



9 October 2009  
XIGLB\GLB\MF\SUBMISSION

Review of Employee Share Schemes  
The Board of Taxation  
C/- The Treasury  
Langton Crescent  
PARKES ACT 2600

**VIA EMAIL:** [taxboard@treasury.gov.au](mailto:taxboard@treasury.gov.au)

Dear Sirs

**Review into elements of the taxation of employee share scheme arrangements.**

Nissen Kestel Harford appreciates the opportunity given by the Board of Taxation to submit its views on specific elements of the taxation of employee share scheme arrangements having regards to the terms of reference.

To provide a context for our submission, Nissen Kestel Harford advises on taxation and other aspects of issuing unlisted rights to:

1. The Company  
Generally, the companies are "listed small- to mid-cap resource stocks" in either exploratory or production phase.
2. The Unlisted Rights Holder be they employee or non-executive director
3. The Company Shareholders

Our experience from advising in this area is that complexity in valuing unlisted rights and, more so, rationalising said valuation(s) to the client, comes from, in the first instance, the number of different values that may be ascribed to a particular unlisted right issue. That being for the purposes of:

- Notice of Meeting
- Audited Financial Accounts / Annual Report
- Pay-roll tax liability as calculated pursuant with the *Pay-roll Tax Assessment Act 2002 (WA)*
- Division 13A of the *Income Tax Assessment Act 1936 (Cth)*

We refer to paragraph 3.27 (in part) of the *Full Report January 31 1975 - Taxation Review Committee ('Asprey Report')*.

Equity, simplicity and efficiency seem to the Committee the three dominant tests of merit for individual taxes and for the tax system as a whole.

Having regard to these three dominant tests, we submit the following:

1. The valuation of an unlisted right is currently provided for in section 139FC of the *Income Tax Assessment Act 1936 (Cth)*.

We submit that clarifying of terms relied upon, directly or indirectly, in this section is critical.

Those terms being:

- Acquiring a right [section 139G(c)]

Currently a person acquires a right, when “another person creates the right in that person”. Whilst there are currently two ATO Interpretative Decisions on this matter,<sup>1</sup> it would be advisable for the Commissioner of Taxation to provide a greater level of certainty via a Taxation Determination covering the most likely acquisition time for employees and non-executive directors.

- Quoted on a stock market of an approved stock exchange on that day [section 139FA(1)]

When determining the value of an unlisted right, the market value of the share that may be acquired by exercising the right is critical to the calculation.

Particular confusion arises when a stock is not traded on a particular day but had been traded during the one week period up to and including that day. More specifically, whether the shares were in a *trading halt* or *suspended*.

Currently, the valuation methodology available in section 139FA does not apply if the share was not quoted on the valuation day.

We are of the opinion a definition of “Quoted on a stock market of an approved stock exchange” is required.

This definition should have regards to ASX Listing Rule 2 – Quotation and based on the explanatory note to ASX Listing Rule 17 – Trading halts, suspension, removal.

To this extent, a share is quoted until such time as the ASX ends the quotation pursuant with Listing Rule 17.10.

That is a trading halt (Listing Rule 17.1), or suspension (Listing Rules 17.1 – 17.6) of a company’s shares would not prevent those shares being “quoted on a stock market of an approved stock exchange”.

2. We note the definition of Qualified Person in section 139FG requires the person to be registered as a company auditor. It is submitted a person who has the necessary expertise to value unlisted shares (as required should the share that may be acquired by exercising the unlisted right not be quoted) need not necessarily be a registered company auditor.
3. We refer to paragraph 2.43 of the Explanatory Memorandum to *Taxation Laws Amendment Bill (No.2) 1995 (Cth)*.

The Tables contained in new sections 139FJ-FN use an accepted methodology for valuing options, which has been modified to make them easier to use. Further, the variable factors underlying the tables are generally concessional.

Our research has not found the basis and modifications for these tables. It is submitted as part of this process, the basis and modifications be released by the Commissioner of Taxation. This is critical for advisors in this area to have an understanding of this when determining the value of an unlisted right for the purposes of draft subsection 83A-315 and draft regulation 83A-315.01.

