



TD 2022/D2 - Income tax: deductibility of expenses incurred in establishing and administering an 'employee share scheme'

 This cover sheet is provided for information only. It does not form part of *TD 2022/D2 - Income tax: deductibility of expenses incurred in establishing and administering an 'employee share scheme'*

This document has been finalised.

 There is a Compendium for this document: **TD 2023/4EC** .



Status: **draft only – for comment**

Draft Taxation Determination

Income tax: deductibility of expenses incurred in establishing and administering an ‘employee share scheme’

📌 Relying on this draft Determination

This publication is a draft for public comment. It represents the Commissioner’s preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Determination turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

Table of Contents	Paragraph
What this draft Determination is about	1
Ruling	3
Establishment expenses	3
Amendment expenses	6
Ongoing expenses	9
Date of effect	11
Appendix 1 – Explanation	12
Appendix 2 – Your comments	31

What this draft Determination is about

1. An employer company may incur expenses in establishing and administering an ‘employee share scheme’¹ (ESS) as part of its remuneration strategy. This expenditure often includes establishing and administering an ‘employee share trust’² (EST) that holds shares or rights for employees participating in the ESS.
2. This draft Determination³ sets out the Commissioner’s views on the deductibility of these expenses.

¹ Has the meaning given by subsection 83A-10(2) of the *Income Tax Assessment Act 1997*. All legislative references in this Determination are to this Act, unless otherwise indicated.

² As defined in subsection 130-85(4). See also Taxation Determination TD 2019/13 *Income tax: what is an ‘employee share trust’?*

³ All further references to ‘this Determination’ refer to the Determination as it will be read when finalised. Note that the Determination will not take effect until finalised.

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Ruling

Establishment expenses

3. Establishment expenses are not deductible to the employer company under section 8-1 because they are capital in nature.
4. Establishment expenses are deductible to the employer company in equal proportions over five years under section 40-880 to the extent that the business is carried on for a taxable purpose.
5. Establishment expenses are outgoings associated with the creation of an ESS and include:
 - legal fees incurred in establishing the EST and ESS plan rules
 - start-up costs; for example, trustee company commencement charges, and
 - registration fees with various authorities; for example, stamp duty and Australian Securities & Investments Commission fees.

Amendment expenses

6. Expenses incurred amending an ESS are not deductible to the employer company under section 8-1 because they are capital in nature.
7. Expenses incurred amending an ESS are deductible to the employer company in equal proportions over five years under section 40-880 to the extent that the business is carried on for a taxable purpose.
8. Examples of expenses that would be incurred amending an ESS include:
 - legal fees paid amending the EST and ESS plan rules, and
 - regulatory fees and stamp duty paid to authorities.

Ongoing expenses

9. Ongoing expenses associated with the administration of an ESS are deductible under section 8-1.
10. Examples of ongoing expenses include brokerage fees, audit fees, bank charges, making new offers to employees under an existing ESS and other ongoing administrative expenses.

Date of effect

11. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Commissioner of Taxation

23 February 2022

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Appendix 1 – Explanation

❶ ***This Explanation is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.***

Not deductible under subsection 8-1(2) as capital in nature

12. An expense is capital in nature if it relates to the business entity, structure or organisation established for the earning of profit as opposed to the process by which the organisation operates to obtain its income.⁴

13. In *Sun Newspapers*⁵, Dixon J outlined three matters to be considered for determining whether an expense is capital or revenue in nature (emphasis added):

There are, I think, three matters to be considered, (a) **the character of the advantage sought**, and in this its lasting qualities may play a part, (b) **the manner in which it is to be used, relied upon or enjoyed**, and in this and under the former head recurrence may play its part, and (c) **the means adopted to obtain it**; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.

14. In *GP International Pipecoaters Pty Ltd v Commissioner of Taxation (Cth)*⁶, the High Court stated:

The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure, for the character of the advantage sought by the making of the expenditure is the chief, if not the critical, factor in determining the character of what is paid ...

15. An ESS sets up a strategy to remunerate employees to reward, motivate and retain staff while linking some of their personal remuneration to shareholder wealth creation.⁷

16. The ESS adds to the business structure of the employer company and is established to deliver benefits to its employees.

17. The establishment expenses are one-off in nature and used in setting up the ESS as part of the employer company’s remuneration structure. The character of the advantage sought is the enduring benefit of having the ESS in its business structure to deliver ESS interests.

