Inland Revenue
Te Tari Taake

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FACT SHEET | PUKA MEKA

Employee share scheme benefits paid in cash – PAYE and KiwiSaver obligations for employers

Issued | Tukuna: Issue Date

IS ##/## FS #

This fact sheet accompanies Interpretation Statement **[XX/XX: Employee share scheme benefits paid in cash – PAYE and KiwiSaver obligations for employers]**, which explains an employer's PAYE and KiwiSaver obligations when an employee receives a benefit under an employee share scheme that is paid in cash.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Introduction

1. This fact sheet sets out the main points from Interpretation Statement **[XX/XX: Employee share scheme benefits paid in cash – PAYE and KiwiSaver obligations for employers]**.

2. An employee share scheme (ESS) benefit is usually provided in **shares**. However, in some circumstances, an employee may receive **cash** instead of shares under an ESS (a **cash-settled ESS benefit**). This fact sheet sets out:

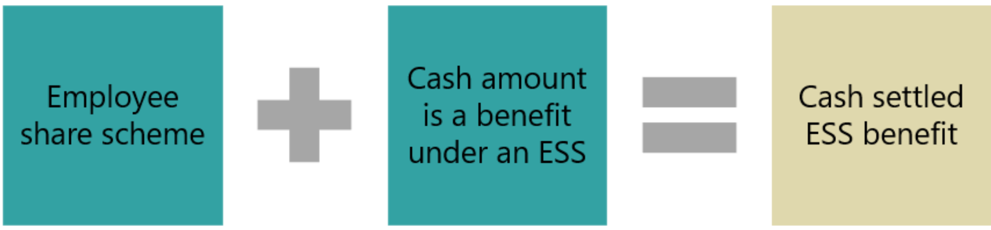
   - what a cash-settled ESS benefit is; and
   - an employer's PAYE and KiwiSaver obligations.

3. It also explains where to find related examples and summarises an employer's PAYE and KiwiSaver obligations for both cash- and share-settled ESS benefits.

What is a cash-settled employee share scheme benefit?

4. The first step in determining the employer's obligations is to clarify whether the cash that an employee receives under a share scheme is truly a cash-settled ESS benefit. This involves considering two questions:

   - Is the scheme an "employee share scheme"?
   - Does the cash amount give rise to a "benefit" under an ESS?



Is the scheme an "employee share scheme"?

5. Broadly, a scheme will be an "employee share scheme" if it is an arrangement with **a** purpose or effect of issuing or transferring shares in a company to an employee. This requirement is assessed when the scheme is entered into. Transferring shares does not have to be the sole or even principal purpose or effect of the arrangement. For example, where an arrangement provides for an award to be paid partly in shares and partly in cash, **a** purpose or effect of the arrangement is to transfer shares to the

employee. The arrangement must be connected to the employee's employment or service.

6. Not every share scheme is an "employee share scheme" for tax purposes. Under some schemes, the benefits are linked to shares but under the terms of the scheme, the employee never becomes a shareholder in the company. The benefits are always paid out in cash. In this case, the amount will generally be an ordinary cash bonus and subject to the usual PAYE rules.

Does the amount give rise to a "benefit" under an employee share scheme?

7. The next question is whether the cash amount gives rise to a "benefit" under an ESS. A cash amount will give rise to a "benefit" under an ESS if the amount is paid for a transfer or cancellation of shares or related rights under the ESS.

8. For example, an employee may be granted rights to acquire shares and the terms of the ESS may allow for the employer to cancel the rights and provide a cash equivalent in certain circumstances (eg on the sale of the company or retirement of the employee). Here, the cash amount received will give rise to a benefit under an ESS. This is because the cash is paid for a cancellation of rights under the ESS.

9. An example of an ESS where the cash amount will not generally give rise to a "benefit" under the scheme is where the incentive is paid partly in cash and partly in shares. The part that is paid in cash is likely to be paid in satisfaction of the rights granted under the scheme (ie there is no transfer or cancellation of rights). In this situation, the cash amount will generally be an ordinary cash bonus and subject to the usual PAYE rules. The part of the incentive scheme that is settled in shares would give rise to a benefit under an ESS.

What are an employer's PAYE and KiwiSaver obligations?

