EARLY ASSESSMENT
REGULATORY IMPACT STATEMENT – EMPLOYEE SHARE SCHEMES AND STARTUPS

TREASURY

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INTRODUCTION

Employee share schemes (ESSs) are schemes in which employers issue shares and/or options (also known as rights) to their employees at a discount[1] on the market value. Firms offer these because they see the benefits of improving the alignment of employee and employer interests, encouraging positive working relationships, boosting productivity through increased employee commitment to a company, reducing staff turnover and encouraging good corporate governance. They can be a particularly valuable tool for cash constrained startups. ESSs offer an option for attracting and retaining talented people with appropriate remuneration, while ensuring sufficient capital is available to allow growth of the startup. As such, the Government provides a level of preferential tax and regulatory system benefits for ESS arrangements to stimulate their use.

CURRENT ARRANGEMENTS

2. Under the current ESS system, Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997) generally taxes any discount on the market value of an interest in a share or right provided to an employee under an ESS. The tax treatment of an employee's 'ESS interest' depends on whether there is a real risk that the employee will forfeit eligibility for the share or right. An ESS interest acquired by an employee is at real risk of forfeiture if a reasonable person would consider that there is a real risk that the employee may forfeit or lose the ESS interest, other than by intentionally taking no action to realise the benefit. A real risk of forfeiture in a scheme may include conditions where retention of the ESS interests is subject to performance hurdles, or a minimum term of employment[2].

3. If there is no real risk that the employee will forfeit eligibility, discounts on ESS interests are taxable up front to the employee. However, employees with adjusted taxable income of $180,000 or less are eligible for a tax exemption on the first $1,000 of discounts received each year on eligible ESS interests.

4. If there is a real risk of an employee forfeiting their discounted shares under the conditions of the ESS (or they are acquired through a salary sacrifice arrangement) then taxation is deferred until the earlier of:

- removal of the risk of forfeiture such that the scheme no longer genuinely restricts disposal of interests;
- cessation of employment; or
- seven years from acquisition of the interest.

5. In situations where the tax is paid and shares or rights are subsequently genuinely forfeited, a tax refund is available. However, as the refund provisions are not intended to protect the employee from downside market risk[3], a refund is not available where shares are forfeited only because the value has fallen due to market forces. Where the taxpayer is not eligible for a refund, the taxpayer would instead have a capital loss under the capital gains tax provisions.

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[1] The discount is generally taken to be the difference between the market value of the share or right and any amount paid by the employee to acquire the share or right.

[2] The Australian Taxation Office provides guidance on the real risk of forfeiture test: http://ato.gov.au/General/Employee-share-schemes/In-detail/Restrictions-and-forfeiture/Real-risk-of-forfeiture/?default=&page=3#Real_risk_of_forfeiture_test.

[3] That is, the financial risk associated with losses – or, the risk of a difference between the actual return and the expected return, where the actual return is less.

6. In order for an ESS to qualify for the above tax treatments, the shares or rights issued under the ESS arrangement must satisfy eligibility requirements. These requirements aim to ensure, among other things, that participation in the scheme is widely available to employees, and that the concessions cannot be accessed by shareholders who are effectively able to exert control over the company's operations.

7. To be eligible:

- the ESS interests must not result in any one employee owning more than 5 per cent of the shareholding or controlling more than 5 per cent of the maximum voting rights;
- the scheme must be offered on a non-discriminatory basis to at least 75 per cent of Australian resident permanent employees with three years' service;
- there cannot be a real risk of forfeiture; and
- the shares must be held for three years or until the employee ceases employment.

QUESTION 1: WHAT IS THE PROBLEM YOU ARE TRYING TO SOLVE?

8. The current taxation arrangements of ESSs arise from changes made in 2009 as part of the 2009-10 Budget. These changes include:

- removing the eligibility of employees to elect when tax would be paid on the discount on rights provided under an ESS, and as a result, taxing all discounts on shares and rights in the income year in which the shares and rights are acquired, unless there is a real risk of forfeiting the shares or rights or they are acquired through a salary sacrifice arrangement;
- capping concessional tax treatment for particular schemes as follows:
  - if discounts are taxed up front, only employees with adjusted taxable income of $180,000 or less remained eligible for a tax concession on the first $1,000 of discounts received each year on eligible ESS interests;
  - tax deferral in limited circumstances (where there is a real risk of an employee forfeiting their discounted shares under the conditions of the ESS or those that are acquired through a salary sacrifice arrangement), until the earlier of removal of the risk of forfeiture; or cessation of employment; or seven years from acquisition of the interest;
- introducing an annual reporting requirement and associated withholding arrangements by companies that participate in these schemes.

