SUBMISSION PAPER:

Submission to Federal Treasury:

Employee Share Schemes

August 2021

This Submission Paper was prepared by FinTech Australia working with and on behalf of its Members; over 300 FinTech Startups, VCs, Accelerators and Incubators across Australia.

About this Submission

This document was created by FinTech Australia in consultation with its members.

Context: Employee Share Schemes

We thank you for the opportunity to comment on the draft legislation that the Treasury has prepared for comment. Our members generally support the proposed legislative reform and they welcome the proposed amendments to the legislation put forth by the Treasury.

The opportunity to provide incentives to new and existing staff in the form of various Employee Share Schemes (**ESS**) offers is important for fintechs and technology companies wishing to attract top talent in Australia.

Tax reform

Under the existing legislation, an employee with rights or shares issued under an ESS is taxed when the employee ceases their employment. Cessation of employment is often the first trigger for deferred taxation. In turn, in a fast-growth company, an employee is likely to be disincentivised from leaving the company or is at risk of losing their rights or share interests.

We support the proposed changes to the tax legislation to remove the cessation of employment as a taxing point for shares and rights issued under ESS schemes for all plans following Royal Assent of the proposed legislation, regardless of the date that an ESS interest was granted. This is in contrast to the current proposed legislation, which only applies to interests granted in the income year that commences after Royal Assent. This proposal is likely to leave behind existing employees that already hold long-standing interests and create additional red-tape for employers as well as a lack of transparency around the timing of the taxable event. Furthermore, our proposal ensures that employees with existing ESS interests in high-growth companies will not trigger a high tax bill upon cessation of employment. Such employees should be encouraged to be mobile between companies to ensure growth and innovation in the sector, rather than discouraged by a potential tax event.

Ultimately, tax reform in this space is important to support Australian businesses in attracting and retaining the talent they need to compete on a global stage.

Regulatory reform

We also support the proposed regulatory reform proposed by the Treasury. However, we would welcome further clarifications to the proposed legislation and explanatory materials to further assist our members fully benefit from these proposed legislative reforms. We have provided our comments below in relation to the proposed reform to the regulatory disclosure framework.

What does “in return for monetary consideration” mean?

The proposed law uses the concept of “in return for monetary consideration” in various sections including, for example, in section 1100N as follows:

> *1100N Application of this Subdivision*
>
> *(1) This Subdivision applies in relation to an ESS offer by a body corporate or responsible entity of a listed registered scheme to which either or both of the following apply:*
>
> *(a) the ESS interests to be offered include ESS interests offered for issue <u>in return for monetary consideration;</u>*

This reference in the proposed law to monetary consideration may be compared to the phrase “does not require payment to participate” in the explanatory materials.[1]

We suggest that the explanatory materials could be further clarified to describe what “in return for monetary consideration” and “does not require payment to participate” means in the context of option plans.

In the case of option plans, the participant is generally not required to make an upfront payment to participate in the plan on the grant of the option, but the participant is ordinarily required to make a payment if the participant elects to exercise the the option after any relevant vesting conditions have been satisfied (generally being 3 to 4 years after the date of grant of the relevant options).

In our view, there is room to clarify in the explanatory materials what “in return for monetary consideration” means, particularly in the context of option plans where the participant is not required to make a payment to participate in the option plan but is required to make a payment of the exercise price of the relevant option in the future.[2]

Is the reference to a $30,000 cap too prescriptive?

Treasury has proposed laws with a $30,000 cap on the value of securities that may be offered under an ESS, where monetary consideration is paid by the participant to participate in that plan. For example, the proposed section 1100J(4) provides an offer value cap as follows:

> *Offer value cap*
>
> *(4) For the purposes of paragraph (1)(c), an offer complies with the offer value cap if, at the time the offer is made, the sum of the following for each of the ESS participants to whom the offer is made is $30,000 or less: …*

[1] See, for example, paragraph 1.14 of the Explanatory Materials.

[2] Note, generally, the exercise price of an option cannot be less than the fair market value of the underlying ordinary share so that the company and employee can rely on the start-up tax concession.

We understand that the proposed $30,000 cap is primarily designed to protect ESS participants who are third party contractors who may receive ESS as the main component of the work they perform and are not protected by workplace relations laws.[3]

Generally, in relation to option plans, we understand that the $30,000 cap would be calculated by reference to the value of the underlying shares at the time of grant to the participant. Because, under option plans, the participant generally only benefits from the increase in value of the underlying shares from the time of grant of the option, this requirement unfairly prejudices those employees who receive ESS under an option plan.

Further, our members are far more likely to offer ESS interests to employees rather than third party contractors and take the view that the proposed legislative reform should be designed to better benefit employees rather than third party contractors.

We view the $30,000 limitation as a restriction that will disproportionately restrict employees being able to participate in, and benefit from, option plans in particular given that option plans (presumably) require a payment in return for monetary consideration to participate.

We understand that employees will be protected by workplace relations laws that require minimum payment of wages in accordance with the law. Employees who work in technology companies that offer ESS interests (in addition to those minimum wage entitlements) should not lose out on such benefits merely to protect the minority of third party contractors who may receive such ESS interests.

We note that the legislation does not impose the $30,000 cap on listed companies. Given that most fintech and start-up technology companies that would utilise this exemption are not listed, we propose that the Treasury consider aligning the requirements for unlisted companies with that of listed companies. In relation to concerns that it is difficult to value unlisted companies, we propose that unlisted companies are required to include a written warning as to such rather than restricting them to a $30,000 cap.

Such a warning will give employees the chance to consider and choose to participate in the ESS. Such employees can assess and make up their own mind and can have regard to the fact that workplace relations laws require the payment of minimum wages (which cannot be abrogated by an employer by offering ESS in lieu of minimum wage entitlements).

