



9 June 2026

To: Senate Economics Legislation Committee

## **1 Employee Ownership Australia: Submission to the Senate Economics Legislation Committee**

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### **Inquiry into the Treasury Laws Amendment (Tax Reform No. 1) Bill 2026 and the Income Tax Rates Amendment (Tax Reform No. 1) Bill 2026**

## **2 Introduction**

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### **Employee Ownership Australia Supports Tax Reform but Identifies Unintended Consequences from the proposed changes**

Employee Ownership Australia welcomes the opportunity to make this submission to the Senate Economics Legislation Committee in relation to the Treasury Laws Amendment (Tax Reform No. 1) Bill 2026 and the Income Tax Rates Amendment (Tax Reform No. 1) Bill 2026 (together, the Bills).

Employee Ownership Australia supports the objective of a coherent, fair and durable tax system. The Government's stated aim of improving the fairness of the tax system, supporting home ownership and helping fund new tax cuts for workers represents a legitimate and important policy objective.

### **The Bills Risk Serious Harm to Employee Ownership in Australia**

In their current form, however, the Bills risk producing serious and unintended consequences for broad-based employee ownership, employee share schemes, employee share trusts, and employee ownership trust structures.

Those arrangements are practical and commercially necessary mechanisms through which employees acquire genuine equity exposure in the businesses for which they work.

## **3 The Economic Importance of Employee Ownership**

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Employee ownership is a matter of significant and growing national economic importance. It aligns the interests of workers with the long-term success of the enterprises in which they are employed, promotes workforce engagement and productivity, and provides a pathway for ordinary Australians to build wealth through participation in productive enterprise rather than through speculative or leveraged investment in existing assets.

Broad-based employee share plans are particularly valuable in an economic environment where home ownership is increasingly inaccessible to younger workers, because they offer an alternative means of capital accumulation tied to productive activity.

In the start-up and growth company sector, employee equity is not merely a supplementary benefit but an essential component of the remuneration package that enables Australia to attract, retain and motivate talent in globally competitive markets.

Internationally, jurisdictions including the United Kingdom, the United States and numerous European countries actively promote employee ownership through dedicated tax concessions because of these productivity, wealth distribution and succession benefits.



Australia should be strengthening its own settings in this area, not inadvertently weakening them.

This submission identifies the provisions of the Bills that give rise to concern, explains the adverse consequences for employee ownership arrangements.

It also recommends amendments that would preserve the broader reforms while avoiding outcomes that undermine employee participation in capital ownership.

## 4 Executive Summary

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### **The Start-up Concession Should Be Preserved and Expanded**

Employee Ownership Australia recommends that equity interests issued under the start-up concession either retain their current CGT treatment or be expressly excluded from the new regime. Without the 50 per cent CGT discount, the concession is reduced to a mere timing deferral with no meaningful incentive on exit. The concession should also be expanded — widening eligibility, increasing the qualifying company cap and extending coverage to growth-stage enterprises.

### **The Grandfathering Provisions Must Be Redesigned for ESS Interests**

Employee Ownership Australia recommends that the grandfathering provisions be redesigned to accommodate the existing ESS architecture. The current mechanism generates arbitrary outcomes because Division 83A and Subdivision 130-D fix acquisition time, taxing point and cost base by reference to different events — an approach fundamentally incompatible with a deemed disposal at a single date. Grandfathering should not turn solely on the legal characterisation of the asset at 1 July 2027.

### **Averaging or Equivalent Relief Should Be Introduced for Broad-Based Plans**

Employee Ownership Australia recommends that an averaging mechanism, capped concessional rate or equivalent relief be introduced for gains realised by employees under broad-based employee share plans. Lower-paid employees in particular face disproportionate detriment from the combined operation of the CGT changes and the separately announced trust minimum tax.

### **The Small Business Concessions Should Be Expanded and an EOT Framework Legislated**

Employee Ownership Australia recommends that the small business CGT concessions be strengthened and an Australian Employee Ownership Trust framework be legislated, providing a full or substantial CGT concession for qualifying sales to an EOT. The higher effective tax burden on small business disposals under the new regime undermines employee-led succession planning and systematically favours trade sales over transitions to employee ownership.

### **Employee Share Trusts and EOTs Must Be Excluded from the Trust Minimum Tax**

Employee Ownership Australia recommends that employee share trusts and genuine employee ownership trusts be expressly excluded from any future trust minimum tax. These structures serve a fundamentally different economic function from the discretionary trust arrangements at which that measure is directed.

### **Targeted Consultation Is Essential**

Employee Ownership Australia recommends that targeted consultation be undertaken with Employee Ownership Australia, employers, professional advisers and scheme administrators prior to further legislation affecting employee share schemes.



## **These Recommendations Are Consistent with the Government's Broader Objectives**

None of these proposals conflicts with the broader reform agenda. Employee ownership arrangements fall outside the mischief at which the Bills are directed, and accommodating them would reinforce — rather than compromise — the Government's stated fairness objectives.

