

EXPOSURE DRAFT

REFORMING THE TAXATION OF EMPLOYEE SHARE SCHEMES

Application and transitional provisions

1.1 The new employee share scheme rules apply to ESS interests acquired on and after 1 July 2009. [*Schedule 1, item 80, paragraph 83A-5(1)(a)*]

1.2 A tiebreaker rule provides that if the time of acquisition differs between the new and the current law, the time of acquisition under the current law will be used and the time of acquisition under the new law will be disregarded. That is, if a share or right was acquired under the current law before 1 July 2009, and under the new law the ESS interest was acquired after 1 July 2009, the old law continues to apply to that arrangement. [*Schedule 1, item 80, paragraph 83A-10(1)(b)*]

1.3 This rule will provide clarity in any unforeseen circumstances where the dates of acquisition may differ between the two regimes.

Example 1.1 Tiebreaker

Michelle acquired shares in her employer under an employee share scheme. The rules in Division 13A consider her to have acquired the share on 20 June 2009. The new employee share scheme rules consider her to have acquired the ESS interest on 25 July 2009.

The tiebreaker transitional provision provides that she is considered to have acquired the shares on 20 June 2009 under the Division 13A rules, and not under the new employee share scheme rules in Division 83A.

SHARES AND RIGHTS TRANSITIONED TO THE NEW RULES

ESS interests over which tax is being deferred are transitioned to the new rules

1.4 Shares or rights acquired before 1 July 2009, on which tax has been deferred beyond 1 July 2009, will be brought within the new employee share scheme rules. This will simplify the law and improve the interaction of the employee share scheme rules with other areas of the law. [*Schedule 1, item 80, subsections 83A-5(2)(3)*]

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Current taxing points are preserved

1.5 An employee who acquired shares or rights under the current employee share scheme rules (Division 13A of the ITAA 1936), or the previous employee share scheme rules (section 26AAC of the ITAA 1936), will continue to pay tax at the time determined by reference to those previous rules. [*Schedule 1, item 80, paragraph 83A-5(4)(b)*]

1.6 However, the new 30 day rule in the ESS deferred taxing point rules will apply to the old taxing points for transitioned shares or rights. The deferred taxing point for the ESS interest is moved to the time the employee disposes of the interest, if they dispose of the interest within 30 days after the original deferred taxing point. [*Schedule 1, item 80, paragraph 83A-5(4)(c)*]

1.7 Applying the new 30 day rule to transitioned shares and rights will assist in preserving the effect of the special market valuation rules that existed in Division 13A. It also lowers the probability that shares or rights will in subject to multiple taxation regimes in very short periods of time.

Example 1.2 Application of previous taxing point

Mark acquired shares or rights in his employer under an employee share scheme on 31 January 2002. Division 13A of the ITAA 1936 applied to his scheme, his scheme was a qualifying scheme and Mark elected to defer tax. Under Division 13A, Mark expected his cessation point to occur on 31 January 2012 (subject to him remaining in employment).

Mark's shares and rights will be transitioned into the new employee share scheme rules. The transitional provisions will ensure that his taxing point will still occur when it otherwise would have, on 31 January 2012 (subject to his remaining in employment).

If Mark disposed of his shares or rights within 30 days of his original taxing point, for example on 5 February 2012, the deferred taxing point will be the time of disposal.

Refund provisions are preserved

1.8 Transitional provisions have also been included to ensure the introduction of the new law will not affect an employee's eligibility for a refund in respect of rights they acquired prior to 1 July 2009. Employees may claim a refund of tax paid on the right, if they forfeit the right and a refund would have been available under the rules applying at the time that they acquired the right. [*Schedule 1, item 80, paragraph 83A-5(4)(d)*]

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Example 1.3 Refund provisions

Lee acquired rights in her employer under an employee share scheme in 2004. Division 13A of the ITAA 1936 applied to her scheme, her scheme was a qualifying scheme and she elected to defer tax. She did not have a cessation time prior to 1 July 2009, so her rights are transitioned into the new rules.

