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Malaysia: Budget 2019

Overview

On November 2, 2018, Malaysia's Minister of Finance announced the 2019 National Budget. Below are the relevant issues from the individual tax perspective:

Tax relief on contributions made to an approved provident fund, takaful, or life insurance premiums: To encourage savings for retirement, the budget proposes increasing the tax relief to RM 7,000 for contributions to approved provident fund or takaful, or life insurance premiums payments, where it will be separated as follows:

1. Up to RM 4,000 of income tax relief for contributions to approved provident funds; and
2. Up to RM 3,000 of income tax relief for takaful contributions and life insurance premium payments.

Employees in the civil service who are covered under the government pension scheme will be allowed to claim up to RM 7,000 of income tax relief for takaful contributions or life insurance premiums.

Effective date: From year of assessment 2019

Tax relief on net annual savings in the National Education Savings Scheme (SSPN): To encourage parents to save money to finance their children's tertiary education, the tax relief on net annual savings in the SSPN is proposed to increase from RM 6,000 to RM 8,000.

Effective date: From year of assessment 2019 to year of assessment 2020

Introduction of departure levy: To encourage domestic tourism, a departure levy will be imposed for all outbound air travelers under the following two tiered structure:

- RM 20 (approximately USD 5) for outbound travelers to ASEAN countries; and
- RM 40 (approximately USD 10) for outbound travelers to non ASEAN countries.

Effective date: 1 June 2019

Decreased statutory contribution rates to the Employees Provident Fund (EPF) for employees aged 60 and above: To encourage the employment of workers past the retirement age of 60, a reduction in the employer portion of EPF contributions from 6 percent to 4 percent is proposed. To boost the disposable income of working retirees, it is also proposed that the current mandatory employee EPF contribution rate for workers above age 60 be reduced from 5.5 percent to zero.

Effective date: 1 January 2019

Tax deduction for contributions to social enterprises: Currently, any contributions made to approved charitable organizations and institutions under the Malaysia Income Tax Act 1967 would qualify for a deduction, capped at 7% of the individual's aggregate income.

It is proposed that contributions to social enterprises be added to the list of approved charitable organizations and institutions. The definition of companies qualifying as social enterprises has yet to be confirmed.

Effective date: To be confirmed

Deloitte's view
The 2019 National Budget, titled "A Resurgent Malaysia, A Dynamic Economy, A Prosperous Society," is the first budget under the newly elected Pakatan Harapan Government, which seeks to reshape and drive Malaysia toward becoming a more developed, competitive, and transparent nation.

The budget focuses on implementing institutional reforms, while ensuring the socioeconomic well-being of Malaysians and fostering an entrepreneurial economy. These efforts are meant to strengthen the economy and reduce income inequality in Malaysia.

The proposals are therefore geared toward increasing the disposal income of Malaysians in general, while looking after the welfare of lower to middle income Malaysians in particular.

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People's Republic of China:
Individual income tax reform: Draft implementation regulations released for public consultation

Overview

On October 20, 2018, China's Ministry of Finance (MOF) and the State Administration of Taxation (SAT) released draft implementation regulations for the amended People's Republic of China individual income tax (IIT) law for public consultation. The consultation will last through November 4, 2018.

A broad reform of the IIT law, approved on August 31, 2018, introduces the 183-day rule for determining the tax residence of individuals, amends the income tax brackets and allowable personal deductions, and introduces anti-avoidance rules applicable to individuals. Most of the measures generally will become effective on January 1, 2019, although some measures (*e.g.*, the increased standard deduction and new tax brackets for salaries and wages) apply beginning October 1, 2018.

Salient points of the draft regulations

Five-year rule: Under existing IIT rules, a non-China-domiciled individual (note: a foreign individual or individual from Hong Kong, Macau, or Taiwan is usually considered a non-China-domiciled individual in practice) can only be subject to Chinese taxation on his or her worldwide income if the individual is in China for five or more years consecutively ("five-year rule"). If the individual has lived in China for one to five years, he or she may be exempt from IIT on his or her foreign-source income. The new IIT law provides that a non-China-domiciled individual who is in China for 183 days or more in a year will be deemed to be a tax resident for that year.

