March 1999¹²⁰ (hereinafter referred to as 'the Stock Option Law'), share options which are offered in writing to individuals and accepted in writing are taxable at the moment of attribution, generally referred to as their grant.¹²¹

In the Stock Option Law, 'option' is defined as:

the right to buy or to subscribe for a certain number of shares during a certain period at a certain price or at a price which can be determined, during a determined period of time.

The term 'offer' is defined in article 41 of the Stock Option Law as 'the offer of the option which has been notified to the beneficiary'.¹²² A beneficiary is deemed to have been notified when he is able to knowingly decide whether or not to accept or refuse the fixed and definitive offer that has been made to him.¹²³

In terms of article 42 of the Stock Law, an option, whether conditional or unconditional, is deemed to be granted on the 60th day following the offer if the offer has, in the meantime, been accepted in writing. No taxable event will occur if the beneficiary rejects or refuses to accept the offer and does so in writing within 60 days from the day on which

¹¹⁸ Muyldermans J & Moeskops C (2001) Belgium: Tax Treatment of Employee Stock Options. *Derivatives and Financial Instruments* Vol 3 No 6, IBFD database (accessed 12 May. 2013).

¹¹⁹ Administrative Commentary on the Income Tax Code 31/8.

¹²⁰ Law of 26 March 1999 concerning the Belgian action plan for employment 1998, Official Gazette 1 April 1999, last amended by the Law of 28 December 2011.

¹²¹ Law of 26 March 1999.

¹²² Art 41 of the Law of 26 March 1999.

¹²³ The Circular Letter dated 17 December 1999, AAF/999-1287 of the Belgian tax authorities.

the offer was made.¹²⁴ Previously, the options were deemed to have been accepted if they were not refused within 60 days. However, this could have led to abuses and in 2002 the Stock Option Law was amended.¹²⁵

Generally, no tax will be due upon the exercise of the option and capital gains on the subsequent sale of the shares by the beneficiary will be exempt from tax under the normal Belgian rules applicable to gains derived from an individual's private investment portfolio.¹²⁶ However, where the option is subject to a provision which provides the employee with a certain benefit, the benefit will be taxable as employment income in the period in which the benefit can be established. It will only be taxable in so far as it exceeds the taxable benefit determined at the moment of grant.¹²⁷

It should be noted that, where article 15 of a DTA applies, the tax administration will see the gain on the date of exercise as the salary payment to which article 15 of the OECD MTC applies and will deem the benefits acquired as a result of the subsequent disposal of the shares as a capital gain to which article 13 of the OECD MTC applies.¹²⁸

4.2.4 Valuation of the benefit

The taxable income related to the grant of share options depends on whether the option itself is traded on the stock exchange. If the options are traded on a stock exchange, the taxable benefit is equal to the closing price of the option on the day preceding the offer. If the options are not traded on a stock exchange, taxable income is calculated on the basis of the value of the underlying shares.¹²⁹

In the case of unlisted options, a distinction should be made between listed and unlisted shares. For listed shares, the value of the shares that will be used to determine the taxable income is, at the choice of the grantor, either the average closing price of the shares during the 30 days preceding the offer or the closing price of the day preceding

¹²⁴ Art 42 of the Law of 26 March 1999.

¹²⁵ Smet P & Laloo H (2008) Tax Treatment of Employee Stock Options in Belgium *Bulletin for International Taxation* Vol 62 No 8.

¹²⁶ Muyldermans J & Moeskops C (2001) Belgium: Tax Treatment of Employee Stock Options. *Derivatives and Financial Instruments* Vol 3 No 6, IBFD database (accessed 12 May. 2013).

¹²⁷ T. Gernay, Belgium - Individual Taxation, Country Analyses IBFD database (accessed 19 Nov. 2012).

¹²⁸ Administrative circular No AFZ 2005/0652, 25 May 2005.

¹²⁹ Law of 26 March 1999.

the offer. For unlisted shares, the value of the shares has to be determined by the grantor of the option. This determination has to be approved by the statutory auditor of the company issuing the underlying shares.¹³⁰

The taxable benefit in accordance with the Stock Option Law is eighteen per cent¹³¹ of the value of the shares, reduced by any amount paid by the employee in order to acquire the option. If the option is granted for a period of more than five years from the date of offer, the taxable benefit is increased by one per cent per year. These percentage rates are reduced by half¹³² if the following conditions are met:

- the exercise price is definitively set at the moment of the offer;
- the option cannot be transferred;
- the option cannot be exercised before the end of the third calendar year following the offer and must be exercised before the end of the tenth year following the offer;
- the downside risk of the option (capital loss on the underlying shares) may not be covered, directly or indirectly, by the grantor of the option;
- the option must relate to shares of the company for whom the beneficiary works or to the shares of a group company that has a direct or indirect interest in the company for whom the beneficiary works.¹³³

Where the strike price is less than the value of the underlying shares at the time of grant, the difference will be added to the taxable benefit. However, the taxable benefit will not be reduced where the strike price exceeds the value of the underlying shares.¹³⁴

4.2.5 Capital gains tax considerations

No tax will be payable by an employee upon the sale of shares acquired in terms of an employee share scheme. Any capital gain realised as a result of the sale will be exempt from tax under the normal rules applicable to gains derived from an individual's private investment portfolio.¹³⁵

¹³⁰ *Ibid.*

¹³¹ Increased from fifteen per cent by art 72 of the Law of 28 December 2011, published in the 4th edition of the official gazette of 30 December 2011.

¹³² The basic percentage will be nine per cent and the yearly increase for options with a period of more than five years will be half a per cent.

¹³³ Law of 26 March 1999.

¹³⁴ *Ibid.*

¹³⁵ Law of 26 March 1999, Art 90(1) of the BITC.

4.3 Summary

Summarised below is the tax treatment of share options in the context of Belgian tax law.

Gain	Time of tax event	Gain to be included	Maximum effective rate of tax applicable
Gain in respect of a share option granted for less than five years	Grant	Eighteen per cent of the value of the shares less any consideration paid by the employee plus the amount by which the value of the shares at vesting exceed the strike price.	50 per cent
Gain in respect of a share option granted for less than five years	Grant	Eighteen per cent plus one per cent per year exceeding five years of the value of the shares less any consideration paid by the employee plus the amount by which the value of the shares at vesting exceed the strike price.	50 per cent
Gain on disposal	Disposal	None	Not applicable

CHAPTER 5: TAX TREATMENT OF SHARE INCENTIVE SCHEMES IN INDIA

5.1 Introduction

Residents of India are taxed on their worldwide income.¹³⁶ However, an exception applies to residents of India who are not 'ordinarily resident'. These individuals' income accrued outside of India will only be subject to tax in India where such income is derived from a business controlled in India or a profession established in India.¹³⁷ Non-residents are taxable on income accrued or arising from Indian sourced income.¹³⁸

5.1.1 Residence

In India, residence is determined with reference to the previous year of assessment and should be determined every year.¹³⁹ An individual is a resident (and ordinarily resident) in a previous year if he:

- is in India for an aggregate period of 182 days or more during the previous year;¹⁴⁰
or
- during the four years preceding the previous year, remained in India for an aggregate period of 365 days or more and is in India in that previous year for 60 days or more.¹⁴¹

An individual is resident but not ordinarily resident in a previous year if he is a resident but:

- has been a non-resident in India in nine out of ten years preceding the previous year;
or

¹³⁶ Sec 5(1) of the IITA holds that residents are subject to income tax in respect of all income which is received or is deemed to be received in India by or on behalf of the resident, accrues or arises or is deemed to accrue or arise to the resident in India and accrues or arises to the resident outside India.

¹³⁷ In terms of the proviso to sec 5(1) of the IITA, were a person is resident but not ordinarily resident in India, he will be taxable on his worldwide income only if it is derived from a business controlled in or a profession set up on India. Foreign income earned including salaries, dividends, interest, capital gains and royalties will not be taxable unless it is directly received in India.

¹³⁸ Sec 5(2) of the IITA holds that non-residents are subject to income tax in respect of all income which is received/accrued/arises or deemed to be received/accrued/arise in India by or on behalf of the non-resident.

¹³⁹ Dave KJ & Nayak MB (2005) Source and Residence: A New Configuration of their principles – India, *IFA Cahiers* Volume 90A p339 Accessed on the IBFD database on 25 September 2013.

¹⁴⁰ Sec 6(1)(a) of the IITA.

¹⁴¹ Sec 6(1)(c) of the IITA.

- has not during the seven years preceding the previous year been in India for a total period of 730 days or more.¹⁴²

5.1.2 Source

Section 9 of the Indian Income Tax Act (hereinafter referred to as the “IITA”)¹⁴³ provides source rules for determining income deemed to accrue or arise in India to a non-resident. According to section 9(1)(ii), income from employment is deemed to arise in India if the services are rendered in India. It specifically deems salaries earned in India to be income accruing or arising in India.¹⁴⁴

5.2 Taxation of share options

5.2.1 General

Previously, share options were taxable in the hands of the employee at the time of vesting.¹⁴⁵ However, in 2001 the Finance Act 2001 amended the provisions of the IITA relating to of the taxation of benefits arising to employees under employee stock option plans.¹⁴⁶ In 2007, the Finance Act made amendments to bring share options within the ambit of fringe benefit tax meaning that the employer was paying the tax while there was no separate taxation in the hands of employee.¹⁴⁷ After protests from the trade and industry, fringe benefit tax was abolished by the Finance Act¹⁴⁸ in 2009 and various benefits provided by employers to their employees, including share options, was brought within the ambit of perquisite tax which makes it taxable in the hands of the employee.¹⁴⁹

¹⁴² Sec 6(6)(a) of the IITA.

¹⁴³ Act 43 of 1961

¹⁴⁴ Sec 9(1)(ii) of the IITA.

¹⁴⁵ *Abbot v. Philbin* 44 ITR 144 (1960).

¹⁴⁶ Dalal, K et al (2002) India: Tax Treatment of Employee Stock Options *Derivatives and Financial Instruments* Vol 4 No 4, IBFD database (accessed 12 May. 2013).

¹⁴⁷ Explanatory circular on Fringe Benefit Tax arising on allotment or transfer of specified securities or sweat equity shares (2007) Circular no 9/2007 dated 20-12-2007.

¹⁴⁸ Act 2 of 2009.

¹⁴⁹ Mhatre S (2010) ESOP Taxation in India – tax issues for globally mobile employees. Available at <http://www.taxindiainternational.com/columnDesc.php?qwer43fcxzt=MTY=>. Accessed 29 September 2013.

5.2.2 Perquisite tax

In accordance with section 17 of the IITA, income from employment is taxable at the earlier of receipt or accrual.¹⁵⁰ 'Salary' as used in section 17(1) has a very wide and inclusive definition¹⁵¹ and includes *inter alia*:

- wages;
- fees commissions, perquisites or profits in lieu of or in addition to salary or wages;
- advance of salary;

In terms of section 17(2)(vi) of the IITA, perquisites include the value of 'specified security' or 'sweat equity shares' which have been directly or indirectly allotted or transferred by an employer to an employee free of charge or at a concessional rate.¹⁵²

The section defines 'specified security' to mean a security which includes shares and similar instruments¹⁵³ as well as rights or interests in such. Where the employee's stock option was granted under any plan or scheme, therefore, any securities offered under such plan or scheme will also constitute 'specified security'.¹⁵⁴

'Sweat equity' is understood to mean equity shares which has been issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or by making available rights in the nature of intellectual property rights or value additions.¹⁵⁵

5.2.3 Valuation of the benefit

In accordance with the amended provisions, perquisite tax will be payable in the exercise of share options.¹⁵⁶ The value of the benefit will be equal to the fair market value¹⁵⁷ of

¹⁵⁰ Sec 15 of the IITA.

