

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Trustee of employee share scheme trust treated as nominee

Issued | Tukuna: 12 June 2024

IS 24/04

This interpretation statement considers the available subscribed capital, treasury stock and dividend implications of a trustee of an employee share scheme holding shares as nominee.

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

Contents | Ihirangi

Introduction Whakataki	2
Tax treatment of an ESS trust	2
Available subscribed capital	4
Application of the treasury stock rules	6
Dividend implications	12
Unallocated shares held by an ESS Trustee	13
Allocated shares held by an ESS Trustee	13
Summary and examples	14
Legislative references Tohutoro whakatureture	16
About this document Mō tēnei tuhinga	17

Introduction | Whakataki

1. The employee share scheme (ESS) tax regime changed in 2018. The objective of the changed rules is to treat ESS benefits neutrally so that, to the extent possible, whether remuneration for labour is paid in cash or shares the tax position does not change for either the employer or the employee.
2. Following the changes to the rules, we have received various questions about how the law applies in certain scenarios. This statement addresses some of those questions by explaining the tax implications of treating a trustee of an ESS trust as a nominee under the changed rules. It also provides examples to illustrate how the rules apply.

Tax treatment of an ESS trust

3. As defined in s CE 7, an ESS is broadly an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee if it is connected to the employee's employment or service. In this context, an employee includes a person who will be, is, or has been an employee or shareholder–employee of the company. An ESS includes providing shares to employees of another company in the same group, or to an associate of an employee, if this arrangement is in connection with the employee's employment or service. For ease of reference, this interpretation statement uses the term "employee" to cover all potential ESS beneficiaries where relevant (including where shares are provided to the employee's associates).

4. The use of the term “arrangement” in the definition of an ESS covers all aspects of a scheme that has a purpose or effect of issuing or transferring shares to employees, including where a trust is set up to administer an ESS. The activities of a trustee of a trust set up to administer an ESS (ESS Trustee) may include:
- receiving contributions from employers;
 - acquiring and transferring shares in accordance with the terms of the ESS (eg purchasing on-market or from employees, subscribing in the company or transferring to employees when ESS criteria are met);
 - maintaining a pool of shares that can be allocated to, or forfeited by, employees in accordance with the terms of the ESS;
 - facilitating and administering loans to employees that are used to acquire shares;
 - receiving payments when shares are allocated, or transferred, to employees and making payments where shares are forfeited by, or reacquired from, employees; and
 - receiving dividends paid on shares that it holds and applying those dividends in accordance with the terms of the ESS.
5. Section CE 6 provides for an ESS Trustee to be treated as a nominee for tax purposes:

CE 6 Trusts are nominees

A trustee is treated as the nominee of a company (company A) to the extent to which the trustee’s activities relate to an employee share scheme or an exempt ESS and—

- (a) shares or related rights in company A are issued or transferred under the scheme:
- (b) shares or related rights are issued or transferred to company A’s employees, shareholder-employees, or associates of them, under the scheme.

6. Section CE 6 provides for the ESS Trustee to be treated as nominee of the company whose shares are the subject of the ESS. Alternatively, if this company is different from the employer company, the ESS Trustee may be treated as the nominee of either or both of these companies. Such a difference might arise where, for example, a parent company’s shares are the subject of the ESS. Where the ESS Trustee could potentially be nominee for two different companies under s CE 6, we consider that the ESS Trustee will be nominee for the company that is most relevant to the activity the ESS Trustee is undertaking at the time, as in these examples:
- For the transfer and holding of shares under the ESS, the ESS Trustee will be treated as nominee for the company whose shares are at issue (rather than the employer if a different company). This is consistent with the purpose of s CE 6, which is to ensure shares held by the ESS Trustee can be treated as held as

