Australian Government

The Treasury

8 February 2012

Ms Deborah O'Neill MP
Chair
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

RESPONSE TO QUESTIONS ON FAMILY BUSINESSES AND EMPLOYEE SHARE SCHEMES

Dear Ms O'Neill

Please find attached responses to the three questions on family businesses and employee shares schemes raised by your committee with the Department of the Treasury.

The Institute of Chartered Accountants Australia submits that the requirement that employee share schemes be offered to 75 per cent of employees is inappropriate for the family business sector, as employee share schemes were used as a strategic lever to attract non-family personnel to key management positions. Were similar concerns raised during the consultation on the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009?

In response to the release of a consultation paper and exposure draft bill on the reform of the taxation of employee share schemes in June 2009 two submissions raised the issue of the 75 per cent requirement and family companies. These were from Mr Neal Bunkum of Perrier Ryan Business Advisors and Dwyer Lawyers. These submissions are available on the Treasury website at http://archive.treasury.gov.au/contentitem.asp?ContentID=1573&NavID=037

Does the ATO or Treasury foresee any policy or practical problems were the family business sector to be exempt from the requirement that employee share schemes be broadly available to employees?

The ESS rules provide that where an employee is provided with shares or rights under an employee share scheme at a discount from the market value, the value of the discount is income and will be taxed in the year the shares or rights are received.

However, the tax can be deferred if the shares are at a real risk of forfeiture and where, among other criteria, shares are offered to at least 75 per cent of Australian resident employees with three or more years of service.

The requirement that the ESS must be offered to at least 75 per cent of employees does not apply to schemes that only offer rights (eg. options) in the company.

Tax concessions, including the deferral of tax, are provided for employee share schemes on the grounds that they can contribute to aligning the interests of employees and employers, encourage positive working relationships, boost productivity through greater employee involvement in the business, reduce staff turnover and encourage good corporate governance. The requirement for schemes to be offered to at least 75 per cent of employees reflects the benefits that arise from broader employee involvement in a company. As the interests of owners and managers are already strongly aligned to the interest of the company, by nature of their positions, the 75 per cent requirement ensures the ESS tax concessions are not inappropriately accessed by those in control of the company.

The Board of Tax considered similar concerns in relation to start-up, research and development and speculative type companies in 2009 and recommended that no change be made to the 75 per cent requirement.[1]

Further, it would be difficult to define "family business" to provide an exemption from the 75 per cent requirement, in a way that would robustly ring-fence particular types of companies. This could also compromise the integrity of the ESS tax regime as a whole, potentially creating situations of inequity and increasing risk of tax avoidance.

Treasury's submission responds to recommendations by family business representatives for deferral of the taxing point by noting that illiquidity is a problem for family businesses and small businesses alike. Is this an issue that should be addressed? If deferring the taxing point is not an appropriate means of addressing this issue for all businesses, are there other strategies that should be explored?

It is a principle of Australia's tax system that income is taxed in the year that it is earned. Consistent with this principle, upfront taxation of discounts on employee share schemes is the Government's starting point for the taxation of employee share scheme arrangements. The changes the Government made in the 2009-10 Budget emphasised this objective and were specifically aimed at improving horizontal equity in the tax system by treating all forms of remuneration more consistently.

The economic value embodied in employee share scheme shares and rights is equivalent to any other form of employee compensation and should generally be taxed in the same manner.

Some companies overcome the problem of employees having to pay tax upfront on discounts received through lending employees the money they need to pay the income tax liability.

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[1] The Board of Taxation, "Review into elements of the taxation of employee share scheme arrangements" February 2010, p 48.