¹⁵¹ *CIT v. Gopal Krishna Suri* [2000] 113 Taxman 707 (Bom.).

¹⁵² Sec 17(2)(vi) of the IITA.

¹⁵³ Sec 2(h) of the Securities Contracts (regulation) Act No 42 of 1956.

¹⁵⁴ Sec 17(2)(vi) of the IITA.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

¹⁵⁷ 'Fair market value' is described in sec 17(2)(vi) as meaning 'the value determined in accordance with the method as may be prescribed'.

the specified security or sweat equity shares on the date on which the option¹⁵⁸ is exercised by the employee less the amount actually paid by or recovered from the employee.¹⁵⁹

In Rule 3 of the Income Tax Rules, 1962, the Central Board of Direct Taxes ('CBDT') prescribes the method for the determination of fair the market value of specified security or sweat equity shares.¹⁶⁰ The rule distinguishes between shares in companies listed on a recognised stock exchange.¹⁶¹ In the case of shares in a listed company, the fair market value will be the average of the opening price and the closing price on that date on the stock exchange where the company is listed. If the company is listed on more than one recognised stock exchange, the stock exchange with the highest volume of trading in the specific share will be looked at to determine the fair market value.¹⁶² Where the share is in an unlisted company, the fair market value will be the value of such share as determined by a registered¹⁶³ Merchant Banker on the date of vesting, or a date not more than 180 days earlier than the date of vesting.¹⁶⁴

5.2.4 Capital gains tax considerations

Profits or gains arising from the sale of a capital asset will be included in a taxpayer's taxable income under the heading 'Capital Gains'.¹⁶⁵ Where an employee disposes of specified security or sweat equity shares, the difference between the consideration received in respect of such disposal and the cost of acquisition thereof, will be included as a capital gain. The cost of acquisition of the specified security or sweat equity shares will be the fair market value which was used to determine the value of the perquisite in section 17.¹⁶⁶

¹⁵⁸ 'Option' is described in 17(2)(vi) as meaning 'a right but no an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.'

¹⁵⁹ Sec 17(2)(vi) of the IITA.

¹⁶⁰ Notification No. 94/2009/ F.No.142/25/2009-S O (TPL), dated 18-12-2009.

¹⁶¹ Rule 3(8)(ii) and Rule 3(8)(ii) of the India Income-Tax Rules, 1962.

¹⁶² Rule 3(8)(ii) of the India Income-Tax Rules, 1962.

¹⁶³ Registered with the Security and Exchange Board of India.

¹⁶⁴ Rule 3(8)(iii) of the India Income-Tax Rules, 1962.

¹⁶⁵ Sec 45(1) of the IITA.

¹⁶⁶ Sec 49(2AA) of the IITTA.

Where the shares were held for more than twelve months prior to the sale, the gains would be long-term capital gains subject to a concessional tax rate as opposed to a progressive tax rate in the case of short-term gains.¹⁶⁷

5.3 Summary

Gain	Time of tax event	Gain to be included	Maximum effective rate of tax applicable
Gain included as perquisite	Exercise	Difference between the fair market value at the time of exercise and the value of the consideration given by the employee	30 per cent
Capital gain	Disposal	Difference between the proceeds received in respect of the disposal and the fair market value used in order to calculate the gain in terms of section 17(2)(vi).	Fifteen per cent for short term capital gains Twenty per cent for long term capital gains

¹⁶⁷ Dalal, K et al (2002) India: Tax Treatment of Employee Stock Options. *Derivatives and Financial Instruments* Vol 4 No 4, IBFD database (accessed 12 May. 2013).

CHAPTER 6: CROSS-BORDER TAXATION

6.1 Double taxation

Double taxation may occur where cross-border services are rendered by an individual.¹⁶⁸ In a legal sense, double taxation refers to two different countries seeking to tax the same income in the hands of the same taxpayer.¹⁶⁹ This could happen where a country, like South Africa, taxes its residents on a world-wide basis and the foreign country in which the services are rendered, taxes non-residents on income derived from services rendered in that country (as is the case in South Africa, Belgium and India). The double taxation in cases like these will be as a result of residence/source conflicts.

6.2 Elimination of double taxation

Generally, countries reduce or otherwise grant relief for double taxation caused by residence/source conflicts by way of:

- foreign tax credit relief; or
- foreign income exemption relief.¹⁷⁰

Foreign tax credit relief will take place where the country of residence allows the foreign tax paid by the taxpayer as a 'credit' against the tax imposed by the country of residence. This involves a deduction of tax against tax.¹⁷¹ Foreign income exemption relief usually excludes the specific foreign income item from the tax base in the residence country.¹⁷²

6.3 South Africa

South Africa, as a country with a residence basis of taxation employs both the methods of foreign tax credit relief and foreign income exemption.

¹⁶⁸ The double taxation which could occur is not limited to double taxation of income, however, this study focusses on the income tax considerations and will therefore not consider any VAT implications which may be applicable.

¹⁶⁹ Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: Siberlnk.

¹⁷⁰ AP de Koker *et al.* (2013) *Silke on International Tax*. Retrieved September 8, 2013, from Lexis Nexis online database.

¹⁷¹ *Ibid.*

¹⁷² *Ibid.*

6.3.1 Relief for South African residents

6.3.1.1 Exemption for foreign employment income

South African residents are taxable on their world wide income.¹⁷³ Therefore, where a South African resident earns income for services rendered in another country, South Africa will seek to tax that income from employment.

According to AP de Koker *et al* (2010),¹⁷⁴ section 10(1)(o)(ii) of the SITA recognises that it could be counterproductive to the competitiveness of South African business with operations or subsidiaries in other countries, to tax employees in South Africa for work performed in another country where the individual spends substantial periods of time working outside of South Africa. However, in the 2013 Budget Review¹⁷⁵, it was mentioned that amendments may be proposed to extend the world wide basis of taxation where the services rendered outside South Africa are rendered to a South African resident employer.

Currently, however, where a resident individual renders services outside South Africa (to any employer) and that individual is physically outside South Africa for:

- a period exceeding 183 full days in any twelve month period;
- of which more than 60 days are continuous;

remuneration derived from such services will be exempt from income tax.¹⁷⁶

Income is deemed to accrue evenly where services are rendered over more than one year of assessment and a single accrual covers the entire period. In these circumstances, the income must be apportioned over the respective years of

¹⁷³ Sec 1 of the SITA.

¹⁷⁴ AP de Koker *et al*. (2013) *Silke on International Tax*. Retrieved September 8, 2013, from Lexis Nexis online database.

¹⁷⁵ National Treasury of the Republic of South Africa (2013), Budget Review p190. Accessed online at

<http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20c.pdf> on 9 September 2013.

¹⁷⁶ Sec 10(1)(o)(ii) of the SITA.

assessment.¹⁷⁷ It should be noted that remuneration in respect of *inter alia* the loss, cancellation or variation of employment is not covered in this exemption.¹⁷⁸

Should an individual not qualify for the section 10(1)(o)(ii) exemption for any reason whatsoever, double taxation relief will still be available to the individual in so far as any income was taxed in the country where the services were physically rendered.

Further exemptions from income will be possible by the application of DTAs (refer to 6.2.4 below).

6.3.1.2 Section 6quat rebate

Section 6quat to the SITA allows a rebate or deduction in respect of foreign taxes paid on income received by or accrued to and capital gains made by a South African tax resident from a source outside South Africa.¹⁷⁹

The rebate allowed will be equal to the sum of any taxes on income proved to be payable by the resident in respect of income or capital gains, without any right of recovery, in a country other than South Africa.¹⁸⁰ However, the rebate may not in aggregate exceed the amount of normal tax payable in South Africa on the same income or capital gain.¹⁸¹ Essentially this means that where the rate of tax in the source country is higher than the applicable marginal tax rate in South Africa or *vice versa*, the taxpayer will only be able to claim a credit equal to the lower tax rate. Where the actual tax paid in another country exceeds the maximum credit allowed in a year of assessment, such credit may be carried forward for a maximum of seven tax years.¹⁸²

It is important to note that the section 6quat rebate may be claimed as an alternative to, and not in addition to relief afforded in terms of a DTA.¹⁸³

¹⁷⁷ Sec 10(1)(o)(ii)C of the SITA.

¹⁷⁸ South African Revenue Service (2003) Interpretation Note 16. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-16%20-%20Exemption%20Foreign%20Employment%20Income.pdf> on 9 September 2013.

¹⁷⁹ Sec 6quat(1) of the SITA.

¹⁸⁰ Sec 6quat(1A) of the SITA.

¹⁸¹ Sec 6quat(1B) of the SITA.

¹⁸² Sec 6quat(1B)(ii) of the SITA.

¹⁸³ Sec 6quat(2) of the SITA.

It is possible that the amount of foreign tax initially claimed as a rebate differs from the foreign tax which is ultimately payable. Furthermore, there may be a timing mismatch in respect of the underlying income.¹⁸⁴ Therefore, SARS may reopen an assessment in order to match the final tax credit to the underlying taxable income in the year in which it is recognised in South Africa.¹⁸⁵

6.3.1.3 Section 6quat deduction

It is possible that some countries may tax income in respect of services rendered, in South Africa's view, from a South African source. In such instances, SARS are not willing to give relief from double taxation in the form of a tax credit. Rather, it allows the individual to claim the foreign taxes paid as a deduction from income.¹⁸⁶

A deduction from income is available under section 6quat(1C) of the SAITA where a South African resident paid tax to a foreign country in respect of income sourced in South Africa.¹⁸⁷ The deduction will only be allowed in respect of income from carrying on a trade (which includes employment income)¹⁸⁸ and will be limited to the total taxable income attributable to the income which is subject to the foreign taxes. This limitation prevents a reduction in the tax payable on other taxable income.¹⁸⁹

Any excess amount of foreign taxes not allowed as a deduction, may not be carried forward to any subsequent year of assessment.¹⁹⁰

As is the case with the section 6quat rebate, the section 6quat deduction may not be claimed in addition to any DTA relief but may be granted in substitution.¹⁹¹

¹⁸⁴ AP de Koker *et al.* (2013) *Silke on International Tax*. Retrieved October 8, 2013, from Lexis Nexis online database.

¹⁸⁵ Sec 6quat(5).

¹⁸⁶ Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

¹⁸⁷ Sec 6quat(1C) of the SAITA.

¹⁸⁸ 'trade' is defined in sec 1 of the SAITA and includes *inter alia* every profession, employment and occupation.

¹⁸⁹ Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

¹⁹⁰ *Ibid.*

¹⁹¹ Sec 6quat(2).

6.3.1.4 Section 6quin rebate

As mentioned above, where income is not sourced outside of South Africa, section 6*quat* will not be able to provide relief from double taxation to a South African resident by way of a rebate.¹⁹²

In terms of section 6*quin*, a resident will be able to claim a rebate for foreign taxes paid in respect of income from a South African source and which is received in respect of services rendered in South Africa.¹⁹³ However, the rebate will only be available if there is a DTA and the foreign tax is withheld when the income was paid to the resident,¹⁹⁴ or where the tax is imposed by a country with which there is no DTA. According to de Koker *et al* (2012)¹⁹⁵ section 6*quin* applies where two countries impose tax on the same taxpayer in respect of the same income for the same period of time.

