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Senator the Hon Nick Sherry
Assistant Treasurer
Parliament House
CANBERRA ACT 2601

By email: senator.sherry@aph.gov.au

Dear Senator Sherry

Reform of the Taxation of Employee Share Schemes

The Australian Institute of Company Directors (AICD) is writing to express its strong concerns with the reform process associated with, and the likely consequences flowing from adoption of, the draft Tax Laws Amendment (Employee share schemes) Bill 2009 (hereafter "the Bill")¹.

AICD is the second largest member-based director association worldwide, with over 24,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

AICD has no difficulty with reasonable measures being undertaken to ensure that executives and directors who are receiving securities by means of company security schemes are meeting their taxation obligations. We do, however, have major problems where proposed measures have the effect of stifling legitimate business activity, and have not benefited from sufficient consultation. If there are taxation shortfalls because of non-compliance, we believe this should be dealt with by means of better enforcement through the compliance measures already contained in existing taxation legislation. We do acknowledge that improved employer reporting arrangements, provided they are not too onerous, may assist in this regard.

We note the likely direct consequences of the Bill, if enacted, will be:

- the use of long term equity-based incentive plans will be discouraged or abandoned;
- broad-based employee salary sacrifice and company matching share plans will disappear;
- the practice whereby non-executive directors receive company shares by way of fee sacrifice will become much less prevalent; and
- start-up and other SME companies, which are critical to longer term economic prosperity and the Government's future taxation base, will be disproportionately

¹ As released by the Federal Government on 5 June 2009. Located at - <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1559>

impacted given their current reliance on equity-based pay due to funding constraints.

The likely indirect consequences will be:

- the alignment of interests between executives and shareholders will be significantly weakened;
- the adoption of sub-optimal remuneration arrangements by companies;
- an increased cost of equity capital;
- hindrance of industry-led initiatives such as AICD's February 2009 *Executive Remuneration Guidelines for Listed Company Boards*, and of proposals by the Australian Prudential Regulatory Authority (APRA)² aimed at reducing the potential for short-termism and/or excessive risk-seeking behaviour by financial institutions, which the Federal Government has said elsewhere is a major priority;
- possible (in our view, likely) hindrance of recommendations being developed by the Productivity Commission in the context of its current Inquiry into Executive and Non-Executive Director Remuneration;
- unnecessary distortions in the further development of remuneration practices and/or restrained future company growth; and
- in the longer term, an adverse impact on general economic growth because of the adoption of sub-optimal remuneration arrangements.

In terms of the specific changes contemplated, we note that the Federal Government proposes to increase the income threshold for the \$1,000 exempt shares concession from \$60,000 per annum to \$150,000 per annum. While this increase is welcomed, we believe there should be no threshold. We consider any such threshold will have a distortive effect and there will be practical problems in its application. For example, employers will not necessarily be in a position to assess whether employees are eligible to participate, on the basis that the latter will invariably derive additional income from other sources.

We also believe there will be considerable business uncertainty concerning what constitutes a "genuine risk of forfeiture" for the purposes of deferring taxation. This uncertainty will be highly undesirable, and work against companies putting in place share plans to motivate employees.

As an additional point, we further note that the Consultation Paper associated with the Bill states "Ceasing employment is a deferred taxing point under the current tax law. Considerable tax integrity issues would arise if it is removed as a taxing point because, amongst other things, employees may move overseas after ceasing employment making it difficult for the Tax Office to collect any tax."³ AICD has argued elsewhere⁴ there would be merit in examining whether tax liability in respect of unvested equity securities under employee share schemes should continue to be triggered on cessation of employment. This

² See APRA Media Release "APRA outlines approach on executive remuneration", 9 December 2008 and APRA, Discussion Paper, Remuneration: Proposed extensions to governance requirements for APRA-regulated institutions, 28 May 2009. Available at <http://www.apra.gov.au/Policy/Remuneration-requirements-consultation-May-2009.cfm>.

³ "Reform of the Taxation of Employee Share Schemes", Consultation Paper, The Treasury, June 2009, at paragraph 68.

⁴ See, for example, the AICD Submission to the Productivity Commission's Remuneration Inquiry, 29 May 2009, at page 36.

is particularly relevant in the context of the intent of the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, as the existing taxation provisions work to promote accelerated payments on termination, thereby putting upward pressure on lump sum payments. These taxation provisions also work against other initiatives (e.g. industry led, current APRA deliberations, etc) that seek to encourage long-term executive incentive plans continuing post-employment.

Whilst we appreciate the Federal Government has engaged in some consultation on the proposed changes following the recent Federal Budget announcement, and that it is seeking to promote business certainty, we are sure the above consequences would have been more apparent if a fuller consultation process had been undertaken. We also point out that the one week consultation period undertaken has occurred shortly after or during a raft of other consultations that have been set in train by Government, which has made it more difficult for respondents. These other consultations include:

- the Productivity Commission's Inquiry into Executive and Non-Executive Director Remuneration;
- the Exposure Draft: the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009;
- APRA's Discussion Paper on Remuneration: Proposed extensions to governance requirements for APRA -regulated institutions;
- the Exposure Draft: Tax Laws Amendment (Prescribed Private Funds) Bill 2009; and
- the Australian Consumer Law Consultation on draft unfair contract terms provisions.

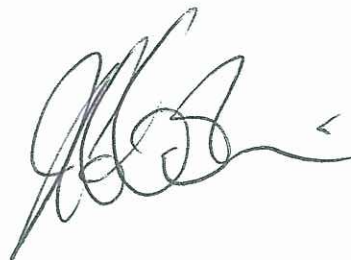
In light of the above matters, we urge the Federal Government to continue to consult on the Bill and its likely consequences, and not finalise its decision on the taxation of employee share schemes until it has considered the outcomes of the current APRA and Productivity Commission remuneration reviews.

We would be happy to discuss any of the points made in this letter.

Yours sincerely



John Story
Chairman



John HC Colvin
Managing Director