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Dear Directors

Response to Exposure Draft Legislation to Reform Employee Share Schemes

Thank you for the opportunity to make a submission to the updated Employee Share Scheme (ESS) Draft Legislation consultation. The Technology Council of Australia (TCA) welcomes the Federal Government's commitment to improve the operation of Australia's ESS regulatory framework and commends the Government for continuing to consult to improve this legislation and to remove regulatory barriers to offering an employee share scheme. The removal of cessation of employment as a deferred point of taxation is a positive change that has been well received and further reforms are vital to the creation of new jobs and the attraction of talent within the tech sector.

We continue to support the changes proposed, subject to some additional recommended amendments to clarify the application, operation and implementation of the scheme. These changes will ensure ESS reforms further bolster scaling Australian companies, through greater attraction of highly skilled employees, whilst allowing employees of successful companies to share in the gains from growth of the tech sector and providing the needed mobility for employees to join, and/or create, the next generation of Australian companies.

About the Australian Tech Sector and the TCA

The TCA is Australia's peak industry body for the tech sector. The Australian tech sector is a pillar of the Australian economy, contributing \$167 billion per annum to the Australian economy, and employing 861,000 people. This makes the tech sector equivalent to Australia's third largest industry, behind mining and banking, and Australia's seventh largest employing sector.

As a sector that depends heavily on being able to attract high quality talent, employee share scheme reform is of critical importance to tech sector companies. This is because it is a crucial mechanism used by tech companies to attract and reward workers.

Ensuring a competitive and efficient ESS framework in Australia is essential to incentivise job creation by tech firms. It is also critical to building a world-class tech sector in Australia. This is because successful ESS frameworks allow younger companies to attract talent when they are not as well capitalised and more established companies to diversify their remuneration packages. They also reward employees in firms that successfully scale. This enables those employees to leave and to reinvest the capital they accrue from holding shares in a successful scale-up firm in the tech ecosystem, such as by founding their own companies or reinvesting in others, and in the economy more broadly. It also enables them to work for, and/or invest in,

new firms that will gain from their expertise without a financial penalty. This creates a virtuous circle that accelerates jobs and growth in the tech sector ecosystem.

This effect has been critical to the formation of tech ecosystems globally, such as Silicon Valley and Israel, and improving Australia’s ESS framework to address these limitations is timely because the tech sector is maturing, and rapidly growing jobs and successful scale-up companies. In the last five years, Australia has successfully grown a strong pipeline of 99 companies with valuations of \$100 million or more.¹ Further, the number of companies being created in each of the last three decades is increasing rapidly,, as Table 1 below shows.

Table 1: Number of \$100m+ companies created in Australia per decade

Decade of company formation	Current no. of companies founded in that decade presently valued at \$100m+	Example companies
2000s	24	Domain, iSelect, Atlassian, Tyro, Health Engine, Finder, Red Bubble, Campaign Monitor, Envato, Hotels Combined, InfoTrack
2010s	67	Airwallex, Deputy, Brighte, 99designs, Airtasker, Koala, Stake, Prospa, Culture Amp, Compass, Sendle, Freelancer, Flare, Canva, Expert360, Afterpay, Judo Bank, Shippit
Total	91	

Source: Airtree

There will be many employees in these firms with employee share interests. Therefore, making changes to the ESS framework now is critical to remove barriers to those employees leaving successful firms, and starting their own companies, or to invest in and/or work for other emerging and growing firms. Australia is also facing a significant shortage in workers for tech jobs. Amending the regime now is critical to help attract workers. Finally, simplifying the current model will make it easier for emerging firms to navigate and use, helping them to grow.

