

## Taxation of Employee Share Schemes in Australia: Does the System Foster Growth?

by Sarah A. Hinchliffe and Reynah Tang

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In this article, the authors consider Australia's approach to the taxation of employee share schemes, noting that the limits of the existing preferences become especially evident when compared with the tax treatment of similar schemes in the United States and concluding that the differences leave Australian start-ups and small businesses at a disadvantage in the global market.

A key initiative of the Australian government under former Prime Minister Malcolm Turnbull — the 29th prime minister, who held office from September 2015 until August 2018 — was the Industry Innovation and Competitiveness Agenda (the competitiveness agenda). The plan focused on stimulating the growth of high-tech start-ups in Australia, including by encouraging employee share ownership. However, whether the efforts to use tax policy to foster these schemes succeeded remains unclear, especially in contrast to the beneficial tax treatment afforded elsewhere.

Despite several positive changes to the tax treatment of employee share schemes (ESSs) effective July 1, 2015 — including a new tax concession for eligible start-up entities and access to a cost-effective safe harbor valuation method in section 83A-33 of the Income Tax Assessment Act 1997 (Cth) (ITAA97)<sup>1</sup> — Australian start-up entities that want to implement an effective, broad-based ESS still face substantial hurdles.

<sup>1</sup> See Legislative Instrument — Income Tax Assessment (ESS 2015/1), registered on July 1, 2015 (F2015L01072). See also Australian Securities and Investment Commission (ASIC) Class Order 03/184.

These broad-based schemes are distinct from more limited incentive plans that focus only on directors and executives.<sup>2</sup> This article provides an in-depth examination of the tax treatment of broad-based ESSs in Australia, comparing Australia's approach with that in the United States. Among other things, this comparison reveals that in practice, items that qualify for preferential tax treatment in the United States do not necessarily qualify in Australia.

Also, one notable ambiguity — even after the 2015 amendments — is the tax treatment when a limited liability company or partnership offers an ESS but the ESS interests do not exactly correlate with “ordinary shares” in a company. The uncertainty means that an overseas entity that might otherwise offer the same equity benefits to its Australian employees that it offers to its U.S. employees may be deterred from doing so. This has significant implications for emerging start-up enterprises and may inhibit their ability to retain talented staff.

This article begins by presenting background information on ESS arrangements in Australia and outlining related federal parliamentary inquiries into these arrangements.<sup>3</sup> Next, it discusses the tax treatment of ESS arrangements following the most recent legislative changes. Third, it examines the challenges that Australian start-up firms face in implementing effective,

<sup>2</sup> See Ingrid Landau, Ann O'Connell, and Ian Ramsay, *Incentivising Employees: The Theory, Policy and Practice of Employee Share Ownership Plans in Australia* (Feb. 2013).

<sup>3</sup> Parliament of the Commonwealth of Australia, Senate Standing Committee on Economics, “Enquiry Into Cooperatives, Mutuals and Member-Owned Firms” (2016); and Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Employment, Education and Workplace Relations, “Shared Endeavours: Inquiry Into Employee Share Ownership in Australian Enterprises” (Sept. 2000).

broad-based ESS arrangements using the example of a hypothetical start-up in the technology sector seeking to expand internationally.

The central thesis of this article is that the 2015 tax reforms have misfired: The system they created is unduly constrained and does not reflect the realities of how high-tech start-ups deliver value to their employees. As a result, employees of Australian start-ups are at a competitive disadvantage compared with their foreign counterparts. This article provides evidence of some of the gaps in the existing regime and offers recommendations for policies that can promote ESS ownership in Australia, including identifying room for change in commonwealth legislation. Unless Australia addresses the tax (and corporate) issues raised in this article, the system will discourage Australian start-ups from using ESSs as a means to foster increased productivity and attract talented employees, and it will also deter start-ups from entering into international corporate consolidations or acquisitions. Both of these consequences run contrary to the goals of the innovation and competitiveness agenda.

