

4 February 2022

Ms Phillipa Cordi
Analyst
Corporate Conduct Unit, Market Conduct Division, Markets Group
The Treasury
Level 29, 201 Kent Street
Sydney NSW 2000

Dear Ms Cordi

Thank you for sending us the Employee Share Schemes (ESS) exposure draft legislation and other explanatory materials concerning Treasury's proposed regulatory reforms to the ESS arrangements.

We enclose our comments and input as set out below.

Corporations Act 2001

Proposed section 9 (paragraph (a)) of the definition of contribution plan.

Comments

Deductions for contributions to the ESS are not only sourced from the wages or salary of an employee or director.

The contributions to the ESS trust are made by the sponsoring organisation for the benefit of employee and or contractors of the sponsoring organisation as a general class.

These contributions enable the ESS trust to provide fringe benefits and other benefits and/or other share benefits to be included in the total remuneration of the participants in the sponsoring organisation's ESS's.

Please note that in line with important tax cases, such as Heather's case and the Lynas Rare Earths Limited Case, the contributions are made by the sponsoring organisation to an ESS trust are fully tax deductible to the sponsoring organisation as a business expense falling under the provisions of section 8-1 ITAA 97 (i.e formerly section 51(1) ITAA 36)

ESS Contributions Loan Plan

We note that, in line with common commercial practice, the provision of the ESS interests are usually funded by an interest free loan provided by the ESS trustee to the ESS participants as outlined in section 100 Q and section 1100R of the Corporations Act 2001. Section 1100T imposes requirements for the ESS supporting documentation to be provided to the ESS participants in a listed body corporate's ESS.

Section 1100R imposes requirements for ESS supporting documentation to be provided to the ESS participants in an unlisted body corporate's ESS.

These disclosure requirements for unlisted bodies are expanded under section 1100U and section 1100V.

Treasury Laws Amendment (Measures for Consultation) Bill 2022 Exposure Draft Explanatory Material

Please note that in table 1.1 Comparison of new law and current law, under the heading of New Law, the reference to “participant” should be a reference to “participate”.

We note that under the heading of “Regulatory relief for employee share schemes” at chapter 1.20, that employee share scheme that requires payments from the participants can be operated without an Australian financial service licence.

As you point out at chapter 1.23, this will allow businesses to run their own employee share schemes without having the same regulatory obligations of financial services providers.

As pointed out at chapter 1.24, any employee share scheme must be in addition to the employees wages, which must be paid in full and in money.

Requirements for an employee share scheme

Under chapter 1.26 an offer under an employee share scheme which requires payments to be participate will be entitled to regulatory relief:

- where the offer is made under Part 7.12 Division 1A of the Corporations Act: and
- the total number of products does not exceed the specified percentage of the body’s issued capital (i.e five per cent for a listed body corporate or 20 per cent for an unlisted body corporate).
- For an unlisted body corporate no participant outlays more than \$30,000 worth of interests under the ESS scheme in a 12 month period, and in the case of options, cumulative ESS interest can be issued to the participant up to a maximum of \$150,000.

Participants in an employee share scheme

Participants of an ESS can be a director, employee, and/or service provider of the body corporate that is issuing interests in the ESS, or related person being a spouse, parent, child, or sibling of the primary participant or a body corporate which is controlled by the primary participant or their spouse, parent, child or sibling, or a body corporate that is a trustee of the primary participant’s self managed superfund.

Interests in an employee share scheme

For an ESS to receive relief under the Bill, the ESS interests for a listed body corporate are:

- a fully paid share tradable on an eligible financial market;
- a beneficial interest in a fully paid share which is tradable on an eligible financial market;
- a fully paid share which can be converted into a beneficial interest (or vice versa) without charge or for a nominal fee where either the beneficial interest or share is tradable on an eligible financial market;
- a unit in, an incentive right, or an option to acquire any of the above interests; or
- a fully paid staple security which is tradable on an eligible financial market consisting of any of the above interests, or interest in a listed registered scheme

The ESS interest for an unlisted body corporate are:

- a fully paid ordinary share; or
- a unit in, an incentive right, or an option to acquire a fully paid share.

The ESS interest for a listed registered scheme are:

- An interested in a listed registered scheme which is tradable on a eligible financial market; or
- a unit in, an incentive, right, or an option to acquire, an interest in Listed registered scheme.

