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The Secretary  
Senate Economics References Committee  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

Email [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Sir

### **Inquiry into Employee Share Schemes**

The Taxation Institute of Australia (**Taxation Institute**) is pleased to provide comments in relation to the Senate Economics References Committee inquiry regarding employee share schemes.

We understand that the inquiry is examining:

- the structure and operation of employee share schemes;
- the benefits of employee share schemes;
- the taxation issues relating to compliance of employers and employees participating in employee share schemes;
- the recent announcement of proposed changes to the treatment of employee share schemes, the background to these changes, consultation undertaken to develop these changes and the anticipated impact of these changes on employees, employers and Australian business generally;
- the rules governing employee share schemes in other countries; and
- any other related matters.

The Taxation Institute's submission below addresses the taxation issues in relation to each of these points of inquiry.

### **Structure and Operation of Employee Share Schemes**

Employee share schemes are generally structured in a manner consistent with the objectives of such schemes. The relevant objectives are, broadly:

- to provide an incentive for employees of a company to act in a manner consistent with the goals of the shareholders of that company;
- to provide an incentive for employees of a company to remain in the employment of the company;
- to provide a means by which employees can share in the value that they contribute to creating in the company; and
- to provide companies with a means of remunerating employees in a manner that does not involve a significant cash outflow for the company involved.

Employee share schemes can be structured in a multitude of ways, depending on the objectives that are seen to be important to the particular company and its employees. However, most employee share schemes will exhibit at least some of the following attributes:

- shares or rights to acquire shares are issued at a discount to the current market value of the share or option;
- shares are able to be disposed of, or rights exercised, only after a particular qualifying period of employment or after particular performance hurdles are satisfied; and
- if the employee resigns or their employment is terminated before the qualifying period expires, the employee usually forfeits their shares or rights. There may be provision for this to be waived in cases of good leavers, redundancy or hardship.

In practical terms, the application of the above attributes means that there is usually a period between the grant of the shares or rights and the time at which employees can first realise the value of the shares or rights.

### **Benefits of Employee Share Schemes**

The Taxation Institute considers that the benefits of employee share schemes are directly linked to achieving the objectives which underpin the schemes (these are outlined above).

### **Taxation Issues Relating to the Compliance of Employers and Employees Participating in Employee Share Schemes**

The Taxation Institute notes that the Australian Taxation Office (**ATO**) has previously expressed its concerns with the level of non-compliance of employees with the existing Division 13A of the *Income Tax Assessment Act 1936*. In general, the ATO's concerns relate to the inappropriate deferral of employee share scheme discounts and a failure to include deferred discounts in assessable income at the required time.

In previous submissions to Treasury, the Taxation Institute has expressed concerns regarding the proposal to give the ATO further specific information gathering provisions to combat such non-disclosure (refer to the Taxation Institute's previous submissions regarding employee share schemes dated 11 June 2009 and 26 May 2009 which are attached at **Annexures A and B** respectively). The Commissioner of Taxation (**Commissioner**) has appropriately wide powers to require the provision of documents or information. As such, the Commissioner is well placed to implement a targeted compliance programme in relation to employee share schemes based on information acquired using his existing powers.

### **Recently Announced Changes to the Taxation Treatment of Employee Share Schemes**

Since the Taxation Institute's previous submissions to Treasury regarding employee share schemes (which are attached at Annexures A and B), further amendments have been announced (refer to Media release No.011 dated 1 July 2009 and the attached Policy Statement released by the Assistant Treasurer).

The Taxation Institute's comments on the further amendments are below. The Taxation Institute's comments in relation to the previously announced amendments are set out in our previous submissions which are incorporated at Annexures A and B.

<b>Proposed Amendment</b>	<b>Taxation Institute Comment</b>
Income test for the \$1,000 tax exemption to be raised to \$180,000	The Taxation Institute welcomes this change.
Further clarity will be provided on the meaning of "real risk of forfeiture"	The Taxation Institute welcomes further clarification. However, as outlined in previous submissions, the Taxation Institute considers that the real risk of

	forfeiture requirement introduces an element of uncertainty that may not be resolved by the release of further explanatory material. This will result in further compliance costs for employers to obtain certainty.
Moving the deferred taxing point from a point at which the taxpayer will no longer have a real risk of losing the share or right to a point at which: <ul style="list-style-type: none"> <li>• for shares – the ending of risk of forfeiture and restrictions on disposal;</li> <li>• for rights – the ending of the risk of forfeiture and restrictions on exercise or disposal of the option and disposal of the underlying share acquired on exercise;</li> <li>• cessation of employment; or</li> <li>• 7 years.</li> </ul>	The Taxation Institute welcomes the re-introduction of the deferral until the point at which there are no disposal restrictions (subject to certain limitations).
Limited deferral for arrangements available for salary sacrifice schemes offering no more than \$5,000 worth of shares	The Taxation Institute welcomes this change.
Removing the reporting requirement for employers to report the market value of employee share scheme benefits in the year of grant, if this is not the year in which the employee is taxed	The Taxation Institute welcomes this change.
The refund rules for forfeited benefits will be fine tuned to ensure that a refund of tax is denied only where the decision to forfeit is related more directly to the loss in market value of the securities.	The Taxation Institute supports this fine tuning, subject to the details being released.
Establishing a three part forward plan of consultation.	The Taxation Institute supports the proposal for further consultation regarding employee share schemes.

The Taxation Institute was disappointed with the consultation process in relation to the proposed amendments to the employee share scheme rules. The Taxation Institute is aware of the problems associated with consultation on Budget measures. However, the uncertainty created by the Government's original proposed amendments and subsequent reversal on certain proposed amendments could have been avoided by consultation (which could have occurred on a limited and confidential basis).

### **The Rules Governing Employee Share Schemes in Other Countries**

The Taxation Institute submits that the taxation methods in other countries for employee share schemes are not necessarily based upon the application of an internally consistent policy approach. As such, unless a "best practice" approach can be identified, it is inappropriate to adopt a taxation methodology simply because another country or countries adopt such an approach.

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If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirakis, on 02 8223 0011.

Yours sincerely



Joan Roberts  
President

**ANNEXURE A**

**ANNEXURE B**