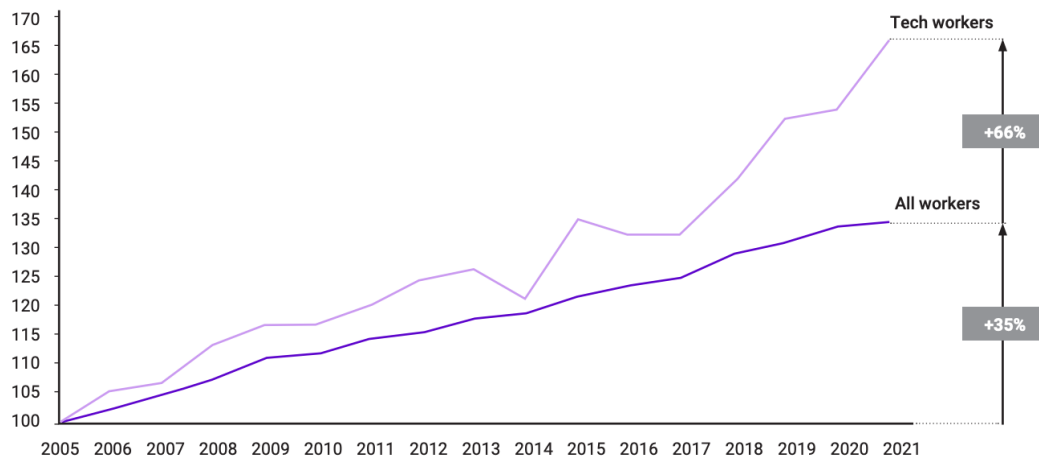
Making these changes can have a positive impact on jobs and economic growth in Australia. The TCA has set the goal of employing 1 million people in tech related jobs by 2025, and growing the sector’s contribution to GDP to \$250bn per year by 2030. These ambitious goals recognise that Tech Sector jobs growth is already strong, increasing by 54 percent between 2005 and 2019 (see Exhibit 1 below), considerably higher than the average growth of 25

¹ [Australian tech companies valued at \\$100M+ | by AirTree | AirTree | Aug, 2021 | Medium.com](https://www.airtree.com.au/insights/australian-tech-companies-valued-at-100m-plus-by-airtree-airtree-aug-2021-medium-com)

percent across the economy. As businesses and governments have rushed to adopt technology during the pandemic to keep their organisations operating remotely and workers in jobs, the tech sector has experienced a further surge in activity. This has led to an additional 65,000 new software and application developer jobs added in Australia in the past year alone.

Exhibit 1: Growth in number of workers in the tech sector and overall economy

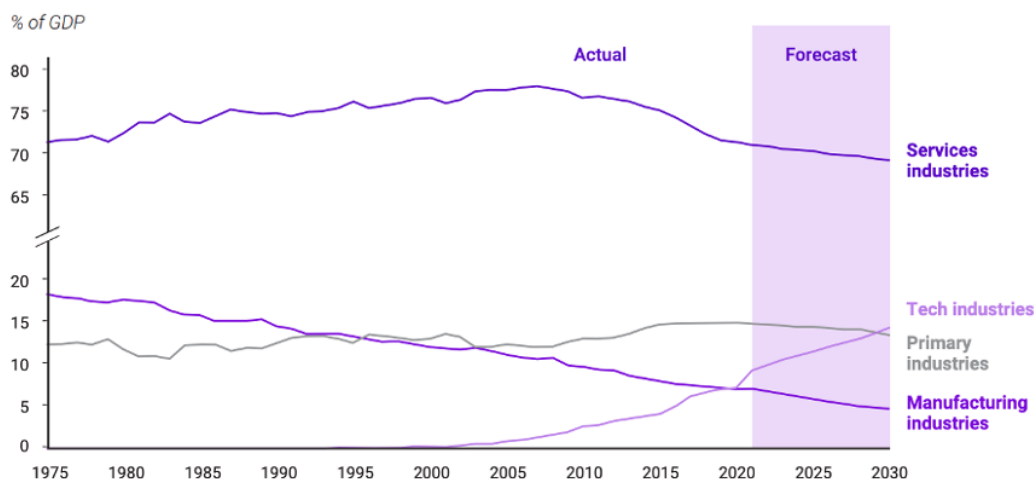
Index, where number of workers in February 2005 is equal to 100



Sources: ABS Labour Force, 2016 Census, Accenture analysis

Analysis by Accenture forecasts that the contribution to GDP of tech industries in Australia already surpasses manufacturing, and will surpass primary industries by 2030 (see Exhibit 2)

Exhibit 2: Australian economy by sector



Source: Accenture analysis of ABS 5204.0 Australian System of National Accounts, 2021

The members of the TCA have committed to work with governments at all levels to ensure that Australia and Australians can take advantage of the vast opportunities technology brings. To capture the full opportunity of a tech supported economic recovery and reach the goals we've set, policy focus across the tech ecosystem is necessary, particularly on frameworks such as the ESS.

