# Inquiry into Employee Share Ownership in Australian Enterprises

## Answers to questions received on 6 January 2000

**Question 1**

*Does the ATO have any information on the number of taxpayers who are involved in Division 13A or non-Division 13A employee share schemes, and the total value of holdings?*

As indicated in the ATO submission to the Committee, dated 30 April 1999, the office does not have details as to the precise extent to which employee share ownership schemes have been established or the amount of contributions being made to either Division 13A or non-Division 13A arrangements.

Details concerning deductions claimed or income returned from these arrangements are recorded by taxpayers at “general” income or deduction labels in the return forms and cannot be separately identified from other income or deductions returned at these labels. For the detailed information you require it would be necessary to include specific label fields into the return forms and to provide explanatory information in the "Tax Pack". This would have impacts on cost of compliance issues with regard to tax return preparation.

Under the move to a self assessment environment the Australian Parliament provided taxpayers with a legislative framework that enables them to obtain binding and reviewable technical advice from the ATO in the form of Private Binding Rulings (PBRs). However, as it is not a requirement to obtain a ruling on transactions entered into the number of PBRs issued in respect of employee share schemes would not provide meaningful information.

Most product developers in the employee share plan field have regular contact with ATO and Treasury staff and the one plan can service a number of employers and their employees. Advice is also provided to taxpayers and their advisers through the public ruling and tax determination programs.

The ATO recently developed a new service aimed at developers of taxation products or arrangements. Under the Product Ruling system, product developers can supply the ATO with the facts surrounding their arrangement and obtain a technical clearance for the income tax consequences relating to those facts. This system provides confidence to taxpayers, particularly, at the small to medium end of the market who cannot afford individually designed arrangements.

**Question 2**

*The Committee has received evidence about the widespread use of trusts in the operation of share schemes.*

- *Under the recent changes to the ITAA, when a share is transferred from a trust to an employee, when is tax payable and at what rate?*
- *Please set out the most common trust arrangements, indicating taxing points and rate of taxation for share schemes.*

In relation to this question, it is our understanding that "the recent changes" refer to proposed changes under Business Tax Reform (BTR) agenda of the Government. In this context we advise that we can see nothing in the BTR process that would be inconsistent with the policy objectives of Division 13A and that mainstream trust arrangements used in employee share schemes will not suffer any deleterious effects from the reforms proposed.

More specifically we advise:-

There are two references in the Ralph Report (*A Tax System Redesigned*) that specifically deal with employee share schemes:

- Recommendation 15.2 which provides that certain employee shares are to be disregarded in determining whether an entity is a wholly owned group for consolidation purposes; and

- Recommendation 22.19 which deals with the taxation of share discounts provided under a qualifying employee share scheme to an employee that ceases to be an Australian resident.

The consistent entities treatment rules, which tax trusts and companies in a similar manner, may apply to trusts used in employee share schemes in some situations.

Under these measures, trusts to which the measures apply will be taxable entities and will be subject to tax at the trust level. Provisions will be made to exclude certain trusts from the entities regime. Excluded trusts will essentially be taxed as they are now (ie under Division 6 of the ITAA 1936) with some modifications.

The Ralph Report provides some examples of excluded trusts. One example is a trust established for absolutely entitled beneficiaries that meet the criteria of Recommendation 16.11 (see page 547 of *A Tax System Redesigned*). Recommendation 16.11 does not apply only to employee share schemes. It applies to all trusts for absolutely entitled beneficiaries. These trusts are not taxed under the consistent entity treatment rules. Employee share schemes could be of this kind. Another example is the purchaser trusts referred to in Recommendation 16.14 (see page 549 of *A Tax System Redesigned*). Recommendation 16.14 does not apply only to employee share schemes. It applies to all trusts where the beneficiaries are, as such, in the position of purchasers of the trust property under an uncompleted sale of the property. These trusts are ignored and the actions of the trustee are treated as those of the beneficiaries. Employee share schemes could be of this kind. If an employee share scheme uses a trust that meets the criteria of Recommendation 16.11, that trust may be an excluded trust. It should be noted that an important criterion is that in such an arrangement, the trust property must be held for absolutely entitled beneficiaries. If an employee is in effect the purchaser of shares under an uncompleted contract, although not yet absolutely entitled to the shares, and the shares are held by a trustee, then the criteria of Recommendation 16.14 may be met. In that case the trust would be ignored and the trustee's actions would be treated as those of the employee. It should be noted that in general the employee's position will not meet this description only where the employee's rights are substantially subject, not only to conditions, but to conditions which reduce the employee to less than a purchaser under an uncompleted contract.

