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6 February 2015

Dear Sir/Madam

**EXPOSURE DRAFT LEGISLATION - TAX AND SUPERANNUATION LAWS AMENDMENT (2015 MEASURES NO. 1) BILL 2015: IMPROVEMENTS TO TAXATION OF EMPLOYEE SHARE SCHEMES**

BDO welcomes the opportunity to provide a submission on the Exposure Draft Legislation: *Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015: improvements to taxation of employee share schemes* (Exposure Draft), and the accompanying *Explanatory Materials* (EM) released by Treasury for public consultation on 14 January 2015.

We make the submissions set out below in respect of the matters addressed in the Exposure Draft and EM.

Unless otherwise indicated, references to statutory provisions are references to the provisions of the *Income Tax Assessment Act 1997*.

**Ceasing of employment as a taxing point**

One of the problems many companies and their employees have with the current employee scheme rules is the cessation of employment automatically being a taxing point. Although this issue is not dealt with specifically in the Exposure Draft legislation, we suggest the Federal Government take this opportunity to further enhance the Employee Share Scheme rules. We submit that the Federal Government consider removing the second taxing point (cessation of employment) for both shares and rights.

The second taxing point is particularly problematic for companies with foreign parent companies where the employee share scheme provides shares or options for shares in the foreign parent company. Many foreign countries' tax rules for employee share schemes do not have cessation of employment as a taxing point. This makes it difficult for Australian employees of these multinational groups to participate in their employer's employee share schemes. With the Australian economy becoming increasingly integrated into the global economy, for the Australian employee share scheme rules to work to genuinely encourage employees to take up equity interests in their employers, the rules need to ensure they are not too different to rules in the countries where most of head companies of Australian subsidiaries that offer employee shares schemes are located, particularly the USA and

Europe.

We submit that the other taxing points that happen when there is no real risk of forfeiture and disposal restrictions cease, should provide sufficient integrity to the tax deferral arrangements for employee shares scheme rules.

The current taxing point on cessation of employment generally requires the employee to fund the tax on the discount. Where the employee can dispose of the shares or rights, this would require the employee to dispose of a large proportion of the shares or rights to fund the payment of tax. This is particularly problematic for shares or rights in foreign companies, where there may not be a ready market for the employees to sell the shares or rights.

The problem is compounded further where the employee leaves employment with options or shares that continue to have disposal restrictions. In these cases the employee can't possibly dispose of the shares or rights and is forced to find other sources to fund the tax on the ESS discount.

We note that under the tax deferral rules in the original employee share scheme rules in Section 23AAC *Income Tax Assessment Act 1936 (ITAA 1936)*, cessation of employment was not a taxing point, provided there were restrictions on disposal of the shares (except where the employment ceased during the year of issue of the shares). Our review of the Explanatory Memorandum for the Bill that introduced Division 13A *ITAA 1936* as the replacement for s26AAC *ITAA 1936*, could not find any policy discussion about why the cessation of employment was introduced as a taxing point in Division 13A *ITAA 1936*. The cessation of employment taxing point carried over to the current rules in Division 83A without any further explanation for the policy reasoning behind the cessation of employment being a taxing point.

We submit the legislative change to achieve the removal of the second taxing point for both shares and rights would be to omit s83A-115(5) and s83A-120(5).

**Overstatement of potential interest held by rights holder in proposed s83A-45(6), s83A-130(10) and s208-215(3)**

Proposed s83A-45(6) provides, in relation to the prohibition against holding more than 10% in s83-45(5), deemings in respect of beneficial interests in rights to acquire beneficial interests in shares, as follows:

> *"10% limit on shareholding and voting power*
>
> (5) This subsection applies to an *ESS interest in a company if, immediately after you acquire the interest:
>
> (a) you do not hold a beneficial interest in more than 10% of the *shares in the company; and
>
> (b) you are not in a position to cast, or to control the casting of, more than 10% of the maximum number of votes that might be cast at a general meeting of the company.
>
> (6) For the purposes of subsection (5), you are taken to:
>
> (a) hold a beneficial interest in any *shares in the company that you can acquire under an *ESS interest that is a beneficial interest in a right to acquire a beneficial interest in such shares; and
>
> (b) be in a position to cast votes as a result of holding that interest in those shares"

There is an inappropriate inflation of the percentage interest deemed to be held by an interest holder, under s83A-45(6), in it not taking into account the holdings of other holders of ESS interests that are rights to acquire beneficial interests in shares in the relevant company in determining the relevant percentages. A similar observation could be made in respect of each of s83A-130(10) and s208-215(3). We submit that for the purpose of the 10 precent of shares calculation in s83A-45(5), s83A-45(6) should also include a deeming of all other ESS rights to acquire shares as beneficial interests in shares in the company.

The effect of proposed s83-45(6) would, in addition, be exacerbated by the changes proposed to be made to s83A-305 by items 24 and 25 of the Exposure Draft in respect of the aggregation of interests held by associates. We further submit that this aggregation of interests of associates should only apply to interests held by associates that were acquired in respect of the employee's employment.

**Exempting the issue of rights to acquire shares from Fringe Benefits Tax (FBT) where valuation rules for Div 83A purposes assign them a nil value**

A cause of much concern for taxpayers and the tax profession has been the approach adopted by the ATO in asserting that FBT can apply to the issue of rights to acquire shares where such rights have a zero value for Div 83A purposes. The argument put forward by the ATO is that the valuation rules for Div 83A do not apply for FBT purposes and for those purposes the ATO can assess the issue of such rights to FBT in respect of the "discount" at which they are issued.

We submit that the Exposure Draft should mandate that the valuation rules that apply in respect of rights to shares for Div 83A purposes should also apply for FBT purposes. Alternatively, a provision should be introduced exempting any "discount" on the issue of such rights from the imposition of FBT.

**CGT cost base of shares in small start up companies acquired from excising ESS rights – Error in Paragraph 1.66 of the EM**

There is an error in paragraph 1.66 of the EM in not including in the cost base of the "resulting share", the exercise price under the right.

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Should you have any questions, or wish to discuss any of the comments made in the above submissions, please do not hesitate to contact Lance Cunningham on 02 9240 9736 or lance.cunningham@bdo.com.au or Matthew Wallace on 02 9240 9760 or matthew.wallace@bdo.com.au.

Yours sincerely

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