As a sector that depends heavily on being able to attract highly skilled talent, ESS reform is a matter of critical importance to our membership as a key enabler to attracting that talent and securing greater employee investment in firm success. The ESS framework also alleviates cashflow challenges of early stage tech companies, whose operational expenditure is often weighted towards salaries & wages.

Supported changes to the ESS draft legislation

The TCA welcomes the changes to the ESS regulatory framework, and congratulates the Federal Government on proposing these further regulatory reforms. The proposed changes will be particularly beneficial for early-stage unlisted companies. In particular we welcome and support changes to:

- Withdrawing the Corporations Act 2001 requirements for ESS offers to employees who do not pay or incur debt to participate in these schemes and increasing the value cap from \$5,000 to \$30,000 for all other ESS offers of unlisted companies. This will streamline the process for unlisted companies to attract high quality talent and consequently continue to grow the contribution of the tech sector in Australia.
- Clarifying where disclosure documents are required under the Corporations Act.

While these changes are positive, we believe there is an opportunity to further optimise the proposed approach to ensure the scheme remains a catalyst for Australia's rapidly growing tech sector.

As a nation, we are close to full employment. We will need to attract skilled workers to enable the technology sector to continue to grow. In seeking to do this, we will be competing with other economies who will equally want to attract skilled migrants, to address a period where immigration globally has fallen. Most western economies will increasingly compete to attract talent.

TCA proposed amendments to the ESS draft legislation

The TCA recommends a set of targeted amendments to the draft legislation to maximise the benefits of the reform. These amendments would better target eligibility for the scheme, and improve its operation.

These amendments are:

- To increase the proposed \$30,000 regulatory relief cap for unlisted companies offering equity to \$100,000, and to increase the \$10,000,000 limit for Offer Information Statements (**OIS**) to \$50,000,000 and to permit OIS's to be used for an offer of options by Australian private companies
- Amend and simplify the qualifying criteria for the start-up concession to a sole, bright-line turnover threshold of \$200m
- Remove the three year sale restriction on interests offered by eligible start-ups
- Amend s 113(3)(a) of the Corporations Act to put Australian private companies on the same footing as foreign companies.

Making these amendments to the draft ESS legislation will achieve the reform's objectives of reducing red tape and enabling early stage companies to create jobs and attract top talent. These amendments will also encourage labour mobility and new company formation by employees with current shareholdings in successful, scaling companies.

Critically, making these amendments will not impact the taxation revenue derived from the scheme.

I. Increasing the regulatory relief cap and extending the Offer Information Regime

Proposed changes to the Corporations Act 2001 to streamline the process for unlisted companies in their offer of ESS interests to employees are welcome modifications.

The proposed relief from the Corporations Act 2001 requirements for unlisted companies that offer ESS interests to employees who do not pay or incur debt to participate in these schemes is a favourable outcome for the Australian tech sector and given employees are not risking their own capital, this change does not appear to impede the benefits sought by the Corporations Act 2001 as described above.

However, for other ESS interests, the proposed legislation includes regulatory relief for unlisted schemes where the participant is paying to participate, but is receiving less than \$30,000 worth of interests (previously the cap was \$5,000). While the increased cap is welcomed, it does not materially assist tech companies to retain key employees or to attract top international talent. A large portion of the existing and targeted workforce of the next wave of leading Australian tech companies would receive or expect to receive equity allocations above this level. As such, we believe the cap could have more impact if it was increased to \$100,000 to allow for unlisted companies to easily offer meaningful amounts of equity to employees within their businesses.

There is little legislative benefit in requiring detailed disclosure documents for offers to employees or contractors where such individuals are either not paying for the equity offered or who are participating in a limited recourse loan funded plan. To our mind, an extension of the Offer Information Statement regime would be a relatively simple way to provide meaningful relief, and avoid the need for early stage and emerging companies to incur significant advisor fees to implement an employee incentive scheme. This could be achieved by increasing the \$10,000,000 limit for Offer Information Statements (OIS) to \$50,000,000 and permitting OIS's to be used for an offer of options by Australian private companies (this is discussed further below).

Recommendation: To increase the proposed \$30,000 regulatory relief cap for unlisted companies offering equity to \$100,000, and to increase the \$10,000,000 limit for Offer Information Statements (**OIS**) to \$50,000,000 and to permit OIS's to be used for an offer of options by Australian private companies.