10. If an ESS benefit is provided in **shares**, there is no requirement for the employer to withhold tax. However, the employer can elect to withhold and pay tax on the share benefit if they choose to. In this situation, the benefit is an "extra pay" and the relevant "extra pay" tax rate applies. The Accident Compensation Corporation (ACC) earners' levy does not apply.

11. If the employee receives a **cash-settled ESS benefit**, the employer **must** withhold tax at the applicable "extra pay" rate plus the ACC earners' levy (if applicable). This is because a cash-settled ESS benefit:

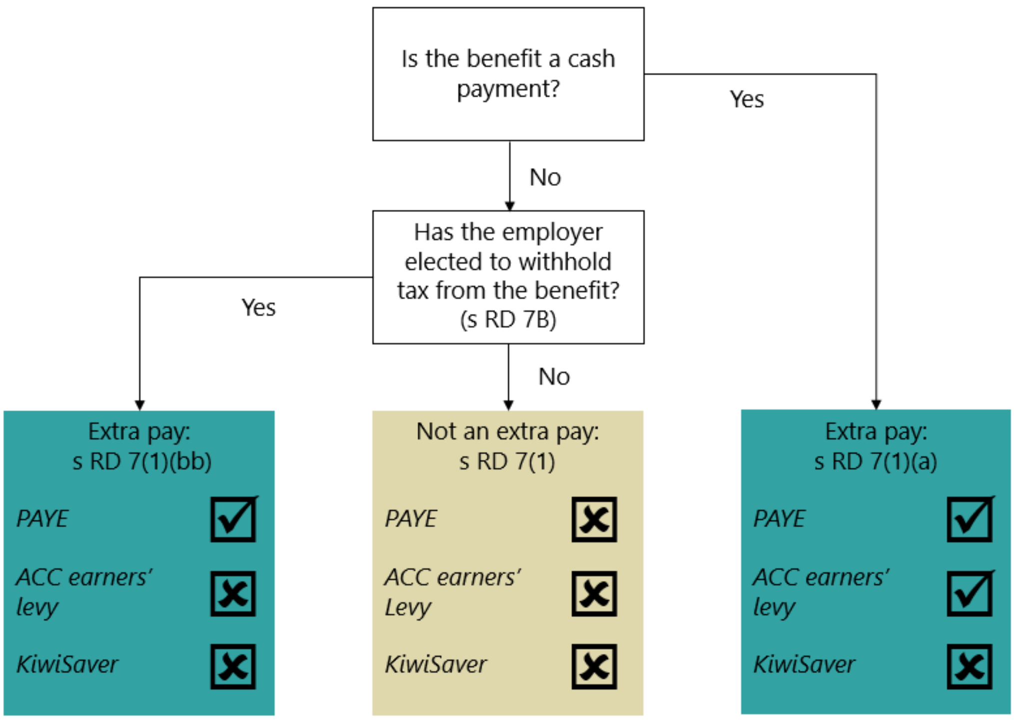
- is an "extra pay" under the general definition of "extra pay" in s RD 7(1)(a) and a PAYE income payment; and
- is not excluded from the definition of "earnings as an employee" under the Accident Compensation Act 2001.

12. The election to withhold tax from an ESS benefit applies only to share-settled benefits (ie non-cash benefits). An employer cannot make an election to withhold tax (or choose not to withhold tax) where withholding is already required.

13. An employer is not required to make KiwiSaver deductions or employer contributions for either cash- or share-settled ESS benefits. This is because KiwiSaver deductions and contributions are based on an employee's gross "salary or wages" and an ESS benefit is excluded from the definition of "salary or wages" for the purposes of the KiwiSaver Act 2006.

14. Figure | Hoahoa 1 shows an employer's obligations for both cash- and share-settled ESS benefits.

Figure | Hoahoa 1: Employer's PAYE and KiwiSaver obligations for cash- and share-settled ESS benefits



What are an employer's reporting obligations?

15. An employer is required to report the value of an ESS benefit to Inland Revenue in its employment income information (EI) (unless the person is a former employee receiving a share-settled benefit and the employer has not chosen to withhold tax). If the employer has chosen to withhold tax (for a share-settled ESS benefit) or is required to withhold tax (for a cash-settled ESS benefit), then it must also report the amount of tax withheld in its EI.

Where can I find out more?

16. IS XX/XX explains an employer's PAYE and KiwiSaver obligations for cash-settled ESS benefits in more detail and sets out a number of factual scenarios illustrating the points discussed in this fact sheet on pages 30 to 37.

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