From: Leigh Riley [leigh@jlrpartners.com.au]
Sent: Thursday, 8 October 2009 11:16 PM
To: Tax Board
Subject: 08 10 09 RE: Submission for the Review of Employee Share Schemes
Attention: The Board of Taxation - Review of Employee Share Schemes

As stakeholders with an accounting firm servicing numerous SME business clients, my submission vents our concerns for the affects of the ESS proposal toward SME business owners. We find that SMEs are in great need for succession solutions and one option we propose to overcome the problems is to utilize an employee share ownership plan.

The agenda of the ESS proposal has been almost entirely focused on the affects for large company share schemes, however this has been to the detriment of small business which has very different needs for the use of employee share ownership plans. SME business owners can use employee share ownership plans as a genuine succession planning strategy to assist employees to fund the eventual buyout of the owners.

In particular, the proposal to limit salary sacrifice to $5,000 p.a. into an ESS is a devastating blow. For a small business valued at $500,000, it would take an employee 100 years to fund the acquisition at this rate. When we consider the value of many of these small businesses being in the realm of $1million to $5million, it makes the scenario even more unattainable.

SME business owners are facing enormous problems when exiting their business due to retirement.

Situational Facts about the Australian SME Business Marketplace

- **The combined wealth of the Australian SME market is estimated to be $4.3 trillion (AUD) (Ernst & Young 2007, Smyrnios et al., 2003), and represents 97% of all businesses, employing 40% of the Australian workforce (ABS).**

- **The average age of these business owners is 55 years, and it is expected that more than 81% are retiring in the next 10 years, resulting in sales estimated to be $3.5 trillion, with a high percentage of the sale proceeds being relied upon to fund retirement lifestyle (RMIT 2006).**

- **In 2006, Australia had 1,963,907 actively trading businesses (ABS Annual Report 2006/07), and it is estimated approximately 1.6 million business will be changing hands by 2017 with a staggering 75% of these having no formal succession plan to manage the transition (RMIT 2006), funding, and tax implications that would maximise the business owners financial outcome**

- **The Institute for Independent Business (IIB) conducted an SME business survey that revealed around 40% of respondents had the topic of Succession Planning listed as their most pressing, unresolved issue.**

Resultant Problems

- **The collective size of so many small businesses has a large impact on the economy. The successful continuity of this sector is a vital contributor toward the continued strength of the Australian economy.**

- **Younger generations may be willing to purchase the businesses about to change hands; however they typically have insufficient equity or borrowing capacity to fund the purchase from retiring business owners.**

- **People that can buy into businesses are forced to take unnecessary risk through excessive borrowings, which affects business profitability and potential viability, and has spin on effects for the Australian economy.**

- **Banks and financiers are scrutinising very carefully the loans they approve on business purchases since the Global Financial Crisis which is making it more difficult for business owners to sell**

because purchasers cannot obtain sufficient finance.

- **Buyers' inability to finance acquisitions requires business owners to resort to Vendor Finance terms, which even at best, results in retiring business owners to be without direct access to their full capital value to fund their retirement. This in turn puts financial strain on the national social security system (Centrelink) as retiring business owners are frequently insufficiently funded with superannuation. Typically they have operated with virtual full reliance on the sale of their business to fund their retirement. When the funds are unavailable, they are reliant on the public purse to provide during their retirement.**

Summary

Small business owners can use an employee share ownership plan or ESS very effectively as a genuine succession planning strategy.
We would like to see and recommend unlimited ability for SME employees to salary sacrifice into genuine succession planning strategies involving employee ownership plans or ESS. Small business employees are not usually paid at levels comparable to large company executives so it is unlikely there would be the possibility to exploit the tax system by using this strategy.

If we consider an example of an employee earning $180,000 pa who agrees to salary sacrifice $100,000 into an employee share ownership plan over 10 years to acquire a business worth $1million. We can assume 46.5% tax would normally be paid on the full amount, so the loss to the tax system would be $46,500 pa. Over 10 years, this would amount to $465,000 in lost tax revenue. However when we consider the benefits back to the economy, the costs quickly fall into perspective, being:-

- **The existing owner would exit the business with $1 million therefore no call or strain on national social security benefits (Centrelink). This factor alone very quickly establishes the value of such a strategy with the greater cost to the government to maintain aged pension benefits effectively being avoided.**
- **Employee has not taken undue risk with borrowings, as has maintained a steady payment plan over time to acquire – healthier and more stable growth for the economy.**
- **The likelihood of successful business continuity is far greater from an existing employee that has operated within the business for some time. The benefit to this for the Australian economy is that it has long term viability affects for the tax system, employment and economy in general.**

It is hoped you will apply due consideration to this submission as a voice for small business owners, and your response is greatly anticipated.

With regards

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