



Restrictions and forfeitures

Find out about restrictions and forfeitures relating to employee share schemes.

ESS – Genuine disposal restrictions and deferred taxing points



Understand genuine disposal restrictions under an employee share scheme (ESS) and when they no longer apply.

Lapsed and forfeited employee share scheme interests



The tax treatment of lapsed and forfeited employee share scheme interests acquired under an employee share scheme (ESS).

ESS – Real risk of forfeiture



Test whether there is a real risk that the benefits of shares or rights may never be realised.

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ESS – Genuine disposal restrictions and deferred taxing points

Understand genuine disposal restrictions under an employee share scheme (ESS) and when they no longer apply.

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We consider there are genuine disposal restrictions that apply under an employee share scheme (ESS) and conditions when they will no longer apply. The following information applies to ESS interests (shares, stapled securities and rights to acquire shares or stapled securities) acquired under an ESS after 30 June 2009.

Tax-deferred schemes

ESS interests can be acquired under a:

- taxed-upfront scheme
- tax-deferred scheme
- scheme that provides employees with the start-up concession – from 1 July 2015.

Under a tax-deferred scheme, the discount the employee receives on the ESS interests is included in the employee's assessable income when the ESS deferred taxing point occurs.

The scheme and employee must satisfy certain conditions including:

- for rights – there must be either
 - a real risk of forfeiture

- restrictions preventing the immediate disposal and the scheme's rules must specifically state that it is a tax-deferred scheme (for rights acquired after 30 June 2015 only).
- for shares and stapled securities
 - there must be a real risk of forfeiture
 - the shares and stapled securities must be acquired under certain salary-sacrifice arrangements.

See also

- ESS – Real risk of forfeiture

Deferred taxing point

The deferred taxing point for a share or stapled security is the earliest of the following times:

- when the employee ceases the employment in respect of which they acquired the share (employment ceasing on or after 1 July 2022 will no longer be a deferred taxing point)
- when there is no real risk of forfeiture and the scheme no longer genuinely restricts the disposal of the share
- for shares or stapled securities acquired between 1 July 2009 – 30 June 2015, seven years after the employee acquired them
- for shares or stapled securities acquired from 1 July 2015 – 15 years after the employee acquired them.

The deferred taxing point for a right is the earliest of the following times:

- when the employee ceases the employment in respect of which they acquired the right (unless employment ceased on or after 1 July 2022, as it will no longer be a deferred taxing point)
- when there is no real risk of forfeiting the right and the scheme no longer genuinely restricts disposal of the right
- for rights acquired between 1 July 2009 – 30 June 2015

- when there is no real risk of forfeiting the right or underlying share, and the scheme no longer genuinely restricts exercise of the right or disposal of the resulting share
 - seven years after the employee acquired the right
- for rights acquired from 1 July 2015
 - when the employee exercises the right, there is no real risk of forfeiting the underlying share and the scheme no longer genuinely restricts the disposal of the resulting share
 - 15 years after the employee acquired the right.

If the employee disposes of the ESS interest or the share acquired on exercise of the right within 30 days of the deferred taxing point, the deferred taxing point will instead be the date of that disposal (this is called the 30-day rule).

See also

- Tax-deferred schemes – 30-day rule

Genuine disposal restrictions

For a restriction to be a genuine disposal restriction it must be in the conditions of the ESS when the employee acquires their ESS interest. For a share that an employee acquires on exercise of a right that is an ESS interest, the disposal restriction must have been in place when the employee acquired the right.

The conditions may be contained in the:

- plan rules
- offer document
- other governing documents of the scheme
- documented company policies that the employee is required to comply with
- employee's employment contract.

A genuine disposal restriction can be a condition of the scheme that:

- prohibits the employee from disposing of a share for a fixed period of time, where the disposal restriction is enforced by a holding lock or by the shares being held in a trust
- is contained in documented company policy that prohibits disposal of the shares or rights or the exercise of the rights, where that disposal would be in breach of the insider trading prohibitions in the *Corporations Act 2001*
- is contractual and prohibits the employee from disposing of their ESS interests, provided that there are serious and enforced consequences for breaching the condition.

