RESOURCES
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What You Need To Know About Executive Share Schemes

For Mining and Resources Executives

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Table of Contents

Introduction

This document has been prepared for mining and resources executives and employees who have an Executive Share Scheme (ESS) as part of their salary package.

Its purpose is not to provide an exhaustive description of the terms and conditions of ESS and the circumstances that can impact upon them.

Indeed, rather than exhaustive, it would be 'exhausting' to write and equally so for a reader to make sense of the multitude of terms and conditions as they expressly apply to each individual ESS holder's circumstances.

Our purpose is to provide an insight into the nature of ESS.

In doing so, we aim to create an awareness of the inherent complexity involved in managing an ESS, the requirement for constant review and the high probability of costly errors which frequently occur as a consequence of strict terms and conditions that are highly sensitive to, and unforgiving of, changes in circumstances.

While all general advice disclaimers beseech readers to seek professional advice in accordance with their specific circumstances, this is particularly important for holders of an ESS. In fact, we would argue that effectively managing your ESS is unlikely to occur *without* professional advice.

As professional financial advisers for mining and resources, we are known for our expertise in ESS. Our credentials include over 20 years' consulting in this highly specialised area of personal financial management, and as one of our principal advisers (Brett Cribb) is a former mining engineer, we benefit from his years of direct hands-on ESS experience.

Please take a moment now to review this document, and please accept our invitation to contact us should you have any needs, or importantly, concerns about your ESS.

James Marshall

About James Marshall

Associate - Resources Unearthed
Financial Adviser & Director - Stratus Financial Group

James helps time-poor mining and resources executives and professionals to implement integrated, long-term financial strategies that aim to build wealth and protect their family as they build their career in a demanding industry.

His clients include engineers (electrical, mechanical, maintenance), metallurgists, environmental scientists and specialists in occupational health and safety, many of whom are based in southeast Queensland.

James holds the highest designation in financial planning, CFP® (CERTIFIED FINANCIAL PLANNER®) from the Financial Planning Association of Australia. Recognised in 26 countries, the CFP® designation is the gold standard in financial planning. Becoming a CERTIFIED FINANCIAL PLANNER® professional demonstrates James' commitment to upholding world class professional standards. He is a SMSF Specialist (KAPLAN) and Justice of the Peace (Qualified).

James completed his Bachelor of Business (Distinction) majoring in Finance at the Queensland University of Technology (QUT) Business School. He has maintained ties with QUT as a Sessional Academic in the Accounting faculty. Here he mentors students and teaches Superannuation, Regulation and Practice, Data Analysis and Personal Financial Planning.

Together with Brett Cribb, James co-founded Resources Unearthed, which is an online professional services and information hub. Resources Unearthed is recognised for providing executives, professionals and business owners in mining and resources access to integrated and specialised financial, legal and business advisory support and specialised tax services. His role at Resources Unearthed has afforded him rare exposure to a concentration of advice specifically for mining and resources professionals.

James' areas of expertise include Executive Share Scheme (ESS) management and advice, investment strategies, portfolio management, superannuation, estate planning, and retirement planning and transition.

He is the author of *Five Key Financial Matters for Mining and Resources Professionals*, a strategy paper that succinctly addresses the central financial planning needs of this audience.

Glossary

Award: the series of shares or options granted to the executive as part of their Executive Share Scheme.

Grant: the point at which the awarded shares or options are awarded under an Executive Share Scheme.

Vest: the point at which shares or options are able to be acted on. The most common vesting period is three years from grant (but can be as long as 15).

Service days: the number of days between the date on which the award is granted and the date on which the award vests to the executive.

Exercise: the action of converting unvested shares into ordinary shares or converting unexercised options into ordinary shares. For most Executive Share Schemes, this occurs automatically at the point of an award vesting.

1. Tax: When do I pay?

In Australia, tax is usually payable at the time of vesting (to you), regardless of whether you retain or sell the shares. It is important to note that vested shares or options are usually taxed as income and not treated as a capital gain for tax purposes.

