



Australian Government  
Australian Taxation Office

# Employee share schemes: start-up companies

Instructions for using the standard documentation

# 1. Standard ESS documents and this instruction guide

## 1.1 Standard ESS documents

The ATO has developed a set of standard documents to help start-up companies who are eligible to use the tax concessions in section 83A-33 of the *Income Tax Assessment Act 1997* (the Tax Act). This allows start-up companies to establish and operate an ESS that relates to offers of Options to acquire newly issued ordinary shares.

The standard documents include:

- > a standard Employee Option Plan, and
- > a standard Offer Letter.

The standard documents have been developed to save you some of the time and cost associated with the initial set up of an ESS for the offer of Options (for example, by reducing the time spent consulting with professional advisors.)

The standard documents should be used to assist with the initial planning and information gathering stages, rather than a replacement for professional advice. You will need to seek independent professional advice about certain aspects of your draft plan.

The standard documents are not necessarily designed to meet all the requirements of every company and you may need to change the plan to suit your individual circumstances. You should seek professional advice about any modifications or additions you wish to make to the Employee Option Plan or Offer Letter.

To further help start-up companies establish and operate an ESS, the ATO will publish from time to time a list of software developers (and a link to their website) that have produced interactive applications to assist with the task of assembling and populating the standard ESS documents. LawPath ([lawpath.com.au/easy-ess](http://lawpath.com.au/easy-ess)) is one such developer and who have an interactive application to create legal documents.

Please note that the ATO cannot recommend or endorse any one product or service over another and will not be responsible for any loss, damage, cost or expense in connection with using this application. The ATO has not carried out any testing of the listed applications and does not carry out any form of security testing of developer products or services. If you intend to use the interactive application you are encouraged to ask the developers about the security aspects of their products and the services they provide.

## 1.2 This instruction guide

This instruction guide is designed to accompany and explain the standard ESS documents developed by the ATO. It contains:

- > a checklist of matters to consider when establishing an ESS and links to helpful further information
- > brief background information about employee option plans generally
- > information about the start-up tax concessions and the eligibility of Companies for these concessions
- > information about the key obligations for Companies making offers under an ESS under the *Corporations Act 2001* (Corporations Act)
- > an explanation about how to use the standard documents and their terms

- > an Annexure containing a useful flow diagram of the likely Corporations Act obligations for companies making ESS offers under the standard Employee Option Plan.

## 2. Matters to consider when establishing an ESS

The table below outlines some matters you should consider when establishing an ESS and contains some useful links to further information about each of these matters.

Things to consider		Links to helpful information
1.	Would an ESS help develop your business?	See the Government's <i>Industry, Innovation and Competitiveness Reform Agenda</i> at the Department of Industry and Science website ( <a href="http://industry.gov.au">industry.gov.au</a> )
2.	What type of ESS is best for your business?	See the <i>Employee Ownership Australia and New Zealand</i> website ( <a href="http://employeeownership.com.au">employeeownership.com.au</a> )
3.	What features are important for your ESS?	See the ATO's <i>Guide for Employers</i> and <i>Guide for Employees</i> ( <a href="http://ato.gov.au/ess">ato.gov.au/ess</a> )
4.	Is your business eligible for the start-up tax concession?	<p>Details of start-up concession can be found in the enabling legislation and explanatory material through the Australian CommLaw website <a href="http://commlaw.gov.au">commlaw.gov.au</a>:</p> <ul style="list-style-type: none"> <li>&gt; The enabling legislation (<i>Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015</i>) and Explanatory Memorandum</li> </ul> <p>and through <a href="http://ato.gov.au/ess">ato.gov.au/ess</a>:</p> <ul style="list-style-type: none"> <li>&gt; ATO Market Value Safe Harbour Legislative Instrument and Explanatory statement</li> </ul>
5.	What information does your employee require?	<p>The ATO's <i>ESS - Guide for Employees</i> provides helpful information (<a href="http://ato.gov.au/ess">ato.gov.au/ess</a>)</p> <p>The ATO also provides useful information in the <i>ESS - Guide for Employers</i> under 'What to expect from your employer'</p>
6.	Does your ESS trigger any Corporations Act issues?	<p>ASIC policy, guidance and class orders relating to employee incentive schemes are available from the ASIC media centre (<a href="http://asic.gov.au">asic.gov.au</a>)</p> <ul style="list-style-type: none"> <li>&gt; <a href="#">ASIC Media release on Employee Incentive Schemes</a></li> <li>&gt; <a href="#">Regulatory Guide 49 — Employee Incentive Schemes</a></li> <li>&gt; <a href="#">Regulatory Guide 228 — Prospectuses: Effective Disclosure for Retail Investors</a></li> </ul> <p>The Australian ComLaw website (<a href="http://comlaw.gov.au">comlaw.gov.au</a>) has information under <a href="#">ASIC Class Order 14/1001 — Disclosure Relief</a></p>

