



## **Global Rewards Update**

### New Zealand – Changes to the Taxation of Employee Share Schemes

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#### **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.
- 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<sup>1</sup>.

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.

<sup>1</sup> 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 installments.
- 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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