



ZAMBIA REVENUE AUTHORITY

DIRECT TAXES DIVISION

INCOME TAX (AMENDMENT) ACT 2002

PRACTICE NOTE NO. 2/2002

SHARE OPTION SCHEMES

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GENERAL

This PRACTICE NOTE describes the provisions of the Eighth Schedule introduced by the Income Tax (Amendment) Act 2002.

The commentary is for general guidance only and is not to be taken as an authority in any particular case.

The commentary is not exhaustive and does not, therefore, affect any person's right of appeal on any point concerning their liability to tax, nor does it preclude any discretionary treatment which may be allowed under the Act.

Inquiries may be made at the nearest office of the Zambia Revenue Authority, Direct Taxes Division offices or Advice Center, Lusaka.

2.0 INTRODUCTION

The new eighth schedule to the Income Tax Act introduces provisions for Share Option Schemes.

The objective of the share option scheme is to encourage employers to set up schemes for employees to own shares in the companies in which they are employed.

Under the share option scheme, the employer gives an employee a right, known as a share option, to buy a certain number of shares.

Employees join the scheme in the hope of making a profit as they expect the value of shares, when they finally acquire them, to be substantially more than the price they will pay. Management hopes that as employees have a stake in the company that employs them, their productivity and thus profits for the company, will increase.

Where an employer sets up such a scheme, and it is approved by the Commissioner – General, the following tax benefits will be enjoyed by both the employer and the employees:

2.1 Employer's Tax Benefits

- a) Costs incurred by the employer to set up and administer the scheme will be allowed as a deduction in computing the company's profits for tax purposes.
- b) The income of an approved share option scheme will be exempt from tax.
- c) The employer will be exempt from paying Property Transfer tax on shares transferred under the terms of an approved share option scheme.

2.2 Employee's Tax Benefits

The benefit which arises to an individual on allotment or acquisition of shares under an approved share option scheme will be exempt from tax.

3.0 DEFINITIONS

In this Practice Note, the following words and expressions will have the following meaning:

3.1 Accountants/Auditors:

Accountants/auditors, who examine or report on the financial statements of the employer.

3.2 Approved Share Option Scheme:

A scheme that has been approved by the Commissioner – General.

3.3 Eligible Employee:

An employee whose employer has an approved share option scheme and the employee meets any of the following requirements:

- i. Has worked for the employer for a minimum of twenty hours per week during a period of two years.
- ii. A seasonal, full-time employee who has worked for at least five months during a period of two years.
- iii. Any employee of a holding, subsidiary or affiliated company of the employer.

3.4 Holding, Subsidiary and Affiliated Companies:

As defined in section 43 of the Companies Act (Cap 388).

3.5 Interest in Shares:

Means an employee's entitlement to shares held by the scheme or his right to exercise an option to acquire shares.

3.6 Market Value:

For listed companies, the price of the shares as quoted on the Lusaka Stock Exchange. For companies not listed on the Lusaka Stock Exchange, the valuation as determined by the Commissioner – General under the Property Transfer Tax Act (Cap. 340).

3.7 Pricing Formula:

The basis for determining the price of the shares at the time the option is exercised.

3.8 Shares:

Any ordinary shares issued by a company incorporated in Zambia or elsewhere.

3.9 Share Option:

A right to buy a set number of shares in a company at a fixed price during a set period of time.

3.10 Trustees:

Means any person having the management or control of a scheme which has been approved by the Commissioner – General.

4.0 APPLICATION FOR APPROVAL OF A SHARE OPTION SCHEME (Paragraph 2(1) and 4(1)).

An application for approval of a share option scheme should be made in writing to the Commissioner – General, by the trustees or an employer where trustees have not been appointed. The application should be accompanied by a copy of the instrument constituting the scheme and the rules of the scheme (Paragraph 2(1) and 4(1)).

5.0 REQUIREMENTS FOR THE APPROVAL OF A SHARE OPTION SCHEME(Paragraph 2(2)).

For the Commissioner – General to approve a share option scheme, the following requirements must be met:

- a. The scheme must be established in Zambia and the employer carries on business wholly or partly in Zambia.
- b. The scheme should provide for the participation of all eligible employees (including directors).
- c. An employee participating in the scheme should not acquire more than one fifth of the shares to be issued under the scheme.
- d. Only ordinary shares of the company may participate in the scheme.
- e. The scheme entitles an employee to acquire a set number of shares at a fixed price.
- f. The employee must be restricted to a set period of time to use an option to buy shares.
- g. The employees must be citizens or permanent residents of Zambia regardless of where they perform their duties.

6.0 CONSTITUTION AND RULES (Paragraph 2(2))

The constitution and rules should –

1. Provide for the participation of all eligible employees.
2. Exclude:
 - (i) Employees who are not individuals; or
 - (ii) Employees who have worked for less than twenty hours per week during the period of two years; or
 - (iii) Full time seasonal employees who have worked for less than five months during the period of two years.

3. Limit the number of shares an employee may acquire to one fifth of the shares being offered under the scheme.
4. Provide for the following:
 - (i) Employers should inform the employees of their eligibility in writing;
 - (ii) Employers should make available to employees the following:
 - ❑ A copy of the constitution and rules of the scheme;
 - ❑ A statement of the results of the scheme over the last ten years of operation or since inception if the scheme was established for less than ten years;
 - ❑ The pricing formula and period over which the share option may be exercised;
 - ❑ The risk and benefits to be associated with participation in the scheme.
5. Provide that:
 - ❑ The price of the shares should be fixed at the time the option is given;
 - ❑ The price of shares shall not be less than market value at that time;
 - ❑ Only ordinary shares of the company may participate in the scheme.
6. Provide that:
 - ❑ All shares acquired through the scheme are registered with the registrar of companies;
 - ❑ The price at which shares are issued or disposed of be stated.
7. Require that:
 - ❑ The employer bears all administrative and other expenses of the scheme;

- The scheme is independently audited by auditors or independent accountants.
8. Require that the eligibility and scope of participation in the scheme be based on:
- The period of service with the employer;
 - Basic emoluments over a defined period;
 - Termination of service benefits from the employer;
 - A combination of some or all of these criteria applying equally to all employees.