An employee share scheme trust in which the employee was neither absolutely entitled to the shares nor their purchaser under an uncompleted contract would be one in which the employee might not get the shares and someone else might. In terms of the recommendations of the Review of Business Taxation, such a trust might properly be subject to the consistent entity treatment rules. Where a trust is taxed at the entity level, provisions can apply to ensure that the benefit of the employee share scheme concessions is maintained in the event that the trust property is transferred to the employee. The express recommendation to ensure that employee shares do not prevent consolidation shows that the Review did not expect removal of the employee share scheme concessions.

It should also be noted that policy in this area is still being developed and as a result, it is not possible at this stage, to provide an absolute opinion as to how the employee share scheme tax concessions will be maintained. Ultimately, the matter is one for Government.

In relation to the question on taxing points we advise that the discount may be included in a taxpayer's assessable income in the year of income in which the share or right is acquired [subsection 139B(2) ITAA 1936]. However, where the shares or rights are qualifying shares or rights and no election has been made under section 139E ITAA 1936 to have the discount taxed in the year of income in which the share or right is acquired, the discount is included in assessable income in the year of income in which the cessation time occurs [subsection 139B(3) ITAA 1936]. So the discount is measured by reference to the value of the share or right at that time, not at the time the share or right was originally acquired. The cessation time is set by sections 139CA and 139CB ITAA 1936.

The discount is assessable to the associate where acquired by a taxpayer in respect of the associate's employment [section 139D ITAA 1936]. An associate includes a spouse, relative, company, or trustee of a trust from which the taxpayer or associate may benefit.

Because the discount is included in the employee's assessable income, and is a gain from employment, the rate of taxation is that taxpayer's marginal rate of tax and is not assessed under the CGT provisions.

**Question 3**

*The ATO stated in its submission that "the ATO considers that aggressive tax planning in EBAs can be regulated under existing tax laws, including anti-avoidance provisions". (Submission 24, p. 18)*

- *Please indicate what provisions would be used and the effect that they would have, in respect of employee share schemes (whether such schemes are under Division 13A or not).*

As indicated in our submission to the committee and in a media release by the Commissioner of Taxation[1] aggressive tax planning has occurred across a wide range of "products" designed to provide deductions to a taxpayer and non-taxed benefits to employees.

The non-Division 13A share plan arrangements referred to in our submission sought to secure even more concessional treatment than supported by Parliament and were contrived arrangements that were intended to frustrate the clear policy of the law. The arrangements we have encountered to date around employee share schemes have typically involved the establishment of a special purpose company, shares in which are allocated to selected employees for a nominal amount. The employer then contributes a sum of money to the company, greatly increasing the value of the employees' shares. The employer claims an income tax deduction for this contribution.

The ATO has a number of concerns in relation to these employee share schemes. These are:

- The calculation of the discount for the purposes of Division 13A of the ITAA 1936.

- The application of the Fringe Benefits Tax Assessment Act 1986 to the contributions made by the employer to the special purpose company.

- The provision of a tax benefit, being the deduction claimed for the employer's contribution to the special purpose company, for the purposes of the potential application of Part IVA of the ITAA 1936.

In our view the contributions made by way of premium or otherwise, in respect of each employee is taxable as follows:

1. as income under Division 13A which should be included in the assessable income of the employee; and/or

2. as a property fringe benefit or a residual fringe benefit taxable to the employer; and/or

3. Part IVA may apply to cancel the deduction that has, or may be claimed by the employer in respect of each contribution; and/or

4. Part IVA may apply to include the amount of the contribution in the assessable income of the employee; and/or

[1] Nat 99/16 dated 19 May 1999 see attachment C

5. Section 67 of the Fringe Benefits Tax Assessment Act 1986 may apply to increase or adjust the aggregate fringe benefit to include the premium contribution amount.

Furthermore, deductions under section 69 or subsection 51(1) of the ITAA 1936, or section 8-1 of the Income Tax Assessment Act 1997 for advisers fees in relation to the employee share schemes may not be allowable.

