

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

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In brief

On 18 September 2019, the Australian Taxation Office (ATO) released draft tax determination (TD) TD 2019/D8 Income tax: ‘what is an ‘employee share trust?’ The draft determination deals with the Commissioner’s interpretation of what activities undertaken by a trust meet the “sole activities” test under subsection 130-85(4) of the Income Tax Assessment Act 1997 such that the trust satisfies the definition of an ‘employee share trust’ (EST).

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 for an employee share scheme (ESS).

The ATO is currently accepting submissions in relation to the draft TD until 18 October 2019. The ATO previously released guidance on the Commissioner’s interpretation of the “sole activities” test in ATOID 2010/108 which has now been withdrawn and replaced by the draft TD.

In detail

The key tax concessions of 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 and obtain the 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.

The ATO explains in the draft TD that in the Commissioner’s opinion, the provisions relating to ESTs are concessional in nature and, as such, the statutory definition is not intended to be interpreted broadly.

The draft TD outlines examples of activities considered to be ‘merely incidental’ including most of those specified in the withdrawn ATOID 2010/108. It also provides additional examples of those activities that are not ‘merely incidental’ in the ATO’s view and thus would fail to meet the ‘sole activities’ test. Activities relating to waiving certain entitlements including dividend waivers (e.g. on unallocated shares held by the

EST) and cash payments made to participating employees rather than shares or ESS interests are not considered to be ‘merely incidental’ by the ATO.

The ATO states that 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 Commissioner provides advice in the form of a private binding ruling (PBR) (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 listed in the TD as being considered merely incidental (and thereby meeting the sole activities test) and the activities considered to be not incidental (and thereby failing the sole activities test):

Activities considered merely incidental	Activities considered not incidental
Opening and operating a bank account to facilitate the receipt and payment of money.	Providing financial assistance to employees (i.e. 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 (e.g. 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.	Distributing mainly cash payments to participating employees.
	Providing additional benefits to participants and/or employees over and above the delivery of ESS interests, or resulting shares, or any permitted DEP.

The ATO’s compliance approach

The ATO notes where a trust deed contains a dividend waiver clause as at 19 September 2019, the Commissioner will not apply compliance resources to investigate if any action has been taken in respect of

such a clause or dividends waived for periods prior to 1 January 2020. If the right to be paid or credited dividends are waived on or after 1 January 2020, this compliance approach will not apply.

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

The takeaway

For companies that have an existing EST in place to facilitate their ESS arrangements (particularly with dividend waiver clauses, although other activities may also cause an issue), it would be prudent for a review of the actual trust activities and trust documentation to be undertaken in order to identify whether the ATO would consider there to be a breach of the “sole activities” test. These should be considered in the context of any PBRs obtained for an EST and their expiration date.

Similar considerations would be required if you are establishing an EST or would like to obtain PBRs on their operation.

Let's talk

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

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