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Manager
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The Treasury
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By Email: ESSreforms@treasury.gov.au

Dear Sir/Madam

The Taxation Institute of Australia (**Taxation Institute**) welcomes the further opportunity to provide comments on the exposure draft of *Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009* and the related legislation, regulations and explanatory material. This submission follows discussions at the meeting on Wednesday 19 August 2009 convened by the Board of Taxation to explore the technical issues arising from the exposure draft bills to implement the Government's new Employee Share Scheme regime.

Summary of Conclusions

In summary, the Taxation Institute's position is that the legislation released in exposure draft form needs further work. It is hoped this work is undertaken before the Bill is introduced into Parliament. In its current form the Bill is difficult to interpret, uses some terms inconsistently and contains potential flaws of application. The introduction of safe harbour rules would also reduce the administrative burdens imposed by the proposed legislation on employers and employees.

Detailed Comments

The following is not intended to be a comprehensive list of the areas of uncertainty; rather, it sets out the key areas of concern. Whilst the comments are necessarily brief, the Taxation Institute would be happy to expand on any of these in further consultation with Treasury.

1. The concept of "real risk of forfeiture" is central to the ability to defer the taxing point on employee share scheme **(ESS)** interests. At present this term is not defined (even in an objective, "reasonable person" sense) other than by implication. The Taxation Institute submits that safe harbour provisions be introduced which (non-exhaustively) give conditions that will be considered to provide a real risk of forfeiture. The alternatives would seem to involve employers seeking private rulings or the Australian Taxation Office **(ATO)**.issuing class rulings for all taxpayers who implement or have on offer an ESS. This would impose a significant burden on both the taxpayers and the ATO.

2. In addition, there is no guidance as the meaning of genuine restriction on disposal. There is a need to clarify whether a restriction within the rules is sufficient or whether there needs to be a holding lock or the ESS interest held within a trust in order for the ESS interest to be subject to a genuine restriction on disposal?

3. Further to point 1, proposed s 83A-115 and the balance of the amendments more generally do not use consistent terminology around the real risk of forfeiture condition. Thus, in one section the terms used include "real", "genuine", "forfeit" and "lose". On the principle that where Parliament uses different words it intends them to have different meanings, especially in a single section, the drafting is confusing.

   For example, using "lose" interchangeably with "forfeit" causes interpretational issues, particularly in a situation where forfeiture requires a physical disposal of an interest (eg a share) by the employee. It is difficult to conclude that the employee has "lost" the interest when they have been active in its transfer. Thus, single, defined terms need to be used consistently in all cases.

4. Further to point 3, the term "non-discriminatory" is also used inconsistently in proposed ss 83A-105(2) and 83A-35(6). In this case the intention appears to be that the meanings should be different, even though the same words are used (admittedly only in a heading in proposed s 83A-105(2)). This uncertainty needs to be addressed.

5. Similarly, there is no definition of "permanent employee". We recommend one is included particularly if the definition in Division 13A is intended to apply (ie to only include employees with at least 36 months of service (continuous or non continuous)).

6. There appears to be no real attempt to provide any assistance or safe harbour methodolgy in determining for the purposes of s 83A-110 "the extent that it relates to your employment outside Australia". This is of importance where employees are non-residents as where an overseas employer sends an employee to Australia for a limited time or an Australian employer sends an employee overseas and the employee becomes non-resident. The employee in these two situations faces potentially difficult compliance issues of working out how these provisions apply.

7. The definition of "Employee Share Scheme" is quite narrowly defined. This could lead to unintended scenarios where what would previously meet the definition of an employee share scheme under Division 13A may not be considered an employee share scheme for the purposes of Division 83A. For instance, if employees of a company are granted shares in a sister company, it would not be an employee share scheme for the purposes of Division 83A. This seems to be an unintended consequence and the Taxation Institute recommends that the definition be redrafted to incorporate such arrangements.

8. The proposed s 83A-310 provides the rules to decide whether employees who lose ESS interests can amend an earlier tax return to remove the discount from assessable income. The Taxation Institute is concerned that paragraph (c) denies the ability to amend where the loss of the interests is a result of a "choice" made by the employee. Almost all employee share schemes will have provisions which cause employees to lose their interests if they resign. Resignation is, ultimately, a choice of the employee, albeit that it could be forced by reason of illness, harassment or other non-tax reasons. The intention of the section has been stated to be to strike at provisions of employee share schemes that protect employees against downside risk. As currently drafted, paragraph (c) takes the section well beyond downside risk avoidance. A neater solution would be to link the choice to situations where the dominant purpose is to avoid downside risk.

9. Proposed s 83A-115(3) provides the deferred taxing time for rights. The subsection is confusing because it uses a structure of nested "earliest" statements with both "and" and "or" conjunctions. Further it seems that as currently drafted the conditions in subparagraph (a) could almost always be earlier than those in subparagraph (b) resulting in the unintended consequence of options or rights always being subject to tax at the time the risk of forfeiture lifts even though the share acquired on exercise of the right may have disposal restrictions. These timing rules need to be rewritten to provide certainty to employers who have reporting obligations and employees who have tax payment obligations.