Under the draft regulations, a non-China-domiciled individual would be exempt from Chinese IIT on foreign-source income that is not paid by a Chinese domestic entity or resident individual in the following situations:

- The individual has not been a Chinese tax resident for five consecutive years; or
- The individual has been a Chinese tax resident for five consecutive years but was outside China for more than 30 days in a single trip during the five-year period.

In all other cases, as from the sixth year in which a non-China-domiciled individual stays in China for 183 days or more, the individual's foreign-source income would all be subject to Chinese IIT for a specific year in which the individual is a Chinese tax resident.

The new version of the five-year rule aims to ensure a stable policy and attract foreign talent. Foreign individuals working in China should welcome the proposed regulations since they may be able to benefit by having their foreign-source income outside the Chinese IIT net. However, a reporting obligation would be introduced to apply for the exemption under the five-year rule.

Source of income: The draft regulations would add the following categories of income that would be deemed to have a China source:

- Income derived from business operations carried out in China;
- Gains derived from the transfer of equity investments in Chinese domestic enterprises and other economic organizations in China; and
- Author's remuneration and occasional income paid or borne by Chinese domestic enterprises, other economic organizations in China, or Chinese resident individuals.

Given the rapid development of the digital economy, the regulations also would empower the MOF or SAT to make adjustments to the sourcing rules where appropriate.

Taxable income: To align the annual standard deduction with the increase in the standard deduction for salaries and wages (*i.e.*, from monthly RMB 3,500 to RMB 5,000; salaries and wages will be included in "comprehensive income" under the amended IIT law), the annual standard deduction of RMB 42,000 for income from the operation of a business would be increased to RMB 60,000. The draft regulations also provide that certain itemized deductions would be allowed in calculating taxable income from the operation of a business.

Income derived from the transfer of a partnership interest would fall under the category, "income from the transfer of property," which signals that tax issues relating to partnerships are on the SAT's radar.

Deemed sale rule: The draft regulations would introduce a deemed sale rule under which an individual generally would be considered to sell nonmonetary property and derive gains (or incur losses) for IIT purposes if the individual uses the property in exchange for other property or for purposes of donation, the repayment of a debt, sponsorship, investment, etc., unless otherwise stipulated.

We do not yet know how the deemed sale rule, as well as other regulations under the new IIT law, will affect or apply to donations. From a donor's perspective, the existing IIT law and regulations do not specifically provide that a donation of property should be deemed a sale of the property at its fair market value. From the donee's perspective, there are limited situations in which a donee is taxed on the donated property (*e.g.*, certain real estate donations) and, in these cases, the income is taxed under the "other income" category. Since this category is abolished under the new IIT law, it is unclear whether a donee would continue be subject to IIT in the relevant situations and/or whether an exception to the deemed sale rule would be provided for gifts among family members and donations to charities.

The deemed sale rule in the draft regulations is similar to the rule found in the enterprise income tax (EIT) law. However, unlike the EIT rules, the draft regulations are silent on whether the deemed sale rule would apply where an individual provides services in exchange for property or for purposes of donations, the repayment of debt, etc. Many individuals also will be interested in knowing whether tax deferral treatment (which is an exception to the general deemed sale rule) would be included in the IIT regime to facilitate reorganizations involving individuals.

Foreign tax credit: For income taxed under the categories of "comprehensive income" or "business operation income," the draft regulations provide that domestic and foreign-source income would be aggregated for resident individual IIT assessment purposes. However, for other categories of income, domestic and foreign-source income would be accounted for separately. Foreign-source losses arising from the operation of a business (including where the business is conducted in the form of a sole proprietorship or partnership) would not be able to be offset against domestic-source business income for IIT assessment purposes.

The foreign tax credit (FTC) generally still would be calculated on a "per country (region)" basis, with a five-year carryforward for unused FTCs. Unless otherwise specified, the FTC limitation for a specific country (region) would be calculated as the sum of the limitation for comprehensive income, income from the operation of a business, and other income derived from that country (region).