The meaning of ESS participant

We note that the proposed definition of an "ESS participant" is:

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[3] The explanatory materials state at paragraph 1.25: Employee share schemes which apply to independent contractors are subject to stricter requirements under the Bill because independent contractors do not receive the same workplace protections as employees under the Fair Work Act 2009.

> *Meaning of ESS participant*
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> *(2) any of the following is an ESS participant of a body corporate or listed registered scheme:*
>
> > *(a) an employee or director of the body corporate or of the responsible entity of the listed registered scheme;*
> > *(b) an employee or director of an associated entity (an associate) of the body corporate or of the responsible entity of the listed registered scheme;*
> > *(c) an independent contractor who provides services predominantly to the body corporate or to the responsible entity of the listed registered scheme or to an associate of the body corporate or responsible entity;*
> > *(d) a prospective person to whom paragraph (a) or (b) may apply.*

Many of our members have parent entities that issue ESS interests to Australian employees from overseas. Given that many ESS participants may indeed be employed by an associated entity of the issuer of the ESS interest, we support the inclusion of the definition of "associate" in section 1100E(2)(b).

We also support the inclusion of a prospective person as described in section 1100E(2)(d). Our view is that this is critical to the success of these regulatory reforms as many of our members offer ESS interests to prospective employees as part of their initial sign on incentives as well as progressively as part of annual or periodic reviews and bonuses.

Some of our members may engage independent contractors to provide certain services and offer ESS interests in connection with such engagement, so we query why section 1100(2)(d) does not also apply to paragraph (c).

Should the board be required to pass monthly solvency resolutions?

One key problem that our members have encountered with the existing regime is that it assumes ESS offers are made at a single point in time, as opposed to throughout the year. Practically, fintechs and technology companies will make ESS offers to prospective new employees throughout the year and to existing employees at periodic performance review times (eg, annually, bi-annually or on an adhoc basis dependent on performance). This makes it challenging for employers as they have to re-verify their disclosure documents each month (or even shorter periods, such as daily, depending on any fast-moving changes to the business at the time). These onerous verification requirements are not practicable for ESS offers that are offered throughout the year, as is the norm for most fintechs and technology companies in other jurisdictions such as the United States.

Section 1100R(c)(iii) continues an aspect of these onerous verification requirements by requiring a positive solvency declaration passed within one month before each ESS offer is made. This statutory obligation requires the board of each company to alter its usual meeting times (which may be quarterly or some other less frequent time than monthly) to meet to pass such a resolution or to otherwise pass a circulating resolution on the same.

We believe that for some companies who may have complex structures, including those involving overseas holding companies, the requirement to hold a monthly board meeting or pass a monthly resolution specific to an Australia employee share scheme is an extra layer of administrative burden that makes Australia an unattractive destination to employee staff relative to other jurisdictions that do not impose such a requirement.

We propose an alternative statutory requirement that, rather than requiring a board resolution to be passed each month, the company must not make an ESS offer if it is insolvent or that the company will become insolvent because of the ESS offer. If necessary, the board can resolve annually that the company is solvent and direct its managers not to make ESS offers where the company is insolvent or that the company will become insolvent because of the ESS offer.

Should the recipient of financial information be required to keep it confidential?

Under section 1100S(c), a company must provide financial statements in relation to an ESS offer to an ESS participant. Such financial statements may be particularly commercially sensitive for smaller fintechs and technology companies. We propose that the explanatory materials make it clearer that companies may impose obligations of confidentiality on the recipient regarding such information including limiting the access and disclosure of such information through digital means to avoid the widespread dissemination of such information to unauthorised recipients (such as competitors of the company).

Should a valuation be required every month?

Section 1100T requires that valuation for unlisted companies be conducted within one month of the day the ESS offer is made. Practically, this requires companies who make ESS offers to potential new staff to obtain a valuation each month.

Under section 1100T(1)(c), this valuation must be carried out by an independent valuation expert if the company's aggregate turnover exceeds $50 million. It is an expensive process to obtain an independent valuation to be obtained on a monthly basis rendering the proposed legislative reform redundant (as most companies would not invest in continuous, monthly external valuations).

In addition, given that certain companies making an ESS offer may be an overseas parent that is part of a corporate group with a relatively small Australian presence, many larger fintech and technology companies may see Australia as too difficult to operate in to incentivise staff given the $50 million requirement would apply to the parent (despite the Australian business having a relatively smaller footprint).

We propose that an external valuation for companies with a turnover exceeding $50 million is obtained on at least an annual basis and that for companies with a turnover of $50 million or less a directors valuation is obtained on at least an annual basis. Given that the valuation is only obtained on an annual basis, we propose that a warning is included in the ESS offer that the information is accurate as at the specified date so the prospective ESS participant can make an informed decision based on the date of the valuation.

In relation to companies that make ESS offers throughout the year to prospective employees, it is not feasible to continuously obtain or carry out valuations each month, especially for companies that have a turnover exceeding $50 million – it is likely that such companies will not rely on the exemptions this legislative reform is seeking to achieve given the expense.

Is it an offence if a company complies with existing disclosure requirements?

Section 1100G(3) makes it an offence if a company does not lodge a notice of intent with ASIC with respect to ESS offers covered by that section. It is unclear whether a company who may have already prepared a disclosure document and/or lodged a disclosure document with ASIC under existing laws must then also comply with section 1100G to avoid a penalty. We propose that the law should include a carve out or transitional period to allow companies who prepare traditional disclosure documents to continue to do so (at least for a period of time after this new law is introduced).