

TD 2017/26 - Income tax: employee share schemes - when a dividend equivalent payment is assessable to an employee as remuneration

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Taxation Determination

Income tax: employee share schemes – when a dividend equivalent payment is assessable to an employee as remuneration

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If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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What this Ruling is about

1. This Determination sets out when a dividend equivalent payment is assessable as remuneration, and therefore ordinary income, under section 6-5 of the *Income Tax Assessment Act 1997*¹ (ITAA 1997) to an employee² (you) as an Australian resident participant of an employee share scheme (ESS) and beneficiary of a trust.³
2. A 'dividend equivalent payment' is a cash payment paid by a trustee of a trust to you. That cash payment is funded from dividends (or income from other sources) on which the trustee has been assessed⁴ in previous income years because no beneficiary of the trust was presently entitled to the income. The amount of the dividend equivalent payment is ordinarily calculated by reference to the amount of the dividends (or other income) received by the trustee during a specified period, less the amount of tax paid by the trustee on that income.

¹ All legislative references in this Determination are to this Act, unless otherwise specified.

² For the purposes of this Determination, an 'employee' has its common law meaning and includes those in relationships similar to employment as extended by section 83A-325. It includes a director of an incorporated company and may include a past employee who is still a participant of the ESS.

³ In this Determination, the term 'trust' is a reference to a resident trust estate that is set up by an employer under an ESS to provide employees with an ESS interest (as defined in section 83A-10). This Determination does not deal with whether such a trust is an employee share trust under subsection 130-85(4), refer to Taxation Determination TD 2019/13 *Income tax: what is an 'employee share trust'?*.

⁴ Under section 99A of the *Income Tax Assessment Act 1936* (ITAA 1936).

Ruling

3. A dividend equivalent payment is assessable to you as remuneration (and therefore ordinary income) under section 6-5 when you receive such a payment for, or in respect of, services you provide as an employee, or similarly, where the payment has a sufficient connection with your employment.

Examples***Example 1 – dividend equivalent payment for, or in respect of, services provided***

4. A Co is an Australian resident company that carries on a business.

5. A Co establishes a trust for the purpose of providing shares (ESS interests) under an ESS to eligible Australian resident employees.

6. A Co makes a contribution to the trustee of the trust so the trustee can purchase and hold shares in A Co under the terms of the trust deed, plan handbook and invitation to the employees (together ESS agreement).

7. Under the terms of the ESS agreement an eligible employee is a beneficiary of the trust and has an interest in the trust that is a right to acquire the shares being held by the trustee. This interest does not entitle the employee to any income generated by the shares over the course of the ESS until such time as the employee satisfies certain conditions set by A Co that are specific to the employee's performance and their continuous employment with A Co being three years (performance conditions).⁵

8. Upon satisfying the performance conditions the employee is entitled to own the shares held by the trustee of the trust. In addition, the employee is entitled to receive from the trustee an amount reflecting the dividends (post-tax) the employee would have earned had the employee owned the shares from the day the employee received their interest in the trust. The trustee funds this payment from trust capital. According to the ESS agreement, this payment can be made by the trustee or the employer.

9. As the dividend equivalent payment will be made to the employee because the employee has satisfied certain performance conditions, these payments are made to the employee for, or in respect of, services provided by the employee (they are, in substance, a reward for performance). They are assessable to the employee under section 6-5. While the quantum of the payment reflects a dividend equivalent that may have been received had the employee acquired the shares at the outset of the arrangement, this is merely a calculation mechanism and does not reflect the character of the payment in the recipient's hands. The character of the payment in the employee's hands is remuneration.

⁵ The trustee is assessed on this income under section 99A of the ITAA 1936.

Example 2 – dividend equivalent payment not for, or in respect of, services provided

10. Assume the same facts as Example 1. However, separate to the terms and conditions in the ESS agreement, the trust deed also confers an absolute power on the trustee to make a dividend equivalent payment to a beneficiary at the trustee's discretion. The trustee takes no recommendation from A Co and has no regard to the continuing service of an employee, or the satisfaction of any performance conditions, before it makes such a payment. However, the trustee is only able to make such a payment once certain vesting conditions are satisfied. A beneficiary can receive the payment even if they are no longer an employee. The payment can only be made by the trustee.

11. If the trustee makes a dividend equivalent payment in exercising its discretionary power under the trust deed^{5A}, the payment will not be assessable to an employee as remuneration under section 6-5. This is because the payment is received in their capacity as a beneficiary of the trust. The payment would have only a distant causal connection to an employee's employment and, therefore, would not be remuneration.

