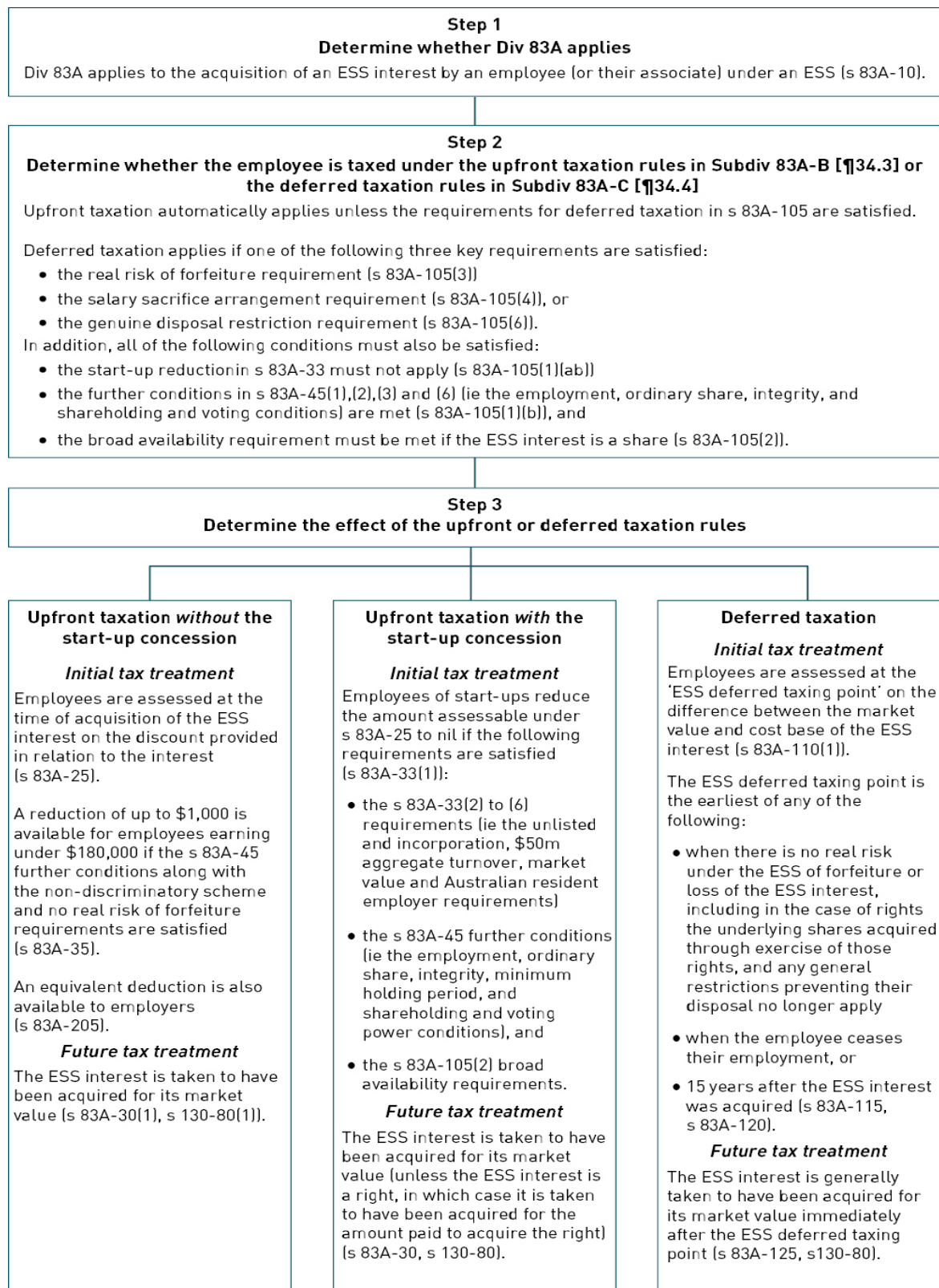


***Employee Share Schemes



- Notable sections
 - s6-25 – Statutory income rules outweighs ordinary income rules
 - 118-20 – other provisions take precedence over CGT

Step 1 - Does Div 83A apply?

