Inland Revenue
Te Tari Taake

COMMISSIONER'S STATEMENT

Determining the “market value” of shares that an employee receives under an employee share scheme

Issued: 31 July 2024

CS 24/01

About this document

The purpose of a Commissioner’s Statement is to inform taxpayers of the Commissioner’s position on a particular tax matter.

This statement provides guidance on working out the market value of a share benefit that employees receive under an employee share scheme.

This statement updates and replaces the Commissioner’s Statement CS 17/01: Valuation of employee share schemes, issued on 28 April 2017, which is withdrawn from the date of issue given at the end of this statement.

The main changes relate to the legislative confirmation of the market value formula to value shares under an employee share scheme.

All legislative references are to the Income Tax Act 2007 (“the Act”) unless otherwise stated.

Introduction

1. This Commissioner's Statement has been updated from CS 17/01 to include the reformed rules after the introduction of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 and the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

2. Employers are required to determine the value of any share benefit that an employee receives under an employee share scheme (ESS) and to report this value in the relevant employment information for which the share benefit arises. Note that this value is also relevant in determining expenditure or loss for employers in relation to an ESS.

3. In addition, the rules allow employers to elect to withhold PAYE on share benefits that employees receive.

4. This statement provides taxpayers with safe harbour valuation methods that the Commissioner will accept. However, it will not apply to any arrangements that are subject to any anti-avoidance provisions in the Act.

5. This statement also provides guidance on the information the company[1] should retain to support the valuation (in addition to any constitutional and Companies Act 1993 requirements).

6. This statement is not intended to provide a definitive and comprehensive set of valuation techniques, and companies may still apply other valuation methods that determine the market value of a share. If a company does use another valuation method, the valuation must reflect the market value of the shares on the share scheme taxing date.

Discussion

7. An ESS is defined in s CE 7 of the Act as:

> (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—
>
> (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

[1] Please note that "company" refers to the employing company even if another entity issues or transfers the shares in question to the employee.

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but

(b) does not include an arrangement that—

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

8. Broadly, an ESS is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee if it is connected to the employee's employment or service. This includes past, present and future employees. An ESS also includes where shares are provided to an associate of an employee, if this is in connection with the employee's employment or service.

9. These arrangements cover a wide range of share schemes. They may involve the immediate transfer of shares, the granting of share options, or deferred share schemes where shares vest or are transferred at a later date.

10. Section CE 2 of the Act determines the amount of the benefit the employee receives, by applying a formula on the share scheme taxing date (SSTD). It is the employee that receives this benefit under s CE 2, regardless of whether it is the employee or an associate of the employee that receives the shares.

11. Section CE 7B of the Act determines the SSTD. Where the trigger for the SSTD is that the employee (or their associate) receives shares under an ESS, the amount of the benefit under s CE 2 for the employee will be the market value of the shares on the SSTD less the amount the employee (or their associate) paid for the shares.

12. For ease of reference, the rest of this statement uses the term "ESS beneficiary" to mean persons that receive shares under an ESS (including where shares are provided to the employee's associates).

Value of share benefit

13. The amount of the benefit arising for an employee under an ESS is determined by the formula in s CE 2(1) as follows:

share value – consideration paid + consideration received – previous income

14. The definitions in the formula are set out in s CE 2(2):

- **share value** is the market value of shares or related rights owned by an employee share scheme beneficiary on the SSTD, if the SSTD is not triggered by a transfer or cancellation of the shares or related rights:
- **consideration paid**, is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:
- **consideration received**, is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:
- **previous income**, is the total amount of income under s CE (1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent of 29 March 2018 for the Taxation (Annual Rates, Employment and Investment Income, and Remedial Matters) Act 2018.

15. The Act defines the term "market value" in s CE 7CB[2] for the purpose of the ESS rules. It states that market value:

> (a) has the same meaning as in section YA 1 (Definitions), definition of market value, paragraphs (a) and (b); and
> (b) includes, for a share or option quoted on the official list of a recognised exchange, at the time, an amount equal to the 5-day volume weighted average price or any other method that is accepted by the Commissioner or is comparable to the 5-day volume weighted average price, for such shares or options.

