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GMS Flash Alert

Global Compensation Edition

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Australia - Removal of Cessation of Employment Taxing Point for ESS Interests

The proposed change to Australia's employee share scheme (ESS) rules to remove cessation of employment as a deferred taxing point has been passed into law.

On 22 February 2022, the *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021* (the Bill) received Royal Assent.[1]

Effective from 1 July 2022, the removal of cessation of employment as a deferred taxing point will now apply to **all** new and existing ESS interests that have not reached an ESS taxing point before 1 July 2022.

WHY THIS MATTERS

This reform will be welcomed by many as it aligns Australia's equity tax rules more closely with other international jurisdictions and will alleviate the cash-flow burden previously caused by taxing ESS interests at cessation of employment where the employee is yet to realise any value for those interests.

This is a change from the original proposal outlined in the Exposure Draft, which was that the reforms would only apply to awards granted from 1 July 2022. The final legislation outlines that the changes will also apply to grants of ESS interests prior to 1 July 2022, that have not had a taxing point before 1 July 2022. This means employees who terminate employment after 1 July 2022, will fall under the new rules and it will make it easier for employers to align the interests of employees with the long-term interests of shareholders.

Background

Under Australia's employee share scheme rules, a discount on shares, rights, and options (ESS interests) given to employees in respect of their employment is taxed either at the time of grant or on a deferred basis. If the ESS grant is subject to tax on a deferred basis, prior to the change, tax would be deferred generally until the earliest of:

- vesting, exercise (in the case of options), and removal of any sale restrictions;
- cessation of employment; and
- 15 years from grant.

Employers have an Australian ESS reporting obligation in respect of any ESS interests provided to their employees working in Australia. Employers are required to file an Annual Report to the Australian Taxation Office (ATO) by 14 August following the end of the financial year and issue an ESS statement to employees with the taxable value of their ESS interests by 14 July where a taxing event has occurred in the financial year.

The cessation of employment as a taxing point had been a major area of concern for many stakeholders of company share plans, and there had been lobbying by interest groups for its removal for a number of years.

Often terminated employees who have been made redundant are treated as "good leavers" and are able to retain some or all of their ESS interests as a result. These employees were required to pay tax on those ESS interests at a time when they had yet to realise any value from those interests, and this created a potential cash-flow issue. In addition, these employees who have ceased employment may end up paying tax on their ESS interest when they ceased employment at a higher share price or value than what the shares are actually worth when they are able to dispose of the shares.

For cross-border employees, the cessation of employment taxing point for ESS interests also created additional complexities due to the misalignment with the common taxing point for other foreign jurisdictions and implementation of tax-equalised arrangements.

An Organisation's Employee Share Plans: Things to Consider

For employees ceasing employment on or after 1 July 2022, this change will now result in tax being deferred until the earlier of the remaining taxing points (where the employee share scheme qualifies for tax deferral). This change may require an organisation to consider the following:

1. **Review employee communications:** The success of any employee share scheme requires employees to understand the tax implications associated with participation. Organisations may wish to consider refreshing their employee equity communications to incorporate these updates or arranging a presentation to help employees understand what it means for them.

2. **Data preparation for ESS reporting**: Organisations will need to continue to keep good records of ESS awards that will have a taxing point post-termination as well as personal details (e.g., tax file numbers, correspondence addresses) of former employees to facilitate any future ESS reporting obligations.

3. **"Indeterminate Right" plans**: An "indeterminate right" is when an employee's entitlement to a share or a specific number of shares is not certain at the time of grant of the right. For example, the plan rules may allow the delivery of cash or shares at the discretion of the employer at a later date, or the award is based on a specified total value rather than a specified number of shares. Once it is known that the "indeterminate right" will result in the employee receiving a share, the employer is required to treat it as if it was always an ESS interest. For organisations that use indeterminate rights and have employees who terminate employment prior to 1 July 2022, specific advice may need to be sought in relation to the relevant taxing point arising from these changes.

FOOTNOTE:

1 For the legislation on the parliament of Australia's website, click here.

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People Services in Australia

Sydney, New South Wales & Melbourne, Victoria **Mardi Heinrich** Partner – Deals, Tax & Legal People Services Mobile: +61 410 602 993 meheinrich@kpmg.com.au	**Perth, Western Australia** **Dan Hodgson** Partner – People Services Mobile: +61 416 017 131 dghodgson@kpmg.com.au
Melbourne, Victoria **Ursula Lepporoli** Partner – People Services Tel.: +61 3 8626 0967 udlepporoli@kpmg.com.au	**Brisbane, Queensland** **Hayley Lock** Partner – People Services Mobile: +61 477 764 638 hlock@kpmg.com.au
Sydney, New South Wales **Ablean Saoud** Partner – Deals, Tax & Legal People Services Mobile: +61 421 052 596 asaoud@kpmg.com.au	**Sydney, New South Wales** **Jackie Shelton** Partner – Deals, Tax & Legal People Services Mobile: +61 412 291 846 jsshelton@kpmg.com.au

Special contributors to this article: Priscilla Tang and Belinda Rong.

Contact us

For additional information or assistance, please contact your local GMS or People Services professional* or one of the following professionals with the KPMG International member firm in Australia:

Dan Hodgson (in Perth)
Tel. +61 8 9278 2053
dghodgson@kpmg.com.au

Ablean Saoud (in Sydney)
Tel. +61 2 9335 8550
asaoud@kpmg.com.au

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