18. In working out whether an expense is capital in nature, there is also a need to identify a counterfactual. The High Court in *Commissioner of Taxation v Sharpcan Pty Ltd*⁸ opined that (emphasis added):

... specifically, whether the outgoing is calculated to effect the acquisition of an enduring advantage to the business. And the identification of what (if anything) is to be acquired by an outgoing ultimately requires a counterfactual, not an historical, analysis: specifically, **a comparison of the expected structure of the business after the outgoing with the expected structure but for the outgoing**, not with the structure *before* the outgoing.

⁴ *Sun Newspapers Limited v Federal Commissioner of Taxation* [1938] HCA 73 (*Sun Newspapers*).

⁵ *Sun Newspapers*.

⁶ [1990] HCA 25.

⁷ Paragraph 1.26 of the Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 states:

Tax support is provided on the grounds that aligning the interests of employees and employers encourages positive working relationships, boosts productivity through greater employee involvement in the business, reduces staff turnover and encourages good corporate governance.

⁸ [2019] HCA 36 at [33].

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19. In comparing the business structure after the payment of establishment expenses with the expected structure but for the expense, an employee company would not have been able to offer its employees an ESS interest.

20. Therefore, the expense is capital or of a capital nature as it has an enduring benefit to the employer company. The purpose of setting up the ESS (being a one-off)⁹ was for it to be part of the employer company's business structure. Therefore, these expenses are capital or of a capital nature.

21. Further, any expense to amend the ESS is similarly of a capital nature.

22. Therefore, subsection 8-1(2) is not satisfied.

Deductible under section 40-880

23. Broadly, section 40-880 allows deductions for certain business capital expenditure that fall outside the scope of the deduction provisions of the income tax law. It requires the expenditure to be capital and in relation to the business.¹⁰

24. As this expenditure relates to remuneration of employees of the employer company who work within that business, the expenditure must be incurred in relation to that business.

25. Section 40-880 contains limitations and exceptions in subsections 40-880(3) to (9) which may prevent a deduction being allowed.

26. Subsection 40-880(3) indicates that the expenditure is only deductible to the extent that the business carried on is for a taxable purpose.

27. The other limitations and exceptions in subsections 40-880(4) to (9) do not prevent establishment expenses from being deductible under section 40-880.

28. Therefore, establishment expenses are deductible in equal proportions over five years under section 40-880 to the employer company to the extent that the business carried on is for a taxable purpose.¹¹

Ongoing expenses

29. Ongoing expenses to administer and operate an ESS are regular and recurrent. They do not add to the business structure of the employer company nor are they one-off in nature.

30. Therefore, ongoing expenses are deductible under section 8-1.

⁹ *AusNet Transmission Group Pty Ltd v Commissioner of Taxation* [2015] HCA 25 at [17]; *Commissioner of Taxation v Healius Ltd* [2020] FCAFC 173 at [57].

¹⁰ See Taxation Ruling TR 2011/6 *Income tax: business related capital expenditure – section 40-880 of the Income Tax Assessment Act 1997 core issues*.

¹¹ Pursuant to subsection 995-1, 'taxable purpose' is defined in section 40-25.

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Appendix 2 – Your comments

31. You are invited to comment on this draft Determination, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

32. A compendium of comments is prepared when finalising this Determination and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 25 March 2022

Contact officer details have been removed following publication of the final determination.

Status: **draft only – for comment**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2011/6; TD 2019/13

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 8-1(2)
- ITAA 1997 40-880
- ITAA 1997 40-880(3)
- ITAA 1997 40-880(4)
- ITAA 1997 40-880(5)
- ITAA 1997 40-880(6)
- ITAA 1997 40-880(7)
- ITAA 1997 40-880(8)
- ITAA 1997 40-880(9)
- ITAA 1997 Div 83A
- ITAA 1997 83A-10(1)
- ITAA 1997 83A-10(2)
- ITAA 1997 130-85(4)

Cases relied on:

- AusNet Transmission Group Pty Ltd v Commissioner of Taxation [2015] HCA 25; 255 CLR 439; 2015 ATC 20-521; 99 ATR 816
- Commissioner of Taxation v Healius Ltd [2020] FCAFC 173; 2020 ATC 20-766; 384 ALR 408; 112 ATR 306
- Commissioner of Taxation v Sharpcan Pty Ltd [2019] HCA 36; 2019 ATC 20-715
- GP International Pipecoaters Pty Ltd v Commissioner of Taxation (Cth) [1990] HCA 25; 170 CLR 124; 90 ATC 4413; 21 ATR 1
- Sun Newspapers Limited v Federal Commissioner of Taxation [1938] HCA 73; 61 CLR 337; 5 ATD 87

Other references:

- [Explanatory Memorandum](#) to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

ATO references

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