



THE TAX INSTITUTE

25 August 2021

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

By email: ESSreforms@treasury.gov.au

Dear Directors

Employee Share Schemes

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the Exposure Draft Legislation and Explanatory Materials in relation to the announced changes to certain arrangements for employee share schemes (**ESS**). Our submission is limited to comments on:

- Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Employee Share schemes – Removing cessation of employment as a taxing point (**Exposure Draft Legislation**); and
- Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Employee Share schemes – Removing cessation of employment as a taxing point exposure draft explanatory materials (**Exposure Draft Explanatory Materials**).

We have not commented on the regulatory, non-tax, aspects of the draft legislation and explanatory materials.

The Tax Institute supports the enactment of legislation amending the ESS provisions contained in Division 83A of the Income Tax Assessment Act 1997 (**ITAA 1997**) to remove cessation of employment as a taxing point.

As drafted, the changes will apply to ESS interests issued on or after the first 1 July after the commencement date. The commencement date is not until the first 1 January, 1 April, 1 July or 1 October to occur the day after the enabling legislation receives Royal Assent. This means that provided the enabling legislation receives Royal Assent before 1 April 2022, the changes will apply to ESS interests issued on or after 1 July 2022.

We recommend that the amendment made by the Exposure Draft Legislation apply to any cessation of employment which occurs on or after the first 1 July to occur after the commencement date.

We make this recommendation on the basis that it:

- will simplify the application of the ESS rules;
- is not detrimental to employees or employers; and
- should not materially impact taxation revenue.

Our detailed response is contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more about The Tax Institute.

If you would like to discuss any of the above, please contact Tax Counsel, Julie Abdalla, on (02) 8223 0058.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Peter Godber', with a stylized, flowing script.

Peter Godber

President

APPENDIX A

Recommendation

The Tax Institute recommends that the amendment made by the Exposure Draft Legislation apply to any cessation of employment which occurs on or after the first 1 July after the commencement date.

We have set out below further details supporting our reasoning for this recommendation.

Simplicity

If the amendment applies only to ESS interests acquired after the commencement date, employees and employers will have to distinguish between pre- and post-ESS interests and, at the cessation of employment, apply different taxation rules to each ESS interest accordingly. This will unnecessarily increase complexity for both employees and employers.

Alternatively, if the amendment applies to all ESS interests when the cessation of employment happens after the commencement date, the tax treatment in relation to the cessation of employment will be consistent for all ESS interests. This is simpler for both employees and employers, and will reduce the risk of errors arising from the incorrect application of different rules.

No detriment

Employees who cease employment will, in most cases, have their ESS interests terminated on or before cessation of employment. This generally occurs either by a forfeiture of unvested ESS interests or by an acceleration of the vesting date for the ESS interests. The amendment contained in the Exposure Draft Legislation has no impact on such cases.

However, in a minority of cases, employees will continue to hold ESS interests with ongoing vesting conditions. The amendment will generally operate to the benefit of employees in these cases. This is because it removes a taxing point which occurs before the employee is able to monetise their ESS interests and fund their income tax liability. It follows that, if the amendment were to apply to ESS interests acquired before the commencement date, it should not disadvantage employees who subsequently cease employment.

Conversely, if the amendment does not apply to ESS interests acquired before the commencement date, employees with ESS interests who cease employment will continue to trigger a taxing point in relation to their ESS interests when their employment ceases. While this is not an unexpected outcome, it is not consistent with the policy underpinning the removal of the cessation of employment taxing point. The simple reason the amendment is being made is because the taxation of unvested ESS interests when a person's employment ceases is an undesirable outcome.

Employers have ESS reporting obligations, to both the employee and the ATO, at the time of a deferred taxing point. If the amendment does not apply to ESS interests acquired before the commencement date, employers will have to undertake an additional step in determining whether there is a relevant reporting obligation. Specifically, employers will need to consider every cessation of employment over the next 15 years from the commencement date (being the maximum tax deferral period) to determine whether, based on when the ESS interest was acquired, there is an ESS reporting obligation.

In addition, when employers communicate the ESS rules to their employees, they will need to distinguish between ESS interests acquired before and after the commencement date for the next 15 years. This additional complexity is likely to cause confusion for employees and diminish the attractiveness of ESSs.

Impact on taxation revenue

The removal of the cessation of employment as a taxing point will result in a deferral of payment of income tax, but this is largely a timing difference and is unlikely to result in a reduction to income tax revenue. This is because the former employee will ultimately be assessed at one of the remaining deferred taxing points. Further the removal of the cessation of employment taxing point delays when the relevant shares becomes subject to tax under the capital gains tax rules, and potentially results in more gains being taxed as ordinary income rather than discounted capital gains.

The requirement for employers to report the ESS discount at the deferred taxing point to the former employee and ATO, mitigates the risk of former employees not reporting the ESS discount in their income tax return. Extending the removal of cessation of employment as a taxing point to ESS interests acquired before the commencement date therefore should not materially reduce the taxation revenue.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.