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New Zealand – Proposals on Simplifying Tax for Employee Share Schemes
by KPMG, New Zealand (a KPMG International member firm)

New Zealand's Inland Revenue has released an issues paper[1] on ways to simplify the collection of tax on employee share schemes. The aim is to reduce tax compliance cost barriers to the take-up of these schemes.

Why This Matters

The current tax collection mechanism has presented significant challenges for businesses and employees for some time. It imposes compliance costs on employees, making employee share schemes burdensome from a tax perspective. While the measures proposed will impose additional compliance obligations on employers, the burden on employees will be eased, particularly because the way tax is collected from employee share scheme income will change.

What's the Main Difficulty?

Employees who receive shares as part of a remuneration package are required to pay tax on this "income" in their own tax returns. (The income is the value of the shares less any payment by the employee for the shares.)

This contrasts with normal salary and wages and fringe benefits, which are subject to PAYE and Fringe Benefit tax (FBT). The employee does not typically have an end-of-year tax liability for these amounts, whereas he or she can face a hefty tax bill on employee share scheme income and may also have to manage provisional tax and use of money interest as a result.

What's Being Proposed?

The issues paper proposes to change the way tax is collected from employee share scheme income. The options are to apply either the PAYE or FBT rules. The issues paper asks for feedback[2] on a number of design issues, including:

- Whether employers should be able to elect the existing rules continue to apply to employee share scheme income.
- Whether there should be choice between FBT and PAYE to account for the tax.
- The cash-flow impact on employees, if PAYE applies. As shares are a non-monetary benefit, there is no cash from which PAYE can be deducted and paid.
- The impact on employers if FBT is the preferred option. While all employers will pay PAYE, not all will pay FBT, so some employers will not be in the FBT system.

- Transitional issues, including whether there needs to be the ability to preserve the existing tax treatment for employees in current schemes and ensuring there is no adverse impact on non-tax obligations and entitlements.

Who Should Take Note of These Proposals?

All employers should take note. Businesses for which employee share schemes form an important part of their remuneration structure, or may do so in future, should pay particular attention. This includes start-ups and those businesses looking to innovate in their remuneration policies.

KPMG Note

The proposed changes in New Zealand illustrate the difficulties that global companies can have in designing reward systems. Different tax systems will impact employees differently. It can be foolhardy to assume that a stock plan will produce the same – and therefore fair – results for all employees. Managing employee expectations is a key part of successfully implementing a plan.

The government proposals represent a move in the right direction. However, much will depend on getting the detailed design right.

Under the current rules, employees must fund the tax and the tax cost is clearly theirs. Under either PAYE or FBT, the employer will need to fund the tax payment and recover this from the employee. If the proposals become enacted, employers will likely experience additional compliance obligations. However, some residual employee obligations may remain. For example, if cash salary is insufficient to fund PAYE on employee share scheme income, there may still need to be an employee “square up” at year end. Of particular concern, therefore, is who bears the tax.

Our experience with overseas employee share plans, where a withholding tax applies, is they will typically allow the employer to sell shares to fund the tax. The employee bears the tax cost and receives a net after-tax value of shares. New Zealand employee share plans will not necessarily operate in a similar manner. As New Zealand employers have not had an obligation to withhold tax to date, there has been no need for such a rule.

The need for a legislative override and other detailed design issues should be carefully considered. In light of the proposals, employers need to pay careful attention to ascertain that benefits provided under existing schemes have the expected outcome for both the employer and the employee.

Importantly, this issues paper is limited to the tax collection and compliance costs aspects. Consultation on the tax treatment of employee shares schemes is targeted for later this year. This should consider what is taxable, and when, to bring further clarity to the treatment of employee share schemes.

Employee share schemes are popular, well established, and tax-incentivized overseas, but are less well entrenched in New Zealand. The current tax barriers can detract from the otherwise attractiveness of employee share schemes, which offer employees an ownership stake in the business. To help fuel an innovative and competitive economy, it is important that these types of schemes be encouraged and the tax barriers removed.

Next Steps

Any organizations with concerns regarding how these proposals might impact them should consult with their professional tax advisers.

Footnotes:

1 Inland Revenue, Issues Paper: "Simplifying the Collection of Tax on Employee Share Schemes."

2 The closing date for submissions was 5 May 2015. For the published submission from the KPMG International member firm in New Zealand, click here.

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