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...essential information for business people

December 2014 | Audio CD



the extras

Business Essentials Monthly Audio CD



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For more information about the topics discussed on this program, please contact the relevant organisations listed below.

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Example 1 – Options that are eligible for the start-up concession

Kerry works for a small company that meets the eligibility criteria for the start-up concession*. On 1 July 2015, Kerry is given 10,000 options to purchase shares in her employer's company for \$5 per share (that is, the exercise price is \$5) between 1 July 2018 and 1 July 2019 under a qualifying employee shares scheme.

The market value of shares in her employer's company on 1 July 2015 is \$4 per share (which is less than the exercise price of the options) so the shares are 'out of the money'. Because the shares are not 'in the money' (which occurs when the exercise price is lower than the market value of the shares), Kerry is eligible for concessional treatment under the start-up concession.

Kerry does not pay anything for the options, but they are worth \$0.50 each (total value of \$5,000) when they are provided to her. The total discount provided to Kerry is \$5,000, equal to the market value of the options (\$5,000) minus any amount paid by Kerry (\$0).

Under the old rules, and assuming there was no risk that Kerry could forfeit the options, Kerry would have had to pay income tax on the discount component (\$5,000) in the income year that she received the options (2015-16).

Under the new concessional start-up rules, Kerry will be able to defer any tax on this ESS arrangement until she sells the underlying shares, unless another taxing point** occurs first. If Kerry sells the shares for more than \$5 per share (the exercise price, which will also likely be her cost base for CGT purposes), she will be liable for capital gains tax upon sale of those shares. In this example, if Kerry sells the shares for \$8 per share, she will pay CGT on her gain of \$3 per share when she sells the shares (the sale price of \$8 minus what she paid for each share, \$5).

*Eligibility criteria include: the 3 year minimum holding period; company having aggregated turnover of not more than \$50 million; being unlisted; and being incorporated for less than 10 years.

**Another taxing point will occur if a non-sale CGT event occurs to the options or shares before the sale event occurs (e.g., Kerry stops being an Australian resident taxpayer).

Example 2 – Options that are not eligible for the start-up concession

Kate works for a company that does not meet the eligibility criteria for the start-up concession. On 1 July 2015, Kate is given 10,000 options to purchase shares in her employer's company for \$5 per share (that is, the exercise price is \$5) between 1 July 2018 and 1 July 2019 under a qualifying employee share scheme. Kate does not pay anything for the options, but they are worth \$0.50 each (total value of \$5,000) when she receives them. The total discount provided to Kate is \$5,000, equal to the market value of the options (\$5,000) minus any amount paid by Kate (\$0).

Under the old rules, and assuming there was no risk that Kate could forfeit the options, Kate would have had to pay income tax on the \$5,000 discount provided in the 2015-16 income year – the year in which she was provided the options. This is despite the fact that Kate cannot use the options to purchase shares (exercise the options) until 1 July 2018.

Under the new rules, Kate will not be liable to pay income tax on this ESS arrangement until she converts the options to shares (exercises the options),

provided the employee share scheme is a deferred tax scheme and not an upfront tax scheme (as determined by the governing rules of the scheme)*. If Kate chooses to exercise the options on 30 June 2019, she will pay income tax on the difference between the market value of the option at that time (say \$1 per option (the difference between \$6 share price on that day and the exercise price of \$5) and the amount she paid to acquire them (in this case, nil). Kate will be liable for capital gains tax on any further gains in the value of the underlying shares when she sells the shares. For example, if Kate sells her shares for \$8 per share on 1 July 2020, she will be liable, in the 2020-21 income year, for capital gains tax on \$8 less the sum of: the market value of options on the exercise date (\$1 per option) and the exercise price of \$5 per share.

*Another taxing point will occur if Kate stops being an employee or the maximum time period is exceeded.

Example 3 – Shares that are eligible for the start-up concession

John works for a small company that meets the eligibility criteria for the start-up concession*. This means that John's employer can offer him shares through an ESS at a discount of up to 15 per cent relative to market value, and have that discount exempt from income tax. John's employer offers John 10,000 shares that are valued at \$1 per share (\$10,000 worth of shares) in their company for \$8,600 (\$10,000 x 0.86) which is a 14 per cent discount on market value.

John accepts the offer, and purchases \$10,000 worth of shares for \$8,600. As long as the scheme requires that John holds the shares for at least three years, the \$1,400 discount will be exempt from income tax. Capital gains tax (CGT) will be payable if John sells the shares for more than \$1 per share on the difference between the sale price and \$1.

*Eligibility criteria include: the 3 year minimum holding period; company having aggregated turnover of not more than \$50 million; being unlisted; and being incorporated for less than 10 years.

Example 4 - Shares that are not eligible for the start-up concession

No Risk of Forfeiture

Tom is given 1,000 shares in his employer's company under an ESS on 1 July 2015. The shares are provided at no cost to Tom, but are worth \$4 each when he is given them (total market value of \$4,000). If there is no risk that Tom will forfeit the shares, then he will pay income tax up-front (in the 2015-16 income year) on the discount provided on those shares. In this case, the discount will be \$4,000, equal to the market value of the shares when provided (\$4,000) minus any amount paid by Tom (\$0).

No risk of forfeiture and employee earns less than \$180,000

If Tom earns less than \$180,000 in the 2015-16 income year, he may be eligible to receive the first \$1,000 worth of discounts on ESS shares (or options) tax-free. This would reduce the taxable discount on his shares to \$3,000 in 201516.

Risk of Forfeiture

If there is a risk that Tom will forfeit the shares (for example, Tom must meet a performance target before being able to sell the shares) then he will become liable to pay tax once that risk no longer exists (for example, the performance hurdle is met and there are no restrictions on disposal). At that time, the shares are worth \$5 each and Tom will pay income tax on the difference between the acquisition cost and the market value of the share at that time*.

Capital Gains Tax

In all cases, Tom will be liable to pay capital gains tax when he sells the shares, on the difference between the sale price and the market value of the shares at the time of the ESS taxing point.

*Another taxing point will occur if Tom stops being an employee or the maximum time period is exceeded.

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Individual resident marginal tax rates for the year ended 30 June 2015

Income year 2015 Taxable Income \$	Income year 2015 Tax Payable (excluding Medicare levy)
0 – 18,200	Nil
18,201 – 37,000	19% of excess over \$18,200
37,001 – 80,000	\$3,572 + 32.5% of excess over \$37,000
80,001 – 180,000	\$17,547 + 37% of excess over \$80,000
180,001 +	\$54,547 + 47% of excess over \$180,000 (this includes the 2% temporary budget repair levy)

The tax rates do not include the Medicare Levy. From 1 July 2014 the Medicare levy rose from 1.5% to 2.0%. Your Medicare levy is reduced if your income is below a certain threshold and in some cases you may not have to pay the levy at all. The thresholds are higher for seniors. If your income is above the thresholds, you may still qualify for a reduction based on your family taxable income.

For more visit our website, www.cfmc.com.au

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