

# Global Rewards Update: AUSTRALIA

October 2009

## EMPLOYEE SHARE PLAN BILLS RELEASED

**Note:** This communication is a further update to the Australia Global Rewards Updates which were released in May, June, July and August 2009, as well as the Australia Global Rewards Update issued earlier this month.

### BACKGROUND

Two bills and explanatory materials on the reform of employee share plans were finally released by the Australian Federal government on October 21, 2009. The bills and explanatory materials are a follow-up to the release of the 2009-10 Federal Budget, and corresponding policy statement, from the Australian Federal government. The spirit of the policy statement is reflected in the bills, and many of the Australian tax changes embodied in the bills are the same as those highlighted in our earlier GRUs. However, a few important differences have been proposed in the bills, and we have highlighted those differences below.

It is our understanding that the bills are expected to be fast tracked through Parliament and passed without any significant amendment. As such, companies should now review their existing and proposed employee share plan arrangements in light of the expected new employee share plan tax laws.

### BROAD OVERVIEW OF TAX CHANGES

In line with our previous guidance, the tax changes incorporated in the two bills apply to shares (which includes stapled securities where at least one of the ownership interests is a share) and rights to shares acquired on or after July 1, 2009.

Division 83A of the *Income Tax Assessment Act 1997* ("new law") deals with securities granted under employee share plans both before and after July 1 2009. However, the transitional guidance released by the Australian government ensures that the pre-July 1, 2009 tax treatment of securities under Division 13A ("old law") will be maintained under the new legislation.

Additionally, the new reporting requirements, as previously described, will apply for all taxable events that occur on or after July 1, 2009, whether the employee awards were granted before or after July 1, 2009.

As mentioned, the new bills incorporate a few changes that depart from the language previously released by the Australian government. Outlined below are the key changes applying to shares or rights acquired on and after July 1, 2009 under an employee share plan, and the new conditions proposed in the most recent bills. We have separately identified the differences contained in the most recent bills by placing the new conditions in **bold**.

#### **TERMS OF AN EMPLOYEE SHARE PLAN**

The actual employee share plan (and not the share or right granted) must meet the conditions for either up-front taxation (together with requirements to be met by the employee), or for deferred taxation. **In some cases, the plan terms must specifically refer to the taxation arrangement that applies (e.g. deferred taxation)**. The ability of the employee to elect, at grant, to defer taxation of the award remains absent from the new bills.

#### **LIMITED UP FRONT TAX EXEMPTION**

**Broad-based employee share plans which meet certain conditions will be eligible for a tax exemption of up to AU\$1,000, provided that the employee has adjusted taxable income of AU\$180,000 or less.**

#### **DEFERRAL OF TAXATION**

As mentioned in prior GRUs,

- The typical 'deferred taxing point' on shares or rights granted after July 1, 2009 should be:
  - for share plans that meet certain conditions (in effect, the 'old' qualifying share conditions), when there is no longer a real risk of forfeiture and no genuine disposal restrictions (set at acquisition) attached to the shares;
  - for rights plans that meet certain conditions (in effect, the 'old' qualifying rights conditions), when there is no longer a real risk of forfeiture and no genuine disposal restrictions (set at acquisition) preventing the disposal or exercise of the rights. Note, if shares acquired on exercise of the rights are subject to a real risk of forfeiture and/or genuine disposal restrictions (set at acquisition), the taxing point should be deferred until there is no longer a real risk of forfeiture or no genuine restrictions are attached to the shares
- The maximum time for the deferral of tax is reduced from ten years to seven years and termination of employment will also continue to trigger an early deferred taxing point.

- A limited tax deferral for a salary-sacrifice based employee share plan which offers no more than AU\$5,000 worth of shares, and that meets certain conditions (this limited deferral is available despite the shares not being subject to a real risk of forfeiture).

