Tax concessions under an Employee Share Scheme (ESS) are beneficial to employees

Startup ESS Fact Sheet

Tax Concessions

1. No Upfront Taxation

The value of the discount will not be taxed upfront when the employee receives the shares, or exercises an option to receive shares. Instead, it is taxed when those shares are sold. This allows employees to plan for the tax expense, and possibly to use the proceeds of the sale to pay it.

For example, a startup offers 100 shares at $8 per share to their employee Joe in April 2015. The market value of a share is $10. Accordingly, the taxable discount income is:

($10 – $8) x 100 = $200

(Market value – discounted share price) x number of shares bought

Joe later sells these shares in April 2022. He will only be taxed on the discount value ($200) at this time (i.e. as part of his 2021-22 income).

The share sale also generally creates a Capital Gains Tax (CGT) event. This means a 50% CGT discount may apply if the shares are sold at least 12 months after the share issue or the grant of the options.

Joe sells his shares in April 2022 for $1500. As he is selling these shares more than 12 months after the share issue (which was in April 2015), he will only have to pay CGT on:`

($1500 – $800) x 50% = $350.

(Share sale value – discounted share price) x CGT discount

As Joe is an individual, the CGT tax rate that will apply to the $350 is the same as his income tax rate.

2. Safe Harbour Valuation

You may also reduce employees' taxable discount income by issuing shares or options using the safe harbour valuation method.

Generally, market value of shares is calculated as the amount for which the shares can be sold on the date of valuation. However using the net tangible assets test, a startup's valuation can be calculated using the following formula:

$$(A – B) / C = \text{Valuation}$$

where:

A means the company's net tangible assets at that time;
B means the return on any preference shares on issue at that time if the shares were redeemed, cancelled or brought back; and
C means the total number of outstanding shares in the company.

For many startups, their tangible assets are minimal or nil. Often this is because their value relies on their intangible assets. So, the safe harbour valuation is usually beneficial for employees as:

- employees are more likely to afford to pay market value for the share; or
- there is no or little taxable discount income.

Eligibility Requirements

Criteria	Description
Shares Cannot be Listed	The company's shares (and the shares of any holding company, subsidiary or sister company of the company) are not listed on a stock exchange.
Company Incorporation	Company incorporation (along with any holding company, subsidiary or sister company of the company) occurred in the last 10 years.
Aggregated Turnover	The aggregated turnover of the company (and any holding company, subsidiary or sister company of the company) in the previous income year was less than $50 million.
Payment Amount	If the proposed ESS scheme is an ***options*** scheme, employees must pay at least fair market value to exercise the right (unless eligible for the Safe Harbour Valuation).
	If the proposed ESS scheme is a ***share*** scheme, the share price offered to employees must be at least 85% of fair market value (unless eligible for the Safe Harbour Valuation).
Australian Residency	The company must be incorporated in Australia.
Employee Status	The company can only grant ESS interests to employees (i.e. not contractors) of the company or its subsidiaries.
Ordinary Shares Only	All the options or shares under the ESS relate to ordinary (not preference) shares.
Company's Predominant Business	The company's main business is not investing in other shares or investments (e.g. an investment bank).
ESS Operation	An employee must hold the ESS interest for: • three years; or • until they stop working for the company.
Maximum Share Limit	The company cannot grant an ESS interest to an employee who: • holds more than 10% of the shares in the company; or • controls more than 10% of the vote at a general meeting.
Share Offer	If the proposed scheme is a ***share*** scheme, the company must make the plan available to at least 75% of its Australian resident permanent employees who have completed at least 3 years' service.

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