A company may have an internal share trading policy prohibiting disposal of ESS interests. We consider such an internal policy to be a genuine disposal restriction only if there are serious and enforced consequences for breaching the policy.

We will consider a disposal restriction that can be lifted in special circumstances or in cases of financial hardship to be a genuine disposal restriction if it otherwise meets the conditions to be a genuine disposal restriction.

We consider that a scheme does not genuinely restrict disposal of an ESS interest if the employee can take action to dispose of the ESS interest.

Under some schemes, before employees can dispose of their ESS interests, they must request approval from the board of directors of the company or a company delegate. The need to make a request is not a genuine disposal restriction if such requests are routinely approved.

See also

- *TD 2022/4 Income tax: when are you genuinely restricted from immediately disposing of an interest provided under an employee share scheme?*

When are disposal restrictions lifted?

The genuine disposal restrictions are lifted on the first date on which an employee has an opportunity to dispose of their ESS interests. This will be the first time an employee can take some action to deal with or realise the interests. Disposal for ESS purposes is any act that divests

the employee of ownership of an ESS interest. That can include sale or cancellation of an ESS interest.

It does not matter whether or not the employee chooses to dispose of their ESS interest. An example of this is trading windows. The disposal restrictions are lifted during certain periods (trading windows), allowing the shares to be traded. At the end of each trading window, the disposal restrictions are put back in place.

We consider that the disposal restrictions are lifted at the start of the first trading window in which the employee has an opportunity to trade their shares.

If the employee does not trade their shares during the first available trading window and the shares then become restricted again, this does not change the fact that the disposal restrictions were lifted.

Examples of disposal restrictions

The following examples assume that the 30-day rule will not apply and that the general conditions for deferral have been met.

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Example 1: Fixed period with holding lock

Jack acquires shares under an ESS from his employer Pipeline Co., through a salary sacrifice arrangement. The salary sacrifice arrangement meets the conditions for tax deferral. Under the conditions of the scheme, Jack is not permitted to dispose of his shares until the earlier of either:

- five years from the time of acquisition
- him ceasing employment with the company.

Pipeline Co. put in place a holding lock to prevent employees from disposing of their shares within the five-year period, at the end of which time the shares are released.

A genuine disposal restriction exists on Jack's shares. Jack is still employed with Pipeline Co. at the end of the five-year period. This is Jack's deferred taxing point.

Example 2: Fixed period with holding lock subject to release in special circumstances affecting the employer

Using the first example, a condition of the ESS allows Pipeline Co. to release the holding lock in the following circumstances:

- There is a change of control of Pipeline Co.
- If Pipeline Co. is an unlisted company, the shares in Pipeline Co. are listed on a recognised stock exchange.

We still consider the scheme to genuinely restrict disposal.

Example 3: Fixed period with holding lock subject to release in special circumstances affecting the employee

Using the first example, a condition of the ESS allows Pipeline Co. to release the holding lock for shares held by an employee in special circumstances, namely, if the employee:

- suffers serious injury or illness
- suffers severe financial hardship
- is affected by a natural disaster.

We still consider the scheme to genuinely restrict disposal.

Example 4: Fixed period with holding lock subject to release in special circumstances under the policy and practice of the board

Using the first example, a condition of the ESS allows Pipeline Co. to release the holding lock for shares held by an employee in circumstances determined at the discretion of the board.

The board's policy and practice is to only release the holding lock in special circumstances, namely, if the employee:

- suffers serious injury or illness
- suffers severe financial hardship
- is affected by a natural disaster.

We still consider the scheme to genuinely restrict disposal.

Example 5: Fixed period with trust

Justin works for Brick Co. and is granted rights to shares in Brick Co. under an ESS. The scheme does not permit disposal of the

rights.