## **5 The Proposed Changes Undermine the Start-up Concession**

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### **5.1 The Start-up Concession Is Essential Infrastructure for Australia's Innovation Economy**

The start-up employee share scheme concession in Subdivision 83A-C of the ITAA 1997 is one of the most important policy settings supporting Australia's innovation economy. It recognises that early-stage companies typically lack the cash flow to compete for talent on salary alone and instead use equity as a recruitment and retention tool.

The concession defers the taxing point and — critically — allows the resulting gain on qualifying shares or options to be taxed as a capital gain eligible for the 50 per cent CGT discount where the employee holds the shares for at least 12 months.

It is the combination of deferral and the CGT discount that gives the concession its economic value. Deferral alone merely delays the tax liability. The CGT discount is what transforms the concession from a timing mechanism into a meaningful incentive — one that makes the risk and illiquidity of start-up equity worthwhile for employees.

Without it, an employee who accepts equity in a high-risk, cash-constrained early-stage company — often at a discount to market salary — receives no meaningful tax recognition of the risk they have assumed or the economic contribution they have made to building the enterprise.

### **5.2 The Bills Strip the Start-up Concession of Its Substantive Value**

The proposed CGT measures in Schedule 1 repeal the 50 per cent CGT discount for individuals and trusts for capital gains arising on or after 1 July 2027, replacing it with cost base indexation and a 30 per cent minimum tax. The Explanatory Memorandum confirms that the default discount percentage is reduced to zero.

No carve-out or preserved discount is provided for ESS interests, including start-up concession shares and options.

Post-Budget analysis confirms that this change may materially reduce the practical value of the start-up concession. Start-up shares and options will lose the CGT discount on post-acquisition gains.

The principal remaining advantage will be mere deferral of the taxing point — not a genuinely concessional outcome on exit. That would undermine the policy rationale for the concession and strip it of the feature that makes it effective.

### **5.3 Start-up Employees Bear Genuine Risk and Deserve Meaningful Tax Recognition**

Employee equity in start-ups performs an important economic function. It enables risk-sharing between founders and early employees, incentivises innovation, and supports the creation of new enterprises that contribute disproportionately to employment growth.

Start-up employees are not passive investors seeking concessional tax treatment on asset appreciation. They accept below-market cash remuneration, career risk and illiquidity in exchange for a share in the enterprise they are helping to build.

The existing CGT discount recognises that bargain and is central to making it economically rational.

Without a meaningful tax concession on exit, Australia risks falling behind competitor economies that use tax settings to encourage employee equity participation in high-growth companies.



In those jurisdictions, dedicated employee equity regimes are treated as essential infrastructure for innovation ecosystems.

#### **5.4 Weakening Employee Equity Incentives Is Inconsistent with Expanding Venture Capital Support**

The Budget materials state that the Government is expanding venture capital tax incentives and providing further support to start-ups in other areas. Those initiatives sit uneasily alongside a CGT change that weakens employee equity incentives for start-up workers.

Venture capital incentives attract financial capital; employee equity incentives attract human capital. Both matter to a functioning innovation economy, and it is inconsistent to expand one while diminishing the other.

#### **5.5 The Start-up Concession Should Be Preserved and Expanded**

Employee Ownership Australia's position is that preservation of the start-up concession is the minimum necessary response. The Committee should recommend that equity interests provided under the start-up concession either remain subject to existing CGT treatment or be carved out from the new regime so that the concession's economic value is preserved.

Beyond this, the reform of the CGT regime presents an opportunity not merely to preserve but to expand and strengthen the start-up employee equity framework.

If the Government is committed to supporting innovation, entrepreneurship and productive investment — objectives stated in the Budget materials — it should use this legislative moment to:

- widen eligibility for the start-up concession;
- increase the cap on qualifying companies;
- extend the concession to a broader range of growth-stage enterprises;
- consider enhanced concessions for employees who hold their equity for extended periods.

An expanded start-up regime would be consistent with the Government's stated policy of directing investment towards productive uses rather than speculative housing investment.

It would also demonstrate that CGT reform is accompanied by a commitment to the forms of capital participation that benefit workers and the broader economy.

The Committee should satisfy itself that either the Bill is amended to preserve the start-up concession, or that binding assurances are given regarding the timing and content of corrective legislation.

The Explanatory Memorandum's acknowledgement that future tranches may address complex interactions is not a substitute for certainty on this point.

## **6 Summary of Relevant Measures and Their Significance for Employee Ownership**

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### **The CGT Discount Is Abolished and Replaced with Indexation and a Minimum Tax**

The Bills replace the 50 per cent CGT discount for individuals, trusts and partnerships with cost base indexation and introduce a 30 per cent minimum tax on capital gains from 1 July 2027.

The reforms apply to capital gains made directly or indirectly by Australian resident individuals and trusts, and the minimum tax applies to all CGT assets — with exemptions only for new residential dwellings, affordable housing, and certain income support recipients.

No equivalent exemption is provided for employee share scheme interests.



### **The Grandfathering Mechanism Creates Anomalies for ESS Interests**

The grandfathering mechanism in the proposed CGT measures in Schedule 1 deems CGT assets held before 1 July 2027 to be disposed of and reacquired at that date, with any gain or loss deferred until actual realisation event. As explained in Section 7 below, this mechanism creates serious anomalies when applied to employee share scheme interests.

