

# HR & Tax Alert

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## Australia – Introduction of New Cross Border Employee Share and Option Taxation Rules

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### Executive summary

The Australian Government has introduced legislation to clarify and change the tax treatment of employee share and option plan awards granted to employees on international assignments. The two major amendments will be firstly the introduction of an exemption from Australian tax for employee share or option income related to foreign assignments and secondly a reform to ensure the taxation of such income when the tax point does not occur until after the employee has left Australia.

### Background

Australia's current income tax rules for employee share plans generally work as follows:

- Qualifying shares and qualifying options are taxed at the 'cessation time', which will generally be when shares are no longer subject to restrictions on disposal or when the options are exercised.
- There are no specific rules about the 'sourcing' of employee share plan income for tax purposes, or any specific exemptions for foreign assignments.
- Capital gains tax (CGT) rules also apply as follows:
  - Shares or options acquired while an individual is an Australian tax resident may be taxed when the individual becomes a non-resident and also again at the 'cessation time' as a non-resident. The individual receives no credit for the tax paid when s/he became a non-resident.
  - Shares or options acquired as a non-resident for Australian tax purposes are generally taxable only under CGT rules. An employee would normally only be taxed on the sale of the underlying share on any increase in the value of that share since the date the holder became a resident.
- Australia's worldwide tax system means that international employees who are resident at the tax points are fully taxable on the gains, even though some or most of the gain may have arisen prior to arrival.

## **New Legislation**

The changes seek to clarify the treatment of share and option plan income as employment income and to align Australia's domestic treatment of such income with the OECD approach.

This change means that shares or rights granted while employees are overseas which are still held at the date of arrival in Australia can now meet the requirements of being 'qualifying' shares or rights, provided that the Australian taxing point (the 'cessation time') has not yet occurred.

The changes cover employees who are working overseas as non-residents of Australia and Australian resident employees working overseas on an exempt foreign assignment.

## **Income Tax Changes**

A number of changes have been introduced in the new legislation affecting the income tax provisions as follows.

Firstly, the discount from employee shares and options will be exempt from income tax in Australia to the extent that it relates to 'foreign service' carried out while the individual was a non-resident of Australia, or service while resident but on an exempt foreign assignment.

Secondly, employees entering Australia holding non-qualified shares or options may be taxable in their year of arrival on the discount from the shares or options to the extent it relates to their future Australian service.

Thirdly, individuals granted qualifying shares or options while exempt from Australian tax will now either need to elect for taxation in the year they become taxable employees or alternatively pay Australian tax at the cessation time on the discount to the extent that the discount relates to Australian duties.

It is important to note that there are no legislated rules on how to allocate the discount between Australian (taxable) and non-Australian (tax exempt) sources and this will need to be determined on a case by case basis. However the Government explanation of the proposed rules suggests an allocation according to the employee's workdays between the grant of a share or

right and the date the share or right 'vests', as recently stated with approval by the OECD. This method would be consistent with Australia's more recent double tax treaties, e.g. the treaties with the US and UK.

Where the taxation of shares or options occurs at either the date of grant or the date of arrival in Australia, employees will be able to amend prior returns if a portion of the income previously taxed is ultimately found to relate to non-Australian duties and becomes exempt from Australian tax.

## **Capital Gains Tax Changes**

CGT deemed disposal and acquisition rules on ceasing to be a resident or becoming a tax resident will now not apply to qualifying shares or qualifying rights for which the employee has not elected to be taxed 'at grant'. This is provided that the cessation time has not yet occurred. These shares or rights will now only be taxed at the relevant cessation time under the income tax employee share plan rules.

The CGT cost base for qualifying shares or options granted prior to arrival will be determined at the cessation time provided that the employee does not elect to tax the shares or options at arrival.

Only shares or options where the cessation event occurs before arrival in Australia, or when an election to tax at arrival is made, will be able to benefit from the market value cost base at arrival rules.

## **Application and Other Matters**

The new rules will apply to any employee shares or options granted after the date the legislation receives royal assent. This is likely to occur in the next few months.

The new rules will also apply to all shares and options held by an individual who becomes a taxable employee in Australia after the date of royal assent regardless of when the shares or options were granted.

## **Conclusion**

These changes will provide some certainty on the principles to apply when deciding the Australian tax

position of shares and rights granted to employees who work inside and outside Australia.

### **Next steps**

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Employers should consider the impact of these new rules and the requirement to file Australian tax returns for periods after an expatriate has departed Australia.

Employers will also need to consider whether positions regarding share plan interests under their tax equalisation policies need to be revised.

Individual expatriates who would benefit from the current rules on share plan awards granted while overseas may wish to consider returning to Australia prior to the new rules receiving royal assent.

For further information, please contact your local Ernst & Young Human Capital professional, or in Australia:

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