



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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Manager
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Dear Treasury

**Discussion Paper — Employee Share Schemes and Start-Up
Companies: Administrative and Taxation Arrangements**

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals in Australia. It is the leading independent authority on best practice in board and organisational governance and risk management. Our accredited and internationally recognised education and training offerings are focused on giving governance and risk practitioners the skills they need to improve their organisations' performance.

CSA has unrivalled depth and expertise as an independent influencer and commentator on governance and risk management thinking and behaviour in Australia. Our Members are all involved in governance, corporate administration and compliance, and play an important role in the reporting functions of their organisations, which include public listed and public unlisted companies, private companies, and not-for-profit (NFP) organisations.

CSA welcomes the opportunity to comment on the *Discussion Paper — Employee Share Schemes and Start-Up Companies: Administrative and Taxation Arrangements* (the discussion paper) and draws upon the experience of our Members in formulating our submission.

General comments

CSA is pleased to see the policy settings on employee share schemes (ESSs) in relation to start-up companies are open for discussion following their somewhat turbulent history as an incentive program for rewarding employee performance. CSA strongly supports the discussion of the administrative and taxation settings of ESSs, particularly in light of the challenges that face start-up companies, including accessing capital, attracting and retaining skilled employees, managing fast growth and being competitive in overseas markets.

CSA is cognisant that the discussion paper puts ESSs in the context of the broader government strategy of updating the national digital economy strategy. CSA is also aware that discussions about ESSs have stemmed from the *2012 Review of Venture Capital and Entrepreneurial Skills* and *A Plan for Australian Jobs: the Australian Government's Industry and Innovation Statement*.

ESSs offer companies a competitive advantage by being able to align employee interests with those of the company, namely the performance of the company's share price. The employee is provided with an opportunity to derive a benefit by realising the value of the share or option at a later time than when initially offered to the employee or executive. In many cases the option being offered to the employee or executive is also discounted, making the potential gain more profitable in the longer run. Options, therefore, are attractive for companies and employees because they can provide real value to the employee if the share prices moves upwards over time.

By way of example, CSA notes that ESSs offer great benefit to those in the mining and resources industry, whereby a mining company during the exploration phase can offer an options scheme to executives when the share price is low, in order to motivate them to continue explorations. The executives are then able to realise the increased value of the options when a mine is discovered, and the share price subsequently moves upwards.

Indeed, the risks associated with the mining industry are the reason why the *Corporations Act 2001* provides for no-liability companies to exist, thereby encouraging investment in potentially risky mining ventures with shareholders able to withdraw from a call on shares without incurring liability.

These benefits, however, accrue to all types of organisations, not just start-ups and not just mining companies. CSA notes that discussions about ESSs should not be restricted to simply considering the policy settings relevant to start-up companies. As the Productivity Commission revealed in their inquiry into executive pay in Australia in 2009, boards attempt to link executive remuneration to the interests of shareholders by paying in shares or options and requiring executives to hold this equity for a period of time, thereby linking executive wealth directly to the share price and dividends of the company.

The policy settings for ESSs, therefore, are also applicable more broadly with established companies and **CSA strongly recommends** that the current review into the administrative and policy settings for ESSs be broadened to look at the policy settings for ESSs for all company types and sizes, regardless of whether they are start-ups or well-established companies.

Broadening the review of policy settings

CSA is aware that addressing the administrative and taxation burdens placed on ESSs in the context of start-up businesses does not fully capture the broader settings which influence the desirability of adopting ESSs.

Focusing too closely on the impact of policy settings for start-ups is fraught with danger, as providing concessions for start-ups only, for example, taxing ESSs for start-ups at a lower rate, will lead to a fragmentation of the existing system. CSA believes that this might also result in unintended consequences.

For example, CSA notes that the valuation methodology currently used to determine the value of options provided to executives or employees is based on international accounting standards. Changing the valuation process, therefore, might result in further complexity for companies seeking to adopt ESSs as an incentive for their employees. Further complexity in working out valuations might further lead to increased costs and administration.