Following the reelection of the Liberal/National Party Coalition headed by Prime Minister Scott Morrison, there is a real opportunity for the government to reconsider these issues and design a more effective tax regime that allows start-ups — and small and medium-size enterprises more generally — to make better use of ESS arrangements.

### Background of ESS Arrangements

According to Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015 (Cth), an ESS is a remuneration scheme under which a firm offers its shares (or similar equity interests) or the option or right to acquire shares (or similar equity interests) to employees and contractors of the firm (or its subsidiaries).<sup>4</sup> These schemes are also commonly referred to as an employee share ownership plan or, as the United States calls them in 26 U.S.C. section 423, equity incentive plans.<sup>5</sup>

<sup>4</sup> See also Australian Senate Economics References Committee, "Employee Share Schemes" (Aug. 2009).

<sup>5</sup> See also James C. Sesil et al., "Broad-Based Employee Stock Options in U.S. New Economy Firms," 40(2) *Brit. J. of Indus. Rel.* 273 (2002).

### Industry Innovation and Competitiveness Agenda

At the federal level, the idea of encouraging the use of broad-based ESSs has — in theory — enjoyed bipartisan political support in Australia. The competitiveness agenda expressly highlighted the Australian government's intent to "work to reduce taxes, simplify the tax system and increase certainty" in order to foster stronger and more enduring economic growth.<sup>6</sup>

The competitiveness agenda further highlighted the then government's commitment to:

Encouraging entrepreneurship and creating the best possible conditions for small and large businesses to thrive. The Government's vision is that, alongside successful large Australian businesses, Australian small businesses will be innovation leaders, contributing strongly to national economic growth and competitiveness.

Ambition 4 — a key element of the competitiveness agenda's "framework for boosting Australian Industries' competitiveness and driving greater innovation and investment across the nation" — specifically identifies improving the tax treatment of ESSs as one of the government's goals.

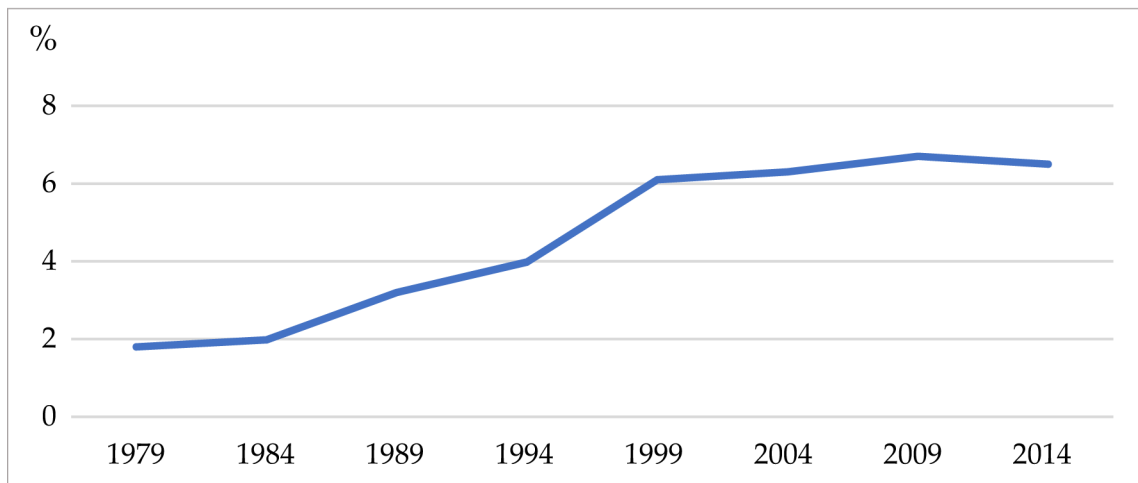
This involves:

- improving tax settings for productivity, international competitiveness, and economic growth;
- improving incentives to work, including through the interaction of the tax and transfer systems; and
- improving incentives to save.

