

FACT SHEET

Employee Share Schemes

What is an Employee Share Scheme?

An Employee Share Scheme is a scheme in which interests in an employer company or its subsidiaries are provided to employees or their associates in respect of the employees' employment. "Interests" take the form of shares or rights (options) to acquire shares, and are generally provided at a discount from market value.

Tax Deferral

The taxing point can be deferred if the interests obtained under the scheme are at "real risk of forfeiture" and certain conditions are met. Interests obtained under a salary sacrifice arrangement may also qualify for tax deferral under certain circumstances.

If a real risk of forfeiture is deemed to exist, taxing point is deferred until the earliest of:

- In the case of shares:
 - The date any real risk of forfeiture ceases to exist, and
 - The date any disposal restrictions present at grant date no longer exist
- In the case of rights to acquire shares:
 - As above, and
 - The date the shares resulting from subsequent exercise are not subject to a real risk of forfeiture or disposal restrictions
- Cessation of employment
- Seven years

These are collectively referred to as "ESS deferring taxing points".

What are the tax implications of receiving Employee Share Scheme grants?

Any discount received as a result of participation in an Employee Share Scheme must be included in your taxable income. The calculation of the discount is:

| Grant Type | Assessable Discount |
|------------------------------|---|
| Vesting immediately | Number granted X (Market value per unit at date of grant less unit cost) |
| Vesting over a future period | Number granted X Market value per unit at date of grant X Discount % |

The taxing rules around Employee Share Schemes changed effective 1 July 2009, with the most significant change relating to the timing of recognition of the assessable discount. For grants issued on 1 July 2009 or after, the taxing point is the date of the grant unless the scheme qualifies for tax deferral.

Concessions

You qualify for a \$1,000 reduction in assessable discount income under certain conditions. These include personal circumstances such as passing an income test and scheme characteristics such as the shares issued (or rights in respect of) being ordinary shares.

"Real Risk of Forfeiture"

The "real risk of forfeiture" test basically operates by defining what would NOT constitute a real risk. Something is not a real risk if a reasonable person would disregard the risk as either highly unlikely to occur, or as nothing more than a rare eventuality or possibility. Therefore, for a share or right to be subject to a real risk of forfeiture, the share or right must be subject to a condition that is more than a mere possibility.

The following table summarises some common situations which potentially would and would not constitute a real risk of forfeiture:

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| Situations which WOULD potentially constitute a real risk of forfeiture | Situations which WOULD NOT constitute a real risk of forfeiture |
|---|--|
| Grants which are subject to performance hurdles | Conditions that merely restrict an employee from disposing of an ESS interest for a specified time |
| Shares or rights which are forfeited if a minimum term of employment is not satisfied | Conditions that enable an employee to simply request that the ESS interest be forfeited |
| | ESS interests that are forfeited in the event that the employee commits fraud or gross misconduct |

Operation with Capital Gains Tax

Once your ESS interest has been taxed under the ESS rules (i.e: taxing point has occurred), it is then subject to the capital gains tax regime assuming your ESS interest is not trading stock. For CGT purposes, the acquisition date of your ESS interest is the date of the taxing point, and your cost base is the market value on that day. When deciding to dispose of an ESS interest and looking to take advantage of the 50% CGT discount concession, it is important to bear in mind that the grant and vesting date are not necessarily relevant.

Old Rules versus New Rules

If you have participated in Employee Share Schemes in years prior to 1 July 2009, you may be interested in a comparison of the new rules with the old rules, summarised below:

| Table | Old Rules | New Rules |
|---|------------------------------------|-------------------------------------|
| Taxing point | Default position = Tax deferral | Default position = Upfront taxation |
| Election available? | Yes, to be taxed upfront | No |
| Tax deferral available? | Yes, default position | Yes, if certain conditions are met |
| \$1,000 tax concession available? | Yes, if certain conditions are met | Yes, if certain conditions are met |
| Tax refund available if ESS benefits later forfeited? | Yes, if certain conditions are met | Yes, if certain conditions are met |

What if I am taxed upfront on my grant but I later forfeit the shares or rights?

If you are taxed upfront on your ESS grant and you later forfeit some or all of your shares or rights, you are entitled to a refund of income tax paid in respect of those forfeited interests so long as the forfeiture is not a result of:

- A choice made by you (except ceasing employment)
- A scheme condition triggered protecting you from a fall in market value, or
- Disposal or exercise (in the case of a rights grant)

Reporting Requirements

From 1 July 2009 onwards, your employer must provide you with an annual statement providing details around ESS interests which have their taxing point within the year being reported on. This statement discloses the amount of assessable discount to include in your taxable income for the year.

What Next?

If you participate in Employee Share Schemes, contact your manager or partner at Enspira Financial to discuss the tax implications of receiving employee share scheme benefits.

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This page contains some examples of Employee Share Scheme situations and their outcomes. Each assumes an employee / employer relationship.

| Example | Real Risk of Forfeiture? | Assessable Discount in Year of Grant |
|---|--|--|
| Grant resulting in 1,000 shares being issued immediately at 85% of prevailing market price. Market price at date of grant is \$100. | No, the shares will be received immediately and unconditionally. The grant is taxed upfront and the assessable discount is included in taxable income in the year of the grant. | \$15,000 (100 shares x (\$100 x 15%)). Shares are a CGT asset with an acquisition date equal to grant date and cost base of \$100,000. |
| Grant resulting in 1,000 shares being issued in 12 months time at 85% of prevailing market price, provided still employed at that time. | Yes, the shares are at risk as they will be forfeited in the event employment ceases. The taxing point is deferred until the earliest ESS deferred taxing point. | NIL – assessable discount will be calculated and included in taxable income in the year the ESS deferred taxing point occurs. |
| Grant resulting in 1,000 shares being issued in 12 months' time at 85% of prevailing market price, provided market share has increased by 10% in the 12 month period. Market share was steady over the previous 12 months. | The circumstances indicate a real risk of forfeiture therefore the taxing point is deferred until the earliest ESS deferred taxing point. | NIL – assessable discount will be calculated and included in taxable income in the year the ESS deferred taxing point occurs. |
| Grant resulting in 1,000 rights to acquire shares at 85% of the prevailing market price. 500 rights vest in 12 months and 24 months respectively, and the rights are subject to being employed at each vesting date. | Yes, the rights are at risk as they will be forfeited in the event employment ceases. The taxing point is deferred until the earliest ESS deferred taxing point. | NIL – assessable discount will be calculated and included in taxable income in the year the ESS deferred taxing point occurs. |
| Grant resulting in 1,000 rights to acquire shares at 85% of the prevailing market price. 500 rights vest immediately and the remaining 500 vest in 12 months' time provided still employed at that time. Market price as at the date of grant is \$100. | The first vesting is not at risk as they will be received immediately and unconditionally. The second vesting is at real risk as it is subject to continuing employment. Therefore the first vesting is taxed upfront, with the assessable discount being included in taxable income in the year of grant, whereas the taxing of the second vesting will be deferred until the earliest ESS deferred taxing point. | \$7,500 (500 rights x (\$100 x 15%)), in relation to the first vesting. The assessable discount on the second vesting will be calculated and included in taxable income in the year the ESS deferred taxing point occurs. If the initial 500 rights are exercised immediately, resulting shares have an acquisition date equal to grant date and cost base of \$50,000. |

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