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INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

PAYE – How an employer funds the tax cost on an employee share scheme benefit

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This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver if an employer wants to fund the cost of tax (and student loan, if applicable) on an employee share scheme benefit provided in shares.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

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Summary | Whakarāpopoto

1. This interpretation statement explains an employer's PAYE, student loan and KiwiSaver obligations where an employer wants to fund the cost of tax on an employee share scheme (ESS) benefit provided in **shares**.

2. It is unlikely that an employer would fund the cost of tax on an ESS benefit provided in cash. For this reason, this interpretation statement does not consider that situation.

3. An ESS benefit is income to an employee. Where an employer provides the benefit in shares (ie a non-cash benefit), it is not required to withhold tax from the benefit and in that case the employee pays tax on the benefit through the end-of-year tax return process.

4. To simplify the end-of-year tax return process for the employee, an employer might choose to withhold tax from the ESS benefit under the PAYE rules. When an employer chooses to withhold tax from an ESS benefit that it provides in shares, the benefit in shares is treated as an "extra pay" and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate. If the employee has a student loan, the employer may need to make a student loan deduction. Accident Compensation Corporation (ACC) earners' levy and KiwiSaver deductions (and contributions) do not apply to an ESS benefit provided in shares.

5. As the ESS benefit is in shares and a non-cash benefit, the tax withheld will need to be funded in some way. If the employer has not agreed to fund the tax payment, it will need to be funded by the employee. For example, the employer and employee may agree that, to fund the tax the employer will deduct it from the employee's net salary or sell a portion of the shares on behalf of the employee.

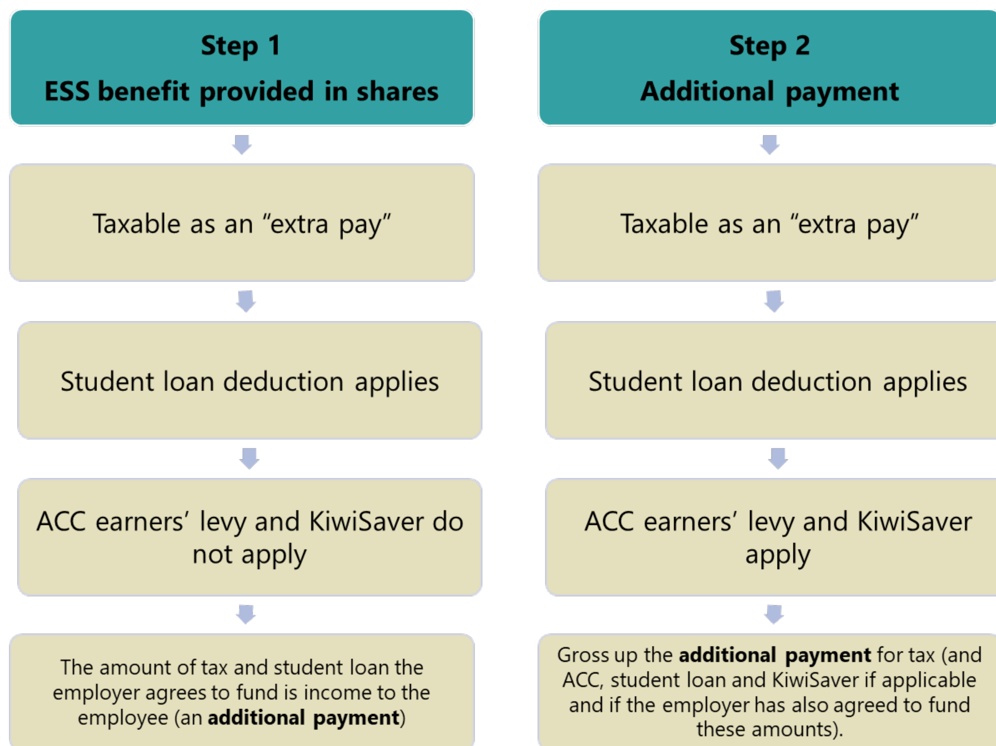
6. Alternatively, the employer may agree to fund the tax (and any student loan deduction, if applicable) on the benefit with the intention that the net benefit the employee receives is the value of the ESS benefit. Any additional payment that an employer makes to fund the cost of the tax on an ESS benefit (and a student loan deduction, if applicable) is itself an "extra pay". As an extra pay, it is income to the employee and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate.

7. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver deductions (and contributions) that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes. The employer will need to consider whether it wants to fund the cost of ACC earners' levy and KiwiSaver deductions on the additional payment.

8. If the employer wants to ensure the net benefit the employee receives is the value of the ESS benefit, it must gross up any additional payment it makes for any resulting tax, and student loan , ACC earners' levy and KiwiSaver. This outcome arises because the employer is providing the employee with a further benefit (the additional payment) that is assessable income to the employee. As a result, further tax (and student loan, if applicable) is payable, and ACC earner's levy and KiwiSaver deductions (and contributions) may also apply to the additional payment.

9. Figure | Hoahoa 1 illustrates these obligations.

Figure | Hoahoa 1: Summary of the tax consequences when an employer elects to withhold tax from an ESS benefit provided in shares and agrees to fund the cost of the tax (and potentially other deductions).



10. If an employer wants to fund only the tax (and ACC earners' levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that it will need to make a deduction from their net salary or wages to cover the student loan and KiwiSaver deductions.

11. To the extent that an employer is required to separately identify the amount of the ESS benefit in its employment income information, this amount should not include an additional payment made to fund tax (and student loan deduction, if applicable) on the ESS benefit. An additional payment of this nature is not part of the ESS benefit for tax purposes.

12. Examples illustrating the points discussed in this interpretation statement follow from [66].

Introduction | Whakataki

Background

13. Generally, where an employee receives a benefit under an employee share scheme (ESS), their employer provides it in **shares** (ie it is a non-cash benefit). The amount of the benefit is income to the employee and the employee pays tax on the benefit through the end-of-year tax return process (and through provisional tax, if applicable).[1]

14. An employer is not required to withhold tax on an ESS benefit provided in shares. However, an employer can choose to withhold tax under the PAYE rules. Withholding tax simplifies the end-of-year tax process for the employee.

15. If an employer decides to withhold tax, it also needs to think about how that tax will be paid given that shares are a non-cash benefit. Specifically it needs to consider whether it will be the employee or the employer that funds the payment of the tax. In some situations, an employer may want to fund the payment of the tax. It might do this so that the employee receives a net benefit equal to the value of the ESS benefit (the shares).

16. If it is intended that the employee should bear the cost of the withholding, the employer and the employee will need to agree how the tax will be paid. Possible alternatives include the employer deducting the tax from the employee's salary or selling a portion of the shares on behalf of the employee. Ultimately whether the employer or the employee funds the tax will depend on what they agree between them.

17. In some circumstances, an employer provides an ESS benefit in cash.[2] In this situation, the PAYE rules require an employer to withhold tax. As the employer pays the benefit in cash, it would generally deduct tax from the payment under the PAYE rules in the usual way. As it is unlikely an employer would fund the payment of tax where it provides the ESS benefit in cash, this interpretation statement does not consider that situation.

18. Where an employer elects to withhold tax from an ESS benefit it provides in shares, it is also required to make a student loan deduction, if applicable. If the employee has a

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[1] For more information about how receiving an ESS benefit that is not taxed at source affects an employee, see **QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted** *Tax Information Bulletin* Vol 35, No 5 (June 2023).

[2] For more information on ESS benefits provided in cash, see the draft interpretation statement currently out for consultation, PUB00364/D: ESS benefits paid in cash – PAYE and KiwiSaver obligations for employers.

student loan, then the employer will need to consider whether it will fund the cost of the student loan deduction or whether the employee will fund this cost.

19. KiwiSaver and Accident Compensation Corporation (ACC) earners' levy do not apply to an ESS benefit that an employer provides in shares. However, where the employer bears the cost of tax (and student loan deduction, if applicable) on an ESS benefit, KiwiSaver and ACC earners' levy may apply to that additional payment.

20. This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver where an employer:

    - has elected to withhold tax in relation to an ESS benefit provided in **shares**; and
    - has agreed to fund the cost of the tax (and potentially other obligations).

21. While this statement is focused on the situation where an employer agrees to fund the cost of the tax, an example of the situation where an employer has elected to withhold but has not agreed to fund the cost of the tax can be found at Example | Tauira 2.

What this statement covers

22. For ease of reference, this statement uses **additional payment** to mean the amount of tax (and student loan deduction, if applicable) that the employer funds on an ESS benefit.

