level 6 365 queen street
melbourne victoria 3000
t +613 9664 7333
f +613 9600 0050
w actu.org.au

President Gerardine (Ged) Kearney
Secretary Dave Oliver

5 June 2016

Dr Kathleen Dermody
Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Dr Dermody,

Inquiry into Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015

Thank you for your recent email inviting the Australian Council of Trade Unions (ACTU) to make a submission to your inquiry.

The ACTU represents nearly 2 million working Australians and their families. We believe our tax system should be designed with the aim of helping to create a more equal and cohesive society in which all taxpayers pay their fair share regardless of the source of their income and when it is received.

While all tax systems necessarily develop complex rules in an attempt to incentivise or discourage particular forms of economic and social behaviour, it is vital such rules are fair. In particular, they must not act to allow some to benefit disproportionately from concessional treatments that are intended primarily to achieve a broader public good.

Disproportionate benefits bring the tax system into disrepute, encourage non-compliance, and help to cultivate the impression that some members of our community pay less than they should for the vital public services and infrastructures that all workers, families and businesses in Australia rely upon.

It is in this context that we have serious concerns about some of the amendments to the tax treatment of deferred tax Employee Share Schemes (ESSs) that the government is proposing to make.

The ACTU supports ESSs that are available to all levels of a company's workforce and which are effectively regulated by government to minimise the risk of unfair avoidance, particularly by senior company managers and executives. However, we believe the current proposals risk incurring a cost to public revenues and public faith in the fairness of our tax system that is disproportionate to the purported benefits.

Australian Unions
Join. For a better life.

Our concerns are as follows:

1. The changes the government wishes to make have been heavily promoted as being designed to support eligible start-up companies by better enabling them to use employee share schemes to attract and retain talented employees. We note, however, that the definition of an 'eligible start-up' proposed by the government covers companies that have been incorporated for up to 10 years and have an aggregated turnover of up to $50 million. We are concerned that this definition may be unduly expansive with the consequence that the start-up concession is poorly targeted. For example, it is not clear why a company that has established a successful business after 5 years, and which is generating a taxable profit of perhaps $8 million, should be entitled to taxpayer support to reward some of its employees.

We therefore recommend that the Committee examine the appropriateness of the parameters of eligibility for any start-up concession with a view to ensuring any such concession is targeted to start-ups that are most likely to need it. One option could be to limit eligibility to companies incorporated for 7 years or less and whose level of taxable profit as a proportion of turnover is less than a specified percentage. This would link the availability of any concession to the likely ability of a company to do without it.

2. In addition to our concerns about defining eligibility for the start-up concession, we are further concerned that the substance of the new concessional arrangements is excessively generous. For example, under the proposed changes for eligible start-ups an employee would no longer pay income tax on the discount on options provided under a deferred tax ESS. Instead, the only tax payable will be CGT applied to a gain resulting from a future sale of shares. That gain will be taxed at half the employee's marginal rate. So an employee may receive a significant benefit from their employment in the form of options and subsequently only pay tax at a significantly reduced rate.

The very large majority of employees in Australia do not have access to an employment-related share scheme of any sort.[1] If they work hard and their employer is successful any consequential reward is likely to take the form of a pay increase or bonus that is taxed when it is received at the full marginal rate. The government is now proposing that the already generous treatment of deferred ESS arrangements is made more generous, further accentuating the inconsistent tax treatment of the few that have access to an ESS and the many that do not.

Moreover, leaving aside special pleading by those with a selfish interest in supporting this change, we are not aware of an objective evidence base relating to the recruitment and retention of employees by start-ups that means this change will make for good public policy. In this context good public policy requires sufficient evidence to justify that an increased cost to taxpayers is likely to result in a proportionate public benefit. That justification does not presently exist.

We therefore recommend that the Committee reject the government's proposal to abolish the application of income tax to the discount on options in the year they are received.

[1] Lenne, J., R. Mitchell & I. Ramsey (2005) *Employee Share Ownership Schemes in Australia: a survey of key issues and themes*, Centre for Corporate Law and Securities Regulation, University of Melbourne.

3. The government is proposing that for all companies that offer a tax deferred ESS, the maximum deferral period will be increased from 7 years to 15 years. We have a number of concerns about this proposal.

Among tax professionals it is a widely understood principle of tax planning that a tax deferred is more likely to become a tax reduced. This is because the liability of an individual for tax can change significantly over time as their circumstances change, and particularly after they retire. More than doubling the deferral period will increase the risk that more of those who benefit from participating in an ESS will pay even less tax than they otherwise would under the already generous CGT discount arrangements.

Furthermore, among tax professionals deferring tax on a capital gain is commonly regarded as being equivalent to an interest free loan from the ATO. This is because the value that would otherwise be paid in taxation continues to be held by the taxpayer without charge and can continue to be utilised to accumulate further wealth. If realised during retirement, the taxation of that deferred further wealth is unlikely to benefit public revenues.

The government has argued that significantly increasing the deferral period will give start-up companies further time to succeed. However, it is not clear why the government wishes to apply the increase to all deferred ESSs, regardless of whether they are a start-up or not.

Finally, in 2009 the then government increased the deferral period to 7 years because this reflected general industry practice in Australia and abroad. It is not clear why more than doubling the period is now thought to be appropriate. It is likely to encourage tax avoidance, particularly among senior employees with high-value stakes in an ESS and who can afford to delay realising that value until they pay little or no tax on it.

We therefore recommend that the Committee rejects the proposed extension to the deferral period. There is no evidence that such a significant extension is warranted, and it is likely to further promote tax avoidance to the detriment of public revenues.

I hope the Committee finds these comments and recommendations useful. I would be happy to contribute further to the Committee's work on this important issue on request.

Please do not hesitate to contact me again.

Yours sincerely,

Dave Oliver
Secretary