The rights are subject to a real risk of forfeiture for a 12-month period. Under the conditions of the scheme, if the employee has not forfeited their rights, an employee share trust will allocate shares to the employee to satisfy their rights, at the end of the 12-month period. The employee cannot withdraw the shares from the trust or dispose of the shares for a further two-year period. At the end of the two-year period, the employee may withdraw the shares from the trust or request that the shares be sold on their behalf.

Justin is still employed by Brick Co. at the end of the three years. At that time Justin no longer risks losing his rights and is no longer restricted from disposing of the shares acquired on exercise of the rights. This is Justin's deferred taxing point.

Example 6: Contractual restriction

Rosemary acquires shares from her employer Apple Co., on 16 January 2010, under an ESS. Rosemary has a real risk of forfeiting those shares until 16 January 2011. Under the conditions of the scheme, Rosemary is prohibited from selling her shares until the company has been listed for two years. Apple Co. becomes a listed company on 10 May 2010.

The conditions of the scheme provide that if the employees sell their shares before the company has been listed for two years, their employment will be terminated. Apple Co. strictly enforces this condition.

This is a genuine disposal restriction, as the consequence of breaching the condition is serious and enforced. As long as Rosemary remains employed by Apple Co, her deferred taxing point is 10 May 2012, two years after the company was listed.

Example 7: Share trading policy

Henry is an executive employee of Ludo Co. He acquires shares under an ESS from Ludo Co. on 30 May 2010. Those shares meet the conditions for deferral because they are subject to a real risk of forfeiture for a period of one year. Henry cannot dispose of his shares while they are subject to a real risk of forfeiture.

Under the conditions of the scheme, Henry must also comply with Ludo Co.'s policies and procedures on share trading. Ludo Co.'s *General Policy and Procedures* document states that all executives are considered to have inside information about the company. For this reason, Ludo Co.'s executives are allowed to trade only during the month commencing the day after the release of the company's annual report. A breach of this policy will result in termination of employment or demotion.

This is a genuine disposal restriction, as there are serious and enforced consequences for a breach of the policy.

There is no longer a real risk of Henry forfeiting his shares on 31 May 2011. However, Henry is restricted from disposing of his shares until the month after the release of Ludo Co.'s 2011 annual report. The report is released on 30 September 2011. As Henry is still employed by Ludo Co at this time, Henry's deferred taxing point is 1 October 2011, as this is the first time Henry is able to dispose of the shares.

Example 8: Blackout periods

Giles acquires rights from his employer Fine Fashion Co. under an ESS on 30 November 2010. The scheme does not permit disposal of the rights.

Under the conditions of the scheme, the rights:

- are subject to a real risk of forfeiture for a period of one year
- can be exercised for a period of five years from the day following the end of the forfeiture period, subject to compliance with Fine Fashion Co.'s share trading policy.

Under the policy, certain employees cannot exercise any rights acquired under an ESS in blackout periods. Giles is an employee

covered by this policy. The blackout periods commence on the first day of the last month in the half year (1 December) and full year (1 June) and end on release of the half year or full year financial results (10 February and 10 August). Shares acquired on exercise of rights are not subject to disposal restrictions.

Giles is no longer subject to a real risk of forfeiture on 1 December 2011. As this is in a blackout period under the scheme, Giles is genuinely restricted from exercising his rights. As Giles is still employed by Fine Fashion Co at this time, the deferred taxing point is the first time that Giles is able to exercise his rights and receive the unrestricted shares, that is, 11 February 2012.

Example 9: Trading windows

Jennifer acquires rights from her employer Toys Co. on 29 October 2010 under an ESS. The scheme does not permit disposal of the rights.

The rights are subject to a real risk of forfeiture for a period of one year and can be exercised from the day following that one-year period. The rights will expire three years from acquisition. A contractual condition of the ESS restricts disposal of the shares resulting from the exercise of the rights for two years after exercise. However, the scheme also provides two trading windows during the restriction period: one on 30 October 2011 and one on 30 October 2012. On those dates, the disposal restrictions are lifted for a period of 30 working days.

