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The Standing Committee on Tax and Revenue
PO Box 6021
CANBERRA
Canberra ACT 2600

Inquiry into the Tax Treatment of Employee Share Schemes – Ernst & Young (EY) additional submission

Dear Sir / Madam

Ernst & Young (EY) is pleased to provide this additional submission to the Standing Committee on Tax and Revenue (the **Committee**) in relation to its inquiry into the effectiveness of the 2015 Employee Share Scheme (ESS) changes. As requested during our appearance at the Committee hearing on 19 June 2020, we welcome the opportunity to provide specific suggestions on changes to the regulatory framework for employee share scheme (ESS) offers.

We believe consolidating and simplifying the current statutory exemptions in the Corporations Act and ASIC class order relief for ESS offers, by introducing a new general exemption for offers under employee share plans, would significantly assist companies – in particular, unlisted companies – with reducing the regulatory barriers to offering company shares to their employees.

In our experience, the current regulatory framework has prevented many small businesses from implementing an employee share scheme, or has resulted in unlisted companies offering equity to only a small group of senior executives. With the positive changes introduced to the ESS tax provisions in 2015, the Australian regulatory framework for offering ESS remains the principal barrier to significantly broader take-up of employee share plans by unlisted companies.

Please find attached our brief comments on where specific improvements can be made to the current regulatory framework.

We look forward to continuing to be involved in the inquiry.

Yours sincerely



Chris Galway
Partner – People Advisory Services

Attachment: Appendix: suggested improvements to the current regulatory framework for employee share schemes



Appendix: suggested improvements to the current regulatory framework for employee share schemes

Key recommendation – incorporate general exemption for ESS offers into the Corporations Act

EY would support incorporating into the Corporations Act (**Act**) a general exemption for offers of securities made under employee share schemes. Such an exemption would, where relevant conditions are met, allow ESS awards to be made without needing to comply with the various requirements of the Act that can apply to offers of securities (such as disclosure / prospectus requirements and financial services provisions). The exemption would replace the need for the ASIC Class Orders that can apply for ESS awards (CO 14/1000 and CO 14/1001) and should be available to both listed and unlisted companies.

To provide an element of protection for employees (similar to that included in the ESS Class Orders), appropriate limits could be imposed so that the general exemption would only be available to plans which require contributions from employees within the relevant limits. However, it would be important that the conditions for the general exemption are relatively straightforward to comply with and provide appropriate flexibility for companies to offer plans which are fit for purpose for the organisation.

A general exemption in the Act for ESS offers would significantly simplify the regulatory requirements for companies – in particular, unlisted companies – of operating employee share plans.

Specific issues / other recommendations

The current regulatory framework is complex and causes issues for companies in the following circumstances:

- Where the ESS involves an offer of rights (a right to acquire a share in the future) to employees, and the offer does not meet the conditions of the ASIC Class Orders CO 14/1000 and CO 14/1001. This most often occurs with contribution plans (which require employees to contribute their own money) designed to meet the tax deferral conditions under Division 83A of the Income Tax Assessment Act 1997 (**Tax Act**). The Class Order (for listed companies) does not extend relief to a contribution plan where contributions are used to acquire rights (as opposed to shares) and the Class Order (for unlisted companies) does not extend to any type of contribution plan.

The Act also limits the use of offers using rights to shares because ASIC views rights as “derivatives”¹ and there is no employee share plan exemption in Chapter 7 of the Act (or any relevant exemption that can be used for such offers).

There are however some limited exemptions available where an option is used.

EY does not consider there to be any significant difference between a right (a right to receive a share on a certain date in the future) and an option (a right to receive a share in the future by exercising that option and paying an exercise price), even where the right or option may be settled in cash or at the company’s election.

Therefore, the current regulatory framework could be simplified and broadened to provide flexibility on the use of different ESS vehicles / structures. As noted above, any new general exemption for ESS should provide enough flexibility for companies to implement plans which best fit their organisation and objectives.

- Where an unlisted company wishes to make ESS offers and rely on CO 14/1001 (so that a disclosure document – which would otherwise be prohibitively costly – is not required). However, the Class Order limits the value of any offer under an employee share scheme to \$5,000. In EY’s experience, unlisted companies need flexibility to make offers to employees above this very limited amount, particularly where the offer of securities is often used as a form of remuneration by “start-

¹ ASIC Regulatory Guide 49, *Employee incentive schemes*, paragraph 49.68



up” companies to compete against larger / more mature companies that can pay higher salaries and cash incentives to employees.

The unlisted company Class Order is also incompatible with the requirements of the “start-up” tax concessions for grants of shares. Where an unlisted “start-up” company offers actual shares under an employee share scheme, in order to access the “start-up” tax concessions, the shares cannot be offered at a discount to market value that exceeds 15%. However, under the unlisted company Class Order CO 14/1001 the offer cannot be for more than nominal consideration. As a result, it is not possible for an offer of shares by an unlisted company to satisfy both requirements.

Where an unlisted “start-up” company offers options (or rights) under an employee share scheme, and an exercise price is required to be paid on exercise, the underlying Shares need to be listed (which may not always occur) or a valuation document needs to be prepared (which involves additional costs)

This often leads to companies not making offers to the general employee population or redesigning the offer to adopt terms that may not suit the company.

Therefore, where a general exemption for ESS is incorporated into the Act, it will be important to provide sufficient flexibility for all companies (listed and unlisted) when setting the conditions that need to be met to access the general exemption.