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By Email: *ESSreforms@treasury.gov.au*

Dear Nathania

EMPLOYEE SHARE SCHEMES

1. Thank you for the opportunity to provide comments on the Treasury Consultation Paper titled Employee Share Schemes ("**Consultation Paper**").

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many small businesses that would be impacted by any changes to the regulation and taxation of an employee share scheme ("**ESS**").

3. We note that the Consultation Paper is primarily seeking feedback on the specific Government's proposals announced on 13 November 2018 that relate to the regulatory framework for employee share schemes. However, our view is that reforms in these areas, while welcome, will only produce minimal benefits (e.g. minor cost savings) in supporting small and medium sized businesses in implementing arrangements to attract and retain the right staff to help their business grow and prosper.

4. In contrast, we believe that changes to the tax treatment of ESSs will go much further in encouraging small and medium business and their employees in using such arrangements that align the interests of the employer with that of the employee. In our view, the key issue with the taxation of ESSs is the crystallisation of an up-front unfunded tax liability that arises in many situations in relation to interests that cannot readily be sold. This causes such business to abandon or limit their plans for an ESS or to enter into alternate arrangements such as loan-backed schemes and share buy-back which contain their own complexities and challenges.

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5. While the tax concessions for “start-ups” were a positive step in support of the use of ESSs, the taxation hurdle posed by the current treatment of ESSs continues to be a major impediment for other small and medium companies in using such arrangements.

6. We note that some of our suggestions may possibly come at a cost to revenue. This would need to be weighed up against the potential economic benefits and boost to productivity and growth as outlined on page 3 of the Consultation Paper.

7. The following are high-level comments on other key (non-tax) hurdles preventing small businesses from implementing an ESS.

   7.1. **Cost of advice and implementation –** The Australian Taxation Office (“**ATO**”) template rules are a positive step to reduce the cost of implementation for “start-ups”. However, they tend not to be used once venture capital or private equity is involved, or where the small business has bespoke shareholders agreements. Where the ATO template rules are not adopted, the average cost of business advisory, tax advisory and legal fees for design, drafting and implementation of a scheme is approximately $30,000 (plus GST). In addition to the costs of ongoing administration, this can be prohibitive on a per-head basis.

   7.2. **Privacy concerns (employees being aware of other employee offerings) and the high cost of using employee share trusts to alleviate this –** Employee share trusts provide an added advantage of allowing employees to maintain their privacy (e.g. their fellow employees could simply search ASIC to find out the shareholders of the company and the quantum of shares held). However, employee **s**hare trusts are complex vehicles to manage and require strong taxation advisory support, in addition to the costs generated by the AFSL requirements. As a consequence, it is difficult for employers to be able to make equity offers to employees and maintain their privacy.

   7.3. **Administration concerns on exit –** Most small and medium businesses do not want to retain departed employees on their equity register, meaning the exit of an employee requires a share buy-back or some equivalent exit event. This creates a funding issue for the company This tends to limit the range and quantity of employees that such companies are willing to consider for participation in the ESS. The narrower the employee class (and more senior) the lower the expected turnover of staff who hold shares reducing the obligations on exit as well as tax and reporting considerations. These concerns undermine the potential benefits of broader participation in the ESS.

   7.4. **Regulatory constraints –** The scope of the ASIC Class Order for unlisted companies is very limited, and we have no experience of a client relying on this class order, such is its limited scope.

8. Our submission seeks to address many of the questions contained in the Consultation Paper but focusses primarily on the tax impediments that make it difficult or impractical for small businesses to establish ESSs or similar forms of employee remuneration.

9. We have included our detailed comments with respect to the key tax considerations for ESSs in Appendix A and responses to specific questions posed in the Consultation Paper in Appendix B.

10. If you would like to discuss any aspect of this submission, please contact either Ali Suleyman on (03) 8610 5520 or Alexis Kokkinos on (03) 8610 5170 or Michael Dundas on (02) 8236 7788.

