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ESS – Foreign income exemption for Australian residents and temporary residents

Explains the tax treatment of employee share schemes (ESS) for temporary residents and Australian residents engaging in foreign service.

From 1 July 2006, you will not have to pay tax on most of your foreign income if you:

- are an individual who is a [resident of Australia for tax purposes \(/individuals/international-tax-for-individuals/work-out-your-tax-residency/\)](#), or
- satisfy the requirements of being a temporary resident.

Temporary residents and employee share schemes

What is a temporary resident?

You are a temporary resident of Australia if you hold a temporary visa granted under the *Migration Act 1958* and neither you nor your spouse are Australian residents under the *Social Security Act 1991*.

See also:

- [Foreign income exemption for temporary residents – introduction \(/Individuals/International-tax-for-individuals/In-detail/Foreign-income-of-Australian-residents/Foreign-income-exemption-for-temporary-residents---introduction/?anchor=H2#H2\)](#)

Some companies encourage their employees to take part in employee share schemes, whereby they acquire shares, stapled securities, or rights to acquire them (ESS interests), at a discount.

When an employee who is a temporary resident acquires ESS interests for their employment before or after coming to Australia, the discount for employment services performed in Australia is taxed in accordance with employee share scheme (ESS) rules.

If part of the employment under which the employee received the ESS interests is performed outside Australia, only a portion of the discount is taxed in Australia. This is the case whether the discount is taxed on acquisition of the ESS interests, when the person becomes employed in Australia, or at a later time.

See also:

- [Employees \(/General/Employee-share-schemes/Employees/\)](#)

Temporary residents who become employees in Australia

When an employee who is a temporary resident acquires ESS interests before coming to Australia and continues the employment or service connected to the ESS interests whilst in Australia, ESS rules may apply from the time they begin work in Australia.

If you are a temporary resident, look at your own circumstances in conjunction with your employee share plan to determine whether the time after you became an employee in Australia is related to your ESS interests.

You will not be taxed under ESS rules if, when you become an employee in Australia, no forfeiture conditions remain on the ESS interests you hold. However, if a condition of your employee share plan is that ESS interests may be forfeited unless you undertake further employment or services, a portion of the discount will generally be assessable in Australia under the ESS rules.

The ESS interests will be assessed:

- in the year you become an employee in Australia for the first time, or
- for ESS interests acquired before 1 July 2009 – at a cessation time for qualifying ESS interests – where a section 139E election was not made (when you first became an employee in Australia), or
- for ESS interests acquired after 30 June 2009 – at a deferred taxing point.

If the ESS interests are assessed in the year you became an employee in Australia, the discount will be calculated by reference to the market value at the time you originally acquired the ESS interests.

Capital gains tax (CGT) implications

Once the discount for an ESS interest has been taxed under the ESS rules, any future gain or loss is then taxed under the capital gains tax (CGT) regime or other rules such as the trading stock provisions. A capital gain or loss will only arise when a CGT event occurs, such as the sale of the ESS interest or your departure from Australia.

The consequences of the CGT event depend on whether:

- the ESS interest has the necessary connection with Australia (for CGT events which occurred before 12 December 2006), or is taxable Australian property (for CGT events which occurred on or after 12 December 2006)
- you made an election to include the discount as income on acquisition (for ESS shares and rights acquired before 1 July 2009) or deferred declaring the discount until a later time
- you are a resident or non-resident of Australia for tax purposes or have become a permanent resident.

The cost base of ESS interests depends on when the discount is taxed. If the discount given for the ESS interests was taxed at acquisition, the cost base for CGT purposes will be the market value when you became a temporary resident or the market value at acquisition if you acquired them while you were a temporary resident. If the ESS interests were taxed at cessation or at a deferred taxing point, the cost base will be the market value at cessation or the deferred taxing point.

For CGT events occurring before 12 December 2006

ESS interests with a necessary connection with Australia

If you are a temporary resident and a CGT event happened to an ESS interest you hold that has the necessary connection with Australia, those ESS interests are subject to the CGT rules.

ESS interests without a necessary connection with Australia

If you elected to pay tax upfront

If you were a temporary resident when the CGT event happened to the ESS interests, you will only be taxed on the gain or loss from the CGT event happening to the ESS interests that relate to your employment in Australia, as they have the necessary connection with Australia. The remaining gain or loss will be disregarded.

To determine how much of the gain or loss relates to your employment in Australia, refer to the discount you recorded under the ESS rules for the ESS interests. If only a portion of the discount was assessable in Australia because part of the employment under which you received the ESS interests was performed outside Australia, the same proportion of the capital gain or loss will be assessable in your Australian income tax return.

If you were a permanent Australian resident for tax purposes when the CGT event happened (and had previously been a temporary resident), the capital gain or loss would be the sum of:

- the portion of the capital gain or loss accrued up to the time you became a permanent Australian resident that related to working in Australia, and
- the capital gain or loss that accrued from the time you became a permanent Australian resident.

