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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TREASURY LAWS AMENDMENT ENTERPRISE INCENTIVES BILL 2016

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EXPLANATORY MEMORANDUM

(Circulated by authority of the  
Treasurer, the Hon Scott Morrison MP)



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## **Glossary**

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

<i>Abbreviation</i>	<i>Definition</i>
ASIC	Australian Securities and Investments Commission
Corporations Act	<i>Corporations Act 2001</i>
ESS	Employee Share Scheme
Issuing company	Company which issues the ESS interests under the ESS.
ITAA	<i>Income Tax Assessment Act 1997</i>
Pre-lodgment year	Issuing company's most recent income year before the year in which the disclosure document is lodged with ASIC.



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## ***General outline and financial impact***

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### **Schedule # – Improving Employee Share Schemes**

This Schedule amends the *Corporations Act 2001* (Corporations Act) so that employee share scheme (ESS) disclosure documents lodged with the Australian Securities and Investments Commission (ASIC) are not made publicly available for certain start-up companies.

***Date of effect:*** These amendments apply from the date of commencement which is the day after Royal Assent.

***Proposal announced:*** 7 December 2015

***Financial impact:*** None

***Human rights implications:*** This Bill does not raise any human rights issue. See *Statement of Compatibility with Human Rights* – see Chapter 3.

***Compliance cost impact:*** None





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# **Chapter 1**

## ***Improving Employee Share Schemes***

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### **Outline of chapter**

1.1 This Schedule amends the Corporations Act so that ESS disclosure documents of certain start-up companies lodged with ASIC are not made available on ASIC's public register.

### **Context of amendments**

1.2 The Government announced a package of reforms to support national innovation and increase the attractiveness of small businesses and start-ups. As part of these reforms, it aims to make it easier for start-up companies to offer ESS interests.

1.3 ESSs give employees shares in their employer-company or a subsidiary as part of, or as a bonus to, their employment remuneration. In this way, ESSs align the company and employees' interests, motivate employees and enable employees to share in their employer's success.

1.4 ESSs are considered to be an offer of securities or other financial products to investors. Most disclosure documents for offers of securities, including ESS interests, must be lodged with ASIC and made available for public inspection under sections 718 and 1274 of the Corporations Act.

1.5 The public disclosure of ESS documents may be discouraging start-up companies from offering ESS schemes. This is because public disclosure may allow competitors to access potentially commercially sensitive information at a stage when the start-up company is still establishing market share.

### **Summary of new law**

1.6 This Schedule amends the Corporations Act so that ESS disclosure documents do not need to be made publicly available if:

- the offer is of an ESS interest under an ESS;

- the disclosure document states that ESS interests will be made available only to employees of the company or its subsidiary, and relate only to ordinary shares;
- none of the equity interests in the issuing company or the companies in its group are listed for quotation in the official list of an approved stock exchange at the end of the issuing company's most recent income year (the pre-lodgement year);
- the issuing company and all companies in its group were incorporated less than 10 years before the end of the pre-lodgement year; and
- the issuing company has an aggregated turnover not exceeding \$50 million for the pre-lodgement year.

### Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>ESS disclosure documents lodged with ASIC are exempt from public inspection if:</p> <ul style="list-style-type: none"> <li>• the offer is of an ESS interest under an ESS;</li> <li>• the disclosure document states that the ESS interests will be made available only to employees of the company or its subsidiary, and relate only to ordinary shares;</li> <li>• none of the equity interests of the issuing company or the companies in its group are listed for quotation in the official list of an approved stock exchange at the end of the issuing company's most recent income year (the pre-lodgement year);</li> <li>• the issuing company and all companies in its group were incorporated less than 10 years before the end of the pre-lodgement year; and</li> <li>• the issuing company has an aggregated turnover not exceeding \$50 million for the pre-lodgement year.</li> </ul>	<p>ESS disclosure documents lodged with ASIC must generally be made available for public inspection.</p>

## Detailed explanation of new law

1.7 Most disclosure documents for offers of financial products must be lodged with ASIC and made available for inspection by the public under existing sections 718 and 1274 of the Corporations Act. Existing subsection 1274(2) creates an exemption and prohibits the public from inspecting specific types of documents lodged with ASIC, such as liquidators' and receivers' reports.