Yours sincerely

A M KOKKINOS
Executive Director

Yours sincerely

A SULEYMAN
Executive Director

APPENDIX A - TAX CONSIDERATIONS

11. In this section, we have provided detailed comments with respect to key tax considerations for ESS that we believe are currently acting as an impediment to the middle market using ESS to reward employees. While we acknowledge that changes to these rules may come at a cost to revenue this is uncertain as, in our experience, we find it rare for small and medium businesses to enter into ESSs which are taxed upfront. Consequently, we believe that changes to the tax treatment of ESSs will primarily result in more businesses in this market entering into such arrangements rather provide a tax saving for those that would enter into such arrangements under the current rules despite the adverse tax outcomes.

12. Our comments in this Appendix relate to:

    12.1. the taxing point for employees;

    12.2. share buy-backs of employee shares;

    12.3. the implications of Division 7A where loans are used to fund ESSs;

    12.4. availability of the capital gains tax ("**CGT**") discount on a disposal of employee shares;

    12.5. dividend imputation in respect of certain employee shares;

    12.6. CGT rules where employee share trusts are used; and

    12.7. valuation requirements.

13. A common theme that arises out of our comments below is that the rules can often result in funding pressures in relation to the ESS that discourage many smaller businesses from entering into ESSs.

Taxing point for employees

14. The legislative framework in Division 83A of the *Income Tax Assessment Act 1997* ("**ITAA 1997**") broadly results in the taxing point occurring at a time before the employee has cash to fund the tax liability (in addition to the liability to pay a premium or exercise price where applicable). This creates a material and often insurmountable hurdle for companies, especially those not seeking a trade sale or IPO in the medium term. Further, this often encourages the employee to sell the share, defeating a key purpose of implementing the scheme in the first place.

15. For most small and medium businesses which operate through unlisted companies, the sale may be impractical due to there being no liquid market for the shares or otherwise restricted by a shareholders' agreement. Although a share buy-back by the company can provide a means for the employee to liquidate their shares, this cost would need to be funded by the company and may give rise to further tax issues (see below).

16. The taxing point occurring prior to the receipt of cash by the employee is the key barrier limiting the prevalence of traditional ESSs and results in business seeking to use other arrangement (e.g. loan plans). Alignment of the due date of the tax liability to the cash receipt would, in our view, remove the most significant factor that discourages employees from participating in ESSs.

17. This could be achieved in a manner similar to that which applies to deferred settlements for the sale of CGT assets – see *Taxation Determination TD 94/89*. The gain or assessable amount could be calculated in the exact same way but only becomes certain once a sale occurs. The employee would then have the obligation to amend his or her tax return with an unlimited period to do so.

Share buy-backs

18. Division 16K of the *Income Tax Assessment Act 1936* ("**ITAA 1936**") contains the income tax rules in respect of share buy-backs. One of the features of the rules for off-market share buy-backs is that the shareholder is deemed to have disposed of their shares at their market value where this is greater than the buy-back price – see subsection 159GZZZQ(2).

19. Take the example where the employee originally purchased their shares for full value but funded this with a limited recourse loan from the company on the condition that if they cease employment the company will be able to buy-back the shares as consideration for waiving the employee obligation to repay any remaining loan. Despite otherwise dealing at arm's length, the provisions would deem the employee to have received the full market value if it exceeds the remaining loan balance.

20. This results in a further (unfunded) taxation liability for the employee as well as a further need to value these unlisted shares to determine this.

21. A carveout for employee shares from this deemed market value rule would prevent this adverse outcome on exit which acts a further discouraging factor for employees and employers when considering whether or not to participate in an ESS.

Division 7A

Treatment of loans to fund ESS

22. The rules in Division 7A of Part III of ITAA 1936 seek to treat a payment, loan or debt forgiveness provided by a private company to a current or former shareholder (or their associate) as a deemed dividend where the company has profits.

23. Notably, Division 7A does not apply to future shareholders. This creates an arbitrary outcome where a private company can, without any Division 7A consequences, lend to an employee for the purpose of their initial acquisition of shares in the company (i.e. a once-off lending opportunity). Afterwards, the employee becomes a shareholder and Division 7A will apply to any subsequent loans.