In 2010 Lee ceases employment, triggering the cessation time, and Lee pays tax on her rights.

In 2011 Lee allows her rights to lapse without having exercised them. As she would have been able to claim a refund of tax under Division 13A, she will be able to claim a refund of tax under the transitional provisions.

Foreign employment provisions are preserved

1.9 Consistent with the current law, employees will not pay tax on shares and rights that have been transitioned into the new rules to the extent that the shares or rights relate to the employee's employment outside Australia. [*Schedule 1, item 80, paragraph 83A-5(4)(a)*]

Certain new rules apply to transitioned shares or rights

1.10 The new rules relating to, among other things, employer reporting and TFN withholding tax (ESS) will apply to those shares or rights which have been brought within the new rules.

1.11 When calculating the amount to include in assessable income the new rules will apply. That is, at the deferred taxing point (which may be determined by reference to the Division 13A or section 26AAC of the ITAA 1936), the market value of the shares or rights is reduced by the cost base of the shares or rights. When determining market value the new arrangements will apply (see paragraphs ##.## to ##.##).

Current rules continue to apply to non-transitioned shares and rights

1.12 The current rules will continue to apply to shares or rights which are not being brought into the new rules (see paragraph 1.4). That is, shares or rights on which tax was paid under Division 13A of the ITAA 1936 will continue to be subject to those rules. [*Schedule 1, item 80, subsection 83A-10*]

1.13 The previous rules contained in section 26AAC of the ITAA 1936 will continue to apply to shares or rights acquired under those rules which are not being brought into the new rules (see paragraph 1.4). [*Schedule 1, item 80, subsection 83A-10*]

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1.14 Given that tax has already been paid on the untransitioned shares and rights under the previous regimes, their ongoing application will provide certainty to affected employees, particularly regarding to the refund provisions.

Consolidation rules in the current law continue to apply

1.15 The tax law provides rules to ensure that shares and rights provided under an employee share scheme are disregarded for the purposes of establishing whether a company is a wholly-owned subsidiary of another. These rules ensure that company groups whose subsidiary companies offer employee share schemes are not prevented from consolidating for tax purposes merely because the holding company does not hold 100 per cent of the subsidiary because of shares or rights provided to employees under an employee share scheme.

1.16 Transitional provisions have been included to ensure that the current rules relating to consolidation, that apply to shares acquired under Division 13A, continue to apply to shares and membership interests that it applied to prior to the introduction to the new law. These provisions apply to both the consolidated groups and multiple entry consolidated groups (MEC groups). [*Schedule 1, items 80A and 80B*]

Retrospective regulations will apply

1.17 Regulations made for the purposes of, or relating to, the new employee share scheme rules may have retrospective effect from 1 July 2009, if they are made within two months from the date that these Bills receive Royal Assent. [*Schedule 1, item 82*]

1.18 The Government has announced that it will replicate the rules for valuing unlisted shares or rights in the Regulations as an interim measure pending the recommendations of the Board of Tax in relation to these valuation methods.

1.19 To ensure that appropriate valuation methods are provided for unlisted shares and rights acquired or disposed of between 1 July 2009 and the date that these Bills receive Royal Assent, and to provide certainty to providers and employees participating in employee share schemes, these regulations will have retrospective effect.

1.20 The *Legislative Instruments Act 2003* provides that a legislative instrument will have no effect if it would take effect before the date it is registered and as a result... liabilities would be imposed on a person in respect of anything done or omitted to be done before the date of registration. [*Legislative Instruments Act 2003, subsection 12(2)*]

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1.21 The new rules provide that retrospective regulations relating to the new employee share scheme rules may have effect from 1 July 2009 despite the *Legislative Instruments Act 2003*. This is considered appropriate because the purpose of the regulations is to provide certainty to providers and employees participating in employee share schemes. Draft versions of the regulations were made available to the public for comment on 14 August 2009.