The Explanatory Memorandum acknowledges that the amendments are the first tranche of changes and that future amendments may be needed to manage complex interactions between CGT and other rules.

### **The Trust Minimum Tax Will Compound the Adverse Consequences**

The Bills do not contain the discretionary trust minimum tax measure separately announced in the 2026–27 Budget — a proposed minimum tax of 30 per cent on discretionary trusts from 1 July 2028, imposed at trustee level with non-refundable credits for non-corporate beneficiaries.

The CGT adjustments in Schedule 1 independently create adverse consequences for employee ownership, and the trust minimum tax (when legislated) will compound them.

## **7 Employee Ownership Arrangements Are Not the Policy Target**

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### **The Reforms Appear to Target Leveraged Housing and High-Income CGT Deferral, Not Employee Equity**

The Explanatory Memorandum confirms that the reforms target the CGT discount's tendency to favour leveraged investment in existing housing, enable higher-income earners to achieve lower tax rates than ordinary workers, and benefit predominantly the highest-income Australians.

Employee ownership and employee ownership structures are materially different from these targets.

Employee share trusts acquire, hold and allocate shares or other equity interests to employees under regulated employee equity plans. They do not produce the leveraged property returns or high-income CGT deferral strategies at which the Bill appears to be directed.

### **Australian Tax Law Already Recognises Employee Share Schemes as Distinct**

Australian tax law and ATO guidance already treat employee share schemes as a distinct regime requiring separate treatment.

### **No Carve-Out Is Provided Despite Exclusions for Other Asset Classes**

A reform designed to address overcompensation for inflation on housing assets, concentration of CGT benefits among high earners, and incentives for leveraged property speculation should not — through broad drafting or unduly narrow exclusions — apply to structures whose primary function is to facilitate employee equity participation.

Yet no carve-out is provided for employee ownership arrangements, despite the Bill providing targeted exclusions for new residential dwellings, affordable housing and small business.

## **8 Impact of the CGT Adjustments on Employee Share Scheme Interests**

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### **8.1 The Grandfathering Mechanism Produces Arbitrary Outcomes for ESS Interests**

The proposed CGT measures in Schedule 1 produce arbitrary and anomalous outcomes for the current mechanism that determines capital gains on the disposal of ESS interests. This results from the interaction between the proposed regime and the existing provisions dealing with employee equity.



The categories of ESS interests affected include shares acquired under a \$1,000 exemption plan, shares acquired under a tax-deferred plan including broad-based plans and salary sacrifice plans, options and ultimately shares acquired under a rights plan, performance rights, options acquired under a start-up plan, out-of-the-money option plans, and at-market-value share plans.

For each of these categories, the current law may produce different outcomes as to the date of acquisition of the employee share scheme interest, the date of acquisition of the underlying share where relevant, the cost base of the right or option, and the cost base of the resulting share.

## **8.2 The Disconnect Arises from the Multi-Event Architecture of the ESS Rules**

There is a disconnect between the grandfathering provisions and the existing employee share scheme capital gains tax rules. That disconnect arises because Division 83A and Subdivision 130-D do not work by fixing all of the capital gains tax inputs at the time the employee first receives the interest. Instead, those provisions split the analysis across different times and, in some cases, across different assets.

This produces arbitrary results. The problem is compounded where the interest converts from one form of asset to another, most commonly from an option or right into a share. In those cases, additional amounts may be included in the cost base, and it is not appropriate to look only at the asset characterisation at 1 July 2027.

For many ESS interests, the deemed acquisition time is the date the interest is originally granted or acquired. But the cost base for CGT purposes is often determined by reference to a later taxing point under the ESS rules, or to the later conversion of an option or right into a share.

The result: an asset may have been acquired before 1 July 2027, but its cost base is determined by a later event. Additional amounts may be included on exercise or conversion. Economically similar arrangements may therefore be treated differently because of differences in legal form or timing mechanics.

That produces arbitrary outcomes if grandfathering turns on whether the employee holds a particular legal form of asset at 1 July 2027.

## **8.3 Illustrative Examples Demonstrate the Severity of the Disconnect**

The detailed interaction of the ESS rules with the proposed grandfathering mechanism for each category of ESS interest is set out in the Schedule to this submission. The outcomes are different across different forms of employee equity. Two categories are highlighted here because they illustrate the nature and severity of the disconnect.

**Shares acquired under a tax-deferred plan:** On the basis that no consideration is paid by the employee, the cost base of the share is the relevant market value of the share at the tax deferral point.

If the shares are issued before 1 July 2027 and the employee is still in the deferred regime at that date, the grandfathering rules require the taxpayer to work out what the gain would have been if the shares had been disposed of at 1 July 2027.

But the present ESS rules do not determine that amount at 1 July 2027 — the statutory framework determines the relevant amount only later, when the deferred taxing point occurs and section 83A-110 fixes the amount included in assessable income.

This highlights the disconnection between the time of acquisition of the share and the later point at which the cost base is established for capital gains tax purposes.