The rebate will be limited to the amount of normal tax which is attributable to the income received by the resident.¹⁹⁶ Furthermore, the excess of foreign taxes are forfeited and may not be carried forward to a subsequent year of assessment.¹⁹⁷

The provisions of section 6*quat*, and section 6*quin* are mutually exclusive. Where the resident claimed a rebate or deduction in terms of section 6*quat* he will be prohibited from claiming a rebate in terms of section 6*quin* on the same income.¹⁹⁸

6.3.2 Relief for non-residents

Individuals who are tax resident in South Africa are only taxable on income from a source within South Africa. As mentioned in 3.1 above, in South Africa, the source of employment income is the place where the services were physically rendered.¹⁹⁹

¹⁹² Sec 6*quat* is only applicable where foreign tax was paid by a resident in respect of foreign sourced income.

¹⁹³ Sec 6*quin*(1).

¹⁹⁴ Sec 6*quin*(1)(a).

¹⁹⁵ AP de Koker *et al.* (2013) *Silke on International Tax*. Retrieved October 8, 2013, from Lexis Nexis online database.

¹⁹⁶ Sec 6*quin*(2).

¹⁹⁷ Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

¹⁹⁸ Sec 6*quin*(3).

¹⁹⁹ *CIR v Lever Bros & Unilever Ltd* 1946 AD 441.

In ITC 77²⁰⁰ it was held that services which are rendered purely incidentally in a country other than the normal place of employment, should be ignored in deterring the source of income. In *COT (SR) v Shein*²⁰¹ a similar approach was followed.

As there is no specific provision for apportionment in the SAITA a 'dominant source' rule, looking at the dominant source of an accrual and adopting that source to the whole, has been adopted as an appropriate solution in cases where there are similarly no specific provisions for apportionment.²⁰²

Therefore, in the case of non residents rendering services in South Africa, it would be necessary to ask whether the services rendered are sufficiently incidental to the services rendered in the home country that they have no bearing on the payment to him of his remuneration.²⁰³

6.3.3 Application to share options for services rendered

Where a restricted equity instrument is granted to an employee in respect of services rendered partially in South Africa, it is necessary to consider how South Africa may seek to tax the income upon the vesting of such restricted equity instrument and the capital gain upon the subsequent disposal thereof.

Where the restricted equity instrument is granted to a South African resident employee, South Africa will, in the first instance, seek to tax the full gain as calculated in accordance with section 8C of the SAITA. However, should the employee render services (which may be attributable to the option granted) in a country other than South Africa, the exemption in terms of section 10(1)(o)(ii)²⁰⁴ or double taxation relief in terms of section

²⁰⁰ (1997) 3 SATC 72.

²⁰¹ 1958 (3) SA 14, 22 SATC 12.

²⁰² *C Tuck V CIR* 1988 (3)SA 819 (A), 50 SATC 99; *CIR v Legal and General Assurance* 1963 (3) SA 876 (A), 25 SATC 303.

²⁰³ AP de Koker *et al.* (2010) *Silke on International Tax*. Retrieved September 8, 2013, from Lexis Nexis online database.

²⁰⁴ South African Revenue Service (2011) *Binding Class Ruling 025: Income tax implications for employees/senior executives in relation to a share option plan/share appreciation rights plan*. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BCR-2012-25%20-%20Tax%20Implications%20Employees%20Senior%20Executives%20Share%20Option%20Plan%20Appreciation%20Rights%20Plan.pdf> on 9 September 2013.

6quat or a DTA may apply. As section 10(1)(o)(ii) only applies to remuneration, relief from double taxation must be sought by way of section 6quat or a DTA.

Conversely, South Africa will seek to tax the portion of income or taxable gain in respect of an equity instrument granted to a non-resident, in so far as it is attributable to a source within South Africa (i.e for services rendered in South Africa).²⁰⁵

In their Binding Class Ruling 025,²⁰⁶ SARS adopts a practical approach with reference to the extent to which the relevant benefits are taxable in South Africa.²⁰⁷ The formulas below were used by SARS to determine the taxable gain and portion of the gain exempt from tax where services were rendered partly in South Africa. It should be noted that the BCR was specifically issued in respect of share options and share appreciation rights which still carried restriction up to the date of exercise. Therefore, the formulas look at the date of exercise as the date of vesting.

Non resident employees

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of vesting}} \times \text{Section 8A/8C gain}$$

= The portion of the gain that will be deemed to be from a South African source and taxable in South Africa during the year in which a section 8A or 8C event took place

Resident employees

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of vesting}} \times \text{Section 8A/8C gain}$$

= The portion of the gain that will be exempt under section 10(1)(o)(ii) during the year in which a section 8A or section 8C event took place.

It has long been a SARS practice to apportion income earned by a non-resident on the basis of the number of days worked in South Africa²⁰⁸ which makes it interesting to note

²⁰⁵ *Ibid.*

²⁰⁶ *Ibid.*

²⁰⁷ Bincker TE 2011. *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 8 September 2012 from the Lexis Nexis database.

²⁰⁸ Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: SiberInk.

that in the BCR SARS allows an apportionment based on the number of calendar days physically spent in South Africa.

6.4 Belgium

Double taxation relief in Belgium is eliminated by the application of DTAs. Belgium has an extensive network of DTAs which uses the credit method to avoid double taxation.

6.4.1 Relief for Belgian residents

In principle, residents of Belgium are taxable on their world-wide income.²⁰⁹ Foreign income will be taxable irrespective of how and if it is taxed in the foreign country. However, this may become relevant when applying the provisions of a DTA.²¹⁰

In terms of article 156(2) of the BITC, income tax on income earned outside Belgium is reduced by 50 per cent if that income was taxed in another country and would have otherwise been subject to the progressive income tax rates.²¹¹ Income would be seen to be earned outside Belgium if it is as a result of services physically rendered outside Belgium.²¹²

Foreign income will be deemed taxed in a foreign country if it was subject to the normal foreign tax regime. This is in accordance with a doctrine developed by the Supreme Court.²¹³ The doctrine requires the income to be principally subject to tax and disregards whether such income may be exempt in accordance with the foreign tax rules. It is also not necessary for the income to be taxable in the hands of the Belgian resident who claims the reduction as long as it is in principle subject to tax.²¹⁴

²⁰⁹ Articles 5 and 183 of the BITC.

²¹⁰ Schoolvliet E (2005), *Source and Residence: A New Configuration of their principles – Belgium*, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

²¹¹ Article 156(2) of the BITC.

²¹² Schoolvliet E (2005), *Source and Residence: A New Configuration of their principles – Belgium*, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

²¹³ Cass., 15 September 1970, *Bulletin der Belastingen* No. 489, 1679.

²¹⁴ Schoolvliet E (2005), *Source and Residence: A New Configuration of their principles – Belgium*, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

6.4.2 Relief for non-residents

In Belgium, a special tax is used to assess non-residents. 'Non-residents' Income Tax' is based on the principles of the individual income tax, but aims to tax only Belgian sourced income.²¹⁵

Dependent on the fulfilment of certain conditions, non-resident employees are taxable in Belgium on employment income.²¹⁶ Where remuneration is at the expense of a Belgian resident or by a Belgian permanent establishment of a non-resident, the non-resident employee's remuneration will be taxable in Belgium.²¹⁷ Furthermore, if the non-resident employee is paid by a non-resident employer for services rendered in Belgium, and that employee is present in Belgium for more than 183 days during the taxable period, such remuneration will also be taxable in Belgium.²¹⁸ However, if the remuneration is paid by a resident employer for services rendered outside of Belgium and the remuneration is borne by a foreign permanent establishment, the income will be exempt from tax in Belgium.²¹⁹

A special tax regime exists for foreign executives, directors, top-level specialists and research experts who are appointed by a foreign enterprise or group to work in Belgium temporarily in one or more of the foreign enterprise or group's establishments or companies. This is governed by administrative circular no Ci.RH 624/325.924, 8 August 1983.²²⁰

The foreigners referred to above are deemed to be non-residents based on ties with their home country.²²¹ Typically, the non-resident status is supported by, *inter alia*, the following facts:

- The employee was recruited from the foreign labour market;
- The nature of employment in Belgium is temporary;

²¹⁵ Art 228 of the BITC.

²¹⁶ *Ibid.*

²¹⁷ 'At the expense of' means that either the Belgian debtor deducts the employment cost from its income or the foreign debtor recharges the employment income to, for example, a Belgian company. Administrative Commentary on the Income Tax Code 228/89.

²¹⁸ Administrative Commentary on the Income Tax Code 228/93.

²¹⁹ Art 228 of the BITC.

²²⁰ T. Gernay, *Belgium - Individual Taxation, Country Analyses* IBFD database (accessed 19 Nov. 2012).

²²¹ Circular RH 624/325.294 of 8 August 1983.

- There is a possibility of being transferred at any moment to another country

Persons who qualify for this special non-resident status are assessed exclusively on remuneration for services actually rendered in Belgium. Where it is not possible to definitively show which portion of the non-resident employee's income can be attributed to Belgian services, the following formula may be applied.²²²

$$\frac{\text{Number of days working abroad}}{\text{Total number of work days}} \times \text{Total remuneration}$$

6.4.3 Application to share options for services rendered

In Belgium, where a DTA is applicable, there is a deviation from the domestic tax law. In accordance with administrative circular No AFZ 2005/0652, 25 May 2005, where article 15 of the OECD applies and Belgium does not have the right to tax, the difference between the exercise price of an option and the value of the underlying share at the moment of exercise is considered to be a salary payment for purposes of the article. However, where Belgium has the taxing rights, the taxable amount will be determined in accordance with the Law of 26 March 1999.²²³

6.5 India

In India, double taxation relief will be available by way of the credit method in respect of income derived from a country with which India does not have an applicable DTA.²²⁴

6.5.1 Relief for Indian residents

Where an Indian resident has been seconded abroad but remains tax resident in India, the individual will be taxable on his world-wide income.²²⁵

²²² T. Gernay, *Belgium - Individual Taxation, Country Analyses* IBFD database (accessed 19 Nov. 2012).

²²³ *Ibid.*

²²⁴ Sec 91 of the IITA.

²²⁵ Sec 5 of the IITA.

In so far as the individual's income, for services rendered in another country, is taxed in the country where the services are rendered, he will be able to claim a foreign tax credit in accordance with section 91 of the IITA or will be eligible for double taxation relief in accordance with a DTA (see 6.2.4 below).²²⁶

Residents of India will be able to claim a tax credit in respect of foreign income which accrues or arises outside of India and is not deemed to accrue or arise in India. The tax credit will be limited to the lower of the Indian or foreign tax rate.²²⁷

- The Indian tax rate will be the average tax rate over the total income, after deduction of any relief due under the IITA other than double taxation relief.²²⁸
- The foreign tax rate will be the income tax and super tax actually paid in the foreign country after the deduction of all relief due, but before any double taxation relief due in that country, averaged over the whole amount of income assessed in the foreign country.²²⁹

6.5.2 Relief for non-residents

Where an individual who is not resident in India, renders services in India, any income derives as a result of such services will be subject to tax.²³⁰

The income from services rendered in India by a non resident will be exempt if:

- (a) The services are rendered to a foreign enterprise which is not engaged in any trade or business in India; and
- (b) The employee's stay in India does not exceed 90 days in aggregate over a year; and
- (c) The remuneration is not deductible from income of the employer which is taxable in India.²³¹

²²⁶ Sec 90 of the IITA and sec 91 of the IITA.