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<sup>1</sup> ATO ID 2007/66 and ATO ID 2009/85

4. The reason behind the above points, is that in the absence of using the intrinsic value of a right,<sup>2</sup> there are multiple methodologies and variation of inputs for each methodology.
5. We submit a *de minimis* test allowing the use of the intrinsic value of a right is preferable as part of the provisions. As it is a valuation methodology in question, the *de minimis* test should not be based on value. Practicably, it would be based on the number of rights or term to maturity. Whilst there has been a trend towards providing relief to those entities satisfying the meaning of a small business entity [section 328-110 of the *Income Tax Assessment Act 1997 (Cth)*], it is submitted providing the ability to value rights on its intrinsic value to a company solely on the basis of it being a small business entity may have unintended consequences as a number of “small- to mid- cap” listed exploration companies may satisfy this definition.
6. Notwithstanding point 5 above, speculative-type companies that are also small business entities require non-cash incentives to attract employees / non-executive directors as they generally have limited cash reserves.
7. Therefore, there is an argument for valuing those rights on an intrinsic basis. Not to the point of allowing an infinite number of rights to be measured in this manner but for an increased number of rights able to be issued or extending the term to maturity.
8. For all other entities, the test could be based on a maximum number of rights issued per employee / non-executive director say 100,000 or for the term to maturity say 12 months. Refer the attached Tables and Charts for analysis.
9. To the extent the intrinsic value is unavailable and a method based on the current sections 139FC and 139FJ to 139FN not used, then the other valuation methods should be based on commonly used option valuation models (including those models commonly referred to as “Black & Scholes” and “Binomial Tree”).
10. Models of this type or other types used by advisors in this area are required to be used for purposes listed above (Audited Financial Accounts / Annual Report – having regard to AASB 2 – Share-based Payment for example).

Whilst the current “table” method relies on the following inputs:

- Underlying Share Price
- Exercise Price
- Term to Maturity
- Other *unspecified* inputs / formulas that must be included as part of the table so that it generates the stated percentages (refer 3 above).

Most other methods would use the following *forecasted* inputs (in addition to the first 3 bullet points immediately above):

- Risk-free rate
- Possibility of early exercise of right
- Future volatility of the share that may be acquired by exercising the unlisted right (this is a critical input)
- Future value of dividends
- Transferability
- Vesting period
- Sophistication of right holder

These inputs are likely to be (and in some circumstances, extremely) subjective. Valuations determined in this manner, should they not be already reviewed as part of an audited set of financial statements could be expensive to review, for both the Commissioner of Taxation and the right holder.

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<sup>2</sup> The value of a right being the sum of its intrinsic value and time value. With the intrinsic value being the value of the share that may be acquired by the exercise of the right in excess of the exercise price of that right.

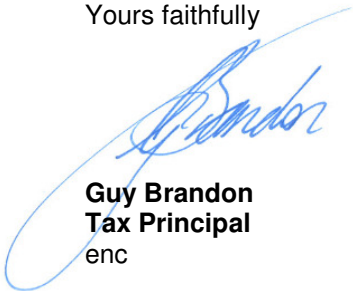
From an equity, simplicity and efficiency perspective, our recommendations are:

1. The provision of clear definitions of:
  - a. Acquiring a right
  - b. Quoted on a stock market of an approved stock exchange
2. The broadening the definition of:
  - a. Qualified person
3. The provision of the fundamentals behind the current tables.
4. A *de minimis* test to allow for rights to be valued on an intrinsic basis having no regard for time value. This would be based on either rights issued (submitted as 100,000) or term to maturity (submitted as 12 months).
5. This *de minimis* test to be broadened for speculative-type *small business entities* by increasing the number of rights able to be issued or extending the term to maturity.
6. To the extent the rights are valued (or prior valuation reviewed) as part of an audited set of financials statements, that value is acceptable for proposed Regulation 83A-315.01(a).

We would welcome the opportunity to discuss any of the issues raised in this submission should you require.

Please address all correspondence in respect of this submission to the undersigned.

