

**Senate Standing Committee on Economics**

**ANSWERS TO QUESTIONS ON NOTICE**

**Treasury Portfolio**

Additional Estimates

10 – 11 February 2010

**Question: aet 65**

**Topic: PC Report ‘Executive Remuneration in Australia’  
– Tax Issues**

**Hansard Page: Written**

**Senator CAMERON asked:**

1. Despite the PC's observation in Chapter 10 that using the tax system to "constrain particular components of executive remuneration can have perverse consequences" (p.325), does the PC consider that the favourable tax treatment of equity base executive remuneration relative to cash salary remuneration is leading to increasing complexity and lack of transparency?
2. In the report (Chapter 10), the PC canvasses tax issues in relation to executive remuneration at some length but makes absolutely no recommendations or findings in this regard. Does the PC consider that this aspect of executive remuneration should be the sole province of the Henry Tax Review? If not, does the PC have any suggestions for reform of the taxation arrangements of executive pay? In other words, does the PC believe that current tax arrangements are optimal?

**Answer:**

1. Taxation of equity-based payments is complex as they may be taxed as salary or substitutes for salary, fringe benefits, or capital gains. There are also several points in time at which tax can apply and the value of future, or contingent, equity rights can be difficult to determine. Consequently, the timing of the taxation of equity-based payments and the value placed on equity can have a significant influence on the total amount of tax paid. Clearly, equity based pay is more complex and less transparent (ex ante) than cash salary and, depending on circumstances, the tax treatment may or may not be more ‘favourable’ (see 327-36). Whether taxation treatment ‘drives’ equity based payments is moot, because such forms of payment are a key means of overcoming principal-agent problems to ensure greater alignment between executives and shareholders. Equity based payments are advocated by boards, shareholders, corporate governance advisers and international and domestic regulatory authorities such as the G20 and APRA.
2. The Terms of Reference directed the Commission to ‘liaise with the Australia’s Future Tax System Review and the Australian Prudential Regulatory Authority in relation to, respectively, any taxation and financial sector remuneration issues arising out of this Review’. As noted in chapter 10,

The Australian tax system does not specifically target executive remuneration quantum or structure (p. 325).

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The Commission took the view that, apart from the highly context-specific matter subject to recommendation 13, it would not have been appropriate to single out executive remuneration in a piecemeal fashion for special tax arrangements while a fundamental ‘root and branch’ evaluation of the Australian tax system was under way.

Moreover, proposals to constrain executives’ pay pose obvious difficulties in deciding on the ‘price’ and adjusting it over time such that there is an appropriate balance of supply and demand in the market. Getting this wrong could be damaging to Australia’s national economic interests (see pp 359-61).