If you were taxed at cessation

If you were a temporary resident when the CGT event happened to the ESS interests, you will only be taxed on the gain or loss from the CGT event happening to the ESS interests that relate to your employment in Australia, as they have the necessary connection with Australia. The remaining gain or loss will be disregarded.

If you were a permanent Australian resident for tax purposes when the CGT event happened to the ESS interests (and had previously been a temporary resident), the capital gain or loss will be the gain or loss that accrued from the time you became a permanent Australian resident for tax purposes.

For CGT events occurring on or after 12 December 2006

ESS interests that are taxable Australian property

The temporary resident provisions do not change the way the CGT rules apply to ESS interests which are taxable Australian property. If a CGT event happens to these ESS interests, the capital gain or loss will be assessable in your Australian income tax return, in the income year when the CGT event occurred.

If you were a temporary resident when the CGT event happened, you will only be taxed on the gain or loss from ESS interests that relate to your employment in Australia. The remaining gain or loss will be disregarded.

To determine how much of the gain or loss relates to your employment in Australia, refer to the discount you recorded under the ESS rules for the ESS interests. If only a portion of the discount was assessable in Australia because part of the employment under which you received the ESS interests was performed outside Australia, the same proportion of the capital gain or loss will be assessable in your Australian income tax return.

ESS interests that are not taxable Australian property

If the tax was paid on acquisition

If you are a permanent Australian resident for tax purposes at the time the CGT event happens to the ESS interests (and had previously been a temporary resident), the capital gain or loss is the sum of:

- the portion of the capital gain or loss accruing up to the time you became a permanent Australian resident that relates to Australian employment
- all the capital gains or losses accrued from the time you became a permanent Australian resident.

If the taxation of the discount was deferred

If you are a temporary resident at the time the CGT event happens to the ESS interests and the ESS interests are not taxable Australian property, you will not be required to record a capital gain or loss in your Australian income tax return.

If you are a permanent Australian resident for tax purposes at the time the CGT event happens to the ESS interests and had previously been a temporary resident, the capital gain or loss is the gain or loss that accrued from the time you became a permanent Australian resident.

For CGT events occurring between 12 December 2006 and 30 June 2009

If you were a temporary resident at the time the CGT event happened to the ESS interests, you will only be taxed on the gain or loss from the CGT event happening to the ESS interests that relate to your employment in Australia. The remaining gain or loss will be disregarded.

To determine how much of the gain or loss relates to your employment in Australia, refer to the discount you recorded under the ESS rules for the ESS interests. If only a portion of the discount was assessable in Australia because part of the employment under which you received the ESS interests was performed outside Australia, the same proportion of the capital gain or loss will be assessable in your Australian income tax return.

Residents with foreign service income

If you are an Australian resident and you acquired ESS interests during your engagement in foreign service, the discount received on those ESS interests may be exempt from tax. In order to be exempt, you must have been engaged in foreign service for a continuous period of not less than 91 days.

The exemption will not be available if your ESS interests are exempt from tax in the foreign country only because of one or more of the following reasons:

- a double tax agreement with Australia or a law giving effect to a double tax agreement
- the foreign country does not impose income tax on employment or personal services income, or similar income, or
- a law of the foreign country or an international agreement to which Australia is a party, which deals with diplomatic or consular privileges and immunities, or privileges and immunities for people connected with international organisations (such as the United Nations).

ESS interests acquired after 30 June 2009

In addition, for ESS interests acquired after 30 June 2009, for foreign service performed after 30 June 2009, the ESS interests will not be exempt unless the continuous period of foreign service is directly related to:

- the delivery of Australia's overseas aid program by your employer
- the activities of your employer in operating a developing country relief fund or a public disaster relief fund
- the activities of your employer being a prescribed institution that is exempt from Australian income tax
- your deployment outside Australia by an Australian government (or an authority thereof) as a member of a disciplined force,
- an activity of a kind specified in the regulations.

These additional requirements do not apply to:

- ESS interests acquired before 1 July 2009 for foreign service performed before, on or after 1 July 2009
- ESS interests acquired after 30 June 2009 for foreign service performed before 1 July 2009.

See also:

- [Section 23AG of the Income Tax Assessment Act 1936 \(/law/view/document?DocID=PAC/19360027/23AG&PiT=99991231235958\)](#)
- [Foreign income exemption for temporary residents – introduction \(/Individuals/International-tax-for-individuals/In-detail/Foreign-income-of-Australian-residents/Foreign-income-exemption-for-temporary-residents---introduction/?anchor=H2#H2\)](#)
- [Employees \(/General/Employee-share-schemes/Employees/\)](#)
- [Guide to capital gains tax \(/GuideToCapitalGainsTax-redirect\)](#)
- [PAYG withholding from interest, dividends and royalties paid to non-residents \(/forms/payg-withholding-from-interest.-dividend---royalty-payments-to-non-residents---annual-report/?anchor=Australian_tax_treaty_rates/#Australian_tax_treaty_rates/\)](#)
- Phone us on **13 28 61** for more information on the taxation implications of acquiring shares, stapled securities or rights under an ESS

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