1.8 The Bill amends subsection 1274(2) of the Corporations Act to ensure that ESS disclosure documents do not need to be made publicly available if:

- the offer is of an ESS interest under an ESS;
- the disclosure document states that ESS interests will be made available only to employees of the company or its subsidiary, and relate only to ordinary shares;
- none of the equity interests of the company issuing the ESS interests (the *issuing company*) or the companies in its group are listed for quotation in the official list of an approved stock exchange at the end of the issuing company's most recent income year (the *pre-lodgement year*);
- the issuing company and all companies in its group were incorporated less than 10 years before the end of the pre-lodgement year; and
- the issuing company has an aggregated turnover not exceeding \$50 million for the pre-lodgement year.

*[Schedule #, items 2 and 3, subparagraph 1274(2)(a)(iva) and subsection 1274(2AA)]*

1.9 These conditions are broadly the same as the conditions for qualifying for the ESS start-up concession in section 83A-33 of the *Income Tax Assessment Act 1997* (ITAA) which grants a concession from upfront taxation for employees of certain start-up companies. Terms used in the new law are also defined in the same way as in Division 83A of the ITAA *[Schedule #, items 1 to 3, section 9, subparagraph 1274(2)(a)(iva) and subsection 1274(2AA)]*.

1.10 Some changes have been made to the requirements in the ITAA to ensure that the conditions are based on the characteristics of the company and the ESS interest (rather than the employee) and to remove tax integrity rules. The timing rules have also been changed so that they

relate to the income year before the documents are lodged with ASIC, rather than the income year before the employee receives their interest as in the ITAA. This change is necessary because ESS disclosure documents are lodged with ASIC (and either released or exempt from disclosure) before the ESS interests are issued to employees.

**Condition 1 – Offer is an ESS interest under an ESS**

1.11 The exemption from disclosure is not available unless the disclosure document relates to an offer of an ESS interest under an ESS. [Schedule #, items 2 and 3, subparagraph 1274(2)(a)(iva) and paragraph 1274(2AA)(a)]

1.12 ESS interest and ESS have the same meanings as in section 83A-10 of the ITAA. An **ESS interest** is a beneficial interest in a share of the company or a right to acquire a beneficial interest in a share of the company [Schedule #, item 1, section 9]. An ESS is a scheme under which ESS interests in a company are provided to employees or associate of employees of the company or its subsidiaries (including past or prospective employees) and relate to the employee’s employment [Schedule #, item 3, paragraph 1274(2AA)(a)].

1.13 The Bill uses different methods for capturing the ITAA definitions of ESS interest and ESS. The new law applies the ITAA definition of ESS interest by amending the dictionary section in the Corporations Act so that it defines ESS interest by reference to the definition in the ITAA.

1.14 On the other hand, the Bill does not insert a new dictionary definition of ESS but instead applies the ITAA definition by inserting the words ‘within the meaning of the ITAA’ in new subparagraph 1274(2)(AA)(a). A different approach is used because there is already a definition of ESS in existing section 9 of the Corporations Act and this definition continues to apply in all sections of the Corporations Act, except section 1274.

1.15 The differences between the definitions of ESS in the ITAA and section 9 of the Corporations Act are subtle and in many cases, will not have any practical effect. The main differences are summarized in Table 1.1.

**Table 1.1: Comparison of the ITAA and Section 9 Definitions of ESS**

<i>ITAA Definition (applies to new law)</i>	<i>Section 9 Definition (applies to all other sections in the Corporations Act)</i>
Limited to situations where the interests are provided 'to' certain persons	Extends to situations where the interests are provided to or 'for the benefit' of specified persons
Limited to shares in the company	Extends to shares in the company or its holding company
Limited to employees of the company or its subsidiaries	Extends to employees of a related body corporate
Widely defines employment relationships and includes service contracts with independent contractors	Narrowly defines employment relationship

***Condition 2 – Certain information included in the disclosure document***

1.16 Two pieces of information must be included in the disclosure document in order to qualify for the exemption from disclosure.