The administration of foreign-source income derived by Chinese individuals increasingly is becoming an important issue on the government's agenda. The enhanced visibility of this issue is due to the development of a globalized economy and the promotion of the "One Belt One Road" initiative, both of which have resulted in Chinese individuals deriving more foreign-source income. On the other hand, many Chinese companies have seconded employees overseas under global mobility programs. The FTC calculation under the new IIT law appears more sophisticated than that under existing law. Practically speaking, handling Chinese and foreign income tax calculations and filings is challenging because of the complicated interactions between the Chinese and foreign income tax regimes, as well as the fact that many issues remain unclear under Chinese law. Affected individuals and enterprises should consider seeking professional assistance where necessary.

Anti-avoidance: The draft regulations provide guidance on the anti-avoidance rules in the new IIT law by:

- Defining the arm's length principle and related parties;
- Defining certain key terms such as "control" and "significantly lower tax rate" in the controlled foreign enterprise (CFC) rules; notably, the draft regulations indicate that CFC treatment may be avoided if the CFC meets certain as yet unknown requirements; and
- Clarifying that an arrangement that "lacks reasonable business purpose" is one whose main purpose is to reduce, avoid, or delay the payment of tax.

The draft regulations provide the general calculation rules for interest arising from anti-avoidance adjustments, with more guidance expected to be released by the MOF and SAT.

The anti-avoidance rules in the new IIT law and the draft regulations are similar to those in the EIT law. The SAT is expected to leverage its experience in EIT to tackle IIT avoidance cases in the future. High-net-worth individuals with assets in China and cross-border business arrangements should consider undertaking an assessment of their arrangements and managing potential tax exposure. Some issues remain unanswered, such as whether there is an exception to the arm's-length principle for certain property transfers among family members, since, under existing rules, an equity transfer with a significantly low price among certain family members may be exempt from pricing adjustments for IIT purposes.

Designated withholding agent: The draft regulations stipulate that the competent tax authorities of the State Council may designate an entity to act as an IIT withholding agent where the entity possesses the relevant income information on a taxpayer, as well as the right to control the process through which a taxpayer derives the income.

This is the first time the tax authorities would be empowered to designate a withholding agent in special circumstances, and many believe that the regulation is proposed to address the challenges arising from the development of the digital and sharing economy. If the regulation is adopted, it would remain to be seen whether the SAT would designate online marketplaces or platform operators as IIT withholding agents.

Tax ID: The draft regulations would introduce a requirement that an individual provide his or her tax ID when filing a tax return.

The identification number for a Chinese citizen who has a Chinese identification number would be considered his or her tax ID. Such an individual would have to provide the tax ID and other relevant information required for tax filing to the withholding agent or the tax authorities, and would be required to report any changes to personal information to the withholding agent or the tax authorities. Individuals who do not have a Chinese identification number would be assigned one by the tax authorities when the individual files his or her tax return for the first time

Annual filing: The draft regulations provide that an annual tax return of comprehensive income must be filed in the following cases:

- A resident individual receives comprehensive income from two or more sources, and the total comprehensive income net of itemized deductions is at least RMB 60,000;
- The resident individual receives independent services income, authors' remuneration and/or royalties (all of which are taxed under the comprehensive income category), and the total comprehensive income net of itemized deductions is at least RMB 60,000; or
- The resident individual's advance IIT payments on comprehensive income are less than the IIT payable in the relevant tax year.

Where an individual's tax residence cannot be determined (because the number of days spent in China for a specific year is available only after the year-end), the individual tentatively would be treated as a nonresident, with his or her annual filing obligation determined after year-end.

A resident individual would be allowed to authorize the withholding agent or other party to file the annual return on the individual's behalf.

The tax authorities would be permitted to reject a refund request in either of the following situations:

- The information in the tax return is false and the taxpayer refuses to make a correction; or
- The tax refund was requested after the deadline for filing the tax return.

The tax authorities would not be allowed to reject a refund request by claiming they did not receive the advance tax payments if there is no evidence that the taxpayer has not complied with his or her filing obligations.

The SAT will develop and issue more guidance on the filing of the annual tax return and refund applications.

