

Worked example

## Adjustment for employee shares (in ACA step 2)

**Description** This example shows how employee shares may be treated as a liability of the joining entity for the purposes of adding liabilities at step 2 of the allocable cost amount (ACA) calculation.

**Commentary** Employee shares may be disregarded in determining whether a joining entity is a wholly-owned subsidiary of the head company → section 703-35, *Income Tax Assessment Act 1997* (ITAA 1997). However, for the purposes of adding liabilities at step 2 of the ACA calculation, those shares are treated as a liability of the joining entity at an amount equal to their market value.

That amount will be reduced where the employee shares were issued after the group acquired membership interests in the joining entity. These employee shares are not treated as liabilities to the extent that the membership interests held by members of the group are reduced in value as a result of the issue of the employee shares. This rule only applies if the market value of the employee share interests at the time of their issue exceeds the consideration paid for their acquisition by the employees.

The amount of the reduction is determined by first working out a factor using the following formula:

$$\frac{\text{Market value of head company's membership interest (just before the employee share interest is acquired by the employee)}}{\text{Market value of all membership interests (just before the employee share interest is acquired by the employee)}} \times \frac{\text{Market value of employee share interests at time of acquisition} - \text{Consideration paid or given for acquisition of employee share interest}}{\text{Market value of employee share interests at time of acquisition}}$$

This factor is then applied to the market value of the employee share at the time it was issued to work out the reduction amount for that share. The reduction amount is subtracted from the market value of the share at the joining time. The result is included at ACA step 2 as a liability.

### Example

**Facts** As a wholly owned subsidiary of XCo, BCo has 9,920 ordinary shares on issue at 30 May 2000. On the following day (31 May 2000), 40 employee shares are issued, with employees contributing 50 cents per share. Just before the employee shares are issued, the other ordinary shares each have a market value of \$1.00.

On 30 June 2000, BCo has 9,960 ordinary shares on issue (including the 40 employee shares). On 1 July 2000, ACo acquires 5,976 ordinary shares (60% interest) in BCo from XCo.

On 31 May 2001, a further forty employee shares are issued, with employees contributing 60 cents per share. Just before these are issued, the ordinary shares each have a market value of \$1.20.

On 1 July 2002, ACo chooses to form a consolidated group with its other subsidiaries.

On 31 July 2002, BCo has 10,000 ordinary shares on issue, comprising 9,920 shares owned by XCo and ACo, and 80 employee shares. The same day ACo acquires from XCo the remaining shares in BCo (3,944 ordinary shares). As a consequence, BCo joins ACo's consolidated group. The market value of employee shares at the joining time is \$1.60 each.

Without the adjustment described in this example, the amount to be added at ACA step 2 for employee shares would be calculated as follows:

$$\$1.60 \times 80 \text{ employee shares} = \$128.00$$

However, this amount needs to be reduced because some employee shares are issued after the head company (ACo) acquires membership interests in the joining entity (BCo).

## Calculations **Reduction amount for employee shares issued 31 May 2000**

Table 1: Share details

	Just before 31 May 2000		After share issue 31 May 2000		Joining time 31 July 2002	
	Number of shares	Market value @ \$1.00 each	Number of shares	Market value @ \$0.9980 <sup>2</sup> each	Number of shares	Market value @ \$1.60 each
3 <sup>rd</sup> party shares	9,920	\$9,920	9,920	\$9,900.08 <sup>3</sup>	0	
Employee shares	0		40	\$39.92 <sup>4</sup>	80	\$128
ACo's shares	0				9,920	\$15,872
<b>Totals</b>	<b>9,920</b>	<b>\$9,920</b>	<b>9,960</b>	<b>\$9,940.00<sup>1</sup></b>	<b>10,000</b>	<b>\$16,000</b>

Notes:

<sup>1</sup> Total value of the assets (thus the shares) of BCo was increased as a result of the \$20 contribution by employees to acquire 40 employee shares (\$0.50 x 40).

<sup>2</sup> Total value of shares divided by number of shares outstanding (\$9,940/9,960).

<sup>3</sup> 9,920 shares x \$0.9980 (market value of each share).

<sup>4</sup> 40 shares x \$0.9980 (market value of each share).

<sup>5</sup> In practice, issuing small numbers of employee shares (less than 1% of total ordinary shares) may not affect the market value of the ordinary shares.

## Calculation of reduction amount factor for employee shares issued 31 May 2000

Market value of head company's membership interest (just before the employee share interest is acquired by the employee)		Market value of employee share interests at time of acquisition	–	Consideration paid or given for acquisition of employee share interest
0		39.92		20
9,920	X	39.92		
Market value of all membership interests (just before the employee share interest is acquired by the employee)		Market value of employee share interests at time of acquisition		

The reduction amount factor is zero. (The amount is not reduced as these employee shares are issued before ACo acquires any membership interest in BCo.) Accordingly, the amount to be included in ACA step 2 for the employee shares issued on 31 May 2000 is their market value of \$1.60 per share.

## Reduction amount for employee shares issued 31 May 2001

Table 2: Share details

	Just before 31 May 2002		After share issue 31 May 2001		Joining time 31 July 2002	
	Number of shares	Market value @ \$1.20 each	Number of shares	Market value @ \$1.1976 each	Number of shares	Market value @ \$1.60 each
3 <sup>rd</sup> party shares	3,944	\$4,733	3,944	\$4,723.33	0	
Employee shares 2001	40	\$48	40	\$47.90	40	\$64
Employee shares 2002			40	\$47.90	40	\$64
ACo's shares	5,976	\$7,171	5,976	\$7,156.87	9,920	\$15,872
<b>Totals</b>	<b>9,960</b>	<b>\$11,952</b>	<b>10,000</b>	<b>\$11,976.00</b>	<b>10,000</b>	<b>\$16,000</b>

## Calculation of reduction amount factor for shares acquired 31 May 2001

Market value of head company's membership interest (just before the employee share interest is acquired by the employee)		Market value of employee share interests at time of acquisition	—	Consideration paid or given for acquisition of employee share interest
7,171		47.90		24
11,952	X	47.90		
Market value of all membership interests (just before the employee share interest is acquired by the employee)		Market value of employee share interests at time of acquisition		

The reduction amount factor is 0.2993653 ( $\$7,171/\$11,952 \times 23.9/47.9$ ). This factor is applied to the market value of the employee shares issued on 31 May 2001 (\$1.1976) to determine the reduction amount of 36 cents per share. It follows that \$1.24 (\$1.60 less 36 cents) is included in ACA step 2 for each employee share issued on 31 May 2001.

### Calculation of amount to be added at ACA step 2 for employee shares:

Employee shares issued 31 May 2000:

$$\$1.60 \times 40 = \$64.00$$

Employee shares issued 31 May 2001:

$$\$1.24 \times 40 = \$49.60$$

Total = **\$114** (\$64.00 + \$49.60 rounded)

## References

*Income Tax Assessment Act 1997*, sections 705-35 and 705-85; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraphs 5.75 to 5.77