1.17 First, the disclosure document must state that the ESS interests will only be made available to employees of the company or its subsidiary [*Schedule #, item 3, subparagraph 1274(2AA)(b)(i)*].

1.18 'Employees', 'company' and 'subsidiary' have the same definitions as in Division 83A of the ITAA. [*Schedule #, item 3, subparagraph 1274(2AA)(b)(i)*]

- 'Employees' include employees, directors and independent contractors (section 83A-325 of the ITAA). This is broader than the ordinary English meaning that applies in other sections in the Corporations Act.
- 'Company' means a body corporate or any other unincorporated association or body of persons (section 995-1 of the ITAA). This is broader than the definition of 'company' which generally applies in the Corporations Act as it may include corporations which are not registered.
- The ITAA definition of a 'subsidiary' states that it is to be worked out in the same way as in the Corporations Act. It is

not possible to simply apply the Corporations Act definition because the ITAA adopts a broader definition of ‘company’.

1.19 Second, the disclosure document must state that the ESS interests will only relate to ordinary shares. The ESS interest may include rights to or indirect interests in ordinary shares, such as options to purchase ordinary shares. However, it must not include interests relating to non-voting or preference shares. [Schedule #, item 3, subparagraph 1274(2AA)(b)(ii)]

### **Condition 3 - Prohibition on listing**

1.20 The exemption from disclosure will not apply if an equity interest of the issuing company or one of the companies in its group was listed on an approved stock exchange at the end of the pre-lodgement year. [Schedule #, item 3, paragraph 1274(2AA)(c)]

1.21 **Approved stock exchanges** include both Australian and foreign stock exchanges. They are listed in Schedule 5 of the *Income Tax Assessment Regulation 1997*. [Schedule #, item 1, section 9]

1.22 The **pre-lodgement year** is the issuing company’s most recent income year before the income year in which the disclosure document was lodged with ASIC [Schedule #, item 3, paragraph 1274(2AA)(c)] and the **income year** is the period for which the company works out its taxable income under the ITAA [Schedule #, item 1, section 9]. The income year (and hence the pre-lodgement year) are not necessarily the same for all companies in a group. If the companies in a group have different pre-lodgement years, only the pre-lodgement year of the issuing company is relevant.

### **Example 1.1: Definition of pre-lodgement year**

Company A has one subsidiary (Company B). Company A’s income year ends on 30 June. Company B’s income year ends on 31 December.

Company A lodges an ESS disclosure document with ASIC on 29 September 2018.

The end of the pre-lodgement year is 30 June 2018.

1.23 The prohibition on listing only needs to be met at the end of the pre-lodgement year. In other words, it does not matter for the purposes of the exemption if one of the companies becomes listed after this point. Similarly, it does not matter if one of the companies in the group is listed on a stock exchange prior to the end of the pre-lodgement year, provided that the company is no longer listed at the end of the pre-lodgement year.

1.24 The issuing company's group includes:

- the issuing company;
- a subsidiary of the issuing company;
- a holding company of the issuing company; and
- a subsidiary of that holding company.

*[Schedule #, item 3, paragraph 1274(2AA)(c)]*

1.25 For the purposes of the new disclosure exemption, only those companies which are subsidiaries, holding companies or subsidiaries of holding companies at the end of the pre-lodgement year are part of the group. For example, if a company had a subsidiary at the beginning of its pre-lodgement year but the subsidiary had been wound-up by the end of the pre-lodgement year, the subsidiary would not be part of the company's group for the purposes of the new law. *[Schedule #, item 3, paragraph 1274(2AA)(c)]*