### An Industry Snapshot

International authorities have recognized ESSs — and, in particular, broad-based ESSs — as positively associated with high profitability, productivity, and growth, with little evidence of

<sup>6</sup> See Department of Prime Minister and Cabinet, "Industry Innovation and Competitiveness Agenda: An Action for a Stronger Australia" (Oct. 14, 2014).

**Figure 1. Australian Employees Receiving Shares as an Employment Benefit**

Source: Australian Bureau of Statistics, "6105.0 Spotlights: Employee Share Schemes in Australian Labour Market Statistics" (July 2005).

reverse causality.<sup>7</sup> Weltmann and his colleagues show that high-performing firms have a disproportionately high incidence of providing ESSs.<sup>8</sup> Employers are more likely to use ESSs when employees' work and performance are complex or hard to monitor, such as may occur in fast-growing firms, large firms, or innovative firms when value is predominantly generated from intangible capital.<sup>9</sup> Positive correlations between ESSs, productivity, and profitability include evidence of increased product and process innovation by employees who receive

shares or share options, particularly in accordance with broad-based schemes.<sup>10</sup>

ESSs encourage employees to invest in the business they work for — both financially and in terms of increased commitment. The schemes provide a link between corporate and individual performance and, therefore, they can provide extra motivation for employees.

Survey data indicate that the main reason Australian firms use ESSs is to motivate, attract, and retain competitive and valuable employees.<sup>11</sup> As Figure 1 illustrates, according to a 2005 release from the Australian Bureau of Statistics, in 1979 only 1.3 percent of Australian employees received shares as an employment benefit.<sup>12</sup> By 2004 this figure grew to 5.9 percent of employees. The

<sup>7</sup> See David Guest et al., "Human Resource Management and Performance: First Findings From the Future of Work Study" (2010); Martin J. Conyon and Royce B. Freeman, "Shared Modes of Compensation and Firm Performance: UK Evidence," National Bureau of Economic Research Working Paper No. 8448 (2001); and Sandra E. Black and Lisa M. Lynch, "What's Driving the New Economy? The Benefits of Workplace Innovation," 114 *The Econ. J.* 97 (2004).

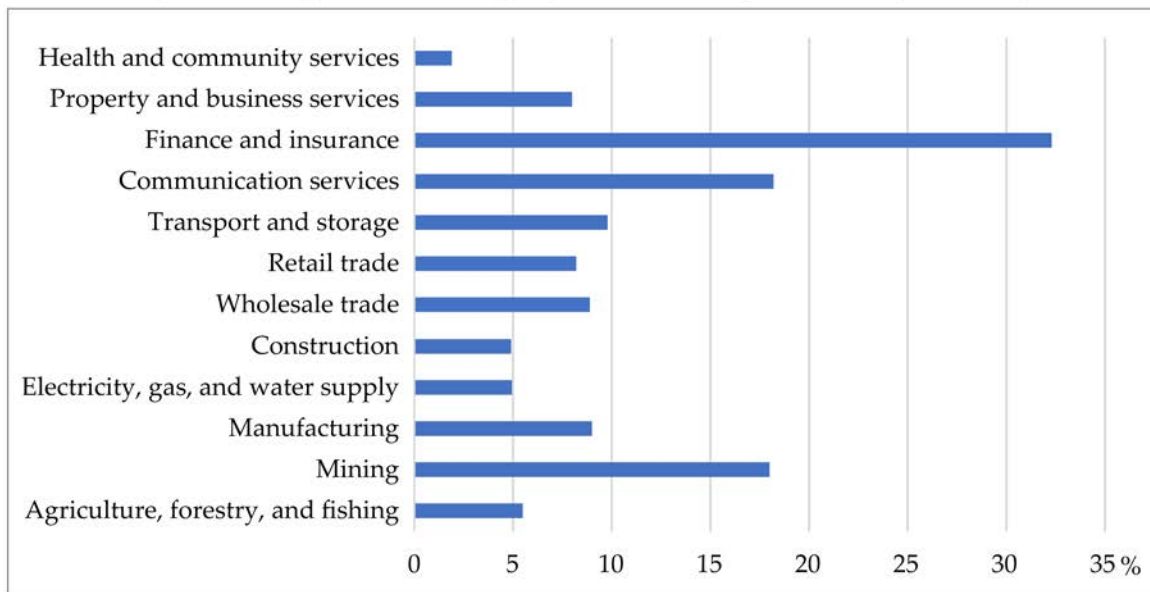
<sup>8</sup> Dan Weltmann, Joseph R. Blasi, and Douglas L. Kruse, "Does Employee Ownership Affect Attitudes and Behaviors? The Role of Selection, Status, and Size of Stake," 16 *Advances in the Economic Analysis of Participatory & Labor-Managed Firms* 249, 255-256 (2015).