- treasury stock to eliminate any uncertainty around whether an ESS Trustee holds shares on revenue account.
- Where there are funding costs to provide loans to employees, the ESS Trustee would be treated as nominee for the employer company.
7. One possible interpretation of s CE 6 is that the ESS Trustee is only treated as nominee of the relevant company to the extent of the issue or transfer of shares or related rights. However, we consider the better view is that paras (a) and (b) of s CE 6 serve to identify the company that the trustee is treated as nominee for, rather than to limit the effect of s CE 6 to those issues or transfers. This is because it would not make sense to treat the company as issuing or transferring the shares under s CE 6, but not subject to the related circumstances or consequences of holding those shares. Further, if s CE 6 only applied to the extent of the issue or transfer of shares or related rights, there would be no need to refer to both the company whose shares are at issue and (if different) the employer company.
 8. Accordingly, for tax purposes, to the extent an ESS Trustee's activities relate to an ESS, it will be treated as nominee of the company whose shares are the subject of the ESS and (if different) the employer company. This means that the activities of the ESS Trustee on behalf of those companies will be treated as activities that the companies themselves undertake directly.
 9. Where an ESS Trustee holds shares in a company on the terms of the ESS, and is treated as nominee of the company, the effect (for tax purposes) is to treat the:
 - company as holding shares, and issuing and buying back shares, in itself; and
 - ESS Trustee as not holding, and not acquiring or transferring, shares in the company.
 10. This means that, for tax purposes, the company is treated as holding the shares in itself held by the ESS Trustee in accordance with the treasury stock rules. This in turn has flow-on effects for the company's available subscribed capital and how dividends on those shares are treated for tax purposes. The following sections discuss these matters in more detail.

Available subscribed capital

11. The concept of available subscribed capital (ASC) is important in determining whether a distribution by a company to its shareholders is a dividend. This is because ASC can be returned to shareholders on certain off-market share buybacks (s CD 22) or on liquidation (s CD 26) and not be a dividend.
12. Section CD 43 sets out how to calculate the amount of a company's ASC for a class of share at a point in time. Broadly, it reflects the amounts paid to the company on the

issue of shares, less amounts paid out on the repurchase of shares when those amounts are not treated as dividends under specified rules. Section CD 43 sets out adjustments for specific scenarios and transactions.

13. Section CD 43 has been amended to expressly address the situation where an ESS Trustee is treated as nominee for the company whose shares are the subject of the ESS. Relevantly, subss (1) and (2) of s CD 43 state (with underlining added to highlight where the section addresses shares held by an ESS Trustee):

CD 43 Available subscribed capital (ASC) amount

Formula for calculating amount of available subscribed capital

- (1) For a share (the **share**) in a company at any relevant time (the **calculation time**), the amount of available subscribed capital is calculated using the formula—

1 July 1994 balance + subscriptions – returns – look-through company returns.

Definition of items in formula

- (2) In the formula in subsection (1),—
- (a) **1 July 1994 balance** is,—
- (i) if the company existed before 1 July 1994, the amount calculated under subsection (3); and
- (ii) in any other case, zero:
- (b) **subscriptions**, subject to subsections (6) to (21), is the total amount of consideration that the company received, after 30 June 1994 and before the calculation time, for the issue of shares of the same class (the class) as the share, ignoring section HB 1 (Look-through companies are transparent), and including consideration for the issue of shares by the company as a result of the application of section CE 6 (Trusts are nominees):
- (c) **returns**, subject to subsections (22) and (23), is the total amount of consideration that the company paid, after 30 June 1994 and before the calculation time, on the cancellation of shares in the relevant class and that was not a dividend because of section CD 22, CD 23B, or CD 24 or a corresponding provision of an earlier Act:
- (d) **look-through company returns** is the total amount of consideration that the company paid, before the calculation time, on the cancellation or buyback of shares in the relevant class while the company was a look-through company, ignoring section HB 1.

[Bold emphasis in original; underlined emphasis added]

14. As set out under [13], a company is treated as having a “subscriptions” amount (increasing its ASC) where it is treated as receiving consideration for the issue of shares under s CE 6.

