Article Information

Author: Will Fennell

Service: Tax Consulting, Taxation

Budget 2021 | ESS interests: Australia finally catches up with the rest of the world

Will Fennell, Piper Alderman's Tax Partner reflects on the recent Federal Budget, exploring the key changes announced.

Tuesday night's Federal Budget included a welcome change to the taxation of employee share schemes in Australia. In a nutshell, employees holding interests in tax-deferred schemes will be able to leave their employment (or have it terminated by the employer) without that event being the trigger for a 'deferred taxing point'.

Under the current rules, employees who receive shares or rights (including options) at a discount are able to defer the payment of tax to a later time, known as the 'deferred taxing point'. The deferred taxing point is the earliest of:

- cessation of employment
- for shares, when there is no risk of forfeiture and no restrictions on disposal
- for unexercised rights, when there is no risk of forfeiting the right and no restriction on its disposal
- for exercised rights, when there is no risk of forfeiting the resulting share and no restriction on its disposal
- the maximum deferral period of 15 years.

Under the changes, 'cessation of employment' will be removed as a deferred taxing point, which will become the earliest of the remaining taxing points.

For many years Australia has been a global outlier by seeking to impose deferred tax on cessation of employment under its employee share scheme taxation laws. Taxing employees on cessation of employment made no practical or commercial sense, and in some cases meant employees would have to sell shares upon termination of employment to meet a tax liability.

Up until now most employee share schemes have been designed with the cessation of employment deferred taxing point in mind. However with this change employers will have greater flexibility in designing the underlying mechanics of their schemes. With these changes it will be possible to defer the taxing point to a much later stage and well beyond the cessation of an employee's employment, if desired. Employers may wish to review their schemes and redesign them accordingly, once the changes becomes law.

However when designing employee share schemes employers should bear in mind that deferred taxation comes with a significant downside: namely that any increase in value of ESS interests between their time of issue and the deferred taxing point is taxed on income account. Where deferred taxation is not used, whilst employees may have to pay some tax earlier, any gain in value is generally taxed on capital account which means that the 50% CGT discount can be accessed provided the interests have been held for at least 12 months prior to disposal.

The changes will not affect employees with ESS interests issued under the generous start-up provisions. Under those provisions, employees can be awarded shares or rights at a discount, and provided certain conditions are met, the discount doesn't have to be brought to account as assessable income by the employee. And unlike interests held subject to deferred taxation, gains and losses incurred between the time of issue of the interests and the time of disposal are generally taxed on capital account meaning that the 50% CGT discount can be applied.

Other changes

The budget has indicated that different disclosure requirements will apply depending on whether the employer charges or lends to employees. Employers of unlisted entities who charge or lend to the employees to whom they offers ESS interests will be able to issue each employee up to $30,000 in shares a year, an increase from $5,000.

Employers that do not lend or charge for the shares will be exempt from disclosure requirements as well as licensing, anti-hawking and advertising bans.

If you wish to talk to me about your employee share scheme and how these changes might impact you, feel free to get in touch at wfennell@piperalderman.com.au