Yours faithfully



**Guy Brandon**  
Tax Principal  
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NKH WORKING PAPER			
For	The Board of Taxation	Code	NKH
Income Year	2009-10	Prepared by	GLB
Matter	Attachment Submission for Review into elements of the taxation of employee share scheme arrangements	Date	9/10/09

Market Value, on the particular day, of the share that is the subject of the right. \$ 0.1000  
Amount, or lowest amount, that must be paid to exercise the right. \$ 0.1000 x 100% 

CALCULATION PERCENTAGE
100.00%
Table 1

Exercise period (in months) 12  
Table 1 Percentage 3.3%

Base Percentage  
Additional Percentage  
Excess  
Market value of the right (Table 1) \$ 0.0033

MARKET VALUE PER RIGHT: DIVISION 13A OF THE INCOME TAX ASSESSMENT ACT 1936	\$ 0.0033
NUMBER OF RIGHTS	100,000
<b>TOTAL MARKET VALUE OF RIGHTS: DIVISION 13A OF THE INCOME TAX ASSESSMENT ACT 1936</b>	<b>\$ 330.00</b>
TOTAL TAX PAYABLE AT TOP MARGINAL RATE (INCLUDING STANDARD MEDICARE LEVY)	\$ 153.45

Table 1

Exercsie Price	Assessable Discount	@ 46.50%
\$ 0.10	\$ 330.00	\$ 153.45
\$ 0.13	\$ 412.50	\$ 191.81
\$ 0.16	\$ 515.63	\$ 239.77
\$ 0.20	\$ 644.53	\$ 299.71
\$ 0.24	\$ 805.66	\$ 374.63
\$ 0.31	\$ 1,007.08	\$ 468.29
\$ 0.38	\$ 1,258.85	\$ 585.37
\$ 0.48	\$ 1,573.56	\$ 731.71
\$ 0.60	\$ 1,966.95	\$ 914.63
\$ 0.75	\$ 2,458.69	\$ 1,143.29
\$ 0.93	\$ 3,073.36	\$ 1,429.11
\$ 1.16	\$ 3,841.71	\$ 1,786.39
\$ 1.46	\$ 4,802.13	\$ 2,232.99
\$ 1.82	\$ 6,002.67	\$ 2,791.24
\$ 2.27	\$ 7,503.33	\$ 3,489.05
\$ 2.84	\$ 9,379.16	\$ 4,361.31
\$ 3.55	\$ 11,723.96	\$ 5,451.64
\$ 4.44	\$ 14,654.94	\$ 6,814.55
\$ 5.55	\$ 18,318.68	\$ 8,518.19
\$ 6.94	\$ 22,898.35	\$ 10,647.73
\$ 8.67	\$ 28,622.94	\$ 13,309.67
\$ 10.84	\$ 35,778.67	\$ 16,637.08