15. Because the ESS Trustee is nominee of the company under s CE 6, the shares it holds in the company under the ESS will be treated as held by the company itself for tax purposes. This means that, where the ESS Trustee sells shares on market or transfers shares to an employee, for tax purposes the company will be treated as selling or transferring its own shares. This would generally constitute an issue, or re-issue, of the company's shares. Accordingly, any consideration received by the ESS Trustee for the sale or transfer that, applying s CE 6, is treated as consideration received by the company for an "issue" of its shares, may therefore give rise to an increase in ASC in the company (subject to the treasury stock rules). In the context of an ESS Trustee being nominee for a company under s CE 6, an "issue" of shares may also include situations where the ESS Trustee allocates shares (or rights to shares) to an employee in accordance with the terms of the ESS. We discuss this in more detail in the context of the treasury stock rules from [18].
16. For completeness, where the company (or the ESS Trustee as nominee) receives consideration for the "issue" of shares from a subsidiary company in the same wholly owned group as the company under an ESS, the consideration will not give rise to an increase in ASC (s CD 43(20B)). This is because other subsections of s CD 43 (eg s CD 43(6E) to (6K) and (29)) address the effect of the provision of ESS benefits and related intra-group payments on the ASC of the relevant group members.
17. In brief, in addition to the amount received for the issue of shares under s CD 43(2)(b), s CD 43(6E) to (6K) provide for an amount of ASC to arise for the employing company and (if different) the share issuing company. As a starting position, an amount of ASC arises equal to the amount that is a benefit for the employee and expenditure for the employer, with some adjustments. Conceptually, the tax treatment is the same as if the company paid the amount in cash to the employee as remuneration and the employee then used the cash to subscribe for the shares.

Application of the treasury stock rules

18. Under the Companies Act 1993 (CA 1993), a company incorporated in New Zealand can hold its own shares. While the presumption is that when a company acquires its own shares they are cancelled (s 66, CA 1993), the company is permitted to elect to hold up to 5% of its own shares (s 67A, CA 1993). Where a company holds shares in itself under s 67A of the CA 1993, the rights attached to the shares are suspended under s 67B of the CA 1993 – that is, the company cannot vote or receive distributions in respect of the shares.
19. As a company can hold shares in itself under the CA 1993, the Income Tax Act 2007 contains provisions to address what happens for tax purposes in such a situation. The key provision is s CD 25 concerning "treasury stock". Broadly, s CD 25 allows a company to hold shares in itself as treasury stock for up to 1 year, and the payment to

acquire those shares will not give rise to a dividend for the seller shareholder or any ASC or imputation consequences for the company. However, if the company does not make an arm's length transfer of a share of the same class within a year, or if it cancels the share within that year, then ASC and imputation consequences occur.

20. In addition to dealing with the situation of a company holding shares in itself in accordance with the CA 1993, s CD 25 expressly addresses a company being treated as holding shares in itself under s CE 6 due to the activities of an ESS Trustee.
21. Section CD 25 states (with bold added to highlight where the section addresses shares held by an ESS Trustee):

CD 25 Treasury stock acquisitions

Treasury stock generally

- (1) An amount paid by a company in acquiring any of its shares is not a dividend if—
 - (a) the shares acquired by the company are held by the company in itself, **including shares acquired by the company as the result of the application of section CE 6 (Trusts are nominees)** and, in the case of shares acquired other than as the result of the application of section CE 6, section 67A(1) of the Companies Act 1993 or section 24 of the Co-operative Companies Act 1996 apply to provide that the shares are not deemed to be cancelled; and
 - (b) the acquisition is not part of a pro rata cancellation or something that is in substance a pro rata cancellation.

