

# Will your Employee Share Trust meet the “sole activities” test under the ATO’s new guidance?

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## In brief

On 6 December 2019, the Australian Taxation Office (ATO) published the final Taxation Determination [TD 2019/13](#) Income tax: what is an ‘employee share trust’? (Final TD). This deals with the Commissioner’s interpretation of what activities undertaken by a trust meet the “sole activities” test, which is relevant to identifying whether the trust satisfies the definition of an ‘employee share trust’ (EST) for income tax purposes.

The ATO expresses the view that the “sole activities” test is not intended to be interpreted broadly and outlines various examples of activities which would cause a failure of the test. The ATO suggests that once a failure of the “sole activities” test is triggered the trust cannot regain its status as an EST. Where the trust administers multiple employee share scheme (ESS) arrangements, it is the trustee’s activities in relation to the whole of the trust that are examined.

The issues in this Final TD were first considered in draft tax determination [TD 2019/D8](#), which was released for consultation on 18 September 2019. The most significant changes made from the draft are clarifications in relation to the Commissioner’s compliance approach and further examples of what the Commissioner views as activities that are merely incidental and not incidental to the operation of an EST.

## In detail

The key tax concessions applicable to a qualifying EST are:

- Certain capital gains or losses in the hands of the trust or employee beneficiary arising where the trust allocates shares to settle an ESS obligation, or where the beneficiary becomes entitled to the resulting shares, are disregarded; and
- Certain contributions made by the employer to the EST to acquire shares are not subject to fringe benefits tax.

Satisfaction of the “sole activities” test is necessary in order for a trust to be considered an EST under subsection 130-85(4) of the *Income Tax Assessment Act 1997* (ITAA) and obtain these tax concessions. ‘Sole activities’ of an EST broadly include obtaining shares or rights in a company and ensuring that the shares or rights are provided under an ESS to employees of that company or subsidiary thereof. Activities that are ‘merely incidental’ to these activities are also permissible.

According to TD 2019/13, when determining whether or not a trustee has breached the “sole activities” test, an analysis of what the trustee actually does is required, not only the powers and duties that are prescribed in the trust deed. Notwithstanding this, the ATO’s compliance approach appears to give significant weight to the powers of the trust deed, as is explained below. The ATO’s compliance approach

further notes that if the Commissioner provides advice in the form of a private binding ruling (or class ruling) for future periods, he will tend to make the assumption that the power/ duties in the trust documents will be exercised by the trustee.

The table below outlines the activities the ATO has listed in the Final TD as being merely incidental (thereby meeting the sole activities test) and the activities considered to be not incidental (thereby failing the sole activities test):

<b><i>Activities considered merely incidental</i></b>	<b><i>Activities considered not incidental</i></b>
Opening and operating a bank account to facilitate the receipt and payment of money.	Providing financial assistance to employees (in other words, a loan) to purchase shares in the employer.
Receipt and distribution of dividends from allocated shares to participating employees.	Payment of income or accrued capital from unallocated shares to any beneficiaries.
Receipt of dividends in respect of unallocated shares and bank interest and using those funds to acquire additional shares for the ESS.	Waiving or relinquishing certain entitlements (for example, dividend waivers).
In certain circumstances, paying dividend equivalent payments (DEP) to participating employees.	Exercising a general discretion to make distributions to beneficiaries of trust amounts unrelated to their ESS entitlements.
Dealing in forfeited shares under an ESS and using proceeds of sale for permitted activities.	Investing in assets other than shares or rights to shares in the employer company.
Transfer of shares to participating employees, or sale of shares on their behalf and remittance of net proceeds.	Engaging in trading activities in relation to shares in the employer company.
Receiving and immediately distributing shares under a demerger or taking actions to participate in a takeover or restructure under s83A-130 of the ITAA.	Distributing mainly cash payments to participating employees.