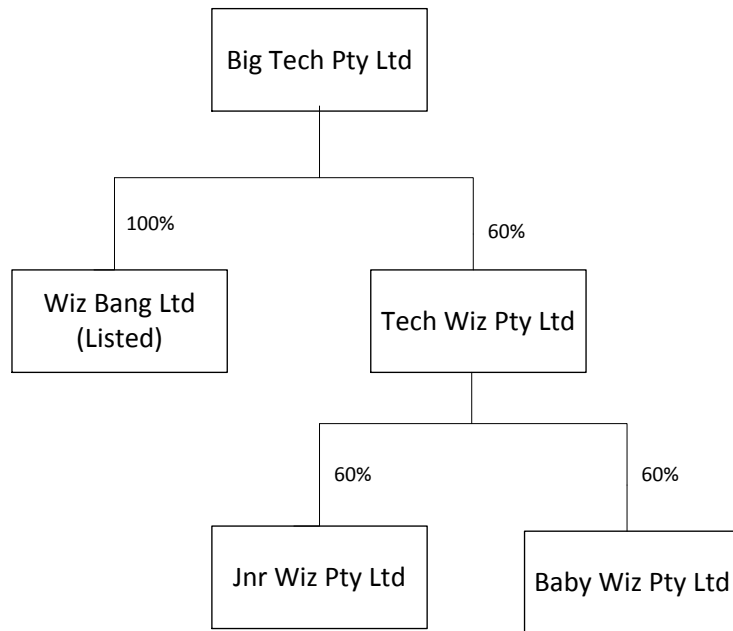
1.26 The question whether a company is a 'subsidiary' is worked out in the same way as in section 46 of the Corporations Act. A company (Company A) is a subsidiary of the issuing company if the issuing company controls the composition of Company A's board, controls more than half of the votes at Company A's general meetings or holds more than half of Company A's share capital. Company A is also a subsidiary of the issuing company if Company A is a subsidiary of a subsidiary of the issuing company.

1.27 The 'holding company' is a company of which the issuing company is a subsidiary (see section 9 of the Corporations Act). Under subsection 83A-33(7) of the ITAA 1997, investments by venture capital and tax exempt entities are ignored when identifying holding companies *[Schedule #, item 3, subsection 1274(2AB)]*.

### **Example 1.2: Prohibition on listing – company groups**

Assume that Tech Wiz Pty Ltd wants to offer ESS interests to its employees.

Tech Wiz Pty Ltd is part of a corporate group. The diagram below shows the structure of the group and the percentages connote the ownership interests. Only one company in the group, Wiz Bang Ltd, is listed.



The prohibition on listing applies to Tech Wiz Pty Ltd, its holding companies, its subsidiaries and the subsidiaries of its holding company.

The subsidiaries of Tech Wiz Pty Ltd are:

- Jnr Wiz Pty Ltd; and
- Baby Wiz Pty Ltd.

The holding company of Tech Wiz Pty Ltd is Big Tech Pty Ltd. Big Tech Pty Ltd's subsidiaries are:

- Wiz Bang Ltd;
- Tech Wiz Pty Ltd;
- Jnr Wiz Pty Ltd; and
- Baby Wiz Pty Ltd.

All of the companies in the diagram need to meet the third eligibility condition (prohibition on listing) because they are holding companies, or subsidiaries of Tech Wiz Pty Ltd, or subsidiaries of the holding company (Big Tech Pty Ltd). As Wiz Bang Ltd is listed, Tech Wiz Pty Ltd's ESS disclosure documents are not exempt from disclosure.



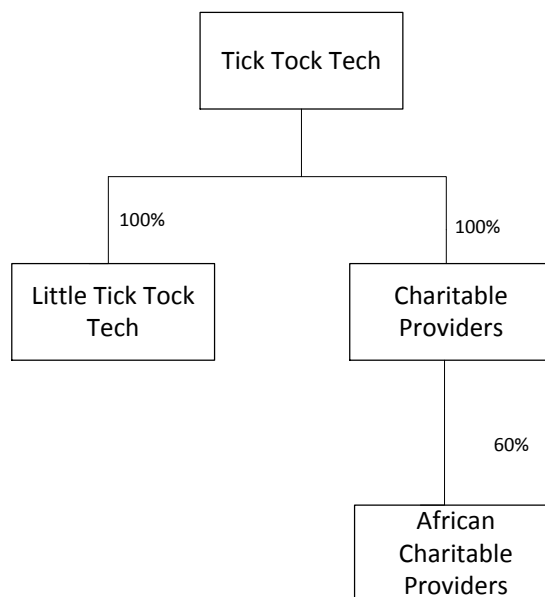
**Condition 4 – Incorporation for less than 10 years**

1.28 The fourth requirement is that all companies in the issuing company’s group must have been incorporated less than 10 years before the end of the pre-lodgement year. The prohibition is on incorporation for 10 years or more under Australian law or foreign law [Schedule #, item 3, paragraph 1274(2AA)(d)]. Foreign law has the same definition as in the ITAA and means a law of a country outside Australia and the external territories [Schedule #, item 1, section 9].