16. Paragraphs (a) and (b) of the definition of "market value" in s YA 1 provide:

> (a) for a share or option quoted on the official list of a recognised exchange, at the time, means an amount equal to the middle market quotation at the time for a share or option having the same terms as the share or option to be valued, unless the quotation is not a fair reflection of the market value, having regard at the time to the matters referred to in paragraph (e) of the definition of recognised exchange:
> (b) for a share or option not quoted on the official list of a recognised exchange at the time, means the amount that a willing purchaser would pay to acquire the share or option in an arm's length acquisition at the time and that is determined using a method that—
>
> (i) conforms with commercially acceptable practice; and

[2] Inserted by the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

(ii) may, in appropriate cases, have regard to the present value at the time of the company's anticipated income or cash flows and the realisable value at the time of the company's assets; and

(iii) results in a valuation that is fair and reasonable:

Acceptable valuation methods

17. Where the company adopts one of the methods outlined in this statement and retains the necessary documentation to support the valuation, the Commissioner will accept the market value of the share in the formula in s CE 2(1).

18. Absolute accuracy is not expected in all scenarios (as accuracy depends in part on the data sets available and in some situations on subjective judgement). However, the Commissioner expects that the company will follow a reasonable, appropriate process when determining the share value at the time the shares are issued.

19. It is also expected that the company will fully document and retain the valuation method and any input assumptions it used to prepare the valuation because the Commissioner may request to examine this documentation.

20. Where a company adopts a method not outlined in this statement, it should retain the documentation with the valuation method, any input assumptions and reasons for adopting the alternative method. Again, the reason is that the Commissioner may request to examine this documentation.

21. Which methods the Commissioner will accept will depend on whether the type of shares issued to an ESS beneficiary under an ESS are shares in:

- a listed company;
- an unlisted company; or
- an unlisted start-up company.

22. For unlisted or unlisted start-up companies, discounts on the market value may be acceptable under the following circumstances:

    - Discount for lack of control arising from an inability or reduced ability for the prospective shareholder to influence the operational activities, policies and governance of the underlying company.
    - Discount for lack of liquidity to buy and sell shares arising from the absence of a readily available market.

23. This section outlines the methods the Commissioner will accept for these three types of shares.

Listed shares

24. Where the company issuing shares to an ESS beneficiary has shares listed on a "recognised exchange", the Commissioner will accept the share value reached (applicable to the class of shares, and any rights attaching to them, to which an ESS applies) using one of the following methods:

- **Option A:** an amount equal to the 5-day volume weighted average price (VWAP) over the last 5 trading days (including the SSTD) for the listed share;[3] or
- **Option B**: closing price of listed share on the SSTD; or
- **Option C:** if on the SSTD an ESS beneficiary disposes of any of the shares at market value on a recognised exchange, the actual proceeds of sale for those shares on that date and, if the proceeds of sale are in a foreign currency, the New Zealand dollar equivalent by applying the close of trading spot exchange rate on the sale date.

Recognised exchange

25. A recognised exchange is defined in s YA 1 as a recognised exchange market in New Zealand or anywhere else in the world where it has the following features:

- the exchange market brings together buyers and sellers of shares or options over shares;
- it involves the listing of prices, whether by electronic media or other means, at which persons are willing to buy or sell shares or options; and
- it provides a medium for determining arm's length prices likely to prove fair and reasonable, having regard to:
  - the number of participants in the market or having access to the market;
  - the frequency of trading in the market;
  - the nature of trading in the market, including how prices are determined and transactions are affected;
  - the potential or demonstrated capacity of a person or persons significantly to influence the market;
  - any significant barriers to entry to the market; and

[3] This method is now provided for in s CE 7CB (meaning of market value) and is not technically part of the Commissioner's "safe harbour" (though the outcome is the same, and the option has been retained here for convenience).