²²⁷ Sec 91(1) of the IITA.

²²⁸ Para (ii) of the explanation in sec 91 of the IITA.

²²⁹ Para (iii) of the explanation in sec 91 of the IITA.

²³⁰ Sec 5(2) of the IITA.

²³¹ Sec 10(6)(vi) of the IITA.

6.5.3 Application to share options for services rendered

Where an employee is based in India for only a part of the grant period, a proportionate amount of the value of the perquisite will be subject to tax.²³²

The following formula will apply:

$$\frac{\text{Length of period of stay in India during the grant period}}{\text{Length of the grant period}} \times \text{Value of the fringe benefit}$$

6.6 Double Taxation Agreements

6.6.1 OECD Model Tax Convention

South Africa is an observer of the OECD and its Model Tax Convention on Income and on Capital (hereinafter referred to as 'MTC'), is generally used to interpret South African tax treaties.²³³ Belgium is one of the founding members of the OECD²³⁴ and India has a working relationship with the OECD.²³⁵

The OECD MTC is based exclusively on a tax system which uses the basic concept of residence rather than source²³⁶ and will, therefore, be helpful in the interpretation of DTAs, to which South Africa, Belgium, and India are party.

²³² Nishith Desai Associates (2013) Welcome to work in India: Recent rulings on taxation of seconded expats *Research and Articles* Accessed online at <http://www.nishithdesai.com/1/?item=Research+and+Articles/NDA+Hotline/Tax+Hotline&article=1857#page=1> on 7 October 2013; Assistant Commissioner of Income Tax v. Robert Arthur Keltz (Delhi Income Tax Appellate Tribunal), dated May 24, 2013; Yoshio Kubo v. Commissioner of Income Tax, dated July 31, 2013 (Delhi High Court).

²³³ Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: SiberInk.

²³⁴ *Ibid.*

²³⁵ OECD (2013) India and the OECD. Available online at www.oecd.org/india/indiaandtheoecd.htm Accessed on 29 September 2013.

²³⁶ Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: SiberInk.

6.6.2 Residency

In order for a DTA to find application, the person seeking relief from double taxation must be a resident of one or both of the contracting states.²³⁷

The term 'resident of a contracting state' is defined in the OECD MTC as a person who is liable for tax in that state as a result of his domicile, residence or other criteria of a similar nature.²³⁸ Furthermore, article 4(2) provides guideline on determining the state in which a person will be exclusively resident for purposes of the DTA where he is found to be resident, according to domestic legislation, in both states.²³⁹

In the Convention between the Kingdom of Belgium and the Republic of South Africa for the avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on Income (hereinafter referred to as 'the SA/Belgium DTA'), and the Agreement between the Government of the Republic of South Africa and the Government of the Republic of India for the avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on Income (hereinafter referred to as 'the SA/India DTA'), a resident of South Africa will be a person who is ordinarily resident in South Africa.²⁴⁰

6.6.3 Income from employment versus capital gains

For the application of DTAs, it is necessary to determine whether the benefit derived from the participation in an employee share scheme constitutes income from employment or capital gains. If the benefit constitutes income from employment, article 15 will apply. However, if it constitutes a capital gain, article 13 will apply.²⁴¹

According to the OECD Report on 'Cross-Border Income Tax Issues Arising from Employee Stock Option Plans' (2004)²⁴² and the OECD Commentary (2010),²⁴³ article

²³⁷ Art 1 of the OECD MTC.

²³⁸ Art 4(1) of the OECD MTC.

²³⁹ Art 4(2) of the OECD MTC.

²⁴⁰ Art 4(1)(b) of the SA/Belgium DTA Art 4(1)(b) of the SA/India DTA.

²⁴¹ OECD (2005). The taxation of Employee Stock Options, *OECD Tax Policy Studies*. OECD Publishing. Available online at <http://www.sourceoecd.org/taxation/9264012486>.

²⁴² OECD (2004), *Cross-Border Income tax Issues Arising from Employee Stock-Option Plans*, available on the OECD website at <http://www.oecd.org/ctp/treaties/33700277.pdf>. Accessed 15 September 2013.

²⁴³ OECD (2010), *Articles of the OECD Model Tax Convention on Income and Capital*, OECD Publishing.

15 will apply to any benefit derived from the equity instrument up to the date of vesting or exercise. Any subsequent gain realised in the capacity of shareholder, will be capital gains, and article 13 will apply.

Furthermore, in so far as the income from employment or capital gain is subject to double tax (i.e relief in accordance with article 15 and article 13 does not apply), relief may still be available through the application of article 23A and 23B by way of an exemption or a tax credit.²⁴⁴

6.6.3.1 *Income from employment*

The 'income from employment' provision contained in article 15 of the OECD MTC holds that salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of employment is taxable only in the resident state, unless the employment is exercised in the other state.²⁴⁵

The OECD Commentary on article 15 at 2.1 states that most countries have generally understood 'salaries, wages and other similar remuneration' to include benefits in kind (e.g share options) received in respect of employment.²⁴⁶

The state of source will have the right to tax remuneration derived from services rendered in that state regardless of when payment will take place to the employee.²⁴⁷

However, where the conditions in terms of article 15(2) apply, the resident state will have the first taxing right. Firstly, the employee must have been present in the state of source for more than 183 days.²⁴⁸ Depending on the wording of the specific agreement, the 183 days will be in respect of a twelve month period starting or ending in the tax year concerned, as is the case in the SA/India DTA,²⁴⁹ or in any twelve month period, as in the case of the SA/Belgium DTA.²⁵⁰

²⁴⁴ OECD (2005) OECD (2005). The taxation of Employee Stock Options, *OECD Tax Policy Studies*. OECD Publishing. Available online at <http://www.sourceoecd.org/taxation/9264012486>.

²⁴⁵ Commentary to Article 15, OECD (2010), *Articles of the OECD Model Tax Convention on Income and Capital*, OECD Publishing.

²⁴⁶ *Ibid.*

²⁴⁷ *Ibid.*

²⁴⁸ *Ibid.*

²⁴⁹ Article 15(2)(a) of the SA/India DTA – accessed from the IBFD database on 12 May 2013.

²⁵⁰ Article 15(2)(a) of the SA/Belgium DTA – accessed from the IBFD database on 12 May 2013.

According to the OECD Commentary on article 15 at 5, the ‘physical presence method’ should be used in order to determine the 183 day period.²⁵¹ Included in the calculation is part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family. It is, therefore, not limited to days spent working but encompasses all days physically spent in the State but excluding any days spent in the state while in transit. It should also be limited to days spent in the state as a non-resident.²⁵²

Secondly, the employer paying the remuneration must not be a resident of the state in which the services are rendered.²⁵³ The objective of the provisions is to prevent the source taxation of short term employment to the extent that the income will not be allowed as a deduction in the state of source as the employer is not a resident in that state.²⁵⁴

Lastly, where the employer has a permanent establishment in the country of source, the relief in terms of the article will apply as long as the cost of the remuneration is not borne by that permanent establishment. According to the Commentary to article 15 at 7, the term ‘borne by’ should be interpreted in the context of the objective of this provision. The objective, as in the case of previous provision, is to ensure that the relief will only be applicable in so far as no deduction will be available in the source country in respect of the remuneration which is exempted.²⁵⁵

The provisions of article 15 will apply to a benefit from the equity instrument until the irrevocable vesting thereof. Any subsequent gain will be covered by article 13 which applies to capital gains.²⁵⁶ However, when applying article 15 to gains arising from

²⁵¹ OECD (2010) Commentary to Art 15 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁵² *Ibid.*

²⁵³ Article 15(2)(b) of the OECD MTC.

²⁵⁴ OECD (2010) Commentary to Art 15 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁵⁵ *Ibid.*

²⁵⁶ *Ibid.*

participation in an employee share scheme, difficulties arise as the gain is often taxable at a time other than when the services are rendered.²⁵⁷

It is important to note that though Belgium, in terms of domestic legislation, will tax the benefit derived from the granting of a share option on the date of grant, for tax treaty purposes the tax administration will consider the difference between the exercise price of the option and the value of the underlying share at the moment of exercise to be the salary payment to which article 15 applies.²⁵⁸

Where the benefit from an equity instrument is considered to be in respect of services rendered in more than one country it is necessary to determine which portion of the gain is attributable to services rendered in each state. This determination can be made by applying the following formula:²⁵⁹

$$\frac{\text{Number of days employment exercised in the country}}{\text{Total number of days employment exercised over the vesting period}} \times \text{Benefit from employment}$$

6.6.3.2 Capital Gains

Article 13 of the MTC governs the taxation of capital gains and states in paragraph 5 that gains derived from the alienation of any property²⁶⁰ by a person will be taxable only in the state in which the person is resident.²⁶¹

The taxation of capital gains varies from country to country.²⁶² Some countries deem capital gains not to be taxable, while others only tax capital gains in specified cases.²⁶³

²⁵⁷ *Ibid.*

²⁵⁸ Administrative circular No AFZ 2005/0652, 25 May 2005.

²⁵⁹ OECD (2010) Commentary to Art 15 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁶⁰ Except the alienation of immovable property, movable property which forms part of the business property of a permanent establishment and shares which derives at least 50 per cent of their value in immovable property.

²⁶¹ Art 13 of the OECD MTC.

²⁶² OECD (2010) Commentary to Art 13 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁶³ *Ibid.*

Furthermore, taxes on capital gains also vary. In some countries it is taxed as normal income, while some others apply special taxes.

In South Africa, for example, taxable capital gains²⁶⁴ are included in a person's taxable income and normal tax is levied thereon.²⁶⁵ India, also include capital gains in a person's income²⁶⁶ and do not levy a separate capital gains tax.²⁶⁷ The same applies in Belgium.²⁶⁸

However, the provision is not aimed at addressing different ways in which capital gains are taxed and leave it to each country's domestic law to govern. It also does not give a country the right to tax capital gains if such a right does not exist in the domestic law.²⁶⁹

6.6.4 Method for the elimination of double taxation

In terms of the OECD MTC, there are two articles which provide a method for the elimination double taxation. Article 23A holds that the country of residence must exempt any income which has been taxed in the other state²⁷⁰ and article 23B provides for the country of residence to allow a deduction from tax or a tax credit in so far as income was taxed in the other state.²⁷¹

These articles deal with the situation where the same income or capital gain is taxable in the hands of the same person in both countries.²⁷² This can happen when:

- both of the countries tax the same person on his worldwide income; and
- both of the countries impose tax on income derived in and capital which is owned in the country other than his country of residence.²⁷³

²⁶⁴ As calculated in accordance with the provisions of the Eighth Schedule to the SAITA.

²⁶⁵ Sec 26A of the SAITA.

²⁶⁶ Sec 2(24)(vi) of the IITA.

²⁶⁷ Shah S (2013) *India - Individual Taxation, Country Analyses* IBFD database (accessed 12 May 2013).

²⁶⁸ Gernay, *Belgium - Individual Taxation, Country Analyses* IBFD database (accessed 19 Nov. 2012).

²⁶⁹ OECD (2010) *Commentary to Art 13 Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁷⁰ Art 23A(1) of the OECD MTC.

²⁷¹ Art 23B(1) of the OECD MTC.