It is a common misconception that the value of the shares is not taxed until they are sold. This is not the case.

The administrator of your scheme is required to provide you with a statement at the end of each year. The report should indicate the amount of income to be reported on your tax return from any shares that vest to you.

It is important for you to note the following key matters in terms of accurate tax reporting:

i) If you sell your shares *within* 30 days of vesting, the 'value of the proceeds' is treated as taxable income rather than the 'value at vesting'.

ii) If you retain or sell your shares 30 days *after* vesting, you would be required to report the 'value of the shares' at the date of vesting as income. There would also be a standard capital gain consideration to account for any share price movement between time of vesting and sale.

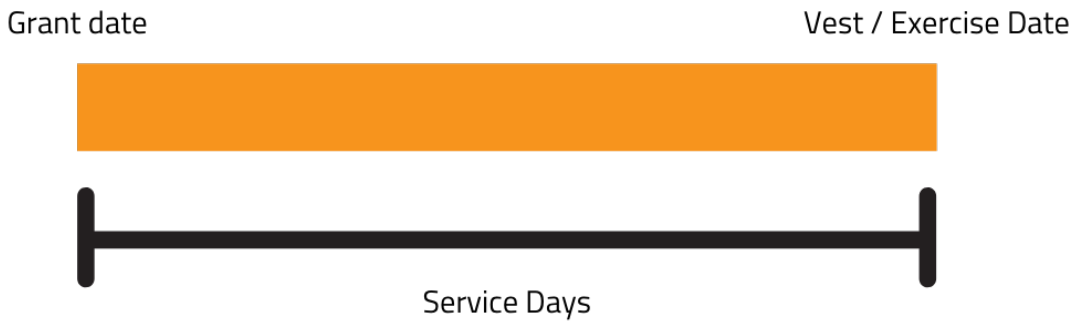
Being fully informed of your tax position at each vesting is important for avoiding errors that can cause unnecessary tax liability when lodging your tax return.

2. Vesting

2.1 Vesting Contradiction (It's a taxing point, but not always)

In Australia, the taxing point for awards differs from when the award was granted.

The legislation has changed several times over the years to add further complexity. At time of writing (June 2020), the legislation requires that awards granted *after* 1 July 2015 are subject to being taxed as income at the point at which they are exercised.



- For awards granted *before* 1 July 2009, you were given the choice of being taxed upfront or paying tax at the point of vesting or exercise. In the circumstance of an appreciating share price from the period of grant to vest or exercise, electing to pay tax upfront could have saved you a significant amount of tax.
- Awards granted after 1 July 2009 but before 1 July 2015 are generally taxed at the point of the awards vesting.
- If you have awards granted after 1 July 2015, the taxing point is generally the point at which your award is exercised.

Most companies have awards that exercise automatically at vesting. However, not every mining and resources company operates in this way. For example, start-up mining and resources companies were given additional tax concessions from 1 July 2015 and some organisations have awards that vest to you after a set period and are *not* exercised until you make a specific choice with the ESS administrator. This allows greater control of the taxing point of your awards.

Consideration must also to be given to *when* you choose to exercise your award as outlined in the following two scenarios:

i) *Exercising the award now with the value on vesting resulting in taxable income which would be paid at Australia's standard income tax rate*.

You would receive dividends on exercised shares, with the future sale of shares then being subject to tax as a capital gain rather than income. Further, if the shares are held for more than 12 months, you would qualify for the discounted capital gains tax provision.

ii) *Exercising the award later, to delay having the value of shares treated as income until a future financial year.* This approach would delay when income tax is payable.

This would likely depend on your personal circumstances at the time, as each has advantages and disadvantages. However, such is the contradictory nature of ESS, while it could apply, it is important to know that the majority of ESSs offered by mining and resources companies do not offer the above flexibility of your being able to choose when your awards may be exercised.

2.2 Vesting Criteria

The type of award issued drives the criteria for an award vesting to you. The most common form of award is one which has a time-based vesting condition, which is generally around three years.

Depending on the mining and resources company you work for and the seniority of your position, you may be granted an award which has both time and performance-based conditions for vesting.