9. A post-implementation review of those arrangements was completed by the Treasury on 21 November 2013, which assessed that the ESS measure was broadly meeting its objectives. The post-implementation review also acknowledged that concerns had been raised that the changes to the tax treatment of ESSs made since the 2009-10 Budget may have a negative impact on some sectors of the economy. In particular, the following issues were identified as barriers to firms, particularly startups, wishing to utilise ESS arrangements:

- the amount of administrative burden required to establish an ESS;
- the complexity of the valuation methodology for options; and
- the taxation point of options.

10. As a result of those concerns, the former government had commenced consultation with industry on the most effective measures to address the barriers faced by startup companies.

11. Since the post-implementation review was completed last year, the current Government has indicated that addressing the issues outlined above is a priority. The Prime Minister announced on 18 December 2013 that the National Industry Investment and Competitiveness Agenda will consider, among other things, the current ESS arrangements.

12. The current Government has continued consultations on this issue and their consultation process is referred to at various points in this Regulation Impact Statement, and outlined in further detail under Question 5: *Who will you consult about these options and how will you consult them?* below. There have been two main streams of concern that have arisen out of this current process. Firstly, *all companies* have argued that it is not reasonable to tax options until the employee takes action to realise or convert them to tradeable shares. Secondly, *unlisted startups* have argued that they face additional problems around both valuation and liquidity – as their shares are not listed there are difficulties determining valuations cost effectively, and there is not a ready market to enable liquidity to pay the tax.

13. Although the 2009 changes appear to have reduced the popularity of options issued under Division 83A of the ITAA 1997 by all companies, the impact appears to have been felt more keenly by startups, which lacked the capacity to implement alternative ways to remunerate employees through shares or options. This issue has been identified by both the former[4] and current[5] Governments as a key area for attention. Innovation is vital to Australia if we are to continue to improve living standards, create new business opportunities and be globally competitive. The development of a strong and innovative economy is essential to creating jobs and improving productivity.

14. Industry has indicated that the existing taxation arrangements are causing an increasing number of Australian startups to move overseas.

15. The ESS interests can also be unaffordable to the beneficiaries due to cash flow issues arising from the timing of the payment of tax. The current tax arrangements require tax to be paid in the income year in which the shares or options are effectively acquired, rather than at the point of exercise or sale of the interest. Given that only a small proportion of startups will succeed, tax may be required to be paid on shares that may never have a convertible or realised value to the employee. It has been suggested that the changes that were made to the tax arrangements in 2009 have exacerbated this problem by advancing the taxing point for options to acquire shares in startups. Stakeholders claimed that these tax arrangements are inconsistent with global practice and this can result in talented employees choosing to work overseas instead.[6]

16. Once established, there are further costs involved in the ongoing operation and administration of an ESS, a key cost being that a company valuation is required when additional shares or options are issued under an ESS. Stakeholders have advised that this can cost as much as $50,000 per valuation in Australia, compared, for example, with the United States where the cost is US$2,000 to US$5,000. Stakeholders have also advised that multiple valuations can be required each year depending on when shares and options become taxable. This often makes an ESS unaffordable to many capital intensive startups as they seek to focus their capital on the growth of the company. Other operating and

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[4] *Advancing Australia as a Digital Economy: An Update to the National Digital Economy Strategy,* 12 June 2013

[5] *Securing Australia's Manufacturing Future,* 18 December 2013

[6] It is worth noting that not all stakeholders were equally informed regarding current domestic or international arrangements relevant to the taxation of ESSs.

administrative costs, such as the documentation required to establish an ESS, were also identified in the consultation process.

QUESTION 2: WHY IS GOVERNMENT ACTION NEEDED?

17. The problems identified with the existing ESS taxation arrangements can only be addressed by changing the legislation to make the use of ESS more attractive and accessible.