²⁷² OECD (2010) *Commentary to Arts 23A and 23B Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁷³ *Ibid.*

In the first case, the application of article 4 would be able to eliminate double taxation to some extent by providing for a country of exclusive residence. However, the provisions of article 4 are only applicable where the liability in both countries is concurrent. If income is fully taxable at different points in time, as would be the case of share options taxed at the time of grant in one country and the time of vesting in the other, article 4 would not be able to adequately eliminate the double taxation.²⁷⁴

In the second case, the double taxation may be alleviated by the allocation of taxing rights between the two countries.²⁷⁵ For example, in article 15 of the MTC, the country in which the income is sourced will have the taxing right subject to certain conditions not being met in which case the country of residence will have the right to tax.²⁷⁶

For example, in article 15(1) of the SA Belgium DTA and the SA/India DTA, income from employment exercised in one country 'shall be taxable only' in the country of residence.²⁷⁷ The term 'shall be taxable only' will preclude the other state from taxing the income thereby preventing double taxation.²⁷⁸ Furthermore, the article holds that where the income is as a result of services rendered in the other country (i.e the country which is not the country of residence), the income so derived 'may be taxed' in that other country.²⁷⁹ Where this is the case, the country of residence will have to give relief to the person, by way of an exemption from income or a deduction from tax, in order to avoid double taxation.²⁸⁰

Where the above is not sufficient to eliminate the double taxation, articles 23(a) and 23(b) must be applied.²⁸¹

In the SA/Belgium DTA, the elimination of double taxation is provided for in two ways.²⁸² Firstly, if the person is resident in Belgium, income which has been subject to tax in South Africa must be exempt from income in Belgium. However, Belgium may still apply the tax

²⁷⁴ *Ibid.*

²⁷⁵ *Ibid.*

²⁷⁶ Art 15 of the OECD MTC.

²⁷⁷ Art 15(1) of the OECD MTC.

²⁷⁸ OECD (2010) Commentary to Arts 23A and 23B *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁷⁹ Art 15(1) of the OECD MTC.

²⁸⁰ OECD (2010) Commentary to Arts 23A and 23B *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

²⁸¹ *Ibid.*

²⁸² Art 22 of the SA/Belgium DTA – accessed from the IBFD database on 12 May 2013.

rate which would have been applicable had the income not been exempt.²⁸³ On the other hand, if the person is resident in South Africa, a tax credit must be applied to the individual's tax liability to the extent that tax was paid on income in Belgium.²⁸⁴

The SA/India DTA provides that the country of residence (be it India or South Africa) must provide a tax credit in so far as the resident's income was taxed in the other country.²⁸⁵

²⁸³ Art 22(1)(a) of the SA/Belgium DTA – accessed from the IBFD database on 12 May 2013.

²⁸⁴ Art 22(1)(b) of the SA/Belgium DTA – accessed from the IBFD database on 12 May 2013.

²⁸⁵ Art 22 of the SA/India DTA – accessed from the IBFD database on 12 May 2013.

CHAPTER 7: PRACTICAL DIFFICULTIES OF CROSS-BORDER SHARE INCENTIVE SCHEMES

There are various practical difficulties which may arise where an employee is able to participate in a share incentive scheme and where he is rendering services in more than one country.

When comparing the tax treatment of income from employee share incentive schemes in various countries (i.e where the services in respect of that income was rendered in more than one country), there can be difference in *inter alia* the timing and character of the income.²⁸⁶

The different domestic taxation of income from employee share schemes could possibly result in double taxation of the same income. It could also result in the income not being taxed in any country.

In order to illustrate the differences, consideration is given to the tax treatment in South Africa, Belgium and India as well as how DTAs will apply. For purposes of the illustration it is assumed that the employee remains tax resident in South Africa at all times. Furthermore, from a South African context, only share options taxable in accordance with section 8C of the SITA will be considered as section 8A and section 8B share options are not as relevant.²⁸⁷

7.1 Allocation of the income

The services (either past services or future services) in respect of which an individual is eligible for participation in an employee share incentive scheme, could be rendered in more than one country.²⁸⁸

²⁸⁶ Colon JM (2003) Double-Dipping: The Cross-Border Taxation of Stock Options *Rutgers Law Journal*, Vol. 35, p175. Available at SSRN: <http://ssrn.com/abstract=559221>.

²⁸⁷ Sec 8A share options, though they still exist, are limited as they would have had to be granted prior to 26 October 2004 and sec 8B share options are not taxed as income from employment.

²⁸⁸ Colon JM (2003) Double-Dipping: The Cross-Border Taxation of Stock Options *Rutgers Law Journal*, Vol. 35, p175. Available at SSRN: <http://ssrn.com/abstract=559221>,

7.1.1 Reward for past or future services

In the first place, it is important to establish if the share options relate to past or future services as this will impact the sourcing of such income as illustrated below.

For example, if the award of share options is in respect of a period of past services, the income would be sourced to Countries A and B as the countries in which the services which gave rise to the income was rendered. However, if the award of share options is in respect of future services, the income would be sourced to Countries B and C.

2009	2010	2011
Working in Country A	Working in Country B	Working in country C
	Past Services	Future Services

Grant of share option

The general guidelines followed when determining if the award is in respect of past or future services are as follows:

- The award should not be considered to relate to any services after the required period of employment which is necessary to acquire the irrevocable right to the benefit;
- It should only be considered to relate to services rendered before the time when it was granted to the extent that the grant is conditional on such services having been performed;
- In cases of doubt, the general assumption is that the award is primarily related to future services.²⁸⁹

7.1.2 Place where the services are rendered

Once it has been established whether the award is in respect of past or future services, it is necessary to understand to which country the income is sourced.

²⁸⁹ Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

Internationally, the general principle is that the source of income for services rendered or income from employment is:

- Where the services are rendered; or
- The place where the contract of employment is entered into; or
- Where the payment is made.²⁹⁰

In South Africa, India, and Belgium, the source of employment income will be where the services are physically rendered.²⁹¹

There are difficulties in sourcing income attributable to services rendered in more than one of the countries. In general, the benefits from participation in an employee share incentive scheme should be proportionately attributed to the services rendered in the different countries. The proportion should be determined according to the ratio of the period when the services were rendered in a particular country to the whole period of service to which the benefit relates.²⁹² However, different countries use various methodologies to determine the portion of the income sourced to it.

When comparing the methodologies applied by South Africa, Belgium and India, there are two distinct differences in approach which impacts the allocation of income to a particular country.

The first difference is the period which is considered. In South Africa, the period for consideration will be the period between the date of grant and the date of vesting.²⁹³ In Belgium, if the employee is rendering services in Belgium at the date of grant, the total income will be taxed in Belgium at the date of grant. However, the upfront taxation may need to be revised when the options are exercised in order to take into account the

²⁹⁰ Rohatgi R (2005) *Basic International Tax*, Richmond Law & Tax Limited.

²⁹¹ *CIR v Lever Bros & Unilever Ltd* 1946 AD 441; Sec 9(1)(ii) of the IITA; Schoolvliet E (2005), Source and Residence: A New Configuration of their principles – Belgium, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

²⁹² Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

²⁹³ South African Revenue Service (2011) *Binding Class Ruling 025: Income tax implications for employees/senior executives in relation to a share option plan/share appreciation rights plan*. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BCR-2012-25%20-%20Tax%20Implications%20Employees%20Senior%20Executives%20Share%20Option%20Plan%20Appreciation%20Rights%20Plan.pdf> on 9 September 2013.

number of days of Belgian employment to which the grant relates.²⁹⁴ In India the period considered will be from the date of grant until the date of exercise.²⁹⁵

The second difference is in respect of the definition of numerator and denominator.²⁹⁶ In South Africa²⁹⁷ and India²⁹⁸, the numerator and denominator is defined in respect of calendar days. However, in Belgium, work days are used to define the denominator and numerator.²⁹⁹ The approach followed by Belgium is consistent to the approach followed by the OECD MTC.³⁰⁰

7.1.3 Summary

Set out below is a summary of how South Africa, India and Belgium allocate income from share options where the services in respect of which the share options are granted are for future services and where the services was rendered in more than one country.

²⁹⁴ Smet P & Laloo H (2008) Tax Treatment of Employee Stock Options in Belgium *Bulletin for International Taxation* Vol 62 No 8.

²⁹⁵ Nishith Desai Associates (2013) Welcome to work in India: Recent rulings on taxation of seconded expats *Research and Articles* Accessed online at <http://www.nishithdesai.com/1/?item=Research+and+Articles/NDA+Hotline/Tax+Hotline&article=1857#page=1> on 7 October 2013; Assistant Commissioner of Income Tax v. Robert Arthur Keltz (Delhi Income Tax Appellate Tribunal), dated May 24, 2013; Yoshio Kubo v. Commissioner of Income Tax, dated July 31, 2013 (Delhi High Court).

²⁹⁶ Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

²⁹⁷ South African Revenue Service (2011) *Binding Class Ruling 025: Income tax implications for employees/senior executives in relation to a share option plan/share appreciation rights plan*. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BCR-2012-25%20-%20Tax%20Implications%20Employees%20Senior%20Executives%20Share%20Option%20Plan%20Appreciation%20Rights%20Plan.pdf> on 9 September 2013.

²⁹⁸ Nishith Desai Associates (2013) Welcome to work in India: Recent rulings on taxation of seconded expats *Research and Articles* Accessed online at <http://www.nishithdesai.com/1/?item=Research+and+Articles/NDA+Hotline/Tax+Hotline&article=1857#page=1> on 7 October 2013; Assistant Commissioner of Income Tax v. Robert Arthur Keltz (Delhi Income Tax Appellate Tribunal), dated May 24, 2013; Yoshio Kubo v. Commissioner of Income Tax, dated July 31, 2013 (Delhi High Court).

²⁹⁹ T. Gernay, *Belgium - Individual Taxation, Country Analyses* IBFD database (accessed 19 Nov. 2012).

³⁰⁰ OECD (2010) Commentary to Art 13 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

Country	Formula used to determine portion of income sourced in / out of the country
South Africa	$\text{Income sourced in South Africa} = \frac{\text{Calendar days in SA from the date of grant to the date of vesting}}{\text{Total Calendar days from the date of grant to the date of vesting}} \times \text{Section 8C Gain}$
Belgium	$\text{Income sourced outside of Belgium} = \frac{\text{Number of days working abroad in respect of which the remuneration is paid}}{\text{Total number of work days in respect of which the remuneration is paid}} \times \text{Remuneration}$
India	$\text{Income sourced in India} = \frac{\text{Length of period of stay in India from the date of grant to the date of exercise}}{\text{Length of the period from the date of grant to the date of exercise}} \times \text{Income}$

As the countries all have a different methodology to determine which portion of the income relates to it, there is a mismatch between the portions attributed to the various countries by each other. The example below illustrates how the mismatch may occur.

7.1.4 Example 1

- An employee is granted a share option on 1 March 2010. The option will vest on 31 December 2011 and the employee elects to exercise the option on 31 August 2012.
- The value of the share option remains unchanged at R100 from 1 March 2010 to 31 August 2012.
- The employee rendered services in Belgium from 1 January 2010 to 31 January 2011, in South Africa from 1 February 2011 to 31 March 2012 and in India from 1 April 2012 to 31 December 2012.

2010	2011	2012
Working in Belgium	Working in South Africa	Working in India
	Grant to vest 671 calendar days / 442 workdays	Vest to exercise 245 calendar days / 163 workdays

In the table below, the income attributable to each country is illustrated from the various countries' point of view.