**Options and shares acquired under a rights plan:** This category illustrates the problem especially clearly.

The interest originally acquired is an option or right, whereas the asset ultimately disposed of may be a share. If the employee holds the option at 1 July 2027 and the deferred taxing point has not yet occurred, the taxpayer does not yet know whether the later ESS taxing



outcome will be determined by reference to the option or by reference to the resulting share.

It is not only that the cost base has not yet been determined — the identity of the asset to which the relevant statutory valuation will later attach may not yet be known at 1 July 2027.

A further anomaly arises in relation to acquisition dates. When rights qualify for the start-up concession and are later exercised, the resulting share is treated as having an acquisition date corresponding to the time the original right was acquired, rather than the time of exercise.

The rules provide that both the option and the share acquired on exercise have an acquisition date referable to when the original option was acquired.

This is a very specific design element of the existing regime which treats the CGT status as being determined from the acquisition of the ESS interest.

The introduction of the new regime should not alter that outcome.

It is intentionally unlike an option otherwise under the ESS, where the relevant date is the date of acquisition of the option itself.

#### **8.4 Grandfathering Must Accommodate the Existing ESS Architecture**

Grandfathering in the ESS context should not turn solely on the legal characterisation of the relevant asset at 1 July 2027. That approach fails to reflect how the existing ESS rules operate — acquisition time, taxing point and cost base often depend on different events.

It would produce arbitrary distinctions between economically similar interests, particularly where an option or right later converts into a share and the resulting cost base reflects additional amounts or later taxing point consequences.

A coherent grandfathering rule should accommodate the existing ESS architecture and preserve consistent CGT treatment across the full range of common plan structures.

### **9 Broad-based Employee Ownership Plans Would Be Disproportionately Affected**

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#### **9.1 Broad-Based Plans Benefit Ordinary Employees, Not High-Income Earners**

Broad-based plans depend on administratively workable structures and reasonably stable, comprehensible tax outcomes. These plans are not confined to senior executives. They are frequently designed to give ordinary employees modest but meaningful equity interests so they can share in the value they help create.

Evidence from comparable jurisdictions shows that broad-based employee ownership increases workforce productivity, reduces turnover, improves business resilience during downturns, and contributes to more equitable wealth distribution. These outcomes align with the Government's own stated objectives.

#### **9.2 The Combined Reforms Will Materially Weaken Broad-Based Employee Participation**

The trust measure (when legislated) and the capital gains measure in Schedule 1, operating together, may materially weaken broad-based employee participation.

If employee share trusts are brought within the trust minimum tax rules, trust-level taxation will apply, with only non-refundable credits for non-corporate beneficiaries.

If the capital gains tax discount is removed and replaced with indexation plus a 30 per cent minimum tax, employees who hold shares for longer periods will no longer obtain the ordinary benefit of the current post-12-month discount on future gains.

The result is that arrangements intended to spread ownership through the workforce may become less attractive or more costly — particularly where the equity interest is modest and the tax treatment is central to participation.



### **9.3 Lower-Paid Employees Will Bear the Greatest Relative Detriment**

Lower-paid employees are more likely to participate in broad-based plans where the equity interest is modest but the tax treatment is fundamental to making participation worthwhile.

They are also less likely to have alternative access to wealth accumulation structures outside their employment arrangements. If the tax treatment of employee equity is worsened, lower-paid employees will often bear the greatest relative detriment.

This is particularly concerning for broad-based \$1,000 exemption plans and related employee share plans. Employees in those plans are not high-income trust beneficiaries engaging in tax arbitrage — they are workers in approved employee equity structures.

### **9.4 The Absence of an Averaging Mechanism Compounds the Unfairness**

Employee Ownership Australia notes that the regime introduced by the proposed CGT measures in Schedule 1, unlike earlier versions of the CGT system, does not incorporate an equivalent of the prior averaging concept that historically moderated the effect of large capital gains being taxed at high marginal rates.

As a result, one-off realisations of employee equity may produce disproportionately severe outcomes when compared with the role those gains play in employees' long-term wealth formation.

The absence of such a moderating mechanism is especially important for lower-paid employees who may realise a gain only once and who are less able to absorb tax volatility.

The Explanatory Memorandum's discussion of the minimum tax acknowledges that certain income support recipients should be exempt to ensure low-income, low-wealth individuals are not adversely affected.

But a lower-paid employee with a one-off ESS gain would not ordinarily be receiving income support and would therefore get no benefit from this exemption. The same policy concern — protecting individuals with genuinely low lifetime wealth — applies to those employees but is not addressed.

## **10 Small Business Succession, the Need for Expanded Concessions, and the Case for an Australian Employee Ownership Trust Regime**

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### **10.1 The Bills Effectively Increase Tax on Small Business Transitions**

The Explanatory Memorandum states that there will be "no changes to the operation of the small business CGT concessions" as a result of these amendments. In practical terms, however, that statement is misleading.

Under the current law, the small business concessions in Division 152 operate in conjunction with the 50 per cent CGT discount: the method statement in section 102-5 applies the CGT discount at step 5 before the small business concessions are applied at step 6.

From 1 July 2027, the discount will no longer reduce the gain before the concessions apply, and any residual gain will be subject to the 30 per cent minimum tax.