10. The proposed s 83A-35 is drafted to apply if certain subsections all apply. Those subsections then have both positive and negative requirements. This form of drafting is complex and confusing. Further, it seems that subsection 5 may contain a drafting error. Under Division 13A, this integrity measure was contained in Section 139DF. Subsection 5 has been written in the reverse to Section 139DF and seems to be meet the taxpayer meets one of either paragraphs a, b or c. However, in Section 139DF it was necessary to meet all conditions. The current drafting seems to indicate that you can meet this section if you are not employed by the company, but in order to meet subsection 3 you must be employed by either the company or a subsidiary. In order to promote understanding the legislation should set out all requirements as paragraphs of a single subsection (with linking "ands") or setting out all positive requirements in one subsection and all negative requirements in a second.

11. The proposed s 83A-105(4) deals with salary sacrifice plans. It requires the scheme rules to refer to the relevant provision in order to take advantage of the concession. In the case of schemes already in existence, it is not entirely clear whether this requires amendments to the overall scheme rules, or merely the updating of offer documents provided to each employee to refer to the relevant section. This needs to be clarified.

12. A further concern relates to s.83A-105(2) which it is possible to read as saying that until the 75% qualification is reached no employee receiving an offer under their employer's scheme is entitled to the benefit of the provision. This is clearly not the intention and needs to be made clear. One way of doing this might be by looking at the position by the end of the year of income in which the ESS interest in a scheme is acquired.

13. No transitional provisions have been provided. The explanatory material at 1.283 refers to the fact that all plans will be brought under the new Division, with appropriate savings provisions. It is unclear how this will occur. For example, some schemes provide employees with a "right" to be issued with an "option" on the happening of certain events (eg a minimum period of service). This "option" can then be exercised and converted to a share at a later point. Where an employee started employment before 1 July 2009 and (arguably) acquired the "right" at that point, it is not clear whether the issue of the "option" will be dealt with under the old or the new legislation. Further, it is not clear whether the reporting obligations will be required in respect of shares and options granted prior to 1 July 2009. Therefore, consultation on the transitional provisions is essential.

14. The proposed s 83A-305 provides rules for the taxation of ESS interests when acquired by associates of the employee. The interaction of these provisions with the capital gains tax **(CGT)** regime is unclear on the face of the exposure draft. If the current situation is to be maintained (that is, the associate bears the CGT consequences while the employee bears the ESS consequences) this needs to be made clearer. If this is a policy change then this should be clarified in the explanatory materials.

15. Further to 11 above, it seems that the interaction of the CGT rules and Division 83A where trusts are involved should be clarified. The amendments to Section 130-80 do not allow for a capital gain (or loss) made by either the trust or beneficiary to be disregarded when the beneficiary becomes absolutely entitled to a share acquired as a result of exercising a right. As currently drafted, the exemption would apply to the acquisition of a share by an employee but not to one acquired from the exercise of a right. This should be rectified to be consistent with the current provisions of Section 130-90 of the Income Tax Assessment Act 1997 **(ITAA 97).**

16. The proposed s 392-5(3) of the *Taxation Administration Act 1953* provides the minimum information requirements to be in the reporting provided by employers. The subsection refers to amounts "paid at or before" the time of acquisition or deferred taxing point as the case may be. It is possible that, especially in the case of the deferred taxing point, that some amounts may be payable a short time after the reference time. As the intention is to provide information to the ATO that is useful for data matching purposes, bringing in

amounts *payable* at or before the reference time or payable as a result of the happening of the deferred taxing event would provide more complete information. Further, the Taxation Institute queries the need for employers to report the market value at the relevant taxing point as it may lead to unnecessary queries from the ATO where the employee subsequently disposes of the ESS interest within 30 days of the ESS taxing point and thus may report a value different from that reported by the employer

17. The termination of employment continues to be a taxing point. It seems inequitable to tax an employee on an ESS interest at the point of termination of employment when the employee may still be subject to a real risk of forfeiture on that interest particularly given the fact that the intention of the ESS deferred taxing point is to align the taxing point of the ESS interest to the time the relevant interest can be realised. Further, any concern regarding avoidance of tax should be rectified by the reporting obligation on the employer which includes past employees.

18. The reporting requirements are imposed on the "provider" of the ESS interest. This will cause difficulties for the ATO in enforcement where the provider is a foreign parent of the Australian employer with no presence in Australia.

19. The EM currently assesses the compliance cost impact as "low". In the context of a scheme that imposes new reporting obligations on employers and alters the parameters of employee share schemes there needs to be a more accurate assessment of both the transitional and on going compliance costs.

Conclusion

The Taxation Institute believes that the legislation requires substantial rewording to make the legislation useable and understandable and better reflect the policy position (see especially points 1, 7 and 8 above).

The compliance cost impact of this legislation, in combination with the transitional provisions yet to be released, will be high for affected taxpayers. Where these costs can be mitigated by safe harbour provisions, this should be seriously explored. The transitional provisions will need to be the subject of significant consultation.

The above comments are illustrative of the types of concerns the Taxation Institute's members have identified with the legislative package released. The Taxation Institute would welcome the opportunity to discuss the above and further examples and issues with you and to be involved in further consultation on these provisions.

If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

Joan Roberts
President