In these cases, an award may vest with a positive or negative multiplier effect. This is dependent on a range of performance measures that apply to the company which could include:

- Relative and absolute total shareholder return
- Growth in earnings per share
- Growth in reserves per share

There may be a matrix of each performance measure input to assess the outcome at vesting or your award may be split into multiple tranches, each with a different performance criterion.

2.3 Vesting and Exercising your ESS

Each vesting and exercise of your ESS is a decision point at which there are a number of choices for your consideration:

i) Retain the vested shares
You can choose to retain your newly vested shares. Should you do so, you will need to consider where best to hold them – in your own name, the name of your spouse, superannuation or another structure. Further, as noted earlier, vesting and exercising shares trigger a tax point that results in a tax liability for that financial year. You will therefore need to consider the risk of that tax liability at that tax point being greater than the value of the shares should the share price fall significantly in future.

ii) Sell enough shares to cover your future tax liability
The Australian tax legislation does not require the administrator of your ESS to withhold tax. With this in mind, it may be prudent to consider selling a sufficient number of shares for the purpose of covering, at a minimum, payment of your future tax liability. This approach reduces the risk of paying a tax liability after the value of your shares have fallen significantly.

iii) Sell all your shares and use the proceeds elsewhere
Depending on your personal circumstances, selling all vested and exercised shares may be appropriate, as the proceeds could be used to repay debt, reinvest into other assets to diversify your investments or for contribution to superannuation.

Each of these considerations needs to be carefully worked through, taking into account your personal circumstances, your tax liabilities in Australia, and if relevant, foreign tax jurisdictions.

Of greatest importance, the relevant documentation must be retained to support the establishment of the cost base of the shares at each vesting and exercise point.

3 Dividends

Whether you receive a dividend before vesting usually depends on your mining and resources company. For the majority of companies, you won't receive any dividends (or have voting rights) on any of your unvested shares.

Some companies provide a dividend equivalent payment upon your award vesting and being exercised, while other companies pay dividends each year on your unvested and unexercised shares.

4 Overseas Secondment or Permanent Relocation

Having an overseas posting is both an exciting and rewarding part of working in the mining and resources industry. However, working and living overseas can have significant implications on your ESS, particularly from a tax perspective.

Clarifying the basis of your Australian and foreign tax residency is key to determining how your ESS will be impacted when you have a period of overseas service.

For more information regarding tax residency, please read our strategy *paper* *What You Need to Know About Living & Working Overseas*

4.1 Departing Australia

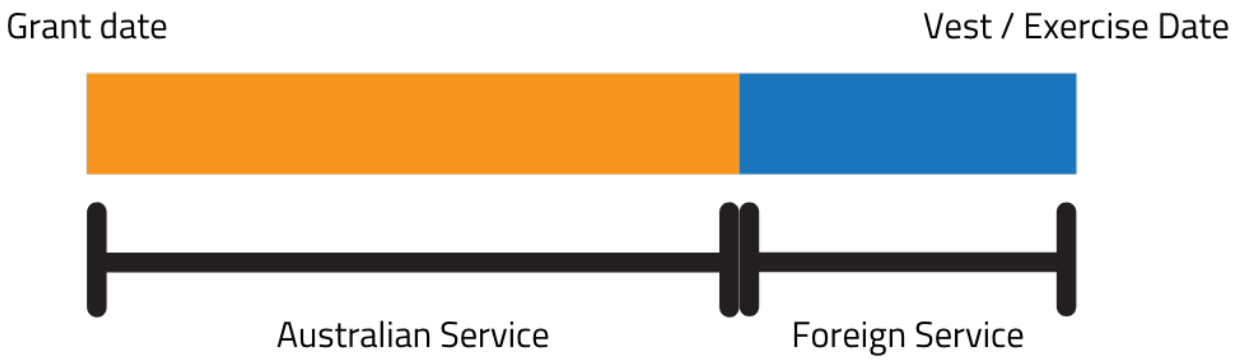
In many cases when you undertake an overseas secondment or relocate permanently overseas for work, your employer will provide accounting services (usually through a Big 4 firm).

