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The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

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

Dear Sir / Madam

Inquiry into Employee Share Schemes

The Australian Institute of Company Directors (AICD) welcomes the opportunity to provide its submission in connection with the Inquiry being undertaken by the Senate Economics References Committee into Employee Share Schemes.

AICD is the second largest member-based director association worldwide, with over 24,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

Employee share schemes not only play an important role in attracting, motivating and retaining directors, executives and other employees, they also serve to align the interests of employees and directors with shareholders in a way that promotes the long-term success of companies.

AICD had significant concerns with the announcement in the most recent Federal Budget papers regarding proposed changes to the taxation provisions relating to employee share schemes. We subsequently summarised these concerns in a letter dated 16 June 2009 to Senator Nick Sherry about the draft Tax Laws Amendment (Employee share schemes) Bill 2009 (hereafter "the draft Bill") (see attached).

AICD welcomes the changes made by the Federal Government to its proposed amendments following the Budget announcement and after the release of the draft Bill. We continue, however, to have concerns with the Federal Government's "final" positions announced on 1 July 2009. The revised proposal still does not adequately recognise the fundamental imperative to promote *ongoing* share ownership by employees and directors. The taxation of scheme benefits is an impediment to ongoing ownership and should be deferred as long as possible, while recognising the need to balance the potential net impact on Commonwealth revenue. That objective was largely achieved by the Division 13A because it deferred tax until all conditions and restrictions ceased. The revised proposal will significantly diminish that position and therefore significantly compromise the commercial value of these schemes.

Some of the more vivid examples of this inherent failing will be as follows.

- The bias against non-executive directors sacrificing fees for company shares created by the proposed regime will be at odds with shareholder calls for director share ownership and voluntary codes of good corporate governance practice[1].

- The proposed taxation treatment for employee options and rights (e.g. potentially harsh taxation treatment of employee options that are "underwater" when they vest) will work against alignment objectives generally, and will be particularly disadvantageous for cash starved start-ups and SMEs, which often place a high degree of emphasis on such securities for remuneration purposes. We note the Australian Tax Office has been asked by the Federal Government to examine whether shares and rights under an employee share scheme that are provided by start-up, research and development and speculative-type companies should be subject to separate tax deferral arrangements. We believe that any proposal to change the current tax deferral arrangements in relation to securities provided by these companies to their employees should include a review of the taxation of options [vesting while out-of-the-money/before exercise] more generally.

- We continue to maintain there would be merit in examining whether, from a broader economic policy perspective, tax liability in respect of unvested or restricted equity securities under employee share schemes should continue to be triggered on cessation of employment. We believe there is a good case for encouraging (or at the very least not deterring) executive share schemes to continue for some years post-employment. If the commercial circumstances of the company require ongoing vesting conditions or sale restrictions, taxation arrangements should not work against this practice. The suggestion by the Assistant Treasurer that "it is open for a company to offer a 'partial vesting' arrangement to enable their employees to dispose of a proportion of shares or rights to pay tax crystallised on cessation of employment"[2] does not go far enough. Moreover, the "integrity" issue arising when ex-employees leave Australia[3] is not peculiar to share schemes. It is already an accepted feature of our capital gains tax regime: departing Australian residents must return capital gains on assets other than Australian real estate. The Assistant Treasurer's suggestion also potentially creates problems in the context of a company

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[1] See, for example, the draft Revised International Corporate Governance Network (ICGN) Non-Executive Director Remuneration Guidelines and Policies (2009). These guidelines are located at - http://www.icgn.org/files/icgn_main/pdfs/best_practice/exec_remun/2009_guidelines_and_policies_consultation.pdf.

[2] Senator Nick Sherry, "Taxation of Employee Share Schemes", Media Release, 1 July 2009.

[3] Referred to in the June 2009 Treasury consultation paper: *Reform of the Taxation of Employee Share Schemes*, at paragraph 68.

exceeding its shareholder approval threshold under the proposed Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009. In other words, apart from the economic and good policy reasons to pursue deferral of tax liability post employment in certain circumstances, Government policy and taxation laws appear to be in conflict, providing sub-optimal results for Australian companies in both the short and long term.

We would be happy to discuss any of the points made in this letter.

Yours sincerely

John H C Colvin
Chief Executive Officer

cc *Ms Sandra Roussel, Commonwealth Department of Treasury*