18. An attractive and accessible ESS is essential to encourage a flourishing startup sector which is an important element of ensuring Australia is a thriving hub for innovative industry.

19. International research suggests that companies in which employees have an ownership interest are more productive than those that do not.

QUESTION 3: WHAT POLICY OPTIONS ARE YOU CONSIDERING?

20. There are two main aims for this proposal:

- For all companies, the aim is to ensure that they remain internationally competitive and reduce disincentives for employers and employees to participate in ESSs.
- For startups, the aim is to minimise complexity and compliance costs associated with the tax law, and increase the incentives for the startup sector to use ESSs.

21. In addition to 'status quo' and 'deregulatory' options, consultation has contributed towards the development of various options for reform. This process, commenced by the previous government but now taken forward under the current Government, has included the release of a discussion paper prior to the 2013 Federal election and a small number of submissions received in response to that paper, with further submissions received from stakeholders in January and February 2014 under a new consultation process involving direct consultations with stakeholders and liaison with various Ministers, government agencies and departments.

22. This Regulation Impact Assessment examines five options.

Option 1: Maintain the status quo ['the do nothing option']

23. Under option 1, no changes will be made to the legislative arrangements that govern ESS. That is, the status quo will be maintained.

Option 2: Remove the ESS tax concessions ['the deregulatory option']

24. Under option 2, all concessions for ESS will be removed. One submission to the existing consultation process raised a similar suggestion, arguing that increasingly smaller numbers of companies are utilising the current ESS arrangements, and instead establishing alternative 'workaround' arrangements to avoid both the tax and regulatory imposts of the current scheme, and that as a result the ESS tax arrangements deliver insignificant revenue while placing a burden on the economy.

25. Under this option, employers will not have to comply with the rules in Division 83A of the ITAA 1997. While the compliance cost savings for employers will be large, employers will not be able to access concessional income tax treatment for the shares and options that they provide to their employees.

26. In addition, ESS will also become subject to fringe benefits tax. Currently, where an ESS meets the requirements of Division 83A of the ITAA 1997, the legislation provides that it is not a fringe benefit (for

the purposes of the *Fringe Benefits Tax Assessment Act 1986*) and therefore not subject to fringe benefits tax. This is to avoid double taxation because ESS is taxed under the ITAA 1997. However, if the tax treatment of ESS concessions was no longer covered under the ITAA 1997, ESS would then be subject to fringe benefits tax. Any compliance savings to the employer from removing it from the ITAA 1997 would be lost and, in many cases, the ESS interest would be subject to a higher rate of tax than it is at present.

27. Furthermore, the environment external to the ESS arrangements, in which many of the existing 'workaround' arrangements operate, is also constantly evolving.

Option 3: Defer the taxing point for all companies, and address administrative concerns, while retaining existing integrity measures ['the first regulatory option']

28. This option involves a number of elements which, in combination, would reduce or delay the tax burden faced by employees receiving interests in ESSs at a discount and would reduce the costs faced by startups in establishing and maintaining ESSs.

First element

29. The first element would change the taxing point for ESS back to that which existed prior to the changes made in 2009 (while retaining suitably adjusted reporting obligations to the ATO to maintain integrity)[7]. The exemption for the first $1,000 of assessable discount on shares taxed up front for employees with assessable income exceeding $180,000 could also be reinstated.

30. This option would see the taxing point for rights be deferred to the *earliest* of:

- when the right is disposed of (other than by exercising it);
- when the employment in respect of which the right was acquired ceases;
- if the right is exercised, and the share acquired as a result has disposal restrictions attached to it or there are conditions that could result in the share being forfeited – the time when those restrictions or conditions expire;
- if the right is exercised and there is no such restriction or condition – the time when the right is exercised; or
- fifteen years after the right was acquired.

31. For shares, there will be no change to the taxing point. If there are no conditions which could lead to the share being forfeited, the taxing point is the time of acquisition.

32. In other cases the taxing point for shares is the *earliest* of:

- when the share is disposed of;
- the later of:
  - the time when the disposal restrictions expire; and

[7] The changes in 2009-10 introduced increased reporting requirements to improve the integrity of the tax system. As a result, employers are currently required to report shares and rights acquired under an ESS both at issue and at an employee's taxing point.

  - the time when relevant forfeiture conditions expire;

- when the employment in respect of which the share was acquired ceases; or
- fifteen years after the share was acquired.

