

Greenwoods & Freehills

Tax Brief

29 May 2009

Shares & option plans still on hold

As anticipated by our Federal Budget *Tax Brief* and as widely reported in the media new grants of shares and options to Australian employees have been stalled this month by proposed tax changes announced with the Budget.

Initial budget announcement

The Budget night announcement on 12 May 2009 was that:

- tax deferral for employee share and option plans would be eliminated – all grants of shares and options after 12 May 2009 would be taxed up-front; and
- the \$A1,000 tax exemption available for broadly based plans would be limited to employees with incomes below the average wage (about \$A60,000).

Pending amelioration

After widespread criticism, the Government announced on 24 May 2009 that it would consult with industry to ameliorate the initially proposed measure, and in particular to consider reinstating tax deferral in 'limited circumstances', including where there is a 'real risk of forfeiture'. The consultation is currently underway and a revised 'policy options paper' containing new proposals is expected from Government by Friday, 5 June 2009.

Interim uncertainty

So far though the start date for the changes remains 12 May 2009. Accordingly, there is very significant uncertainty at present as to how new offerings will be taxed. Industry is generally hopeful that some tax deferral will be reinstated, at least until vesting of shares and options, but in probably most cases companies are deferring new offerings pending further clarification of the new tax position. If it transpires that tax deferral is not available at least for some employees, deferring grants of shares and options until after 30 June 2009 could defer the time for payment of tax by one year, because employees are taxed on assessment of their income tax returns for the year of acquisition i.e. provided there is not also an up-front PAYG withholding introduced. More clarity is required anyway to avoid very low participation rates for new offerings.

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The 24 May announcement also flagged the possibility of:

- increasing the taxable value of rights and options, seemingly regardless of whether they are taxed up-front;
- additional employer reporting and possibly tax withholding arrangements; and
- increasing the income threshold for the \$A1,000 tax exemption.

Note that:

- additional employer reporting arrangements are very likely because the Government action was apparently prompted by high income employees deferring tax on equity for up to 10 years (as was permitted) and then either departing Australia or simply failing ultimately to include the correct 'discount' income in their tax returns; and
- the initially announced measure could have particularly adversely affected conditional grants of shares because the tax rules do not currently provide for refunds of tax paid up-front, by election, on shares that do not vest – presumably at least that will be redressed.

Opportunity

You should also recognise though, that there is also potential opportunity in this review. It has elevated employee share and option plan tax arrangements to the Federal Parliament's legislation agenda. It is therefore an opportunity to address various aspects of the existing rules that are already unsatisfactory; for example, compulsory taxation on cessation of employment. Companies should raise these issues now, because it may be years before employee share and option plan taxation is next on Parliament's agenda.

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These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.

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