BUDDLE FINDLAY

Legal update - Simplifying collection of tax on employee share schemes

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The Government released an Issues Paper last week signalling a change to require tax on employee share schemes to be collected at source from employers through the PAYE or FBT systems.

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The proposal

The changes proposed in the Issues Paper were marketed as an initiative to simplify the way that tax is collected on employee share schemes. They seek to ensure that such benefits are taxed in a similar manner as other forms of employee remuneration.

Whilst the proposed changes will relieve employees from the associated tax compliance obligations, the proposal can raise other issues:

- The Government acknowledged that the proposal can shift the burden of recovering the tax onto employers. As the benefit is a non-cash benefit, the employer will either have to sell a portion of the shares granted, or to recover the tax paid from the employees (where there is no liquid market for the shares). This issue is of a particular concern for start-up companies which have limited disposable funds and typically use employee share schemes as non-cash means to incentivise employees.
- The Government has yet to decide whether the tax should be collected through the PAYE or FBT systems. As the FBT system operates on the basis that the benefit received is net of tax, the extent of the tax cost will be greater if it is accounted under the FBT system relative to the PAYE system. The Government also acknowledged that some companies do not currently account for FBT and the additional compliance costs could be greater for these companies if the FBT option is adopted.
- The Government is also considering whether the option for employees to account for the tax themselves should remain available. It is proposed that even if this option is taken, employers will be required to provide to the IRD details of benefits paid and employees receiving the benefits granted. This will enhance the Government's ability to monitor tax payable on benefits granted under employee share schemes.

Employers should be more wary of tax costs on share schemes

Employee share schemes are currently under IRD's spotlight. The proposal is a first step taken by the Government to tighten up the rules in this area and to enhance its ability to monitor and recover tax payable on employee share schemes.

It is important to emphasise that the Issues Paper did not consider the more difficult and substantive issues on how employee share schemes should be taxed, but only focused on collection of tax. Consultation on the wider and substantive issues is expected to occur separately later this year.

The Government is currently seeking feedback on the proposal. It is not clear at this stage the date from which employers will be expected to account for tax on shares issued under an employee share scheme, or whether the Government will permit employers and employees the option to continue to return tax under the current rules.

Until then, employers should be mindful of the potential tax costs when designing employee share schemes as these costs will become more relevant to employers under the proposal. Careful drafting of the terms of employee share schemes to "future proof" these schemes may be warranted - in particular, to manage the potential tax costs and ensure that employers can recover the tax from employees in a manner that is practical for both parties.

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