The net result is a material increase in the effective tax rate on small business transitions — for vendors who qualify for Division 152 concessions, and more so for those who do not fully qualify. This has significant implications for business succession across the Australian economy.

### **10.2 The Small Business Concessions Are Critical for Orderly Founder Transitions**

Australia faces a generational transition in small business ownership. A large cohort of baby boomer founders are approaching or have reached retirement age.



The tax settings governing disposal of their businesses directly affect whether those businesses survive, who acquires them, and whether the value built over decades is preserved.

The Division 152 concessions have historically played an important role in facilitating orderly founder transitions. They recognise that small business owners — unlike passive investors — have built enterprise value through personal effort, risk-taking and long-term commitment.

The concessions provide a retirement pathway that reflects the nature of that contribution.

The removal of the CGT discount materially weakens the combined effect of these concessions.

Employee Ownership Australia considers that the Government should not merely preserve but expand the scope of the small business concessions to support founder transitions — particularly transitions to employee ownership structures that retain the business within the community and distribute value among the workforce.

### **10.3 An Australian EOT Regime Would Facilitate Employee-Led Business Succession**

One of the most significant applications of concessional small business settings — and of employee equity structures internationally — is facilitating the succession of small and medium-sized businesses from retiring founders to their employees.

The United Kingdom's Employee Ownership Trust (EOT) regime illustrates what is achievable. Since 2014, the UK has provided a complete CGT exemption for vendors who sell a controlling interest in a trading company to an EOT for the benefit of employees.

This concession has driven a substantial expansion of employee-owned businesses, with over 1,700 companies now held in EOT structures.

The EOT model facilitates business succession while preserving jobs, maintaining company culture, and distributing value among employees rather than concentrating it in external acquirers. The UK Government has since expanded the regime in recognition of its economic and social benefits.

### **10.4 The Increased Tax Burden Makes an Australian EOT More Urgent, Not Less**

The increased effective tax rate on small business disposals under the new regime makes an Australian EOT concession more necessary, not less. The impact is disproportionate for employee-led succession because:

- Employee buyers typically cannot offer the same upfront cash consideration as trade buyers or financial acquirers, making the after-tax proceeds even more critical to the vendor's retirement planning.
- EOT-style transitions are often structured as deferred acquisitions funded from future business profits, meaning the vendor bears ongoing risk and illiquidity — which a higher tax burden makes less tolerable.
- The policy rationale for concessional treatment of EOT sales is strongest precisely because employee ownership delivers broad economic and social benefits that trade sales do not.

Without a dedicated concession, the new regime will systematically favour trade sales over employee-led succession, concentrating ownership rather than distributing it.

### **10.5 Employee Ownership Provides a Wealth-Building Pathway for Younger Australians**

The case for an EOT regime is not only about retiring founders. It is equally about younger Australians.

The Explanatory Memorandum acknowledges that younger Australians are finding it harder than earlier generations to build wealth and buy a home. Employee ownership directly addresses this concern.



When a business transitions to an EOT, employees — including younger workers who may have no realistic prospect of home ownership or significant financial assets — acquire a genuine stake in the enterprise that employs them.

That stake provides wealth accumulation tied to productive work, not leveraged property speculation. It gives younger Australians a direct interest in their employer's success and creates a pathway to financial security that does not depend on the housing market.

An Australian EOT framework would serve two complementary objectives: an orderly, concessionally taxed succession pathway for retiring founders, and a mechanism for distributing business value to younger employees who are otherwise locked out of meaningful capital participation.

## **10.6 The Small Business Concessions Should Be Expanded and an EOT Framework Legislated**

Employee Ownership Australia recommends that the Committee:

- the expansion of the small business CGT concessions to counteract the effective increase in tax on business transitions caused by the removal of the CGT discount;
- specific enhancements to facilitate founder transitions to employee ownership structures, including extended rollover relief and enhanced concessions where a business is transferred to a qualifying employee ownership vehicle; and
- the development and legislation of an Australian EOT framework that provides a full or substantial CGT exemption (or reduction) for vendors who sell a qualifying business to an EOT for the genuine benefit of a broad class of employees.

These measures would offset the increased tax burden on business transitions, provide a clear incentive for retiring founders to choose employee ownership over external sale, and support regional and community businesses where trade sale options are limited.

They would give younger Australians a stake in the enterprises that employ them, and bring Australia into line with international practice in employee ownership policy.

## **11 The Announced Trust Minimum Tax: A Related Concern**

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### **Trust Minimum Tax Will Interact Adversely with the CGT Reforms**

Although the discretionary trust minimum tax is not in these Bills, Employee Ownership Australia notes that the Schedule 1 CGT adjustments will interact with that measure when legislated.

If employee share trusts and employee ownership trusts are brought within a 30 per cent trustee-level tax with only non-refundable credits for employee beneficiaries, the combined effect with the Schedule 1 changes would be particularly damaging.

### **Employee Share Trusts and EOTs Should Be Expressly Excluded**

The Committee should recommend that any future trust minimum tax legislation include express exclusions for employee share trusts and genuine employee ownership trusts, recognising that these structures serve a fundamentally different economic function from the arrangements that measure is directed at.