In relation to known Division 13A arrangements issues arising such as market valuations, the class of shares to be offered and the question of salary sacrifice have, to date, all been dealt with within the Division 13A context.

The recently announced Business Tax Review integrity measures do not impair our approach to the matters described above. The integrity measures being directed at specifically identified areas of the legislation that required clarification. In addition, a review of Part IVA has been announced in a bid to reinforce the ability of the general anti-avoidance provisions to deal with aggressive tax planning. However, these matters are still within the legislative process.

**Question 4**

*The following is an excerpt from a recent newspaper report:*

> *The trick will be to set up share plans which use company loans to buy shares, so that any gains are taxed at CGT rates, not income tax rates…A share plan can be moved outside the income tax system if it uses loans. In a loan plan, the employee borrows money interest-free from the employer to buy shares, and any rise in the share price is then taxed at the much lower capital gains rate, which will be half the employee's marginal income tax rate. Essentially this is a form of gearing, and will work only if the share price rises….*[2]

- *Please provide some more detail on the way the scheme operates that is described in this report.*
- *Does the Commissioner have sufficient power to deal with schemes like this?*
- *Will the new capital gains tax rate act as an incentive for aggressive tax planners to attempt to create share schemes, whether under Division 13A or not, that have the purpose of shifting income to capital and thereby avoiding income tax?*

The arrangement described in this newspaper article needs to be understood in a wider context than just employee share schemes. Company loans, of this type, to employees being used to purchase any type of income producing asset, have the benefit of not incurring FBT. The rationale for this being the "otherwise deductible rule" provided for in the law. If the taxpayer had borrowed the money, at interest, in order to derive a dividend stream, then that interest would have been deductible. Thus the "otherwise deductible rule" means no tax benefit has been derived from the interest free loan from the employer.

However, any profit on disposal of the assets will be subject to tax depending on the circumstances. For example, an isolated purchase and sale transaction on a share held by an individual for over 12 months will attract concessional CGT rates, whereas profits on non-CGT assets will attract marginal income tax rates (for example, where a share trader holds shares as trading stock).

The new capital gains rate is a concession available to individual taxpayers and it is anticipated that there would be an increasing trend for these taxpayers to avail themselves of this concession. However, in relation to the Division 13A arrangements it is important to remember the following points.

- A concessionally taxed benefit is kept on revenue account; and

- A discount is always taxed on revenue account.

In practice, participation in employee share plans and the extent to which employees subscribe to these plans depend on a diverse range of influences, including tax regulation, liquidity, disposable income, risk profile and exposure, company performance, share market and economic conditions.

[2] Hans van Leeuwen, "Boost for Company Share Plans", *Australian Financial Review*, 23 September, 1999, p. 7.

**Question 5**

*At his appearance before the Committee, Mr Jon Kirkwood made reference to "share trading blocks" as vehicles for employee share ownership plans. He said:*

> *More recently, the idea of a share trading block, which is a tripartite agreement among the company, the employee and the share registry, has become the go. The Commonwealth Bank is using that. Telstra is using that. A number of companies are using that. It is so much simpler and easier to administer that I am now recommending that companies stay well away from trust arrangements. (EEWR Transcript of Evidence, p. 132.)*

- *Please provide the Committee with more detail on the nature of a "share trading block" and the way that such blocks operate, especially from a taxation perspective.*

The term "Share Trading Blocks" refers to an electronic stop or indicator which restricts the ability to transfer shares on the ASX CHESS system. We are aware that some companies use these Share Trading Blocks to impose restrictions on the transfer of shares. For further information we suggest you contact the ASX.

**Question 6**

*Mr Andrew Purdon, a tax partner with KPMG, testified that current taxation laws disadvantage employees of foreign-listed companies, who are participants in employer share schemes, when those employees relocate to Australia. Mr Purdon testified that an employee who exercises options, while resident in Australia, even though those options were acquired while abroad, will be faced with taxation levied not only in Australia but in the country of origin. This amounts to double taxation.*[3]

*Mr Charles W Blunt advised the Committee that "US companies operating in many countries… are not prepared to modify plans to accommodate the unique rules or requirements of a single country". As a result, a share plan may not be offered to the employees in that country.*[4]