The annual filing obligation for comprehensive income derived by resident individuals is a significant change in the new IIT law. Affected taxpayers will need to understand the annual filing requirement to ensure compliance and should consider seeking professional assistance to handle complex situations (*e.g.*, where the taxpayer needs to pay additional tax or claim a refund). Foreign individuals who travel to China should keep travel records to determine whether they become Chinese tax resident for a specific year and, therefore, fall under the annual filing requirement.

Companies (particularly those with many expatriate employees in China) should consider setting up an internal process to communicate the impact of the new law on employees, assist them in handling IIT affairs, and to improve their own tax risk controls. According to the draft regulations, a taxpayer may authorize the withholding agent (*e.g.*, the employer) to file the annual tax return on behalf of the individual. This being the case, an employer may need to collect all information required for the filing (*e.g.*, information relating to additional itemized deductions), which may be complicated if the employee has sources of income other than salaries and wages from the employer.

Tax clearance upon emigration: The new IIT law requires a taxpayer to settle his or her IIT liabilities before the individual can deregister his or her Chinese household registration (hukou) for emigration purposes. The draft regulations further clarify that such taxpayers must report the following information to the tax authorities when carrying out hukou deregistration:

- Information relating to the settlement of IIT obligations for comprehensive income and income from the operation of a business for the year in which the hukou is deregistered;
- IIT information relating to other income for the year in which the hukou is deregistered; and
- Information relating to IIT payable on income for previous periods.

The tax authorities will examine the individual's tax compliance status in the current and previous years before the individual emigrates overseas. Individuals with emigration plans should regularly review their IIT compliance status to manage any potential tax risk.

Additional itemized deductions: The new IIT law introduces a new category of "additional itemized deductions" that include deductions for child education expenses, expenses for continuing education, health care costs incurred for serious illnesses, home mortgage interest, etc. The draft regulations provide the following guidance on the additional itemized deductions:

- A resident individual would be permitted to provide information relating to his or her additional itemized deductions to the IIT withholding agent (normally the employer) so that the agent could deduct these items from salaries and wages to compute the advance IIT payment to be withheld. If the resident individual derives salaries and wages from two or more sources, the individual would have to choose one source for deducting the items for each type of additional itemized deductions. For other comprehensive income, such as independent services income or an author's remuneration and royalties, additional itemized deductions could be deducted only from such income when the individual files the annual return.
- Taxpayers and withholding agents would be required to retain the relevant tax documents for future inspection for the period stipulated by the SAT (as yet unclarified).
- The tax authorities would be empowered to conduct random tax inspections on the additional itemized deductions. If incorrect information is identified before the deadline for filing the annual tax return, the tax authorities could ask the taxpayer to make corrections and notify the withholding agent. Penalties may be imposed for a subsequent violation and the violation could be recorded in the relevant social credit system.

Cooperation among government agencies: To ensure that the tax authorities are equipped with necessary data for tax collection purposes, other government agencies would be obliged to assist the tax authorities by providing relevant information for additional itemized deductions.

Deloitte's view

IIT withholding agents and taxpayers should be aware of the new rules and consider taking the following steps:

- **Employers (withholding agents):** The new IIT law does not reduce the obligations of withholding agents, and the introduction of additional itemized deductions may complicate the information-collection process for employers in computing the amount of IIT to be withheld. Employers should review their current internal workflow and risk-control processes in relation to salaries and the calculation of IIT. Technology solutions may be considered to improve efficiency.
- **Foreign individuals in China:** Although the retention of the five-year rule should be welcome, foreign individuals in China should monitor the development of the future guidance relating to the five-year rule, as well as the annual tax return filing requirement and maintain travel records that can be used to determine tax residence status.
- **High-net-worth individuals:** These individuals should take steps to understand the new anti-avoidance rules, assess the reasonableness of their current business arrangements, and consider any adjustments to manage potential tax risks and ensure compliance.

With the establishment and improvement of the social credit system in China, the costs of noncompliance for both taxpayers and withholding agents will increase significantly. Both parties should understand the impact of the new law and regulations and take steps to ensure compliance. With more guidance and clarifications expected to be issued, future developments should be monitored carefully.