## **12 Recommended Amendments and Policy Adjustments**

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Employee Ownership Australia recommends that the Committee support the following reforms:



### **12.1 The Start-up Concession Must Be Preserved and Expanded**

Equity interests provided under the existing start-up concession should either remain subject to current CGT treatment or be carved out from the new regime so that the concession's economic value is preserved.

At minimum, gains on such interests should continue to receive treatment equivalent to the current discount-based regime, rather than being moved entirely into the indexation and minimum tax model.

Beyond preservation, the Government should use this opportunity to expand the start-up regime — widening eligibility criteria, increasing the qualifying company cap, and extending concessions to growth-stage enterprises — so that CGT reform is accompanied by a strengthened commitment to employee equity participation in Australia's innovation economy.

### **12.2 Averaging or Equivalent Relief Should Be Introduced for Broad-Based Plans**

The Government should adopt an averaging-style mechanism or equivalent relief for gains realised by employees under broad-based employee share plans, particularly where those gains arise from long-term participation and involve lower-paid employees or modest allocations.

This could take the form of an averaging mechanism, a capped concessional rate, or an excluded class of gains for specified broad-based plans.

### **12.3 The Grandfathering Provisions Must Be Redesigned for ESS Interests**

The proposed CGT measures in Schedule 1 should be amended to accommodate the existing employee share scheme architecture so that grandfathering rules preserve coherent capital gains tax treatment across the full range of common plan structures.

Grandfathering should not be determined solely by reference to the legal characterisation of the relevant asset at 1 July 2027, but should instead reflect the operation of the ESS rules under which acquisition time, taxing point and cost base often operate by reference to different events.

### **12.4 Small Business Concessions Should Be Expanded and an EOT Framework Legislated**

The small business CGT concessions should be expanded to counteract the effective increase in tax on business transitions caused by removal of the CGT discount. Specific enhancements should facilitate founder transitions to employee ownership structures.

The Government should develop and legislate an Australian EOT framework providing a full or substantial CGT concession for vendors who sell a qualifying business to an employee ownership trust for the benefit of a broad class of employees.

This would offset the increased tax burden on small business transitions, prevent the reforms from systematically favouring trade sales over employee-led succession, and give younger Australians a pathway to wealth accumulation through productive enterprise.

### **12.5 Employee Share Trusts and EOTs Must Be Excluded from Any Future Trust Minimum Tax**

When the trust minimum tax is legislated, it should expressly exclude trusts that exist solely or predominantly to facilitate employee share schemes or genuine employee ownership.

### **12.6 Targeted Consultation with Employee Ownership Stakeholders Is Essential**

Treasury should undertake targeted consultation with Employee Ownership Australia, listed and unlisted employers, professional advisers and scheme administrators before finalising any further legislation affecting employee share schemes.



## 13 Why These Adjustments Are Consistent with the Government's Broader Policy

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### **Employee Ownership Falls Outside the Mischief Targeted by the Bills**

The adjustments recommended here do not undermine the broader reforms. The Explanatory Memorandum makes clear that the reforms are directed at levelling the playing field for first home buyers, maintaining incentives for new housing supply, and ensuring fairness.

Employee ownership structures are not within this policy target. Excluding them would preserve the Government's fairness objectives, not weaken them.

### **The Risk Is Legislative Overreach, Not Policy Conflict**

The risk here is not one of policy intention — it is one of legislative overreach or insufficiently tailored exclusions. That is a problem capable of straightforward correction at the design stage.

## 14 Conclusion

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### **Employee Ownership Arrangements Are Productive and Should Not Be Burdened**

Employee Ownership Australia supports a principled tax system and recognises the Government's broader reform objectives.

But the CGT measures in Schedule 1, unless adjusted, risk imposing inappropriate burdens on employee ownership arrangements that are economically productive, socially beneficial, and clearly outside the intended policy target.

Broad-based employee share plans, employee share trusts, employee ownership trusts and start-up concession arrangements are not tax shelters. They are mechanisms through which employees participate in enterprise value, align their interests with their employers, and build long-term wealth through productive investment.

The existing tax settings recognise that employee share schemes are a distinct policy area, and the proposed reforms should maintain that distinction.

### **The Committee Should Act Before the Bills Are Passed**

The reforms before the Committee should reinforce — not inadvertently dismantle — the settings that make broad-based employee ownership viable in Australia.

Employee Ownership Australia urges the Committee to recommend the policy adjustments set out in this submission before the Bills are passed and before further legislation implementing the trust minimum tax is introduced.



## Schedule – Detailed Analysis of Grandfathering Outcomes Across ESS Interest Categories

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The following sets out the detailed interaction of the ESS rules with the proposed grandfathering mechanism for each principal form of employee share scheme interest. As noted in Section 7, the outcomes are different across different forms of employee equity. The central difficulty is the disconnect between the determination of cost base and acquisition date under the existing ESS provisions, and the assumptions underlying the grandfathering rules.

The central difficulty is the disconnect between the determination of cost base and acquisition date under the existing ESS provisions, and the assumptions underlying the grandfathering rules.

### Shares acquired under a \$1,000 exemption plan

Where the interest is taxed upfront under Subdivision 83A-B, section 83A-35 provides for a reduction of up to \$1,000, subject to the conditions in section 83A-45.