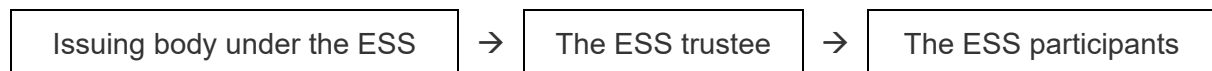
Trustees managing an employee share scheme

A business can engage a trustee to manage interests issued under an ESS on its behalf and still obtain relief if the trust deed states that:

- The activities of the trustee are limited to managing only the ESS – by allocating interests under the ESS or allocating units in the interests to the participants.
- The trustee keeps written records of the administration of the trust.
- The trustee only charges reasonable disbursements to the business for administering the trust.
- The trustee only exercises voting rights in accordance with instructions of the participating fiduciary duties; and
- The trustee will hold no more than:
 - for a listed body corporate or listed registered scheme – five per cent of the fully paid ordinary shares of the body corporate or interest in the listed registered scheme; or
 - for a body corporate that is not listed – 20 per cent of the fully paid ordinary shares of the body corporate
 - If the offer is made by the trustee that manages the ESS that requires a participant to make a payment to participate, the offer must include:
 - The trust deed; or
 - A summary of the trust deed and a statement that the full deed will be made available upon the participant's requests within 10 days.

Diagram 1 – Trustees under employee share schemes

Diagram 1 below illustrates the relationship between the body corporate issuing the interests under an ESS, the trustee and the participants in the ESS



ESS contribution plans

ESS plans can be contribution plans that enable participants to purchase ESS interest and still receive regulatory relief under the bill.

However, to receive the regulatory relief the contribution plan must:

- Have contributions held on trust with an authorised deposit - taking institution which is solely kept for that purpose
- If an offer is made under an ESS contribution plan, each participant receiving the offer must be provided with the terms of the contribution plan; or
- A summary of the terms and statement that the full terms will be made available upon the participants request.

Employee ESS Loans

An ESS with an associated loan can be eligible for relief, in circumstances where the participant can take ownership of their ESS interests immediately then pay for their interests over time.

However, for the ESS to be eligible for the relief;

- The loan cannot be provided to an existing shareholder (i.e to prevent an income tax liability under division 7A ITAA 36).
- The loan must have no interest or fees payable; and
- In the event of non-payment of the loan, the rights against the participant are limited to forfeiture of the interests acquired using the loan

The issue cap

ESS issue cap is limited to five per cent for an ASX listed body corporate and 20 per cent for an unlisted body corporate

The monetary cap

The monetary cap applies to interests in an unlisted company under an ESS.

The monetary cap allows a participant to outlay \$30,000 on offers over a 12 month period, plus 70 per cent of any dividends and 70 per cent of cash bonuses received in that year.

The first 12 month period applies from the day when the participant accepts that offer under an ESS.

Heather's Case One

Unlike the ESS arrangements covered in the attached draft legislation, which requires that the ESS offers to participants must be made for no consideration by the participants, the Remstrategy Employee Share and Investment Trust (ESIT) makes offers to the Participants of allocations of shares and/or other investments for consideration equal to the relevant arms-length market value, funded by an interest free loan provided by the ESIT trustee on behalf of the sponsoring body corporate.

These interest free loans will have no FBT taxable value due to the application of the otherwise deductible rules applying under section 19 (1) (b) of the fringe benefits tax assessment act 1986,

This FBT tax free status was confirmed in Heather's Case and other relevant UK and Australian tax cases.

That FBT tax free status of interest free loans was also confirmed in many private and public tax rulings issues by the Australian Taxation Office see below.

Heather's Case Two

The ESIT is akin to the employee share trust (EST) involved in Heather's Case (Heather v P-E Consulting Group Ltd [1973] 1 All ER 8), in which the House of Lords ruled that employer contributions to the EST trust be fully tax deductible to the employer, being the P-E Consulting Group Ltd. In Heather's Case, the shares were sold to the Employees at their arm's length "fair value", paid for from interest free loans provided by the EIT trust to the participants,

The decision in Heather's Case was confirmed in the subsequent similar cases, such as Jeffs v. Ringtons Ltd [1986] 2 All ET 144 and E Bott Ltd v Price [1987] STC 100. Clearly under the EIT arrangements, the employer is providing the benefits and other investments, along with the loan fringe benefits, contemporaneously with the contributions of monies to the EIT, to be provided as part of the remuneration to the employees and/or contractors participating in the EIT. This EIT arrangement was also confirmed in further Australian cases, as ruled in the Essenbourne Case (1), the Spotlight Case (2) and the Indooroopilly Case (3).

The EIT arrangement and its attributes was also confirmed in the ATO's public rulings concerning Employee Remuneration Trusts (ERT's), being the public rulings contained Taxation Ruling TR 2018/7, at paragraphs 16, 17 and 19, and paragraphs 87, 88, 89 and 90. This public ruling was originally issued on 31 October 2018.

1. Essenbourne Pty Ltd v FC of T [2002] FCA 1577
2. FC of T v Spotlight Stores Pty Ltd [2004] FCAFC 339
3. FC of T Indooroopilly Children Services (QLD) Pty Ltd [2007] FCAFC 16

Thank you again for the opportunity to contribute to the Employee Share Schemes exposure draft legislation. If you have any questions or queries about this submission, please do not hesitate to contact me on 1300 303 357 and email gary.fitton@remstrategy.com.au.

Yours sincerely,

Gary Fitton | Director
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