Submission to the Treasury, Philanthropy and Exemptions Unit, Personal and Retirement Income Division

Reform of the Taxation of Employee Share Schemes

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CONTENTS

1. Introduction

1.1. Established in 1918, AMMA is the national employer association for the mining, hydrocarbons and associated processing and service industries, including significant numbers of construction and maintenance companies, catering companies, vessel operators, etc. operating in the resources sector. All major mining and oil and gas operates are AMMA members.

1.2. AMMA strongly recommends that the government's budget night announcement and subsequent considerations in relation to employee share schemes be placed on hold until a comprehensive review process is activated and completed. The unintended consequences of the announcement are significant and requires detailed consideration.

1.3. In principle, AMMA believes the government should continue to encourage employee share ownership.

1.4. AMMA acknowledges that the ATO has a key role in relation to addressing any tax avoidance issues associated with employee share schemes and reporting arrangements can be improved.

1.5. AMMA submits a balance needs to be achieved in retaining and increasing employee share scheme arrangements and addressing wide ranging anomalies and enforcement around taxation issues.

1.6. The government's budget announcement of changes to employee share schemes, the tax treatment and other associated unexpected changes, has AMMA members and their employees left extremely, as some have described it, 'distressed and concerned'. Left unchanged employers and employees will be disadvantaged and government tax collections will reduce.

1.7. A recent members survey reflects the announcement and subsequent alternate proposals, left unchanged, will result in majority of employee share schemes in the industry remaining frozen.

1.8. Employers across the resources sector have put planned rollout of employee share ownership plans on hold as future participation in such schemes will be unattractive to most employees and employers.

1.9. The budget night announcement also makes Australia far less attractive in relation to other global/employment practices and tax treatment of such schemes. Multinational employment and company structures are common in the resources sector.

2. Employee Share Plans in the Resources Sector

2.1. Many resources sector employers have had employee share plans in place since the early 1980s. Employee share plans have become enmeshed in remuneration design across the industry as they:

2.1.1. provide an incentive for employees to participate in the growth of the company, establishing a better alignment between their interests and those of the employer and facilitation of greater levels of employee engagement;

2.1.2. improve employee productivity by linking performance of work with the activities of the company and performance of company share prices;

2.1.3. increase workplace harmony by dissuading disputation that impacts on company performance and encouraging more cooperative relationships; and

2.1.4. provide flexibility to both employers and employees in remuneration packaging, particularly where otherwise high salaries and other benefits are not available.

2.2. Data obtained in 2004 showed that the mining industry accounted for 16 percent of all employees who received shares as an employment benefit.[1] This was only second to the finance and insurance industry.[2] In the past 5 years employee share participation in our industry has continued to increase.

2.3. A survey of AMMA members, and those responding collectively employ in excess of 100,000 employees, reveals that: [3]

2.3.1. 82.5 percent of respondents have an employee share plan in place covering more than 40,000 employees. Of those respondents, 30 percent have been operating an employee share plan for longer than 5 years;

2.3.2. 66 percent of respondents have implemented a broad based employee share plan, which is available to all employees.

2.3.3. 58 percent of those that do not currently have an employee share plan were considering implementing such a plan or were in the process of rolling one out. Of these respondents, the predominant reason for implementing such a plan was to 'align the interests of the employee and employer' (87 percent) followed closely by 'improve employee recruitment and retention' (85 percent), and 'provide a benefit to the employee (75 percent).

[1] Ingrid Landau et al, *An overview of existing data on employee share ownership in Australia*, *Employee Share Ownership* Research Report, March 2007, Centre for Corporate Law and Securities Regulation, Centre for Employment and Labour Relations Law, the Tax Group and the University of Melbourne., 5.
[2] Ibid.
[3] AMMA, Survey on Employee Share Plans in the Resources Sector, May 2009, AMMA.

2.4. The government's announcement has already resulted in 50 percent of respondents placing their employee share plans on hold and another 30 percent answered that they will no longer consider having an employee share plan. Responding to a question about the impact of cancelled employee share plans on their remuneration arrangements, a typical response was:

> *It will negatively affect our recruitment and retention strategies and lead to an increase in direct salary costs. Our preference is to have employees participate positively in the growth and success of the company through a share plan where the rewards of ongoing success are mutually shared.*

Another respondent was critical of the changes and the restriction it has posed on engaging in long term strategic approaches:

> *The issue for us is the amount of time and resources required to resolve this issue without any notice or chance to prepare and take a long term approach. On top of all the other uncertainty in our business because of the economic situation, the last thing our employees need is greater uncertainty.*

Another stated:

> *With cash flow capabilities severely stressed, we were about to roll out an employee share plan. This is now on hold and we encourage active lobbying to reverse the decision.*

2.5 Mooted changes, post the budget night announcement, including increasing the remuneration threshold will still result in most employee share schemes in the resources sector remaining frozen.

As one ‘blue chip’ resources company responded.

