



## Employee Shares and SMSFs – July 2010



*On 30 June 2010 the ATO released a Taxpayer Alert with respect to the acquisition of shares or options by a SMSF as part of an Employee Share Scheme Arrangement.*

### Standard Practice

Currently, when a taxpayer is offered shares or options in their employer as part of an employee share scheme (ESS), they may nominate their SMSF to receive the shares or options. Generally, this would result in the following:

- The individual would need to pay personal income tax on the difference between the market value of the shares or options and the consideration paid for the shares or options (usually nil);
- The fund becomes the owner of the shares or options, for which they have paid no consideration, or the consideration is below market value;
- The benefit of this transaction is that any future growth in the shares or options is generated within the superannuation fund, which benefits from concessional tax treatment.

### Areas of Concern

The ATO has outlined the following areas of concern:

1. That the individual is not recognising the receipt of the shares or options as income correctly in their personal names;
2. That the fund is not recognising that the share amount has a value and is a contribution from the member;
3. That the fund may be acquiring an asset from a related party, and accordingly it needs to fall within the exemptions available.

These are outlined in more detail below.

### 1. Personal Income Disclosure

In an ESS, the employee receives shares or options as part of their compensation for services provided to their employer. Accordingly, the shares are provided to the individual, who may then be able to nominate that they be issued in the name of their super fund or alternative entity.

From an income tax perspective the receipt of the shares or options by the fund is a taxing point for the individual. The individual needs to include in their assessable income an amount equal to the market value of the shares or options, less the consideration paid.

For example – Bob is eligible to receive 4,800 shares in his employer as part of the employer's ESS in 2010/2011. Bob nominates that the shares be issued to his SMSF. The market value of the shares at the time is \$5.50, and Bob will pay nothing for them. Accordingly, an amount of \$24,600 needs to be included in Bob's income in his 2011 tax return, pursuant to the ESS provisions.

Often because the shares or options are issued directly to the SMSF from the company, many taxpayers fail to include the income amount in their tax return, which is the concern of the ATO. The ATO has increased their audit activity substantially with respect to ESS, particularly for directors of publicly listed companies, as such shareholder information is readily available.

### 2. Superannuation Contributions

As with the income tax disclosure, many taxpayers fail to recognise the issue of the shares or options to the fund at the correct value, as well as fail to account for it as a superannuation contribution.

By nominating the fund as the recipient of the shares or options, effectively the taxpayer is:

- (a) Participating in the ESS and receiving the shares or options personally, then;
- (b) Disposing of the shares or options to the superannuation fund, at which point they pay tax;
- (c) The fund is then acquiring the shares or options at the market value that the individual is taxed on, not for nil consideration.

The ATO released TR 2010/1 earlier in the year, which outlined their view as to what is classified as a superannuation contribution. Their view is that any increase in capital of the fund that is not attributable to income or growth on existing assets is classified as a contribution.

Shares issued to the fund rather than an individual as part of an ESS results in an increase in the level of capital of the fund, and accordingly needs to be recognised as a contribution.

Following on from Bob's example, this would mean that the shares would be a \$26,400 contribution to his fund. This would be the cost base of the shares in the fund, and count towards Bob's \$150,000 annual non-concessional cap. Accordingly, it would need to be taken into consideration when reviewing Bob's contribution caps to ensure he does not exceed his limit. The penalty for exceeding such contribution caps can be as high as 93%.

Therefore, it is important to consider the fact that:

- The fund is not acquiring the shares or options for no value;
- The value of the contribution is the market value of the shares or options at the date of acquisition;
- If the fund pays no consideration for the shares or options, then the market value will be the value of the contribution.

We note that where the value of such interests is higher than \$150,000 in any one year, the taxpayer may be able to aggregate up to three years of contribution limits and make a one-off \$450,000 contribution to mitigate any excess contributions tax.

### 3. Acquisition of Assets from Related Parties

The final area of concern in the Taxpayer Alert with respect to these arrangements is whether the issue of the asset to the fund falls within the general prohibition against a fund acquiring an asset from a related party. It is unclear at this point how the ATO may apply this provision.

Generally, a super fund is prohibited from acquiring an asset from a related party, with exceptions being:

- Listed securities;
- Business real property.
- In-House Assets;

It is unclear whether the issue or assignment of shares, options or rights to the fund would be considered by the ATO to fall under the general prohibition. In our view this will particularly be the case where the employer is not a listed entity, or the asset being acquired by the SMSF are options or rights. We await the ATO's formal view on this area.

### Other Superannuation Announcements

Other recent superannuation news and announcements of note are as follows:

- On 30 June 2010 the Superannuation System Review (Cooper Review) was handed down by the review panel to the Government. The Government will now formulate their response and any changes to superannuation that they will implement. It is expected that this will occur within a short period of time, particularly given the backlash over the timing of the release of the Henry report and the Government's response;
- On 30 June 2010 the Government announced that the 50% relief provided to self-funded retirees with respect to the minimum pension payments for superannuation pensions would be extended for the 2010/2011 financial year;
- On 29 June 2010 the changes to the superannuation borrowing rules received Royal Assent (please refer to our previous newsletter dated June 2010). This means from that date any future borrowing arrangements in superannuation need to be structured correctly to accord with the changes.

### The Next Step

The penalty for not recognising these amounts correctly or not taking into consideration the non-concessional contribution limit can be substantial. Excess superannuation contributions can be taxed at up to 93% tax, and a 45% tax rate is applied if the fund is deemed to be non-complying.

Accordingly, it is imperative that when you are participating in an ESS that the above views are taken into consideration.

**If you have any queries, or would like advice in relation to any matters outlined above, please contact either Jemma Sanderson, Michelle Saunders or Marissa Bechta on (08) 6311 6900.**

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