Determining the status of your Australian and foreign tax residencies is among the key matters to be worked through. The appointed accountants will advise on the need for cessation of Australian tax residency and commencement of a new foreign tax residency. This is then reported to the administrator of your ESS.

It is important to note that tax residencies are not mutually exclusive. That is, you can be a tax resident of multiple tax jurisdictions at the same time.

Tax residency is generally based on your personal circumstances at a particular point in time, rather than you choosing to be a tax resident (or not) of a particular jurisdiction.

There are other matters to be considered as well and it is for this reason I would like to make the point that tax residency advice needs to be specific to your individual circumstances. And that the importance of getting it right should not be underestimated.



For example: If the taxing point of your ESS occurred while you were not an Australian resident for tax purposes, then you would be subject to tax in Australia on as much of the ESS as is related to your Australian service. This is usually determined on the basis of time, whereby a pro-rata of Australian service days over the period of grant to vest is applied to the value of shares on vesting. (Refer to the diagram above). From an Australian tax perspective, you would likely be assessed at higher non-resident tax rates.

There are also foreign tax implications resulting from each vesting which will require advice from a foreign tax jurisdiction adviser.

A word of caution. Even with the best of intentions, mistakes happen. It is important to know that company appointed accountants can make errors in their calculations and provision of relevant date information to the administrators of the ESS. In recent years, we have recovered significant sums of money for our clients which have been incorrectly withheld as a result of such errors.

4.2 Arriving in Australia

Where an award is granted to you in a foreign tax jurisdiction but vests to you while you are an Australian resident for tax purposes, the value on vesting is generally fully taxable in Australia, with a credit applied for any foreign tax paid.

If it is possible, it can be beneficial to action a taxing point prior to your returning to Australia. This is particularly appropriate if your ESS is unlikely to result in assessable income in the foreign tax jurisdictions your awards are subject to.

However, any company specific tax equalisation policy may cause this to be irrelevant if the policy compensates you for the additional tax payable in Australia.

4.3 Tax Equalisation

It is crucial to understand that many large mining and resource companies have tax equalisation policies that apply to your personal ESS while seconded to an overseas posting.

Tax equalisation policies can have unintended consequences which can include:

- paying more tax than required by foreign tax jurisdictions; and
- premature sale of shares from your ESS for the purpose of covering hypothetical withholding taxes on vesting.

By nature of hypothetical scenarios, errors can be made by companies and company appointed tax advisers which can be both costly for mining and resources executives and lengthy to resolve. As a case in point, in a recent 12-month period, we reviewed two cases and successfully recovered in excess of $150,000 for mining and resources executives whose tax equalisation circumstances had been incorrectly applied.

4.4 Tax Advisers and Briefings

Tax equalisation matters are complex and you *will* need advice. With regard to advice, your expectations should include attending an initial briefing meeting with your company appointed tax advisers prior to your secondment. Your adviser should help you understand any matters in relation to the company's tax equalisation policy. Importantly, you should expect your adviser to investigate and determine any errors in applying those policies (particularly any errors in regard to your ESS) and of course, resolve them for you.

5 Matching Schemes

Most large mining and resources companies offer their full-time employees opportunity to purchase shares in accordance with the company's matching scheme. This generally involves an after-tax payroll deduction that accumulates cash for the purpose of acquiring shares. On your acquisition of shares, the company will 'match' your share acquisition by purchasing the same number of shares on your behalf.

Following a service period, which is generally three years, the matched shares vest to you (this is when they are taxed as income in your name) and you have full access and rights to these shares. For some schemes, you will receive an adjustment to the number of matched shares at vesting to account for dividends not received along the way.

6 ESS, Diversification and Balance

Many mining and resources executives work in pressurised and demanding environments and by their own admission, don't commit the amount of time necessary for fully digesting the complexity of their ESS or for making well-considered financial decisions that may affect their future financial security or retirement plans.

