

STRUCTURING EMPLOYEE SHARE SCHEMES IN TIMES OF CHANGE

The current economic climate has led the government to announce in the 2009/10 Budget new measures be introduced to ensure a fairer and more equitable system for all Australian employees.

One result of this shift in policy has been the release of a draft exposure Bill (**Bill**) by the Treasury on 24 July 2009. The Bill deals with income tax concessions available to participants in employee share ownership schemes and arrangements (**Employee Schemes**). If the Bill is enacted as law, its operation will extend retrospectively to all shares and rights acquired under such Employee Schemes after 1 July 2009.

Impact of changes

If enacted as law, the Bill will provide for a number of procedural changes to the tax assessment of Employee Schemes. The changes would impact on the tax assessment of any discounts on shares or options issued under an Employee Scheme by requiring assessment for taxation purposes, in the year that they are acquired. In effect, the option to defer tax assessment of any such discount (the deferred benefit) will no longer apply.

At present, where the 75% rule is met, an employer company is able to provide participants of Employee Schemes with \$1000 discount or salary sacrifice concessions in assessable income. If the employer company wishes to take advantage of this option, the Bill provides for an expansion in the 75% rule such that participation in the Employee Scheme must consist of permanent Australian resident employees who have completed at the least 3 years of service with the employer company.

Employee Schemes

To understand the significance of the potential changes, the rationale behind an Employee Scheme must first be understood.

An Employee Scheme is a plan under which employees acquire or are offered the opportunity to acquire shares in an employer company or units in a specially established trust of the employer company.

An Employee Scheme is intended to enhance employee commitment to the broader corporate objectives of their employer company over their own personal interests by merging the objectives of the employee with those of the employer company.

An Employee Scheme may also allow the employer company to benefit from certain tax concessions available under the *Income Tax Assessment Act* (1936) (**Act**).

Also, since employees normally need to remain with the employer company for a certain period of time before being able to receive any benefits from such an offering, Employee Schemes encourage employee loyalty and can assist in the retention of valued staff.

Non-qualifying schemes

A non-qualifying (or deferred) employee share option scheme (**ESOS**) is one which allows the employer company to provide the participants an option to buy shares (in the employer company) at some point later in time. Division 13A of the Act describes the tax treatment of such schemes.

The employer company may decide to limit the 'right' to convert an option to a share based on its needs and at its discretion. For example, the

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right could be subject conditions such as minimum performance standards, duration of service, timing and approval of the existing shareholders.

Under the Bill, if the right either by itself or by way of the limitations and/or conditions is considered to be at 'real risk of forfeiture before it materialises', deferral of the tax assessment may be permitted by the Australian Taxation Office.

Qualifying Schemes

On the other hand, a qualifying (or upfront) employee share scheme (**ESS**) grants the participant a share or unit holding immediately upon commencing employment in the employer company. Under an ESS, there is no question of timing of tax assessment.

Structuring

There are various Employee Scheme structures available to employer companies depending on their particular needs. For example, if the Bill is enacted, where performance of employees is of particular and genuine concern to the employer company, a ESOS may be the more suitable option since it will not necessitate tax assessment of the discount until the right is actually 'acquired' by way of conversion of a right to a share or unit holding.

Similarly, where the priority of the employer company is to benefit by providing scheme participants the \$1000 discount or salary sacrifice concession in assessable income (which is permitted under relevant legislation) or for example, if the tax liability in respect of the shares is to be leveraged for the participant, a qualifying (or upfront) scheme would be most suited.

Another option that is available is for the employer company to establish a Unit Trust which in turn establishes a Trust Company. Employees would purchase units in the Trustee Company which would entitle them to distributions of income.

Employees acquiring a (non-qualifying) right to buy shares at a later point will no longer be able to elect to defer taxation of the discount.

Communication and Documentation

Employee Schemes need to be properly communicated and understood by relevant employees.

This document outlines why an Employee Scheme is important to structure appropriately.

Summary

The Explanatory Memorandum to the Bill provides an outline as to what constitutes a 'real risk of forfeiture'. Despite this, there remains a significant degree of uncertainty surrounding this term.

Also, given the existing complexity of the issues and the potential of further complication by way of enactment of the Bill as law, employer companies would benefit significantly from reviewing the structure and design of any existing or proposed ESSs or ESOSs.

For these reasons and more, it is recommended that expert legal, tax and accounting advice be obtained by an employer company that is seeking to establish or to review its Employee Schemes.

If you would like any further information on this topic, please contact Ilona Teremi on 8239 6503 or ilona.teremi@kreissonlegal.com.au

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