## **VALUATION RULES**

The proposed bills state that “ordinary market valuation” rules will apply to listed shares and rights and unlisted shares, regardless of any conditions and restrictions that prevent a taxpayer from converting their employee share plan interest into cash. In effect, with respect to these awards, employers can choose to use the market value of the shares granted (or the shares underlying a rights award) or the value set out in the current regulations (which continue to use valuation tables for option awards). **The two new bills provide that these new valuation rules, and their inherent flexibility, will also apply to awards granted prior to July 1, 2009 which have not yet been subject to taxation.**

With respect to unlisted rights, the rules for determining market value under current law have been replicated in the new law (via regulations), as an interim measure pending final recommendations from the Board of Taxation. However, the Board of Taxation is scheduled to provide its full report on the new draft legislation to the government by February 2010, and the report is expected to provide further guidance with respect to the valuation of employee share plan benefits.

## **REPORTING REQUIREMENTS**

The provider of the employee share plan interest (which may be the holding company of the employer in many situations) will be required to provide an annual report to both the employee and the Australian Taxation Office the number of shares and rights acquired under an employee share plan at both grant and the taxing point (for awards granted on or after July 1, 2009).

The employer will be required to provide an estimate of the market value of the awards at the employee’s taxing point; **in cases where the point of taxation is deferred further to actual sale (i.e. where sale is within 30 days of what would otherwise be the deferred tax point), the employer can provide this estimate based on the market value of the award at the original deferred tax point rather than sale.**

**The employer granting the awards (e.g. the U.S. parent of an Australian entity) may appoint an agent (e.g. the local Australian entity which employs the award recipient or the plan administrator) to fulfil the above-mentioned reporting requirements on its behalf.** The report must be provided to the employee by July 14<sup>th</sup> each year and to the government by August 14<sup>th</sup>.

## **ADDITIONAL CONSIDERATIONS**

- **Where employees are granted employment benefits and, at a later time, the benefit materializes into an employee share plan interest, the employee will be taxed as if always entitled to receive an employee share plan interest. For example, if an employer has the discretion under an incentive plan to deliver either cash or shares, and ultimately delivers shares, then the benefit will be deemed to have been an employee share plan interest at grant i.e. a right to a share at grant. The employee may be required in such a case to amend an earlier year's tax return to disclose any taxable discount and may potentially be subject to an interest penalty. The provider will also be required to report and withhold on the employee share plan interest, as applicable.** If the employee's award is ultimately settled in shares, taxation on the market value of the award at grant, plus interest, will only be due if the award would not have qualified for deferral of taxation under the old qualifying rules.
- **Where an employee assigns their right to an award to an associate (e.g. partner or relative) the value of the award will continue to be taxable to the employee, but will not necessarily be taxable at grant, as is currently the situation. If the employee share plan meets the conditions for deferred taxation or up-front taxation, the employee will be taxed accordingly. Up-front taxation can no longer be automatically achieved by making awards to associates.**
- An employee may claim a refund of tax paid on grant of forfeited shares and rights, but only if the forfeiture is not the result of either a choice by the employee (excluding a choice to terminate employment) or a condition of the plan that protects the employee against a fall in market value
- Australian tax treatment of employee share plan benefits will depend on the employee's residency status and the source of the income, which will be considered from a foreign source to the extent it relates to employment outside Australia. There will no longer be any tax exemption for foreign source gains derived by Australian residents; relief will need to be claimed by way of foreign tax offsets

## **ACTION**

- Companies should review existing share plan arrangements to assess the impact of the tax changes on employee share plan awards to Australian participants made on or after July 1, 2009.

- Companies that operate plans that may deliver in cash or shares, or have plans where the actual number of shares to be acquired cannot be determined at the grant date, should immediately review such plans to assess the impact of the new law.
- Companies with cash bonus programs with a 'sacrifice into shares' component should reassess the efficacy of these programs and consider design alternatives.
- Companies should implement appropriate processes to track and record all employee share plan transactions that will need to be reported at tax year end.
- Companies should begin drafting employee communications that explain the relevant new tax laws and their impact on the company's employee share plans.

### People to Contact

For assistance in this matter or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services advisor or email us at: [globalequity@deloitte.com](mailto:globalequity@deloitte.com) and a global rewards consultant will contact you.

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