- any discrimination on the basis of quantity bought and sold unless based on the risks involved, the transaction costs or economies of scale.

Volume weighted average price

26. The VWAP method is set out in s CE 7CB(b). It is independent of the Commissioner's "safe harbour" (though the outcome is the same).

27. The VWAP for a share is calculated by adding up the dollars traded for every transaction relating to that share (price multiplied by number of shares traded) and then dividing by the total shares traded over the 5-day trading period (see Example | Tauira 1).

Example | Tauira 1: VWAP for ABC Limited over a 5-day trading period

Company ABC's shares are traded on the NZX. ABC Ltd issues shares to its employees on Friday 13 January.

Information obtained from the NZX shows the following ABC shares were traded over the previous 5 trading days (Monday 9 January to Friday 13 January):

Date	Number of shares	Volume weighted daily price
9 January	5,000	$2.00
10 January	Nil	NA
11 January	4,000	$1.98
12 January	10,000	$2.05
13 January	Nil	NA

ABC calculates the VWAP as follows:

(5,000 × $2.00) + (4,000 × $1.98) + (10,000 × $2.05) divided by 19,000 shares

= $2.02

The market value of the shares issued to ABC's employees on 13 January is $2.02.

Foreign-listed shares

28. If the shares are not listed in New Zealand but are listed on one or more overseas recognised exchanges, the foreign value determined in accordance with the above options will need to be converted to its New Zealand dollar equivalent by applying the close of trading spot exchange rate on the SSTD.

29. If the shares are listed on more than one recognised exchange (including for an employee not resident in New Zealand or a dual resident here, a recognised exchange in the employee's normal country of residence), the listed price should be based in the first instance on the recognised exchanges in the employee's country of residence. Alternatively, if that is not applicable, it should be based on the average of all the listed prices as converted to New Zealand dollars.

Newly listed company

30. Shares that a newly listed company issues to ESS beneficiaries as part of an initial public offering (IPO) should be valued using the published offer price for the IPO.

31. The published offer price is the price included in the retail offer documentation. If the company only offers the shares to non-retail investors (eg, institutional buyers, fund managers), it should use the VWAP of the investors following the relevant offer documentation.

32. If there has been no arm's length trading of the newly listed shares, the published offer price can be used for shares issued to ESS beneficiaries after the date of the IPO for a period not exceeding 6 months (unless the assumptions used to calculate the offer price change materially).

Information requirements

33. The company should retain information that can support the share value and method and should be able to supply the relevant documentation to the Commissioner on request. It should retain one of the following categories of information, based on its individual circumstances:

    - if it uses Option A, VWAP calculation and supporting listed price data;
    - if it uses Option B, closing market listed price data;

- if it uses Option C, documents evidencing the sale and currency conversion and, where an independent third party undertakes the sale and any subsequent conversion of the proceeds to New Zealand dollars, that third party's advice of the New Zealand dollar equivalent of the transaction;
- if newly listed shares, the published offer price; or
- if foreign-listed shares, the relevant published offer price or listed price data and the spot FX rate used.

Unlisted shares

34. Where the company issuing shares to an ESS beneficiary has unlisted shares (excluding a start-up company, which is defined for the purposes of this guidance at [45]), the principles in para (b) of the definition of "market value" in s YA 1 (as set out at [16]) will apply. This requires finding the amount that a willing but not anxious purchaser would pay to acquire the share or option in an arm's length acquisition at the time using methods set out in para (b) of the "market value" definition in s YA 1.

35. Taking those considerations into account, the Commissioner will accept the share value reached (applicable to the class of shares, and any rights attaching to them, to which an ESS applies) using one of the following methods:

    - **Option A:** an arm's length value determined by an independent, suitably qualified valuer that conforms with commercially accepted practice;[4]
    - **Option B**: a valuation involving the arm's length issue or sale of the same class of shares to a non-associated third party in the 6 months prior to the SSTD (eg, a previous capital raising or sale of a parcel of shares) where, if new shares are being issued to ESS beneficiaries, the valuation is adjusted for dilution of existing shares; or
    - **Option C**: a valuation that an appropriate person in the company prepares using an appropriate method (see [44] for an explanation of this option and the requirements for using it).

