

# Ad Hoc Observation

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## Taxation of Employee Share plans – Still Some Way to Go

The passage of the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 while in the majority positive, also needs to be recognised as a lost opportunity for positive governance reform.

“In the case of executive share ownership plan reform, this package is two steps forward but one significant step backward. Given the global consensus for executive remuneration reform following the global financial crisis – especially executive remuneration in the form of deferred equity – the package is an enigma” said Erik Mather, Regnan Managing Director.

Regnan supports the tightening of executive share ownership plan reporting to the Australian Taxation Office as the appropriate means of dealing with a tax leakage problem identified in some cases of ESOP’s.

Regnan however, has been forced to be highly critical of the hardening of “cessation of employment” as a taxing point under the package. Regnan has been calling for reform of this obstacle since March 2009 arguing that strengthening the ability of boards to award executives equity that vest in the longer term, including post cessation of employment, will encourage a longer term focus and contribute to overcoming short termism. Regnan’s stance has since been echoed by APRA, The UK’s Walker Review and the draft Productivity Commission Report.

“Given reform of tax compliance has been delivered via new reporting protocols, it would seem the major hole in tax revenue has been plugged. The remaining compliance risk is no different from any other transactions that are subject to taxation such as gains from the sale of an investment property and thus the “cessation of employment” trigger appears both excessive and unhelpful for long-term investors such as superannuation funds”, Mr. Mather continued.

In addition to the desired benefit of enabling boards to require key executives to hold equity risk exposure during part of their legacy, such reform may actually increase tax revenues in a rising market as the value of equity at vesting will be higher than at cessation of employment. In a falling market the value of equity at vesting date is likely to be lower than at cessation of employment thereby resulting in potential refunds of taxation incurred at the date of cessation of employment. Put simply, removing the “cessation of employment” taxing point and having the taxing point at vesting has the potential to grow taxation revenues and further, avoid the payment of taxation refunds.

Regnan has already submitted its views to the second round of consultation for the Productivity Commission’s public inquiry into executive remuneration, and will be echoing these views to the board of Taxation. Regnan also notes the fact that Australia’s rapid rise from the depth of the GFC and ever-improving economic prospects mean that what may have previously been regarded as “untenable “ from a fiscal perspective deserves to now be reviewed.

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