Reversion to on-market cancellation treatment

- (2) Subsections (4) to (6) apply in the case of an acquisition of a share to which subsection (1) or section CD 17(1) of the Income Tax Act 2004 or section CF 3(1)(d) or (da) of the Income Tax Act 1994 applies if,—
 - (a) before the first anniversary of the acquisition, the company cancels the share; or
 - (b) at the first anniversary, the company has failed to transfer a share of the same class in an arm's length transfer **and has failed to allocate a share or right to a share, of the same class to an employee share scheme beneficiary under an employee share scheme**, except if the company is established under New Zealand co-operative company legislation; or
 - (c) after the first anniversary, the company, which is established under New Zealand co-operative company legislation, cancels the share.

Requirement for arm's length transfers

- (3) When subsection (2)(b) is applied,—
 - (a) a transfer is arm's length only if it is—
 - (i) to a person not associated with the company; or

- (ii) in a transaction that occurs on a recognised exchange, through a broker or some other agent independent of the company, and that is not preceded by any arrangement between the transferee and the company for the transfer; and
- (b) each arm's length transfer of a share is taken into account only in relation to a single share acquisition to which subsection (1) has applied.

Reduction of available subscribed capital

- (4) If subsection (2) applies, then, with effect from the cancellation or the first anniversary, depending on which first causes subsection (2) to apply, the available subscribed capital of the class of the share is reduced by the lesser of—
 - (a) the amount paid to the shareholder on the acquisition; and
 - (b) the available subscribed capital per share calculated under the ordering rule and, in the case of the first anniversary, calculated as if the share and any other shares to which this subsection applies on that date were cancelled on that date.

Imputation credit account debit

- (5) If subsection (2) applies, then, with effect from the date of the acquisition by the company, section OB 42 (ICA on-market cancellation) applies as if the original acquisition were an on-market cancellation but item "ASC per share excess" of the formula in section OB 42 were equal to only the excess of the amount received by the shareholder over the reduction described in subsection (4).

Relief from imputation penalty tax

- (6) No imputation penalty tax is imposed under section 140B of the Tax Administration Act 1994 (nor any late payment penalty imposed under that Act in relation to the imputation penalty tax) if it would not have arisen had subsection (5) applied only with effect from the date of cancellation or first anniversary, depending on which first causes subsection (2) to apply.

Employee share schemes

- (7) **For the purposes of subsection (2), if the company has, before the first anniversary, allocated a share or right to a share to an employee share scheme beneficiary under an employee share scheme but subsequently the allocation is cancelled, the shares acquired under subsection (1) by the company are treated as acquired by the company on the date of cancellation for the amount the company paid for their acquisition under subsection (1).**

[Emphasis added]

22. As emphasised above, in the context of s CD 25 and an ESS, a distinction is drawn between a share (or a right to a share) being allocated to an employee under the terms of the ESS and a share (or a right to a share) not being allocated to an employee. The clear inference from subs 2(b) and (7) is that where a share (or a right to a share) is allocated to an employee it is treated as being held by the company on trust for the purposes of the ESS. This is in contrast with shares (or rights to shares) that are not allocated to an employee under an ESS; unallocated shares are treated as held by the company in itself and subject to the treasury stock rules.