There are serious and enforced consequences for disposing of the shares outside of the two trading windows.

Jennifer no longer has a real risk of losing her rights on 30 October 2011. On that day she is no longer restricted from exercising her rights. That day is also the first day of a trading window, so she is not restricted from disposing of the shares acquired on exercise of the rights.

The deferred taxing point occurs on 30 October 2011, if Jennifer is still employed by Toys Co. at that time. This is the first time

that Jennifer can take action to realise the benefit (whether or not Jennifer chooses to exercise the rights at this time).

If Jennifer acquires her rights after 30 June 2015, the date she could take action to realise the benefit would not have been her deferred taxing point unless she had exercised her rights at or before that time.

For example, if Jennifer acquires her rights on 29 October 2015, exercises those rights on 10 January 2017 and if the two trading windows are on 30 October 2016 and 30 October 2017, then her deferred taxing point would be 30 October 2017. That is the first time after she exercises the rights that she can take action to dispose of the shares.

Example 10: No fixed period with request for release of shares routinely approved

Sarah acquires shares in Clothing Co. under an ESS. Under the conditions of the scheme, an employee share trust allocates the shares to Sarah and holds the shares for her benefit subject to forfeiture conditions. The shares are subject to a real risk of forfeiture for a period of three years.

Sarah can't dispose of the shares until a delegate of the board approves a request for withdrawal of the shares from the employee share trust. The board will routinely approve the withdrawal of the shares after the forfeiture period has passed.

Sarah no longer has a real risk of forfeiting her shares at the end of the three-year forfeiture period. We consider that Sarah is not genuinely restricted from disposing of her shares at this time because she can request that the delegate of the board approve withdrawal of the shares and such a request is routinely approved. As Sarah is still employed with Clothing Co. this will be her deferred taxing point.

Example 11: Insider trading policy that requires Board approval

Boots Co. provides its employees with rights to acquire Boots Co. shares under an ESS in April 2010. The scheme does not permit disposal of the rights.

The rights are subject to a real risk of forfeiture for a three-year period. If the rights are not forfeited, shares are transferred to the employee in satisfaction of the rights at the end of the three-year period.

Under the conditions of the scheme, employees are required to comply with the share trading policy of Boots Co. for shares acquired in satisfaction of the rights.

Some employees are considered likely to be routinely in possession of inside information (restricted employees). As such, they are prohibited by the company's share trading policy from dealing in Boots Co. shares unless they are cleared to deal by a delegate of the board of directors.

These employees are required to state in writing, at the time of making a request to deal in their shares that they are not in possession of inside information. The delegate will approve a request if they are satisfied that the employee is not in possession of inside information. There are serious and enforced consequences for disposing of the shares without obtaining approval.

Louise is a restricted employee covered by the share trading policy.

We consider Louise to be genuinely restricted from disposing of her shares, on the basis that she is unable to obtain the delegate's approval to trade if, when Louise receives the shares in satisfaction of the rights, she has both:

- possession of inside information
- records that provide evidence that she possesses this information.

If, when Louise receives the shares in satisfaction of the rights, she does not have possession of inside information, we do not

consider Louise to be genuinely restricted from disposing of her shares. She can take action at that time to realise the benefit by requesting the delegate's approval to trade. This will be her deferred taxing point.

If, within 10 business days (for example) from receiving the shares in satisfaction of the rights, Louise makes a request and the delegate refuses that request, we will consider Louise to have always been restricted from disposing of the shares and that her deferred taxing point has not occurred. Her deferred taxing point will occur when she no longer has possession of inside information at which time she can make another request (unless within 10 business days of being able to make the request, she makes the request and that request is refused).

Boots Co. employer reporting obligations are explained in Example 12.