24. Any future loans will need to charge interest at a benchmark rate, be for no longer than 7 years and require a repayment of principal and interest every year. This in turn

provides another near insurmountable funding pressure on the ESS arrangement, as small to medium businesses cannot typically sustain dividend flows to allow the employees to meet these annual repayments nor do the employees typically have the personal savings to make these loan repayments. Further, even if the loan repayments are funded by company dividends, the setting off of the dividend against the loan does not result in the employee receiving any cash to pay tax on the dividend that is fully in his or her hands.

25. An existing Division 7A exception exists for loans used to acquire ESS interests to which certain provision of Division 83-A of ITAA 1997 apply – see section 109NB of ITAA 1936. This means that the terms of the entire loan may not need to comply with Division 7A requirements if it is used to acquire ESS interests at a small (e.g. 1%) discount to their market value but not where the ESS interests are not acquired for any discount (i.e. acquired at their full value).

26. The inconsistent Division 7A treatment for existing employee shareholders compared to prospective employee shareholders and for shares offered at some discount compared to no discount could be resolved with a broad Division 7A exemption for loans made to an employee to acquire ESS interests in the company.

Debt forgiveness

27. Following on from the example mentioned above in relation to share buy-backs, the market value of the share may have decreased to less than the outstanding loan balance. If the company discharges the loan in full, the excess over the market value of the shares may be considered to be a debt forgiveness.

28. We note that *ATO ID 2003/317* concludes that such a discharge of a loan in these circumstances does not give rise to a debt waiver for Fringe Benefits Tax ("**FBT**") purposes because the transfer of property in full and final satisfaction of a loan is not considered to be a release or waiver. However, a debt forgiveness for income tax purposes can also occur where a debt is extinguished other than by repaying the debt in full – see paragraph 245-35(a) of ITAA 1997.

29. Some further clarity around this issue as well as whether subsection 109F(4) of ITAA 1936 applies as an exception for Division 7A purposes would provide further certainty to taxpayers who have entered into ESS loan plans. Subsection 109F(4) states that an amount of debt is not forgiven where it is discharged by a payment consisting of a transfer of property (e.g. shares).

CGT discount and 12-month holding rule

30. The 50% CGT discount rules include a special rule in Item 9A of the table in subsection 115-30(1) of ITAA 1997. This rule deems employee shares that were acquired as a result of the exercise of a right or option to have been acquired at the time the right or option was acquired only if the acquisition of the right or option was eligible for the concession applicable to "start-up" companies.

31. For companies that weren't start-ups, the employee would be required to hold the shares for 12 months after exercise to be eligible for the CGT discount. This can be

problematic where the proceeds from the sale of the share are needed to fund the tax liability under the ESS rules.

32. Given that the economic gain is made for the period between obtaining the right or option and the ultimate sale of the share, expanding this deemed acquisition time treatment for all employee shares acquired through the exercise of a right or option will provide a further incentive for employees to participate in ESSs.

Employee shares and the 45-day rule

33. Employees who received franked dividends on their employee shares must be a qualified person to obtain the relevant imputation benefits – see paragraph 207-145(1)(a) of IAA 1997. This may require the employee to hold the shares “at risk” for 45 days in the relevant qualification period in accordance with Division 1A of former Part IIIAA of ITAA 1936.

34. The “at risk” requirement is determined by considering the “positions” held by the shareholder and whether these result in the shareholder having a delta of +0.3 or above – former subsection 160APHM(2). The definition of a “position” in former subsection 160APHJ(2) disregards the conditions attached to employee share scheme securities that prevent the holder from disposing of the share. Employee share scheme security is defined in former section 160APHD by reference to Division 13A of Part III of ITAA 1936 (i.e. the predecessor to Division 83A of ITAA 1997) which ceased to have effect from 1 July 2009.

35. This outdated legislative reference should be updated as it otherwise leaves employees in some doubt about their eligibility for imputation benefits in relation to dividends received on their employee shares.

