Global Taxation Update

AUSTRALIA
Taxation of Employee Share Schemes

Employee Share Schemes ("ESS") are used worldwide to attract, retain and motivate staff by aligning employee interests with shareholder interests. Having a vested interest in a business is said to give employees a sense of participation, and a good reason to want to see the company grow and profit.

The tax laws governing ESS in Australia are unlike those of many countries, and companies operating schemes in Australia should be aware of these differences.

In Australia, the default taxing point for individuals granted ESS interests is at grant unless the interests qualify for deferred taxation. Subject to meeting a number of conditions, interests will usually qualify for deferred taxation where there is a real risk that the individual will lose or forfeit the interests (other than by disposing of it). A 'real risk of forfeiture' is considered to exist when there is a real risk the employee may lose, or never receive, the actual shares or options to which they become entitled under an ESS. For example, a real risk of forfeiture may exist where an employee needs to meet performance hurdles or work for their employer for a minimum period before their ESS interests vests.

The taxing point for deferred taxation interests occurs when any real risk of forfeiture lifts and there are no restrictions on disposing the underlying shares. For many ESS interests, this is at the vesting date. The employee may also be subject to capital gains tax where the underlying share is sold after 30 days from the taxing point. Where the underlying share is sold within 30 days of the taxing point, there is no assessable capital gain.

What is the Taxable Amount?

The amount that is subject to income tax in the hands of the employee is the 'discount' they receive in respect of their ESS interests at the taxing point. The discount is the difference between the amount that the employee paid to acquire the ESS interests and their market value at the taxing point. The 'market value' of ESS interests is its market value according to ordinary concepts. If the ESS interest is an unlisted option, its market value is determined by using two different methods stipulated in the ESS legislation.

Where the underlying share is sold after 30 days from the ESS taxing point, the assessable capital gain is calculated as the difference between the sales proceeds received and the amount taxed at the ESS taxing point. It is important to note that where a capital asset is granted to an employee and there is no assessable discount under the ESS rules, there may be Fringe Benefits Tax (FBT) payable by the employer (FBT is an employer tax on non-cash benefits provided to employees). The valuation rules for FBT are different to the ESS rules.

What Can Companies do?

The downside of these rules for plan participants is that a taxing point may arise for their ESS interests (e.g. at grant or at the deferred taxing point) before employees are able to sell the underlying shares to fund the tax liability. Where this is the case, employees will need to have access to cash to fund their tax liability, which can generate cash flow issues and a reduced desire to participate in the ESS.

Thoughtful structuring of an ESS can reduce this risk. The scheme can be designed to ensure that the taxing point is either early enough to ensure negligible value or late enough such that the employee is readily able to cash-in and cover any tax liability.

In some cases, employers may consider it preferable for employees to be assessable at grant or 'upfront' on the unrealised discount under the ESS provisions (cash flow permitting) where:

1. The options are likely to be exercised;
2. The options are likely to increase in value; and
3. The funding costs (e.g. interest on borrowings to pay the tax) are likely to be less than the tax savings (or they have capital losses).

This is because a greater amount of the overall economic value is treated as a capital gain and therefore subject to tax at the maximum rate of 23.25% when the resulting shares are sold (assuming that the shares increase in value and satisfy the 12 month holding period test to obtain the 50% discount), rather than at 46.5% under the ESS provisions.

As noted above, the main downside associated with the employees being assessable upfront is that the employee would have to fund a tax liability on an unrealised discount. It goes without saying that the share price could subsequently fall.

ESS Reporting

While there is no withholding obligation for ESS interests in Australia (unless the employer does not have their employees Tax File Number), employers are required to fulfil annual ESS reporting obligations by providing ESS statements to employees in the format approved by the Australian Taxation Office ("ATO") as well as an Annual ESS Report to the ATO.

BDO comment

When designing ESS plans to be operated in Australia, companies need to consider the Australian taxing point as well as their reporting obligations. Simply 'importing' a foreign ESS plan to Australia is unlikely to provide the best tax outcome for the employee and most foreign ESS plans will benefit from modification.

Care should be taken to ensure there is an understanding of income tax issues and interaction with Capital Gains Tax (CGT) and consideration of how a scheme can be set up to achieve the desired tax outcome.

