THE TAX INSTITUTE

THE MARK OF EXPERTISE

5 June 2015

Dr Kathleen Dermody
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Dr Dermody,

Inquiry into Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015

The Tax Institute welcomes the opportunity to make a submission to the Senate Economics Legislation Committee (**Committee**) in relation to the inquiry (**Inquiry**) being conducted in respect of the *Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015* (**Bill**).

The Tax Institute made a comprehensive submission to the Treasury in relation to the *Improvements to the Taxation of Employee Share Schemes* consultation conducted in January and February this year. We raised a number of issues in relation to the exposure draft legislation and we note that some of these matters have been addressed in the current Bill. A copy of our submission has been submitted together with this letter.

We seek to raise for the Committee's attention particular matters of importance, including:

- The 'start-up' concessions should be extended to apply to listed companies;
- Cessation of employment should not be a deferred taxing point; and
- Certain amendments to the transitional rules should be made.

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These are detailed further below.

1. Extending the 'start-up' concessions to listed companies

We fail to see why the 'start-up' concessions contained in new section 83A-33 of the *Income Tax Assessment Act 1997* (Cth) should be limited to unlisted companies, particularly given that many 'small cap' listed companies (in industries such as life science, IT and mining exploration and development) clearly meet the other eligibility criteria in section 83A-33 for being considered a 'start-up'.

It should not be assumed that listed companies have ready access to capital. Many have listed to fund exploration, technology or medical advancement projects and are yet to make profits. They remain start-ups in every sense.

A significant practical effect of this rule would be to disqualify sources of future growth for our economy. We submit there is no reason to discriminate against 'otherwise eligible' listed companies and they should be dealt with as any other start-up.

Recommendation: The 'start-up' concessions should also apply to listed companies.

2. Cessation of employment as an ESS deferred taxing point

The Tax Institute is disappointed that the Bill does not include the removal of 'cessation of employment' as an 'ESS deferred taxing point'. The Explanatory Memorandum (**EM**) refers to the changes as being designed to make Australia's taxation of employee share schemes (**ESS**) more competitive by international standards[1]. However, the fact that Australia continues to tax employees on ESS interests on cessation of employment notwithstanding those interests are unable to be converted into cash at that time puts Australia out of step with almost every other country that taxes share plans and is clearly not competitive by international standards.

Employment income should be taxed when it is derived. Taxing ESS interests on cessation of employment where those interests are not at that time able to be sold (e.g. because they are not yet vested, or because the shares continue to be subject to a lock-up period post cessation of employment) means that tax is payable at a time and by reference to a share price which does not correspond to the derivation of income principles.

We understand the intention of Division 83A is to facilitate better alignment of interests between employers and their employees. This interest is clearly not served by having 'cessation of employment' as a taxing time. Employers often prefer that employees do not 'monetise' their ESS interests on leaving employment to ensure that, while

[1] Paragraph 1.5

employed, the employees remain focused on the long term interests in the company. That is, continuing to hold ESS interests after cessation of employment helps to ensure that decisions the employee makes in the lead up to them leaving the company continue to be in the longer term interest of the company (instead of making decisions for the short term interest only and then cashing in on that upon leaving the employment).

Recent developments in the area of Corporate Governance and the resulting impact on the design of equity incentive plans, together with the implementation in the 2009 changes of a comprehensive employer tax reporting requirement, strongly support the view that it is no longer appropriate policy for cessation of employment to be a taxing time. In particular, it is now common practice on cessation of employment for equity awards to continue to be subject to the same forfeiture and disposal restrictions that would have applied if employment had continued. This simply exacerbates the problems noted above.

Any concerns that Treasury may previously have had about former employees appropriately reporting ESS interests for tax purposes after the employment has ceased should have been adequately dealt with by the employee ESS reporting rule which was introduced in 2009.

Recommendation: The Tax Institute recommends that 'cessation of employment' as a taxing point for ESS interests be deleted. If this is not able to be achieved, then we strongly recommend that 'cessation of employment' be removed as a deferred taxing point in respect of a 'good leaver' (e.g. death, total and permanent disability, redundancy etc).

3. Consequential amendments to the transitional rules

It is proposed that the changes only apply to ESS interests granted on or after 1 July 2015. The Tax Institute requests that further consideration be given to transitioning ESS interests granted before that date into the new rules. In particular:

a) The Tax Institute recommends that the changes to section 83A-310 (forfeiture of ESS interests) to ensure a refund is available for rights which lapse unexercised should be extended to certain rights granted before 1 July 2015. For rights granted on or after that date, the amended section's relevance is likely to be limited to cessation of employment cases and where a deferral of the taxing time was not available on grant (e.g. where the new 10% limits are breached). However, subject to any other transitional rules that may be developed, rights granted between 1 July 2009 and 30 June 2015 will continue to be taxed on vesting (not exercise) and therefore are most in need of an amended section which allows a refund of the tax paid on vesting in the event the rights ultimately lapse.

b) The Tax Institute recommends that the changes to section 83A-120(7) (the ESS deferred taxing point for rights) apply to all rights granted on or after 1 July 2009 which had not yet had an ESS deferred taxing point before 1 July 2015.

Recommendation: Amendments to the transitional rules should be made to assist to transition ESS interests granted before 1 July 2015 into the new rules.

4. Minor drafting amendment

The Explanatory Memorandum to the Bill states that the proposed amendments are intended to alter the taxing point for rights to the point when the right is actually exercised, rather than the point at which a right can be exercised.

However, section 83A-120(4*)* remains unchanged in the Bill. This section provides that rights will continue to be subject to tax on vesting where the rights can be disposed of, even if the rights are subject to an exercise restriction or there are restrictions on disposal of the underlying shares. This outcome is inconsistent with the key objective of the changes to move the taxing point for rights to exercise.

Recommendation**:** Section 83A-120(4*)* should be removed or amended to reflect that the deferred taxing point for rights is the exercise of the right (as set out in section 83A-120(7) and in line with the stated intention in the Explanatory Memorandum).

Yours sincerely

Stephen Healey
President