23. This statement covers:

    - 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;
    - an employer's obligations in reporting the additional payment; and
    - examples illustrating the points discussed.

Analysis | Tātari

The nature of the additional payment

24. When considering an employer's PAYE, student loan and KiwiSaver obligations in the situation where an employer is funding the tax (and student loan deduction, if applicable) on an ESS benefit, it is necessary to understand the nature of what the employer is providing to the employee.

25. An ESS benefit is income to an employee under s CE 1(1)(d). Where the benefit is in shares and the employer has elected to withhold tax under s RD 7B, then the benefit is treated as an "extra pay" under s RD 7(1)(bb). An "extra pay" is a PAYE income payment from which an employer is required to withhold tax under ss RA 5 and RD 3.

26. Where an employer is funding the tax payable on an ESS benefit (and student loan deduction, if applicable), then the question is whether this additional payment is also:

- income to the employee; and
- a PAYE income payment from which an employer is required to withhold tax.

27. Employment income is defined in s CE 1 and includes an "extra pay" under s CE 1(1)(a) and an employee share scheme benefit under s CE 1(1)(d).

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> …
>
> (d) a benefit received under an employee share scheme:
>
> …

28. Section RD 7(1)(a) contains the general definition of an "extra pay".

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; and
>
> (ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and
>
> (iii) is not overtime pay; and
>
> (iv) is made in 1 lump sum or in 2 or more instalments; and
>
> …
>
> (d) does not include a payment of exempt income.
>
> …

29. The additional payment the employer makes meets the requirements of s RD 7(1)(a). It is a payment made to a person (which is then applied to their tax and student loan accounts) and it is made in connection with their employment (it relates to an ESS benefit). As a one-off payment, it is not a payment regularly included in the employee's salary or wages and is generally made in one lump sum. It is not overtime pay. It is unlikely to be a payment of exempt income (see subparts CW and CZ for exempt income provisions).

30. Accordingly, the additional payment is an "extra pay" as defined in s RD 7(1)(a). As an "extra pay", it is income to the employee under s CE 1(1)(a) and a PAYE income payment from which an employer must withhold tax under ss RA 5 and RD 3.

31. It is important to note that the additional payment is not part of the ESS benefit for tax purposes. For tax purposes, the amount of the ESS benefit is determined under s CE 2(1) and (2).

> **CE 2 Benefits under employee share schemes**
>
> *Benefit*
>
> (1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or (ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—
>
> share value − consideration paid + consideration received − previous income.
>
> *Definition of items in formula*
>
> (2) In the formula in subsection (1),—
>
> (a) **share value** is the market value of the shares or related rights owned by an employee share scheme beneficiary on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights:
>
> (b) **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:
>
> (c) **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:
>
> (d) **previous income** is the total amount of income under section CE 1(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 for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.

> …

32. Broadly, when an employee receives an ESS benefit in shares, the amount of the benefit is the market value of the shares on the share scheme taxing date less the amount paid for the shares (if anything).

33. The additional payment to fund the tax on the ESS benefit (and student loan deduction, if applicable) is not part of the "share value" and neither is it "consideration received". "Consideration received" is an amount paid in relation to a transfer or cancellation of shares or related rights under an ESS.

34. The fact that the additional payment is not part of the ESS benefit for tax purposes means that any special rules that apply to an ESS benefit generally do not apply to the additional payment. For further discussion of the impact of this conclusion, see [42] in relation to ACC earners' levy and [51] on KiwiSaver.

An employer's PAYE, student loan and KiwiSaver obligations

35. This section considers an employer's obligations to deduct PAYE (including ACC earners' levy), student loan repayments and KiwiSaver from:
    - an ESS benefit where the employer has elected to withhold tax; and
    - an additional payment an employer makes to fund the tax on the ESS benefit.

Income tax

36. As discussed at [25], when an employer elects to withhold tax from an ESS benefit, then the benefit is treated as an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

37. Likewise, as concluded at [30], an additional payment that an employer makes to fund the tax (and student loan deduction, if applicable) on an ESS benefit is also an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

38. Tax on the ESS benefit and the additional payment is calculated at the employee's extra pay tax rate. The extra pay tax rate is determined under s RD 10, s RD 17 and sch 2, part B. Tax rates for an "extra pay" are also available in the current PAYE deduction tables, which Inland Revenue publishes annually.

