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**ESOPs - reforms to help Australian Companies attract key executives**

Thank you for the opportunity to present to your committee on reforms to ESOPs which will help small Australian Venture Capital backed companies attract senior executives.

We recommend the following reforms:

1. That employees who receive options are treated for tax purposes in the same way as ordinary option holders who are not employees i.e., they are liable for CGT
2. Replace the 5% limitation on ownership and control with 30% to enable larger option plans to be given to employees
3. Amend s. 139fb of the Act so that it states that Directors valuations are an acceptable valuation methodology. Current practice requires independent valuations which can cost small companies up to \$30,000

We thank you again for the opportunity to submit these recommendations, which if implemented, will significantly enhance the ability of small Australian Venture Capital backed companies to attract world best executives from world best corporates.

Yours sincerely,

**ANDREW GREEN**  
**Executive Director**

## **EMPLOYEE SHARE OPTION PLANS**

### **CAPITAL GAINS TAX CHANGES**

There should be no distinction between capital gains made by employees and ordinary shareholders. Therefore the gains made by an employee from future increases in value of the company should fall to be taxed as capital gains.

The discount given between the value of the share on the day of issue and the exercise price, should be treated as income. Any gain over and above this should be taxed as a capital gain.

This treatment is line with the US system.

### **THE 5% RULE**

There is no logical reason why the number of shares issued to a particular individual should be limited to 5 % of the voting shares in a company.

This is particularly so for Venture Capital backed small companies that are trying to attract highly skilled and paid executives. These individuals will only join these companies, if they have a large participation in the increase in value of the Venture Capital backed companies.

### **PRIVATE COMPANY VALUATION RULES**

Section 139FB of the 1936 Act is too restrictive in relation to the valuations of private companies for the purpose of determining the discount that may exist in an employee share option.

At the moment the law requires a valuation from a qualified person who is defined to be:

- A registered company auditor who is NOT,
- A director, secretary or employee of the company, etc.

The valuations of private companies under the above requirement in practice would cost \$5 - 100 K, depending on the size of the company.

Our recommendation is that a director or a shareholder should be able to value a private company. These people are in the best position to determine a value and have a vested interest in getting the valuation right.

Yours sincerely

DELOITTE TAX SERVICES

## ORDINARY INCOME v CAPITAL GAINS

Facts	
Share price today	\$1.00
exercise price	\$1.00
term of option	5 years"
market value in 5 years	\$2.50

### Alternative One - tax on exercise of Option

Gain made (\$2.50 - \$1.00)	\$1.50	
<b>Tax @ 48.5%</b>		<b>\$0.73</b>

### Alternative Two - elect tax Upfront

Gain upfront - ordinary income (\$1.00 * 11.6%)	\$0.12	
<b>Tax @ 48.5%</b>	<b>\$0.06</b>	
Capital on sale of shares (\$2.50 - \$1.00 - \$0.12)	\$1.38	
<b>Tax @ 48.5% * \$1.38/2</b>	<b>\$0.34</b>	
<b>Total Tax</b>		<b>\$0.39</b>