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Taiwan:
Implications of CRS regulations on expatriates and financial institutions

On January 1, 2019, in response to the global trend toward an automatic exchange of information between tax jurisdictions, Taiwan's Ministry of Finance (MOF) will implement the Common Reporting Standard (CRS) mandated by the Organization for Economic Cooperation and Development.

The CRS will require financial institutions in Taiwan to gather information about their:

- Nonresident account holders; and
- Nonresident controlling persons of passive nonfinancial entity accounts.

Collectively, these two groups will be referred to herein as "expatriates."

The financial institutions will then report the information to Taiwan tax authorities who will in turn pass the information to tax authorities in reportable jurisdictions where expatriates are residents.

Accordingly, expatriates should act before the end of 2018 to ensure they are fully compliant with the obligations in their home jurisdictions for disclosing offshore income or foreign financial accounts.

Overview

On November 16, 2017, Taiwan's MOF announced the implementation of Regulations Governing the Implementation of the Common Reporting Standard and Due Diligence for Financial Institutions ("Taiwan CRS regulations").

Starting on January 1, 2019, the Taiwan CRS regulations will be applicable to Taiwan financial institutions, including:

- Depository institutions;
- Custodial institutions;
- Investment entities; and
- Specified insurance companies.

Taiwan's CRS framework

Under the CRS framework, financial institutions in Taiwan will be required to conduct due diligence to identify and document the following information about expatriates who hold accounts at their institutions:

- Name;
- Address;
- Jurisdiction of tax residence;
- Taxpayer identification number; and
- Date and place of birth.

For expatriates from reportable jurisdictions, financial institutions will be required to report the above information as well as account number, account balance or value at the end of the calendar year, and total amount credited to expatriate during the year, on an annual basis to Taiwan tax authorities.

The Taiwan tax authorities will exchange this information with tax authorities in reportable jurisdictions where expatriates are residents. To implement the information exchange, the MOF has started discussions with countries that already have signed tax agreements with Taiwan, and will announce a list of reportable jurisdictions that agree to carry out the automatic exchange of information with Taiwan. The announcement is expected by the end of 2019.

It should be noted that, currently, China, Hong Kong, Macau, and the United States are not within the scope of the Taiwan CRS regulations. However, this does not mean that financial institutions in Taiwan will not examine the accounts of expatriates who are tax residents in these jurisdictions or other nonreportable jurisdictions. In fact, the Taiwan CRS regulations follow a wider approach to due diligence in which all expatriates will have their accounts examined and their residence jurisdictions identified and documented.

Taiwan's CRS timetable

Starting on January 1, 2019, financial institutions in Taiwan will need to perform due diligence when onboarding new customers for both individual and entity accounts.

For pre-existing individual accounts, the deadlines for due diligence differ depending on the account value:

- **High-Value Accounts:** Due diligence must be completed by the end of 2019, if the value of an individual account is more than USD 1 million as of December 31, 2018.
- **Low-Value Accounts:** Due diligence must be completed by the end of 2020, if the value of an individual account is less than or equal to USD 1 million as of December 31, 2018.

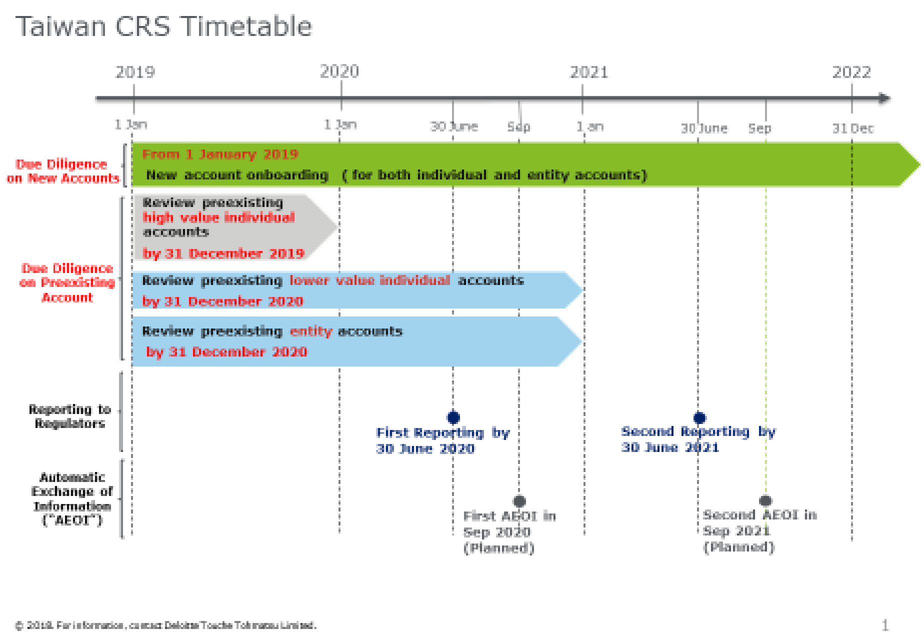
For pre-existing entity accounts, the deadlines for due diligence differ depending on the account value:

- Due diligence must be completed by the end of 2020 on pre-existing entity accounts valued at more than USD 250,000 as of December 31, 2018.
- Due diligence is not necessary on pre-existing entity accounts valued at USD 250,000 or less as of December 31, 2018.

The first annual reporting of information to Taiwan tax authorities for new accounts and pre-existing high-value individual accounts will be carried out between June 1, 2020 and June 30, 2020, and the planned due date of exchange of information with other tax jurisdictions is by September 30, 2020.

Information on accounts for which due diligence must be completed by the end of 2020 will be reported to Taiwan tax authorities between June 1, 2021 and June 30, 2021, and the planned due date of exchange of information with other tax jurisdictions is by September 30, 2021.

Similar June deadlines and September distribution dates will apply to information reported in subsequent years.



Deloitte's view

Taiwan financial institutions will begin proceeding with due diligence procedures on expatriates' accounts in 2019. Once due diligence is complete, the information may be exchanged with tax authorities in expatriates' home countries. As a result, before the end of 2018, expatriates in Taiwan should check their tax returns in their home countries to ensure there is no:

- Underreporting of their individual incomes; or
- Nondisclosure of offshore income or foreign financial accounts.

Taiwan financial institutions will need to complete their business impact analysis, implement due diligence procedures, modify client information systems, and carry out staff training by the end of 2018.

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Global Rewards Updates:
Belgium: Draft legislation to require taxable stock compensation income reporting/withholding for foreign company plan benefits and social security authorities also target foreign company plan benefits

Key points to know

- Early draft legislation has been approved by the Council of Ministers and is expected to become law which will introduce a new general requirement for Belgian subsidiaries to report the stock compensation realized by Belgian employees and directors via participation in a foreign, non-Belgian related-company plan.
- The draft legislation will also impose an income tax withholding obligation for such taxable stock compensation beginning in January, 2019.
- The new income tax reporting and withholding obligations will bring a spotlight on the historical and current social security tax provisions that apply to benefits under a non- Belgian related-company plan.
- Following increased audit activity, the Belgian National Social Security Office (NSSO) have introduced a new, broad interpretation of the relevant tests within the NSSO's "Administrative Instructions", indicating the NSSO will reject the argument that no social security contributions are due because the benefits are granted indirectly via a parent company plan, without a Belgian employer's intervention or action as contact point.

Background

Under existing law, except for certain stock option grants, when a foreign related-company (*i.e.* foreign parent company) has offered compensation plan benefits to employees and directors of a Belgian subsidiary, there generally has been no obligation for the Belgian subsidiary to report the taxable compensation if the individual's participation in the foreign compensation plan is not directly or indirectly "at the charge" of the Belgian subsidiary and the Belgian subsidiary is not an intermediary for operation of the foreign compensation plan. However, if the foreign-related company charges the cost of the employee plan benefit to the Belgian subsidiary, or the Belgian subsidiary participated in the operation of the foreign plan as an intermediary or contact point, a wage income reporting obligation would exist for the Belgian subsidiary, for both income tax and social tax purposes.