Second element

33. The second element would address the difficulties that startups face in valuing rights where the taxing point occurs prior to the existence of an objective market price. There are two components to this.

34. The *first component* would involve amendments to the existing 'safe harbour' valuation tables, to update the tables to reflect current market conditions. A 'safe harbour' method is one that is endorsed by the ATO for use in tax affairs. The existing safe harbour valuation tables (in Division 83A of the Income Tax Assessment Regulations 1997) are used to value unlisted rights, to ensure that they reflect current market conditions. However, these tables have not been updated since the 1990s and are based on outdated estimates of dividend yield, risk-free interest rate and volatility of share prices. As the tables have become outdated, they are not widely used. Other things being equal, this change would generally reduce the amount of income tax employees would be obliged to pay on unlisted rights that were acquired at a discount.

35. The *second component* would involve the ATO working with industry to develop a simple valuation method that will streamline the process of establishing an ESS. A simple valuation method means that valuations could be conducted in house; thus minimising the expense and difficulty incurred in seeking an independent valuation. ASIC will also be consulted given their oversight of disclosure documents that involve the offer of securities.

Third element

36. The third element relates to existing disclosure requirements under the *Corporations Act 2001*, which have also been identified in consultation as a deterrent to startup companies looking to issue shares under an ESS. While not designed to address ESSs specifically, the Corporations Act provides relief from disclosure requirements for offers totalling not more than $2 million that result in securities being issued or transferred to no more than 20 investors, within a 12 month period.

37. In addition, ASIC Class Order 03/184 provides limited relief for unlisted bodies from the requirement to produce a disclosure document when offering options through an ESS. ASIC is currently reviewing that Class Order, and has consulted on a range of matters, including broadening the classes of financial products that may be offered, and expanding the categories of persons who can participate in an ESS which qualifies for relief. ASIC expects to release its updated regulatory guide in the third quarter of 2014.

Fourth element

38. Finally, the fourth element of option 3 would be to retain the current employer reporting and withholding requirements that were introduced in 2009. Employer reporting ensures that the ATO has a source of data to cross match against individuals' tax returns, while withholding allows tax to be collected that might otherwise not be.

Regulatory Cost

39. Table 1 shows the average annual regulatory costs for this option, 'the first regulatory option'. The total compliance cost incurred by industry is estimated at $0.3 million per year, which is comprised of:

- the total set-up costs for existing ESS users of around $380,000, averaged (over ten years) at $38,000 per year; plus

- the total set-up costs for new ESS users of around $540,000, averaged (over ten years) at $54,000 per year; plus

- the total ongoing compliance costs for new ESS users of approximately $209,000 per year.

40. This is based on the assumption that firms currently offering an ESS would incur a one-off compliance cost (but no new ongoing costs) because of the new rules. This cost is based on an additional seven hours per firm spent on learning, communication, systems and record keeping.

41. It is estimated that new ESS users will incur a one-off start-up investment of 40 hours per firm (on average), spent preparing reports on ESS interests. It also assumes that reporting to the ATO and the employees of the business will take an average of 15 hours per firm (per year).

42. A regulatory offset has been identified from within the Treasury portfolio. This offset relates to the Future of Financial Advice (FOFA) reforms.

TABLE 1: OPTION 3 REGULATORY BURDEN AND COST OFFSET ESTIMATE

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (<u>$million</u>)	**Business**	**Community Organisations**	**Individuals**	**Total change in cost**
Total by Sector	0.3	-	-	0.3
Cost offset (<u>$million</u>)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	0.3	-	-	0.3
Total by Sector	0.3	-	-	0.3
Are all new costs offset? **☒yes, costs are offset (see below) ☐ no, costs are not offset ☐ deregulatory, no offsets required**				
Total (Change in costs - Cost offset) (<u>$million</u>) 0				

Option 4: Provide the same four elements as Option 3, and add additional concessions for startups [‘the second regulatory option’]

43. Industry has argued that the 2009 changes to the taxing point are out of step with global practice and that they put Australian companies at a disadvantage in attracting and retaining the staff they need.

44. In addition to the elements outlined under Option 3, a further benefit could be provided to startups, along the lines of concessions currently operating in the United Kingdom, in order to improve the international competitiveness of Australia’s arrangements.