[4] For the purposes of [41] and [51], "commercially accepted practice" means a valuation prepared under Advisory Engagement Standard 2: Independent Business Valuation Engagements issued by Chartered Accountants Australia and New Zealand, or an equivalent valuation engagement standard.

Dilution effect when issuing new shares

36. All methods of valuation should consider the diluting effect of issuing new shares to ESS beneficiaries, as Example | Tauira 2 illustrates.

Example | Tauira 2: Dilution effect of issuing new shares

Company A has previously issued 1 million shares to non-associated third parties for $1 million. Subsequently, Company A issues 100,000 new shares to employees for no consideration. The value of the shares will be calculated as follows:

> Total consideration paid for shares issued $1 million divided by total shares issued 1.1 million
>
> = $0.91 per share.

Foreign company

37. If a company holds its unlisted shares in a foreign company, it will need to convert the foreign value determined in accordance with the options set out at [35] to its New Zealand dollar equivalent by applying the close of trading spot exchange rate on the SSTD.

Previous valuation

38. The Commissioner will accept a value based on the most recent valuation prepared by a company using Option A, B or C if the valuation:

- is for the same class of shares as the shares issued to the employee; and
- was prepared within a period not exceeding 6 months prior to the SSTD.

39. This statement will not apply where a company uses a previous valuation and the original share value is adjusted, resulting in a lower value (discounting). This statement will also not apply where the previous valuation relates to shares of a different class from the shares issued under the ESS.

Information requirements

40. The company should retain information that can support the share value and method and should be able to supply the relevant documentation to the Commissioner on

request. The information that the company should retain depends on which option it uses, as outlined in the following paragraphs.

41. If the company uses Option A, it should retain a copy of the independent valuation report it received.

42. If the company uses Option B, it should retain:

- documentation supporting the value of the shares issued or sold to the non-associated third party (eg, a copy of sale and purchase agreement or capital raising documentation);
- confirmation that the shares are of the same class; and
- written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary at the SSTD.

43. If the company uses Option C, the information requirements are more detailed, as outlined at [44].

Option C: Information requirements for an internally prepared valuation

44. The company should provide a copy of the internally prepared valuation along with:

- confirmation that the person who prepared the valuation was employed by the company and has the necessary financial skills, qualification and experience to prepare a valuation;
- confirmation that the valuation is based on an appropriate method. The Commissioner considers either of the following methods is appropriate:
  - discounted cash flow (DCF); or
  - capitalisation of earnings;
- contemporaneous documentation supporting all workings, input assumptions and comparable data used to prepare the valuation. This should include the following information (where applicable):
  - financial information used to determine earnings (for capitalisation of earnings method) or future cash flows (for DCF method), including (but not limited to): prior year financial statements; current operating results; and cash flows and future-oriented financial information such as budgets, forecasts and projections;

  - documentation supporting any normalising adjustments;
  - documentation supporting discount rates;
  - documentation supporting capitalisation rates or earnings multiples (including any comparable data used to determine earnings multiples); and
  - reasoning and support for any discounts or premiums;
- written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary on the SSTD or, alternatively, confirmation that an independent, suitably qualified valuer, who was appointed or instructed by the board of directors, has reviewed and agreed with the valuation; and
- a copy of the independent valuation opinion (if applicable).