Generally, the foregoing rules resulted in Belgian employer reporting of income only for stock options granted by a foreign entity to individuals working for a Belgian company that came under the scope of the stock option law of 26 March 1999, which are stock options that are taxable at grant based on a formulaic value. Despite the general lack of Belgian subsidiary employer reporting of taxable compensation realized via foreign related-company plans, Belgian individual plan participants have always been obligated to report all remuneration received in an individual annual tax return.

New legislation

Under the draft legislation, which is expected to become law, a Belgian subsidiary employer will be required to comply with an income reporting and income tax withholding obligation when remuneration is granted under a foreign related-company plan to an individual plan participant by virtue of the professional activity performed by the plan participant for that Belgian employer.

The draft legislation provides that income tax withholding should be collected and remitted by the Belgian subsidiary employer for foreign compensation plan taxable transactions occurring in 2019 and future years.

The draft legislation also establishes an income reporting obligation, to be completed by end of February, 2019, of the Belgian subsidiary employer for foreign compensation plan taxable transactions occurring in 2018, although income tax withholding will not be required for 2018 transactions.

New NSSO position

In a related development, the Belgian social security authorities continue to refine and apply stricter positions on benefits (generally long-term incentives) granted by non-Belgian parent companies.

In its 2018 3rd quarter "Administrative Instructions", the NSSO indicated a change in their position regarding the concept of "at charge of the employer," by removing wording about "the employer's intervention and point of contact" and substituting a much broader test on whether Belgian social security contributions are due on foreign related-company compensation plan benefits.

According to the amended "Administrative Instructions", benefits will be considered as being "at charge of the employer" and subject to Belgian social security if:

- The benefit is granted by a third party (*i.e.* parent company) to employees, and when the costs are recharged to the actual employer; and/or
- Granting this benefit rewards the work performed within the framework of the employment contract concluded with the (Belgian) employer, or is linked to the function performed by the employee.

The new NSSO position amounts to a rejection of the historical argument that no social security contributions are due on benefits granted indirectly via a parent company because no employer intervention or contact point exists within the Belgian subsidiary employer.

As a result of the change of NSSO's position, a material social security contribution liability may exist for both employers and plan participants for foreign compensation plan benefits. Currently, the employee social contribution rate is 13.07% and the employer social contribution rate is approximately 28% on all social-taxable compensation.

Deloitte's view

These new developments create a new tax landscape for the operation of non-Belgian company share-based compensation plans, with consequences for both Belgian employers and employees and directors.

Non-Belgian companies that offer compensation plans to employees and directors of a Belgian subsidiary should begin now to address these developments in the various aspects of subsidiary employer payroll tax liability, reporting and income tax and social contribution withholding from plan participant compensation realized under the foreign plan, and financial accounting, and prepare for further developments in the coming months.

Global Rewards Updates:
New Zealand: Changes to the Taxation of Employee Share Schemes

Background

On March 29, 2018, new legislation was enacted in New Zealand, which introduced changes to the taxation of employee share schemes.

These changes come after a lengthy period of consultation. According to the Inland Revenue, the changes remove the potential uncertainty under the previous rules, which may have deterred employers from offering share schemes to their employees. The changes now bring to an end the ability to deliver non-taxable capital gains to employees.

In addition, on September 29, 2018 new rules came into effect regarding the apportionment of equity awards for internationally mobile employees.

Overview of the new rules

Definition of an employee share scheme: Under the new legislation, an employee share scheme is widely defined and includes arrangements with a purpose or effect of issuing or transferring shares in a company to a person who has been an employee of that company or of another company in the same group.

The rules therefore cover all arrangements which involve the provision of company shares to past, present or future employees (or their associates), if the arrangement is in connection with a person's employment or service.

Arrangements such as loans to buy shares, bonuses, put and call options and transfers to employee trusts are all covered. There are some exceptions, and the rules will not apply to:

- An "exempt employee share scheme" (discussed below).
- Arrangements where employees pay market value for the shares on the "share scheme taxing date."
- Arrangements that require employees to put at risk shares they acquired for market value with no protection to the person against a fall in share value provided none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

Timing of taxation: The new rules define the taxing point for any share benefits (the "Share scheme taxing date") to be the point in time when:

- There is no material risk that the beneficial ownership (*i.e.* entitlement) may change, or that the shares will be required to be transferred or cancelled;
- There is no benefit accruing to the employee in relation to a fall in the value of the shares; and
- There is no material risk that there will be a change in the terms of the shares affecting their value.