	Sourced in Belgium	Sourced in South Africa	Sourced in India
According to Belgium	= 100 x 212 / 605 = 35	= 100 x 296 / 605 = 49	= 100 x 30 / 605 = 16
According to South Africa	= 100 x 338 / 671 = 51	= 100 x 333 / 671 = 49	= 0
According to India	= 100 x 338 / 671 = 37	= 100 x 426 / 671 = 46	= 100 x 153 / 671 = 17

It is evident from the above that the difference in sourcing methodology may create a mismatch which could lead to difficulties in the elimination of double taxation. Belgium will allocate the income between itself, South Africa and India in the proportion 35:49:16. South Africa will, as the period under consideration is only between the date of grant and the date of vesting, disregard the services rendered in India and will allocate the income between Belgium and itself in the proportion 51:49. Though the period under consideration is the same in India and Belgium (from grant to exercise) as the definition of the numerator and denominator differs, India will allocate the income between Belgium, South Africa and itself in the proportion 37:46:17

7.1.5 Problems identified with the elimination of double taxation

7.1.5.1 Double taxation agreements

Article 15 of the SA/India DTA, and SA/Belgium DTA, allows the country of residence to tax income from employment unless the employment is exercised in the other country,

in which case the other country may tax the income.³⁰¹ As illustrated in example 1 above, difficulties could arise where countries use different methodologies to determine which income is sourced to it. If, as in the example, South Africa deems R49 of the income to be sourced to South Africa and R0 to be sourced to India, while India deems R46 of the income to be sourced to South Africa and R17 to India, how could the provisions of the DTA practically apply to eliminate double taxation?

SA/India DTA application

From a South African resident perspective, the total income will be taxable in South Africa. However, India may, in accordance with article 15 of the SA/India DTA, tax such portion of the income as it deems is from a source within India (i.e in respect of Indian services).³⁰² In applying article 22, which eliminates double taxation, South African as the country of residence should allow the tax paid in India as a deduction against the resident's normal tax liability.³⁰³ The double taxation will not be eliminated as the deduction under article 22 is limited to the normal tax payable on the income so taxed. As South Africa does not consider any of the income to be from an Indian source, the normal (South African) tax will be zero, therefore, disallowing any Indian tax to be claimed as a tax credit and leaving the resident in a double taxed position.

This is illustrated as follows:

- Total taxable income in South Africa = R100
- Taxable income sourced in India³⁰⁴ = R0
- Normal tax on total income (at 40 per cent) = R40
- Tax paid in India (17³⁰⁵ at 30 per cent) = R5.10

³⁰¹ Art 15(1) of the OECD MTC. This provision is also applicable in terms of the SA/India and SA/Belgium DTAs.

³⁰² Art15 of the SA/India DTA.

³⁰³ Art 22 of the SA/India DTA.

³⁰⁴ From a South African perspective.

³⁰⁵ This is the taxable income from an Indian perspective.

Limitation of tax credit	=	$\frac{\text{Taxable income sourced in India}}{\text{Total taxable income}}$	X	Normal tax on total income
	=	$\frac{0}{100}$	X	40
	=	0		

SA/Belgium DTA application

Where, as in the example, South Africa deems R49 of the income from employment to be sourced in South Africa and R51 of the income from employment to be sourced in Belgium, but Belgium deems R49 of the income from employment to be sourced in South Africa but only R35 of the income to be sourced in Belgium, the South African resident will be in a more favourable tax position than he would have been had South Africa and Belgium applied the same sourcing rules. When applying the provisions of article 15 of the SA/Belgium DTA, Belgium may tax the Belgian sourced employment income while South Africa, as the country of residence would tax the total income.³⁰⁶ Article 22 of the SA/Belgium DTA must be applied in order to eliminate double taxation. This is done by South Africa allowing a tax credit for taxes paid in Belgium in respect of Belgian sourced income.³⁰⁷ The credit must be limited to the normal tax payable in South Africa on the Belgian sourced income.

This is illustrated as follows:

- Total taxable income in South Africa = R100
- Taxable income sourced in Belgium³⁰⁸ = R51
- Normal tax on total income (at 40 per cent) = R40
- Tax paid in Belgium (R35³⁰⁹ at 50 per cent) = R17.50

³⁰⁶ Art 15 of the SA/Belgium DTA.

³⁰⁷ Art 22 of the SA Belgium DTA.

³⁰⁸ From a South African perspective.

³⁰⁹ The income which is taxable from a Belgian perspective.

$$\begin{array}{rcl}
 \text{Limitation of} & & \text{Taxable income sourced in} \\
 \text{tax credit} & = & \frac{\text{Belgium}}{\text{Total taxable income}} \times \text{Normal tax on total} \\
 & & & & \text{income} \\
 & = & \frac{51}{100} \times & & 40 \\
 & = & 20.40 & &
 \end{array}$$

Therefore, even though the Belgian tax rate exceeds the South African tax rate, the resident would not have the burden of the higher tax rate as the income which is actually taxable in Belgium is much less than the Belgian sourced income from a South African perspective.

7.1.5.2 SAITA

Section 6quat of the SAITA provides that a resident of South Africa may claim a rebate in respect of foreign taxes paid in respect of foreign sourced income.³¹⁰ It also provides that a resident may claim a deduction in respect of foreign taxes paid in respect of South African sourced employment income.³¹¹

The relief in terms of section 6quat is available to a resident as an alternative to any relief afforded under a DTA³¹² and will be limited in aggregate to the total normal tax payable on the underlying income.³¹³

In the example above, South Africa would allow a foreign tax credit up to an amount calculated as follows:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable on income from all sources}$$

- The taxable income from all foreign sources is equal to R51³¹⁴
- The taxable income from all sources is equal to R100

³¹⁰ Sec 6quat(1) of the SAITA.

³¹¹ Sec 6quat(1C) of the SAITA.

³¹² Sec 6quat(5).

³¹³ Sec 6quat(1B).

³¹⁴ Taxable income of R51 from Belgium and R0 from India.

- The normal tax payable³¹⁵ on all sources is equal to R40

Therefore, the foreign tax credit will be limited to R20.40.

Assuming a tax rate of 50 per cent in Belgium and 30 per cent in India, the total foreign taxes paid would equal R22.60 and would be mostly allowed as a tax credit. The R2.20 excess may be carried forward for up to seven years.³¹⁶

Therefore, in order for the resident to be in the most tax efficient position, the South African resident would have to elect not to apply DTA relief but to rather apply the rebate available under the provisions of section 6quat. This could be problematic as the resident may have, at the time of vesting, already applied the favourable DTA relief in respect of taxes paid in Belgium thereby making it ineligible for section 6quat relief when it is retrospectively applied to the tax paid in India on exercise. The section 6quat relief would then not be very effective in eliminating the double taxation from India as no rebate would be allowed in that particular year of assessment; rather it would have to be carried forward to a following year of assessment and may potentially be lost if not applied within seven years.³¹⁷

7.2 Timing of the income

The time at which benefits from participation in an employee share scheme becomes taxable varies from country to country. Furthermore, there is generally a difference between the time when the services are rendered and the time when the benefit becomes taxable.³¹⁸

Depending on the provisions of their domestic tax legislation, countries may seek to tax the income and/or capital gain at various points in time. These are generally:

- At the time the share option is granted;
- At the time the share option irrevocably vests;

³¹⁵ Calculated at 40 per cent.

³¹⁶ Proviso (ii) to sec 6quat(1B)(a).

³¹⁷ Even though the rebate is not allowed in that particular year of assessment, it may in terms of proviso (ii) to sec 6quat(1B)(a) be carried forward for up to seven years.

³¹⁸ Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

- At the time the share option is exercised or otherwise disposed of;
- At the time the underlying shares are sold.³¹⁹

South Africa, Belgium and India each consider a different point in time as the taxable event. Below is a summary of when each country will tax share options as income from employment as well as capital gains.

The difficulties which could occur in eliminating double taxation are illustrated in the example below.

7.2.1 Example 2

- An employee is granted a share option for no cost on 1 March 2010. The option will vest on 31 December 2011 and the employee elects to exercise the option on 31 August 2012.
- The value³²⁰ of the share options is equal to the value of the underlying shares.
 - On 1 March the value is R100
 - On 31 December 2011 the value is R150
 - On 31 August 2012 the value is R250
- The employee rendered services in Belgium from 1 January 2010 to 31 January 2011, in South Africa from 1 February 2011 to 31 March 2012 and in India from 1 April 2012 to 31 December 2012.

2010	2011	2012
Working in Belgium	Working in South Africa	Working in India
Grant @R100	Vest @R150	Exercise @R250

³¹⁹ *Ibid.*

³²⁰ For purposes of the example the term 'value' refers to the value used in order to calculate the taxable income. From a South African perspective, this will be the 'market value'. From a Belgian perspective, this will be the 'share price' and from an Indian perspective, this will be the 'fair market value'.

Country	Tax base for income from employment
South Africa	The taxable income will be equal to the value on the date of vesting less any consideration given by the employee in respect of the grant of the share option. $R150 - R0 = R150$
Belgium	The taxable income will be equal to eighteen per cent of the difference between the value on the date of grant less any consideration given by the employee in respect of the grant of the share option. $(R100 - R0) \times 18 \text{ per cent} = R18$
India	The taxable income will be equal to the difference between the value on the date of exercise less any consideration given by the employee in respect of the grant of the share option. $R250 - R0 = R250$

As illustrated above, South Africa will include R150 as income from employment at the time the share option vests and R150 as capital gains at the time of disposal. Belgium will only include R100³²¹ as income from employment and India will include R250 as income from employment and R100 as capital gains.

7.2.2 Problems Identified

7.2.2.1 Double taxation agreements

Where countries tax the gain in respect of share options at different points in time, they will apply article 15 of the DTA at such time as they deem the tax event to take place.³²² This means that, for example, Belgium will apply the article at the time the share option is granted, while South Africa will only apply the article at a later point in time when the share option vests. The questions which arises is how relief from double taxation should

³²¹ Prior to the percentage based inclusion.

³²² Commentary to Article 15 OECD (2010), *Articles of the OECD Model Tax Convention on Income and Capital*, OECD Publishing.

be provided and if one country grants relief, which part of the tax levied by the other country corresponds to what is taxed in the first country?³²³

In example 2 above, the differences in the tax base for employment income is illustrated. Belgium, which taxes at grant, will have a tax base of R100. South Africa, which taxes at vesting, will have a tax base of R150. And India, which taxes at exercise, will have a tax base of R250.

SA/Belgium DTA

From a SA/Belgium DTA perspective, Belgium will, in the case of a South African resident rendering services in Belgium at the time of grant, tax R100 when the share option is granted. At the time the share option vests, South Africa as country of residence will allow a tax credit for the tax paid in Belgium.³²⁴ Belgium will, in so far as the granting of the share option relates to South African services as well, retrospectively adjust the taxable gain to only include what relates to Belgian services. However, Belgium will use R100 as the tax base from which to apportion, while South Africa will use R150 as the tax base from which to apportion.

If the services were rendered 50:50 in South Africa and Belgium, South Africa would allow a tax credit of up to R30³²⁵ for taxes paid in Belgium. However, the Belgian tax would only equal R25.³²⁶ Therefore, the full amount of tax payable in Belgium will be allowed as a tax credit even though the Belgian tax rate is higher than the South African tax rate.

