
TAX AND SUPERANNUATION LAWS AMENDMENT (2015 MEASURES No. #)
BILL 2015: IMPROVEMENTS TO THE TAXATION OF EMPLOYEE SHARE
SCHEMES

EXPLANATORY MATERIALS

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EXPOSURE DRAFT

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ATO	Australian Taxation Office
Commissioner of Taxation	Commissioner
ESS	employee share scheme
ITAA 1997	<i>Income Tax Assessment Act 1997</i>

EXPOSURE DRAFT

Chapter 1

Improvements to the taxation of employee share schemes

Outline of chapter

1.1 Schedule # to this Exposure Draft amends the *Income Tax Assessment Act 1997* (ITAA 1997) to improve the taxation of employee share schemes (ESS) by:

- reversing for employees of all corporate tax entities some of the changes made in 2009 to the taxing point for rights;
- introducing a further taxation concession for employees of certain small start-up companies; and
- supporting the Australian Taxation Office (ATO) to work with industry to develop and approve safe harbour valuation methods and standardised documentation that will streamline the process of establishing and maintaining an ESS.

1.2 These changes will improve the tax treatment of ESSs so as to facilitate better alignment of interests between employers and their employees, and to stimulate the growth of innovative start-ups in Australia by helping small unlisted companies be more competitive in the labour market.

Context of amendments

Policy background

1.3 In recognition of the concerns that have been raised by stakeholders in relation to the tax treatment of ESSs, the Government announced on 18 December 2013 that it would focus on potential measures to encourage innovation, including the taxation and regulation of ESSs. Following this announcement, the Government conducted public consultations on ESSs and start-ups for two weeks commencing 28 January 2014. Consultations were conducted in Melbourne and Sydney, and teleconferences were held for those unable to attend the meetings.

1.4 In developing its reforms, the Government drew on these consultations, advice from the Prime Minister's Business Advisory Council and a study prepared by the Business Council of Australia in July 2014. On 14 October 2014, the Government released the *Industry Innovation and Competitiveness Agenda*. As part of this, the Government announced that it will reform the tax treatment of ESSs to bolster entrepreneurship in Australia and support innovative start-up companies.

1.5 The changes are designed to make Australia's taxation of ESSs more competitive by international standards and to facilitate the commercialisation of innovative ideas in Australia. The changes will assist innovative Australian firms to attract and retain high quality employees in the international labour market.

1.6 The Government is also committed to reducing the compliance burden faced by small businesses, and will make it easier and cheaper for businesses to set up and maintain an ESS.

Current taxation treatment

1.7 An ESS is a scheme under which shares, stapled securities or rights to acquire them (ESS interests) in a company are provided to an employee or their associate in relation to the employee's employment.

1.8 Some companies encourage employees to participate in ESSs by offering employees shares, stapled securities or rights (including options) to acquire them (ESS interests) at a discount. ESS income tax rules apply to this discount.

1.9 For ESS interests acquired after 30 June 2009, the ESS tax rules contained in Division 83A of the ITAA 1997 apply.

1.10 Division 83A contains specific rules about how tax applies to ESS interests. These rules apply to shares, stapled securities and rights to acquire them (including options), that have been provided to employees at a discount under an ESS.

1.11 If ESS interests have not been granted at a discount, the benefits given to employees may be taxed under other provisions of the tax law, such as capital gains tax.