- Applies to an 'ESS interest' acquired under an 'ESS' at a discount (s 83A-20(1))
 - ESS interest
 - Beneficial interest in a share, or a right to acquire a beneficial interest in a share, in a company (s 83A-10(1)).
 - ESS
 - Scheme under which 'ESS interests' in a company are provided to employees, or 'associates' of employees, (including past or prospective employees) of the company or its subsidiaries in relation to the employees' employment (s 83A-10(2)).
 - An 'associate'
 - Defined widely (s 318 ITAA36)
 - Covers persons such as an employee's relatives (s 995-1 ITAA97)
 - ESS interest provided to an employee's associate is treated as if it was acquired by the employee (s83A-305)
 - Eg. If an employee's spouse receives shares under an ESS, the employee will include the discount in their assessable income as if the employee had acquired the shares.
 - However, associate will pay CGT if they dispose
 - However, when the associate later disposes of the shares any capital gain or loss arising from the CGT event will be made by the associate (s 130-85(3)).
 - Discount
 - Not defined and takes on its ordinary meaning.
 - Acquired
 - Includes where employee has an interest in an employee share trust that holds shares or right
 - Employee deemed to have a beneficial interest to their corresponding interest in the trust (s 83A-320, s130-85 ITAA 97)
- Div 83A does not apply to a share acquired as a result of the exercise of a right under an ESS (s 83A-20(2))

Step 2 – Determine whether the employee is taxed under the upfront taxation rules in Sub-div 83A-B or the deferred taxation rules in Subdiv 83A-C

Taxing Points

- Depends on nature of the ESS
- Discounts may be taxed
 - On an upfront basis (time of acquisition) (Subdiv 83A-B) or
 - Deferred basis (time of the occurrence of a specific event) (Subdiv 83A-C)
- Generally taxed upfront
- To qualify for deferred taxation, ESS interest must be
 - At real risk of forfeiture or
 - Share obtained under a salary sacrifice arrangement or
 - Right that is subject to a genuine disposal restriction

Interaction of Div83A with the CGT regime

- Capital gains and capital losses arising from CGT events relating to an ESS interest are generally disregarded to the extent that they happen at or before the relevant taxing point (s 130-80 ITAA97).

- Subsequent dealings in ESS interests (ie the shares or the rights to acquire shares) are, however, subject to ordinary CGT treatment

Step 3 – Determine the effect of the upfront or deferred taxation rules

Upfront Taxation Without the Start-up Concession

- Discount is ordinarily assessed upfront (s83A-25(1))
- Ensure start up concession or deferred taxation does not apply
- Initial Tax Treatment
 - Discount is the market value of the ESS interest less any consideration paid by the employee (or their associate)
 - Reduction of up to \$1000 for employees earning under \$180,000 (s83A-25)
 - Only available if the sum of the employee's taxable income, reportable fringe benefits total, reportable superannuation contributions, and total net investment loss for the income year does not exceed \$180,000 (s 83A-35(2))
 - Conditions under s83A-45 must be satisfied
 - Employment Condition
 - Must be employed by company or subsidiary at time of acquisition
 - Ordinary share Condition
 - All ESS interests must relate to ordinary shares
 - Integrity Condition
 - Predominant business of the company cannot be the acquisition, sale or holding of shares, securities or investments
 - Minimum Holding Period Condition
 - Can't be permitted to dispose of ESS interest before the earlier of: three years or the time they cease employment
 - Shareholding and Voting conditions
 - Must not hold a beneficial interest in more than 10% of the share in the company or control more than 10% of voting rights
 - Also requirements in s83A-35(6) and (7) must not be met
 - Non-discriminatory scheme requirement
 - ESS must be offered to at least 75% of the permanent employees of the company who have completed 3 years of service and are Australian residents
 - No real risk of loss or forfeiture requirement
 - At the time when the ESS interest is acquired:
 - Share
 - No real risk that the share will be forfeited or lost (other than by disposing of it); or
 - Right
 - No real risk that the right will be forfeited or lost (other than by disposing of it, exercising it or letting it lapse); and,
 - If the right is exercised, no real risk that the share will be forfeited or lost (other than by disposing of it)

- Future Tax Treatment
 - CGT applies to the ESS interest when it is disposed of
 - Cost base is the market value of the ESS interest rather than the amount paid
 - Recognizes that the employee has been assessed on the discount

