Submission to the Inquiry into the Tax Treatment of Employee Share Schemes

Standing Committee on Tax and Revenue

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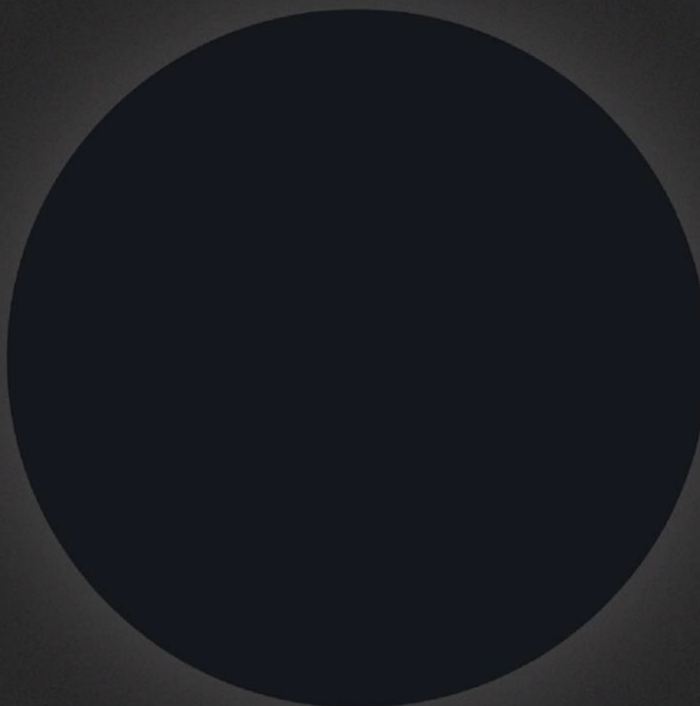

Palantir appreciates the opportunity to make a submission to the Standing Committee on Tax and Revenue (the "Committee") on this matter. Headquartered in Silicon Valley, we are a global enterprise software company that has been enabling Australia's most important public and private institutions to make better decisions with their data.

We wish to highlight two regulatory provisions that we believe are unique to Australia - in that we don't experience similar effects elsewhere in the world - and which we expect could hinder the growth of Australian companies. These provisions speak to the first and third terms of reference. Specifically, that taxation of equity upon cessation of employment hampers employee engagement and inhibits the growth of Australian companies. We also outline how the requirements to file with ASIC certain disclosures related to employee share schemes act as a costly and unnecessary brake on growth.

To overcome the burden and disadvantages associated with these provisions, we recommend the Government consider:

- removing cessation of employment as a deferred taxing point from Division 83A by deleting sections 83A-115(5) and 83A-120(5); and
- expanding the exemption from public access to disclosure documents, or clarify and expand the statutory disclosure exemptions and/or ASIC employee equity class order relief, and expanding the reporting exemptions for foreign controlled proprietary companies, to (i) save companies money and (ii) allow them to hire and grant equity to employees.

This Inquiry was established prior to the outbreak of the COVID-19 pandemic. Strong engagement between employees and employers are necessary as Australia and the world endure and emerge from the effects of the pandemic.

This was demonstrated in the Government's approach to JobKeeper, in particular. Similarly, we believe that strengthening the relationship between employees and their employers can be achieved through a simple and manageable ESS regime. it should be easier for employees of all enterprises to share in the value they create through their work. This

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approach underpins our submission to this Inquiry.

We outline our position not only as a global technology enterprise; but as a local company supporting long-term investment in a vibrant and cohesive Australian entrepreneurial community. Again, we thank the Committee for the opportunity to respond.

For further information, please contact:

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B. Background

Palantir Technologies is an enterprise software company that allows complex organisations to make better decisions with data. We have over 2500 employees around the world - most of which are engineers. Our headquarters are in Silicon Valley, California and we have had local offices in Sydney, Melbourne and Canberra since 2008. Palantir Technologies Australia Pty Ltd is an Australian company and the wholly owned subsidiary of Palantir Technologies Inc., the US parent company (together with its other global entities, “Palantir”).