Types of ESS

1.12 From 1 July 2009, there are four different types of ESS that can be offered to employees:

- Taxed-upfront scheme: the default position – if the scheme does not meet the conditions for concessional tax treatment, employees will be taxed on the discount on the ESS interests in the income year the ESS interests were provided to them;
- Taxed-upfront scheme: eligible for \$1,000 reduction – subject to certain conditions being met by both the ESS and employees, concessional tax treatment is available for employees who have received ESS interests under a taxed-upfront scheme if they also meet an income test. The concession allows employees to reduce their taxable discount income by up to \$1,000;
- Tax-deferred scheme: salary sacrifice – subject to certain conditions being met by both the ESS and employees who have acquired ESS interests under salary-sacrifice arrangements, these ESS interests will be taxed in the income year that the deferred taxing point occurs; and
- Tax-deferred scheme: real risk of forfeiture – subject to certain conditions being met by both the ESS and employees who have acquired ESS interests when there is a real risk of forfeiture under the conditions of the scheme, these ESS interests will be taxed in the income year that the deferred taxing point occurs.

1.13 The type of scheme offered will generally determine the tax treatment of the ESS interests provided to employees. ESS interests can be provided to employees under more than one type of scheme.

General conditions for concessional tax treatment

1.14 To qualify for concessional tax treatment as detailed above, the ESS and the employee must meet all the following conditions:

- the ESS interests acquired by employees must be in their employer or a holding company of the employer;
- when an employee acquires the interest, all ESS interests available for acquisition under the scheme must relate to ordinary shares; and
- the ESS interests provided must not result in either of the following immediately after acquisition:
 - an employee owning more than five per cent of the shareholding in their employer; or

- an employee controlling more than five per cent of the maximum voting rights.

Taxed-upfront schemes

1.15 The default position is that ESS interests will be taxed in the income year that the ESS interest is received.

Eligible for the \$1,000 reduction

1.16 Some employees are entitled to reduce the amount included in their assessable income if they meet certain conditions.

1.17 In addition to the above general conditions, employees must meet other specific conditions to qualify for the \$1,000 reduction. These conditions are:

- the employee must not have a real risk of forfeiting the ESS interest under the conditions of the scheme;
- the scheme must be operated so that all the employees must hold the ESS interest (or any share acquired on exercise of an ESS interest that is a right) for three years or until the employee ceases employment; and
- the scheme must be offered on a non-discriminatory basis to at least 75 per cent of the company's Australian-resident permanent employees with at least three years of service.

1.18 The employee must also meet the income test to access the \$1,000 reduction. Under the income test, the employee's taxable income (after adjustments) for the income year must be \$180,000 or less.

1.19 Employees will not be eligible for the upfront or deferred tax concession if:

- the predominant business of the employing company that the employee acquires ESS interests in, is the acquisition, sale or holding of shares, securities or other investments (directly or indirectly); and
- they are employed by the company that conducts that business; and
- they are also employed by a subsidiary of that company or a holding company of the company that conducts that business,

or a subsidiary of the holding company that conducts that business.

Tax-deferred schemes

1.20 If an ESS and employees who have acquired the ESS interests under the scheme meet certain conditions, the ESS interests will be taxed in the income year that the deferred taxing point occurs.

Tax-deferred scheme - salary sacrifice

1.21 In addition to the general conditions, the following conditions must be met for the scheme to be considered a tax-deferred scheme – salary sacrifice:

- the ESS interests are shares (or stapled securities) that are acquired under a salary-sacrifice arrangement from their employer or a holding company;
- when the shares (or stapled securities) are provided, the discount must equal the market value of the shares (or stapled securities);
- the rules governing the scheme must expressly state that the deferred tax arrangement applies to the scheme;
- at least 75 per cent of the Australian-resident permanent employees with at least three years' service are, or at some earlier time had been, entitled to acquire ESS interests in their employer or a holding company under an ESS; and
- any rights acquired under the scheme must be subject to a real risk of forfeiture.

1.22 For the tax to be deferred, an employee must not receive more than \$5,000 worth of shares (or stapled securities) during the year, under salary-sacrifice arrangements from their employer or a holding company of their employer.