> *The proposed amendments to the budget announcement would still prevent the continued operation of pre budget employee share schemes – over 65% of our employees take up share allocations and the company and employees are deeply disturbed and distressed by the impact of the announcements on employee share schemes.*

3. Submission Approach

3.1. The Consultation Paper released by the Treasury on 5 June 2009 in response to the government’s proposed changes has put forward the government’s proposed modifications to the announced measures. These modifications are listed at page 12 of the Consultation Paper and are reproduced below for ease of reference:

3.1.1. to raise the income threshold for the $1000 tax exemption to $150,000;

3.1.2. to introduce a limited deferral of the taxing point for some schemes;

3.1.3. to introduce an annual reporting requirement and associated withholding arrangements by companies that participate in these schemes;

3.1.4. to review existing rules for valuing discounted and deferred shares or rights; and

3.1.5. to modify the rules relating to the refund of income tax for forfeited benefits.

3.2. The first three proposed modifications will be addressed below.

4. The Tax Exemption Income Threshold

4.1. The 2009 Budget announcement proposed to introduce a new income threshold that will determine eligibility to access the $1000 tax exemption. The threshold announced by the government was $60,000.

4.2. In a sector such as the resources sector where average earnings are in excess of $105,000 per annum, the new measure would preclude a number of resources sector employees from the benefit of the exemption.

4.3. The government proposes to modify the threshold by increasing it to $150,000 on the basis that it 'should cover the vast majority of employees who currently participate in schemes designed around the $1000 exemption'.[4]

4.4. However, despite this subsequent announcement to increase the threshold, most employee share schemes in the resources sector will remain on hold as it will create unequal accessibility among employees. This is an important issue for resources sector employers that, due to improved productivity, increased employee engagement and better employer/employee relationships, have in place 'all staff' employment arrangements that do not draw a line in the sand between employees and management. The appeal for employers to implement broad based employee schemes that align with this 'all staff' arrangement will be lost.

[4] The Treasury, Reform of the Taxation of Employee Share Schemes, Consultation Paper, June 2009, Australian Government, 14.

4.5. AMMA does not support the imposition of any threshold eligibility for the $1000 taxation exemption. The imposition of a threshold for eligibility is at odds with 'all staff' arrangements in the resources sector. AMMA therefore supports the continuation of the existing scheme which treats all employees equally.

5. Deferral of the Taxing Point

5.1. The 2009 Budget announcement proposes to require taxation to be paid on all discounts on shares and rights to be paid in the income year in which they are acquired.

5.2. Existing law allows payment of taxation to be deferred for a maximum period of 10 years.

5.3. While it is proposed that the general tax up-front measure announced in the Budget will continue, the Consultation Paper proposes to allow limited deferral in situations where there is a 'real risk that the benefits of shares or rights are never realised (because of forfeiture)'.[5]

5.4. More concerningly is the proposal to modify the taxing point to the earliest of:

5.4.1. when the employee can pass title to the share or right;

5.4.2. cessation of employment; or

5.4.3. the end of 7 years.

[5] Ibid, 16.

5.5. AMMA does not perceive any issue with respect to reducing the 10 year maximum deferral period to 7 years. However, particular disadvantage is likely to arise under the deferred taxing point described in paragraph 5.4.1 above (when the employee can pass title to the share or right), where a share is held in trust or where an option has vested but cannot be dealt with by the employee due to timing restrictions imposed in a shareholder agreement.

5.6. A share taxed while held in trust for an employee will remove some of the equity held in the share, lessening the link tying the interests of the employee with those of the employer and performance of the company.

5.7. For those employees whose option has vested but are restricted by shareholder agreement in their ability to sell the share for a period of time may result in the employee being obligated to pay tax on a share value that does not materialise if the share price falls during that restricted period.

5.8. The consequences of this limited deferral option combined with the threshold exclusion of some employees from the schemes will not see a reinvigoration of employee share schemes put on hold by resources sector employers.

5.9. AMMA does not support the deferred taxing point to when the employee can pass title to the share or right, where this results in an employee being required to pay tax on a share or right which has vested, unless the employee has formal control.

5.10. Generally speaking, AMMA supports taxing at point of vesting and control with an employee.

6. Reporting Requirements for Employers

6.1. The government's proposal to introduce reporting requirements for employers offering employee share schemes is not opposed by AMMA.

7. Salary Sacrifice Arrangements

7.1 Some employee share purchase schemes operate on the basis of part salary sacrifice, part employer (matching) contributions that vest typically after 3 years. If employees were forced, as per the revised proposals, to pay tax upfront on the salary sacrifice component of such schemes instead of at the vesting point after three years, then such schemes will also become unattractive.

8. Conclusion

AMMA strongly recommends a return to pre budget announcement treatment of employee share schemes.

The impasse, uncertainty, unintended consequences will result in the removal of employee share schemes as an effective employee engagement and remuneration strategy for employers and employees.

AMMA urges the government to restore certainty and then embark on a more extensive consultation process that encourages employee share scheme ownership and addresses tax avoidance issues.