23. The effect of ss CE 6 and CD 25 is that where an ESS Trustee acquires, holds and transfers shares in a company on the terms of an ESS, the company is treated as undertaking those activities.
24. This means that when the ESS Trustee acquires a share on market or from an employee, the company will be treated as acquiring the share and holding it in itself as treasury stock, and any payment made by the ESS Trustee to acquire that share will not be treated as a dividend to the recipient (s CD 25(1)(a)). The concept of an ESS Trustee acquiring a share for these purposes includes where an employee forfeits a share (or a right to a share) that the ESS Trustee previously allocated to them such that it becomes unallocated (subss (2)(b) and (7)).
25. The ESS Trustee then has 1 year to make an arm's length transfer of a share, or allocate a share (or a right to a share) to an employee under an ESS, of the same class in accordance with s CD 25(2).
26. Where the ESS Trustee meets the conditions at [25] within a year, then no ASC or imputation consequences result under s CD 25(4) to (6). For completeness, the following applies in this situation:
 - No additional ASC arises in respect of consideration received for such an "issue" of shares. This is because the issue means that the amount paid on the previous share acquisition is not subject to s CD 25(4) to (6) (s CD 43(19)).
 - If shares (or rights to shares) are allocated to an employee within the year, but that allocation is later cancelled, then under s CD 25(7) those shares are treated as acquired by the company on the date of the cancellation for the amount paid for their initial acquisition (ie the amount initially paid for the acquisition referred to at [24] above).
27. Where the ESS Trustee fails to make an arm's length transfer or allocate a share to an employee within a year, then under s CD 25(4) the ASC of the company for the class of the share is reduced by the lesser of:
 - the amount paid for the acquisition referred to at [24] above; and
 - the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies on that date were cancelled on that date.
28. Where the ASC per share calculated under the ordering rule is less than the amount paid for the acquisition, and therefore the ASC is reduced by that amount under s CD 25(4), imputation consequences will also result under s CD 25(5) and (6) and s OB 42. Broadly, an imputation debit will arise calculated by reference to the company tax rate and the "ASC per share excess", being the surplus of the amount paid for the acquisition over the ASC reduction.

29. Example | Taurira 1 and Example | Taurira 2 explain how the treasury stock and ASC rules apply to scenarios involving an ESS Trustee.

Example | Taurira 1 – Treasury stock treated as cancelled and then applied for the purposes of the ESS

The trustee of an ESS trust acquires 700 Employer Co shares on market for \$2.50 per share. However, delays occur and shares are not allocated to employees within 12 months.

After 18 months, when the shares are worth \$3.50 per share, the trustee allocates the 700 shares to an employee for \$3.00 per share. The purchase price ($700 \times \$3.00 = \$2,100$) is funded by an employee loan from the trust.

If the employee is still employed by Employer Co 1 year after this allocation, the employee will receive a \$2,100 bonus from Employer Co (grossed up for PAYE). The employee must use this to repay the loan and the trustee will transfer the 700 shares to the employee.

If the employee leaves this employment before the year is up, they will forfeit their benefit and the trustee will retain the shares in satisfaction of the employee loan (ie the shares will return to being unallocated in the ESS trust).

One year after allocation, the shares are worth \$5 each.

ASC result for Employer Co

The trustee's acquisition of the 700 shares is treated as an acquisition of treasury stock by Employer Co for \$2.50 each.

As the 700 shares are not allocated to an employee within 12 months, the acquisition is treated as reverting to an on-market cancellation under s CD 25(2). This means that, with effect from the first anniversary of acquisition, under s CD 25(4) Employer Co's ASC of the class of share is reduced by the lesser of:

- the amount paid on acquisition ($700 \times \$2.50 = \$1,750$); and
- the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies were cancelled on that date.

The 700 unallocated shares are effectively treated as having been cancelled under s CD 25(4). When the trustee later allocates those shares to an employee for the purchase price of \$3 per share, under s CE 6 Employer Co is treated as issuing 700 shares for \$3 per share and it will have ASC of \$2,100 under s CD 43(2)(b).

For completeness, if the employee stays employed for a year, then ASC will arise for Employer Co in respect of the benefit provided to the employee. This will be equal to

the amount that is a benefit for the employee and expenditure for Employer Co under the ESS rules (s CD 43(6E)(a)):

$$700 \text{ shares} \times (\$5 \text{ market value} - \$3 \text{ cost}) = \$1,400.$$

Example | Taura 2 – Treasury stock treated as cancelled and then sold on market in the course of winding up the ESS

The trustee of an ESS trust acquires 700 Employer Co shares on market for \$2.50 per share. Six months later, when they are worth \$3 per share, it allocates 350 shares to an employee for \$2 per share. The purchase price ($350 \times \$2 = \700) is funded by an employee loan from the trust.

If the employee is still employed by Employer Co after 1 year, the employee will receive a \$700 bonus from Employer Co (grossed up for PAYE). The employee must use this to repay the loan and the trustee will transfer the 350 shares to the employee.