Tax-deferred scheme - real risk of forfeiture

1.23 In addition to the general conditions, the following conditions must be met for the scheme to be considered a tax-deferred scheme – real risk of forfeiture:

- the employee must have a real risk of forfeiting the ESS interest under the conditions of the scheme or forfeiting the share resulting from the exercise of the ESS interest; and

- if the ESS interests are shares, at least 75 per cent of the Australian-resident permanent employees with at least three years' service are, or at some earlier time had been, entitled to acquire ESS interests in their employer or a holding company under an ESS.

Deferred taxing point

1.24 If the employee is provided with ESS interests under a deferral scheme and they meet certain conditions, they will be assessed for tax purposes in the income year that the deferred taxing point occurs. The amount assessed will be the market value of the ESS interests at the deferred taxing point, reduced by the cost base of the interests.

For shares

1.25 The deferred taxing point for a share or stapled security is the earliest of the following times:

- seven years after the employee acquired the share;
- when the employee ceases the employment they acquired the share in; or
- when there is no real risk of forfeiture and the scheme no longer genuinely restricts the disposal of the share.

For rights

1.26 The deferred taxing point for a right is the earliest of the following times:

- seven years after the employee acquired the right;
- when the employee ceases the employment they acquired the right in;
- when there is no real risk of forfeiting the right and the scheme no longer genuinely restricts disposal of the right; or
- when there is no real risk of forfeiting the right or underlying share, and the scheme no longer genuinely restricts exercise of the right or disposal of the resulting share.

Summary of new law

1.27 An ESS is a scheme where shares or options in a company are provided to an employee in relation to their employment. A share provides a shareholder with an ownership interest in a company. An option is the right to buy a share in a company at some point in the future.

1.28 The ESS tax rules ensure taxpayers are taxed consistently regardless of the forms of remuneration they receive.

1.29 However, the rules also specifically aim to improve the alignment of employee and employer interests. In recognition of the economic benefits derived from ESS arrangements, the rules provide for tax concessions for employees participating in ESSs.

1.30 International research suggests that companies in which employees have an ownership interest are more productive than those that do not. In addition, ESSs are used in many countries as a way of attracting and retaining high-quality staff for innovative small start-up companies by providing them with a financial share of the potential upside from success of the company.

1.31 ESS tax concessions are provided to facilitate the alignment of the interests of employees and employers, which encourages: positive working relationships, boosts productivity through greater employee involvement in the business, reduces staff turnover and encourages good corporate governance.

1.32 In Australia, certain changes introduced in 2009 to the tax treatment of rights acquired through an ESS detracted from the goal of commercialising innovative ideas in Australia.

1.33 Schedule # to this Exposure Draft makes improvements to the taxation of ESSs by:

- reversing for employees of all corporate tax entities some of the changes made in 2009 to the taxing point for rights;
- introducing a further taxation concession for employees of certain small start-up companies; and
- supporting the ATO to work with industry to develop and approve safe harbour valuation methods and standardised documentation that will streamline the process of establishing and maintaining an ESS.

1.34 While this Schedule reverses certain changes that were made in 2009 to the taxing point for rights, key integrity provisions will be retained.

1.35 For eligible start-up companies, this Schedule will provide an additional concession where the shares or rights are provided at a small discount and are held by the employee for at least three years. Discounts on shares will be exempt from tax, and discounts on rights will generally be treated as capital and deferred until sale of the resulting share.

Reversing and improving certain parts of the 2009 reforms

1.36 Where an ESS right is subject to deferred taxation, the taxing point occurs at the earliest of one of the following times:

- when the employee ceases the employment in respect of which they acquired the right;
- seven years after the employee acquired the right;
- when there are no longer any genuine restrictions on the disposal of right (for example, being sold), and there is no real risk of the employee forfeiting the right; or
- when there are no longer any genuine restrictions on the exercise of the right, or resulting share being disposed of (such as by sale), and there is no real risk of the employee forfeiting the right or underlying share.