SA/India DTA

From a SA/India perspective, India will at the time the option is exercised tax a portion of R250 in respect of services rendered in India by a South African resident.³²⁷ South Africa would have already, at the time of vesting, taxed R150 as the state of residence.

³²³ Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

³²⁴ Art22 of the SA/Belgium DTA.

³²⁵ The tax credit will be calculated as follows: Taxable income from Belgium (R75) / Total taxable income (R150) x Normal tax on total income at 40 per cent (R60) = R30.

³²⁶ The Belgian tax is calculated at a rate of 50 per cent.

³²⁷ Art 15 of the SA/India DTA.

However, South Africa will allow a tax credit for taxes paid in India in accordance with the DTA, limited to the amount of normal tax payable in South Africa on the Indian sourced income.³²⁸ Assuming that all services from the date of grant until the date of exercise was rendered in a ration of 50:50 in South Africa and India,³²⁹ the tax paid in India may not be fully allowed as a tax credit. This is due to the taxable income from India, from a South African perspective, not being equal to the taxable income from an Indian perspective.³³⁰ Assuming that only the income from employment is being taken into account, the tax credit available in South Africa would be limited to the amount of South African tax due on the Indian income.³³¹ This would mean that only R30³³² of the R37.50³³³ tax paid in India will be allowed as a tax credit even though the tax rate in India is lower than the tax rate in South Africa.

7.2.2.2 SAITA

As explained above, section 6quat of the SAITA provides that a resident of South Africa may claim a rebate in respect of foreign taxes paid in respect of foreign sourced income.³³⁴ This rebate will be limited to the normal tax payable when applying the ratio of total foreign sourced taxable income to total income from all sources.³³⁵

In the example above, South Africa would allow a foreign tax credit up to an amount calculated as follows, assuming a ratio of 30:40:30 for services rendered in Belgium, South Africa and India:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable on income from all sources}$$

³²⁸ According to the OECD Commentary to Article 23(a) and 23(b), the country of residence would have to allow the tax credit even though the tax in the country of source is levied after the tax was levied in the country of residence.

³²⁹ Assuming the individual does not qualify for relief under sec 10(1)(o)(ii) of the SAITA.

³³⁰ This is partly due to a portion of the income taxed as employment income in India, being taxed as a capital gain in South Africa. This is discussed further under 7.3.

³³¹ Indian income from a South African perspective.

³³² The limitation is calculated as follows: Total taxable income from India (R75) / Total Taxable Income (R150) x Total normal tax on total income at 40 per cent (R60) = R30.

³³³ The Indian tax is calculated at a rate of 30 per cent on R125 = R37.50.

³³⁴ Sec 6quat(1) of the SAITA.

³³⁵ Sec 6quat(1B)(a) of the SAITA.

- The taxable income from all foreign sources is equal to R90³³⁶
- The taxable income from all sources is equal to R150
- The normal tax payable³³⁷ on all sources is equal to R60

Therefore, the foreign tax credit will be limited to R36 while the actual foreign taxes paid are equal to R37.50³³⁸ resulting in R1.50 being disallowed and double taxation to occur.

7.3 Character of the income

The gains realised as a result of participation in an employee share scheme could be categorised as income from employment, capital gains or both. Difficulties may occur in the elimination of double taxation where one country deems the gain to be income from employment while another country deems all or a part of the gain to be a capital gain.³³⁹

While Belgium does not recognise a capital gain in respect share options,³⁴⁰ South Africa and India consider a part of the gain to be income from employment and another part as a capital gain. South Africa includes the gain from the date of grant to the date of vest as income from employment³⁴¹ and the gain from the date of vest to the time of disposal/sale as a capital gain.³⁴² India, on the other hand, includes the gain from the date of grant to the date of exercise as income from employment³⁴³ and the gain from the date of exercise to the date of disposal/sale as a capital gain.³⁴⁴

7.3.1 Example 3

- An employee is granted a share option on 1 March 2010. The option will vest on 31 December 2011 and the employee elects to exercise the option on 31 August 2012. On 31 December 2012, the employee sells the underlying shares.

³³⁶ Taxable income of R45 from Belgium and R45 from India.

³³⁷ Calculated at 40 per cent.

³³⁸ The Belgian tax will be 30 per cent of R100 taxed at 50 per cent equaling R15 and the Indian tax will be 30 per cent of R250 taxed at 30 per cent equaling R22.50. The sum of the Belgian and Indian tax will be R37.50.

³³⁹ Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 1 *European Taxation*. August/September 2007 p407.

³⁴⁰ Law of 26 March 1999, Art 90(1) of the BITC.

³⁴¹ Sec 8C of the SAITA.

³⁴² Para 20(1)(h) of the Eighth Schedule to the SAITA.

³⁴³ Sec 17(2)(vi) of the IITA.

³⁴⁴ Secs 45(1) and 49(2AA) of the IITTA.

2010		2011		2012	
	South Africa - Income from employment		South Africa - Capital gain		
	India - Income from employment			India - Capital gain	
Grant		Vest	Exercise		Sale

As illustrated above, South Africa will deem a smaller portion of the gain than India to be income from employment. India on the other hand, will deem a smaller portion of the gain than South Africa to be a capital gain. There is a mismatch in the characterisation of a part of the income which could result in difficulties to eliminate double taxation.

7.3.2 Problems identified

7.3.2.1 Double taxation agreements

In terms of article 13 of the OECD MTC, the country of residence will have the right to tax capital gains, while article 15 will give the right to tax income from employment to the country in which the income was sourced. As illustrated in example 3 above, a mismatch in the characterisation of income may occur in respect of the gains derived from a share option. It is clear that in so far both countries deem the gain to be a capital gain or income from employment, articles 13 and 15 respectively provide relief from double taxation. What is not clear is what should happen in cases where one country deems the gain to be a capital gain while the other deems the gain to be income from employment.³⁴⁵

According to the OECD MTC Commentary (2010),³⁴⁶ the share option is linked to employment until the date of exercise and gains derived until that time should be treated as income from employment for the purposes of article 15. Thereafter, a gain in respect of the disposal of the underlying shares should be treated as a capital gain, and article 13 would apply.

³⁴⁵ Végh PG(2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

³⁴⁶ OECD (2010) Commentary to Art15 *Model Tax Convention on Income and Capital: Condensed Version* OECD Publishing.

As indicated in example 3, there will be a mismatch between what South Africa and India deem to be a capital gain. South Africa will determine the capital gain from the date of vesting, while India will only determine the capital gain from the date of exercise. Therefore, a portion of the gain (between vesting and exercise) will, from a South African perspective, be subject to the provisions of article 13 of the SA/India DTA which gives South Africa the sole taxing right on the capital gain. However, India will seek to tax that same portion in accordance with the provisions of article 15 which gives it the right to tax in so far as services were rendered in India.

From the South African resident's perspective, there will not be any relief from the double taxation by the application of the DTA as South Africa, having the sole taxing right would not apply the provisions of article 22 as the article specifically states that a credit must be given for taxes paid in India 'in accordance with the provisions of the [a]greement'. From South Africa's point of view, taxes paid to India in respect of what South Africa deems to be capital gains, will not be in accordance with the provisions of the DTA.

7.3.2.2 SAITA

From a South African resident perspective, a solution is available through the application of section 6quat of the SAITA. Section 6quat will allow a tax credit in respect of foreign taxes paid on foreign sourced 'income'.³⁴⁷ As capital gains are included in 'income'³⁴⁸ the section 6quat rebate will be available even though one country deems the gain as a capital gain while the other deems it to be income from employment. In order for section 6quat to apply to the capital gain, it must be from a source outside South Africa which is not deemed to be from a source³⁴⁹ within South Africa.³⁵⁰

When applying the provisions of section 6quat, it is necessary to compare the amount subject to foreign tax with the amount subject to South African normal tax. The amount which may be used in order to determine the rebate will be limited to the amount which

³⁴⁷ Sec 6quat(1).

³⁴⁸ South African Revenue Service (2003) Interpretation Note 16. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-16%20-%20Exemption%20Foreign%20Employment%20Income.pdf> on 9 September 2013.

³⁴⁹ Sec 9(k)(i)(bb) of the SAITA holds that a gain in respect of the disposal of moveable property is deemed to be from a South African source if the proceeds of the disposal is taxable in another country.

³⁵⁰ Sec 6quat(1)(e).

is subject to South African normal tax.³⁵¹ This means that if South Africa ultimately only includes 25 per cent in the person's income while India levies tax on the full amount, only the 25 per cent will be taken into consideration for calculating the rebate.

In example 3 above, it would result in only a portion of the income taxed in India as income from employment to be eligible for relief. South Africa, as country of residence, would include part of what is seen as income from employment in India as a capital gain (which is taxed more favourably than income from employment). The credit is correctly limited to the amount which is included in the resident's taxable income and, therefore, does not create a situation where double taxation occurs.

7.3.3 Recommendations

Differences in allocation, timing and characterisation of income from share options may lead to double taxation where the employee to whom the share options were granted performed services in more than one country.

By introducing a specific provision in double taxation agreements dealing with the taxation of share options, the double taxation could be effectively eliminated. This would require the countries to reach an agreement on the allocation, timing and characterisation of the income from share options to be applied where one of the countries is the country of residence and the other the country of source. The specific provisions would ensure that the employee is effectively taxed in one or both states but also that the employee is not subject to double taxation as the two countries would not be applying different methodologies in calculating the income.

While the ideal position would be for DTA's to set specific guidelines for the taxation of share options, the process involved would most likely be a very lengthy one. In the meantime the South African legislation in respect of the elimination of double taxation could also be amended to give more effective relief to South African residents.

³⁵¹ South African Revenue Service (2003) Interpretation Note 16. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-16%20-%20Exemption%20Foreign%20Employment%20Income.pdf> on 9 September 2013.

Section 6quat should be amended to provide specific principles in respect of share options. This should include guidance on how to determine the portion of the income for which a credit may be claimed (i.e the definition of the numerator and denominator). It should also have the capacity to take into account the different sourcing methodologies which may be applicable in the other country to better match up the income sourced in each country. There should be a provision to match employment income to employment income and capital gains to capital gains. This would ensure that the double taxation faced by the employee is minimalised.

In my view, it would also be helpful for SARS to issue a complete guide on the taxation of share options, whether it is in respect of South African services only, or cross-border services, in order to give guidance to employees and employers on how to treat the income from the participation of share incentive schemes.

CHAPTER 8: CONCLUSION

Where employees are granted share options and the services in respect of the share options are rendered in more than one country, double taxation could occur as a result of each country taxing the benefits resulting from the share options in a different manner.

Mainly, the differences are in respect of the allocation, timing and character of the income. A mismatch in respect of any of these aspects, results in the measures to prevent double taxation in DTA's as well as the South African domestic legislation being ineffective.

8.1 Allocation of Income

Countries may, in accordance with their domestic legislation, have different ways of calculating income which is sourced to it. This particularly creates difficulties where services in respect of which an individual is granted a share option is rendered in multiple countries.³⁵²

For the application of DTAs the country of residence's source rules will apply when determining the portion of income from employment for which it will provide relief from double taxation. This does not necessarily agree with the source rules of the other country and may result in a portion of the income being taxed in both countries with no relief or the extent of the relief being overstated. This could be resolved by incorporating specific source rules in respect of share options into DTAs.