If the employee leaves this employment before the year is up, they will forfeit their benefit and the trustee will retain the shares in satisfaction of the employee loan (ie the shares will return to being unallocated in the ESS trust).

One year after allocation, the shares are worth \$5 each.

ASC result for Employer Co

The trustee's acquisition of the 700 shares is treated as an acquisition of treasury stock by Employer Co for \$2.50 each.

In respect of the 350 shares allocated to the employee within 12 months of acquisition, the acquisition is not treated as reverting to an on-market cancellation under s CD 25(2). Accordingly, s CD 25(4) does not apply to treat the amount paid to acquire those shares ($350 \times \$2.50 = \875) as reducing Employer Co's ASC. Likewise, the \$700 the employee paid to acquire the shares does not increase Employer Co's ASC (s CD 43(19)).

If the employee stays employed for a year, then ASC will arise for Employer Co in respect of the benefit provided to the employee. This will be equal to the amount that is a benefit for the employee and expenditure for Employer Co under the ESS rules (s CD 43(6E)(a)):

$$350 \text{ shares} \times (\$5 \text{ market value} - \$2 \text{ cost}) = \$1,050.$$

If the employee does not stay for 12 months and the shares become unallocated again, Employer Co will be treated as acquiring those 350 shares at that time for \$2.50 per

share (\$875). This is the amount for which the shares were initially acquired on market (s CD 25(7)). This acquisition will not reduce Employer Co's ASC if it allocates the shares to another employee within 12 months.

Additional facts – ESS trust to be wound up and remaining unallocated shares sold on market

Out of the 700 Employer Co shares that the trustee acquired on market for \$2.50 per share, 350 were not allocated in accordance with the ESS within a year.

Employer Co decides to wind up the ESS trust. Accordingly, the 350 unallocated shares held by the trustee are sold on market for \$5.50 per share (in aggregate \$1,925). Any cash remaining in the ESS trust is returned to Employer Co when it is wound up.

ASC result for Employer Co

For the 350 shares that are not allocated to an employee within 12 months, the acquisition is treated as reverting to an on-market cancellation under s CD 25(2). This means that, with effect from the first anniversary of acquisition, under s CD 25(4) the ASC of the class of share is reduced by the lesser of:

- the amount paid on acquisition ($350 \times \$2.50 = \875); and
- the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies were cancelled on that date.

The unallocated shares are effectively treated as having been cancelled under s CD 25(4). When the trustee sells those shares on market for \$5.50 per share, s CE 6 applies: Employer Co is treated as issuing 350 shares on market for \$5.50 per share. ASC of \$1,925 will arise for Employer Co under s CD 43(2)(b).

Dividend implications

30. As set out at [18], where a company holds shares in itself, rights attached to the shares are suspended under s 67B of the CA 1993. In other words, the company cannot receive dividends from itself on shares it holds in itself.
31. However, s 67B of the CA 1993 will not apply where an ESS Trustee holds shares in a company under the terms of an ESS. It is only for tax purposes that the ESS Trustee is treated as nominee for the company under s CE 6, and therefore the company is only treated as holding shares in itself for tax purposes.
32. Accordingly, dividends may still be paid on the shares held by an ESS Trustee and applied in accordance with the terms of the ESS. As set out from [22], under s CD 25 whether shares are treated as held by a company as treasury stock in itself for tax

purposes depends on whether the shares are allocated to an employee or not. Each of these situations is considered below.