1.37 This Schedule amends the second and fourth of those taxing points so that the taxing point occurs at the earliest of one of the following times:

- when the employee ceases the employment in respect of which they acquired the right;
- fifteen years after the employee acquired the right;
- when there are no longer any genuine restrictions on the disposal of right (for example, being sold), and there is no real risk of the employee forfeiting the right; or
- when the right is exercised and there is no real risk of the employee forfeiting the resulting share and there is no genuine restriction on the disposal of the resulting share (if such risks or restrictions exist, the taxing point is delayed until they lift).

1.38 This Schedule will allow rights schemes which do not contain a real risk of forfeiture to access tax deferred treatment where the scheme rules state that tax deferred treatment applies to the scheme and the scheme genuinely restricts an employee from immediately disposing of the right.

1.39 Further, this Schedule makes a number of additional refinements and improvements to the 2009 reforms, including by extending the maximum deferral period for shares received under an ESS, relaxing the significant ownership and voting rights limitation and changing the refund of income tax on forfeited shares or rights rules.

Small start-up companies

1.40 Employees of certain small start-up companies may receive the start-up tax concession, if their employer and the scheme meets a number of conditions.

1.41 The start-up concession provides that an employee does not include a discount on ESS interests in their assessable income if the scheme meets certain conditions and their employer meets certain conditions.

Reducing compliance costs

1.42 The Schedule also supports the ATO to work with industry to develop and approve safe harbour valuation methods to improve certainty and reduce compliance costs in maintaining an ESS.

1.43 The Schedule does this by introducing a new power for the Commissioner of Taxation (Commissioner) to approve market valuation methodologies. Approved methodologies will be binding on the Commissioner but the taxpayer remains able to choose another methodology if he or she believes the alternate methodology is more appropriate in their circumstances.

1.44 The ATO will also work with industry and the Australian Securities and Investments Commission to develop standardised documentation that will streamline the process of establishing and maintaining an ESS. The standard documentation will be issued under the Commissioner's general powers of administration.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>In ESS deferred schemes where income tax is deferred, the taxing point is the earliest of:</p> <p><i>For shares</i></p> <ul style="list-style-type: none"> • when there is no real risk of forfeiture of the shares and any restrictions on the sale are lifted; • when the employee ceases employment; or • 15 years after the shares were acquired. <p><i>For rights</i></p> <ul style="list-style-type: none"> • when there is no risk of forfeiture of the rights and any restrictions on the sale are lifted; • when the employee exercises the rights; • when the employee ceases employment; or • 15 years after the rights were acquired. 	<p>In ESS deferred schemes where income tax is deferred, the taxing point is the earliest of:</p> <ul style="list-style-type: none"> • when there is no real risk of forfeiture of the benefits and any restrictions on the sale or exercise are lifted; • when the employee ceases employment; or • seven years after the shares or rights were acquired.
<p>Employees of certain small start-up companies receive further concessions when acquiring certain shares or rights in their employer or a holding company of their employer. These further concessions are an income tax exemption for the discount received on certain shares and the deferral of the income tax on the discount received on certain rights which are instead taxed under the capital gains tax rules.</p>	<p>All ESS rules and concessions apply equally to all corporate tax entities and their employees.</p>
<p>The ESS rules generally use the ordinary meaning of market value.</p> <p>The Commissioner can, by legislative instrument, approve safe harbour valuation methodologies which will be binding on the Commissioner.</p> <p>The method for calculating the value of an ESS interest can also be specified by regulation in the <i>Income</i></p>	<p>The ESS rules generally use the ordinary meaning of market value and do not specify which valuation methodology can be used.</p> <p>The method for calculating the value of an ESS interest can also be specified by regulation in the <i>Income Tax Assessment Regulations 1997</i></p>

<i>New law</i>	<i>Current law</i>
<i>Tax Assessment Regulations 1997.</i>	

Detailed explanation of new law

Schedule # to this Exposure Draft makes various amendments to the ITAA 1997 (primarily Division 83A) to:

- alter one of the taxing points for ESS interests that are rights so that it applies *not* at the point at which a right can be exercised but at the point at which it is exercised (subject to the share obtained by exercising the right not being further subject to a real risk of forfeiture or genuine restrictions on sale);
- increase the maximum deferral period from 7 years to 15 years for ESS interests subject to deferred taxation;
- make other improvements to certain parts of the 2009 reforms;
- introduce a further concession for employees of certain start-up companies so that the discount on issue is either exempt from income tax (for shares) or deferred until exercise or sale under capital gains tax rules (for rights); and
- allow the Commissioner to approve market valuation methodologies that are binding on the Commissioner.

Reversing and improving certain parts of the 2009 reforms

ESS deferred taxing points

1.45 The deferral period for ESS interests covered under deferred taxation schemes is limited by the ESS deferred taxing points to ensure fairness, continue to align the interests of the employer and employee, and preserve the integrity of the tax system by preventing unlimited deferral of tax on employment remuneration.

1.46 The maximum deferral period has been increased from seven years to 15 years for ESS interests that are either shares or rights.

[Schedule #, item 18, subsections 83A-115(6) and 83A-120(6)]

1.47 The deferred taxing point relating to the exercise of an ESS interest which is a right has also been altered so that it now applies when

an employee exercises the right rather than when the employee can exercise the right. However, the existing exceptions continue to apply if the share obtained from exercising the right is subject to a real risk of forfeiture or genuine restrictions on sale. In this situation, the deferral will continue to be the time at which those risks and restrictions are lifted.

[Schedule #, items 19 and 20, subsections 83A-120(7)]

Allowing further access to deferred taxation

1.48 This Schedule also provides that certain rights schemes that do not contain a real risk of forfeiture can access deferred taxation treatment.

1.49 An ESS interest an employee can acquire under an ESS is subject to deferred taxation if:

- the scheme is a scheme in which employees can access ESS interests that are rights;
- the scheme genuinely restricts the employee immediately disposing of those rights; and
- the scheme rules expressly state that the scheme is subject to deferred taxation.

[Schedule #, item 17, subsection 83A-105(6)]

1.50 The other general eligibility conditions for ESS to access a taxation concession must also be satisfied.

Relaxing the significant ownership and voting rights limitations

1.51 One of the general eligibility conditions for an ESS to access a taxation concession is that the employee (and their associates) must not already have a significant ownership or voting rights in their employer or a holding company of their employer (if the ESS interests are issued are issued in the holding company).

1.52 This limitation encourages the benefits of the ESS to be spread widely among employees. The concession is intended to encourage employees with small or no ownership in their employer to take up an interest in the company. It is considered that if an employee owns more than a certain percentage of the voting rights or shares in their employer, interests between the company and that shareholder are already aligned, and no tax concession is appropriate or warranted.

1.53 Further, this acts as an integrity rule that prevents employees from misapplying the concession in order to buy a business or indirectly access company profits through the ESS rules. The concession is intended

to apply in respect of the employee/employer relationship and not in relation to the company/shareholder relationship.

1.54 This Schedule relaxes the significant ownership and voting rights limitations by doubling the existing 5 per cent test to 10 per cent, and for integrity reasons ensuring all interests in the employer (including interests employees have a right to acquire) are taken into account in applying the test.

1.55 The interest provided to an employee must not result in the employee having effective ownership of greater than 10 per cent of their employer, and not controlling more than 10 per cent of the maximum voting rights in the employer. [*Schedule #, item 11, subsection 83A-45(5)*]

1.56 In determining the employee's effective ownership and voting rights, the employee must take into account the holdings they could obtain by exercising rights they have over shares in their employer (regardless of whether those rights are ESS interests acquired under an ESS or not) and the holdings of their associates. [*Schedule #, items 11 and 25, subsections 83A-45(6) and 83A-305(2)*]

1.57 These changes will allow employees to obtain a greater ownership share in their employer through ESS interests whilst ensuring the fairness and integrity of the tax system by preventing the misuse of ESS arrangements.