Example 12: Employer reporting – insider trading policy requires board approval

Boots Co. operates a tax-deferred scheme. Boots Co. must give an ESS statement to its employees and an ESS annual report to the ATO for the income year in which the deferred taxing point for the rights occurs. For reporting purposes, Boots Co. needs to take reasonable steps to identify accurately when the deferred taxing point arises.

In April 2013, employees receive shares in satisfaction of rights.

A deferred taxing point will occur when the shares are transferred to Boots Co. employees, unless an employee is a restricted employee that is either:

- in possession of inside information and has records that provide evidence of having that information
- in satisfaction of the rights, has made a request to trade within 10 business days of receiving the shares and that request has been refused by the delegate.

For the 2012–13 income year, Boots Co. will report in the following way, Boots Co. provides an:

- ESS statement to all employees that are not restricted employees
- ESS statement to all restricted employees, unless the restricted employee
 - has advised the company that they have possession of inside information, or
 - has submitted a request to trade which was refused within 10 business days of receiving the shares
- ESS annual report to the ATO for all employees who received an ESS statement.

For those restricted employees that Boots Co. does not report in the 2012–13 income year, Boots Co.:

- requires the restricted employees to advise when they are no longer in possession of inside information and Boots Co. will record this date as the deferred taxing point
- advises the employees that Boots Co. will report on the basis that a deferred taxing point will have occurred at the beginning of the next financial quarter, unless the employee either
 - advises them that they are still in possession of inside information
 - makes a request to trade and that request is refused within 10 business days of the beginning of the next financial quarter.

Boots Co. continues to report on this basis.

When Louise receives her shares in April 2013, she has inside information. Louise advises the company that she has inside information. On that basis, Boots Co. does not provide an ESS statement to Louise and does not include information about Louise in the ESS annual report for the 2012–13 income year.

At the beginning of July and October 2013, Louise advises Boots Co. that she still holds inside information. Louise continues to hold inside information until November 2013. Louise then advises Boots Co. that she is no longer in possession of inside information. Louise decides not to request approval to trade.

Boots Co. records Louise's deferred taxing point as the date that she ceased to hold inside information, and for the 2013–14 income year, provides an ESS statement to Louise by 14 July 2014 and an ESS annual report to the ATO by 14 August 2014.

For more information about ESS for employers, see:

- [ESS – Employers](#)
- [ESS – Reporting requirements for employers](#)

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ESS – Real risk of forfeiture

Test whether there is a real risk that the benefits of shares or rights may never be realised.

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Sometimes we consider employee share scheme interests (ESS interests), that is – shares, stapled securities and rights to acquire shares and stapled securities – to be at a real risk of forfeiture.

This information applies to ESS interests acquired under an employee share scheme (ESS) after 30 June 2009.

Deferred taxing point

Generally, a discount to the market value of an ESS interest is taxed on acquisition of the ESS interest.

However, when there is a real risk that the benefits of an ESS interest may never be realised because the ESS interest may be forfeited, the tax will be deferred until a deferred taxing point.

The 'real risk of forfeiture' test is relevant at the time the employee is granted the ESS interest in order to determine the deferred taxing point.

For the tax to be deferred, the ESS and the employee must also meet certain conditions determined at the time of grant of the ESS interest.

See also:

- [ESS – Employees](#)

Real risk of forfeiture test

Whether or not a real risk of forfeiture is present will depend on the facts and circumstances of each scheme and the individual circumstances of the employee at the time of grant of the ESS interest.

An ESS interest acquired by an employee is at real risk of forfeiture if a reasonable person would consider that there is a real risk that the employee may forfeit or lose the ESS interest, other than by intentionally taking no action to realise the benefit.

The meaning of 'real' is something more than a mere possibility. An ESS interest will not be at real risk of forfeiture if a reasonable person would disregard the risk as highly unlikely to occur or as nothing more than a rare eventuality or possibility.