36. Further, we note that a non-recourse loan made to acquire the share can be considered to be a position under former paragraph 160APHJ(2)(f). Paragraph 4.54 of the explanatory memorandum to the *Taxation Laws Amendment Bill (No. 2) 1999* notes that a non-recourse loan repayable up to the value of the shares effectively contains a put option (i.e. a short position).

37. Further to the examples mentioned above, many loan plans for the acquisition of employee shares are funded by such non-recourse loans. Where franked dividends are paid on these shares while such loans remain on foot, there is uncertainty and complexity for employee shareholders in calculating their net position in relation to the shares.

38. An exception to non-recourse loans being considered a position in the case of employee shares, similar to that which intends to disregard the restriction on disposal, would significantly reduce complexity and uncertainty for those participating in ESSs.

Exemptions from CGT events E5 and E7 where employee share trusts used for loan schemes – unlisted companies

39. The rules in Division 83A of ITAA 1997 are meant to be the primary taxing rules for ESS interests. Subdivision 130-D of ITAA 1997 was introduced under the same amending

legislation to help clarify the interactions between the main ESS rules and the general CGT regime to give primacy to Division 83-A during the period of deferred taxation – see section 130-75.

40. The CGT amendments in sections 130-80 to 130-90 also included rules where the ESS interests are held by employee share trusts. In particular, these deem the employee beneficiary of the trust to be absolutely entitled to the underlying share or right held by the trust when they acquire the ESS interest (under subsection 130-85(2)). The beneficiary is provided with a CGT exemption (e.g. from CGT event E5) in relation to this deemed absolute entitlement under section 130-80. Further, the employee share trust and the employee beneficiary are provided with exemptions under from CGT events E5 and E7 under section 130-90 in certain circumstances (e.g. vesting of rights or transfer of shares from the trust to the employee).

41. It is important to note that these rules only apply where the ESS interest is one to which Subdivision 83A-B or 83A-C apply. Sections 83A-20 and 83A-105 set out when these respective Subdivisions apply to ESS interests and a requirement common to both is that the interest was acquired at a discount.

42. Similar to our comments in relation to Division 7A, these rules will therefore not apply to loan funded schemes where full value is provided for the ESS interests but would apply if the interests were acquired at a small (e.g. 1% discount).

43. This creates further risk and uncertainty for employees participating in loan-backed ESSs involving an employee share trust as the ordinary CGT rules would apply. The risk of these CGT events applying could result in the crystallisation of a tax liability for the employee before any cash is received for the disposal of any shares. See our discussion above in relation to the deferred taxing point and treatment of share buy-backs for the issues this raises.

44. Further, where the rules in Subdivision 130-D do not apply there would also be a need to conduct a costly analysis of complex concepts such as absolute entitlement to determine if and when an employee becomes absolutely entitled to the ESS interest against the trustee. The ATO's draft ruling on absolute entitlement (*Taxation Ruling TR 2004/D25*) is yet to be finalised nearly 15 years after its publication due to the uncertainty of this concept.

45. We would support a broader application of the rules in Subdivision 130-D to all ESS interests (whether acquired at a discount or not) where they are held through an employee share trust where the company is an **unlisted company**. This would ensure that loan-backed arrangements are covered for shareholders who do not have a readily available market to liquidate their interests are not taxed on unrealised gains before they have the means to fund the tax liability.

Scope of definition of "employee share trust"

46. We also note that from our experience, the ATO has taken a very narrow definition of the meaning of employee share trust contained in subsection 130-85(4) of ITAA 1997. To meet the definition, the trust's sole activities may only be those listed in the paragraphs of that subsection. In particular, paragraph (c) permits the trust's

activities to include those that are merely incidental to those in paragraphs (a) and (b). The ATO has consistently ruled that where the trust lends to the employees to enable them to acquire an ESS interest that this activity goes beyond one that is merely incidental.