<sup>9</sup> Maya Kroumova and Sesil, "Intellectual Capital, Monitoring and Risk: What Predicts the Adoption of Broad-Based Employee Stock Options?" 45(4) *Indus. Rel.: J. Econ. and Soc'y* 734 (Sept. 2006); and Xin Chang et al., "Non-Executive Employee Stock Options and Corporate Innovation," 115(1) *J. of Fin. Econ.* 1 (2015).

<sup>10</sup> Jonathan Michie and Maura Sheehan, "No Innovation Without Representation? An Analysis of Participation, Representation, R&D and Innovation," 2(2) *Econ. Analysis* 86 (1999); Michie and Sheehan, "Labour Market Dynamics and Innovation," 8(2) *Indus. & Corp. Change* 213 (1999). See also Sesil et al., "Broad-Based Employee Stock Options in the U.S.: Company Performance and Characteristics" (2004); and Chang et al., *supra* note 9.

<sup>11</sup> See Landau, O'Connell, and Ramsay, *supra* note 2; Yu Ping Lin and Sesil, "Do Broad-Based Stock Options Promote Organization Capital?" 49 *Brit. J. of Indus. Rel.* 402 (2011); and Blasi, Richard B. Freeman, and Kruse, *The Citizen's Share: Reducing Inequality in the 21st Century* (2013).

<sup>12</sup> Australian Bureau of Statistics, "6105.0 Spotlights: Employee Share Schemes in Australian Labour Market Statistics," (July 2005). See also TNS Social Research, "Employee Share Ownership: Summary of Awareness, Attitudes and Endorsement," Research report for the Department of Employment and Workplace Relations Services for Australians (2004) (one of the sources that the bureau relied upon when compiling this data).

**Figure 2. Proportion of Employees Receiving Shares (by industry)**

Source: Australian Bureau of Statistics, "6105.0 Spotlights: Employee Share Schemes in Australian Labour Market Statistics" (July 2005).

majority of the increase occurred between 1989 and 1999, when the percentage of employees receiving shares increased from 2.4 percent to 5.5 percent.

A more recent government-sponsored study from 2017 reports that the percentage of Australian firms using ESSs grew from 0.23 percent in 2006-2007 to 0.57 percent in 2013-2014.<sup>13</sup> This was followed by a sharp decline to 0.26 percent in 2014-2015. In fiscal terms, the total estimated ESS payments grew from \$1.4 billion in 2006-2007 to \$2 billion in 2014-2015, and they accounted for approximately 0.38 percent of total wages and salaries in Australia in 2014-2015.

Figure 2 shows the percentage of employees who participated in ESSs in several major industries.

The industry with the highest proportion of employees receiving shares as an employment benefit was finance and insurance (32 percent), followed by mining (16 percent), and communication services (16 percent). Although only 4 percent of all Australian employees

worked in finance and insurance, that sector accounted for 21 percent of all employees who received shares in the course of employment.

Despite their benefits for employers and employees, there may be a decline in ESS arrangements following the 2015 changes. But this need not be the case if employers become better informed about the tax benefits of — and, admittedly, tax concerns associated with — ESS.

## Regulation of ESS Arrangements

### Income Tax Regulation

Division 83A of the ITAA97 establishes the tax treatment of ESSs in Australia.