Upfront Taxation with the Start-Up Concession

- Initial tax treatment
 - Concession contained in s83A-33(1)
 - Assessable discount is reduced to nil and there is therefore effectively no upfront taxation
 - To qualify for the reduction, must satisfy 3 sets of requirements
 1. First set of requirements set out in s83A-33(2) to (6)
 - a. Unlisted and incorporation requirements
 - Company must not be listed on a stock exchange
 - Must be incorporated for less than 10 years before the end of the income year before the ESS was acquired
 - b. \$50 million aggregated turnover requirement.
 - The company must have no more than \$50 million aggregated turnover in the income year before the ESS was acquired
 - c. Market value requirement.
 - Share - the discount must be less than 15% of the market value
 - Right - the amount that must be paid to exercise the right must be greater than or equal to the market value of an ordinary share in the company when the ESS interest is acquired (s 83A-33(5)).
 - d. Australian resident employer requirement.
 - Employer (which may not necessarily be the company issuing the ESS interest) must be an Australian resident at the time the taxpayer acquires their ESS interest (s 83A-33(6)).
 2. Further Conditions (s83A-45)
 - a. Employment Condition
 - Must be employed by company or subsidiary at time of acquisition
 - b. Ordinary share Condition
 - All ESS interests must relate to ordinary shares
 - c. Integrity Condition
 - Predominant business of the company cannot be the acquisition, sale or holding of shares, securities or investments
 - d. Minimum holding period Condition
 - Can't be permitted to dispose of ESS interest before the earlier of: three years or the time they cease employment
 - e. Shareholding and voting conditions

- Must not hold a beneficial interest in more than 10% of the share in the company or control more than 10% of voting rights
 - 3. Broad availability requirements (s83A-45(7))
 - a. ESS must be offered to at least 75% of the permanent employees of the company who have completed 3 years of service and are Australian residents
- Future Tax Treatment
 - Share
 - CGT applies to the ESS interest when it is disposed of
 - Cost base is the market value of the ESS interest rather than the amount paid
 - Right
 - No CGT consequences on the exercise of rights
 - Right is taken to have been acquired for the amount paid to acquire it
 - Exercise price of the rights will form part of the cost base of the resulting shares (s134-1)

Deferred Taxation

- To be eligible for deferred taxation, must satisfy below criteria
 - Must satisfy one of three key requirements
 - 1) Real risk of forfeiture requirement
 - Share
 - Must be a real risk that, under the conditions of the ESS, the share will be forfeited or lost (other than by disposing of it); or
 - Right
 - Must be a real risk that, under the conditions of the scheme, the right will be forfeited or lost (other than by disposing of it, exercising it or letting it lapse); and,
 - If the right is exercised, must be a real risk that, under the conditions of the scheme, the share will be forfeited or lost (other than by disposing of it)
 - 2) Salary Sacrifice arrangement requirement
 - Only applies to ESS interests that are shares and requires that
 - the ESS interest is to be provided in return for a reduction in the employee's salary or wages, or as part of their remuneration package
 - Discount must equal the market value of the ESS interest (ie the employee or associate provided no consideration for the shares) and the governing rules of the ESS must state that deferred taxation applies, and
 - the total market value must not exceed \$5,000 (s 83A-105(4)).
 - 3) Genuine disposal restriction requirement
 - Only applies to ESS interests that are rights and requires that
 - ESS interest is acquired, the ESS must genuinely restrict the disposal of the right and the governing rules of the scheme must state that Subdiv 83A-C applies to the scheme (s 83A-105(6)).
 - Must also satisfy additional considerations (s83A-105)

- a) Employee must not be eligible for the start-up reduction under s83A-33
 - b) Further conditions in s83A-45(1), (2), (3) and (6) must be satisfied
 - Employment, ordinary share, integrity and shareholding and voting conditions *see above*
- If ESS interest is a share
 - Broad availability requirements (s83A-45(7))
 - ESS must be offered to at least 75% of the permanent employees of the company who have completed 3 years of service and are Australian residents
- Deferred Taxing Point
 - For shares
 - Earliest of
 - When there is no real risk under the ESS of forfeiture or loss of the shares (other than by disposal) and any genuine restrictions preventing their disposal no longer apply
 - when the employee ceases their employment
 - 15 years after the shares were acquired (s 83A-115).
 - For rights
 - Earliest of
 - when (in the case of rights that have not been exercised) there is no real risk under the ESS of forfeiture or loss of the rights (other than by disposal, exercise or lapsing) and any genuine restrictions preventing their disposal no longer apply
 - when the employee ceases their employment
 - 15 years after the rights were acquired, or
 - when (in the case of rights that have been exercised) there is no real risk under the ESS of forfeiture or loss of the underlying shares and any genuine restrictions preventing the disposal of the shares no longer apply (s 83A-120).
- Assessable amount
 - For the income year in which the ESS deferred taxing point occurs, the employee must include in their assessable income the market value of the ESS interest at the ESS deferred taxing point, reduced by the 'cost base' of the ESS interest (which is determined according to the CGT rules [¶19.7]) (s 83A-110(1)).