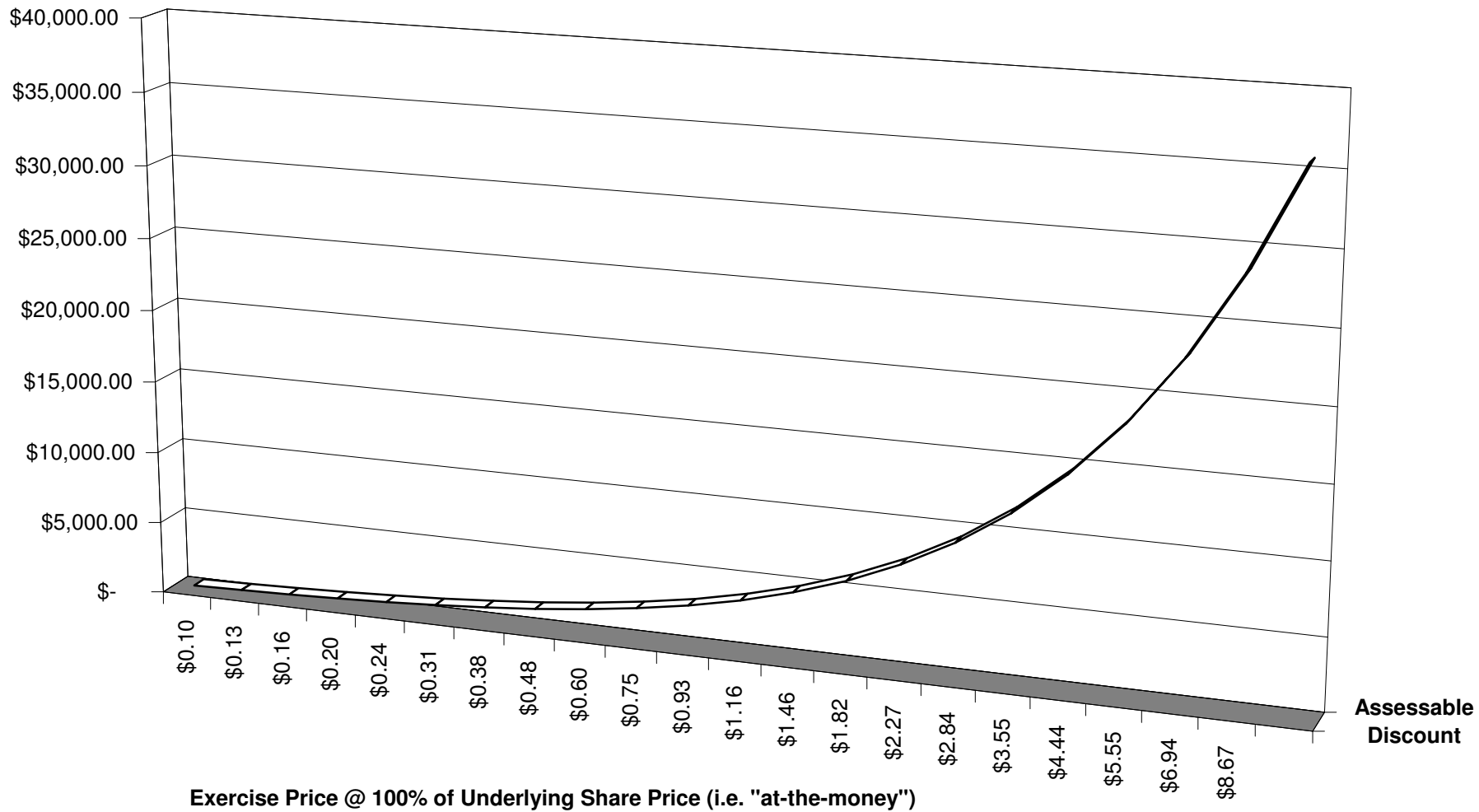
Table 2

Exercsie Price	Assessable Discount					
	10	100	1,000	10,000	100,000	1,000,000
\$ 0.10	\$ 0.03	\$ 0.33	\$ 3.30	\$ 33.00	\$ 330.00	\$ 3,300.00
\$ 0.13	\$ 0.04	\$ 0.41	\$ 4.13	\$ 41.25	\$ 412.50	\$ 4,125.00
\$ 0.16	\$ 0.05	\$ 0.52	\$ 5.16	\$ 51.56	\$ 515.63	\$ 5,156.25
\$ 0.20	\$ 0.06	\$ 0.64	\$ 6.45	\$ 64.45	\$ 644.53	\$ 6,445.31
\$ 0.24	\$ 0.08	\$ 0.81	\$ 8.06	\$ 80.57	\$ 805.66	\$ 8,056.64
\$ 0.31	\$ 0.10	\$ 1.01	\$ 10.07	\$ 100.71	\$ 1,007.08	\$ 10,070.80
\$ 0.38	\$ 0.13	\$ 1.26	\$ 12.59	\$ 125.89	\$ 1,258.85	\$ 12,588.50
\$ 0.48	\$ 0.16	\$ 1.57	\$ 15.74	\$ 157.36	\$ 1,573.56	\$ 15,735.63
\$ 0.60	\$ 0.20	\$ 1.97	\$ 19.67	\$ 196.70	\$ 1,966.95	\$ 19,669.53
\$ 0.75	\$ 0.25	\$ 2.46	\$ 24.59	\$ 245.87	\$ 2,458.69	\$ 24,586.92
\$ 0.93	\$ 0.31	\$ 3.07	\$ 30.73	\$ 307.34	\$ 3,073.36	\$ 30,733.64
