

IT 2609 - Income tax: employee share acquisition schemes

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 This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

TAXATION RULING NO. IT 2609

INCOME TAX: EMPLOYEE SHARE ACQUISITION SCHEMES

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I 1012320	EMPLOYEE SHARE ACQUISITION SCHEMES	26AAC Part IIIA, 160ZYI

OTHER RULINGS ON THIS TOPIC: IT 2522

PREAMBLE

Employee share acquisition schemes (ESAS) tend to fall within three general categories:

- . share schemes - where the employer company issues shares direct to an employee, usually subject to certain restrictions on the employee's right to deal with the shares;
- . option schemes - where the employer company grants an employee a right to acquire shares. The right must usually be exercised by a certain date and may also be subject to other restrictions; and
- . trustee schemes - where the employer company issues shares to a trustee who holds them for the benefit of an employee, again usually subject to certain restrictions on the transfer to the employee.

2. Section 26AAC of the Income Tax Assessment Act 1936 (the Act) includes in the assessable income of a taxpayer a benefit received under an employee share acquisition scheme. The section applies to rights acquired after 17 September 1974 and to shares acquired after that date unless acquired as a result of the exercise of rights acquired on or before that date. This Ruling considers several questions that have arisen in respect of share acquisition schemes other than those administered by trustees. Issues such as capital gains tax questions relating to trustee administered ESAS are not dealt with in this Ruling.

RULING

3. The key provision in section 26AAC is subsection 26AAC(5). Broadly stated, the subsection operates to include in the assessable income of a taxpayer a benefit received under an employee share acquisition scheme. The benefit is measured by reference to the amount by which the value of the shares acquired exceeds the consideration paid or payable by the taxpayer for

them. In particular, subsection 26AAC(5) requires the determination of the value of the shares when they are acquired.

Date of acquisition

(a) Where there are no restrictions on disposal

4. In the past, opinions have been expressed to the effect that shares in a company are acquired for the purposes of section 26AAC by an employee on the date the employee's name is entered in the share register. This is not necessarily correct. Although it might be the date a person becomes a registered shareholder of the company, the date of acquisition may actually occur prior to such a date.

5. The sequence of events generally found in an employee share acquisition scheme where there are no restrictions on the sale of shares by employees is as follows:

- . through a prospectus the company offers its shares to its employees;
- . an employee may make an application to the company for those shares;
- . on receipt, the company considers the application; and
- . if the application is accepted by the company the shares are allotted and issued to the employee.

6. It is arguable that the date of acquisition is the date on which an employee's legal right to the share arises (see *Tyrer v. Smart* (Inspector of Taxes) [1976] 3 All ER 537, affirmed in [1978] 1 All ER 1089 and affirmed on this point by the House of Lords in [1979] 1 All ER 321). However, as a share does not exist as a separate piece of property prior to allotment (per Gibbs J in *Ord Forrest Pty Ltd v. F. FCT* (1974) 130 CLR 124 at p. 148) it is considered that the better view is that, although the legal right to a share may be created prior to allotment of the share, the date of acquisition for section 26AAC purposes will be the date on which the shares are allotted to the employee.

(b) Where there are restrictions on disposal

7. If conditions or restrictions are attached either to the shares or to their issue so that the right of the employee to dispose of those shares is restricted, or the employee is liable to be divested of the ownership of those shares, subsection 26AAC(15) deems the shares not to have been acquired by the employee for the purposes of section 26AAC until the restriction or liability ceases.

8. For subsection 26AAC(15) to apply it is necessary for the shares to have been acquired under an employee share acquisition scheme, and the restriction or liability to apply solely to shares issued under that scheme. In addition, the restriction

must relate to the employee's right to sell or to the possible divesting of the shares. If the employee does not have an unfettered right to sell the shares or if the employee's ownership may be divested (for instance, where a minimum period of service with the company is not met) there is no acquisition by the employee until the restriction is removed.

9. A common area of enquiry concerns shares in respect of which the subscription price is paid by instalments. According to the terms of the employee share acquisition scheme the employee may be prevented from disposing of the share until the subscription price is fully paid. In such a case, the date of acquisition is the time when the shares are fully paid. If one of the terms of the scheme is that shares can not be fully paid prior to a specified date and, in addition, the shares can not be disposed of until that time, the restriction is one in which subsection 26AAC(15) would apply.

