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26 May 2009

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Dear Madam

Employee Shares Schemes – Consultation

The Taxation Institute of Australia (**Taxation Institute**) welcomes the Government's decision in the joint Media Release of 24 May 2009 (No. 074, Employee Share Schemes) (**Media Release**) to reconsider its policy approach to countering problems it perceives with employee share schemes, as outlined in the 12 May 2009 Budget.

Although the Taxation Institute understands from the joint Media Release that a 'policy options paper' will be released in the next fortnight, the Taxation Institute believes it is important to provide the following initial comments on the four options referred to in the Media Release.

The reporting requirements which should be applied to address tax avoidance concerns, such as the application of withholding arrangements or enhanced Tax File Number (TFN) reporting

The Taxation Institute submits that specific legislation is not required to address tax avoidance concerns in relation to employee share schemes. The Taxation Institute believes that the Commissioner of Taxation already has extensive powers to obtain the information required and to identify those individuals who have a vested interest under an employee share scheme (and hence a potential tax liability). Further, targeted information gathering powers would merely increase the length and complexity of the law without notable enhancement and could even fetter the Commissioner's existing powers. If the issue is one of lack priority under the Australian Taxation Office's **(ATO)** Annual Compliance Plan due to competing compliance activities with greater risks then the evasion problem could be addressed through targeted funding of the ATO thereby ensuring that this perceived risk is accorded a higher priority within the ATO Compliance Plan.

The level of the income threshold for accessing the $1,000 tax exemption for upfront taxation, which would ensure the continued availability of employee share schemes for low and middle income employees

The Taxation Institute recommends that the Government abandon the announced $60,000 income threshold for accessing the $1,000 tax exemption as it is too low and is inconsistent with the income thresholds of a number of other recent tax measures such as the tax bonus and the proposed paid maternity leave. The Taxation Institute submits that the $60,000 income threshold will discourage participation in employee share plans across the workforce. Further, the Taxation Institute believes that this cap may not affect high income earners who would typically be expected to receive shares or rights under employee share schemes with a discount in excess of $1,000 and would be expected to defer their taxing point. Therefore, this measure does not appear to deal with the high income earners who appear to be the target of the proposed changes.

An alternative to the $60,000 income threshold which could be considered is increasing the income threshold for accessing the $1,000 tax exemption to an amount that is consistent with other recent tax measures such as the tax bonus and the proposed paid maternity leave (i.e. to at least $150,000).

Whether there are circumstances under which it may be appropriate to provide for the deferral of taxation, the period of deferral and what those limited circumstances would be (such as when there is a real risk of forfeiture)

The Taxation Institute believes that the abolition of deferral of the taxing point will generally end the use of most employee share schemes providing genuine employee exposure to shareholdings in the employer due to the upfront costs and risks involved. In particular, this will adversely affect low and middle income earners without addressing the fundamental problems perceived by the Government of evasion and over use of the discount concession by high earning taxpayers.

In relation to the increased costs and risks of demanding upfront payment of tax, the Taxation Institute submits that without deferral of the taxing point:

- employees may not have the ability to pay the tax associated with the employee share scheme upfront. It is essential employees are in a position to their sell shares or have time in which to save to cover their tax liability otherwise the costs associated with investment will be untenable; and
- employees may not be willing to participate in an employee share scheme as they will incur upfront tax costs in relation to a gain that may never materialise.

Given the current volatile market conditions, the Taxation Institute believes that without deferral of the taxing point, low and middle income earners in particular will not be willing or able to participate in employee share schemes where there is an upfront tax cost. On the other hand, high income earners are likely to be better placed financially and be more sophisticated investors, and are more likely to still be willing and able to incur the upfront tax costs despite the fact that a gain is not assured.

For these reasons, the Taxation Institute submits that the abolition of deferral of the taxing point will affect low and middle income earners in particular rather than the high income earners, which appear to be the target of the proposed changes announced in the Budget. Therefore, the Taxation Institute believes that the deferral of the taxing point needs to be restored. If not, the underlying policy objective of employee share schemes (ie encouraging an alignment of the interests of companies and their employees through continuing share ownership by employees) will be significantly discouraged.

Whether the tax law provisions which determine the market value of discounted and deferred shares or rights result in undervaluation

The provisions which deal with the valuation of discounted and deferred shares and rights were considered as part of the revision of the tax treatment of employee shares and options in the mid 1990s. The Taxation Institute submits that, in the absence of empirical evidence establishing that the current approach results in over or undervaluations, the current approach should be retained. If it is established to the reasonable satisfaction of all concerned that the current approach results in over or undervaluations, then alternatives should be considered. In which case, the Taxation Institute would be pleased to comment at that time.

The Taxation Institute would be happy to meet to discuss these issues further. 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 Dirkis, on 02 8223 0011.

Yours sincerely

Joan Roberts
President