ACC earners' levy

39. The Accident Compensation Act 2001 (ACC Act) sets out an employer's obligations for collecting ACC earners' levy.

40. An employer collects ACC earners' levy by making a deduction from an employee's "earnings" (s 221, ACC Act). "Earnings" include "earnings as an employee", which means all PAYE income payments (as defined in s RD 3(1)) of the person for the tax year (ss 6 and 9, ACC Act). Section 11 of the ACC Act then excludes from "earnings as an employee" any benefit arising from an ESS under s CE 2 when the employer makes an election under s RD 7B to withhold and pay tax in relation to the benefit.

41. Accordingly, an employer is not required to deduct ACC earners' levy from an ESS benefit that it provides in shares because the benefit is excluded from being "earnings" for the purposes of the ACC Act.

42. However, as discussed from [31] to [34], the additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on an ESS benefit is not itself an ESS benefit. Therefore, the additional payment made to fund the cost of tax (and student loan deduction, if applicable) on the ESS benefit will be "earnings" for the purposes of the ACC Act (as it is not otherwise excluded). This means that an employer will be required to deduct ACC earners' levy from the additional payment subject to the maximum earnings threshold for employees set by the Accident Compensation (Earners' Levy) Regulations under the ACC Act.

Student loan

43. The Student Loan Scheme Act 2011 (SLS Act) sets out an employer's obligations for collecting student loan repayments under ss 36 and 37.

44. An employer collects student loan repayments by making a deduction from an employee's "salary or wages", which includes an "extra pay" under the SLS Act.[3] The definition of "salary or wages" in the SLS Act does not exclude an ESS benefit.

45. Accordingly, an employer is required to deduct student loan repayments from an ESS benefit and any additional payment.

46. As discussed at [18], where an employer wants to fund the tax on an ESS benefit provided in shares (ie a non-cash benefit) and the employee has a student loan, then the employer needs to consider whether it also wants to fund the cost of the student loan deduction. If the employer does not agree to fund the student loan deduction, the employee must fund it (eg the employee may agree to the employer deducting the amount from their salary, or the employee may pay the student loan amount out of their net salary).

[3] Section 4 ("salary or wages").

KiwiSaver

47. The KiwiSaver Act 2006 (KiwiSaver Act) sets out an employer's KiwiSaver obligations.

48. Broadly, if an employee is a KiwiSaver member and is not on a savings suspension (ie is not taking a break from making KiwiSaver contributions), then their employer is required to deduct KiwiSaver at the employee's contribution rate from the employee's gross salary or wages. An employer is also generally required to make a compulsory employer contribution based on an employee's gross salary or wages.

49. Section 4 of the KiwiSaver Act defines "salary or wages". It relevantly states:

> **salary or wages**, in relation to any person, means salary or wages as defined in section RD 5(1)(a) to (c) of the Income Tax Act 2007 (whether the salary or wages are primary or secondary employment earnings) except that, in this Act,—
>
> (a) it excludes—
>
> ...
>
> (vi) the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:
>
> (b) it includes extra pay (as defined in section YA 1 of the Income Tax Act 2007), unless—
>
> (i) otherwise excluded under paragraph (a) of this definition; or
>
> (ii) the amount is a redundancy payment for the purposes of the Income Tax Act 2007.

50. It follows that an employer is not required to make KiwiSaver deductions or employer contributions in relation to an ESS benefit. This is because KiwiSaver deductions and contributions are based on an employee's gross salary or wages and an ESS benefit is expressly excluded from the definition of "salary or wages" in s 4 of the KiwiSaver Act.

51. However, as discussed from [31] to [34], any additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on the ESS benefit is not itself an ESS benefit. Therefore, any additional payment made to fund the cost of tax (and student loan deduction, if applicable) on the ESS benefit will be "salary or wages" for the purposes of the KiwiSaver Act. This means that an employer may be required to make KiwiSaver deductions from or employer contributions on the additional payment.

Summary

52. When an employer elects to withhold tax from an ESS benefit provided in shares, the ESS benefit is treated as an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to

make a student loan deduction. ACC earners' levy and KiwiSaver deductions (and contributions) do not apply to the ESS benefit.

53. Any additional payment that the employer makes to fund the tax (and student loan deduction, if applicable) on the ESS benefit is also an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes.