The provisions of the South African tax legislation provides relief against double taxation. However, as there are differences between the income on which foreign tax is levied and the income on which the tax rebate is calculated, double taxation may not necessarily be eliminated, or the rebate allowed, may be overstated. This could be resolved by including specific provisions within the domestic legislation to take into account the actual income underlying the foreign taxes paid, rather than such income from a South African perspective.

³⁵² Colon JM (2003) Double-Dipping: The Cross-Border Taxation of Stock Options *Rutgers Law Journal*, Vol. 35, p175. Available at SSRN: <http://ssrn.com/abstract=559221>.

8.2 Timing of Income

Generally there is a difference between the time when services are rendered and the time when the benefits from the participation in an employee share scheme becomes taxable.³⁵³ Depending on the provisions of their domestic tax legislation, countries may seek to tax the income and/or capital gain at various points in time.

The provisions of a DTA will be applied by each country whenever that country deems the income to become taxable. As the country of residence may not necessarily tax the income at the same time as the country of source, it would be necessary for both countries to take into account when the other taxes the income.

In order to eliminate the timing differences, countries could agree on specific rules in respect of the taxation of share options under a DTA. This may require some countries to retrospectively apply the DTA provisions where it had already taxed the income at an earlier point in time, but will ensure that both countries consider the same income for purposes of the DTA application.

The South African domestic legislation does allow SARS to reopen assessments in respect of previous tax years in order to allow tax credits retrospectively. The legislation could be amended to make special provision in respect of share options in order to ensure that the actual income underlying the foreign taxes paid, rather than such income from a South African perspective, is taken into account for purposes of calculating the rebate.

8.3 Character of Income

The gains realised as a result of participation in an employee share scheme could be categorised as income from employment, capital gains or both. Difficulties may occur in the elimination of double taxation where one country deems the gain to be income from employment while another country deems all or a part of the gain to be a capital gain.³⁵⁴

³⁵³ Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265.

³⁵⁴ Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 1 *European Taxation*. August/September 2007 p407.

When applying a DTA, a mismatch in the characterisation of income could create difficulties in determining which article (13 or 15) applies to the income. This could lead to double taxation as the country of source may, due to its interpretation tax income which from the country of residence's perspective may only be taxed in the country of residence. By reaching agreement on the point at which each of the articles will apply, double taxation would be more effectively eliminated.

The South African legislation allows a tax credit in respect of capital gains. However, if the foreign tax was levied on which is deemed by the other country to be income from employment, the tax credit will be limited to what the taxable income would have been in South Africa. This effectively eliminates double taxation.

8.4 Recommendations

If countries could agree on a uniform approach to share options from a DTA perspective, double taxation could effectively be eliminated. Agreement should be reached on what income should be taxed, at what time it should be taxed and how the income should be characterised.

South Africa should amend its legislation to provide specific sourcing, timing and characterisation provisions in respect of providing relief from the double taxation of share options.

Word count (including footnotes) 23,701

References

South Africa

AP de Koker *et al.* (2013) *Silke on International Tax*. Retrieved September 8 2013 and October 8, 2013, from Lexis Nexis online database.

AP de Koker *et al.* (2012) *Silke on South African Income Tax*. Retrieved May 20, 2012, from Lexis Nexis online database.

AP de Koker *et al.* (2013) *Silke on International Tax*. Retrieved October 8, 2013, from Lexis Nexis online database.

Bincker TE (2011) *Taxation Principles of Interest and Other Financing Transactions*. Retrieved 8 September 2012 from the Lexis Nexis database.

C Tuck V CIR 1988 (3)SA 819 (A), 50 SATC 99.

CIR v Legal and General Assurance 1963 (3) SA 876 (A),25 SATC 303.

CIR v Black 1957 AD.

CIR v Lever Bros & Unilever Ltd 1946 AD 441.

Cohen v CIR 13 SATC 362, *CIR v Kuttel* 54 SATC 298.

Du Plessis I (2005) Section 8C of the Income Tax Act: A discussion. *Stellenbosch Law Review* Vol.1 p 104.

Haupt, P. (2012) *Notes on South African Income Tax* Cape Town: H & H Publishing

ITC 1493 53 SATC 187(T).

Jonas S (2012) A Critical Analysis of the tax Efficiency of Share Incentive Schemes in Relation to Employees in South Africa. Unpublished MComm Dissertation, University of Stellenbosch.

Koekemoer *et al.* (2013) *Silke: South African Income Tax* (Stiglingh, M, Ed.) Durban: LexisNexis.

Muller TC (2009) A Critical Analysis of Section 8C: Taxation of Directors and Employees on Vesting of Equity Instruments. Unpublished MComm Dissertation, University of Pretoria.

National Treasury of the Republic of South Africa (2013), Budget Review. Accessed online at <http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20c.pdf> on 9 September 2013.

Nyelisani TP 2010 *Employee Perceptions of share schemes*. Unpublished Master of Business Administration dissertation, University of Pretoria: Gordon Institute of Business Science.

Olivier L & Honiball M (2011), *International Tax: A South African Perspective*. Cape Town: SiberInk.

SA/Belgium DTA – accessed from the IBFD database on 12 May 2013.

SA/India DTA – accessed from the IBFD database on 12 May 2013.

SIR v Kirsch 40 SATC 95.

South African Revenue Service (2003) Interpretation Note 16. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-16%20-%20Exemption%20Foreign%20Employment%20Income.pdf> on 9 September 2013.

National Treasury (2004) *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2004* Pretoria: South African Revenue Service.

South African Revenue Service (2009) *Guide on the residence basis of taxation for individuals 2008/09* Accessed online on 27 September on the SARS website at <http://196.37.40.40/home.asp?pid=4150&tid=65&s=pubs&show=1260>.

South African Revenue Service (2011) *Binding Class Ruling 025: Income tax implications for employees/senior executives in relation to a share option plan/share appreciation rights plan*. Accessed online at <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BCR-2012-25%20-%20Tax%20Implications%20Employees%20Senior%20Executives%20Share%20Option%20Plan%20Appreciation%20Rights%20Plan.pdf> on 9 September 2013.

South African Revenue Service (2013) *Summary of all Treaties for the Avoidance of Double Taxation*. Accessed online on 26 September on the SARS website at <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf>.

Belgium

Belgian Income Tax Code Act 2 of 2009.

Administrative circular No AFZ 2005/0652, 25 May 2005.

Administrative Commentary on the Income Tax Code 228/89.

Administrative Commentary on the Income Tax Code 228/93.

Administrative Commentary on the Income Tax Code 31/8.

Cass., 15 September 1970, *Bulletin der Belastingen* No. 489, 1679.

Circular RH 624/325.294 of 8 August 1983.

Law of 26 March 1999 concerning the Belgian action plan for employment 1998, Official Gazette 1 April 1999, last amended by the Law of 28 December 2011.

Muyldermans J & Moeskops C (2001) Belgium: Tax Treatment of Employee Stock Options. *Derivatives and Financial Instruments* Vol 3 No 6, IBFD database (accessed 12 May. 2013).

Notification No. 94/2009/ F.No.142/25/2009-S O (TPL), dated 18-12-2009.

Schoolvliet E (2005), Source and Residence: A New Configuration of their principles – Belgium, *IFA Cahiers*, Volume 90A, p181. Accessed on the IBFD database on 25 September 2013.

Smet P & Laloo H (2008) Tax Treatment of Employee Stock Options in Belgium *Bulletin for International Taxation* Vol 62 No 8.

Supreme Court 15 November 1990 *F.J.F.* 1991 70.

Supreme Court 7 February 1979 *Bulletin der Belastingen* 611 2713.

T. Gernay, Belgium - Individual Taxation, Country Analyses IBFD database (accessed 19 Nov. 2012).

The Circular Letter dated 17 December 1999, AAF/999-1287 of the Belgian tax authorities.

India

Abbot v. Philbin 44 ITR 144 (1960).

CIT v. Gopal Krishna Suri [2000] 113 Taxman 707 (Bom.).

Dalal, K et al (2002) India: Tax Treatment of Employee Stock Options. *Derivatives and Financial Instruments* Vol 4 No 4, IBFD database (accessed 12 May. 2013).

Dave KJ & Nayak MB (2005) Source and Residence: A New Configuration of their principles – India, *IFA Cahiers* Volume 90A p339 Accessed on the IBFD database on 25 September 2013.

Explanatory circular on Fringe Benefit Tax arising on allotment or transfer of specified securities or sweat equity shares (2007) Circular no 9/2007 dated 20-12-2007.

H Padamchand Khincha (2002) Taxation of Employee Stock Option Plans: International Principles. *Revenue Law Journal*. Vol 12 Iss 1, p145.

India Income-Tax Rules, 1962.

Mhatre S (2010) ESOP Taxation in India – tax issues for globally mobile employees. Available at <http://www.taxindiainternational.com/columnDesc.php?qwer43fcxzt=MTY=>. Accessed 29 September 2013.

Nishith Desai Associates (2013) Welcome to work in India: Recent rulings on taxation of seconded expats *Research and Articles* Accessed online at <http://www.nishithdesai.com/1/?item=Research+and+Articles/NDA+Hotline/Tax+Hotline&article=1857#page=1> on 7 October 2013; Assistant Commissioner of Income Tax v. Robert Arthur Keltz (Delhi Income Tax Appellate Tribunal), dated May 24, 2013; Yoshio Kubo v. Commissioner of Income Tax, dated July 31, 2013 (Delhi High Court).

Shah S (2013) *India - Individual Taxation, Country Analyses* IBFD database (accessed 12 May 2013).

OECD

OECD (2010), *Articles of the OECD Model Tax Convention on Income and Capital*, OECD Publishing.

Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 1 *European Taxation*. August/September 2007 p407.

Pötgens FPG & Jakobsen M (2007) Cross-border Taxation of Employee Stock Options: How to Improve the OECD Commentary – Part 2. *European Taxation*. October 2007, p467.

OECD (2004), *Cross-Border Income tax Issues Arising from Employee Stock-Option Plans*, available on the OECD website at <http://www.oecd.org/ctp/treaties/33700277.pdf>. Accessed 15 September 2013.

OECD (2005). The taxation of Employee Stock Options, *OECD Tax Policy Studies*. OECD Publishing. Available online at <http://www.sourceoecd.org/taxation/9264012486>.

OECD (2013) India and the OECD. Available online at www.oecd.org/india/indiaandtheoecd.htm Accessed on 29 September 2013.

OECD (2010), *Articles of the OECD Model Tax Convention on Income and Capital*, OECD Publishing.

OECD (2012), 'R(20). Cross-border income tax issues arising from employee stock-option plans', in OECD, *Model Tax Convention on Income and on Capital 2010: Full Version*, OECD Publishing.

Végh PG (2002) OECD Faces Employee Stock Options. *European Taxation*. June/July 2002, p265

Other

Colon JM (2003) Double-Dipping: The Cross-Border Taxation of Stock Options *Rutgers Law Journal*, Vol. 35, p175. Available at SSRN: <http://ssrn.com/abstract=559221>.

Madden C 2013 *Employee Share Incentive Schemes*. Unpublished presentation, KPMG International.

Poutsma E et al. (2012) Employee share ownership and profit sharing in different institutional contexts. *The International Journal of Human Resource Management* Vol 23 No 8 p1513.

Rohatgi R (2005) *Basic International Tax*, Richmond Law & Tax Limited.

The Law Dictionary Accessed online on 27 September 2013 at <http://thelawdictionary.org>.