45. This option will allow eligible startups to issue rights or shares at a small discount, and have the tax treatment of that discount deferred until disposal (for both options and shares), with any gains on the options or shares from the date of issue taxed under normal capital gains rules.

46. The level of tax exempt discount able to be provided on options will be capped by requiring that the strike price of the option is greater than or equal to the market value of the underlying share on the date of issue (that is, the option is not ‘in the money’ when issued). Shares that are provided at a discount of no greater than 15 per cent will also not be subject to income tax on issue.

47. A key policy driver in providing such a concession would be to enhance the productivity of startups, by seeking to further align employer and employee interests through the use of ESSs. With this policy focus in mind, the concession could be restricted to unlisted companies with an aggregated turnover of no more than $50 million that has been incorporated for less than 10 years, as a proxy for defining a startup. To ensure that the concession operates to further align interests and is not simply used as a vehicle to indefinitely defer the payment of tax, appropriate integrity arrangements could include maximum limits on the amount of options and/or shares that an employee may hold in the company; exclusion of particular associates of directors or significant shareholders from participation in the scheme;

ESS options and shares could be subjected to minimum holding periods of 3 years; and requirements could apply to employers to report on the number of ESS interests issued under this option.

Regulatory Cost

48. Table 2 shows the average annual regulatory costs for this option, the 'second regulatory option'. This option would result in the same compliance costs as option 3 plus the additional compliance costs associated with the small business concessions of $1.02 million. These additional compliance costs are comprised of:

- the total set-up costs of around $2.16 million, averaged (over ten years) at $216,000 per year; plus
- the total ongoing compliance costs of around $809,000 per year.

49. This is based on the assumption that preparing reports on ESS interests would be a one-off start-up cost involving an average of 40 hours per firm. It also assumes that reporting to the ATO and the employees of the business will take an additional 15 hours per firm (per year).

50. A regulatory offset has been identified from within the Treasury portfolio. This offset relates to the Future of Financial Advice (FOFA) reforms.

51. Options 3 and 4 combined have an estimated cost to revenue of $200 million over four years.

TABLE 2: OPTION 4 REGULATORY BURDEN AND COST OFFSET ESTIMATE

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (\$million)	**Business**	**Community Organisations**	**Individuals**	**Total change in cost**
Total by Sector	1.02			1.02
Cost offset (\$million)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	1.02	-	-	1.02
Total by Sector	1.02	-	-	1.02
Are all new costs offset? ☒yes, costs are offset (see below) ☐ no, costs are not offset ☐ deregulatory, no offsets required				
Total (Change in costs - Cost offset) (\$million) 0				

Option 5: Provide direct funding to startups to reduce the cost of establishing ESSs ['a non-regulatory option']

52. A non-regulatory option may provide benefits to startups offering ESSs. One non-regulatory option that has been suggested is to provide funding to startups to assist them with the cost of setting up an ESS. This would provide direct benefits to startups but would not provide any direct benefits to employees of startups (or employees of larger companies).

QUESTION 4: WHAT IS THE LIKELY NET BENEFIT OF EACH OPTION?

Option 1: Maintain the status quo

53. A 'do nothing' option is to be considered in cases where problems may be self-corrected by market mechanisms. As the perceived problems are caused by existing legislative requirements, maintaining the status quo and hence doing nothing will not resolve the issues.

Option 2: Remove the ESS tax concessions

54. Removing the existing ESS tax concessions would be likely to reduce the overall attractiveness of ESSs, which may lead to a decline in their use. This may have impacts for the startup sector – some stakeholders claimed that this sector in particular relied upon ESSs to remunerate or reward their staff while ensuring capital could be retained for reinvestment in the business. The additional impact might be that any productivity gains associated with the use of ESSs would be lost. Any regulatory savings achieved will likely be outweighed by new FBT compliance costs.

Option 3: The first regulatory option

55. The proposal to reverse, for all companies, the changes to the taxing point for options made in 2009 while retaining the integrity provisions would delay the taxing point for most employees and improve the attractiveness of participating in an ESS relating to options, including for employees of startups. This proposal would address the key concerns raised by all companies during the consultations.