Date of effect

12. This Determination applies to dividend equivalent payments where they are paid under the terms and conditions attached to ESS interests⁶ granted on or after 1 January 2018. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

13. If you are granted an ESS interest (including a right that later becomes a right to acquire a beneficial interest in a share for the purposes of section 83A-340⁷) prior to 1 January 2018, and the terms and conditions attached to your ESS interest include eligibility to receive a dividend equivalent payment, the Commissioner's general administrative practice will be to treat any such dividend equivalent payments paid to you as not assessable to you as ordinary or statutory income. This is conditional on the dividends or other income (that the dividend equivalent payment is calculated on) being assessed to the trustee under section 99A of the ITAA 1936 in the income year the dividends (or other income) were received.

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^{5A} Note that if a trustee exercises its power in this way, it will not meet the requirements for an employee share trust under subsection 130-85(4), refer to TD 2019/13.

⁶ 'ESS interest' is defined by section 83A-10.

⁷ For more information on what is an indeterminate right refer to Taxation Determination TD 2016/17 *Income tax: in what circumstances does a contractual right, which is subject to the satisfaction of a condition, become a right to acquire a beneficial interest in a share for the purposes of subsection 83A-340(1) of the Income Tax Assessment Act 1997?*

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

When will a dividend equivalent payment paid to you have the character of remuneration?

14. A dividend equivalent payment made to you by a trustee out of an amount assessed to the trustee in an earlier income year is not an amount subject to tax under the trust assessing provisions.

15. Trust distributions which are not dealt with by the trust assessing provisions can be assessed as ordinary income to you if they bear that character in your hands. Division 6 of Part III of the ITAA 1936 is not an exclusive code in assessing distributions from a trust.⁸

16. Benefits (in the form of money or money's worth) that you receive for, or in respect of, services you provide as an employee, or, similarly, payments which have a sufficient connection with your employment, will be characterised as remuneration and therefore ordinary income.⁹

17. The character of the benefit must be determined in the hands of the recipient.¹⁰ It is irrelevant whether:

- it is paid in advance of the services to be performed or after¹¹
- the remuneration is paid by the employer or another entity¹²
- it is paid from the income or the capital of a trust,¹³ or
- it is paid from an amount previously assessed to a trustee under the trust assessing provisions in an earlier year.¹⁴

⁸ *Federal Commissioner of Taxation v. Belford* (1952) 88 CLR 589; [1952] HCA 73; (1952) 10 ATD 105; (1952) 5 AITR 392 and *Union Fidelity Trustee Co. v. Federal Commissioner of Taxation* (1969) 119 CLR 177; [1969] HCA 36; 69 ATC 4084; (1969) 1 ATR 200.

⁹ The discussion of ordinary income principles has been confined to a discussion in relation to income from the provision of services (including remuneration). Benefits from a trust may nevertheless be ordinary income, other than as consideration for the provision of employment services. Those other ordinary income principles are not addressed in this Determination.

¹⁰ See for example, *Case C5771* ATC 250; *Jackson's Trustees v. Commissioners of Inland Revenue* (1942) 25 TC 13; *Inchyra (Baron) v. Jennings (Inspector of Taxes)* [1966] 1 Ch 37; [1965] 2 All ER 714; *Case Q85* 83 ATC 430; *Case Nos 260-262/1982* 27 CTBR(NS) 80.

¹¹ *Sent v. Commissioner of Taxation* [2012] FCA 382 at [41]-[44]; 2012 ATC 20-318 at 13,563-13,564; (2012) 85 ATR 1 at 15-16 and *Blank v. Federal Commissioner of Taxation* (2016) 258 CLR 439 at 458; [2016] HCA 42 at [56]; (2016) 104 ATR 41 at 51-52; 2016 ATC 20-587 at 18,992.

¹² *Federal Commissioner v. Dixon* (1952) 86 CLR 540 at 556; [1952] HCA 65 at [5]; (1952) 10 ATD 82 at 85; (1952) 5 AITR 443.

¹³ *Murdoch v. Commissioner of Pay-roll Tax (Vic)* (1980) 143 CLR 629 at 645; [1980] HCA 33 at [10]; 80 ATC 4424 at 4432; (1980) 11 ATR 135 at 144.

¹⁴ While subsection 99B(1) of the ITAA 1936 provides that certain property of a trust estate paid to, or applied for the benefit of, a resident beneficiary, is assessable to the beneficiary, it does not apply unless the trust is or was a non-resident trust estate. Accordingly, neither it, nor the exception to it in subparagraph 99B(2)(c)(ii) of the ITAA 1936 (concerning amounts previously assessed to the trustee), generally applies to the trust described in this Determination. See also Hill J's comments in *Traknew Holdings Pty Ltd v. FC of T* 91 ATC 4272 at 4284; (1991) 21 ATR 1478 at 1492.

When is a dividend equivalent payment for, or in respect of, services you provide as an employee, or when does the payment have a sufficient connection with your employment?