Superannuation Obligations for Employers of Inbound Expatriates

When seconding employees to work in Australia, employers need to consider their Australian superannuation obligations.

Superannuation is a type of pension scheme – but it is quite different to most other countries' pension schemes, particularly when it comes to its tax treatment. It is primarily an employer funded scheme where the contributions are made to privately run funds and are fully vested in the employee.

Contribution Rates

Employers are required to pay superannuation contributions into an Australian complying superannuation fund on a quarterly basis at 9.25% of 'ordinary times earnings' for eligible employees working in Australia subject to certain exemptions (see below).

Compulsory contributions are capped at 9.25% of the lower of an employee's quarterly earnings or the 'maximum contribution base' (currently $48,040 per quarter, rising to $49,430 per quarter from 1 July 2014).

The compulsory contribution rate is increasing incrementally to 12% by the year ending 30 June 2020.

Exemptions

Superannuation contributions are not compulsory when employees are:

1. Inbound assignees to Australia where a Certificate of Coverage is in place; or
2. Senior executives holding a temporary visa (a 'prescribed employee').

Bilateral Social Security Agreements and Certificates of Coverage

Australia has entered into agreements with a number of countries which address the issue of international assignees and their employers paying social security contributions in both their home and host country (superannuation being treated as a social security for this purpose).

Superannuation contributions are not required for inbound assignees where Australia has a bilateral social security agreement with the assignees' home country and a Certificate of Coverage has been obtained from that country's social security authority thereby confirming that home country social security contributions continue.

Senior Executives Exemption

Where an employee holds a certain temporary visa, typically subclass 457, they may be classified as a 'prescribed' employee for the purposes of compulsory superannuation contributions and so exempt from superannuation.

In order to be a prescribed employee, the employee must meet one of several tests in the Superannuation Regulations. As a general rule they must:

- Hold a certain temporary visa
- Have a full time position
- Be a senior executive and carry senior executive responsibilities.

Guidance should be sought to confirm if an employee will meet the definition of prescribed employee as there are several qualifying categories.

Taxation of Contributions and Fund Growth

Unusually, for pension contributions by global standards, Australian employer superannuation contributions are taxed at 15% on entry to the fund.

Contributions up to $25,000 per annum (increasing to $30,000 for the year ending 30 June 2015 or $35,000 for older employees) can be made into Australian superannuation with this 'entry tax' rate, although if the employee has income over $300,000 per annum, the entry tax is increased to 30%.

Contributions above the applicable contribution cap are taxed at the employee's marginal tax rate after taking into account the entry tax paid.

In addition, growth in the fund is taxed at 15% or 10%.

Accessing the Funds

Australian citizens, permanent residents and New Zealand Citizens can retire in Australia and withdraw their superannuation fund as a lump sum or pension at a set age dependent on their year of birth. Importantly, the lump sum or pension is tax free.

However, temporary residents (apart from New Zealanders) who cannot retire in Australia can only withdraw their superannuation funds once they leave Australia and their temporary visa has been cancelled. The 'Departing Australia Superannuation Payment' (DASP) is subject to 35% withholding tax, with complications arising if the 30% or marginal tax rates have been applied to contributions.

US Citizens and Residents

Superannuation contributions, DASPs and tax paid on entry, growth are particularly complicated for US citizens and residents. Specialist advice should be sought to ensure that employees understand the US tax implications and reporting requirements.

Failure to Pay Contributions

Failure to pay superannuation when required will result in having to pay a 'Superannuation Guarantee Charge' without an accompanying corporate tax deduction. This consists of the superannuation payment originally required plus penalties and interest.

BDO comment

Be aware that Australian superannuation is very different from most other countries' pension arrangements with:

- Compulsory employer contributions
- Complicated and potentially adverse tax consequences – especially for US citizens and residents
- Exemptions in some cases – well worth considering given the tax consequences for many employees
- Penalties for not paying.

