

KPMG welcomes proposal to simplify tax for employee share schemes

Inland Revenue has released an [issues paper](#) on ways to simplify the collection of tax on employee share schemes. The aim is to reduce tax compliance cost barriers to the take up of these schemes.

What's the current problem?

Employees who receive shares, as part of a remuneration package, are required to pay tax on this "income" in their own tax return. (The income is the value of the shares less any payment by the employee for the shares.)

This contrasts with normal salary and wages and fringe benefits, which are subject to PAYE and FBT. The employee does not typically have an end of year tax liability for these amounts, whereas they can face a hefty tax bill on employee share scheme income and may also have to manage provisional tax and use of money interest as a result.

What's the proposal?

The issues paper proposes to change the way tax is collected from employee share scheme income. The options are to apply either the PAYE or FBT rules. The issues paper asks for feedback on a number of design issues, including:

- Whether employers should be able to elect the existing rules continue to apply to employee share scheme income?
- Whether there should be choice between FBT and PAYE to account for the tax?
- The cash flow impact on employees, if PAYE applies. As shares are a non-monetary benefit, there is no cash from which PAYE can be deducted and paid.
- The impact on employers if FBT is the preferred option. While all employers will pay PAYE, not all will pay FBT so some employers will not be in the FBT system.
- Transitional issues, including whether there needs to be the ability to preserve the existing tax treatment for employees in current schemes and ensuring there is no adverse impact on non-tax obligations and entitlements.

Who should take note of these proposals?

All employers should take note. Business for which employee share schemes form an important part of their remuneration structure, or may do so in future, should pay particular attention. This includes start-ups and those businesses looking to innovate in their remuneration policies.

Our view

We welcome the issues paper. The current tax collection mechanism has been a bugbear for business, and employees, for some time. It imposes compliance costs on employees, making these schemes burdensome from a tax perspective. The proposal is a move in the right direction. However, much will depend on getting the detailed design right.

Employees currently bear the compliance costs of paying tax on employee share scheme income and getting this right.

The proposal is a step in the right direction. However, the detailed design of the new rules must take care when shifting compliance obligations to the employer

The proposal will impose additional compliance obligations on employers. This is unavoidable if the compliance burden and risk is to be shifted away from the employee. However, some residual employee obligations may remain. For example, if cash salary is insufficient to fund PAYE on employee share scheme income, there may still need to be an employee square up at year end. Of particular concern, therefore, is who bears the tax.

Under the current rules, the employee must fund the tax and the tax cost is clearly theirs. Under either PAYE or FBT, the employer will need to fund the tax payment and recover this from the employee.

Our experience with overseas employee share plans, where a withholding tax applies, is they will typically allow the employer to sell shares to fund the tax. The employee bears the tax cost and receives a net after tax value of shares. New Zealand employee share plans will not necessarily operate in a similar manner. As New Zealand employers have not had an obligation to withhold tax to date there has been no need for such a rule.

The need for a legislative override and other detailed design issues will need to be carefully worked through. In considering the proposal, employers need to pay careful attention to ensure that benefits provided under existing schemes have the expected outcome for both the employer and the employee.

Importantly, this issues paper is limited to the tax collection and compliance costs aspects. Consultation on the tax treatment of employee shares schemes is targeted for later this year. This should consider what is taxable, and when, to bring further clarity to the treatment of employee share schemes.

Employee share schemes are popular, well established, and tax incentivised overseas, but are less well entrenched in New Zealand. The current tax barriers can detract from the otherwise attractiveness of employee share schemes, which offer employees an ownership stake in the business. To fuel an innovative and prosperous economy, it is important that these types of schemes be encouraged and the tax barriers removed.

Further information

If you would like to discuss the employee share scheme tax proposal in greater detail, please contact your regular KPMG advisor or:

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