The relevant value is determined at the time of acquisition, and the CGT treatment proceeds from that starting point. The acquisition date is known and the value used for the upfront ESS taxing outcome is known. There is no need to wait for a later deferred taxing point.

This category does not suffer from the same impossibility problem as the deferred share case. However, the grandfathering rules still impose a detailed apportionment exercise to determine how much of the capital gain falls within the period before 1 July 2027 and how much falls after. That is a disproportionate calculation for an interest that falls within a concession capped at \$1,000. Even where the provisions can technically operate, the level of calculation required is not aligned with the scale and purpose of that concession.

That is a disproportionate calculation for an interest that falls within a concession capped at \$1,000. Even where the provisions can technically operate, the level of calculation required is not aligned with the scale and purpose of that concession.

### Illustrative Example — \$1,000 Exempt Share Plan

Assume the following facts. An employee of a publicly listed company is provided with \$1,000 worth of shares under a plan that satisfies the conditions in section 83A-45 of the ITAA 1997. The shares are offered to all employees on substantially the same terms. A three-year restriction on dealing applies under section 83A-45(5).

Under the existing regime, section 83A-35 provides a reduction of up to \$1,000 from the amount otherwise assessable under Subdivision 83A-B. The cost base of the shares for CGT purposes is established under section 130-80 by reference to the market value at the time of acquisition.

The acquisition date for CGT purposes is the date the shares are provided to the employee. Assume the shares are acquired before 1 July 2027 and are still held at that date, subject to the dealing restriction.

Assume the shares have a market value of \$1,200 at 1 July 2027. Under the proposed grandfathering mechanism, the employee is deemed to have disposed of and reacquired the shares at that date. The grandfathered gain is the excess of the market value at 1 July 2027 (\$1,200) over the original cost base (\$1,000), being \$200.

That \$200 grandfathered gain is deferred and assessed under the old regime (with cost base indexation) only when the shares are actually disposed of. The new cost base for post-1 July 2027 purposes is \$1,200.

Assume the employee ultimately sells the shares for \$1,800. The total economic gain is \$800 (\$1,800 less the original \$1,000 cost base). This gain must be apportioned as follows:

- Pre-1 July 2027 (grandfathered) gain: \$200, subject to cost base indexation under the old regime (the former 50 per cent CGT discount no longer being available, replaced by indexation of the \$1,000 cost base from acquisition to 1 July 2027).



- Post-1 July 2027 gain: \$600 (\$1,800 less the new cost base of \$1,200), assessed under the new regime including the 30 per cent minimum tax on the capital gain.

The employee must therefore:

- determine the market value of the shares at 1 July 2027;
- calculate the grandfathered gain by reference to the original section 130-80 cost base;
- apply indexation to the original cost base for the pre-transition component;
- separately calculate the post-transition gain using the deemed reacquisition value as the new cost base; and
- apply the 30 per cent minimum tax to the post-transition gain.

This five-step calculation — requiring a formal valuation at 1 July 2027, dual-regime gain computation, and separate minimum tax assessment — is disproportionate to a concession capped at \$1,000 and directed at ordinary employees under a broad-based plan.

### **Shares acquired under a tax-deferred plan**

On the basis that no consideration is paid by the employee, the cost base of the share is the relevant market value of the share at the tax deferral point. Let's assume the deferred taxing point has not yet occurred at 1 July 2027, so the statutory framework has not yet determined the cost base. The grandfathering provisions require a gain to be calculated at 1 July 2027, but the employee share scheme code determines the relevant amount only at the later deferred taxing point.

The calculation is required at one time, but the statutory machinery that produces the amount operates at another time. This highlights the fundamental disconnection between the time of acquisition of the share and the later point at which the cost base is established for CGT purposes.

### **Illustrative Example — \$5,000 Salary Sacrifice Plan (Tax-Deferred)**

Assume the following facts. An employee of a publicly listed company acquires \$5,000 worth of shares under a salary sacrifice arrangement that qualifies for tax deferral under Subdivision 83A-C of the ITAA 1997. A five-year restriction period applies. The shares are acquired for CGT purposes at the time they are provided to the employee (being the acquisition date under section 109-5 of the ITAA 1997, read with section 130-80).

Under the existing deferral regime, the ESS taxing point is deferred under section 83A-110 until the earliest of:

- the lifting of the restriction on disposal, or
- the end of the maximum deferral period (15 years from acquisition).

No amount is included in assessable income until that deferred taxing point occurs.

Critically, the cost base of the shares for CGT purposes is determined by section 130-80(4), which provides that the cost base includes the amount assessed at the deferred taxing point under section 83A-110. That amount is not known until the deferred taxing point actually occurs.

Assume the shares are worth \$6,000 at 1 July 2027. The five-year restriction period has not yet expired and the deferred taxing point has not occurred. The proposed grandfathering mechanism requires the employee to calculate the gain that would have arisen if the shares had been disposed of at 1 July 2027.

However, the cost base cannot be determined at that date. Section 83A-110 has not yet operated to fix the amount to be included in assessable income, and therefore the cost base inclusion under section 130-80(4) is not yet known. The grandfathered gain is incapable of calculation because the statutory inputs required to determine it are fixed by reference to a future event.