However, the rules should exclude employees whose services are to be terminated at the date of eligibility to the scheme, except where the rules permit participation on the basis of accrued terminal benefits or other terminal benefits.

9. Require that where a scheme provides for the acquisition of shares or interests in shares in a private company, the rules should include the following:
- A participating employee on termination of his services or on death, shall be deemed to have given notice to sell or relinquish his shares;
 - Where the shares were not fully paid on acquisition, the trustees shall dispose off the shares and recover the amount outstanding from the sale proceeds.
 - In the event that a participating employee dies, the recovery from the sale proceeds shall be restricted to the amount unpaid.
10. Require the trustees and the employer to act as taxpayer agent for a participating employee for all tax matters relating to the scheme.

11. Permit that the employer could, at his instigation, terminate the scheme provided that:
 - (i) Unconditional arrangements for sale by participants at market value are in place.
 - (ii) The value be certified by the auditor of the scheme and the employer.

12. Provide that employees may sell shares after five years, except where the termination of services with the employer or the death of the employee is earlier.

13. Not provide for the issue of preference shares in the scheme unless:
 - (i) The preference shares participate in dividends declared on ordinary shares and;
 - (ii) The preference shares confer equal rights of participation on dissolution or redemption as ordinary shares.

14. Not require the employee to contribute any additional amounts beyond the amounts agreed upon in the scheme.

15. Not permit changes to the rules or constitution which affect the employees adversely, without the consent of the trustees and confirmation from the Commissioner – General.

16. Not permit the granting of credit towards financing the exercise of an option to acquire shares.

7.0 APPROVAL OF A SHARE OPTION SCHEME (Paragraph 4(2) and 4(3))

7.1 NOTIFICATION:

Within one month of submission of an application, the Commissioner – General shall inform the applicant in writing of the scheme’s approval or rejection of approval and of the charge year in relation to which it is approved.

7.2 DURATION OF APPROVAL:

Where a scheme has been approved by the Commissioner – General for any charge year, the scheme shall be deemed to be approved for each subsequent charge year unless otherwise.

8.0 ALTERATIONS TO A SHARE OPTION SCHEME (Paragraph 4(4)):

Where an alteration is made to the terms of an approved scheme, the trustees should inform the Commissioner – General in writing.

If the Commissioner – General is not so informed, the approval of the scheme shall be deemed to have been suspended as from the date of the alteration.

9.0 WITHDRAWAL OF APPROVAL(Paragraph 4(5) and 4(6)):

(A) The Commissioner – General may withdraw approval from a scheme at any time if:

- (i) Any of the conditions necessary for approval ceases to be satisfied or;
- (ii) Alterations are made to the terms of an approved scheme.

(B) Where the approval of a scheme has been suspended or withdrawn, the Commissioner – General shall endeavour to safeguard the interests of the employees as regards transactions committed prior to the notification of withdrawal or suspension.

10.0 RIGHT OF APPEAL (Paragraph 5):

Any person aggrieved by the refusal of the Commissioner – General to grant his approval or by the suspension or withdrawal of an approval already granted, shall have the right of appeal to the Commissioner – General.

11.0 CONTACT US:

If you have any problems concerning your taxes, please contact the Advice Centre or your nearest Direct Tax Office at the following addresses:

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|--|---|
| 1. Advice Centre
Revenue Hall
Private Bag W136
LUSAKA | 2. Assistant Commissioner
Lusaka "A" Tax Office
P.O. Box 31026
LUSAKA |
| Tel: 01 - 226227/236227
Fax: 01 - 222717 | Tel: 01 - 221497 |
| 3. Assistant Commissioner
Lusaka "B" Tax Office
P.O. Box 31936
LUSAKA | 4. Assistant Commissioner
Lusaka "C" Tax Office
P.O. Box 31988
LUSAKA |
| Tel: 01 – 221496 | Tel: 01 – 236892 |
| 5. Assistant Commissioner
Ndola Tax Office
P.O. Box 70181
NDOLA | 6. Assistant Commissioner
Kitwe Tax Office
P.O. Box 20855
KITWE |
| Tel: 02 – 614096 | Tel: 02 - 229942 |
| 7. Assistant Commissioner
Lusaka Taxes Central unit
P.O. Box 35710
LUSAKA | 8. Assistant Commissioner
DT Investigations Unit
P.O. Box 33675
LUSAKA |
| Tel: 01 – 224935 | Tel: 01 - 235252 |
| 9. Station Manager
Kabwe Tax office
P.O. Box 80909
KABWE | |
| Tel: 05 – 223642 | |
| 10. Station Manager
Chipata Tax Office
P.O. Box 510632
CHIPATA | 11. Station Manager
Mongu Tax Office
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MONGU |
| Tel: 062 – 21155 | 07 - 221662 |

**12. Station Manager
Kasama Tax Office
P.O. Box 410728
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**14. Station Manager
Solwezi Tax Office
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SOLWEZI**

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**13. Station Manager
Mansa Tax Office
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MANSA**

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