- *Do Division 13A and/or the taxation laws in general, create barriers to providing share schemes to Australian-based employees?*
- *Do Australian taxation laws result in double taxation in the circumstances described by Mr Purdon*
- *Do any existing bilateral taxation agreements between Australia and other nations deal with share plans?*
- *If there are barriers facing foreign companies providing share schemes to Australian-based employees, or other problems facing foreign expatriots living in Australia, how can these problems be remedied?*

From our observations Division 13A with its $1,000 concessional treatment and up to ten years deferral of tax has been successful in achieving its aim of encouraging employee participation in taking up share offers in their employer's share schemes. However, it is acknowledged that in the small to medium enterprise segment, which is predominantly privately owned, the take-up has not occurred to the same extent. Employee share schemes in this segment may not be looked favourably upon as they would dilute the "Controller's" interest in the company.

Each jurisdiction seeks to provide benefits to its taxpayers or concessions that will stimulate Government policy objectives. In the case of Australia it is our opinion that the introduction of Division 13A has encouraged employee participation in share schemes and has allowed many employees to make investment in their employer company. In relation to offshore plans Division 13A does not seek to tax them in any way differently to the Australian plans.

With respect to the portability of employee share schemes across jurisdictions we acknowledge that schemes are generally designed to comply with the laws prevailing in the parent company's place of operation. Overseas companies may need to make modifications to the schemes to obtain the Australian tax concessions. However, the same could also be said for Australian companies wanting to operate overseas. The 75% of employees qualification rule allows for the possibility that non-resident employees of an Australian enterprise may, for whatever reason, not be able to participate in the share scheme.

[3] *Transcript of Evidence*, p. 264.
[4] Submission 43.

It is also possible that differences in corporations law between jurisdictions may prevent implementation of trans-national employee share schemes.

In relation to the circumstances described by Mr Purdon. It needs to be understood that a taxpayer does not acquire a share under an employee share scheme if the taxpayer acquires a share as a result of exercising a right that the taxpayer acquired under an employee share scheme [subsection 139C(4) ITAA 1936]. Therefore, the exercise of an option is not a matter covered by Division 13A.

Australia has entered into an extensive number of bilateral taxation agreements with other jurisdictions, although there are no specific provisions in place that deal with share plans, to avoid circumstances where laws would result in the double taxation. In the extraordinary event that a double taxing point did occur, the taxpayer could avail themselves of the mutual agreement procedure article in the relevant double taxation treaty which provides relief from double tax by way of a credit for any foreign tax paid.

Whilst on the matter of options, the ATO has noted in a number of submissions concerns about the need to use the valuation tables provided in the legislation. We would like to highlight the following points:-

- there are limited numbers of qualified persons who can value options and the process can be expensive;
- calculations only take a few minutes; and
- provision of the tables seeks to provide small to medium enterprises with a low cost, low level of complexity and level playing field environment in which to issue options.

**Question 7**

*An article in a recent business publication claimed that salary sacrifice schemes are widespread.*[5]

- *Are such schemes in widespread use?*
- *Are they generally open to all employees or are they usually limited to executives?*
- *The report referred to above claimed that the salary sacrifice funded the entire value of the shares. Would such schemes operate under Division 13A?*
- *When the shares or options acquired under a pre-tax salary sacrifice scheme become liable to tax, at what point is the pre-tax sacrificed salary subject to taxation?*
- *Is the pre-tax sacrificed salary taxed as a separate item when the shares or rights become liable to taxation?*
- *At what rate are the shares or rights in a pre-tax salary sacrifice scheme taxed?*

We do not have any definitive data on the number salary sacrifice schemes in operation or who is actually participating in them. We are, however, aware of the increasing trend within the community to use these arrangements. These types of arrangements were once the preserve of senior management, however, the trend is for these arrangements to be increasing offered to a wider spectrum of employees.

Schemes using salary sacrifice arrangements to fund the purchase of shares can operate under Division 13A, provided the requirements of the Division are met. Division 13A operates to include any discount in the market value of the share in the employee's assessable income. The taxpayer may also become liable for CGT (on further gains above the value which was discounted) at the applicable rate when the shares or rights are sold.

As discussed above, because a discount may be included in the taxpayer's assessable income, the discount on the shares or rights in a pre-tax salary sacrifice scheme may be taxed at the individual's marginal rate of income tax.