Section 83A10(2) of the ITAA97 defines an ESS as:

(2) . . . a scheme under which ESS interests in a company are provided to employees, or associates of employees, (including past or prospective employees) of:

- (a) the company; or
- (b) subsidiaries of the company;

in relation to the employees' employment. [Internal cross-references removed.]

<sup>13</sup> Luke Hendrickson et al., "The Performance and Characteristics of Australian Firms With Employee Share Schemes," Office of the Chief Economist Staff Research Paper 4/2017 (2017).



Section 83A10(1) defines an ESS interest in the following terms:

(1) An ESS interest, in a company, is a beneficial interest in:

- (a) a share in the company; or
- (b) a right to acquire a beneficial interest in a share in the company.

There are, as the introductory paragraphs to this article suggest, two main categories of ESS<sup>14</sup>:

- Narrow-based, which are only offered to executives and directors.
- Broad-based, which an employer offers to all or most employees. Typically, 50 to 75 percent of employees participate in broad-based ESSs.

This article focuses on the latter.

In general terms, Division 83A provides for the taxation of ESSs in accordance with the following rules:

- Employees (rather than employers) are taxed on the discount that they receive on shares, options, or similar interests (referred to as an ESS interest) that their employer provides under the ESS. In principle, the discount is an amount equal to the difference between the market value of the ESS interest and the amount the employee must pay to acquire it. There are special valuation rules for options and similar rights based on a modified version of the Black-Scholes option valuation model. Importantly, section 136(1)(h) of the Fringe Benefits Tax Assessment Act 1986 (Cth) excludes ESS interests covered by Division 83A from the scope of Australia's fringe benefits tax regime, which taxes employers on other noncash benefits they give to their employees.
- According to subdivision 83A-B of ITAA97, the discount is taxable by default on the grant of the ESS interest unless the circumstances meet the specific requirements for an exception.
- For example, if there is a real risk that the ESS interest may be forfeited and there is a

condition that restricts the disposal of the ESS interest, then subdivision 83A-C defers taxation until a future point in time (the deferred taxing point). Generally, the deferred taxing point is the earliest of: the cessation of employment; the time when the ESS interest ceases to be subject to a risk of forfeiture and any disposal restrictions have been lifted, which is often at the time of exercise in the case of options; or the disposal of the ESS interest.

- The discount is taxed as ordinary income at the employee's marginal tax rate under Schedule 7 of the Income Tax Rates Act 1986 (Cth). Marginal tax rates in Australia depend on an individual's taxable income for the tax year. The top marginal tax rate is 45 percent for taxable income in excess of AUD 180,000 (approximately \$129,000), plus a Medicare levy of 2 percent. The 50 percent capital gains tax discount that applies to an individual's capital gains on assets held for 12 months or more does not apply.

### Policy: Supporting Employee Share Ownership

A policy of supporting increased employee share ownership is evident from the availability of several tax concessions for shares or options obtained through an ESS under specific prescribed conditions. For example, section 83A-35 of the ITAA97 provides a tax exemption for up to AUD 1,000 annually of relevant equity, a form commonly adopted by large listed firms.<sup>15</sup>

However, the business sector argues that changes that the previous government made to ESS tax policy in 2009 discouraged the incidence of ESSs.<sup>16</sup> In particular, the concern was that the changes generally brought the taxing point for deferred schemes forward to the time when options vested, even if the employee had not exercised them. This meant employees faced taxes

<sup>14</sup> *Id.*

<sup>15</sup> See, e.g., Australian Taxation Office Class Ruling, CR 2014/43 (the Commissioner of Taxation ruled that securities the Goodman Group offered to its employees were eligible for this concession).

<sup>16</sup> Explanatory Memorandum: Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015, C2015B00037 (Jan. 14, 2015), at [2.68].

on income they had not received yet — and may never receive. Further, business interests suggested that the provisions allowing a refund of tax when ESS interests were lost were too narrow.

The Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015 (Cth), which came into effect July 1, 2015, effectively reversed many of the 2009 changes. It deferred the taxing point for ESS options to the point of exercise and provided an additional concession for shares and options that eligible start-up companies issue to their employees.

### Start-Up Concession

Under the start-up concession, qualifying shares or options are not taxed under Division 83A of the ITAA97. If the ESS interest is in a share, the employee must acquire the share at a discount of no more than 15 percent of the market price at the time of acquisition to qualify. For options, the inherent discount is not taxable as long as the exercise price is not less than the market value of the firm's shares at the time of grant. The capital gains tax regime will apply to any subsequent gain, meaning that employees can benefit from the 50 percent discount.

There are several requirements for the ESS start-up concession under section 83A-33 of the ITAA97:

- the employer is an Australian resident company;
- neither equity interests in the issuer of the ESS interest nor any related companies are listed on any stock exchange;
- the issuer and all related companies must have been incorporated — whether in Australia or elsewhere — for less than 10 years before the end of the company's most recent income year before the issue of the interest; and
- the aggregated turnover of the issuer (and related companies) must not exceed AUD 50 million for the most recent income year before the issuance of the interest.

Also, section 83-(33)(1)(C) of the ITAA97 states that — if the ESS interests are shares — an ESS must be broad-based to benefit from the concession. In all cases, in accordance with sections 83A-33(1)(b) and 83A-45(4), there is a

minimum holding period of three years for the ESS interests (cumulative in the case of options that are exercised), unless the Commissioner of Taxation allows a shorter period.

The start-up concession is the most favorable concession for ESSs. However, because of the stringent conditions for obtaining the concession, many companies that are viewed as start-ups commercially may — in practice — be unable to access the concession for ESS interests they issue to their employees.

### Corporate Regulation

The Australian government recently consulted on options to amend the Corporations Act 2001 (Cth) (Corporations Act) disclosure requirements to make ESSs more user-friendly by giving employers more choices regarding how they offer incentives to their employees and reducing the red tape associated with those incentives.

Section 1274(2AA) of the Corporations Act does not require that ESS disclosure documents be made publicly available if:

- the offer is of an ESS interest under an ESS;
- the disclosure document states that ESS interests will only be made available to employees, directors, and independent contractors of the issuing company (or a subsidiary), and relate only to ordinary shares;
- none of the equity interests of the company issuing the ESS interests nor any of the companies in its group (issuer group companies) are listed on an approved stock exchange at the end of the issuer's most recent income year before the year when the disclosure document was lodged with the Australian Securities and Investments Commission (ASIC) (pre-lodgement year);
- all of issuer group companies were incorporated less than 10 years before the end of the pre-lodgement year; and
- the issuing company's aggregated turnover for the pre-lodgement year did not exceed AUD 50 million.

Absent an applicable exemption, ESS disclosure documents — like most other disclosure documents — must be lodged with

ASIC and made available for public inspection under sections 718 and 1274 of the Corporations Act.<sup>17</sup>

### Case Study

To gain a broader understanding of the tax treatment of an ESS, this section compares the approach taken in Australia with the approach taken in the United States. The analysis reveals that in practice, items that qualify for preferential tax treatment in the United States do not necessarily qualify for preferential treatment in Australia.

#### Australian Technology Start-Up

Australian start-up firms looking to implement effective, broad-based ESS arrangements will encounter several challenges. These are illustrated below using the example of a hypothetical start-up in the technology sector that wants to expand internationally.

Consider the following scenario:

- Three entrepreneurs who met at university establish an Australian start-up in the technology field.
- On the advice of their accountant, they establish the business as a unit trust. Each entrepreneur uses a related discretionary family trust to hold his units.
- The start-up develops new online technology to facilitate payment systems and successfully builds a corporate client base in Australia.
- After five years, the entity is ready to expand into the much larger U.S. corporate market, but it needs additional capital to do so.
- On a U.S. roadshow, the entrepreneurs are introduced to a U.S. private equity fund that offers a good price to acquire the start-up — subject to its restructuring into a corporate form. The U.S. firm wants to establish an incentive scheme to keep the original entrepreneurs and other key employees of

the start-up involved and invested in the business.