56. This option is also attractive in that it would also avoid introducing into the law arbitrary boundaries to identify those eligible for changes to the taxing point. Many in the consultation process indicated that startups are difficult to define in a way that is useful in the tax law. In fact, a number of stakeholders (1 in 4 submissions) were resistant to the idea that any response be limited to just startups.

57. Retaining certain reporting requirements within this adjusted framework would minimise scope for losses to Commonwealth tax revenue through evasion or avoidance. Consultation revealed that many stakeholders (although admittedly not everyone) accept such reporting as a reasonable mechanism for tracking compliance with the law.

58. There are expected to be medium implementation compliance costs arising from this option. Businesses will need to learn about the changes. In particular, they may have to adhere to three different sets of rules to determine taxing points for options; these are the pre-2009 rules (for schemes established during that period and regulated by the arrangements relevant at that time), the 2009-2015 rules (for schemes set up under the existing ESS arrangements and regulated by those arrangements), and the post-2015 rules (for schemes yet to be established under any new arrangements). However, businesses and individuals who have schemes under more than one set of rules are expected to have systems in place and be familiar with the pre-2009 rules. They may also have to develop a communication strategy to inform their employees, and make changes to their systems to track the different taxing point. However, these companies will already have the foundations for ESS.

59. All ongoing impacts are expected to be minor.

60. Individuals who are offered an ESS interest after the changes are introduced will need to learn about the changes and evaluate how they may be affected.

Option 4: The second regulatory option

61. While option 3 would address the key concerns raised by all companies, there may be a need to provide additional concessions to startups in order to improve their competitiveness in an international context.

62. In relation to the proposed concession for startups, businesses will need to determine if they are eligible to qualify. Individuals will also need to learn about this change and determine if they work for an eligible startup. These changes are expected to have medium implementation compliance costs.

63. Ongoing compliance costs are expected to be low. Startups with an ESS will need to indicate via their reports to the Australian Taxation Office whether they are a startup. An individual with shares from an ESS and who is employed by an unlisted startup that utilises this concession may need to complete additional labels on the individual income tax return.

Option 5: Provide direct funding to startups to reduce the cost of establishing ESSs

64. Providing funding to startups to implement ESSs would not address the cash flow problems that employees face in paying tax on discounts received before they are able to find the cash to pay that tax. This option would reduce the costs to startups of setting up an ESS but would not by itself increase the

popularity of ESSs with their employees. This is because direct funding to startups does not change the taxing point, which is the key concern of these companies.

65. This proposal should not give rise to any additional compliance costs, as no changes in regulation would occur. Companies that chose to implement a new ESS, thus incurring additional costs of implementation and ongoing administration, would be provided with funding for their expenses incurred. However, their employees would continue to pay tax on their ESS interests in the year of acquisition (unless there is a real risk of forfeiture).

Summary

66. For both options 3 and 4, the benefits to companies and their employees of more concessional tax treatment of ESSs will outweigh additional compliance costs on businesses and employees flowing from those changes.

QUESTION 5: WHO WILL YOU CONSULT ABOUT THESE OPTIONS AND HOW WILL YOU CONSULT THEM?

67. The Government announced on 21 January 2014 that it would commence direct consultations with interested stakeholders in relation to the existing ESS arrangements for startups.

68. During consultations, stakeholders expressed concern that the current arrangements for ESS in Australia are complex, costly and create a barrier or disincentive for many startups to set up an ESS; so much so that startup companies, like larger and more established corporations, often need to seek legal, financial and accounting advice to establish an ESS. These arrangements put Australian startups at a competitive disadvantage in international markets, by making it harder for startups to attract and retain the skilled employees needed to grow the company (who generally tend to consider work opportunities offered within a global marketplace).

69. The purpose of stakeholder consultation on the taxation of ESSs, which was undertaken in January and February 2014 (and referred to earlier in this RIS) was to better understand the impacts of the current rules for ESSs on startups. An open invitation was placed on the Treasury website inviting stakeholders to nominate to participate in that consultation process[8], meaning that consultation was not necessarily restricted to the startup community. This invitation was subsequently forwarded to known stakeholders, both from the startup and tax advising community. Face-to-face and teleconference roundtable meetings were held with around 90 individual stakeholders in total. Fifty seven submissions (yet to be released publicly) were received from stakeholders, in addition to the 18 submissions that had been received in response to the previous government's discussion paper. Note that the key issues identified in that consultation process have been noted earlier, under *Question 1: What* is the problem *you are trying to solve?*