Aware of the increasing use of salary sacrifice schemes the Commissioner has recently issued a Draft Taxation Ruling (*TR1999/D7*) which provides the ATO's preliminary, though considered, view on salary sacrifice. A copy is provided as Attachment B. However, it does not specifically deal with the issue you raise.

[5] Michael Laurence, "Ralph report leaves share plans out in the cold", *Business Review Weekly*, 5 November, 1999, p. 74.

**Question 8**

*Does the ATO have any views on the likely effects of the implementation of the Ralph review on the operation and development of employee share schemes?*

Refer to the answer provided in question 2. Apart from Recommendation 22.19 dealing with taxpayers leaving the country (see page 675 of *A Tax System Redesigned*), we do not perceive difficulty in preserving the provisions of Division 13A in the Business Tax Reform context. Even in the situation where an employee share scheme trust is taxed as an entity, under Business Tax Reform measures, the benefits to the recipients via Division 13A can be preserved. However, more specific comment in this regard is dependent on the final form of the Government's legislative package.

**Question 9**

*Do you have any specific suggestions that could further reduce the potential and actual abuse of share schemes beyond their intended legislative purpose?*

As indicated in the ATO submission we are of the view that aggressive tax planning in this area can be regulated under existing laws, including the anti-avoidance provisions, and the proposed integrity measures under Business Tax Reform.

**Question 10**

*Should a share scheme operating under Division 13A be permitted to use equities other than ordinary shares or rights to ordinary shares, (for example stapled securities)?*

The answer to this question is no. Division 13A requires that the shares or rights to acquire shares available under a scheme be ordinary shares. Experience with section 26AAC shows that there was a fair amount of abuse of other forms of securities, hence Division 13A was restricted to only ordinary shares.

Division 13A was introduced to encourage employees to make investment in their employer company and to share in the improvement through dividends and the accretion in value in the shares allocated under the scheme. Other equities would not participate fully in the control, management and rewards of participation in the employer company. As other equities would form part of the salary and wage package and would lack the reasons for concessional treatment that apply only to ordinary equity, they should be taxed immediately.

**Question 11**

*The cessation rules provide that taxation is assessable when an employee ceases the employment in respect of which the share or right was acquired under an employee share scheme operating under Division 13A. This effectively reduces the portability of shares and rights between jobs or the retention of shares and rights when a person ceases employment for family reasons.*

- *What would be the effect upon the revenue base of modifying the cessation conditions so that tax was payable only upon sale of the share or right?*

- *What is the rationale for preserving the existing cessation conditions?*

The ATO is unable to quantify the revenue impact of modifying the cessation conditions so that tax was payable only upon sale of the share or right, as we do not collect the necessary data needed to make such a calculation.

The overall rationale for Division 13A, from a taxation point of view, was to treat discounts received on the issue of shares from an employer as salary and wage income. The Division also provides a concession being a $1000 exemption and up to a ten year tax deferral mechanism. These benefits were provided for what is otherwise employee remuneration arising from an employer/employee relationship. Therefore, we do not see that it is unreasonable for a taxing point to arise at the end of this relationship. If the employer/employee relationship ends then any further gains from the arrangement would become just those of an investment scheme, with no claim to special tax benefits.

An issue that is being raised by a number of tax practitioners at the moment is the availability of the CGT discount for a share acquired on the exercise of an employee share scheme option. The main issue is that the options are often exercised at the time of resignation or retirement (generally by the trustee on behalf of the shareholder) and then immediately sold. These shares cannot qualify for the CGT discount because they have not been owned for at least 12 months prior to sale.

This policy approach has been maintained for all options under the original CGT provisions and throughout the process of developing the CGT discount legislation, reflecting the risks of ownership of the option (generally minimal) with the risks of ownership of a share (generally considerably greater).