Real risks of forfeiture in a scheme may include conditions where retention of the ESS interests is subject to:

- [Performance hurdles](#)
- [Minimum term of employment](#)
- [Minimum term of employment and good leaver conditions](#)
- [Minimum term of employment and retirement](#)
- [ESS with both service and performance conditions](#)

- [ESS with only a portion subject to a real risk](#)

There is no real risk of forfeiture where a scheme simply includes a condition which:

- restricts an employee from disposing of an ESS interest for a specified time
- allows an employee to request that the ESS interest be forfeited
- provides for an employee to forfeit an ESS interest if they are dismissed for fraud or gross misconduct.

The examples in this document consider only the real risk of forfeiture determined at the time of grant of the ESS interest. The examples meet all other conditions necessary for a scheme to qualify for tax deferral.

Example 1: Fraud or gross misconduct, no real risk

Ted works for Bear Ltd and is granted shares in Bear Ltd under an ESS.

Ted will forfeit the shares if he is dismissed for fraud or gross misconduct within the next three years.

The ESS does not include any other conditions under which Ted could forfeit his shares.

Ted's shares are not considered to be at real risk of forfeiture.

There is no real risk of forfeiture where we consider the condition to be contrived.

Factors which might suggest a condition is contrived include:

- a short minimum term of employment combined with a long disposal restriction period
- giving the plan operator an overriding discretion to vest ESS interests where performance hurdles are not met, and the operator exercises that discretion on a routine basis.

Performance hurdles

Whether performance hurdles constitute a real risk of forfeiture will depend on the facts and circumstances in each case at the time of grant of the ESS interest.

Where an employee is granted ESS interests that are subject to forfeiture if the company does not achieve specified performance targets, such as an increase in sales over a specified period relative to itself, we will consider the facts and circumstances to determine whether the ESS interests are, at the time of grant, at real risk of forfeiture. We must consider the likelihood of the company meeting its targets.

Example 2: Performance hurdle sales target, no real risk

Tania works for South Ltd and is granted rights to acquire shares in South Ltd under an ESS.

Under the conditions of the scheme, Tania's rights will lapse if South Ltd's current year sales do not exceed last year's sales.

The ESS does not have a minimum employment requirement.

South Ltd has increased its sales by more than 10% in each of the preceding five years and has recently taken over a major competitor.

In this case, we consider that a reasonable person might consider that the rights acquired by Tania were not at a real risk of forfeiture.

Example 3: Total shareholder return, real risk

Anne works for Bob Ltd and is granted rights to acquire shares in Bob Ltd under an ESS.

Under the conditions of the scheme, Anne's rights will lapse if, over the next three years, Bob Ltd's total shareholder return

(TSR), when compared to the TSR of companies in a specified peer group, is not in the top 50%.

Bob Ltd has a history of regularly achieving a high TSR relative to its peer group.

Even though Bob Ltd has regularly achieved a high TSR relative to its peer group, we consider in this case, that a reasonable person might consider the rights acquired by Anne to be at real risk of forfeiture, considering that this performance hurdle is based on the performance of peers.

Minimum term of employment

An ESS may provide (at the time of grant) for ESS interests to be forfeited if the employee doesn't complete a minimum term of employment (forfeiture period).

We accept that there will be a real risk of forfeiture where the minimum term of employment is at least six months and the maximum deferral is no more than three years; or where the minimum term of employment is at least 12 months.

For ESS interests acquired outside these parameters, we will consider all the facts and circumstances to determine whether they are at a real risk of forfeiture.

Example 4: Forfeiture on cessation of employment, real risk

Steve works for Ceiling Ltd and is granted rights to acquire shares in Ceiling Ltd under an ESS.

Under the conditions of the scheme, Steve's rights will lapse if he ceases employment with Ceiling Ltd within the next 12 months.

Steve's rights to acquire shares in Ceiling Ltd are accepted as being at a real risk of forfeiture.

Example 5: Forfeiture after vesting due to choice, no real risk

Aimee works for Skydiving Ltd and is granted rights to acquire shares in Skydiving Ltd under an ESS.

