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The Secretary
House of Representatives Standing Committee on
Employment, Education and Workplace Relations
R1 116
Parliament House
Canberra ACT 2600

Your ref

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Contact Alec Highnam - (03) 9288-6742

Attention: Paul McMahon

5 October 1999

Dear Mr. McMahon

Inquiry into Employee Share Ownership in Australian Enterprises

As requested at our appearance in front of the committee on 7 September 1999 at the Inquiry into Employee Share Ownership, we have set out below our comments on the submission made by Ernst & Young.

Overview of the Submission

We share Ernst & Young's concerns with the need for both legislative clarification as regards the operation of Division 13A of the *Income Tax Assessment Act 1936* ("the Act") and the necessity of clear guidance from the Commissioner as to his opinion on how Division 13A operates. With Ernst & Young we would differentiate the schemes implemented by our publicly listed clients from the abusive plans under examination by the Australian Taxation Office. We respectfully suggest that plans of that kind should not prejudicially influence any recommendations that may arise from the Inquiry which would adversely affect genuine arm's length employer-employee share and option plans.

We share with Ernst & Young a desire to participate in a meaningful consultation process with the Government, Treasury, ATO, corporations, employee bodies and firms to achieve an improved regime for the taxation of shares and options in Australia.

The following comments relate to the numbered points in the Ernst & Young submission. The specific examples raised by Ernst & Young in its overview and its detailed submission are also examples encountered by this firm and its clients.

Detailed Comments

1 . While the Treasurer's Press Release No. 54 of 2 September will address this problem for employees in existing listed public companies, the problem will remain for employees of companies which provide share schemes in the process of listing. It is not uncommon for employer companies to provide employee share schemes as an integral part of the listing process.

2. Many clients of our firm, and other firms, would prefer that the "no forfeiture" provision in section 139CE be relaxed in the terms discussed in the Ernst & Young submission and our submission of 4 May: Forfeiture Conditions.

3. This point addresses concerns, as were raised in our submission of 4 May, that takeovers, restructures and mergers can have unintended consequences under Division 13A of Employees may be taxed because of events beyond their control, and where there may be no fundamental change in the terms on which the employees acquired their shares or options. We agree with Ernst & Young's concerns.

4. We do not wholly agree with the need to amend the 1936 Act and the *Income Tax Assessment Act* 1997 ("the 1997 Act") to explicitly provide that the establishment of the trust, transfer to the trust and from the trust to or for the benefit of an employee should not be taxable transactions. These situations appear to be adequately dealt with in the existing provisions. Please refer to our submission of 4 May - Trusts.

5. As our submission of 4 May noted, the valuation of an option under Division 13A is a complex matter. The recommendations of Ernst & Young should be seriously considered.

6. Whether the change is made to allow deferral where an associate has acquired the share or right would be a matter for Parliament to determine. At present this does not appear to be causing any great problems for our clients; it does not affect adversely the bulk of participants in employee share and option schemes.

   We agree however that S.139DD should be amended to allow an amendment to the employee's assessment where the associate is a participant but the right is lost.

7. The questions raised by Ernst & Young with respect to the cessation time are questions this firm also would raise. These are matters which require clarification at law or at least some statement from the Commissioner as to his view of how the provision operates.

8. We agree that on parity terms, any loss arising from a transaction which would give rise to income within the income provisions should be dealt with in those provisions and not under the capital gains provisions.

9. We agree that there is no clarity at all of the taxation treatment of employee shares or share options for non-residents. The ATO view depends to a large extent on the officer you discuss the matter with. Our clients are looking for certain and equitable treatment at the moment they are offered neither. The recent Review of Business Taxation has clarified only one of the points raised in the Ernst & Young submission.

10. As stated in response to point 7. above, these questions should be considered by Treasury and if necessary amendments should be made.

11. Whilst the requirement that shares provided to employees be 'ordinary' shares has not been onerous in the general range of circumstances encountered, our submission regarding stapled securities provides evidence that changes to encompass securities other than ordinary shares should be made.

12. Our discussions with the ATO on this point have been helpful in that they agree that there is a flow through of the Division 13A amount. There is also a technical basis for this position. We understand that other minor technical issues have recently been addressed with legislative amendments proposed.

13. We agree with the concern expressed by Ernst & Young with the uncertain ambit of the expression 'right' as it is used in Division 13A. It is sufficient to note that a definition of the term 'right' is required to relieve any uncertainty currently being experienced.

14. The recommendation of Ernst & Young should be considered.

15. We agree that the current 'employment' requirements of Division 13A should be expanded to admit employees of joint ventures and other entities. Sub-section 139CD(7) and 139CD(6) effectively discriminate against privately-held companies which wish to implement genuine employee share schemes (not the kind the ATO is examining).

16. Ernst & Young's queries regarding the field of operation of the term "restriction" used in sections 138CA and 139CB of the 1936 Act are shared by this firm and its clients. Whether this is resolved by amendment or clarified by the Australian Taxation Office is not as critical as guidance being provided as soon as possible.

17. We also raise the question put by Ernst & Young on this point. We repeat Ernst & Young's request that the Commissioner of Taxation quickly promulgates what he will accept as "reasonable methods" of valuation. Our private clients have been requesting such action for some time.

18. We have made a similar submission both in our submission of 4 May and by my attendance at the Inquiry.

19. Section 139G of Division 13A is perplexing in its application. Whether the priority of its potential applications is by amendment or by the Commissioner is not as immediately relevant as clarification being dealt with quickly.

If you wish to discuss any aspect of this submission, please call me on (03) 9288-6648.

Yours faithfully

Andrew Purdon
Partner