

TAX ISSUES ENTRY SYSTEM (TIES) BRIEFING

TIES Issue Number:	0036-2009
Submitted By:	Email address: Postal address:
Concerning:	Income tax – capital protected borrowings - Division 247 of the <i>Income Tax Assessment Tax 1997</i>
Issue Raised:	<p>The _____ are aware that certain employers operate employee share schemes where the employer company makes limited recourse loans to employees to acquire shares and charges interest on the loans.</p> <p>As the loan provided to the employees is limited recourse, the capital protected borrowing (CPB) rules in Division 247 of the Income Tax Assessment Act 1997 could apply to restrict the deduction that the employees can claim for the interest paid on the loan.</p> <p>An exclusion from Division 247 applies to shares acquired under an “employee share scheme”. However, under Division 13A of the Income Tax Assessment Act 1936 (“ITAA 1936”), a share is only acquired under an employee share scheme if the share's acquisition price is less than the “market value” of the share as determined under the market value rules in section 139FA of Division 13A of the ITAA 1936.</p> <p>Typically, under these types of plans, shares are acquired for market value, so the exclusion in Division 247 would not apply.</p> <p>This is contrary to the stated intention of Division 247 (Explanatory Memorandum at paragraph 7.41 provides - "this measure is not to apply to CPB's under which a company provided limited recourse loans to employees to buy shares in their employer companies").</p> <p>Affect on clients:</p> <p>Tax treatment of interest expense incurred by employees.</p> <p>possible solution:</p> <p>To extend the exclusion in Division 247 to all shares acquired by employees (where the scheme provides a loan to employees to acquire shares at a market value) rather than shares acquired under an “employee share scheme” (as defined in Division 13A).</p>
Treasury view:	<p>It is not considered appropriate to extend the current FBT exclusion of ESS shares to the means by which ESS acquisitions are financed. That is, it is not considered appropriate to exempt from FBT discounted loans provided by employers to employees just because the loan will be used to purchase ESS shares.</p> <p>Similarly, it is not considered appropriate to exclude the capital protection</p>

premium which would normally be paid on limited recourse loans from FBT just because the loan is provided in connection with the purchase of ESS shares.

A submission received during the development of the legislation stated that there are a “great number” of companies which use limited recourse loans to finance the acquisition of ESS shares. Research by the Department of Employment and Workplace Relations found that only a small number of companies use limited recourse loans to finance ESS share acquisitions.

There also does not appear to be a strong case that the aims of encouraging employee share ownership would be advanced by providing additional concessional treatment for ESS shareholders in relation to FBT.

Consequently, based on these arguments, it is considered to be inconsistent with the principles of FBT, and the principles behind the current ESS exclusion from FBT, to provide a specific carve out for limited recourse loans to purchase shares under an ESS.

The extension of the carve-out would create an unlevel playing field between those investors borrowing as employees and those borrowing as non-employees.

Does Treasury agree that there is a problem with the law as described by the correspondent?

No. Treasury does not agree that there is a problem with the law as it operates as intended.

Does Treasury need advice from the ATO on the operation of the law?

No. Treasury and the ATO agree that the law works as intended.

Is the law operating appropriately? If not, how is it inappropriate?

Yes. The law is operating appropriately.

Is this a care and maintenance issue or does it involve major policy?

This is a major policy issue.

Can the issue be addressed by a minor amendment?

Defining Employee Share Scheme – ring fence -

What are the reasons for the view?

Date of effect	<p>The interim methodology in Division 247 of the Transitional Provisions Act 1997, applies to arrangements entered into, on or from 9.30am, by legal time in the ACT, from 16 April 2003 to 30 June 2007</p> <p>The ongoing methodology in Division 247 of the Income Tax Assessment Act 1997 applies to arrangements entered into from 1 July 2007.</p> <p>Any amendments should apply from the commencement of the ongoing methodology ie 1 July 2007.</p>
Explanation for correspondent	<p>As required, prepare an explanation for the correspondent of why the issue will not be pursued. This explanation should be similar to the content that would be included in a ministerial response. This will be included in the letter sent by the TIES Secretariat.</p>
Sensitivity	<p>Describe any sensitivities with the Treasury view – for example, the Government is considering its response to a report that raises the same issue.</p>
Drafting instructions	<p>Drafting instructions are not attached.</p>
Policy approval information	<p>Policy approval is not being sought.</p> <p>The following information is required:</p> <ul style="list-style-type: none"> • Division 247 of the Income Tax Assessment Act 1997 and transitional provisions. • The current situation is ... • This situation is inappropriate because ... • Therefore, this amendment is proposed: ... • The amendment will have a date of effect of ...