18. It is not necessarily the case that a dividend equivalent payment will have the necessary connection with your employment just because you are an employee at the time you receive it. For instance, if you receive the payment other than in your capacity as an employee, the payment is unlikely to be for, or in respect of, services provided as an employee, as the consideration for the dividend equivalent payment is not your services.¹⁵

19. Factors that indicate a dividend equivalent payment is for, or in respect of, your services as an employee include the following:

- it is agreed that the dividend equivalent payment is consideration for services rendered by you
- the dividend equivalent payment arises from a contract, arrangement or plan established by your employer to enable or facilitate the delivery of employment benefits (such as ESS interests) to you
- the dividend equivalent payment can be provided by your employer
- the dividend equivalent payment is conditional on you meeting individual or specific employment-related targets
- the dividend equivalent payment depends upon your continued employment with your employer and is forfeited on cessation of employment, or
- the dividend equivalent payment is provided at the discretion of your employer or the trustee (based on your employer's direction or recommendations).

20. Factors that indicate a dividend equivalent payment is not for, or in respect of, services you provide as an employee include the following:

- the dividend equivalent payment is consideration for an arm's length surrender, exercise or disposal of an asset (property or rights)¹⁶ and that asset was acquired in return for valuable and arm's length consideration (or as remuneration and those rights were appropriately dealt with as such)
- the dividend equivalent payment arises because you are a beneficiary of the trust and the trustee has exercised its power under the deed to provide those benefits to you independent of an arrangement or understanding with, or direction by, your employer
- the dividend equivalent payment does not arise from a contractual agreement to which you and your employer are party
- the dividend equivalent payment does not depend on your continuing employment
- the dividend equivalent payment does not have regard to, and is not conditional upon you satisfying, your employment-related targets, or

¹⁵ *Deputy Federal Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq)* (2002) 117 FCR 336 at 342-343; [2002] FCA 205 at [25]-[26]; 2002 ATC 4193 at 4198; (2002) 49 ATR 196 at 202.

¹⁶ *Federal Commissioner of Taxation v. McArdle* 89 ATC 4051 at 4058-4059; (1988) 19 ATR 1901 at 1909.

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- the timing and amount of the dividend equivalent payment is identical in respect of all recipients who hold the same property or rights, regardless of their employment relationship with your employer.

Appendix 2 – Compliance approach

① *This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this appendix in good faith and consistently with the ruling section, the Commissioner will administer the law in accordance with this approach.*

21. The Commissioner will accept that a dividend equivalent payment is not for, or in respect of, services provided as an employee, and therefore is not assessable to you as remuneration under section 6-5, if all of the following are satisfied in relation to the payment:

- the trustee of the trust is not an associate¹⁷ of your employer
- the dividend equivalent payment is paid to you because you are a beneficiary of the trust
- the trustee exercises its power under the deed to pay you the dividend equivalent payment, independent of any direction or wishes of your employer
- the dividend equivalent payment is not paid in relation to any of the following:
 - your continued employment with your employer
 - you meeting individual employment-related targets such as performance conditions
 - your termination of employment, redundancy or retirement
- the dividend equivalent payment does not arise from a contractual agreement to which you and your employer are party
- the dividend equivalent payment cannot be made by your employer, in lieu of the trustee making the payment, and
- the trustee was assessed on the dividends (or other trust income) that the dividend equivalent payment is calculated on¹⁸ in the income year the dividends or other income were received.

¹⁷ Within the meaning of section 318 of the ITAA 1936.

¹⁸ Under section 99A of the ITAA 1936.

References

Previous draft:

TD 2017/D2; PCG 2017/D9

Related Rulings/Determinations:

TR 2006/10; TD 2016/17; TD 2019/13

Legislative references:

- ITAA 1936
- ITAA 1936 Div 6 Pt III
- ITAA 1936 99A
- ITAA 1936 99B(1)
- ITAA 1936 99B(2)(c)(ii)
- ITAA 1936 318
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 83A-10
- ITAA 1997 83A-325
- ITAA 1997 83A-340
- ITAA 1997 83A-340(1)

Cases relied on:

- Blank v. Federal Commissioner of Taxation (2016) 258 CLR 439; [2016] HCA 42; (2016) 104 ATR 41; 2016 ATC 20-587
- Case C57 71 ATC 250
- Cases Nos 260-262/1982 (1983) 27 CTBR (NS) 80

- Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (in liq) (2002) 117 FCR 336; [2002] FCA 205; 2002 ATC 4193; (2002) 49 ATR 196
- Federal Commissioner of Taxation v. Belford (1952) 88 CLR 589; [1952] HCA 73; (1952) 10 ATD 105; (1952) 5 AITR 392
- Federal Commissioner of Taxation v. Dixon (1952) 86 CLR 540; [1952] HCA 65; (1952) 10 ATD 82; (1952) 5 AITR 443
- Federal Commissioner of Taxation v. McArdle 89 ATC 4051; (1988) 19 ATR 1901
- Inchyra (Baron) v. Jennings (Inspector of Taxes) [1966] 1 Ch 37; [1965] 2 All ER 714
- Jackson's Trustees v. Commissioners of Inland Revenue (1942) 25 TC 13
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