7.	Do you require document templates to help prepare your ESS?	Standard option plan templates can be accessed from <a href="http://ato.gov.au/ess">ato.gov.au/ess</a> : <ul style="list-style-type: none"> <li>&gt; Employee Option Plan template</li> <li>&gt; Employee Letter of Offer template</li> </ul>
8.	Are you aware of your tax reporting obligations?	The ATO provides an explanation of the ESS tax reporting obligations on its ESS annual report web page ( <a href="http://ato.gov.au/ess">ato.gov.au/ess</a> )

## 3. Option plans generally

Where employees receive Options under the Employee Option Plan, they receive a right (but not an obligation) to purchase shares in the company at a specified time in the future, for an agreed price (the exercise price). When employees convert their Options into shares this is referred to as exercising their Options. Generally, Options cannot be exercised immediately but might require certain conditions to be satisfied before they can be exercised. Option plans are often used to retain key talent and to provide a longer term incentive to stay with the company. Options generally have conditions attached to them that need to be met before the options can be exercised. These are referred to as vesting conditions and can relate to company performance or length of service.

Options usually have an exercise period of between three and five years. During the period that an employee holds the options they are generally not entitled to dividends or voting rights, and generally cannot sell their options. However, once options are exercised and the underlying shares issued, employees generally receive the full benefits of being a shareholder.

## 4. Option Plans eligible for the start-up tax concession

Under changes made to the Tax Act, effective from 1 July 2015, special concessional tax rules apply to ESS that fall within the 'ESS start-up concession' rules.

Under these rules, and provided certain conditions are met, Options will not be taxed on grant, vesting or exercise. Rather, the taxing point will be deferred until the sale of the shares which will generally be a CGT event. The 50% CGT discount will apply if the sale of the shares occurs at least 12 months after the grant of the Options.

### 4.1 What are the 'start-up eligibility criteria'?

To be eligible for the 'start-up' tax concession, each of the company, the ESS, and the employee must meet certain eligibility criteria.

#### 4.1.1 Eligibility criteria for the start-up company

- > The company that grants the ESS interests (Options in this case) must have had an aggregated turnover of less than \$50 million in the income year prior to the year the interests are granted. The turnover test includes connected entities but certain eligible investors in the company, including eligible venture capital investors and any exempt entity that is a deductible gift recipient, are treated as unconnected.

- > The company (and its corporate group) must not have any interests listed on an approved stock exchange in the income year prior to the ESS interest being offered.
- > The company (and its connected entities) must have been incorporated for less than 10 years.
- > The employing company (which can be a subsidiary of the company granting the ESS interests are being offered) must be an Australian resident taxpayer.

#### 4.1.2 Eligibility criteria for the terms of the ESS offer

- > The only interests that can be acquired under the ESS must be ordinary shares or Options to acquire ordinary shares, or rights (including Options) to acquire ordinary shares.
- > The ESS interests must be held for a minimum holding period of 3 years (commencing on the date the ESS interests were acquired).
- > In the case of an ESS for Options — the exercise price must not be less than the market value of shares in the company at the date of grant of the Options.
- > In the case of an ESS that is a share plan — the shares must not be offered for more than a 15% discount on the market value of the shares at the date of grant.