47. This view results in the CGT exemptions in Subdivision 130-D not applying to the trust or any of its beneficiaries with the resultant complexities outlined above. A relaxation of this overly narrow view will further assist small and medium businesses in implementing and funding ESSs

Valuation requirements

Valuation of shares

48. Unlisted companies have no liquid secondary market for their shares and therefore do not have a simple means to determine their market value at any point in time. In order to determine the tax consequences of issuing ESS interests, a costly valuation needs to be obtained every time these are issued in order to properly comply with the tax regime (e.g. to quantify what discount, if any, the ESS interests are issued at). Furthermore, there is a significant risk that the assumptions used in such a valuation could be challenged by the ATO, due to the complexity involved in valuing such entities.

49. While recent capital raising or share sale transactions may be used as a proxy, these do not provide certainty that the Australian Taxation will agree with these proxies as being the true market values.

50. Although the ATO has, by way of legislative instrument ESS 2015/1, approved two safe harbour valuation methodologies (the Net Tangible Asset and CFO Valuation methods), these are limited in scope. They can only be used by “start-ups” and not existing mature (albeit small or medium) businesses. Further, various other restrictions contained in Division 83A of ITAA 1997 need to be satisfied before a company can be considered a “start-up” and access the ability to rely on these safe harbour methodologies.

51. The expansion of these safe harbour methodologies to all small and medium businesses (regardless of how long the company has existed) and all kinds of ESS interests would remove a key impediment to the take-up of ESSs. This could be expanded to any company that has an aggregated turnover of less than $50m in the most recent year, consistent with the current requirement in subsection 83A-33(5) of ITAA 1997.

Valuation of options

52. We note that while Division 83A of the *Income Tax Assessment Regulations 1997*, provides useful concessionary valuation tables in respect of ESS interests that are unlisted options and rights, these rules still require the company and its underlying shares to be valued (see regulation 83A.315.02(1)(a)).

53. Further, these concessionary tables only apply for the purposes of Division 83A of ITAA 1997 and not for other purposes. For example, if an employee acquires options using the concessionary values contained in the regulations, these may still be considered to be acquired at below market value of the purposes of Fringe Benefits Tax ("**FBT**") creating a residual tax exposure for the employer.

54. Broadening the scope of safe harbour valuation methodologies and aligning the income tax and FBT treatment of ESS interests will simplify the valuation requirements and remove some of the significant barriers to companies implementing ESSs or expanding their current ESSs.

APPENDIX B – RESPONSES TO QUESTIONS IN THE CONSULTATION PAPER

Question 1

Question 1.1 – Do you support consolidating and simplifying the statutory exemptions and ASIC Class Order [CO 14/1001] in the Corporations Act?

55. Yes.

Question 1.2 – Does the complexity of the current regulatory framework for ESSs create significant difficulties for businesses looking to offer an ESS?

56. The current regulatory framework creates difficulties, but in our view, they are not the leading hurdles to the implementation of ESS programs (these are outlined in Appendix A). Where the regulatory framework creates the most issues is the access to the disclosure and licensing exemptions. The cost of compliance with disclosure and licensing requirements is material and failure to meet an exemption from these provisions will generally cause a small or medium business to abandon the creation of an ESS.

57. In turn, while the ASIC Class Order endeavours to provide clear overriding access to key exemptions, it has an extremely limited scope and is rarely of any practical use.

Question 1.3 – Would there be significant benefits or risks for business in consolidating and simplifying the current regulatory regime?

58. Our view is that the issue with the statutory provisions are that:

    58.1. it is complex to understand the various disclosure and licensing exemptions and be cognisant of when a given scheme falls within or outside of these; and

    58.2. the exemptions do not go far enough to support low-cost administration of schemes that thread the needle of the complex array of non-regulatory ESS hurdles.

59. Accordingly, the mere simplifying and consolidation of the <u>existing</u> provisions would result in minimal benefits and risks. While this may help with clarity, it would not have a material impact on the underlying objective of increasing participation in ESSs by small and medium businesses.

Question 1.4 – Would compliance be significantly easier if the obligations applying to ESSs were all contained in the Corporations Act?

60. This approach would be preferable and make compliance easier, but this consideration is subordinate to what the obligations and exemptions actually are.

Question 1.5 – Are there significant advantages or disadvantages in using ASIC class orders as opposed to primary legislation to regulate ESSs?