54. When an employer wants to fund the tax on an ESS benefit and the intention is that the employee will receive a net benefit equal to the value of the ESS benefit (the shares), the employer will also need to consider whether it wants to fund the cost of any student loan deduction on the ESS benefit and the cost of ACC earners' levy, student loan and KiwiSaver deductions on the additional payment.

When an employer must gross up the additional payment

55. Whether an employer is required to gross up an additional payment depends on what has been agreed between the employer and the employee.

56. Where an employer has agreed to make a payment sufficient to ensure that the employee receives the shares as a net benefit then the additional payment will be the amount of the tax (and student loan deduction, if any) on the ESS benefit. The employer must gross up that additional payment for PAYE (and student loan and KiwiSaver deductions, if any). This outcome arises because the employer is providing the employee with a further benefit (the tax and student loan payments) that is assessable income to the employee. As a result, further tax (and ACC earners' levy, student loan and KiwiSaver, if applicable) is payable. See Example | Tauira 1 and Example | Tauira 6.

57. Where an employer has agreed to fund only the PAYE on the ESS benefit and the additional payment (not student loan or KiwiSaver) then the amount of the additional payment is the amount of tax on the ESS benefit. The employer must gross up the additional payment for tax (and ACC earners' levy if applicable). Any student loan deduction on the ESS benefit and the additional payment and any KiwiSaver deduction on the additional payment would need to be funded by the employee. See Example | Tauira 5 and Example | Tauira 7.

58. The employer need not gross up if the employee is funding the cost of the tax on the ESS benefit. For example, this applies if the employer deducts the tax from the employee's net salary or sells a portion of the shares on the employee's behalf to fund

the tax. In this case, the employee is not receiving any additional benefit from the employer and so no additional tax is payable. See Example | Tauira 2.

How an employer calculates a gross-up

59. The first step is for the employer to work out the amount of the additional payment. This amount will generally be the total of:
    - the tax on the ESS benefit at the appropriate extra pay tax rate; and
    - the amount of the student loan deduction on the ESS benefit (if applicable and if the employer has also agreed to fund this amount).
60. The next step is for the employer to "gross up" the additional payment for tax (and ACC earners' levy, student loan and KiwiSaver deductions, if applicable and if the employer has also agreed to fund these amounts).
61. Some payroll software will allow an employer to choose whether the value of a benefit it provides to an employee is a net or gross amount. However, in situations where an employer must calculate the value manually, it may use the following gross-up formula:

    Gross income = net income / (1 – tax rate)

62. The "net income" is the amount of the additional payment calculated at step 1 (see [59]). The "tax rate" (where an employer is funding the tax on an ESS benefit) is the appropriate extra pay tax rate for the employee. This is because the tax funded by the employer is a one-off amount and an "extra pay" under s RD 7 (see [26] to [30]). If the employer is funding more than one tax type (or deduction), such as a student loan as well as the tax on an ESS benefit, then it adds the tax rates together. See Example | Tauira 3, Example | Tauira 4 and Example | Tauira 6.
63. If an employer wants to fund only the tax (and ACC earners' levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that it will need to make a deduction from the employee's net salary or wages to cover any student loan and KiwiSaver deductions on the ESS benefit and the additional payment as applicable. See Example | Tauira 5 and Example | Tauira 7.

An employer's reporting obligations

64. Section RD 22 requires an employer (or PAYE intermediary) to provide employment income information to the Commissioner.
65. Where an employer is required to separately identify the amount of the ESS benefit, this amount should not include an additional payment made to fund tax (and student

loan deduction, if applicable) on the ESS benefit. As discussed from [31] to [33], an additional payment of this nature is not part of the ESS benefit for tax purposes.

Examples | Tauira

66. The following examples illustrate the points discussed in this interpretation statement.

Example | Tauira 1 – Employer funds the tax

Marie receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax. The intention is for Marie to receive a net benefit of $10,000 (ie the value of the shares she received).

Marie's annual salary is above the ACC earners' levy threshold. She does not have a student loan and is not a KiwiSaver member.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Marie of 33% ($10,000 × 33% = $3,300).