Unallocated shares held by an ESS Trustee

33. Where an ESS Trustee holds shares that are not allocated to an employee, the ESS Trustee often waives its entitlement to dividends under s 53(3) of the CA 1993 (ie essentially “switched off”). If it does not waive the entitlement, the ESS Trustee usually retains the dividends to defray operational costs or returns them to the company.
34. As the company is treated as holding its own shares under s CE 6, there is no dividend for tax purposes as the company cannot transact with itself or pay dividends to itself. There is no “transfer of company value from a company to a person” under ss CD 4 to CD 6.
35. Where the ESS Trustee uses the cash from the dividend to, for example, defray expenses, then the treatment of those expenses will need to be considered in the ordinary manner. In other words, this will involve treating the ESS expenses as an expense of the company under s CE 6 and determining whether that expense is deductible to the company in accordance with the Income Tax Act 2007. Sections DA 1 and DV 27 will need to be considered in terms of expenditure incurred under the ESS.

Allocated shares held by an ESS Trustee

36. As set out from [22], in the context of an ESS Trustee and ss CD 25 and CE 6, the way a company is treated as holding shares that an ESS Trustee holds depends on whether the shares are allocated to an employee. If they are not, the company holds those shares as treasury stock in itself. However, the outcome of s CD 25 is that where an ESS Trustee allocates shares to an employee, the company is not treated as holding shares as treasury stock in itself. Instead, it is holding those shares on trust for the purposes of the ESS.
37. How dividends paid on shares allocated to an employee are treated for tax purposes will depend on the terms of the ESS.
38. The ESS Trustee may waive its entitlement to dividends under s 53(3) of the CA 1993, in which case no dividend will arise to consider for tax purposes.
39. The employee may be entitled to the dividends under the terms of the ESS. This could take the form of, for example, being entitled to receive the dividends, or having the dividends dealt with on their behalf in repayment of an employee loan (if they obtained one to acquire the share allocation). Assuming the ESS Trustee pays the dividend to the employee or deals with the dividends on the employee’s behalf within

the timeframe required by s HC 6, the dividends will be beneficiary income of the employee.

40. An amount that an employee derives in an income year as beneficiary income is income under ss HC 17 and CV 13(a). The dividend income will retain its character in the hands of the employee as beneficiary income. Accordingly, the usual tax implications of paying a dividend to a beneficiary of a trust as beneficiary income will result – for example, as regards imputation credits, withholding taxes and related tax credits. This outcome is consistent with treating shares held by an ESS Trustee that are allocated to an employee as held by the company (under s CE 6) but for the benefit of the employee and not as treasury stock (under s CD 25).
41. Where dividends are paid on allocated shares but the employee does not have any entitlement to them, they may be applied by the ESS Trustee in the same way that dividends on unallocated shares are applied – for example, to defray operational costs or be returned to the company. In such a situation, the same result as for unallocated shares effectively arises. The dividend is applied for the benefit of the company that will be treated for tax purposes as receiving a dividend from itself (under ss CE 6, CV 13(a) and HC 6). Accordingly, there is no “transfer of company value from a company to a person” under ss CD 4 to CD 6 and therefore no dividend for tax purposes.
42. Where dividends are paid on allocated shares but the employee does not have any entitlement to them, a different tax outcome from that set out at [41] may potentially arise where the employer company is different from the company whose shares are the subject of the ESS. This is because the ESS Trustee may be nominee for both of those companies under s CE 6, and therefore in some circumstances a transfer of company value from a company (the company whose shares are the subject of the ESS) to a person (the employer company) may arise. The tax implications in such circumstances will depend on the particular facts and are not considered in this statement.

Summary and examples

43. Figure | Hoahoa 1 summarises the discussion of dividend implications in this section.

Figure | Hoahoa 1 – Treatment of dividends on shares held by ESS Trustee

ESS Trustee holds shares in accordance with ESS as:	Dividends waived by ESS Trustee (s 53(3), CA 1993)	Dividends paid to ESS Trustee (ie not waived)
Unallocated shares – any cash used to defray operational costs or returned to company	No distribution, therefore no dividend for tax purposes	No dividend as no transfer of company value by a person to a person for tax purposes (ss CD 4 to CD 6, CD 25 and CE 6)

Allocated shares – employee entitled to dividends under ESS	Not applicable	If dividends paid to employee or dealt with on their behalf within the timeframe required by s HC 6, dividends are beneficiary income of the employee (ss CD 25, CE 6, CV 13(a) and HC 17)
Allocated shares – employee not entitled to dividends under ESS and any cash used to defray operational costs or returned to company	No distribution, therefore no dividend for tax purposes	No dividend as no transfer of company value by a person to a person for tax purposes (ss CD 4 to CD 6, CD 25, CE 6, CV 13(a) and HC 6)

44. Example | Taura 3 and Example | Taura 4 explain the tax implications of dividends paid on shares held by an ESS Trustee.