Changes to the refund of income tax for forfeited shares and rights

1.58 The law provides for a refund of income tax paid in relation to discounted ESS interests in certain circumstances where those interests are forfeited and the employee has been taxed on the discount.

1.59 These provisions provide a refund of income tax in circumstances where the employee had no choice but to forfeit the ESS interest, except when that choice was to cease employment, and where the conditions of the scheme were not constructed to protect the employee from market risk.

1.60 Under such circumstances, the forfeited ESS interest is treated as never having been acquired, and the taxpayer can claim a refund of income tax by seeking an amendment to their income tax assessment to remove income previously included in their assessable income. There is no time limit on amending an assessment to exclude an amount from a taxpayer's assessable income for a share interest which is forfeited, or for a right which was lost without being exercised.

1.61 As the refund provisions are not intended to protect the employee from downside market risk, a refund will not be available where the share interest is forfeited due to a choice of the employee (except when that choice was to cease employment), or a condition of the scheme which has the direct effect of protecting the employee from market risk.

1.62 This Schedule ensures that a choice not to exercise a right is also a choice that does not prevent the application of the refund provisions. That is, if an employee decides to let a right lapse, and has previously paid income tax as a result of acquiring the right, the employee will be entitled to a refund provided the scheme has not been structured to directly protect the employee from downside market risk. *[Schedule #, items 27 and 28, section 83A-310]*

Concessions for interests in small start-up companies

1.63 Employees of certain small start-up companies may receive the start-up tax concession if their employer and the scheme meet a number of conditions.

What is the small start-up concession?

1.64 The start-up concession provides that an employee does not include a discount on ESS interests acquired in their assessable income if the scheme meets certain conditions and their employer meets certain conditions. *[Schedule #, item 6, section 83A-33]*

1.65 In relation to shares, the discount is exempt from income tax and the share once acquired is then subject to the capital gains tax system with a cost base reset at market value.

1.66 In relation to rights, the discount is not subject to upfront taxation and the right, and resulting share once acquired, is then subject to capital gains tax with a cost base equal to the employee's cost of acquiring the right. *[Schedule #, items 5 and 32, subsections 83A-30(2) and 130-80(4)]*

What ESS qualifies for the start-up concession?

1.67 The start-up concession is only available if the ESS, the employer and employee meet certain conditions.

General conditions

1.68 The first set of conditions are the general conditions that apply to all ESS concessions, namely the:

- employment condition;

- ordinary shares conditions;
- integrity rule about share trading companies condition; and
- significant ownership and voting rights condition (as amended – see paragraphs #.51 to #.57).

[Schedule #, items 6 and 11, paragraph 83A-33(1)(b) and section 83A-45]

1.69 Further background on these conditions can be found in the Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 and are summarised at paragraphs #.14 and #.19.

Conditions on the scheme

1.70 The following conditions apply to the scheme:

- the scheme must meet the existing minimum holding period condition (see paragraph #.17); and
- the scheme must meet the existing broad availability condition (see paragraph #.21).

[Schedule #, item 6 and 11, paragraph 83A-33(1)(c) and subsection 83A-45(4)]

1.71 Further background on these conditions can be found in the Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009.

Employer conditions

1.72 To access the concession, no equity interests in the employer can be listed on an approved stock or securities exchange.

1.73 The concession is intended to be limited to small start-up companies without easy access to capital and which are difficult to value. A listing of equity interests on an approved stock or securities exchange allows easier access to capital and allows a value for a company to be more easily ascertained. A listing also demonstrates that a company is in a more advanced period in its development where concerns around ESS compliance costs and liquidity are relatively less prohibitive. *[Schedule #, item 6, subsection 83A-33(2)]*

1.74 To access the concession, the ESS interests need to be in a company that was incorporated less than 10 years before the ESS interest was acquired. *[Schedule #, item 6, subsection 83A-33(3)]*

1.75 For integrity reasons, all companies in the corporate group also need to have been incorporated less than 10 years before the acquisition date.

