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**CREATIVE LONG-TERM  
INCENTIVES**

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# CREATIVE LONG-TERM INCENTIVES



## Understanding tax as a business tool

Our tax advice is legally sound and our legal advice, tax sound.  
Integration is the key.



# CREATIVE LONG-TERM INCENTIVES

## ➤ *MAJOR CURRENT DRIVERS*

- INTRODUCTION OF NEW ACCOUNTING STANDARDS (IFRS2/AC 139)
- NEW TAX DISPENSATION (SECTIONS 8B AND 8C)
- APPRECIATION vs. FULL QUANTUM
- STATUS vs. PERFORMANCE (VESTING AND ALLOCATION)
- BLACK ECONOMIC EMPOWERMENT

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## ➤ *NEW ACCOUNTING STANDARDS (IFRS2 / AC139)*

- Equity-settled share-based payments
  - ❖ Company receives goods or services as consideration for equity instruments (shares)
  - ❖ If no performance features
    - Determine “fair value” and expense over option period – only adjust if number of shares will be less (ie. number of qualifying participants reduces)
  - ❖ EXAMPLE : Vanilla Share Option Scheme

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## ➤ *NEW ACCOUNTING STANDARDS (cont.)*

- Cash – settled share – based payments
  - ❖ Liability will be settled in cash or other assets (not shares), but measured by reference to share price
  - ❖ Liability fair-valued at each reporting date i.e. re-measured until liability settled
  - ❖ **EXAMPLE** : Share Appreciation Rights / Phantom Share Scheme

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## ➤ *NEW TAX DISPENSATION*

- Section 8B of IT Act
  - ❖ Broad-based employee share plan
  - ❖ Exemptions – Income Tax, Donations Tax (?), not CGT
  - ❖ Subject to income tax if disposed of within 5 years
  - ❖ Deduction for employer
  - ❖ Qualifying “Equity Share”
    - Equity Shares, not Preference Shares
  - ❖ Market Value < R9000

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## *Section 8B (cont.)*

### ❖ Requirements

- Consideration = Minimum required by Companies Act
- Participants in other schemes excluded
- 90% of remaining full-time employees “entitled” to participate
- Full voting / Dividend rights
- Limited restrictions

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## ➤ *NEW TAX DISPENSATION*

- Section 8C of IT Act
  - ❖ Gain / Loss determined on “vesting” of “equity instruments” (essentially equity shares)
  - ❖ Includes option to purchase shares
  - ❖ Vesting
    - “Restricted Equity Instruments” – earlier of -
      - \* All restrictions cease to have effect
      - \* Disposal
      - \* Option – terminates
      - \* Death

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## *Section 8C of IT Act (cont.)*

- ❖ Gain / Loss
  - Market value on date of vesting - consideration
  - Special rules for swaps / connected persons / non-arm's - length transactions

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## ➤ *APPRECIATION vs. FULL QUANTUM*

- Appreciation
  - ❖ Value / Reward linked solely to a positive, incremental appreciation in underlying share price over time
  - ❖ But, share price often driven by exogenous factors (e.g exchange rate / climate changes)
  - ❖ Employer cannot influence outcome
  - ❖ May ultimately not deliver any benefit
  - ❖ EXAMPLE : Share option schemes

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## ➤ *APPRECIATION vs. FULL QUANTUM (cont.)*

- Full Quantum
  - ❖ Value / Reward linked to full quantum value of the share at date that share vests
  - ❖ Share price can also be driven by exogenous factors
  - ❖ But, employer has more influence on outcome
  - ❖ Will always deliver some benefit
  - ❖ EXAMPLE : Restricted share schemes

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<b>APPRECIATION</b>	<b>FULL QUANTUM</b>
Allocation usually once-off	Allocation usually periodic / annual
Participant liable to make contribution	No contribution by participant
Benefit = Incremental increase in value of shares	Benefit = share value
Restriction most commonly time-based	Restriction usually time-based and company / individual performance

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<b>APPRECIATION</b>	<b>FULL QUANTUM</b>
Only upside potential for participants – never negative	Upside and downside potential
No value if share price below strike price	Always value, provided acceptable company / individual performance
Dilutive	Less dilutive

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relationship driven creative solutions value added service

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## ➤ *STATUS vs. PERFORMANCE*

- Status
  - ❖ Quantum usually increases / more significant
  - ❖ Usually once-off allocations
- Performance
  - ❖ Status not a significant factor
  - ❖ Variable allocation
  - ❖ Choice of performance criteria crucial

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## ➤ *BEE AND SHARE SCHEMES*

- Broad-Based Black Economic Empowerment Act, 2003
- Codes of Good Practice on Broad-Based Black Economic Empowerment (DTI)
- Equity – Statement 100
  - ❖ Unrestricted voting rights held by black people may be counted
  - ❖ Economic interest in enterprise to which black people entitled may also be counted

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## ➤ *SHARE INCENTIVE SCHEMES AND UNLISTED COMPANIES*

- No ready market
- How do you price shares?
  - ❖ Upon allocation to employee?
  - ❖ Upon resale to trust?
- How do you provide for liquidity?
  - ❖ Put option for employee
  - ❖ Window periods
  - ❖ Restrictions related to liquidity of company

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## ➤ *THE FUTURE?*

- Greater emphasis on performance (company / individual) for allocation and vesting
- Greater influence on maximum total compensation
- Increasing public and shareholder demands for “acceptable” share-based incentivisation
- More use of cash-settled schemes
- Use of more than one scheme / approach

relationship  
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value  
added service



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