25 August 2021

Directors
Market Conduct Division and
Individual and Indirect Taxation Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: ESSreforms@Treasury.gov.au

Employee Share Schemes consultation

Dear Sirs/Mesdames,

The Australian Investment Council (**the Council**) is pleased to present a submission to Treasury on the Exposure Draft legislation related to 2021-22 Budget announcement on changes to the regulatory and tax arrangements for employee share schemes (**ESS**) measures.

As the industry association for private capital in Australia, the Council is supportive of policy initiatives and reforms that help ensure our economy is competitive, innovative and able to support Australia now and into the future. In particular, the Council encourages initiatives that help expand entrepreneurship, increase productivity and foster investment – initiatives that drive the development of skills and talent, productive capacity and innovation through technology.

Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy each year. Our members are the standard-bearers of professional investment and include private equity **(PE),** venture capital **(VC)** and private credit **(PC)** funds, alongside family offices and institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies every year. Australian-based PE and VC funds under management reached $37 billion in 2020, which represents a growth in available capital to support investment into businesses across every industry sector of the economy. The industry now has a combined total of around $14 billion in equity capital available to be invested in the short-term.

Investments made by private capital firms into Australian businesses directly result in the creation of new jobs and support growth in economic output across all sectors of the market. These investments represent 2.6 per cent of Australia's GDP output each year and are responsible for creating around 1 in 9 new Australian jobs according to independent analysis by Deloitte Access Economics.[1]

Given the impact of the COVID pandemic and the uncertain times that lay ahead, each and every day businesses are adjusting to the 'new world' economy and are finding ways to provide security to their employees, to increase productivity and to grow their businesses. In this context, the Australian Investment Council is supportive of the ESS measures as they play an important role in remunerating and incentivising staff, particularly in start-ups, scale-ups and other high growth companies. ESS schemes can be an important component of staff remuneration in companies within the innovation ecosystem who are often faced with limited resources during their early stages of growth, despite the potential to grow into large and sustainable businesses. While reforms in this area over recent years have significantly improved the ESS regime, the Council believes there are still

[1] Private Equity Growth and Innovation, Deloitte 2018

opportunities to further enhance how these schemes operate and how companies are able to remunerate their staff. We recognise there is further work to be done to align Australia with comparable jurisdictions as outlined in the Standing Committee on Tax and Revenue's report – *Owning a Share of Your Work: Tax Treatment of Employee Share Schemes* – tabled in the Parliament on Monday, 23 August 2021.

The Council welcomes this current consultation on the ESS measures and in particular, the removal of the cessation of the employment taxing point for shares under the scheme, more streamlined reporting measures and an increased cap on interest from shares eligible for relief. However, we do have some concerns around the start-times in relation to the tax measures and the proposed regulatory measures. These are set out in the submission below.

Proposed tax measures

The Council welcomes the removal of cessation as a taxing point for employee share schemes. The Council has long advocated for the simplification of the taxation of employee shares and options. In particular, the Council has long argued to Treasury that the taxing events need to relate to actual liquidity events for employees (see our submission from 9 October 2009). In removing the cessation of employment as a taxing point, there is removal of one additional taxing point which is not related to the derivation of any gain from any liquid asset of the employee at such time.

However, the Council believes that the proposed transitional measures and effective dates are too far into the future to provide industry with simplicity and certainty on this measure. At the present time, it is proposed that the amendments would apply to schemes issued from 1 July 2022 (assuming the legislation is passed during the year to 30 June 2022). We are unclear why the commencement of this measure needs to be tied to any particular start time at all and why it cannot be applied retrospectively to all grants, provided that the employment termination occurs after a set date such as 7.30pm on Budget night on 11 May 2021 or perhaps even earlier than that. This would ensure that employers and employees are not left to deal with two sets of rules depending on the date on which the awards were issued, thereby ensuring simplicity and reducing compliance costs.

However, if Treasury believes that such a broad start date cannot be implemented for various reasons, we submit that the start date should either be in relation to grants from 1) 7.30pm on Budget night on 11 May 2021 or 2) from 1 July 2021 if Treasury believes that the mandatory tax reporting which employers have made to the ATO under the current rules cannot be adequately addressed in practice to address the issue of employees filing returns inconsistent with such employer reporting.

