

## Changes to Employee Share Scheme Budget Changes

Following the shock 2009 Budget announcement that all employee share schemes would be taxed upfront, the Government has back flipped on most of the changes. This has resulted in the Government introducing new draft legislation reforming the employee share scheme rules. In most cases the new rules will have a similar result to the current rules with some new integrity measures. Under the new rules, the upfront \$1,000 tax exemption will be income tested and the tax deferral will only be accessible where there is a real risk that the shares or rights may be forfeited. It may also be possible for employees to **access both the \$1,000 upfront tax concession and the tax deferral concession in the same year**. Another important change is the basis upon which employees will be eligible for upfront or deferred tax concessions. This will now depend on the structure and characteristics of the scheme and not an election of the employee. The changes will also focus on taxing the value of benefits received by employees so taxpayers are taxed consistently regardless of the form of remuneration they receive. If these changes become law, the new employee share scheme rules will apply to shares and rights acquired on or after 1 July 2009.

### Upfront taxation changes

Generally any discount that an employee receives to the market value of shares provided under an employee share scheme is included in the employee's assessable income in the year the shares are acquired. Under current rules a \$1,000 upfront concession is available for shares that meet the requirements for "qualifying shares". Unlike the current rules, eligibility for the \$1,000 upfront concession will be based on the characteristics of the employee share scheme and a new income test will be applied.

Under the income test, the tax concession will be available to taxpayers participating in an employee share scheme who pay tax upfront, provided they have a taxable income (after adjustments) of \$180,000 or less, and the employee and the scheme meet certain conditions. Taxable income will be adjusted by adding an employee's reportable fringe benefits, super contributions and total net investment loss for the year.

The other conditions for the upfront concession are:

- ▶ The employee must be employed;
- ▶ the scheme must be offered to at least 75 per cent of permanent employees;
- ▶ the shares or rights provided must not be at real risk of forfeiture;
- ▶ the shares or rights must be required to be held by the employee for at least three years or until the employee ceases employment, whichever is earlier; and
- ▶ the employee must not receive more than five per cent ownership of the company, or control more than five per cent of the voting rights in the company, as a result participating in the scheme.

## Deferred taxation changes

Under the current rules, an employee can choose to defer the assessability of the discount on shares or rights provided the shares meet the all the conditions to be “qualifying shares” which are similar to the conditions for the upfront exemption described above. Under the new rules, deferral of tax will no longer depend on whether the shares or right are “qualifying shares”. However, for the deferred tax rules to apply there are some further requirements as outlined below:

- ▶ the relevant employee share scheme interests must be acquired at a discount under an employee share scheme, the interest must relate to ordinary shares and be subject to a “real risk of forfeiture”. A “real risk of forfeiture” means there is a real risk that the benefits of shares or rights are never realised because the employee share scheme interests are forfeited. Therefore deferral of taxation will be the appropriate treatment in these circumstances ; or
- ▶ the relevant employee share scheme interests must be acquired under a salary sacrifice arrangement, and the employee must receive no more than \$5,000 worth of shares under those arrangements in an income year.

## New deferred taxing point

### Current Rules

When an employee qualifies for tax deferral, under the current provisions the taxing point is the earliest of:

- ▶ when the restrictions on sale are lifted;
- ▶ when the employee sells the shares or exercises the options;
- ▶ when the employee ceases employment; or
- ▶ 10 years after the shares or rights were acquired

### New Rules

Where the tax is deferred under the new rules, the taxing point is the earliest of:

- ▶ When there is no risk of forfeiture of the benefits and any restrictions on the sale or exercise are lifted;
- ▶ When the employee ceases employment; or
- ▶ 7 years after the shares or rights were acquired

Note that under the current provisions, there is no upfront concession if the tax deferral is chosen. However, under the proposed changes, it may be possible for employees to access **both the \$1,000 upfront tax concession and the tax deferral concession in the same year.**

## Tax refunds for forfeited shares

Under current law, employees are eligible for a refund of tax on forfeited rights only but not shares. The refund is available if the employee loses the right without having exercised it.

By comparison, an employee is eligible for a refund of tax on forfeited shares and rights under the proposed changes, if the forfeiture was not the result of:

- ▶ A choice of the employee; or
- ▶ A condition of the scheme that protects the employee against a fall in market value

## Reporting requirements for employers

Employers will be subject to new annual reporting requirements. Among the information required to be reported to the Commissioner, employers will be required to estimate the market value of shares and rights acquired under an employee share scheme at the employee’s taxing point and the number of shares and rights an employee has obtained at both grant and at taxing point.

## Withholding tax arrangements

Withholding tax will be payable in circumstances where an employee fails to provide their employer with a tax file number (TFN) or Australian Business Number (ABN) by the end of the year.

Should you require assistance or additional information, please contact your PKF Tax Adviser or:

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