1.29 The group of companies includes the issuing company, the subsidiary of the issuing company, a holding company of the issuing company, and a subsidiary of that holding company at the end of the pre-lodgement year (see paragraphs 1.24 to 1.27 above) [Schedule #, item 3, paragraphs 1274(2AA)(c) and (d)]. Unlike the second condition, investments by venture capital and tax exempt entities need to be taken into account when identifying holding companies.

**Example 1.3: Incorporation for less than 10 years**

Little Tick Tock Tech lodges an ESS disclosure document with ASIC. Little Tick Toch Tech is part of a group of companies as shown below.



African Charitable Providers was incorporated in South Africa 15 years ago but none of the other companies in the group were incorporated within the last 10 years. Charitable Providers is an Australian deductible gift recipient.

Little Tick Toch Tech's group of companies includes itself, its subsidiaries, its holding company, and subsidiaries of its holding company.

Little Tick Tock Tech's holding company is Tick Tock Tech. Tick Toch Tech's other subsidiaries are Charitable Providers and African Charitable Providers.

Therefore, Little Tick Toch Tech fails the fourth eligibility condition as one of the companies in the group was incorporated more than 10 years ago.

**Condition 5– Aggregated turnover not exceeding \$50 million**

1.30 The issuing company will not be eligible for the exemption from disclosure if its aggregated turnover is more than \$50 million in the income year prior to lodging the disclosure document with ASIC. [Schedule #, item 3, paragraph 1274(2AA)(e)].

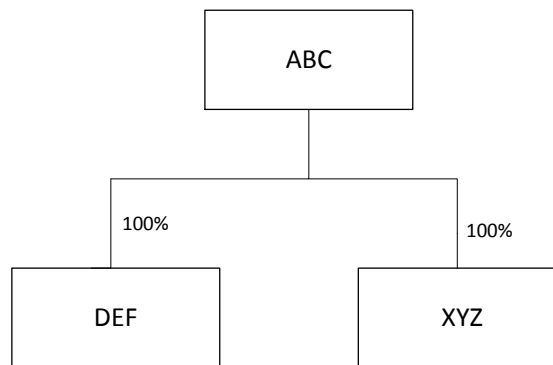
1.31 **Aggregated turnover** has the same meaning as in the ITAA [Schedule #, item 1, section 9]. Under section 328-115 of the ITAA, aggregated turnover is the 'annual turnover' of:

- the issuing company;
- the issuing company's 'affiliates' (that is, any company that would carry out its business by following the wishes of the issuing company); and
- any entity 'connected' to the issuing company (that is, any entity that the issuing company controls or any entity that is controlled by a third company who also controls the issuing company).

1.32 Aggregated turnover does not include amounts from intra-group transactions. The fifth eligibility condition also excludes turnover from venture capital and DGR investors under subsection 83A-33(7) of the ITAA 1997. [Schedule #, item 3, subsection 1274(2AB)]

**Example 1.4: Aggregated turnover not exceeding \$50 million**

DEF lodges an ESS disclosure document with ASIC. DEF is part of a group of companies:



The ordinary income of the companies in the group for the pre-lodgement year was as follows:

- ABC - \$10 million
- DEF - \$20 million
- XYZ - \$30 million

ABC and XYZ are connected to DEF. Therefore the aggregated turnover of DEF is \$60 million and DEF fails the fifth eligibility condition.

### ***Consequences of failing to meet the conditions at a later point in time***

1.33 The conditions only need to be satisfied in, or at the end of, the pre-lodgement year and if the conditions are satisfied, the exemption applies for all time. In other words, if the entity fails to meet one or more of the conditions in a later income year, the ESS disclosure document remains exempt. There would be a significant administrative burden on ASIC if ASIC was required to reconsider whether previously-lodged ESS documents should continue to remain exempt at the end of every income year.

