



Global Reward Update

New Zealand

Proposed change in position on PAYE withholding on cash-settled equity awards and to the taxing point of share scheme benefits

Headlines

- Earlier this year New Zealand Inland Revenue has issued a series of draft interpretation statements which propose to require all employers who currently offer cash-settled employee share schemes (ESS) to withhold PAYE on a “go forward basis”.
- The draft interpretation statements also propose an alternative interpretation of the current law that applies in New Zealand which if confirmed, will result in the taxing point of options moving from the date of exercise to the date on which shares are acquired. This is proposed to be the date the shares are entered on the company's share register in most circumstances.
- These changes are currently undergoing consultation.

PAYE Withholding on ESS benefits

Background

Currently, the widely held interpretation in New Zealand is that while PAYE reporting is required for ESS benefits, withholding PAYE and other related payroll deductions is optional for all ESS benefits, regardless of whether the benefit is delivered to the employee in the form of shares or cash (other than when cash is delivered under a ‘phantom’ share scheme/akin to a bonus scheme that tracks the value of the shares).

Practically, this means that in many scenarios employees have their ESS income reported to the New Zealand Inland Revenue without PAYE withholding. Accordingly, the employee must make arrangements to settle their own tax due via the terminal tax/provisional tax rules. This can at times be complex for employees to manage as they may not be familiar with paying tax in this way.

What is changing?

New Zealand's Inland Revenue has released multiple draft interpretation statements covering a range of issues. One of the statements addresses the issue of PAYE withholding on cash-settled ESS and concludes that the correct interpretation of the law is that for cash settled ESS PAYE is not optional. Accordingly, once the draft statement is finalized PAYE withholding will be required on cash settled ESS.

The basis for this change of interpretation is that essentially all cash payments from an employer to an employee, as a starting point, should have PAYE withheld and the option not to deduct PAYE is only intended to apply to share settled benefits.

While this interpretation statement is still in draft, employers should be ready to withhold tax on cash-settled ESS. New Zealand's Inland Revenue notes that whether employers will be required to ‘gross up’ for the PAYE or deduct PAYE from the gross ESS amount, will depend on the contractual agreements in place.

Once the draft statement is finalised, withholding will be required under the ‘extra pay’ rules (lump sum payment/extra emolument rules), meaning tax will be withheld at the flat extra pay rate applicable to that employee.

If the scheme is a cash-settled ESS benefit, Accident Compensation Corporation (ACC) earners levy will need to be withheld. However there will be no requirement to withhold KiwiSaver deductions from employee earnings, or make compulsory employer KiwiSaver contributions. If the scheme is a share-settled ESS, no withholding is required i.e., withholding remains optional.

If the scheme is neither a cash-settled ESS, nor a share-settled ESS (i.e., a phantom scheme), the treatment remains the same. The scheme does not fall into the ESS rules and is treated in the same manner as a bonus. This will mean ACC earners levy, KiwiSaver and other payroll deductions will need to be withheld. In addition, employers will also need to make the compulsory KiwiSaver contribution.

Some examples of the New Zealand Inland Revenue's current thinking on what a 'cash-settled' ESS (PAYE withholding will be required) are:

- Arrangements where performance rights (e.g. Restricted Stock Units (RSUs)) are granted to employees, and it is at the employee's discretion whether or not cash or shares are delivered.
- An option scheme, where at the employer's discretion the options can be cancelled on vesting and cash provided.
- An option scheme, where at the employee's discretion they can choose on exercise of the options whether they receive the shares or take an equivalent cash payment.
- On the sale of a company where the employee's performance rights (e.g. RSUs) are accelerated to vest, in return for a cash payment.
- At the unwind of an ESS, where cash is received in return for the cancellation of the related rights to the ESS (e.g. at the point of cancellation of RSUs).

Some examples of the New Zealand Inland Revenue's current thinking on what is not a 'cash settled' ESS (and hence PAYE withholding will remain optional) include:

- Share-settled schemes, including RSUs, option schemes where shares are delivered to employees.
- Incentive schemes involving a combination of cash and shares e.g. the employee is entitled to receive \$100,000 after three years delivered 40/60 in cash and shares respectively however the cash component of \$40,000 will be treated like a bonus, rather than cash-settled ESS, meaning all relevant PAYE deductions would be required (including KiwiSaver and ACC).

Some examples of New Zealand Inland Revenue's view on what is not an ESS arrangement:

- Phantom share schemes, where the employee is entitled to participate in an ESS scheme and shares are never offered, however, the employee's entitlement is linked to the company's share price.
- Arrangements where at the outset the employer is unclear as to whether they will provide the employee shares or cash, and at the end of the arrangement cash is provided.
- Bonus arrangements.

Inland Revenue have confirmed that this change will apply prospectively from the point in time when the statements are issued in their final form. Inland Revenue have not indicated when these statements will be finalised.

Tax point for ESS options

Background

In the case of share options, typically, once an employee exercises their rights under the scheme, the employer will need to arrange for shares to be issued and then delivered to the employee, which is a process that can take time. Currently, it is generally accepted that the tax point in relation to employee share options is the date of exercise rather than the date the shareholding is registered.

What is changing?

As noted above, historically it has been accepted by the New Zealand Inland Revenue that the share scheme taxing date for options is the date the employee exercises their right to receive the shares/cash under the ESS.

The New Zealand Inland Revenue's revised interpretation of the rules is that the taxing point for options is not the date of exercise, but rather it is the first date the shares are 'held' by or for the benefit of an employee. This is the date the employee has their name entered on the company's share register.

This position change, if finalised, would mean that employers and employees can no longer rely on the exercise date being the share scheme taxing date for options (i.e., the date that triggers the valuation of the benefit, reporting and potential withholding requirements). This may cause difficulties as employers will now need to seek information on the date the employee is recorded as the owner of the shares, rather than adopting the date of exercise or vest for valuing the benefit.

This change may also impact other ESS arrangements to the extent the shares are not 'held' by or on behalf of the employee at the time the employee is entitled to receive the shares. For example, if there is a trading restriction meaning shares cannot be issued on the RSU vest date, the share scheme taxing date may now become the date the restrictions lift.

Both changes discussed above are currently being consulted on and Inland Revenue has not yet provided a timeline for these guidelines being issued in their final form. However, it is worth noting that this is not a legislative change but represents Inland Revenue's interpretation of the law as it currently stands.

Deloitte's view

Whilst the interpretation statements are still in draft, these proposals represent a change from current practice.

It is unlikely that Inland Revenue will change its view on the treatment of cash settled ESS benefits and employers should consider how these changes may impact any cash-settled ESS offered to their employees and the current processes of reporting income and accounting for PAYE.

Who to contact

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