

25 August 2021

Directors  
Market Conduct Division and  
Individual and Indirect Taxation Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

By email: ESSreforms@Treasury.gov.au

Dear Directors

## Submission: Employee Share Scheme Reforms

Guerdon Associates appreciates the opportunity to provide its submission on the Government's changes to regulatory and tax arrangements for employee share schemes. Specifically:

- The Exposure Draft legislation titled *Taxation Laws Amendment (Measures for a later sitting) Bill 2021: Employee Share Schemes -Removing cessation of employment as a taxing point* ("Tax ED")
- The Exposure Draft legislation titled *Treasury laws Amendment (Measures for a later sitting) Bill 2021: Employee Share Schemes* ("Regulatory ED")

Guerdon Associates acknowledges that the EDs reflect the longstanding requests to remove cessation of employment as a taxing point and to improve the regulatory requirements for employee share schemes.

This submission provides brief background on our firm, responds to the revisions in the EDs, and provides feedback and suggestions where we see the potential to improve the taxation and regulatory requirements of employee share schemes to further wider and deeper participation in employee ownership.

## About Guerdon Associates

Guerdon Associates is an independent<sup>1</sup> executive remuneration and board governance consulting firm. Our clients include a significant proportion of companies in the ASX 300, large private companies and pre-IPO companies. Offices are located in Melbourne and Sydney, with affiliate offices in London, Zurich, New York, Los Angeles, Singapore and Johannesburg. The firm has worked with the boards of many of Australia's listed, and non-listed high growth and pre-IPO companies.

The firm's submissions were among the most cited in the Productivity Commission's review of executive remuneration and, over the years, it has contributed to Treasury, Australian Taxation Office and CAMAC consultations on numerous Corporations Act and taxation

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<sup>1</sup> Independence is defined as a specialist provider of consulting services to boards to minimise conflicts of interest that may otherwise result from being a supplier of multiple services to both management and boards.

legislation changes, as well as regularly engaging with APRA and ASIC on remuneration matters.

As a provider of remuneration and governance advisory services and an expert observer of the impact of executive remuneration internationally, the firm can provide useful insight into:

- the effects of various remuneration frameworks; and
- alternatives or modifications that may more effectively contribute to sound prudential management.

## Feedback & Recommendations

### Tax changes

We agree that the drafting of the Tax ED effectively removes cessation of employment as a taxing point.

A significant detriment to the Tax ED is that it will only apply to ESS interests acquired on or after 1 July following Royal Assent to the Bill. That will be at earliest 1 July 2022 and may even be 1 July 2023. It is recommended that this simple and 'called-for' amendment apply to ESS interests acquired after 7.00pm on the date of the Budget announcement. This is a common practice for many legislative amendments.

We take this opportunity to suggest that the Government should consider a number of other improvements to enhance the effectiveness of ESS for wider and deeper participation in employer ownership.

A further amendment can be readily implemented without detailed technical drafting in much the same way as the Tax ED has been efficiently drafted. Guerdon Associates recommends that the \$1,000 tax exemption be increased to \$50,000 in line with the recommendation of the House of Representatives Standing Committee on Tax and Revenue (Committee) report into ESS, *Owning a Share of Your Work: tax Treatment of Employee Share Schemes* (Report):

**3.82 The Committee recommends increasing the \$1,000 limit in section 83A.35(2)(a) of the Income Tax Assessment Act 1997 to \$50,000.**

It is recommended that this would be achieved by simply changing the dollar value in the legislation.

Our reasons for making this recommendation include:

- This exemption was included in the Division 13A concessions that were introduced in 1995 and has not been changed since that time.
- The concession is targeted at the wider employee group as government policy recognised the benefits of increasing employee ownership. However, since its introduction there has been no increase and, in fact, a limitation on its benefit to those on reportable incomes of less than \$180,000.

- Many employers have ceased operating \$1,000 tax exempt plans because of the administrative cost involved is considered to outweigh the perceived benefits for employees.
- Economic analysis has previously been provided to Treasury to show that the tax exemption scheme would not result in a loss to the Revenue but rather can result in an increase in tax receipts over the forward estimates period and beyond.
- An increase in the value will lead to an increase in employers adopting the tax-exempt scheme that can also result in increased employee savings in addition to superannuation.
- Australia continues to be a global laggard as other OECD countries have more effective and valuable tax-exempt schemes.

**Start-ups:** in line with our previous submission to the Committee and the Committee's recommendation in its Report, we again recommend that the definition of 'start-up' be extended to ASX-listed companies that otherwise meet the current criteria in Division 83A of the *Income Tax Assessment Act 1997* (ITAA).

It is also recommended that the aggregated turnover test be removed to relate to wholly owned groups or entities that meet to control test of the *Corporations Act 2001*.

The start-up concessions in Division 83A provide concessional tax treatment for options with a market value exercise price and shares granted with no more than a 15% discount. As the 15% discount effectively makes the grant of shares not viable, this aspect of the legislation does not work to increase employee participation.

We note that Recommendation 11 of the Committee's report recommends that the requirement for a maximum 15 per cent discount in respect of the grant of shares under the start-up regime be scrapped. Guerdon Associates supports that recommendation.

**Salary sacrifice:** the salary sacrifice provisions of Division 83A continue to be limited to \$5,000. Many employers have ceased to offer salary sacrifice arrangements for employees as this limit has made the arrangements significantly less attractive to employees than prior to 2009. Participation in such plans is often no more than 20% of the employee workforce and does not warrant the administrative costs involved.

It is recommended that removing the limit will be more effective in achieving wider and deeper employee ownership.

### Regulatory changes

We commend Treasury and the Government on the consolidation into the proposed Division 1A of Part 7.12 of the *Corporations Act 2001* of many of the complex regulatory requirements for ESS.

Guerdon Associates notes the substantial content of the consultation process and the consideration already given to the issues raised in submissions. However, it is considered appropriate to submit the following aspects for further consideration. These comments are also relevant given the recommendations of the House of Representatives Standing Committee on Tax and Revenue report released in August into ESS, *Owning a Share of Your Work: Tax Treatment of Employee Share Schemes*.

**Directors' valuation:** the explanatory memorandum notes that the ATO safe harbour methodology for valuing ESS interests "*will likely be considered a reasonable basis for a director's valuation of ESS interest under the Bill.*"

The uncertainty is concerning and will only lead to more cost for employers. This should be made certain.

**The offer value cap:** the proposed increase of the offer value cap to \$30,000 is welcome. However, at that level it limits the ability of employers particularly those in the technology sectors that are competing for global talent, to keep pace with market remuneration.

There is scope to increase the cap to \$100,000 or no less than \$50,000. An increased limit will enable those cash poor companies to better able to attract senior people for whom this level of equity is common in global employers.

The disclosures proposed in the ED will be sufficient protection for increasing the offer cap value.

**Non-voting ordinary shares:** while the existing CO14/1001 carves out non-voting ordinary shares for relief and that the ED now captures much of the relief, the ED does not specifically provide for 'non-voting ordinary shares'. Unlisted companies often prefer to use a class of ordinary shares that have the same rights other than voting rights.

It is recommended that the definition of ESS interest in proposed section 1100F(2) be extended to include non-voting ordinary shares.

## Concluding remarks

Guerdon Associates trusts that our observations and suggestions are of value, and appreciate the opportunity to make this submission.

We would be pleased to respond to any queries you may have in relation to this submission.

Yours faithfully

Guerdon Associates