Assume the deferred taxing point subsequently occurs when the shares are worth \$7,000 (being the market value at that time). At that point, section 83A-110 includes \$7,000 in the employee's



assessable income (less any consideration paid, here \$5,000 salary sacrificed), and section 130-80(4) fixes the cost base at \$7,000.

The employee sells the shares four years after the deferred taxing point for \$9,000. The capital gain is \$2,000 (\$9,000 less the \$7,000 cost base). Under the new regime, this entire gain is assessed as a post-1 July 2027 gain subject to cost base indexation and the 30 per cent minimum tax.

The result is that the entire capital gain of \$2,000 is assessed under the new regime, notwithstanding that a substantial portion of the increase in value of the shares (\$1,000 of the \$4,000 total appreciation from \$5,000 to \$9,000) occurred before 1 July 2027.

This illustrates two difficulties.

First, the grandfathered gain at 1 July 2027 is not capable of determination at that date because the cost base depends on the future deferred taxing point.

Second, the mechanism does not appropriately allocate pre-1 July 2027 growth to the old regime.

An asset acquired before the transition date should be entitled to grandfathering that reflects the economic appreciation attributable to the pre-transition period.

### **Options and shares acquired under a rights plan**

The interest originally acquired is an option or right, whereas the asset ultimately disposed of may be a share. Section 83A-120 governs the deferred taxing point for a beneficial interest in a right to acquire a share.

If the taxing point arises while the employee still holds the option, the statutory amount is determined in relation to the option.

If the taxing point arises only after the option has been exercised, the amount is determined in relation to the resulting share.

The taxpayer is asked to determine a gain at 1 July 2027 in relation to an asset then held, but the later statutory mechanism may determine the relevant ESS amount by reference to the same asset or by reference to a different asset.

It is not only that the amount has not yet been determined — the identity of the asset to which the statutory valuation will later attach may not yet be known.

Additionally, in the employee share scheme context, when rights qualify for the start-up concession and are later exercised, the resulting share is treated for CGT discount purposes as having an acquisition date corresponding to the time the right was acquired rather than the time of exercise. This differs from the ordinary treatment of options outside the ESS provisions. The rules produce the anomaly that both the option and the share acquired on exercise have an acquisition date referable to when the original option was acquired, unlike the treatment of an option otherwise under the ESS.

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### **Start-up options**

Start-up options are subject to a distinct concessional regime. They demonstrate that the present law already contains a coherent framework for dealing with timing of tax and cost base outcomes, and that a crude grandfathering test by reference to asset characterisation at a particular date can disrupt that coherence. The resulting share is treated as having an acquisition date corresponding to the time the original right was acquired. This specific statutory modification shows that the employee share scheme code does not map directly onto the ordinary CGT treatment of options and shares.

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### **Out-of-the-money options**

An out-of-the-money option may have little or no immediate value when granted but may later become valuable. If grandfathering is tested by reference to a single date before exercise, the result may depend on whether the employee is holding an option or a share at that date, even though the ultimate economic gain is attributable to the same underlying remuneration arrangement.

### **Illustrative— Out-of-the-Money Option (Post-Transition Exercise)**

Assume the following facts. An employee is granted options under a tax-deferred ESS plan to acquire 100 shares at an exercise price of \$1.49 per share (total exercise price: \$149). At the date of grant, the shares are trading at \$1.20 — the options are out of the money. The options are subject to deferral under Subdivision 83A-C.

At 1 July 2027, the options remain unexercised. The market value of the underlying shares is \$3.00 per share (\$300 for 100 shares). The options are now in the money, but no ESS deferred taxing point under section 83A-120 has yet occurred because the employee continues to hold the options.

Under the proposed grandfathering mechanism, the deemed disposal and reacquisition applies to the options (the asset held at 1 July 2027). However, the ultimate CGT event will occur in respect of the shares acquired on exercise — not the options themselves.

After 1 July 2027, the employee exercises the options and acquires 100 shares, paying the exercise price of \$149. The cost base of the resulting shares is determined at this point.

Because the shares are treated as a new asset acquired on exercise (after 1 July 2027), the grandfathering that applied to the options does not carry through to the shares. The shares are treated as having been acquired after the transition date.

The employee sells the shares for \$5.00 per share (\$500 for 100 shares). The capital gain on the shares is calculated entirely under the new regime. The full gain on the shares (\$500 less the cost base determined at exercise) is subject to the 30 per cent minimum tax, with no grandfathering benefit.

Yet the economic appreciation from the grant date to 1 July 2027 — reflected in the increase in share value from \$1.20 to \$3.00 — accrued entirely during the pre-transition period. The grandfathering mechanism fails to allocate any portion of that growth to the old regime because it attached to the options (which ceased to exist on exercise), not to the shares (which are the asset ultimately disposed of).

A coherent grandfathering rule should ensure that where an ESS interest is acquired before 1 July 2027, all economic appreciation attributable to the pre-transition period is assessed under the old regime, regardless of whether the legal form of the asset changes from an option to a share on exercise. The present mechanism does not achieve this.