\$ 1.16	\$ 0.38	\$ 3.84	\$ 38.42	\$ 384.17	\$ 3,841.71	\$ 38,417.06
\$ 1.46	\$ 0.48	\$ 4.80	\$ 48.02	\$ 480.21	\$ 4,802.13	\$ 48,021.32
\$ 1.82	\$ 0.60	\$ 6.00	\$ 60.03	\$ 600.27	\$ 6,002.67	\$ 60,026.65
\$ 2.27	\$ 0.75	\$ 7.50	\$ 75.03	\$ 750.33	\$ 7,503.33	\$ 75,033.31
\$ 2.84	\$ 0.94	\$ 9.38	\$ 93.79	\$ 937.92	\$ 9,379.16	\$ 93,791.64
\$ 3.55	\$ 1.17	\$ 11.72	\$ 117.24	\$ 1,172.40	\$ 11,723.96	\$ 117,239.55
\$ 4.44	\$ 1.47	\$ 14.65	\$ 146.55	\$ 1,465.49	\$ 14,654.94	\$ 146,549.44
\$ 5.55	\$ 1.83	\$ 18.32	\$ 183.19	\$ 1,831.87	\$ 18,318.68	\$ 183,186.80
\$ 6.94	\$ 2.29	\$ 22.90	\$ 228.98	\$ 2,289.83	\$ 22,898.35	\$ 228,983.50
\$ 8.67	\$ 2.86	\$ 28.62	\$ 286.23	\$ 2,862.29	\$ 28,622.94	\$ 286,229.37
\$ 10.84	\$ 3.58	\$ 35.78	\$ 357.79	\$ 3,577.87	\$ 35,778.67	\$ 357,786.72