Unfortunately, it is often this lack of time to take action that results in mining and resources executives failing to harness the full benefits of their income and share schemes and avoid pitfalls that can cause unnecessary cost.

Just as importantly, lack of time can often result in mining and resources personnel placing too much reliance on their ESS. Becoming 'top heavy' in their employer company's shares, rather than creating a diversified investment portfolio, can have significant impacts on current lifestyle and future wealth.

Executives with share schemes that represent a large proportion of their wealth run the risk of not only having all of their income tied to the company they work for, but also of having their financial independence and lifestyle outcomes tied to the performance of the company share price and dividends on these shares.

Should there be a fall in the share price or a decrease in dividend, there could be a significant negative impact on both cash flow and lifestyle affordability.

Depending on individual circumstances, strategic and tailored ESS planning may include having a long-term plan that moves to a diversified portfolio. A well-considered sale of some ESS shares at predetermined price points could allow the sale of shares and re-investment of proceeds to achieve a more diversified, and therefore more balanced, portfolio of assets.

For example, we work with derivatives experts to arrange mechanisms for protecting an ESS portfolio in the event of a significant fall in share price, without the requirement for you to sell shares. Such downside protection aims to alleviate the need for selling shares in a depressed market for the purpose of funding your lifestyle.

7 Other Complications

I've left my employer and no longer have access to information.

In our experience, mining and resources executives who leave their employer commonly do so without adequate ESS documentation.

Establishing the cost base is key to understanding the capital gains tax implications of different avenues available. Without documentation it becomes a costly and time-consuming process to re-establish historical cost bases.

The ATO states, "you must keep records of every transaction, event or circumstance that may be relevant to working out whether you've made a capital gain or loss[1]."

The important take-out here is to keep meticulous records, regardless of whether or not you leave your employer. However, it is not surprising, given time deficiencies experienced by most mining and resources executives, that the level of diligence required is unachievable.

For the record, we have systems in place for capturing the information necessary for recording and maintaining accurate cost base information at each vesting and exercise. This of course provides insight as well as allowing us to advise you in context of the implications of available options.

What happens to my awards if I leave my employer?

It is important to be aware that what happens to your awards on leaving your employer is specific to your employer and the ESS rules of each of grant.

When an executive leaves a company due to redundancy or under what the directors of the company deem to be a 'good leaver' provision, what we commonly see is that the number of shares from each grant are applied pro-rata on the number of service days served over the period from grant to vest. The pro-rata awards then generally vest on the cessation of employment.

For executives who leave an organisation due to their resigning or termination, awards are generally forfeited in full with no pro-rata of awards being received. However, these executives will generally receive the value of any shares purchased using contributions made under a matching scheme.

[1] https://www.ato.gov.au/General/Capital-gains-tax/Acquiring-assets-and-keeping-records/Record-keeping-for-CGT/

8 Summary

As you have read here, there is inherent complexity and many seemingly contradictory interpretations of rules that apply to different, but also very specific circumstances, of employment and remuneration in the mining and resources sector.

Such is the complexity of these matters, it is our belief that for many mining and resources executives, the requirement for careful, consistent and ongoing ESS management is simply not achievable given the high-level work responsibility and availability of time to dedicate to such tasks.

While this document aims to address some of the more common matters affecting mining and resources personnel, there are many other issues that require specific advice and actions in consideration of individual circumstances.

By nature of company appointed advisors, matters relating to an individual's specific and changing circumstances are generally not fully considered or only considered in context of presumed or hypothetical situations.

We implore mining and resources executives to appoint their own professional adviser to represent their best interests when dealing with company appointed advisers, keeping records and providing advice based on individual circumstances.

While the purpose of this document is to drive this message home, we also understand that accessing advisers with knowledge and experience in this specialised area can be challenging.

It is for this reason that we invite you to read on to learn about the advice and services we offer our own mining and resources clients and encourage you to download the following documents that provide important information for you while demonstrating our expertise in this highly specialised area of advice.

If you feel we can help you to better understand and manage your ESS, we invite you to contact us.

