

# ESS – some specific interpretive issues (PUB00364/A - F)

## Reading guide for external consultation purposes

The employee share scheme (ESS) tax regime was reformed in 2018. In 2021, we consulted on and published [QB 21/04: When an employer is party to an employee share scheme, when does an employer’s expenditure or loss under s DV 27\(6\) or income under s DV 27\(9\) arise?](#) *Tax Information Bulletin* Vol 33, No 6 (July 2021). During the consultation process, and since then, we have received various questions about how the law applies in certain scenarios and interacts with other regimes (such as PAYE and FBT).

Given the wide range of issues we have been asked to consider, we have produced six items, with each one focusing on specific tax implications for ESS. We decided to take this approach, rather than producing one larger item, so it is easier for people to find guidance on the issue that they are interested in. Which issues are relevant to you will vary according to the nature of the taxpayer and the ESS in your situation.

We are currently consulting on five interpretation statements and one question we’ve been asked (QWBA). Together these items aim to provide guidance and examples that demonstrate the Commissioner’s (draft) view on some of the issues related to ESS.

This guide outlines the issues each item addresses, with the intention of helping you determine which items you are interested in commenting on. Legislative references are to the Income Tax Act 2007.

### **PUB00364/A (interpretation statement): What an employee share scheme is, the taxing date and apportionment**

This interpretation statement addresses questions about:

- whether particular arrangements constitute an ESS and, if so, when the share scheme taxing date (SSTD) arises;
- when the SSTD arises if issuing of shares is delayed or shares are not yet in existence; and
- when the SSTD arises and when the earning period ends (for the purposes of benefit apportionment) for “good leavers” who retain their benefits but receive them in the ordinary course of the ESS.

To do so, it considers the following issues (and includes related examples):

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- what an ESS is, referring to the definition set out in s CE 7 and the exclusions provided for in s CE 7(b);
- when the SSTD arises, referring to the definition set out in s CE 7B, with a particular focus on when shares are held by or for the benefit of an ESS beneficiary for the purposes of s CE 7B(1)(a) and after which the deferral provisions do not apply; and
- how a benefit is apportioned under s CE 2(5), for example when an employee retires early and retains their benefit. A particular focus is on how the “earning period” is determined under s CE 2(6)(c), as the end of this period may not coincide with the SSTD.

### **PUB00364/B (interpretation statement): Deductions for parties to employee share schemes**

This interpretation statement addresses questions about an employer’s expenditure or loss under s DV 27(6) and whether:

- any resulting deduction is limited where the employee does not pay tax on the full benefit;
- a deduction arises, and to whom, when a resident or non-resident parent company issues the shares; and
- *Clough Ltd v FC of T (No 2)* 2021 ATC ¶120-805 will be applied in New Zealand to limit deductions triggered by a liquidity event.

To do so, it primarily considers the expenditure or loss that is deemed to arise for an employer under s DV 27(6), setting out that the general permission still needs to be satisfied and the general limitations must not apply. It discusses the capital limitation and *Clough*.

Also discussed is how the deductibility of such expenditure or loss is not necessarily linked to whether the employee’s benefit is assessable.

Examples are provided to demonstrate the concepts.

### **PUB00364/C (interpretation statement): Trustee of employee share scheme trust treated as nominee**

This interpretation statement addresses questions about the effect of s CE 6, including:

- how dividends paid on shares that an ESS trustee holds are treated for tax purposes; and
- what the consequences for available subscribed capital are where an ESS trustee holds shares and those shares are treated as cancelled after a period under the treasury stock rules.

To do so, it considers the tax implications of treating an ESS trustee as nominee for the share issuing company (or employer, if different) under s CE 6, with a particular focus on available

subscribed capital, the treasury stock rules and the dividend rules. Examples are provided to demonstrate the concepts.

### **PUB00364/D (interpretation statement): Employee Share Scheme benefits paid in cash – PAYE and KiwiSaver obligations**

This interpretation statement addresses questions about whether an employer has PAYE, Accident Compensation Corporation (ACC) and/or KiwiSaver obligations for an ESS benefit that is paid in cash instead of shares, regardless of whether the employer has made an election to apply PAYE to the ESS benefits.

To do so, it considers (and includes related examples of) whether:

- an arrangement is an ESS;
- a payment is a cash-settled benefit;
- an employer is able to elect to withhold PAYE from a cash-settled benefit, in the same way as they can from a share-settled benefit; and
- an employer has KiwiSaver obligations for a cash-settled benefit.

This interpretation statement concludes that a cash-settled ESS benefit is an “extra pay” under the general definition of extra pay and a PAYE income payment, regardless of whether an employer elects to withhold PAYE in respect of the benefit. This reflects the current law. However, the Commissioner acknowledges that advice on Inland Revenue’s website may give the impression that the election to withhold PAYE applies to both cash- and share-settled ESS benefits (rather than only share-settled ESS benefits). See, for instance:

[Paying tax on employee share scheme \(ESS\) benefits \(ird.govt.nz\)](#)

[Receiving employee share scheme \(ESS\) benefits \(ird.govt.nz\)](#)

For that reason, we are proposing this interpretation statement will apply prospectively to cash-settled ESS benefits in accordance with the [Status of Commissioner’s advice Tax Information Bulletin](#) Vol 24, No 10 (December 2012). We are interested in learning about any practical difficulties that might arise.

There is an accompanying fact sheet.

### **PUB00364/E (interpretation statement): PAYE – How an employer funds the tax cost on an employee share scheme benefit**

This interpretation statement addresses questions about an employer’s PAYE, student loan and KiwiSaver obligations where an employer wants to fund the tax cost on an ESS benefit provided in **shares**. To do so, it considers:

- the nature of the additional payment;
- an employer's PAYE, student loan and KiwiSaver obligations;
- when an employer must gross up the additional payment;
- how an employer calculates a gross-up;
- reporting the additional payment; and
- examples illustrating the points discussed.

### **PUB00364/F (QWBA): Fringe benefit tax – employee share loans and associates**

This QWBA addresses the question: Does a fringe benefit arise where a trustee of a family trust that is associated with an employee is provided a loan to acquire shares under an ESS?

The (draft) answer is: No, a fringe benefit does not arise in this situation, provided that a fringe benefit would not arise if the employee were provided the loan to acquire the shares under the ESS in the same circumstances.