10. Restrictions on the rights to vote, to dividends, to bonus issues, or to have shares listed are often encountered under employee share acquisition schemes. These do not represent either restrictions on the sale of those shares nor potential divesting powers for the purposes of subsection 26AAC(15); neither does a right of pre-emption granted to the company or trustee in respect of a disposal of shares by the employee, nor a lien taken over the share certificates until a loan is repaid.

Section 26AAC and Part IIIA

11. As a consequence of the introduction of capital gains and capital losses provisions, section 26AAC was amended in 1986. These amendments give employee taxpayers a right of election in respect of shares in an employer company issued after 19 September 1985 (subsections 26AAC(15A) to (15C)). The effect of the election is to include the value of the benefit in the taxpayer's assessable income in the year of acquisition as if no conditions and restrictions applied even though there are conditions or restrictions attached to the right to dispose of the shares. The gains that accrue from the date of acquisition to the date of disposal of the shares are taxable under the provisions in Part IIIA of the Act. If an employee elects for these subsections to apply, he or she must do so in writing on or before the date of lodgment of the return for the year in which the share was issued, unless otherwise extended by the Commissioner. Each case in which an extension is sought will be decided on its merits. As a general rule, an extension of time to lodge an election may be granted where, for instance, the original non-lodgment of a notice of election was due to a genuine mistake of fact.

12. Irrespective of how the employee elects to be treated under section 26AAC, section 160ZYL ensures that the cost base of the shares acquired includes any amount included in the taxpayer employee's assessable income under section 26AAC. If an amount is assessed under section 26AAC the cost base of the shares will be the subscription price plus the assessable amount. If no amount is assessable under section 26AAC, the cost base of the

shares will be the subscription price.

Value of shares

13. The value of the share for subsection 26AAC(5) purposes is the price of a similar share to that issued to an employee under the employee share acquisition scheme obtainable on the open market on the date of acquisition. From this value is deducted the consideration paid or payable by the employee, resulting in an amount to be included in the employee's assessable income.

14. The open market price should reflect the amount a willing but not anxious arm's length buyer would pay for a similar number of shares issued to the employee. It is recognised, especially in listed companies with a large number of employees acquiring shares over a period of time, that it could be administratively difficult to calculate, for each date of acquisition, the stock exchange price on that date and hence the amount to be included as income by each employee. In recognition of the problem, this Office will accept an arrangement whereby the value of the shares at the time they were acquired by the employees may be calculated as the weighted average market sell price of the shares on the local stock exchange during the five business days immediately before or after the date of offer. A company which chooses to adopt this approach should provide details of the relevant calculation and the names and addresses of the participating employees to the Branch Office in which the company lodges its return.

15. It should also be noted that reference should be made to subsection 26AAC(17) in determining what is paid or payable in respect of the acquisition of a share or right to acquire a share. By virtue of subsection 26AAC(18) any conditions or restrictions that apply only to shares acquired under an employee share acquisition scheme are to be disregarded in determining, for the purposes of section 26AAC, the value of a share. That is, the value of a share or right is not to be discounted because of conditions or restrictions attached to it or its issue.

16. There is no provision in the Act to adjust the amount to be included in an employee's assessable income calculated in accordance with subsection 26AAC(5) if the share price should fall subsequent to the acquisition date. However, if the employee subsequently disposes of the shares at a lower market value a capital loss will be available.

Rights

17. Section 26AAC has also been amended to give employee taxpayers a right of election in respect of rights to shares in an employer company (subsections 26AAC(8A) to (8D)). The effect of the election, available in respect of rights issued after 19 September 1985, is to include the value of the benefit in the employee's assessable income in the year of issue instead of the year in which the right is sold or exercised. If an employee elects for these subsections to apply, he or she must do so in writing on or before the date of lodgment of the return for the

year in which the right was issued, unless otherwise extended by the Commissioner (see paragraph 11 for guidelines). The value of the benefit of a right calculated on an employee's election is measured as the excess of the value of the right at the time of issue over the amount paid or payable as consideration for that right. The value of the right to acquire the shares itself is to be calculated by reference to the market value of the share. To this end, the market value of the share may be calculated in the same way as is set out in paragraph 14.

Bonus shares

18. Because section 26AAC relates to shares acquired under a scheme for the acquisition of shares by employees a question arises as to whether subsection 26AAC(5) requires the value of bonus shares subsequently received to be included in an employee's assessable income. Provided a bonus share issue is one made to all ordinary shareholders, the issue of bonus shares to employees who acquired ordinary shares under a share acquisition scheme would not be within the ambit of the section. It is considered that the employee receives the bonus shares in the capacity of an ordinary shareholder and not as an employee.