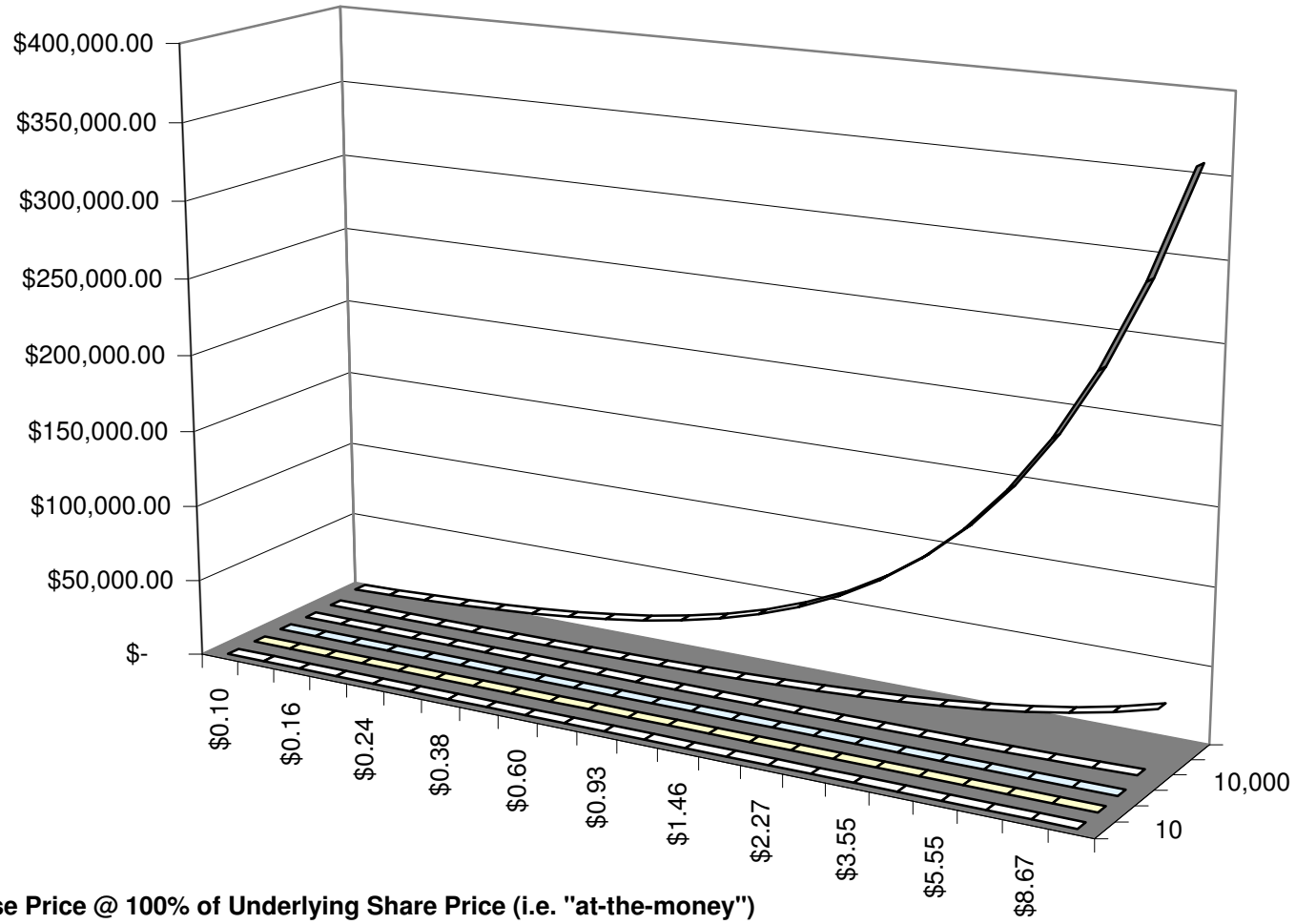
Table 3

Months to Maturity	Assessable Discount (only first 7 exercise prices shown - refer graph)							
	\$ 0.10	\$ 0.13	\$ 0.16	\$ 0.20	\$ 0.24	\$ 0.31	\$ 0.38	
3	\$ 40.00	\$ 50.00	\$ 62.50	\$ 78.13	\$ 97.66	\$ 122.07	\$ 152.59	
6	\$ 120.00	\$ 150.00	\$ 187.50	\$ 234.38	\$ 292.97	\$ 366.21	\$ 457.76	
9	\$ 230.00	\$ 287.50	\$ 359.38	\$ 449.22	\$ 561.52	\$ 701.90	\$ 877.38	
12	\$ 330.00	\$ 412.50	\$ 515.63	\$ 644.53	\$ 805.66	\$ 1,007.08	\$ 1,258.85	
18	\$ 410.00	\$ 512.50	\$ 640.63	\$ 800.78	\$ 1,000.98	\$ 1,251.22	\$ 1,564.03	
24	\$ 570.00	\$ 712.50	\$ 890.63	\$ 1,113.28	\$ 1,391.60	\$ 1,739.50	\$ 2,174.38	
36	\$ 710.00	\$ 887.50	\$ 1,109.38	\$ 1,386.72	\$ 1,733.40	\$ 2,166.75	\$ 2,708.44	
48	\$ 950.00	\$ 1,187.50	\$ 1,484.38	\$ 1,855.47	\$ 2,319.34	\$ 2,899.17	\$ 3,623.96	
60	\$ 1,160.00	\$ 1,450.00	\$ 1,812.50	\$ 2,265.63	\$ 2,832.03	\$ 3,540.04	\$ 4,425.05	
72	\$ 1,340.00	\$ 1,675.00	\$ 2,093.75	\$ 2,617.19	\$ 3,271.48	\$ 4,089.36	\$ 5,111.69	
84	\$ 1,500.00	\$ 1,875.00	\$ 2,343.75	\$ 2,929.69	\$ 3,662.11	\$ 4,577.64	\$ 5,722.05	
96	\$ 1,630.00	\$ 2,037.50	\$ 2,546.88	\$ 3,183.59	\$ 3,979.49	\$ 4,974.37	\$ 6,217.96	
108	\$ 1,750.00	\$ 2,187.50	\$ 2,734.38	\$ 3,417.97	\$ 4,272.46	\$ 5,340.58	\$ 6,675.72	
120	\$ 1,840.00	\$ 2,300.00	\$ 2,875.00	\$ 3,593.75	\$ 4,492.19	\$ 5,615.23	\$ 7,019.04	

**Table 1  
Assessable Discount**



**Table 2**  
**Assessable Discount / Quantity**



**Table 3**  
**Assessable Discount / Months to Maturity**