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Marie with a further benefit (the tax payment) that is an "extra pay" and assessable income to Marie. As a result, further tax is payable. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Steady Ltd makes a payment of $4,925.37 to Marie in its payroll system and withholds tax of $1,625.37 at 33% ($4,925.37 × 33% = $1,625.37). The net amount of $3,300 is applied to pay the tax on the ESS benefit.

The additional payment of $4,925.37 that Steady Ltd makes to Marie is reported in its employer income information but it is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Other scenarios

If Steady Ltd had processed the ESS benefit of $10,000 through its payroll system and paid the tax of $3,300 for Marie without doing anything further, this would have been incorrect. The payroll system would show income of $10,000 and tax of $3,300, leaving net income of $6,700. This outcome is incorrect because Marie actually received net income of $10,000.

If Steady Ltd had limited its additional payment to $3,300, this amount would still be income to Marie and subject to tax. Steady Ltd must report the $3,300 as additional income to Marie. As Steady Ltd would only be funding the tax on the ESS benefit and not on the additional payment, Marie would need to fund the tax on the additional payment. For example, that tax could be deducted from her net salary or wages.

Example | Tauira 2 – Employee funds the tax

Nate receives some shares under an ESS from his employer, Rapid Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Rapid Ltd will elect to withhold tax from the benefit and that Nate can choose whether to fund the tax through a deduction from his net salary or the sale of a portion of the shares.

Nate's annual salary is above the ACC earners' levy threshold. He does not have a student loan and is not a KiwiSaver member.

Nate chooses to fund the tax through a deduction from his net salary. Rapid Ltd calculates the tax on the ESS benefit using the appropriate extra pay tax rate for Nate of 33%. The result is as follows:

ESS benefit	$10,000
Tax at 33%	$3,300
Net income	$6,700

Although Nate has received $10,000 worth of shares, Rapid Ltd has deducted $3,300 from his usual salary payment. Therefore, Nate has received a net benefit of $6,700.

If Nate had chosen to sell a portion of his shares to fund the tax, Rapid Ltd would have sold $3,300 worth of shares on Nate's behalf and Nate would have received $6,700 worth of Rapid Ltd shares. The overall outcome would be the same: that is, Nate would receive a net benefit of $6,700.

The employer need not gross up in either of these situations because the employee is funding the cost of the tax.

Example | Tauira 3 – Employer funds tax and ACC earners' levy

Olivia receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the

scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax. The intention is for Olivia to receive a net benefit of $10,000 (ie the value of the shares she received).

Olivia's annual salary is below the ACC earners' levy threshold. She does not have a student loan and is not a KiwiSaver member.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Olivia of 33% ($10,000 × 33% = $3,300). ACC earners' levy does not apply to an ESS benefit provided in shares.

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Olivia with a further benefit (the tax payment) that is an "extra pay" and assessable income to Olivia. As a result, further tax is payable. ACC earners' levy at 1.60% also applies to the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – (0.33 + 0.016))
	$3,300.00 / (1 – 0.346)
	$3,300.00 / 0.654
	$5,045.87

Steady Ltd makes a payment of $5,045.87 to Olivia in its payroll system and withholds PAYE of $1,745.87 at 34.6% ($5,045.87 × 34.6% = $1,745.87). The net amount of $3,300 is applied to pay the tax on the ESS benefit.

The additional payment of $5,045.87 that Steady Ltd makes to Marie is reported in its employer income information but it is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Example | Tauira 4 – Employer funds tax and student loan deduction

Paora receives some shares under an ESS from his employer, Steady Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction. The intention is for Paora to receive a net benefit of $10,000 (ie the value of the shares he received).

Paora has a student loan and uses an SL tax code. His annual salary is above the ACC earners' levy threshold. He is not a KiwiSaver member.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Paora of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Paora with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Paora. As a result, further tax is payable and further student loan deductions are required. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12))
	$4,500.00 / (1 – 0.45)
	$4,500.00 / 0.55
	$8,181.82

Steady Ltd makes a payment of $8,181.82 to Paora in its payroll system and withholds tax of $2,700 at 33% and deducts student loan of $981.82 at 12%. The net amount of $4,500 is applied to pay the tax and student loan deduction on the ESS benefit.

The additional payment of $8,181.82 that Steady Ltd makes to Paora is reported in its employer income information but it is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Example | Tauira 5 – Employer funds tax but not student loan deduction

Quinn receives some shares under an ESS from her employer, BigCo Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that BigCo Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any student loan deduction. The employee must fund the cost of any student loan deduction on the ESS benefit and this amount will be deducted from the employee's ordinary net salary.

