



Policy and Strategy Division  
Inland Revenue  
PO Box 2198  
Wellington 6140  
New Zealand

5 May 2015

Dear Sir / Madam

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

The Angel Association of New Zealand (AANZ) are pleased to make a submission on the Officials' issues paper which requests input on simplifying the collection of tax on employee share schemes.

The submission request specifically focuses on the issues faced by employers and employees in collecting tax on benefits provided under employee share schemes and proposes alternative "collection at source" mechanisms to address these.

AANZ is an organisation that aims to increase the quantity, quality and success of angel investments in New Zealand and create a greater pool of capital for innovative start-up companies.

We agree there are issues with the current method of accounting for tax on benefits and support the need to eliminate the difficulties faced by employers and employees that participate in employee share schemes. We also understand that there are non-compliance issues with the current method and are cognisant of the risk faced by members of our association when participating in, or administering, employee share schemes.

Please find attached our submission on providing feedback and outlining our concerns about the solutions proposed in this issues paper.

We should also like to note for the record that the AANZ has concerns from a broader policy perspective about the imposition of ESOP tax burdens on start up companies per se, outside the remit of this submission which go to the issue of levying tax on these companies. There might well be thresholds below which tax is not charged but which ensure these companies are able to source the talent and buyin required from talent more qualified than the start up can afford to pay. We would be happy to be involved in any discussion about this issue in the future.

If you would like to discuss our feedback or if you require further feedback please contact me on (021) 490 974 or [suse.reynolds@angelassociation.co.nz](mailto:suse.reynolds@angelassociation.co.nz)

Yours sincerely,

Suse Reynolds  
Executive Director



## **Submission**

The Angel Association of New Zealand (“AANZ”) understands the issues outlined in the officials’ paper on the taxation of Employee Share Schemes (“Schemes”). Non-compliance with the current accounting treatment of tax on these benefits is certainly an issue and largely results from employees’ ignorance of their obligations or because they are unable to access the appropriate information, valuation and calculation required for returning the tax due to financial constraints.

AANZ do have concerns about the solutions proposed by Inland Revenue. Shifting the onus to the employer by taxing at source is likely to make it difficult for employers to comply.

AANZ’s main concerns are for start-up companies. In their infancy, their main objective is to build a credible, experienced team and to attract experienced investor directors. Share schemes are a fundamental tool to attract talent when they are cash constrained. These companies also use share schemes to instil a sense of ownership within the team involved.

## **Concerns with proposed solutions**

Based on our comments above, AANZ’s main concerns with the proposed solutions are:

- Cash flow constraints of start-up companies. By definition, there will be no cash to fund either FBT or PAYE withholding.
- Inability of employees to sell shares to meet tax obligations if required.
- Valuation calculation where the company is unlisted (although we acknowledge this is an issue with the current regime).
- By nature, these benefits are granted in a lump sum, therefore, under a source taxation system, a one off tax withholding would be required. This may have a negative impact on an employees pay for that period. Instead, the tax on this benefit should be spread across a 12 month period, as if it was salary.
- Currently the tax obligation is with the employee, shifting it will increase the employers contractual cost.

## **Response to feedback requested**

### ***Elective versus compulsory source taxation***

Taxation at source should not be compulsory. A blanket rule for collecting taxation is not appropriate for the diverse range of schemes and entities using these schemes in New Zealand. Based on the diversity of affected companies, AANZ consider that any change in the current system of taxing employee share schemes needs to be elective.

For a number of start-up companies, employee share schemes are used in lieu of offering high salaries to entice talented employees. Implementing a compulsory source taxation system could severely disadvantage these companies as cash flow is already constrained and employers would not be able to cover the cost of withholding tax on shares issued.

Further, if tax on share scheme benefits were deducted from an employee's salary in one period, this may result in a negative pay period. Instead, there should be an ability to elect into a disclosure regime to provide Inland Revenue with information on employees who receive share scheme benefits.

If source taxation were compulsory rather than elective, AANZ would like to see an ability for low-value entities (i.e., where the company valuation is less than \$1million) to opt out of source taxation and adopt a disclosure regime instead.

### ***Pay as you earn ("PAYE") versus Fringe Benefit Tax ("FBT")***

Of the solutions proposed, AANZ's preference would be to use PAYE over FBT, based on the familiarity of all employers with operating this system. Often employers in this space do not provide fringe benefits and therefore do not currently operate an FBT system. PAYE is the more appropriate system to handle an employee related withholding tax.

It is important to reinforce the point that start-up companies rarely have the cash to fund a FBT payment or ESOP grants; particularly if required to pay 64% FBT when granting ESOP shares this may well effectively see ESOPs schemes for start-ups disappear in New Zealand. If a withholding at source has to occur, it is best to make it a PAYE withholding and better if it is spread over 12 month period to avoid a negative pay.

### ***Transitional measures***

Transitional measures should be implemented to ensure that current employee share schemes are not adversely affected. AANZ support the option to grandparent existing share schemes to minimise the cost of implementing a new system of taxation and reduce the impact on past employee shareholders.