

5 May 2015

Deputy Commissioner, Policy and Strategy
Inland Revenue Department
P O Box 2198
WELLINGTON 6140

By email: policy.webmaster@ird.govt.nz

Officials' Issues Paper – Simplifying the collection of tax on employee share schemes

Introduction

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on the Officials' Issues Paper, *Simplifying the collection of tax on employee share schemes* (Issues Paper).

Comments

Problems with the current tax collection system and use of source taxation as a solution

2. The Law Society:
 - (i) agrees with the assessment in Chapter 2 of the Issues Paper of the problems that can arise for employees and employers as a consequence of the current tax collection system for employee share scheme income; and
 - (ii) agrees that the extension of a source taxation regime to employee share scheme income could alleviate these problems.
3. The introduction of a regime which enables employers to assist employees in meeting their tax compliance obligations is likely to be welcomed by many employers either with, or contemplating the introduction of, employee share schemes. In particular, this is likely to be the case with employers with a large number of employees who might not otherwise be required to file an IR 3 tax return and for whom the compliance issues could therefore be significant.
4. As the Issues Paper notes in Chapter 2, the fact that share scheme income is non-cash income does not render that income incapable of taxation through a source taxation regime. The Law Society has no strong preference for whether the PAYE or FBT regimes are used for this purpose and recommends that further consultation be undertaken with employers in this regard.

Source taxation should be elective

5. The Law Society does however consider that source taxation for share scheme income should be elective. That election should be at the option of the employer.
6. As the Issues Paper notes, source taxation will not suit every share scheme. In many share schemes (particularly option schemes, but also simple share schemes where beneficial interest in the shares does not vest in participating employees at the scheme outset), the taxable benefit derived by employees will not be ascertainable upon entry into the scheme. It may only be known some period (often several years) later, upon exercise of the relevant options or vesting of the shares.
7. This potentially represents a significant, and unquantifiable, contingent liability for employers. Employers may not have the cash resources to fund this liability when it does arise. Share schemes are a popular means of incentivising and remunerating employees in start-up companies or other companies undergoing significant change or growth (such as upon an initial public offering). In such companies, cash flow is often tight. Share schemes are in part attractive to employers for that reason. To impose source taxation on share scheme income in such circumstances could reduce, rather than increase, use of share schemes.
8. The Law Society disagrees with the suggestion in the Issues Paper that employers might contractually agree with employees that the employees will bear the economic cost of the share scheme taxation (whether the FBT or PAYE system is used). While such an agreement is theoretically possible, it is most unlikely to be palatable to employers, or achievable from a practical perspective:
 - (i) Employers would be forced to assume the credit risk of employees with respect to the reimbursement and to incur the administrative costs of collecting those payments.
 - (ii) In some schemes the benefits derived by employees (particularly executive schemes) can be significant. Deduction from subsequent salary payments is not likely to be feasible in those circumstances, due to the quantum of the share scheme income relative to the regular salary payments. Further, it presupposes that employees will remain in employment for a period sufficient to reimburse employers by way of those deductions.
 - (iii) Mandatory sale of shares to repay the debt owing to employers may be feasible in some circumstances but this will not suit many schemes. It could be expected to be practicable only where the shares are listed and widely traded. For many schemes obviously this will not be the case.
9. Therefore, for the reasons set out above, the Law Society recommends that the adoption of source taxation as a collection means for share scheme income be elective, at the employer's option.

Grandparenting of existing schemes

10. If source taxation for share scheme income is elective at the choice of the employer, grandparenting (or other transitional measures) should not be necessary, other than providing that schemes existing at the date of introduction of the new regime are deemed to remain subject to the current tax system unless the employer elects into the new regime.

11. If elective source taxation is not adopted, the Law Society strongly recommends that full grandparenting for existing schemes (enabling existing schemes to remain under the current taxation method), rather than a phase-in period, be adopted. For the reasons noted above in relation to elective treatment more generally, the Law Society considers that it would be unfair and unworkable to expect employers and employees to renegotiate the terms of existing share schemes, regardless of the length of the period allowed, to provide for the consequences of the introduction of source taxation (and unfair to unilaterally impose on employers the burden of funding the liability for that taxation).

Conclusion

12. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee's convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully

A handwritten signature in black ink, consisting of a stylized, cursive 'C' followed by a horizontal line extending to the right.

Chris Moore
President