- The U.S. private equity fund uses an established U.S. LLC based in Delaware for foreign investments. Therefore, the U.S. LLC wants to offer profits interests to the entrepreneurs and key executives of the Australian target. The profits interests take the form of units in the U.S. LLC. The terms provide that the holders of these units do not have full voting rights. The holders' entitlement to returns on those units is determined by reference to the incremental growth in the value of the U.S. LLC above the threshold value at the time of issue.

#### Key Questions

Key points of inquiry include:

- What is the nature of the profits interests in the U.S. LLC under Delaware company law?
- What tax treatment results from the U.S. LLC giving the profits interests to the employees for free?

#### Nature of the Profits Interests in Delaware

From a Delaware company law perspective, an LLC is a body corporate — thus, for example, it can sue and be sued in its own name — and units in the LLC are securities or membership interests in the LLC. Section 106 of the Delaware General Corporation Law states that:

Upon the filing with the Secretary of State of the certificate of incorporation, executed and acknowledged in accordance with [section] 103 of this title, the incorporator or incorporators who signed the certificate, and such incorporator's or incorporators' successors and assigns, shall, from the date of such filing, be and constitute a body corporate, by the name set forth in the certificate, subject to [section] 103(d) of this title and subject to dissolution or other termination of its existence as provided in this chapter.

From a Delaware company law perspective, units in an LLC are akin to shares in a company. Delaware law might consider the profits interests to be a form of preferred stock — albeit with limitations on the associated rights.

<sup>17</sup> ASIC Class Order CO 03/184 previously granted exemptions for employee incentive schemes from some disclosure, licensing, and other requirements under the Corporations Act 2001 (Cth). ASIC has discontinued it, replacing it with ASIC Class Order CO 14/1000 (for listed bodies) and ASIC Class Order CO 14/1001 (for unlisted bodies).

## Tax Treatment

### In the United States

Although profits interests may have some economic value (effectively, as an option), they do not give rise to any upfront U.S. tax. They have no value for tax purposes because — since the units only gain value if the LLC gains value beyond its value at the time of issue — the holders would not receive any distributions if the U.S. LLC was liquidated at the time of grant.

### In Australia

However, in Australia, one of two things will occur:

- The employee will face upfront tax under Division 83A of the ITAA97 based on the market value of the interests. Although the ATO should treat the profits interests as shares in a company for Australian tax purposes,<sup>18</sup> it will not consider them ordinary shares because the interests enjoy limited rights — for example, in relation to voting and entitlements on winding up — compared with common units in the LLC. Therefore, even assuming all other conditions are met, the interests cannot benefit from the start-up concession or even qualify for a tax deferral, despite the profits' interests being subject to a real risk of forfeiture (for example, under traditional bad leaver provisions).
- Alternatively, if the employee makes a foreign hybrid election for the LLC under Division 830 of the ITAA97, the employer will face fringe benefits tax. The ATO is likely to treat the interests as a residual fringe benefit. In this scenario, the interests are no longer ESS interests — as such, the carveout for employee share plans from the definition of fringe benefit will not apply.

In practical terms, if the LLC wanted to ensure that it offered the employees of the Australian target a similar incentive to that it has offered other employees of the LLC and its related companies, it would need to convert to a phantom-type scheme at the Australian target

<sup>18</sup> See, e.g., ATO Interpretive Decision, ATO ID 2010/125 (albeit in the context of goods and services tax).

level (that is, Australian employees receive a cash payment reflecting the amount they would have received if they held and disposed of a profits interest). The Australian participants would face ordinary employment income tax on receipt of the payment under such a scheme.<sup>19</sup> This is suboptimal because:

- The Australian participants would no longer receive an ownership interest in the U.S. LLC, which is the whole purpose of the incentive scheme.
- It may give rise to funding issues. The phantom scheme would assign the obligation to make payment to the Australian target company (that is, the start-up), but any future exit event is likely to occur at the higher LLC level.
- It gives rise to additional costs that an employer must pay based on taxable wages such as superannuation contributions (that is, pension contributions), state payroll tax, and workers' compensation premiums.
- There might be an Australian corporate law issue with the conversion to a phantom-type scheme. ASIC might consider it a derivative, in which case it will be necessary to comply with ASIC Class Order CO 14/1000 to obtain relief from the general disclosure obligations relating to financial products.<sup>20</sup>

There is, however, a positive side effect for the employer from offering a phantom-type scheme: The Australian target should be able to claim a tax deduction for any amount paid to employees under the plan. Based on the existing Australian corporate tax rate for companies with a turnover of less than AUD 50 million, this would reduce the after-tax cost of the scheme to 72.5 percent of the outlay.

### ESSs in Australia: Reforms and Open Issues

The case study above focuses on only one of the issues with Australia's ESS regime. The system raises several other concerns, including:

<sup>19</sup> See ATO Interpretive Decision, ATO ID 2010/42. See also ATO Private Binding Ruling, Authorization Number 105137685173; and ATO Class Ruling, CR 2001/76 (2001).

<sup>20</sup> See ASIC Regulatory Guide, RG49 (Nov. 11, 2015), at RG49.68-49.71.



- the potential for double taxation of cross-border employees;<sup>21</sup>
- the absence of a market for shares in unlisted entities, giving rise to the need for buyback mechanisms, which can produce adverse tax outcomes;<sup>22</sup> and
- the lack of valuation methods and safe harbors for unlisted ESS interests — other than those qualifying for the start-up concession<sup>23</sup> — which is particularly problematic for start-up entities that want to offer ESS interests unless the offer happens to be proximate in time to an equity raising.

On November 13, 2018, Australian Treasurer Josh Frydenberg and then Minister for Small and Family Business, Skills and Vocational Education Michaelia Cash announced some measures aimed at “improving the ability for small business to offer employee share schemes.”<sup>24</sup> These include:

- a dedicated exemption from disclosure obligations under the Corporations Act 2001;
- extending a concession for salary-sacrifice ESSs to allow ESSs to have a value of up to AUD 10,000 — that is, double the AUD 5,000 limit — and generally permitting contribution plans; and

<sup>21</sup> See generally O’Connell, “Employee Share Ownership Plans in Australia: Cross Border Issues Arising From Employee Share Ownership Plans,” Employee Share Ownership Project Research Report (2010).

<sup>22</sup> Business Law Section of the Law Council of Australia, “Employee Share Schemes Consultation Paper” (June 7, 2016), at 2.1-2.8 (noting complexities of Australia’s income tax regime for buybacks).

<sup>23</sup> *Id.* at 9.1.

<sup>24</sup> See Frydenberg and Cash release on proposals related to employee share schemes (Nov. 13, 2018).

- allowing small businesses to offer ESSs without publicly disclosing commercially sensitive financial information, except when they are otherwise obligated to do so.

Just prior to the Australian election, Treasury issued a discussion paper regarding these reforms. Hopefully, following the election, they will now proceed.

While small businesses would no doubt welcome such changes, Australia needs to undertake further consultation and reform to address the various issues with the existing ESS tax system. Doing so could stimulate the use of ESSs in the start-up sector and by SMEs more generally.

### Summary and Conclusion

The economic case for encouraging broad-based employee share schemes is well-established and broadly accepted in Australia. There is also general agreement about the need to stimulate the start-up sector — and SMEs more generally — to embrace ESSs. However, the existing concessions are too narrowly focused to achieve their ultimate goal of “stimulating the growth of high technology start-ups in Australia.” Further reform to Australia’s ESS tax rules is needed to address various issues including those outlined in this article.

In contrast, the U.S. tax code adopts a more liberal approach — identifying ESSs that can benefit from U.S. tax concession and focusing on the economic outcomes — which give start-ups in the United States an advantage over their Australian counterparts. ■