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9 Resources Unearthed Executive Share Scheme Consulting

Our service includes:

- Advice regarding your ESS at each vesting and exercise opportunity that is personalised to suit your specific circumstances.
- Coordination and consultation on your behalf with company appointed advisers and other professional advisers including tax specialists, accountants, legal advisors and derivative experts.
- Reconstructing existing and historical ESS information to understand after-tax strategic consequences so you have a clear understanding of your current position and can make fully informed decisions.
- Maintaining long-term cost-base records for shares retained which meets your capital gains tax obligations.
- The opportunity to discuss your Executive Share Scheme with a team of qualified and experienced professionals.
- Insights and advice about the implications of a range of complex considerations relating to executive remuneration packaging.
- Overviewing advantages and disadvantages of a remuneration offer as part of an existing or prospective employment package.
- Outlining the benefits and risks associated with executive options and share schemes.
- Assistance with understanding matters including:
    - Australian and international tax strategic implications
    - Company tax equalisation policies and hypothetical tax withholding calculations
    - Vesting criteria
    - Matching schemes

10 Free ESS Resources

10.1 Strategy Papers

The Advice you Need for Mining & Resources Executive Remuneration Packaging and Complex Tax Issues

What you Need to Know about Living & Working Overseas

10.2 Articles

What you need to know about Executive Share Scheme Vesting

The risks of holding too much of your wealth in your Executive Share Scheme

10.3 Video

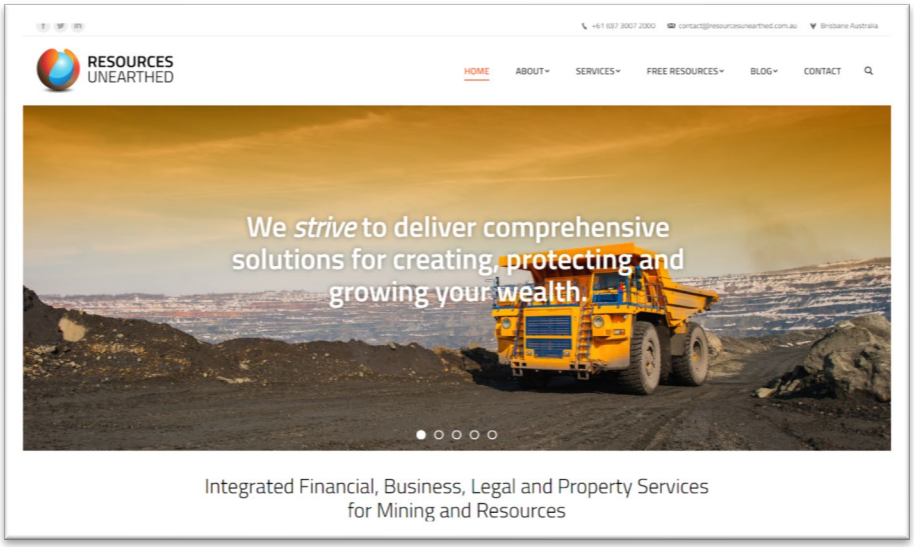
Key Considerations for your Executive Share Scheme

11 Further Reading

At Resources Unearthed, we are continually publishing blog articles that are relevant for executives, professionals and business owners in mining and resources. The articles are written by our contributors, who are highly qualified specialists in financial planning, accounting & business advisory, specialist tax advice, legal counsel, property advice, finance & lending and personalised health.

Please check our blog regularly for updates at https://www.resourcesunearthed.com.au/blog/

Blogs on matters related to executive share schemes may be found here: https://www.resourcesunearthed.com.au/category/executive-share-schemes/



To receive our blogs by email, please sign up at https://www.resourcesunearthed.com.au/

Your Next Step…

If you are the recipient of a past, current or future executive share scheme living in Australia or overseas, it would be our pleasure to talk with you.

If you have any questions about the matters covered in this paper, and/or would like to discuss an integrated financial solution for yourself and your family, please get in touch with me by phone or email: +61 (0)7 3007 2000 or jmarshall@stratusfinancialgroup.com.au