II. Simplify the eligibility criteria for the start-up concession

We recommend simplifying the eligibility criteria for companies to qualify as a start-up, to better target the scheme to early-stage companies, and to reduce red tape.

Under current eligibility criteria, the definition of a start-up is effectively age-based, as the start-up concession is awarded when:

- A company has not been incorporated for over 10 years
- Annual turnover does not exceed \$50million
- A company has not been listed

However, it is common for companies that might otherwise be considered a 'start-up' based on their staff or growth trajectory to be incorporated for more than 10 years.

This can be because some businesses take a significant number of years to become profitable, especially research-intensive and/or highly regulated firms with long lead times to get products to market. It can also occur if a founder utilises an existing corporate structure when starting a new venture. For example, this was the case with SafetyCulture where founder Luke Anear utilised a pre-existing company when he founded SafetyCulture, rather than incur the \$600-1,000 of additional cost to incorporate a new company.

To address these issues, we recommend amending the qualifying criteria for a start-up (facilitating such regime to be available to both start-up companies, and emerging companies) to be a firm under the \$200 million turnover threshold and deleting the reference to a company that has not been incorporated for over 10 years.

Recommendation: Amend qualifying criteria for the start-up concession to be a sole, bright-line turnover test of \$200 million.

III. Removal of the 3-year sale restriction

Currently, employees with interests granted from a company qualifying for the start-up concession, are prevented from disposing of their ESS interest for a period of three years starting from when the ESS interest was acquired (unless the Commissioner waives this requirement, or the limited exceptions apply).

This can be problematic for employers if the company is approached for acquisition by investors or corporations, as it means they must disclose to the Australian Taxation Office that they are entertaining a merger and acquisition discussion, irrespective of how likely the deal is to proceed. Whilst it is possible to have this restriction waived, the process is costly (often in excess of \$15,000 - \$20,000) and lengthy.

This provision can also be problematic for employees who have been a part of a high-growth firm, but who are then restricted from realising the full value of their assets should their firm be targeted for investment.

Our view is that this requirement does not serve a clear purpose and would be better to be removed.

Recommendation: Remove the three-year sale restriction provision.

IV. Amend s 113(3)(a) of the Corporations Act to put Australian private companies on the same footing as foreign companies

This section prevents Australian proprietary companies offering options by way of a disclosure document, such as a prospectus or offer information statement (OIS). The same restriction does not apply to foreign companies and therefore Australian private companies are disadvantaged. Currently foreign private companies can issue an OIS or a prospectus to offer options to Australian employees, whereas an Australian private company cannot.

Importantly, there would be no diminution in protection as an OIS or prospectus would still be required.

This unequal treatment can be remedied by way of a minor amendment to the wording of the Corporations Act. The Extract of s 113(3)(a) of the Corporations Act including the suggested amendment, with the new words underlined, is:

(3) A **proprietary company** (this only extends to Australian proprietary companies) must not engage in any activity that would require disclosure to investors under Chapter 6D, except for:

(a) an offer of its shares or options to:

(i) existing shareholders of the company; or

(ii) employees of the company or of a subsidiary of the company;

Recommendation: Amend s 113(3)(a) of the Corporations Act to put Australian private companies on the same footing as foreign companies.

TCA Recommendations

The TCA commends the Federal Government for proposing reforms to the ESS regulatory framework. We support the changes as they will simplify the scheme's operation and reduce red tape, without incurring greater risk.

We recommend a small number of minor amendments to help ensure the reform achieves its key objectives of reducing red tape and driving growth, without increasing risks associated with ESS arrangements.

- To increase the proposed \$30,000 regulatory relief cap for unlisted companies offering equity to \$100,000, and to increase the \$10,000,000 limit for Offer Information Statements (**OIS**) to \$50,000,000 and to permit OIS's to be used for an offer of options by Australian private companies
- Amend and simplify the qualifying criteria for the start-up concession to a sole, bright-line turnover threshold of \$200m
- Remove the three year sale restriction on interests offered by eligible start-ups
- Amend s 113(3)(a) of the Corporations Act to put Australian private companies on the same footing as foreign companies.

Thank you for the opportunity to make a submission to the ESS draft legislation review. We would be pleased to discuss our comments with the Treasury.

Yours sincerely



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