Calculation of taxable value: Under the new rules, the taxable benefit is defined as the difference between the market value of the shares at the date of taxation (the Share scheme taxing date), less any amount paid for the shares by the employee.

The Inland Revenue has previously issued guidance on methods that can be used to value the shares received under an employee share scheme in CS 17/01 – valuation of employee share schemes. There has been no change to this guidance.

Despite submissions seeking an allowance for 'blackout periods' where employees are restricted from disposing of shares, no allowances have been made on the basis that the Inland Revenue view that schemes can be designed so that the shares vest outside a blackout period and that blackout periods are generally short.

Deductions for employers: The new rules state that employers will no longer need to structure their employee share arrangements to obtain a corporate tax deduction for the cost of the shares.

Employers will be allowed a deduction for:

- Benefits provided under an employee share scheme that is equal to the amount calculated on the "share scheme taxing date" (*i.e.*, the amount of the benefit that is taxable to the employee).
- Costs associated with the administration and managing the scheme, subject to the usual capital/revenue tests.

No deductions will be available for shares issued under an exempt scheme.

Effective dates: Transitional rules will preserve the existing treatment for certain employee share schemes. The new employee share scheme rules do not apply to shares granted or acquired before 12 May 2016 and shares granted before 29 September 2018 (six months after enactment of the new rules) provided the shares were not granted with a purpose of avoiding the application of the new law; and the share scheme's taxing date under the new law is before 1 April 2022.

Exempt schemes: Changes have also been made to employee share schemes that are known as "widely held schemes". These changes apply from 29 March 2018 and allow employers to offer $NZ5,000 of shares to their employees per annum at a discount of up to $NZ2,000 per annum. The discount would not be taxable to the employee.

It is no longer necessary for employers to obtain Inland Revenue approval for a share scheme to be treated as an exempt scheme.

Employers will now need to notify the Inland Revenue of the existence of an exempt scheme using form IR1211 (even if previously approved as exempt) and complete Form IR1212 on an annual basis.

New apportionment rules for overseas service: Under new rules taking effect from 29 September 2018, income apportionment will apply to share scheme income for all employees. Previously this only applied to transitional residents. Any employee share scheme benefits accrued while a person is non-resident and working outside New Zealand will be excluded from taxable income. Currently, employees who are not transitional residents would need to include the entire benefit in their income tax return and claim a credit for any foreign tax paid.

Deloitte's view

It is now time for employers with established schemes to consider how their existing schemes operate under the new rules and make decisions regarding the future of these schemes. In particular, employers may wish to consider whether:

They should simplify their current share purchase scheme to become a more traditional option scheme / the new rules effectively tax all employee share schemes on the same basis as options and remove the ability to structure an arrangement to remove taxation of the gain in share value between the date of grant and vest.

- A deferred tax asset should be recognized in accordance with NZ IFRS. Under the new rules employee share benefits (including options) will be tax deductible to the employer under the new rules. Previously, employee share benefits provided to employees were generally non-deductible).
- To offer an exempt scheme to their employees given the increased benefits that are now available.

As a result of the new apportionment rule, affected employers will need to amend their systems and processes to ensure that the income apportionment rule is correctly applied to all employees, not just transitional residents. The expectation is that this should simplify processes for employers as there will no longer be a need to track whether an employee qualifies as a transitional resident or not.

Broadly to be eligible as an exempt scheme, the following conditions must be met:

- 90% or more of full-time permanent employees must be eligible to participate in the scheme.
- If the scheme requires an employee to buy a minimum amount of shares before they can participate, the minimum amount payable can be no more than $1,000 per annum.
- If the employee is required to pay for the shares, an interest free loan must be made available to the employee or there must be an ability for the employee to be able to purchase the shares by way of regular instalments.
- Any minimum period of service required before an employee can participate cannot exceed three years for full time employees.
- Generally the shares will need to be held for a period of three years.

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