Shares in an unlisted start-up company

45. The company issuing shares to an ESS beneficiary can apply the approach outlined in this section where it is a start-up company. Being a start-up company generally means that the company:
    - is in the first stage of its operations;
    - is initially financed and operated by founding shareholders or investors;
    - has not paid any dividends;
    - has expenses that tend to exceed its revenues and may not yet be producing a profit;
    - tends to have very low net tangible assets;
    - may have a high level of expended research and development costs relative to its tangible assets value; and
    - does not yet have a stable market for its product or service.
46. The Commissioner will accept one of the following methods for valuing start-up company shares:
    - **Option A**: an arm's length value determined by an independent, suitably qualified valuer that conforms with commercially accepted practice;
    - **Option B**: a valuation involving the arm's length share issue or sale of the same class of shares to a non-associated third party in the 12 months prior to the SSTD

(eg, a previous capital raising or sale of a parcel of shares) where, if new shares are being issued to ESS beneficiaries, the valuation is adjusted for dilution of existing shares; or

- **Option C:** a valuation that an appropriate person in the company prepares using an appropriate method (see [44] for an explanation of this option and the requirements for using it). Option C will not be available if the company has a previous valuation under Option A or a recent issue or sale of shares under Option B.

Venture capital funding

47. Given share valuations for venture capital funding rounds are complex, this statement does not apply to a company with a venture capital funding round[5] that is either current or proposed (ie, is intended to take place within 6 months of the SSTD for the ESS beneficiary). The company should obtain a separate arm's length valuation for any shares issued to ESS beneficiaries under an ESS where venture capital funding is involved.

Previous valuation

48. The Commissioner will accept a value based on the most recent valuation that a company has prepared using Option A, B or C if the valuation:

- is for the same class of shares as the shares issued to the ESS beneficiary; and
- was prepared within a period not exceeding 12 months prior to the SSTD for the ESS beneficiary.

49. This statement will not apply where a company uses a previous valuation and the original share value is adjusted, resulting in a lower value. This statement will also not apply where the previous valuation relates to shares of a different class from the shares issued under the ESS.

Information requirements

50. The company should retain information that can support the share value and method and be able to supply the relevant documentation to the Commissioner on request.

[5] A venture capital funding round means funding by a venture capital fund or firm (including Series A funding rounds). It does not include seed funding from private investors.

The information the company should retain depends on which option it uses, as outlined in the following paragraphs.

51. If the company uses Option A, it should retain a copy of the independent valuation report it received.

52. If the company uses Option B, it should retain:

- documentation supporting the value of the shares issued or sold to the non-associated third party (eg, copy of sale and purchase agreement or capital raising documentation);
- confirmation that the shares sold to the non-associated third party are of the same class as the ESS shares and have the same rights attached to them; and
- written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary at the SSTD.

53. If the company uses Option C, the information requirements are more detailed, as outlined at [44].

Option C: Information required for an internally prepared valuation

54. If the company has prepared a valuation internally, it should retain:

- a copy of the internally prepared valuation;
- confirmation that the person who prepared the valuation was employed by the company and has the necessary financial skills, qualification and experience to prepare a valuation;
- confirmation that the valuation is based on an appropriate method. The Commissioner considers the appropriate method is the DCF;
- contemporaneous documentation supporting all workings, input assumptions and comparable data used to prepare the valuation. This should include the following information (where applicable):
  - financial information used to determine future cash flows including (but not limited to): prior year financial statements; current operating results; and cash flows and future-oriented financial information such as budgets, forecasts and projections;
  - documentation supporting any normalising adjustments;

    - documentation supporting discount rates;
    - documentation supporting capitalisation rates; and
    - reasoning and support for any discounts or premiums;
- written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary on the SSTD or, alternatively, confirmation that an independent, suitably qualified valuer, who was appointed or instructed by the board of directors, has reviewed and agreed with the valuation; and
- a copy of the independent valuation opinion (if applicable).

Application

55. This statement along with its predecessor (CS 17/01) provide general guidance on working out the market value of a share benefit that employees receive under an ESS as outlined in the Act. The Commissioner will apply the position in the statements to shares ESS beneficiaries acquire on or after 1 April 2017.[6]

56. If you have any concerns about your compliance with the tax obligations discussed in this statement, you should discuss them with an appropriately qualified tax professional.

Matthew Evans

Technical Lead,

Legal Services (Technical Standards)

Date of Issue: 31 July 2024

[6] This date reflects the Commissioner's safe harbour that applied before the 2018 legislative amendment to define "market value" in s CE 7B of the Act.