Under the conditions of the scheme, Aimee must remain employed with Skydiving Ltd for two years before the rights can be exercised. After the two-year period, the rights can be exercised for a period of four years. However, Aimee's rights will lapse:

- if she ceases employment before exercising the rights
- at the end of the four-year period (if the rights are not exercised).

In this case, we consider that at the time of acquisition the rights are at a real risk of forfeiture.

However, after two years Aimee's rights will no longer be at a real risk of forfeiture. We consider that any risk of Aimee losing her rights after the two-year period will be due to her choosing not to take action to exercise her rights.

Example 6: Forfeiture on cessation of employment and monthly vesting, real risk

Alastair works for Camera Ltd and is granted rights to acquire shares in Camera Ltd under an ESS.

Under the conditions of the scheme, rights will vest progressively at monthly intervals over a four year period. Upon vesting, Camera Ltd will issue shares to Alastair. If Alastair ceases employment with Camera Ltd, any unvested rights will lapse.

The scheme operates to attract and retain the best employees while promoting the success of the company. Camera Ltd's strict insider trading policy allows employees to sell their shares, but only during quarterly trading windows.

Although the required period of employment until the first vesting date is only one month, because Alastair is able to dispose of his vested shares during quarterly trading windows (i.e. the disposal restriction period is commensurate with the vesting period) we consider that a reasonable person would accept that at the time of acquisition, Alastair's rights are at a real risk of forfeiture.

Example 7: Early vesting on takeover, real risk

Jadzia works for Red Ltd and is granted rights to acquire shares in Red Ltd under an ESS.

Under the conditions of the scheme, Jadzia will forfeit her rights if she ceases employment with Red Ltd within the next two years.

As Jadzia must complete a minimum term of employment, the rights are at a real risk of forfeiture.

However, under the conditions of the scheme, Red Ltd has a discretion to vest all or some of Jadzia's rights in the event of a takeover bid for or a change in control of Red Ltd.

Red Ltd is not subject to a takeover bid at the time the rights are granted.

In this case, we still consider that at the time of acquisition, the rights are at a real risk of forfeiture, despite Red Ltd's discretion to vest the rights.

A takeover bid is an event beyond Jadzia's control. If, for example, a bid occurred shortly after Jadzia's acquisition of the rights, Red Ltd could decide not to vest some or all of the rights.

Minimum term of employment and good leaver conditions

An ESS that provides for ESS interests to be forfeited if an employee does not complete a minimum term of employment may contain 'good

leaver' conditions that allow employees to retain their interests if they cease employment during the forfeiture period.

Where a scheme contains good leaver conditions that allow ESS interests to be retained for example, in the event of death, invalidity or bona fide redundancy, we accept that the ESS interests are at a real risk of forfeiture. However, where the scheme routinely allows employees to retain their ESS interests regardless of their reason for ceasing employment, we consider a reasonable person would not accept that the ESS interests are at a real risk of forfeiture.

Example 8: Forfeiture on cessation of employment, real risk where a good leaver leaves for reasons beyond their control

Hudson works for Vine Ltd and is granted rights to acquire shares in Vine Ltd under an ESS.

Under the conditions of the scheme, Hudson will forfeit his rights if he ceases employment within three years, subject to good leaver conditions.

The scheme's good leaver conditions allow employees to retain their rights if they cease employment with Vine Ltd for reasons beyond their control, such as invalidity or redundancy.

The scheme is not operated so as to routinely allow employees to retain their rights regardless of their reason for ceasing employment.

Hudson's rights are accepted as being at a real risk of forfeiture.

Minimum term of employment and retirement

Good leaver conditions in an ESS may allow employees to retain ESS interests if they cease employment to retire from the workforce permanently during the forfeiture period. Whether ESS interests acquired under an ESS with good leaver conditions are at a real risk of forfeiture will depend on the facts and circumstances, including how the ESS is operated and the employee's personal circumstances.

Example 9: Good leaver provisions and retirement, no real risk

Linda works for Central Ltd and is granted rights to acquire shares in Central Ltd under an ESS.