CANADA
Sourcing Stock Option Benefits

The Canada Revenue Agency's (CRA) long standing default position with respect to sourcing stock option benefits was that a stock option benefit is attributable to services rendered in the year of grant (i.e. a past service approach) unless there is compelling evidence to the contrary. Many jurisdictions apply a 'future services' approach based on grant date to vesting date or alternatively grant date to exercise date. The CRA's historical position gave rise to double taxation in many instances. Due to the differing sourcing rules, a stock option benefit may be taxable in both jurisdictions with no foreign tax credit available in Canada for the foreign tax paid on the portion of the benefit which is sourced to Canada and to the foreign jurisdiction with no clear relief under an income tax treaty.

The Organisation for Economic Co-operation and Development (OECD) sourcing principles are contained in commentary to Article 15 of the OECD Model Income Tax Convention which was issued in September 2005. According to the OECD, sourcing stock option benefits between jurisdictions should be based on:

- The number of days worked in a jurisdiction during the period from grant to vest, and
- The total number of days worked during the period from grant to vest.

The CRA has recently announced that it will adopt the OECD sourcing rule for sourcing stock option benefits for Canadian domestic purposes with exercises after 2012. However, where the CRA's sourcing position results in a more beneficial result than the treaty approach, a taxpayer is free to adopt the CRA position.

BDO comment

This change in policy should help minimise the potential for double taxation. Normally, the sourcing provisions of an income tax treaty override the CRA's administrative position. However, the position should be reviewed in each case to ascertain whether the treaty approach or the CRA approach will be more beneficial.

SINGAPORE
Housing – Changes to the Method of Calculating the Taxable Value of Accommodation and Hotel rooms for Expatriates

Changes to the methods of calculating the taxable value on the provision of accommodation and hotel rooms for expatriates will apply from the year of assessment ("YA") 2015 (fiscal period – year ended 31 December 2014) onwards. These are set out below:

From the YA 2015 onwards, for employees provided with housing by their employer (where the tenancy agreement is between the landlord and the employer, with the employee as the designated tenant) the taxable value of the accommodation will be:

- Annual value of the premises (excluding the cost of rental for furniture and fittings)
- Less any rental contributions made by the employee.

The taxable value of the furniture and fittings will be based on a percentage of the annual value of the housing accommodation as follows:-

1. 40% of the annual value if the premises are partially furnished (where only fittings such as lighting, air-conditioners, water heater etc. are provided); or
2. 50% of the annual value if the premises are fully furnished (where both fittings and furniture/household appliances are provided).

Where employees are provided with hotel accommodation by the employer, the taxable value of the hotel accommodation will be the actual costs incurred by the employer for the hotel benefit provided to the employee, less amounts paid by the employee.

BDO comment

Employers who provide expatriates with accommodation in Singapore, and expatriates who are provided with accommodation in Singapore, should review the changes to the tax treatment of such accommodation and ensure it is reported in line with the new rules.

SWEDEN
Employer Social Security Contributions – Research and Development

From 1 January 2014, a relief has been introduced in relation to employees aged between 26 and 65 whose work involves research and development. The relief operates by reducing the amount which would otherwise be subject to Swedish employer social security contributions (e.g. remuneration, salary, benefits in kind etc.) by 10 %. The relief is capped at a total of SEK 230,000 per month per group or company.

BDO comment

Employers subject to Swedish social taxes should review the work carried out by employees to ascertain if they will be eligible to claim this relief.

Review of Taxation Rules for Incentive Programmes

According to a press release from the Swedish Ministry of Finance, the Swedish Government is now appointing a specific investigator to review the taxation rules for share related incentive programmes. The purpose is to enhance the quality of the Swedish taxation rules ensuring the rules are competitive thereby encouraging growth.

Different types of share related incentive programs targeting key individuals are an important tool for encouraging growth in companies, especially newly founded and smaller businesses.

However, appraisal and valuation of options is difficult, especially if the companies concerned are smaller and their shares are not listed on a stock market or otherwise publicly traded. This in turn creates difficulties in predicting tax and social security implications for both the company and the individual.

The investigator will map out different types of incentive programs, analyse how the taxation rules affect the structure of the schemes and provide suggestions for clarifications and/or legislative changes.

The results of the review are to be reported by 1 October 2015.

BDO comment

Businesses operating in Sweden and providing incentives to key individuals should be aware that the tax rules in relation to incentive schemes are under review, and consider the impact on the business once the results of the review are known.

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