## Question 12

*The following are excerpts from business publications.*

> *Case A*
>
> *Whenever Anderson meets staged short and long-term performance benchmarks, the trust will acquire BHP shares. However, Anderson could choose not to exercise his performance rights for up to 10 years and thus defer tax on the accumulated value acquired by the trust during this period. Meanwhile, he receives all dividends.*
>
> *If he had taken the conventional course of immediately taking the rights in his own name, he would have had no access to the dividends before the rights were exercised. He receives the double benefit of tax deferral and a large income. Anderson will pay nothing for either the rights or, provided the performance goals are met, the shares themselves.*
>
> *BHP can claim tax deductions for the cost of providing shares and, under a clause in the FBT Act, employee shares and options held in trust are not subject to fringe benefits tax, provided the securities are in the employer's company. Anderson's "performance rights" are options by another name.*[6]
>
> *Case B*
>
> *Incentive share/option plans. No personal tax is payable in the year that the awards are promised. With shares, capital gains tax (CGT) usually becomes payable by the executive in the year that the actual stock is placed in the person's name. (With most incentive share schemes for executives, all - or a portion - of the shares are vested in the individual after three years provided performance hurdles are met.) With options, the executive generally does not pay CGT until the options are exercised some years after issue, even if the value of the underlying shares has increased markedly in the meantime.*
>
> *Salary sacrifice share schemes. These typically vest in the employee each year. Straight salary or cash bonuses are frequently exchanged for extra contributions to such plans. An employee does not pay tax on the shares - apart from income tax on annual dividends - until the sale of the stock, termination of employment or until 10 years after acquisition. At the point of taxation, CGT becomes payable on the full value of the shares.*[7]
>
> *Case C*
>
> *The first type of plan allows employees to devote a pre-tax amount of $1000 of their income each year to buy shares (the $1000 always remains tax free while subsequent gains are subject to capital gains tax). And the second type of plan provides for employees to direct unlimited portions of pre-tax salary each year to fund the entire value of the shares (the initial amount invested each year plus gains are subject to income tax yet the impost is deferred for up to 10 years). Income tax on tax-deferred plans must be paid after 10 years or earlier if the shares are sold or employment is terminated.*[8] *….*

- *Can you explain in detail how these schemes work, indicating the taxing points and the rates of taxation.*
- *Does the Commissioner have sufficient powers to ensure that participants in schemes such as these are taxed at the appropriate rate?*

The following information is supplied on a general basis as the ATO is precluded by law from making public comments on taxpayers, unless for a specific purpose under the Income Tax Assessment Act.

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[6] Michael Laurence, "A creative deal for BHP's new boss", *Business Review Weekly* 8 Feb, 1999, 21 (1999).
[7] *Business Review Weekly*, June 22, 20 (1998); http://www.brw.com.au/content/220698/brw39.htm
[8] *Business Review Weekly*, Ralph report leaves share plans out in the cold", 5 November, 21 (1999), p. 74.

## Case A

In this scenario a taxpayer can chose not to exercise their "performance rights" for up to 10 years. This deferral is available to all employee share schemes under Division 13A. An assumption is made that the scheme does come within this Division.

It is not clear from the example how a taxpayer is to have access to dividends before they have exercised their rights. There must be a special arrangement between the employer, the trustee, and the taxpayer for this to occur. Arrangements of this nature would be of interest to the ATO as they may attract the general anti-avoidance rules associated with franking credit manipulation. In the event that a taxpayer were to receive dividends in this situation, they should be returned in the year that they become entitle to them. The taxpayer would pay marginal tax rate less any franking credits.

The statement that a taxpayer will pay nothing for the rights or shares can be explained in that they are given to the taxpayer as a bonus which they may choose to defer the payment of or exercising their rights to for 10 years. After this time however tax should be paid on:

a) the original discount received on the rights and/or shares (the correct value of the rights should be determined up front and the cost base of the shares should be established at this point also), and

b) the difference between the cost base and sale price will be subject to CGT.

The employee can claim a deduction for the shares when the rights are exercised and there will be no FBT payable.

## Case B

The scenario in paragraph 1 is correct, the Division 13A legislation provides for course of action.

With regards to the second paragraph, income tax is payable on the discount and CGT on the difference up to selling price.

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## Case C

This scenario is also correct. The first plan referred to is the tax-exempt scheme and although it says that only $1000 can be sacrificed, if more salary is sacrificed, then tax is paid at marginal rates for any discount over $1000.

The Income Tax Assessment Act currently provides the Commissioner of Taxation with sufficient powers to undertake compliance activities around employee share schemes. However, any dilution of the Commissioner’s access powers might affect this position.