Quinn has a student loan and uses an SL tax code. Her annual salary is above the ACC earners' levy threshold. She is not a KiwiSaver member.

BigCo Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Quinn of 33% ($10,000 × 33% = $3,300). The student loan deduction on the ESS benefit is $1,200 (12%).

BigCo Ltd must gross up the amount of $3,300. This is because BigCo Ltd is providing Quinn with a further benefit (the tax payment) that is an "extra pay" and assessable

income to Quinn. As a result, further tax is payable. BigCo Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

BigCo Ltd makes a payment of $4,925.37 to Quinn in its payroll system and withholds tax of $1,625.37. Quinn must fund student loan repayments on the ESS benefit of $1,200 and on the additional payment of $591.04 ($4,925.37 × 12% = $591.04). Big Co Ltd will deduct these amounts from Quinn's ordinary net salary.

The additional payment of $4,925.37 that BigCo Ltd makes to Quinn is reported in its employer income information but is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Example | Tauira 6 – Employer funds tax, and student loan and KiwiSaver

Shoko receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction. The intention is for Shoko to receive a net benefit of $10,000 (ie the value of the shares she received). For that reason, Steady Ltd has also agreed to fund any KiwiSaver deduction that applies.

Shoko has a student loan and uses an SL tax code. She is also a KiwiSaver member and her contribution rate is 6%. Her annual salary is above the ACC earners' levy threshold.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Shoko of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Shoko with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Shoko. As a result, further tax is payable and further student loan deductions are required. KiwiSaver deductions (and employer contributions) also apply to the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12 + 0.06))
	$4,500.00 / (1 – 0.51)
	$4,500.00 / 0.49
	$9,183.67

The gross amount is income to Shoko and is applied as follows:

Tax on ESS benefit at 33%	$3,300.00
Tax on additional pay at 33%	$3,030.61
SL on ESS benefit at 12%	$1,200.00
SL on additional pay at 12%	1,102.04
KS on additional pay at 6%	551.02
	$9,183.67

Steady Ltd may also be required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $9,183.67.

The additional payment of $9,183.67 that Steady Ltd makes to Shoko is reported in its employer income information but it is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Example | Tauira 7 – Employer funds tax but not KiwiSaver

Robert receives some shares under an ESS from his employer, Cars Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Cars Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any KiwiSaver deduction that applies. The employee must fund the cost of any KiwiSaver deduction and this amount will be deducted from the employee’s ordinary net salary.

Robert is a KiwiSaver member and his contribution rate is 6%. Robert does not have a student loan. His annual salary is above the ACC earners’ levy threshold.

Cars Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Robert of 33% ($10,000 × 33% = $3,300).

Cars Ltd must gross up the amount of $3,300. This is because Cars Ltd is providing Robert with a further benefit (the tax payment) that is an “extra pay” and assessable income to Robert. As a result, further tax is payable. KiwiSaver deductions (and employer contributions) also apply to the additional payment. Cars Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Cars Ltd makes a payment of $4,925.37 to Robert in its payroll system. From that $4,925.37, tax of $1,625.37 is withheld and the net amount of $3,300 is applied to pay the tax on the ESS benefit. Robert must fund the KiwiSaver deduction on the additional payment of $295.52 ($4,925.37 × 6% = $295.52). Cars Ltd will deduct this amount from Robert's ordinary net salary.

Cars Ltd may also be required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $4,925.37.

The additional payment of $4,925.37 that Cars Ltd makes to Robert is reported in its employer income information but is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

Send feedback to | Tukuna mai ngā whakahokinga kōrero ki public.consultation@ird.govt.nz.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Accident Compensation Act 2001, ss 6 ("earnings", "earnings as an employee"), 9, 11, 221

Income Tax Act 2007, ss CE 1, CE 2, CE 7 ("employee share scheme"), CE 7B, RA 5, RD 3, RD 7 ("extra pay"), RD 7B, RD 10, RD 17, RD 22, subpart CW, subpart CZ, sch 2, part B

KiwiSaver Act 2006, s 4 ("salary or wages")

Student Loan Scheme Act 2011, ss 4 ("salary or wages"), 36, 37

Other references | Tohutoro anō

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