<p>Bookkeeping, preparing financial, tax and regulatory statements, and other record-keeping and administrative actions necessary to operate the trust and undertake the activities described in subsection 130-85(4)(a), (b) and (c) of the ITAA.</p>	<p>Providing additional benefits to participants and/or employees over and above the delivery of ESS interests, or resulting shares, or any permitted DEP.</p>
<p>Borrowing money to acquire shares or rights in the employer company, where no security is provided over the trust assets and the interest payable on such a loan is not more than arm's length commercial rates.</p>	<p>Borrowing money:</p> <ul style="list-style-type: none"> <li>• for a purpose other than purchasing shares or rights in the employer company, or</li> <li>• with security provided over any of the trust's assets for the loan, or</li> <li>• where the interest payable on the loan is more than arm's length commercial rates.</li> </ul>
<p>Use of funds received from dividends in respect of unallocated shares and interest from bank accounts to:</p> <ul style="list-style-type: none"> <li>• acquire additional shares for the purposes of the ESS, or</li> <li>• pay necessary and incidental costs of administering the trust and undertaking the activities described in paragraphs 130-85(4)(a), (b) and (c) of the ITAA, for example, costs relating to the audit of the trust, fees for professional services provided to the trustee in relation to the trust.</li> </ul>	
<p>Pay interest on loans provided for the acquisition of shares or rights in the employer company, where the interest payable does not exceed arm's length commercial rates.</p>	

The Final TD also specifies that where the trust administers multiple ESS arrangements, it is the trustee's activities in relation to the whole of the trust that are examined. Therefore, if the trust conducts one activity that breaches the sole activities test, the ATO's view is that the tax concessions outlined above will no longer be available for all the plans facilitated via that trust.

Note that Appendix 1 of the Final TD includes additional information with respect to understanding how the Commissioner's view has been reached with an explanation of merely incidental activities and activities that are not merely incidental.

Any doubt on dividend waivers occurring within an EST being a permitted activity, in the ATO's view, has been removed with the determination declaring the activity is not incidental because it does not occur as part of, or in conjunction with, obtaining shares and ensuring that the beneficial interests in those shares

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are provided to the employees. Investing in assets other than shares and rights to shares in the employer company is also stated as being not incidental for the same reasons.

### ***The ATO's compliance approach***

The Final TD outlines that the ATO will not apply compliance resources to investigate, for periods prior to 1 January 2020, whether there are activities that may have been undertaken by a trustee administering an ESS that do not satisfy the requirements in subsection 130-85(4) of the ITAA.

In addition, for periods on or after 1 January 2020, the ATO will not apply compliance resources to investigate whether activities undertaken by the trustee prior to 1 January 2020 affect the trust being considered an EST on or after 1 January 2020, provided the trust's sole activities from that date are those described in subsection 130-85(4)(a), (b) and (c) of the ITAA. Similarly, if the company or trustee apply for a private ruling covering periods on or after 1 January 2020, the Commissioner will not require those

activities undertaken by the trustee prior to 1 January 2020 to be identified in the scheme subject to the private ruling.

Where a company or trust seeks a private ruling for future periods and there are clauses contained in the trust deed such as dividend waiver or other clauses that the ATO considers may cause a "sole activities" test issue, the ATO has suggested that the most appropriate assumption generally will be that the power in the trust deed will be exercised. This would result in a breach of the sole activities test under the ruling being relied upon by the taxpayer.

### ***The takeaway***

In light of the 1 January 2020 cut off, it is recommended that companies which operate employee share plans involving trusts review their actual trust activities and trust documentation in order to identify whether the ATO would consider there to be a breach of the "sole activities" test. This is particularly important as the ATO's view is that if a breach has occurred post 1 January 2020, the trust will not be considered an EST, and this will impact the tax concessions available on all ESSs facilitated through that trust going forward.

Given the short time frame, one approach companies may consider is for all transactions involving the company's EST to be flagged for approval prior to their execution, at least for the first few months of 2020, until a more thorough review of processes can be conducted.

For companies considering establishing a new employee share trust, careful attention should be paid to ensure alignment with the views in TD 2019/13. This is because the ATO has opted for a highly prescriptive approach in relation to ESTs and has dedicated more compliance resources to investigate these arrangements.

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## ***Let's talk***

For a deeper discussion of how these issues might affect your business, please contact:

Daryl O'Callaghan, Melbourne  
+61 (3) 8603 2841  
[daryl.ocallaghan@pwc.com](mailto:daryl.ocallaghan@pwc.com)

Michelle Kassis, Melbourne  
+61 (3) 8603 5676  
[michelle.kassis@pwc.com](mailto:michelle.kassis@pwc.com)

Norah Seddon, Sydney  
+61 (2) 8266 5864  
[norah.seddon@pwc.com](mailto:norah.seddon@pwc.com)

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