Before Linda acquired the rights, she advised her employer that she would be retiring and permanently leaving the workforce within the next year, when she turned 60 years old.

Under the conditions of the scheme, Linda will, subject to good leaver conditions, forfeit her rights if she ceases employment within two years (the forfeiture period).

The scheme contains no other forfeiture conditions.

The scheme's good leaver condition allows employees 55 years old and older who cease employment during the forfeiture period to retain their rights if they are permanently leaving the workforce to retire.

In this case, we consider that a reasonable person would accept that, due to Linda's clear intention to retire during the forfeiture period, the rights acquired by Linda were not at a real risk of forfeiture.

Example 10: Good leaver provisions and retirement, real risk

Sienna works for North Ltd and is granted rights to acquire shares in North Ltd under an ESS.

Under the conditions of the scheme, Sienna will forfeit her rights if she ceases employment within the next two years, subject to good leaver conditions.

The scheme's good leaver condition allows employees 55 years old and older who cease employment during the forfeiture period to retain their rights if they are retiring permanently.

The way the scheme is operated, employees can retain their shares only if the employer is satisfied that they are retiring permanently.

The scheme contains no other forfeiture conditions.

At the time the rights are acquired, Sienna is 55 years old and does not intend to retire during the forfeiture period.

In this case, we consider that a reasonable person would accept that at the time of acquisition, Sienna's rights are at a real risk of forfeiture.

Example 11: Retirement pro-rata clause, real risk

Brenton works for Gamer Ltd and is granted rights to acquire 300 shares in Gamer Ltd under an ESS.

Under the conditions of the scheme, one-third of the rights vest each year and an employee will forfeit unvested rights if they are no longer employed by Gamer Ltd at the end of each particular year.

The scheme contains a good leaver condition that permits Gamer Ltd to allow its employees, who retire during the three-year forfeiture period, to retain a portion of their unvested rights on a pro-rata basis for each day they are employed during the year.

Gamer Ltd does not have a minimum retirement age, but the discretion is exercised such that only employees known to be retiring permanently are able to retain a portion of their unvested rights.

At the time Brenton receives the rights, he is 52 years old and not intending to retire from the workforce permanently. As such, we consider that all 300 of Brenton's rights are at a real risk of forfeiture.

If before the rights were acquired, Brenton advised his employer that he would be retiring and permanently leaving the workforce

in 12 months' time, 200 of the rights would be at real risk of forfeiture and 100 rights would not be at real risk of forfeiture.

ESS with both service and performance conditions

Both performance and service conditions, such as a minimum term of employment, can be taken into account to determine whether there is a real risk of forfeiture on acquisition of an ESS interest.

Where the service conditions are sufficient to satisfy the real risk of forfeiture test at the time of acquisition, it is not necessary to consider whether the performance conditions also satisfy the test.

However, where there is some doubt about service conditions alone satisfying the real risk of forfeiture test, we will also consider whether the performance conditions satisfy the test.

ESS with only a portion subject to a real risk

An employee may receive ESS interests where only a portion of the ESS interests are subject to a real risk of forfeiture. Only the portion that is at real risk will be eligible for tax deferral.

Example 12: Performance hurdles over a portion of ESS interests

James works for Douglas Ltd and is granted rights to acquire 1,000 shares in Douglas Ltd under an ESS.

Under the conditions of the scheme, James will receive 1,000 shares in three years time if Douglas Ltd's total shareholder return (TSR) over the three-year period, when compared to the TSR of companies in a specified peer group, is in the top 50% of its peer group. However, where the TSR is not within the top 50%, James will receive 600 shares.

The ESS does not contain any other forfeiture conditions, including a minimum term of employment.

In this case, we consider that at the time of acquisition only 400 of the rights are at a real risk of forfeiture since James will receive 600 shares in three years time regardless of Douglas Ltd's performance.

See also:

- ESS – Employees

QC 27240

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If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

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