61. Using class orders may offer more flexibility as ASIC would be able to maintain and adapt these more readily than Parliament can amend legislation.

Question 1.6 – Are there any requirements or conditions of the ASIC class order that should be removed or amended as part of the consolidation?

62. With a focus for unlisted entities, we recommend the expansion of the range of financial products that can be issued.

    62.1. It is important to understand that the continuing primary hurdle for small to medium businesses in adopting an ESS is the taxation provisions that create a taxation event at a time when there is no liquidity in the ESS instrument. This creates a funding issue that puts significant burden on creating an effective ESS program.

    62.2. In turn, such businesses are forced to consider arrangements that better align the timing of taxation events to cash flow events. This can include schemes such as:

        62.2.1. company loan-backed share schemes which tend to attach a limited recourse company loan to the acquisition of shares. Not without its tax complexity (see Appendix A above), these schemes tend to operate such that the employee receives cash on exit from the scheme equal to the spread between the loan/issue price and the exit price; and

        62.2.2. share and option schemes involving alternate share classes which tend to provide an advantage due to the ability to control the taxing point of the instrument (i.e. at grant rather vs vesting/exercise) and the ability to offer tailored dividend rates.

    62.3. While there are many other types of arrangements it is important that the regulatory provisions duly acknowledge these arrangements and provide reasonable avenues to regulatory relief without diluting the underlying protections of the provisions.

    62.4. We recommend that the regulatory regime for ESSs:

        62.4.1. allow schemes involving alternate share classes for unlisted companies. The scope of the alternate share class could be limited to prevent abuse;

        62.4.2. amendments to the nominal monetary consideration provisions to recognise the difference between schemes whereby the “consideration” is provided by the company as part of the ESS package, as compared to schemes where “consideration” is provided from the employees personal or external resources; and

62.4.3. consider deferred disclosure requirements for option schemes with an exercise price so that disclosure is required at the time of exercise rather than the time of grant of the option.

62.5. We recommend abolition of the $5,000 per year value limitation per employee. This limitation precludes the Class Order applying to arrangements involving senior leadership and fails to take into account that most arrangements involve a once-off offer to employees (as against an annual attribution). In considering ways to provide employee protections, without a specific value per year limited, we would support:

62.5.1. any limitation being tied to a percentage of the employee's non-equity remuneration (for example, up to 50% per annum of an employee's non-equity remuneration);

62.5.2. the value limitation being based on an average over a period of time (say 3 or 5 years) to provide more scope for larger "once-off" grant programs; and/or

62.5.3. a value limitation aligned with the percentage of fully-diluted equity holding of the recipient after any given grant (the basis being that more material equity positions warrant more financial disclosure). Ideally, in this case, the financial disclosure requirements would be scaled under the Class Order and be slow to revert to the general prospectus and public offer requirements of the Act.

Question 1.7 – Should ASIC be given an additional power to determine that a company should not be permitted to rely on a statutory exemption for an ESS?

63. Fundamental to our view is that access to statutory exemptions is not only a key requirement of unlisted entities in considering an ESS, but that the exemptions need to be easier to understand, easier to apply, and extended in application.

64. If the inference in this question is that either a small business needs to apply to ASIC for an exemption or that exemption access be tightened, then no we do not support this.

Question 2

Question 2.1 – Do you support increasing the offer cap per employee?

65. As per our response to question 1.6, we believe that a fixed cap should be abolished altogether. An annual offer cap is a fundamentally flawed concept and will not be able to generate the breadth of access to the Class Order that we consider to be important.

Question 2.2 – What are the benefits or risks of increasing the employee offer cap?

66. We accept that an offer cap has the benefit of reducing the risk of the employee of receiving an equity instrument without the full reporting and processes contemplated under the Act.

67. The benefit of increasing the cap, or expanding the scope of the Class Order, is that it encourages more companies to implement an ESS under reduced requirements (consistent with the objective of promoting participation in ESSs).