**Question 13**

*Please estimate the cost to the revenue of the Commonwealth, at present levels of employee share scheme participation, of increasing the $1,000 concession to $1,200, $1,500 and $2,000, respectively.*

The ATO is unable to reliably estimate the cost to revenue of any change to the $1,000 concession as data on income from employee share schemes is not captured on taxpayer's tax returns.

It is noted that some practitioners are indicating that if the concessional limit were increased, then, increasing numbers of employees would take larger parcels of shares. In this regard it must be remembered that the setting of the $1,000 limit was struck in the context that it provided a reasonable concession for a larger parcel of shares. The concession was never intended to be a "limit" to a number of wholly tax-free shares to be issued by an employer.

**Question 14**

*Would the administration of share schemes, from a taxation point of view, whether currently falling under Division 13A or not, be facilitated by establishing share schemes under their own, "stand alone" legislation?*

The ATO is aware of current UK initiatives announced in their March 1999 budget and the draft legislation issued on 10 November 1999 for comment and consultation. The ATO would make the following points:-

i. The UK does not have Australia's comprehensive superannuation legislation to promote retirement savings; and

ii. The UK tax legislation is structured on a "schedule" basis much like our current wholesale sales tax structure.

If Division 13A was to be replaced with a broader "stand alone" piece of legislation covering all employee share arrangements we would foresee a number of complications because, unlike the UK and some other jurisdictions, Australia has a "global" personal tax system. That is to say that all the provisions are integrated and inter-connected.

For example the current Division 13A is integrated into the remainder of the Income Tax Assessment Act by references to CGT and FBT legislation which were amended on the introduction of this Division. From a design point of view, if a UK style piece of legislation were implemented, it may be beneficial to make reference to these (CGT & FBT) provisions or even consider the possibility of including these concepts under the "new" employee share scheme umbrella.

Without seeing an outline of what may be proposed, our current view would be that a stand alone piece of legislation may in fact add more complexity and compliance costs.

**Question 15**

*On the next page is a flow chart indicating the way that Division 13A operates.*

*i). Please advise the Committee on the accuracy of this chart and how it may be improved;*

*ii). In particular please confirm the fundamental division of ESOP schemes into*

*a). those that fall outside division 13A, because they fail to meet the criteria for an employee share scheme under Division 13A, as defined in sec 139C, and*

*b). those schemes that are employee share schemes for the purposes of Division 13A, because they do satisfy the conditions in sec 139C.*

*iii). Two of the boxes in the flow chart contain questions, indicating points about which we are uncertain. We would be grateful for answers you may be able to provide.*

**EMPLOYEE SHARE SCHEMES THAT DO NOT FALL UNDER DIVISION 13A BOX**

Acquisitions of shares or rights to acquire shares under the ESS schemes can only be assessed under Division 13A or section 26AAC of the ITAA 1936 (the Act). If they fall outside these provisions, they are not ESS schemes and other provisions of the Act such as CGT or FBT may apply. Section 26AAC (with some exceptions) applies to shares or rights acquired before 28 March 1995. The section does not apply to shares or rights to acquire shares at market value or above market value. It only applies to shares or rights acquired below market value. The answers to your questions in the box are as follows:

- The taxpayer is assessable in the year of acquisition of shares or rights, on the discount they receive in respect of those shares. The discount is the difference between the value of the share when it was acquired, less any consideration paid or payable for the share or right by the taxpayer. The value of the share is the market value of the share on the day of acquisition.

- The discount or the benefit acquired is included in the taxpayer's assessable income in the year the shares or rights are acquired and is taxed at marginal income tax rates. Discounts on shares or rights acquired by a taxpayer under an employee share acquisition scheme will qualify for exclusion from assessable income up to a maximum of $200 per year where certain conditions [see subsections 26AAC(4A) and (4B)] are satisfied.

- Where a taxpayer acquires a share that is subject to conditions and restrictions, the share is deemed to have been acquired when the conditions or restrictions cease to operate or immediately before the taxpayer's disposal of the share, whichever occurs first. Therefore, in such instances taxation of discount on the shares is deferred. However, where a share which is subject to restrictions or conditions is acquired by an employee after 19 September 1985, the employee may elect that the assessment of the benefit not be deferred [see subsections 26AAC(15A) and (15C)]. Capital gains tax provisions will apply to any subsequent sale of those shares, with any gain or loss assessed by comparison to the value from which the taxed discount was estimated.

- Refer to revised diagram contained in Attachment A.