Example | Taura 3 – Shares held by ESS Trustee and dividends on unallocated shares waived

The trustee of an ESS trust holds shares in Parent Co to meet obligations to employees under Employer Co’s ESS.

Out of the 1,000 shares in Parent Co that the trustee holds, 750 are allocated to employees of Employer Co. The employees purchased their allocation using employee loans from the trust. The trustee will transfer shares to the relevant employee when they have completed 3 years of employment.

Any dividends paid on the allocated shares will be immediately applied (after deduction of any applicable taxes) to repay the employee loans.

The trustee waives its entitlement to dividends on the 250 unallocated shares under s 53(3) of the CA 1993.

Dividend implications

No dividends are paid on the unallocated shares as the trustee has waived its entitlement to those dividends.

As any dividends paid on shares allocated to an employee are immediately applied by the trustee in repayment of the employee’s loan, such dividends will be treated as beneficiary income of the employee under ss CD 25, CE 6, CV 13(a) and HC 6. Accordingly, imputation credits and withholding taxes will apply to those dividends in the same way as they would apply to any other payment of a dividend to a trustee that is beneficiary income.

Example | Tauria 4 – Shares held by ESS Trustee and all dividends applied to defray ESS operational costs

The trustee of an ESS trust holds shares in Employer Co to meet obligations to employees under an ESS.

Out of the 1,000 shares in Employer Co that the trustee holds, 750 are allocated to employees and 250 are unallocated. Allocated shares are transferred to the relevant employee when they have completed 3 years of employment.

The trustee does not waive its entitlement to dividends for any of the shares. An employee is not entitled to dividends on any allocated shares under the ESS until they complete 3 years of employment and the shares are transferred to them.

While the shares are held in trust, whether allocated or unallocated, the terms of the ESS provide for the trustee to retain any dividends and apply them to defray operational costs.

Dividend implications

Applying s CE 6, dividends paid on the unallocated shares are, for tax purposes, a payment of an amount by Employer Co to Employer Co. Accordingly, there is no transfer of company value by a person to a person for tax purposes and therefore no dividend for tax purposes (ss CD 4 to CD 6).

For dividends paid on the allocated shares, Employer Co is treated as holding those shares for the purposes of the ESS and not as treasury stock (under ss CD 25 and CE 6). However, as the employee has no entitlement to the dividends and the trustee applies them to defray ESS operational costs, these dividends are dealt with on behalf of Employer Co under s CE 6. Accordingly, there is no transfer of company value by a person to a person for tax purposes and therefore no dividend for tax purposes (ss CD 4 to CD 6, CD 25, CV 13(a) and HC 6).

Where the ESS operational costs relate to a loan or interest, or to establishing or managing the ESS, they will likely be deductible to Employer Co under ss DA 1 and DV 27(3).

Legislative references | Tohutoro whakatureture

Companies Act 1993, ss 53, 66, 67A, 67B

Income Tax Act 2007, ss CD 4 to CD 6, CD 22, CD 25, CD 26, CD 43, CE 6, CE 7 (“employee share scheme”), CV 13, DA 1, DV 27, HC 6, HC 17, OB 42

About this document | Mō tēnei tuhinga

Interpretation statements are issued by the Tax Counsel Office. They set out the Commissioner's views and guidance on how New Zealand's tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner's considered views, interpretation statements are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further [Status of Commissioner's advice](#) (December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in an interpretation statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.