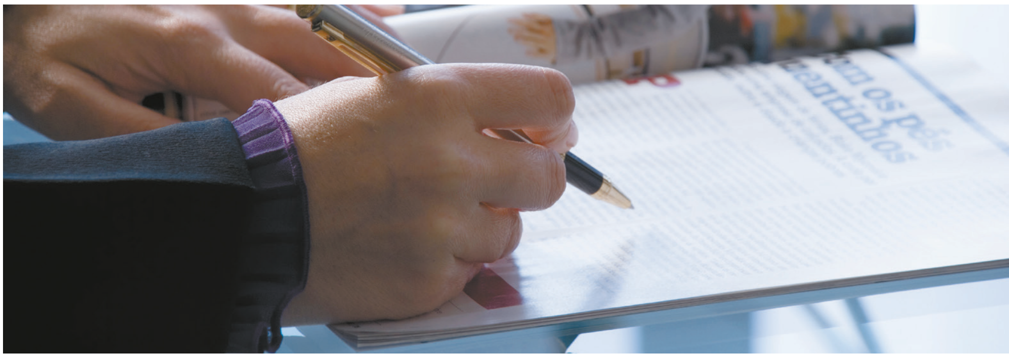

TECHNICAL UPDATE

EMPLOYEE SHARE SCHEMES – HOW THE NEW CONCESSIONS WILL WORK

THE FEDERAL GOVERNMENT HAS RELEASED EXPOSURE DRAFT LEGISLATION IN RESPECT OF THE CHANGES TO THE EMPLOYEE SHARE SCHEME TAXATION RULES IT ANNOUNCED IN OCTOBER 2014 AND WHICH WERE THE SUBJECT OF A PREVIOUS BDO TECHNICAL UPDATE.

The proposed amendments are intended to, amongst other things:

- Reverse and improve upon some of the changes made in 2009, including allowing deferral of the taxing point for rights issued as part of an employee share scheme (ESS) until they are exercised or disposal restrictions are lifted (this applies for employees of all corporate tax entities)
- Introduce a further tax concession for employees of certain small start-up companies
- Change the valuation tables for ESS rights that will generally result in lower valuations for these rights, and
- Allow the Australian Taxation Office to work with industry to develop safe harbour valuation methods, supported by standardised documentation.

Reversal of changes made in 2009

The proposed changes will provide for an alternative condition to a genuine risk of forfeiture for postponement of taxation in respect of the acquisition of a right to acquire an interest in a share. That alternative condition will not require a genuine risk of forfeiture of the right, but will require that, at the time you acquired an interest:

- The scheme genuinely restricted you from immediately disposing of the right, and
- The governing rules of the scheme expressly stated that Subdivision 83A-C applies to the scheme.

The fourth deferred taxing point for rights will be changed to take out the condition that there be no real risk of forfeiture of the right and replacing it with the requirement that the right be exercised.

SECTOR

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Change to time limit on holding period

Currently for both ESS shares and ESS rights, the *'third possible taxing point is the end of the seven year period starting when you acquired the interest'*. Under the exposure draft it is proposed to change this to a 15 year period. This is an even longer period than the pre-2009 rules, which had a ten year maximum deferral period.

Resulting five per cent holding limitation increased to ten per cent

Currently the ESS concessions generally require the employee will not hold more than five per cent of the voting rights for shareholders. It is proposed that this threshold be increased to ten per cent under the exposure draft.

Introduction of further tax concession for employees of small start-up companies

Further relief will be provided to employees issued with ESS interests in start-up companies where:

- None of the company's shares or other equity interests are listed for quotation in the official list of an approved stock exchange
- The company and any group company (subsidiary, holding company or subsidiary of its holding company) were incorporated less than ten years previously
- The company has an aggregated turnover not exceeding $50 million
- Where the ESS interest in the company is a beneficial interest in:
  - A share – the discount is less than 15 per cent of its market value at time of acquisition
  - A right – the amount that must be paid to exercise the right is greater than or equal to the market value of an ordinary share at the time of acquisition of the right
- The employer is an Australian resident
- The taxpayer was employed by the issuing company or a subsidiary thereof
- All ESS interests available for acquisition under the scheme relate to ordinary shares
- The predominant business of the company was not the acquisition, sale or holding of shares, securities or other investments directly or through interposed entities
- The ESS interest acquired must be held for a minimum of three years or until cessation of employment (and everyone else who participated in the scheme was subject to the same restriction)
- After the acquisition of the shares, the taxpayer did not hold more than ten per cent of the shares in the company nor shares carrying the control of the casting of more than ten per cent of votes at a general meeting of the company.

In the case of shares issued at or below the 15 per cent discount, the discount escapes taxation entirely and the employee will receive a market value cost base for the purpose of calculating any capital gain upon a subsequent disposal of the shares.

In the case of rights, the discount will not be subject to upfront taxation but the rights and resulting shares will be subject to the usual capital gains tax rules, except the market value substitution cost base rules will not apply.

Tax refunds on forfeiture of an ESS interest

The current ESS rules allows for tax refunds to employees where they have been taxed under the ESS provisions in relation to an ESS right where these rights are subsequently forfeited or lost. However, this does not apply where the forfeiture or loss is as a result of a choice made by the employee, except where it is a choice to cease employment. The Exposure Draft proposes to extend the availability of these tax refunds to forfeiture or loss as a result of a choice made by the employee not to exercise the right before it lapsed. For example, where a taxpayer allows rights to expire, unexercised because the rights were out of the money. Previously, this provision was interpreted as not providing relief in such a situation.

Valuation methods

Proposed s960-410 provides statutory protection to a taxpayer that determines the market value of an asset using a method which the Commissioner, by legislative instrument, approved.

The exposure draft materials include an exposure draft of the *Income Tax Assessment Amendment (Employee Share Schemes) Regulation 2015* which provides for the substitution of new valuation tables for the calculation of the discount on ESS interests for the existing tables. The proposed new tables appear to provide better outcomes for affected taxpayers.

BDO comment

The changes proposed to be made by the exposure draft legislation are to be welcomed, particularly where they provide means for:

- Start-up companies to reward and incentivise their employees
- Relief to be provided for rights where there is not a genuine risk of forfeiture
- Relief for taxpayers assessed on the amount of a 'discount' on the issue of rights where such rights are 'underwater' at the time of exercise
- More concessional valuation rules.

National expertise

The BDO Tax team is one of the largest and most dynamic tax practices in Australia, with 30 partners and more than 150 specialists located in each major city across the country.

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