Since 2008, Palantir has had offices in Sydney, Melbourne, and Canberra. We hire engineering talent from leading Australian universities and enterprises to support our long-standing work at Australia’s most critical institutions within the federal government, at various State agencies, and at large Australian listed companies, who trust our engineers with their most sensitive work.

We are working to build a future in which public institutions, commercial enterprises, and non-profit organisations can use data to make better decisions. We want to continue to invest in Australia and employ local talent to help us grow our Australian business.

Technology start-up companies with limited resources frequently incentivise their employees by granting interests in the equity of the company. Palantir continues to issue equity to our employees, both in Australia and across our entire network, as a core part of employee compensation. We believe in giving our employees a share in our success. We currently grant equity in over 25 countries including the United States, United Kingdom, Canada, France, Germany, New Zealand, Israel, Sweden, Norway, and Denmark.

For each of our key concerns: taxation of equity upon cessation of employment and ASIC public filing requirements, we have attempted to (i) describe the problem, (ii) identify the relevant problematic Australian law, (iii) explain how it could inhibit growth opportunities for Australian companies, and (iv) propose a solution for the Committee. Again, we welcome the opportunity to engage on these issues.

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We would note that our general position is that it should be easier for all businesses in Australia to allow employees to share in the success of the company. That is the case whether the company is a global enterprise with robust legal and financial support, or whether it's a small business seeking to more closely engage with its employees. Our comments in relation to ESS in Australia could apply equally to both large and small enterprises – to the benefit of all Australians.

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C. Taxation of Equity Upon Cessation of Employment

Recommendation: we would strongly recommend that the Government reconsiders its position on the cessation of employment as a deferred taxing point and removes this deferred taxing point from Division 83A by deleting sections 83A-115(5) and 83A-120(5).

We believe that the tax treatment of ESS interests when an employee ceases employment is currently inhibiting the growth of Australian companies. This is a material issue that can impact the perceived value of interests granted under an employee share scheme. As a consequence, it’s key to engaging our employees.

While we acknowledge that removing the cessation of employment as a deferred taxation point would perhaps delay a very small component of taxation revenue, it is our contention that the tax base as a whole can be widened, additional jobs created and additional economic value generated for and by Australians through (i) increasing the perceived value of ESS to employees who intend to generate value to their company in the long-term – thereby increasing engagement; and (ii) removing the perceived cost of leaving their current role for those employees who desire to become entrepreneurs themselves (and in turn, employ more local Australian talent).

We note that the current tax position applies to those long-term employees in Australia and any employee of a non-Australian subsidiary who seconds to one of our Australian offices long enough to become a tax resident of Australia. Consequently, Australian subsidiaries of foreign companies must reflect on the value of seconding employees from the wider group to support Australian operations if it means that those group employees’ ESS interests would then be treated under Australian law.

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CURRENT POSITION AND POLICY INTENT

Where deferred taxation treatment applies under Subdivision 83A-C of the Income Tax Assessment Act 1997 (Cth) (“1997 Act”), employees are generally not subject to income tax on their equity until a later time (the relevant “deferred taxing point“) which will generally occur on the earliest of:

- the time at which there is no real risk the employee will forfeit or lose the share or option and there are no longer any restrictions on disposing of the share or option;
- for options only, the date on which an employee exercises the option and there is no real risk of forfeiting or losing the ordinary shares acquired and there are no longer any restrictions on disposing of the shares;
- the employee ceases employment with the corporate group; and
- 15 years after acquisition.

This concept of a deferred taxing point appears to reflect the policy ideal that an employee should only be taxed at the time at which they are able to realise the value of the underlying share, or in other words, they are able to dispose of the share to fund the tax liability that arises at that time. We believe that the cessation of employment as a triggering taxing point frustrates this intent.

Cessation of employment has been a taxing point under the Australian ESS rules since 1995 when Division 13A was introduced.[1] This legislative change (which has remained in place despite the 2009 and 2015 amendments) means that the deferral of the taxing time ends on cessation of employment notwithstanding that the former employee may not be in a position to sell (or otherwise cash in on) the share or option awards at that time.