68. We consider there to be a different risk where employees are contributing capital from their own resources in contrast to the situation where the ESS involves nominal consideration or a limited recourse company funding arrangement. Accordingly, we see it important to differentiate these arrangements.

Question 2.3 - Is a $10,000 limit per employee per year appropriate or is a greater increase appropriate?

69. No. In our view, increasing the limit to $10,000 would have little to no impact. Refer to our response to question 1.6. However, we note that any limit in excess of $5,000 is preferable to the current limit.

Question 2.4 – Should senior managers (within the meaning of s9 of the Corporations Act) be excluded from this cap?

70. This is certainly one option to address the shortcomings of the offer cap. However, this in turn would still create flaws in so far as dealing with “middle managers” (those key employees that still warrant participation over and above $10,000 per annum). Further, it does not address the ESSs involving a “once-only” moderate equity allocation rather than small annual allocations.

Question 2.6 – Are there any significant advantages or cost savings for business as a result of an increased cap per employee? Please provide details.

71. As stated earlier, the primary advantage for businesses of increased access to the Class Order (despite our view that the proposed cap increase will work), is certainly the avoidance of the material costs of falling within the licensing and disclosure requirements of the Act.

Question 3

Question 3.1 – Do you support contribution plans being able to be used to fund the acquisition of financial products for an ESS of unlisted companies?

72. Yes.

Question 3.2 – What are the benefits or risks of allowing unlisted companies to offer contribution plans as part of their ESS?

73. The benefit would have to be greater participation in ESS. As outlined in our responses to questions 1.6 and 2.2, we differentiate risk between schemes involving application of personal capital by employees and nominal cost or company funded arrangements. Where employees are making personal contributions, we see the risk as being more substantial and warranting more protections, and contribution schemes are one form of this.

Question 3.3 – Are any additional protections necessary for employees participating in contribution plans? For example, capping monetary contributions at $10,000 per employee per year or requiring an independent valuation where a contribution plan is offered or the $10,000 cap is exceeded. Please provide details.

74. This is one area where we would support use of annual cap to limit the exposure for employees, but again question whether the cap should be a fixed monetary amount, or something tied to the non-equity remuneration of the employee (on the assumption, as with other exemptions in the Act, that the higher the employee's remuneration the more equipped they will be to understand the scheme and existing financial disclosures and/or engage professional advisors).

75. We would not support an enforced requirement for independent valuations, as this can place a material annual administrative burden on the company that would act as a deterrent to implementing the plan. In the place of formal independent valuation requirements, we would suggest consideration be given to offering Class Order relief where:

    75.1. the scheme met the valuation requirements as expected under the ESS tax provisions (creating administrative efficiency);

    75.2. the scheme offered a fixed and clearly defined valuation metric or formula in the plan rules; and/or

    75.3. the scheme offered an appropriate valuation dispute resolution framework.

Question 6

Question 6.1 – Are there any other regulatory barriers to small businesses offering ESSs?

76. AFSL requirements on an employee share trust.

    76.1. We note that many small businesses have a preference for maintaining some degree of privacy in respect of the individual equity offerings to staff. We note that an employee share trust would ordinarily offer a relatively simple solution to managing the pool of equity on issue.

    76.2. The requirement to hold an AFSL to act as trustee of an employee share trust adds a material level of annual cost to the administration of the scheme. We would encourage measures that allow for a trustee of an employee share trust to be exempt from the requirement to hold an AFSL. A possible limited exemption could include, for example, where there are no more than 20 participants and the scheme is not a contribution scheme (i.e. where annual transactions are inherently limited).

77. Legality of bad leaver provisions.

    77.1. We note that we have encountered mixed legal views as to when a "bad leaver" provision constitutes a penalty, and therefore, a voidable transaction.

77.2. To the extent an employee contributes their own capital, it is appropriate in our view for the employee to have protections irrespective of the cause of their departure and exit from the scheme. However, in either nominal cost or company funded schemes, the extent to which the company has powers to unwind the arrangements at nominal cost in the event of material misconduct, fraud or similar scenarios, is the subject of mixed views. Clarity on what constitutes a voidable transaction in this instance would be beneficial.