### **Example 1.5: Entity fails to satisfy the conditions in later years**

Chip Chip Innovation has an income year that ends on 30 June. Chip Chip Innovation lodges an ESS disclosure document with ASIC on 16 August 2020.

Chip Chip Innovation satisfies all of the eligibility conditions for, or at the end of, the pre-lodgement year (the 2019-2020 income year). Accordingly, the disclosure document lodged on 16 August 2020 is exempt from disclosure.

In the 2020-2021 income year, Chip Chip Innovation grows rapidly and its aggregated turnover increases to \$65 million.

The ESS disclosure document lodged on 16 August 2020 remains exempt and does not need to be released at the end of the 2020-2021 income year.

Chip Chip Innovations now decides to employ an additional 10 staff. It establishes a new ESS for the 10 additional staff and lodges a new ESS disclosure document with ASIC on 16 September 2021.

The ESS disclosure document lodged on 16 September 2021 is not exempt from disclosure because Chip Chip Innovations did not satisfy the conditions in the 2020-2021 income year.

### **Example 1.6: Entity fails to satisfy conditions at the time of lodgement**

Milmil Tech has an income year that ends on 30 June. Milmil Tech lodges as ESS disclosure document with ASIC on 1 May 2019.

Milmil Tech satisfies all of the conditions as at 30 June 2018. However, it becomes listed on the ASX on 1 February 2019.

The new law requires the conditions to be satisfied for, or at the end of, the pre-lodgement year. Milmil Tech's pre-lodgement year is 30 June 2018 and it satisfied all of the conditions at this point in time. Therefore, Milmil Tech's ESS disclosure documents are exempt from disclosure. It is not relevant that Milmil Tech failed to satisfy one of the conditions in a later income year or at the time of lodgement.

### ***Scope of exemption***

1.34 The exemption from disclosure in Schedule # is limited to ESS disclosure documents and does not extend to other disclosure documents lodged by start-up companies, such as those relating to the offer of shares to investors outside the company. This is because, when outside investors are involved, public disclosure is key to ensuring that potential investors have access to adequate information to make informed investment decisions.

1.35 Further, the amendment only alters the public's right to access the documents under section 1274 of the Corporations Act. Information contained in an ESS disclosure document may still be made available under other laws of the Commonwealth, such as freedom of information legislation.

## **Consequential amendments**

1.36 None

## **Application and transitional provisions**

1.37 The amendments apply to ESS disclosure documents lodged with ASIC after the commencement date. [*Schedule #, item 4, section 1637*]

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## **Chapter 2**

# **Statement of Compatibility with Human Rights**

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**Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

### **Schedule # – Improving employee share schemes**

2.1 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview**

2.2 This Schedule amends the Corporations Act so that employee ESS disclosure documents lodged with ASIC are not made publicly available for certain start-up companies.

#### **Human rights implications**

2.3 This Schedule does not engage any of the applicable rights or freedoms.

#### **Conclusion**

2.4 This Schedule is compatible with human rights as it does not raise any human rights issues.







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### **Schedule #: Improving Employee Share Schemes**

<i>Bill reference</i>	<i>Paragraph number</i>
Items 1 to 3, section 9, subparagraph 1274(2)(a)(iva) and subsection 1274(2AA)	1.9
Item 1, section 9	1.12, 1.21, 1.22, 1.28, 1.31
Items 2 and 3, subparagraph 1274(2)(a)(iva) and paragraph 1274(2AA)(a)	1.11
Items 2 and 3, subparagraph 1274(2)(a)(iva) and subsection 1274(2AA)	1.8
Item 3, paragraph 1274(2AA)(a)	1.12
Item 3, subparagraph 1274(2AA)(b)(i)	1.17, 1.18
Item 3, subparagraph 1274(2AA)(b)(ii)	1.19
Item 3, paragraph 1274(2AA)(c)	1.20, 1.22, 1.24, 1.25
Item 3, subsection 1274(2AB)	1.27, 1.32
Item 3, paragraph 1274(2AA)(d)	1.28
Item 3, paragraphs 1274(2AA)(c) and (d)	1.29
Item 3, paragraph 1274(2AA)(e)	1.30
Item 4, section 1637	1.37