[1] Section 139CA(2)(c) was introduced by the *Taxation Laws Amendment Act (No. 2) 1995* (Cth).

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SUPPORT FOR A CHANGE OF POSITION

If one of our Australian employees ceases employment with the Palantir group before exercise, they would owe tax on their equity before they own any shares, before those shares have liquidity on public markets (if the company is still private), and perhaps before they have realised any gains from those shares. This tax treatment creates a cash flow issue for employees and, among other things, diminishes the value and impact of equity in Australia.

We have set out below a (non-exhaustive) list of other reasons why we believe this taxing time should be removed (or, at the very least, significantly restricted as to its application), many of which have been raised previously by industry participants and practitioners in submissions to the Senate Economics References Committee in 2009 (in relation to the 2009 employee share scheme changes) and the Economics Legislation Committee in 2015 (in relation to the 2015 employee share scheme changes).

- This treatment inhibits Australian companies' growth: Generally speaking, the talented engineers who join companies like Palantir are the very same people who are more likely to start their own enterprise, and in turn, create jobs and economic value for other Australians. This overall increase in economic productivity is hampered when these entrepreneurs are financially entrenched in their current roles by unfair taxation provisions. Moreover, foreign parent companies (such as Palantir) are less likely to second employees to Australia due to this treatment of their equity, thereby creating knowledge and expertise silos and stunting the growth of Australian operations. As Paul Fletcher MP (as Parliamentary Secretary to the Minister for Communications) summarised:

  > "*in a world where economic growth and prosperity is tied ever more closely to technological progress, countries with low levels of start-up activity risk missing out on the economic growth which technology can deliver…[I]f we do not have vigorous start-up activity, we risk losing some of our best and brightest to other countries which do.*

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> *Already, there is a steady flow of Australians with IT skills heading to Silicon Valley or other places, where they can employ their talents and obtain rewards greater than they believe may be possible in Australia*."[2]

- The rules can reduce the value of employee share scheme interests in Australia: Employees who are concerned that they will not be in a position to fund any tax payments on their ESS interests if they decide to leave a company (and therefore may request to forfeit their ESS interests to avoid the tax liability on the cessation of their employment), envision scenarios where they may have to walk away from their ESS interests without receiving any value from them. For employee share schemes to properly incentivise and attract the top talent required to grow a successful technology business, they must have the potential to create significant value. The current tax treatment of ESS interests directly impacts their actual and perceived value to employees.

- The rules are inconsistent with policy underlying the other deferred taxing points: In the Board of Taxation's Report to the Assistant Treasurer in February 2010, as noted above, the Board recognised that the policy intent of the law is to ensure that ESS interests are "taxed as remuneration to the employee as soon as [they are] realisable to the employee."[3] This is consistent with taxing employees on vesting, exercise, when restrictions are lifted or on disposal (as applicable). Taxing employees on remuneration (ESS interests) at the time they cease employment, however, where those interests may not "realisable to the employee", is inconsistent with the policy underpinning the other employee share scheme deferred taxing points.

- Australia is falling behind international practice: The position in Australia is inconsistent with the vast majority of other developed countries where we operate.

[2] P Fletcher, House of Representatives, Second reading speech: *Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015*, Hansard, 27 May 2015, page 4831.

[3] Board of Taxation, *Review into Elements of the Taxation of Employee Share Scheme Arrangements: A Report to the Assistant Treasurer* (February 2010) <https://cdn.tspace.gov.au/uploads/sites/70/2015/07/Employee_Share_Scheme_Report_to_Minister.pdf>, page 50.