70. There is consensus from submissions that the current tax rules impede the use of ESSs in Australia and that this provides a deterrent to attracting and retaining the internationally-mobile staff that they need to grow their business, with flow-on impacts for decisions to commence and retain operations in Australia; that the costs of setting up ESSs for startups are very high and that any solutions adopted should therefore seek to minimise costs and keep complexity to a minimum; and that it is expensive and conceptually difficult to determine the market value of startups (or unlisted companies more generally) for the purpose of valuing employees' interests in ESSs. However, there was no consensus about a range of

[8] See Treasury website: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Employee-Share-Schemes-and-Startups

matters, including those most deserving of assistance or concessions, and any method for identifying such a group.

71. Any regulatory changes to ESS will involve legislative amendments. Public consultations on the draft legislation will be conducted with the sector on these amendments. Further consultations with industry will focus on working through the practical aspects of any proposed amendments and ensuring that the legislation achieves the intended policy outcomes. It will also provide an opportunity for industry to voice any further concerns for consideration prior to the introduction of legislation into Parliament.

QUESTION 6: WHAT IS THE BEST OPTION FROM THOSE YOU HAVE CONSIDERED?

72. Consultation made it very clear that there was no one agreed view regarding how to define the target group for which any additional assistance or concessions could be provided. Further, it became clear that it was unlikely that any one single policy response would address all identified concerns. Indeed, even startup companies themselves, at different stages of development, did not necessarily agree a single outcome.

73. However, there was a very strong view put that the 2009-10 changes to taxing points for ESS interests had impacted on the decisions of parties to offer ESSs (particularly those relating to options) to their employees.

74. Options 3 and 4 are the preferred options as they address the majority of concerns raised by stakeholders. Option 4 provides the most comprehensive response by giving an additional concession to startups.

75. Reverting to the taxing points that existed prior to the 2009 changes would avoid the need to introduce a definition of a ‘startup’ (which, as outlined above, is likely to be problematic), although eligibility requirements would apply to the startup concession.

76. The second best option is to provide option 3 alone – that is, to change the taxing points to the pre-2009 arrangements, without the accompanying concession for startups focused on enhancing the international competitiveness of Australia’s arrangements.

77. Option 5 only goes part of the way to solving the concerns of companies and does not address their key concern at all, so it is not preferred.

78. The least favourable options are options 1 and 2 because they do not address any of the concerns raised. In addition, in the case of option 2, it may make companies and employees worse off.

QUESTION 7: HOW WILL YOU IMPLEMENT AND EVALUATE YOUR CHOSEN OPTION?

79. Legislation will be introduced to implement changes to the taxing point for interests in ESSs, and draft legislation will be the subject of further consultation. Very strong views have been put forward that early commencement of policy options is desirable, with many advocating strongly that the arrangements should be ready to commence by 1 July 2015.

80. Further consultation on appropriate safe harbour valuation methodologies will also be conducted by the Australian Taxation Office with startups.

81. The ATO and ASIC have also agreed to work to develop and approve standardised documentation for use by companies to reduce the amount of 'red tape' and streamline the establishment and administration of ESSs.

82. In addition, it was noted earlier that ASIC expects to be in a position in the third quarter of 2014 to be able to release its updated regulatory guide with respect to ASIC Class Order 03/184.

83. The effectiveness of the selected proposal in meeting the objective of increasing growth in the startup sector could possibly be measured by an increased take up of ESSs among small to medium sized business entities (SME) over the subsequent years. This proposal may also lead to an increased number of SMEs. Such metrics could be examined in a subsequent review. It is proposed to undertake such a review of the new arrangements after five years from the date of commencement of the legislation, to examine whether the arrangements have achieved their objectives. In addition to considering those objectives, this could also include examination of the extent to which the legislation:

- gives effect to the Government's policy intent, with compliance and administrative costs commensurate with those foreshadowed in the Regulation Impact Statement for this proposal;
- is expressed in a clear, simple, comprehensible and workable manner;
- avoids unintended consequences of a substantive nature;
- takes account of actual taxpayer circumstances and commercial practices;
- is consistent with other tax legislation; and
- provides certainty.