While CSA readily acknowledges that there is a need to reduce the current burdens on ESSs for start-ups, it would be prudent to ensure that the changes are across the board and, therefore, applicable to all companies.

More broadly, CSA is aware that the Australian Securities and Investments Commission (ASIC) is similarly reviewing their class orders relating to the offer of ESSs with a view to broadening the classes of financial products and entities eligible for ASIC relief, and to refine the description of ESSs which may qualify for ASIC relief.

As such, CSA believes that any reform of either the administration or taxation of ESSs should happen in conjunction with other reforms in the regulatory environment, to ensure that there are no unintended consequences and the integrity of the broader ESS program is not compromised in the process.

Moving the taxation point

CSA notes that ESSs were largely discarded by companies of all sizes following the introduction of the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* (the termination benefits legislation), which amended the Corporations Act 2001 to require companies to seek shareholder approval where a termination benefit is to be conferred on a company director or key management personnel (KMP) that exceeded one year's base salary. By broadly including all types of 'benefits' in the definition, the termination benefits legislation made ESSs less attractive to pursue, particularly within the current taxation regime.

The framework of the taxation regime has led to a reduction in use of ESSs. CSA notes that under the current taxation arrangements in the *Income Taxation Assessment Act 1997*, any discount on the market value of an interest in a share or right provided to an employee under an ESS is taxed in the income year of acquisition (where the discount is generally taken to be the difference between the market value of the share or right or any amount paid by the employee to acquire the share or right) as part of the employee's taxable income. If the employee is entitled to a tax concession, the share or interest is still taxed upfront, or deferred for other eligible ESS interests.

As a result, CSA notes that the complex and potentially disadvantageous nature of the current ESS scheme has forced many companies to reconsider whether it provides an appropriate incentive scheme for their executives and employees.

CSA strongly supports the recommendation made by the Productivity Commission — which was the only recommendation not to be accepted and acted upon by the government — to move the tax point of share or options schemes to be delayed until the point of realising the value of the share or option even where the executive or employee has ceased employment with the company. CSA further believes that the review consider reinstating this as an alternative for all ESSs regardless of the nature of the company seeking to utilise a share scheme.

CSA notes that moving the taxation point of the share or option provides certain immediate benefits to companies seeking to utilise ESSs, including assisting to alleviate current concerns about the costs associated with the valuation of shares and options. While the valuation process is crucial to ensuring that a fair price is reached, thereby providing the executive with an incentive to work hard, but also not unfairly disadvantaging other shareholders, moving the taxation point to where the share or option is realised can reduce the need for multiple valuations when additional shares are issued, or at different times of the year, when shares or options become taxable.

This has the potential to reduce the costly and time-consuming processes which companies currently have to undertake in relation to valuing shares and options.

Moving the taxation point would also bring Australia into line with other jurisdictions such as the United Kingdom and the United States of America, where taxation regimes ascribe to the philosophy that employees are largely rewarded through ESSs and should not be taxed until a realisation event occurs.

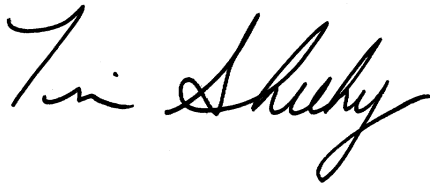
Conclusion

CSA notes that there are much broader issues in relation to ESSs than simply the policy settings concerning start-up companies. CSA would have preferred a more comprehensive review to be undertaken and we highlight our concerns with concentrating on start-ups in isolation.

CSA also reiterates that a review of the taxation point for all entities employing ESSs which would move the taxation point to when the right or option is realised would also provide some benefit to the complex system which currently discourages companies from using ESSs.

CSA looks forward to seeing further recommendations and advice issued on the administrative and taxation arrangements for ESSs and we would welcome the opportunity to discuss any of our views in greater detail.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style.

Tim Sheehy
CHIEF EXECUTIVE