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The current regime uniquely penalises Australian-based employees as compared to employees based in other peer countries such as the United States, the United Kingdom and Germany, who do not generally incur tax on the cessation of employment. This could have the effect of Australian employees feeling like they are treated inconsistently with their colleagues in other countries. This may incentivise those employees to work elsewhere within the company and dissuade other employees from seconding to Australia for work, which further undermines the growth and investment in the Australian business. We note that the Senate Economics Legislation Committee also concluded that "the present system of taxation on cessation of employment seems to be an anomaly internationally" when it reviewed this issue in 2015.[4]

- The position conflicts with the derivation of income principle and is inconsistent with the treatment of cash bonuses: One of the objects of Division 83A is to ensure that employees are taxed consistently on their remuneration, whether that is in the form of cash or ESS interests provided to employees under employee share schemes.[5] Despite this, there is a disparity between the tax treatment of cash bonuses (for example) and ESS interests on cessation of employment. By way of example, where an employee is able to receive a bonus at the end of each financial year (based on her or his performance) if she or he is still employed at the time it is paid, or if she or he has left the company as a 'good leaver' (by way of retirement or redundancy). Assume the employee retires in February but is still entitled under the company policy to receive a cash bonus at the end of the financial year. This cash bonus is then received in September. In this case, the employee would be taxed on the cash bonus where she or he receives the cash bonus – not when he or she ceases the employment to which the cash bonus relates.

- The treatment of remaining and former employees is unequal: It is not clear why two employees should receive different tax treatment where they hold the same ESS

[4] Senate Economics Legislation Committee, Report: *Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015* [Provisions] (June 2015) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TSLAB_Bill_2015/Report>, [2.16].
[5] Section 83A-5; *Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009* (Cth), [1.15].

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interest, where one employee continues working and the other ceases employment. We note that the Productivity Commission reached the same conclusion when it reviewed this issue in 2009.[6]

- The rules can cause issues for deceased estates: If an employee ceases employment due to death, this can result in adverse tax issues for the deceased estate who may be required to sell certain assets to fund that tax liability in circumstances where the shares or options cannot be sold for a number of years (or which later lapse).

MAINTAINING TAX INTEGRITY

We understand that in June 2009 the Government released a Consultation Paper in relation to the proposed reform of the taxation of employee share schemes. In this Consultation Paper, the Government proposed to retain the cessation of employment as a deferred taxing point, noting that: "Considerable tax integrity issues would arise if [cessation of employment] 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."[7]

This concern should have been adequately dealt with by the employee share scheme reporting and withholding rules introduced in 2009.[8] Broadly, these provide that where an employee has not provided a tax file number to their employer before the end of the tax year in which the taxing point occurs, their employer would be required to withhold tax (and can recover that tax from the employee by, for example, offsetting the amount against the employee's salary).[9]

Further, employers are generally required to provide employees with an ESS Statement by

[6] Productivity Commission, *Inquiry Report into Executive Remuneration in Australia* (19 December 2009) <https://www.pc.gov.au/inquiries/completed/executive-remuneration/report/executive-remuneration-report.pdf>, pages 339.
[7] Australia Treasury, Consultation Paper: *Reform of the Taxation of Employee Share Schemes* (June 2009) <https://treasury.gov.au/sites/default/files/2019-04/c2019-t373902-ess.pdf>, [68].
[8] *Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009* (Cth). This was also noted by a number of submissions made to Treasury and the Senate Estimates References Committee in 2009 and 2015.
[9] Subdivision 14-C in Schedule 1 to the *Taxation Administration Act 1953* (Cth).

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14 July after the end of the employee's tax year in which the deferred taxing point occurs (and to provide the ATO with similar information by 14 August).[10] We note that the ATO has made recent advances in the collection of HELP/HECS debt for overseas persons that might mitigate any prevailing concern.