Forfeiture of ESS interests

- s83A-310 deems that the division is generally taken never to have applied to an ESS interest where an employee has been assessed on a discount in respect of the ESS interest, but the ESS interest is subsequently forfeited or lost
- The effect of this rule is that the employee will be refunded the tax that they have paid on the discount
- However, this rule only applies if the forfeiture did not result from a choice made by the employee (other than a choice to cease employment, or, in the case of a right, a choice not to exercise the right before it lapsed or a choice to allow the right to be cancelled)

***Compensation Payments

Quick overview of stuff from revenue

- Payments received by a taxpayer need to be categorized/classified.
- Rules set out in s6-1 ITAA97
 - Assessable income = Ordinary Income + Statutory Income
 - Some ordinary income and some statutory income are exempt income
 - Exempt Ordinary income is not assessable income
 - Some ordinary income, and some statutory income, is neither assessable income or exempt income
- Amount cannot be included more than once
 - S6-1(5) ITAA97
- Capital Receipts are treated under separate statutory regimes to ordinary income
 - Eligible for concessional treatment
- Capital Regimes
 - Part 3-1: capital gains and losses: general topics
 - Part 3-3: capital gains and losses: special topics
 - Part 2-10: capital allowances: rules about deductibility of capital expenditure
 - Eg div 40 or div 43 payments received

Compensation Payments

- Character of the compensation payment is that it takes the character of that which it has replaced
 - For business
 - The character of the payment by reference to the ordinary course of the business and normal proceeds of business
 - Eg. is it structural or is it revenue: eg. consider Californian Copper Syndicate v Harris
 - For employees
 - What has been compensated
 - Loss of salary/wages or capacity
 - Or some other capital character
- Payments that replace, substitute, or compensate a taxpayer for the loss of revenue items, or amounts that would have been received on income account, are generally income
 - Ordinary income under s6-5
- Payments that replace, substitute, or compensate a taxpayer for the loss, destruction or sterilization of capital assets are generally of a capital nature
 - See C2 or C3 events
 - s140.20 – Loss or destruction of a CGT asset: CGT event C1
 - s104.25 – Cancellation, surrender and similar endings: CGT event C2

Compensation for loss of the use of money

- Compensation received in the form of 'interest' for the temporary loss of the use of money will generally be of an income nature.
 - Federal Wharf Co Ltd v DFC of T (1930)
 - Interest paid on a sum of money owed as compensation for the compulsory acquisition of land was income
 - Income on the basis that it was to 'recompense for loss of the use of capital during a period of time in which it would earn income'.
 - Riches v Westminster Bank Ltd
 - Damages for interest on the money from the date the cause of action arose to the date of judgement
 - House of Lords Held that the interest was of an income nature
- Pre-judgement interest received in a personal injury case was capital in nature (Whitaker v FCT)

Compensation Received by Employees

- Loss of income under an insurance policy
 - FCT v DP Smith
 - Income in nature
 - While the policy insured the taxpayer against loss of the ability to earn income, which was a capital asset, the payments were paid in 'substitution for income' and therefore took the place of a revenue receipt.
- Cancellation of employment contract
 - Income
 - C of T (Vic) v Phillips (1936)
 - Managing director who retired before the end of his contract was paid by way of compensation the same amounts as he would otherwise be entitled to receive as salary if he had not retired
 - Payments replaces salary
 - Allman v FC of T
 - Pilot whose employment had been wrongly terminated received damages to compensate him for the loss of his wages.
 - Capital
 - Bennett v FC of T (1947)
 - Managing director paid compensation to change the terms of his employment so that he no longer had effective control of the company
 - Payments made in consideration to cancel one agreement and enter a fresh agreement with different rights
- Personal Injury
 - Capital
 - Note however a Capital Gain for compensation or damages in regards to an injury you suffer is disregarded - s118-37 ITAA 97
 - Whitaker v FCT
 - Compensation for loss of sight from one eye during an operation
- Loss of Reputation
 - Capital
 - FCT v Sydney Refractive Surgery Centre

- Damages for defamation – received for impairment of the taxpayer’s earning capacity rather than their lost revenue itself