Proposed regulatory measures

The Council believes that the proposed regulatory measures are not in line with, or proportionate with, the risk or the informational asymmetry concern which they are purporting to deal with. In particular, we understand that the measures are chiefly concerned with appropriate disclosure to employees so that they do not suffer financial hardship from inappropriate disclosure from their employers. We believe that the proposed measures will in fact mean that employers will be less inclined to offer participation in such schemes to employees. In particular, we submit the below:

1) **Penalties are harsh.** The possibility of incarceration of up to 15 years for directors (see Item 38 and the proposed changes to Schedule 3) is not in line with international best practice for such regimes and Australian employees otherwise eligible to participate in foreign schemes will likely be excluded and Australian employers are unlikely to offer such schemes for fear of the risk of inadvertently being caught up in the measures. We recommend that no penal measures be directed towards company directors be included in any regime and that any non-compliance can be addressed with pecuniary penalties

proportionate with the risk to employees, which we note is usually minimal as such incentives are designed to protect from down-side risk but provide for upside risk rewards to be shared.

2) **Transitional relief.** Proposed section 1100G(3) of the *Corporations Act 2001* (Cth) (**Corporations Act**) makes it an offence if a company does not lodge a notice of intent with ASIC with respect to ESS offers covered by that section. The Council believes there should be transitional relief for those employers complying with existing disclosure requirements (i.e. those that have issued an Offer Information Statement (**OIS**) or Prospectus) shouldn't need to also comply with these new requirements.

3) **Definition of ESS participant too narrow.** Proposed section 1100E(2)(c) and (d) of the Corporations Act exclude from the definition of an ESS participant any prospective independent contractors (with (d) limited to prospective employees and directors). The independent contractor inclusion has a 'predominant provider' test. These limitations are unnecessary and limiting and would impact on smaller start-ups who often need to engage external consultants (for example, as a compliance manager) because they can't afford to engage someone on a full-time basis until they scale-up.

4) **Definition of ESS Interest is too broad**. We understand that the intent of the measure is to ensure that no disclosure is required where the ESS plan "does not require payment to participate", which in turn depends on the concept of "in return for monetary consideration". The Council believes that additional clarity is needed when employees do not need to pay anything on the grant of options, but only when they exercise them and limited recourse loan funded share schemes where participants are actually paying market value for the shares and accordingly, should not be taxed under the ESS tax provisions. In such arrangements, the employees are protected from any downside risk and only have upside returns so it is unclear why the regulation should extend to such arrangements if they are intended to be of a protective nature only.

5) **Offer value cap of $30,000 cap is too low and unnecessary.** The $30,000 cap is too low, especially for option plans where no amount is required to be paid on issue of the options. Whilst we welcome the concession to the current laws, it is out of step with international best practice and effectively limits the regime to options granted by start-ups where the options have no, or nominal, value. The Council recommends that no cap is applied and that instead, the measures are informed by their intent which is to encourage broader ESS participation and to reflect the subjective and sophisticated knowledge of the participants engaged by the employer. This would enable market forces to determine the relevant incentives, taking into consideration the stage of growth and maturity of the issuing entity and its ability to attract talent, while considering the risk/reward for the relevant employee. We are also unsure as to why there is a difference when it comes to contactors, as opposed to employees given the comments made above in (3).

6) **Onerous monthly valuation requirement should be removed**. The Council believes that proposed requirement for an unlisted company with over $50m turnover to get an external valuation each month is too onerous and costly for employers within the innovation ecosystem. Valuations are very costly and do not typically change on a monthly basis but instead, are tied to major liquidity events.

7) **Monthly solvency resolution is unnecessary**. The Council considers the need for a monthly solvency resolution is an unnecessary, additional compliance burden given the existing director related duties to ensure that a company does not trade whilst insolvent and is out of step with international best practice.

The Council provides this submission for consideration by the Treasury and looks forward to participating in any future discussion about the themes set out above as part of the government's work on the ESS Measures.

If you have any questions about specific points made in our submission, please do not hesitate to contact me or our policy team on policy@aic.co.

Yours sincerely

Yasser El-Ansary

Chief Executive