RECOMMENDATION

Considering the above, we believe it is unreasonable and inequitable to impose tax on the cessation of employment in circumstances where an employee may never realise any value from the ESS interest. As such, we would submit that the Government removes this deferred taxing point from Division 83A by deleting sections 83A-115(5) and 83A-120(5). As the Productivity Commission has said, while "*there may be some costs to revenue from extension of tax deferral beyond termination… the broader economic costs of not changing this provision are more significant for policy*".[11]

If this is not possible, then we recommend that the cessation of employment deferred taxing point be significantly limited so that it only applies to:

- as suggested by the Productivity Commission,[12] employee share scheme interests which are not subject to a real risk of forfeiture, but are subject to genuine restrictions on disposal; or
- 'bad leavers'. In other words, it would be removed as a deferred taxing point in respect of a 'good leaver', being someone who ceases employment due to retirement, death, total and permanent disability or redundancy.[13]

[10] Division 392 in Schedule 1 to the *Taxation Administration Act 1953* (Cth).
[11] Productivity Commission, *Inquiry Report into Executive Remuneration in Australia* (19 December 2009) <https://www.pc.gov.au/inquiries/completed/executive-remuneration/report/executive-remuneration-report.pdf>, page 383.
[12] Ibid, page 384.
[13] This was suggested by The Tax Institute of Australia in their submission to the Senate Economics Legislation Committee dated 5 June 2015, page 11.

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D. ASIC Public Filing Requirements

Recommendation: the Government should consider expanding (1) the exemption from public access to disclosure documents and (2) the reporting exemptions for foreign controlled proprietary companies, to save companies money and allow them to hire and grant equity to employees.

For Australian companies that offer an ESS, those that fit a certain profile are subject to expensive and public ASIC filings. These filings are costly for companies to produce, put such companies at a competitive disadvantage, and may result in a disincentive to hire.

The following ASIC filings are unique to Australia vis-à-vis similarly situated nations, such as the United States, United Kingdom, France and Germany, and may inhibit the growth of Australian companies:

- Prospectus Filing: Companies offering securities to employees must file a prospectus or, in some cases, an offer information statement, unless they qualify for an exemption (such as granting equity to fewer than 20 employees within the small scale offering exemption) or fall within limited ASIC relief for unlisted entities (which includes a $5,000 per employee per year limit). Such documents are made publicly available unless a very limited exemption for eligible employee share scheme offers by start-ups applies.

- Financial Report filing: Local companies controlled by a foreign entity must publicly file an audited 12-month financial report, unless they qualify for an exemption (such as meeting the criteria of a “small proprietary company,” which includes having fewer than 100 employees, and not being part of a large group, per the ASIC relief).

We believe that these unique requirements inhibit the growth of Australian companies for the following reasons:

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- Disincentivises Hiring in Australia: Australian companies face disincentives to hire beyond the qualifying personnel caps under the respective exemptions. Start-up and scale-up companies often operate on a lean and responsive hiring schedule where existing employees should the burden of additional work until new employees can be brought on.

- High Compliance cost: Both creating the documents required under these ASIC requirements and applying for an exemption or specific relief is expensive. It requires companies to spend a significant amount of fiscal and human capital on legal and accounting, detracting from capital that could be invested on growth.

- Gives competitors access to confidential information: A company's prospectus and audited 12-month financial report contains sensitive company confidential information that might include key financial data and risk disclosures. Publicly filing these reports could be detrimental to a company's growth since competitors will have access to previously unobtainable information, potentially eroding competitive advantages.

RECOMMENDATION

Considering the above, we believe the Government should consider:

- expanding the exemption from public access to disclosure documents,[14] or clarify and expand the statutory disclosure exemptions[15] and/or ASIC employee equity class order relief;[16] and
- expanding the reporting exemptions for foreign controlled proprietary companies, to (i) save companies money and (ii) allow them to hire and grant equity to employees.

[14] As proposed in Treasury's "*Employee Share Schemes*" Consultation Paper dated April 2019 ("Treasury's Consultation Paper"). However, the proposal there does not go far enough. The exemption should extend to companies who have been incorporated for more than 10 years and have turnover of more than $50 million.
[15] Including updating the thresholds for the small scale exemption, which have not been updated since the commencement of the Corporations Law in 1991, and clarifying the "no consideration" exemption which the Australian Securities and Investments Commission considers does not apply if the offer has any connection with the offeree's employment situation.
[16] As noted in Treasury's Consultation Paper, the $5,000 per employee per year limit is too restrictive.

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