



Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

15th June 2009

Dear Sir or Madam,

Thank you for the opportunity to respond to the Consultation paper "Reform of the Taxation of Employee Share Schemes", and please accept this email as AIIA's comments on the Paper released June 3rd. I apologise for the lateness of the response.

The Government is to be congratulated for acting so promptly on the business concerns expressed after the initial Budget announcement, and for releasing for comment alternative solutions to those widespread concerns. The decision to continue with existing law in the interim is also welcomed, as this provides some degree of certainty in the short-term. However, notwithstanding the suggested changes to the Budget announcements, AIIA remains concerned that the proposed new scheme will have the unintended consequence of closing down many legitimate, compliant and non-evading employee share schemes in organisations of all sizes.

The reasons for this vary but in essence have to do with;

- taxing potential unrealised gains,
- addressing tax avoidance, and
- disparity with international jurisdictions.

Before setting out our comments on this initiative, it may assist if I outline my Association's profile. The Australian Information Industry Association (AIIA) is Australia's peak technology industry body. AIIA's role is to lead and represent the ICT industry in Australia to maximise

the potential of the Australian economy and society. AIIA's membership encompasses all sectors of the ICT sector including hardware, software, services and telecommunications. It has almost 500 member companies, from individual consultants, small to medium enterprises to the world's leading multinational corporations. AIIA member companies employ over 100,000 Australians, generate combined annual revenues of more than \$40 billion (approximately 5% of GDP) and export more than \$2 billion in goods and services each year.

Many of our large and small ICT members have operated employee share ownership schemes as staff incentives for many years. They have done this to match their employees' performance to longer-term objectives, especially when salary rises and other cash benefits are restrained in these dire financial times.

The ICT sector is characterised by small, innovative and entrepreneurial organisations struggling in current economic conditions to motivate and retain good staff. Tying employee performance to the overall performance of their company is one way to ensure engagement and alignment with corporate aims, enabling workers to share in wealth creation longer term.

AIIA supports Government efforts to address alleged abuses of the share scheme, particularly in the wake of recent audit data released by the ATO. However, as a statement of first principle *AIIA urges the Government to address tax evasion and avoidance through the traditional compliance and enforcement measures available to the ATO (or supplemented by additional measures) rather than by compromising viable policy objectives of promoting the alignment of corporate performance and employee performance.*

In particular, AIIA does not agree with the statement at paragraph 16 of the Consultation paper that evidence of avoidance clearly shows that the employee share scheme as originally established 'is not achieving its policy objective'. On the contrary, evidence of tax avoidance is merely evidence of tax avoidance, and clearly shows that enforcement and compliance measures must be tightened to deal with certain individuals. It does not prove that the policy objective has failed.

Income Threshold

The proposed new threshold, although improved, is the not an appropriate mechanism to deal with tax evasion. In any case it is still too low for senior professional workers in the IC industry; a staff software engineer or senior engineering manager routinely makes more than \$150,000. If the purpose of the threshold is to prevent abuse, then setting it to a salary level above \$250,000 would be more appropriate. That said, the threshold model unnecessary if taxation is deferred until the employee realises the value of the shares or rights.

Withholding

Compliance and revenue integrity is clearly an issue, and AIIA does not support or condone evasion of tax obligations. However, compromising an otherwise sound policy objective in

order to address tax evasion is a poor policy response. Compliance issues are always best addressed through the employer, as they are for PAYG and superannuation. Employers are just as able to withhold tax upon shares vesting and options exercising at an agreed rate and remit to the government as they are to do so for PAYG as currently administered. There is no ability to "defer the taxation point", which eliminates the potential for abuse.

Both cameo case studies on page 8 could have been simply remedied by means of the employer withholding taxation at the time that the employer exercised the options.

Taxing Point

Citing paragraph 57, "it is a principle of Australia's tax system that income is taxed in the year that it is earned" (sic). Taxing unrealised benefits is *not* in harmony with this principle.

Specifically, the trigger for shares which are granted by an employer (such as restricted stock that vests over time) should be when they *vest*, which is when the income is actually earned. Similarly, the trigger for options should be when they are *exercised*. Shares have zero value to an employee until they vest. Similarly, options have zero value to an employee until they are exercised. In neither case is the income actually realised prior to the above mentioned triggers. Unrealised earnings should not be taxed, consistent with the statement at paragraph 57.

International Comparisons

The section in the paper on "International Comparisons" does not justify why Australia should pursue a scheme radically different from the US and the UK. Australia cannot afford to be out of step with the rest of developed world especially since business and industry is now a global phenomenon and labour mobility of is a given. AIIA members are particularly concerned about attracting senior talent from overseas if Australia is out of step with the US and the UK. This is not only a concern of larger companies - start-ups frequently lure high quality labour from other jurisdictions with the incentives of lifestyle, concessions and potential sharing in company growth.

As a concrete example of how other jurisdictions deal with employee share options, the following is provided:

Employees in the US and the UK can only sell their shares or exercise their options through Smith Barney (the organisation's globally nominated broker). Smith Barney withholds the tax at the rate by determined by the Government and the employer is obligated to pay that over to the relevant tax authority. It is analogous to way that employers withhold and pay PAYG. There is no way for an employee to override the withholding, unless it is allowed by the relevant tax authority. Further, organisations only issue shares/options rights in the name of the employee, not to an entity such as a trust or super fund. Exercised rights are thus reported as ordinary income against the employee's tax ID, which makes evasion virtually impossible.

In conclusion, AIIA advises that Australia is one of the countries in which our international members operate that *does not require withholding*, so here it is up to the employees to declare the income and pay any taxes due. It would be straightforward for organisations of

all sizes to withhold taxes if required. It would not be much more work than administering the already onerous employee PAYG and superannuation payments.

I would be pleased to elaborate on these points and provide you with access to the CEO's of our member companies to explain in more detail the concerns about retaining the integrity of employee share option schemes. Please do not hesitate to call me if this would be of assistance.

Yours sincerely,

Jan Birks.

Chief Executive Officer | AIIA

P: + 61 2 6281 9444 | M: 0408 64 11 22 | F: + 61 2 6285 1408 | E: i.birks@aiaa.com.au



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AIIA membership is open to everyone in the ICT industry in Australia. Apply on line at http://www.aiaa.com.au/membership_apply.aspx, or contact me for more information.

Your support and contribution is appreciated and encouraged.