1.76 To access the concession, the ESS interests need to be in a company that has an aggregated turnover (an existing concept within the ITAA 1997 – see section 328-115) not exceeding \$50 million for the income year prior to the income year in which the ESS was acquired. *[Schedule #, item 6, subsection 83A-33(4)]*

1.77 To access the concession, the employing company (which may or may not be the company issuing the ESS interest) must be an Australian resident taxpayer. *[Schedule #, item 6, subsection 83A-33(6)]*

1.78 These four conditions ensure that the concession is appropriately targeted to genuine Australian start-up companies, consistent with the policy objective.

ESS interest conditions

1.79 To access the concession, the ESS interest must:

- in the case of a share – be acquired with a discount of less than 15 per cent of the market value of the share when acquired; and
- in the case of a right – have an exercise price (or strike price) that is greater than or equal to the market value of an ordinary share in the issuing company at the time the right is acquired.

[Schedule #, item 6, subsection 83A-33(5)]

1.80 This condition ensures the concession only applies in situations in which the ESS interest is issued at a small discount to the employee. This will ensure the measure is appropriately targeted, is not open to abuse (e.g., through salary packaging arrangements), and fiscally sustainable.

Safe harbour market valuation methodologies

1.81 The Schedule also supports the ATO to work with industry to develop and approve safe harbour valuation methods to improve certainty and reduce compliance costs in maintaining an ESS.

1.82 The Schedule does this by introducing a new power for the Commissioner to approve market valuation methodologies that can be used by taxpayers to comply more easily with the law.

1.83 The Commissioner may, by legislative instrument, approve a method for determining the market value of an asset or non-cash benefit for income tax law purposes. [*Schedule #, item 41, section 960-412*]

1.84 The Commissioner may approve a valuation methodology subject to any condition or conditions the Commissioner thinks appropriate.

1.85 The legislative instrument is disallowable by either House of Parliament.

1.86 An approved methodology is binding on the Commissioner so long as any relevant conditions have been complied with by a taxpayer. This means, if a taxpayer uses the approved methodology, the taxpayer may rely on that method as reflecting the market value of the asset or non-cash benefit being valued.

1.87 While the new approved safe harbour valuation methodology applies more broadly than ESS, it is anticipated that the Commissioner will initially only exercise this new power with regard to ESS arrangements for small unlisted corporate tax entities only.

1.88 Consideration may be given in the future about whether the power can reduce the compliance costs for taxpayers in other circumstances, having regard to revenue and integrity issues that approving valuation methodologies may create.

Consequential amendments

Cross references to the maximum ESS holding rules

1.89 Cross references to the ESS significant ownership or voting rights limitations in other provisions of the tax law have been updated to reflect the new reset test. [*Schedule #, items 22, 23, 33 and 34*]

Cross references to the ESS provisions

1.90 Cross references to the ESS provisions in other provision of the tax law have been updated to reflect the amended provisions. [*Schedule #, items 1, 30, 31 and 38*]

Temporary residents

1.91 The temporary residents capital gain tax concessions have been modified so that they do not apply in relation to ESS interests subject to the new start-up concession. This ensures using the capital gains tax system as the primary taxing regime for these ESS interests does not provide certain employees with additional and unintended concessionary treatment. *[Schedule #, items 36 and 37, sections 768-915 and 768-955]*

Application and transitional provisions

1.92 The amendments apply to ESS interests acquired on or after 1 July 2015. *[Schedule #, item 39]*

1.93 The current law continues to apply to ESS interests acquired before 1 July 2015.

1.94 The Commissioner's safe harbour market valuation methodologies will apply from the date specified by the Commissioner in a legislative instrument.

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