Unit trust

19. The issue of units in a unit trust set up by an employer company to its employees will not constitute an issue of shares or a right to shares within the meaning of subsection 26AAC(3) unless the rights attaching to the units include a right to receive shares from the trust. If the trustee of the unit trust has a discretion to distribute shares to the employee unit-holders subsection 26AAC(3) will apply to any transfer of shares in exercise of the discretion.

1988 Economic Statement amendments

20. Taxation Laws Amendment Act (No.5) 1988 amended section 26AAC so that discounts which satisfy the conditions set out below will not be assessed to the employee in the year in which the shares or rights are acquired but may be dealt with under the capital gains tax provisions on disposal of the shares.

21. The main requirements for the exclusion to apply are that:

- . the shares are acquired or the rights are issued after 30 June 1988 (where shares are acquired as the result of the exercise of rights, the right must be acquired after 30 June 1988);
- . the shares or rights are acquired under an ESAS that is open on a non-discriminatory basis to all full-time and permanent part-time employees with at least 12 months' service;
- . any financial assistance provided in respect of the acquisition of shares or rights under an ESAS is available on a non-discriminatory basis;

- . the terms of issue require the shares or rights to be held for a minimum of three years, unless an employee ceases employment within the three years;
- . shares have the same voting rights as ordinary shares of the company; and
- . the employer has not claimed a deduction in respect of expenditure incurred by the employer in relation to the acquisition of shares or rights under the ESAS.

22. Where these conditions have been satisfied, the employee will be entitled to reduce part or all of the assessable discount up to a maximum of \$200 per year. However, the amount of the discount to be reduced is limited to a maximum discount rate of 10 per cent and a maximum aggregate share value of \$2,000 per year. The total reduction is then determined by multiplying the discount rate by the aggregate share value. Where not all of the discount is reduced because these limits are exceeded, the reduction will continue to apply, but the excess will be assessed under section 26AAC.

23. An employee may elect that the exclusion provisions not apply and for the discount to be assessed in full under section 26AAC. The effect of the election will be that the discount will not be assessed in the year in which the shares or rights are acquired, but will be assessed in the year when any restrictions on disposal of the shares cease.

Termination of employment

24. Where an employee acquires a parcel of shares as a consequence of termination of employment and in such circumstances that the other prerequisites for the operation of Subdivision AA of Division 2 of Part III of the Act are satisfied, the shares would constitute an eligible termination payment as defined in that Subdivision. The income tax liability in respect of the acquisition of those shares would therefore fall to be determined under Subdivision AA and not section 26AAC.

Administration

25. It is not uncommon for an employer company that issues shares under an employee share acquisition scheme to have employees in States other than the State in which it lodges its own return of income. To ensure a standard approach to the shares issued under such a scheme, the Deputy Commissioner with whom the company lodges its return should provide full details of decisions to Deputy Commissioners in other States. These details should enable the identification of participating employees, the calculation of that employee's assessable benefit and include, where appropriate, recommendations regarding factors relevant to the amount of any additional tax that might be imposed.

ADDENDUM

Taxation Ruling IT 2609 discusses the application of section 26AAC of Income Tax Assessment Act 1936 to employee share acquisition schemes. Paragraphs 7 to 10 of the Ruling concern the operation of subsection 26AAC(15).

2. In cases where partly paid shares cannot be disposed of by the employee until the subscription price is fully paid, paragraph 9 of the Ruling indicates that the date of acquisition of the shares will be deemed by subsection 26AAC(15) to be the time when the shares are fully paid. In these cases it is considered that such terms and conditions attaching to, or to the issue of, the shares restrict the right of the taxpayer to dispose of the shares in a manner within the scope of subsection 26AAC(15).

3. This view of the operation of the subsection is a departure from the approach formerly adopted by the Commissioner of taxation as stated in paragraph 3 of IT 2522. It has been brought to the attention of this Office that paragraph 9 of IT 2609 does not adequately highlight the change in our interpretation of subsection 26AAC(15) in this regard. Accordingly, to the extent that IT 2522 is inconsistent with paragraph 9 of IT 2609, IT 2522 is withdrawn with effect from 23 August 1990.

COMMISSIONER OF TAXATION
04 October 1990