Policy position for further tax reform: Employee Share Scheme (ESS)

AusBiotech is leading the industry's call for further tax reform in Australia to provide incentives for innovative companies and high-tech manufacturing to support Australia's future and keep us internationally competitive by attracting and retaining business, and the resulting jobs and exports. AusBiotech advocates making tax incentives an asset for innovation and business, with four pillars:

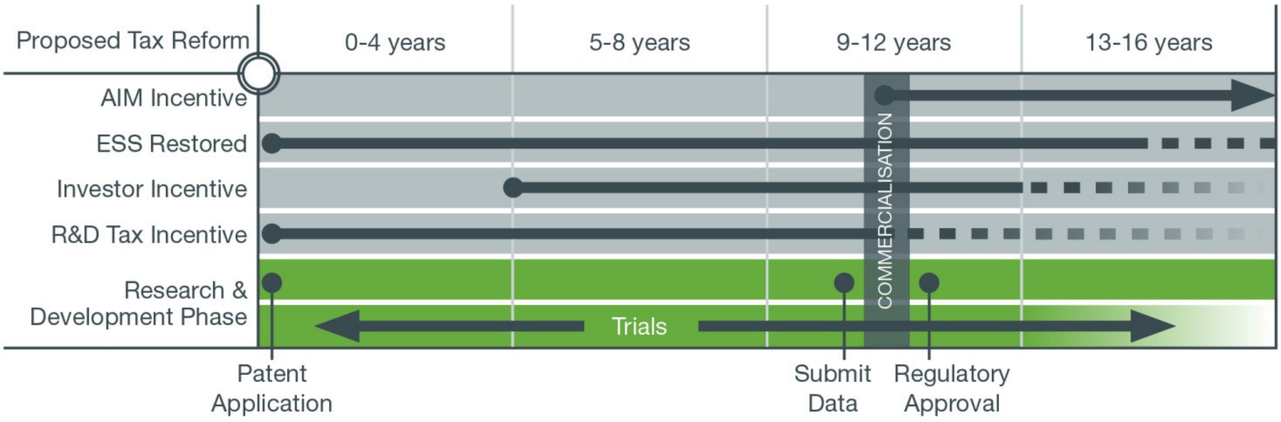
- Retain the Research & Development (R&D) Tax Incentive, which is a top priority for the life sciences industry;
- Introduce the AIM Incentive, a 'patent box'-style incentive to keep home-grown intellectual property (IP) once it reaches commercialisation in Australia;
- Introduce fiscal incentives for investors in pre-revenue and start-up companies; and
- Restore the Employee Share Scheme (ESS) to its pre-2009 form.

What is the Australian ESS Incentive?

The Australian Taxation Office describes the ESS as "a scheme under which shares, stapled securities or rights to acquire them (ESS interests) in a company are provided to an employee or their associate in relation to the employee's employment," at a discount. Special taxation rules apply to this discount.

Why does Australia need the ESS restored?

- Most start-up companies are funded by means other than sales revenue, such as venture capital or share issues, and require those funds to conduct research and development and prepare a product to earn revenue. In this 'cash pressed' state they often rely on the support of ESSs to attract quality employees, and are an important support in enabling innovative start-up companies to establish. ESSs complement cash remuneration, making a salary package appear more substantive and attractive, in addition to mutual benefit of giving employees a vested interest in the success of the company.
- The importance of ESSs is especially poignant and amplified in the biotechnology sector, where the pre-revenue phase is typically extended by the need to clear regulatory hurdles before revenue can be earned – sometimes by more than a decade – and the capital required to reach regulatory approval.
- Australia needs innovation to continue productivity growth and new industries to supplement declining and unsustainable industries. If Australia's tax system does not provide a conducive environment with competitive (comparable) incentives, these new ventures are undermined and Australia's best ideas and the resulting economic benefits are then transferred to other countries and other economies.



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The story so far

When the changes to Australia's ESS taxation provisions were announced in 2009, the measures were predicted by industry to result in less incentive for employees, greater administrative costs for companies, and subsequently result in companies turning away from the use of such schemes. It was feared that the changes would therefore undermine innovation in start-up biotechnology companies and there was a significant ground swell of opposition.

The majority of start-up companies in the biotechnology sector have reported grudgingly turning to alternative, less satisfactory, methods to retain, incentivise and reward employees.

The far-reaching changes to the taxation of shares, options and other rights were made at a time when Australia was becoming more cognisant of the importance of supporting small to medium-sized innovative businesses, due to the spillover benefits to the Australia's economic development. These changes meant that shares were valued at the time of issue and tax charged upon issue.

The Board of Taxation in 2009 conducted a review that explored two issues: how best to determine the market value of employee share scheme benefits; and whether shares and rights for a start-up, R&D or speculative focussed company should have special tax arrangements. The current Review, initiated in 2013, closed on 7 February and a report is expected within weeks. The Review is also interested in the above issues, and more broadly the most effective measures to address the barriers faced by start up companies, including:

- developing guidance to reduce the administrative burden (meaning the cost of valuing shares and options) of establishing an ESS;
- adjusting the valuation methodology of options; and
- examining the point at which share options are taxed for start-up companies.

AusBiotech's position

Since the changes were implemented in 2009, AusBiotech has made two submission (2009 and 2014) after speaking with key accounting firms and AusBiotech members. The changes in 2009 created a new burden on companies, which seems to be aimed at the top end of town and has wrongly captured small, rapidly-growing companies that often do not have the ability to reward employees with cash and so use shares and options as incentives and future rewards. AusBiotech supports a more effective treatment of start-up companies, to support the growth of the innovative sector in Australia.

ESSs are an excellent way to attract high-calibre, experienced staff to a start-up company, providing important support for start-up companies. However they only work when tax is charged on success. If tax is charged pre-success the shares are a cost to the employee with an unknown outcome. This risk is intolerable for many staff and delivers a disincentive. The Australian start-up biotechnology community needs an effective and rational tax system, which enables success sharing at the time it occurs (i.e. when shares are realised).

Call for support

AusBiotech will progress discussions with policy makers and companies that may be supported by an improved Australian ESS. The R&D Tax Incentive is a great foundation for innovation to nation-build for Australia, but the tax reform story is not complete for innovation. Australia needs a supportive ESS to encourage start-up companies. AusBiotech invites your comments and support at: admin@ausbiotech.org