Compensation Amounts - Business

- INCOME
 - Loss of Trading Stock
 - FCT v Wade
 - Compensation for the loss of his cows that had been destroyed by a public authority
 - Moneys recovered from any source representing items of revenue account must be regarded as received by way of revenue
 - Cancellation of Trading Contracts
 - Usually treated as income
 - Heavy Minerals v FCT
 - Forward contracts for the sale of its product which customers sought to be released from
 - Provided a taxpayer’s capital assets have not been permanently impaired, a compensation payment that fills a ‘hole in profits’ will usually be of an income nature
 - Electronic v FC T
 - Taxpayer who purchased defective equipment was awarded a sum of money for loss of profits
 - No destruction of assets but a mere restriction of trading opportunities
 - The Federal Court characterised this amount as income.
 - Restriction created a ‘hole in profits’ which the award of damages was intended to fill.
 - Californian Oil Products v FCT
 - Sums of money paid by way of damages, compensation or indemnity for a loss of profit incurred in the course of carrying on an enterprise or undertaking may, no doubt, be considered income”
 - Cancellation of Agency Agreements that are not integral to the taxpayers business
 - Allied Mills Industries Pty Ltd v FC of T
 - Taxpayer conducting a large food manufacturing and distribution business was paid a lump sum from Arnott’s to cancel the distribution agreement
 - Income as taking into consideration the size, structure and activities of the taxpayer as a whole, the taxpayer had not parted with or received payment for a structural asset, nor had it ceased to carry on business
- CAPITAL
 - Closing down or sterilization of a capital asset
 - Glenboig Union Fireclay Co Ltd v IRC (1922)
 - Compensation paid for prevention of mining land to protect rail line from being damaged
 - Federal Coke Co Pty Ltd v FC of T
 - Compensation for reducing amount of coke that had been ordered, reducing the taxpayers market for coke

- Held to be a windfall gain as the coke company had not given any consideration
 - Special case that turned on particular facts (be careful of following)
- Cancellation of structural contracts
 - Cancellation of structural contracts that are integral to the way that a taxpayer conducts its business operations are usually capital
 - Van den Berghs Ltd v Clark [1935]
 - Cancellation of agreements that regulated the way in which it shared profits with a rival and the way it conducted business in the UK and abroad
 - Capital as they related to the whole structure of the taxpayers profit making apparatus
- Cancellation of Agency Agreements that are integral to the taxpayers business
 - Californian Oil Products Ltd (in liq) v FC of T (1934)
 - Oil products distributor that received ten half-yearly payments for the cancellation of its exclusive agency agreement with its supplier
 - Payments for the abandonment of the only business that the taxpayer conducted

Compensation payments that are un-dissected lump sums

- Apportion compensation receipts where possible to dissect them into distinct income and capital components
 - Federal Wharf Co v DFCT
- Where not possible to apportion
 - Entire amount will be treated as Capital
 - McLaurin v FC of T (1961)
 - Grazier that received a lump sum payment to settle damages for a fire that damaged his land, fences and livestock
 - Allsop v FC of T (1965)
 - Lump sum received for license fees he had paid which were actually invalid
 - Entire amount received was of a capital nature as no part of it could be attributed solely to the refund of fees.
 - FC of T v Spedley Securities Ltd
 - Deed of discharge did not identify how the amount was allocated between the taxpayer's loss of reputation and its loss of commission
 - No basis of apportionment

Reimbursements and refunds

- Not of an income nature as they are not a reward for services rendered
 - Hochstrasser v Mayes
 - Scheme that reimbursed losses arising on the sale of members' homes
 - Not assessable
 - FC of T v Rowe
 - Payments to reimburse him for legal costs from a successful action for wrongful dismissal
 - Not assessable
- NOTE: Refunds of previously deductible amounts are income where they are ordinary proceeds of the taxpayer's business
 - HR Sinclair & Son Pty Ltd v FC of T (1966)
 - Paid excessive rate of royalties for a license for the taxpayer to obtain timber
 - Taxpayer was paid a refund.
 - The High Court held that the refund was an ordinary business receipt of the taxpayer and was therefore of an income nature.

Myer Emporium

- First strand
 - Gains made from extraordinary transactions may be income where they arise from commercial transactions entered into by taxpayers with the intention of making a profit
- Second Strand (separate and independent test)
 - Where a future right to interest is converted into a present lump sum amount, the present lump sum will be income as it replaces the future interest, which would have been treated as income
 - Precedent from C of T (VIC) and Commrs v Paget (compensation cases)