#### 4.1.3 Eligibility criteria for employees

- > Employees cannot hold more than 10% ownership or voting rights in the company in which the ESS interests are being granted — including vested and unvested Options and aggregating both the current and previous grants.

## 5. Corporations Act obligations

Where you make an offer of Options under the ESS using the standard form Offer Letter and Employee Options Plan, a range of obligations under the Corporations Act may be triggered.

### 5.1 The disclosure requirement

The Corporations Act requires that if you make an offer of Options under the Employee Option Plan, you must also give the employee a disclosure document, unless an exemption in that Act applies or you are relying on the relief in the Australian Securities and Investments Commission (ASIC) Class Order [CO 14/1001]: Employee incentive schemes: Unlisted bodies (ASIC CO 14/1001).

For a brief overview of the Corporations Act disclosure obligations and relief conditions, see the flow diagram in Annexure 1 of this information guide.

#### 5.1.1 Disclosure exemptions

There are limited disclosure exemptions that may apply for offers of Options to employees under the Employee Option Plan, which include (among others):

- > offers to senior managers – see section 708(12) and the definition of 'senior manager' in s9 as modified by ASIC CO 04/0899 for more detail, and
- > small-scale offers – offers to up to 20 persons not exceeding \$2 million (calculated by reference to the amount payable on both grant and exercise of the Option) in any 12 month period (see sections 708(1)-(7) for more detail).

## 5.1.2 Disclosure documents

A disclosure document is a term used to describe all regulated fundraising documents for the issue of securities. All disclosure documents must be lodged with ASIC before an offer can be made under the ESS. The simplest type of disclosure document that can be used to make an offer under an ESS is an offer information statement (OIS). A prospectus, which has a more comprehensive content requirement than an OIS, may also be used.

An OIS must include, among other things an audited financial report prepared in accordance with the accounting standards, which covers a 12 month period and with a balance date that occurs within the last 6 months before an offer is first made under the OIS. See ASIC Regulatory Guide 228: Prospectuses: Better disclosure for retail investors (RG 228) for guidance about OISs.

A prospectus must contain all information that investors and their professional advisors would reasonably require to make an informed investment decision. Among other things, it must explain the company's financial position, performance and prospects. See RG 228 for more information on Prospectuses.

## 5.2 ASIC CO 14/1001 and offer documents

ASIC CO 14/1001 reduces the compliance burden for unlisted bodies in establishing their ESS by providing conditional relief from the disclosure, and other requirements of the Corporations Act. One of the conditions of ASIC CO 14/1001 is, when making an offer under an ESS, the company must provide an Offer Document that complies with the requirements of ASIC CO 14/1001. Each offer must also be valued at no more than \$5,000 per employee and for no more than nominal monetary consideration.

For more information on the conditions to be satisfied to rely on the relief in ASIC CO 14/1001, including the content of Offer Documents, see the section G of ASIC Regulatory Guide 49: Employee incentive schemes.

## 5.3 Other requirements of the Corporations Act

The Corporations Act also contains the following provisions that may be relevant, depending on how your ESS is implemented:

- > The requirement to hold an Australian financial services licence for the incidental provision of financial services (such as giving general advice, dealing in financial products or providing custodial or depository services) in connection with the ESS.
- > The prohibition on advertising an offer or an intended offer where that offer needs a disclosure document.
- > The prohibition on the issue of Options or shares arising out of unsolicited contact with investors (which is referred to as hawking).
- > The requirement to register a managed investment scheme for an ESS that has a contribution plan.
- > The restrictions on the on-sale of financial products issued without disclosure within 12 months of their issue.

If your offer is an "eligible employee share scheme" (defined in s9 of the Corporations Act) and is made using a disclosure document, there are some limited exemptions from these provisions. If you are relying on ASIC CO 14/1001, you are generally not required to comply with these provisions.

## 5.4 Further information

You can find further information and guidance about the Corporations Act obligations and class order relief in the links provided in item 6 of the checklist in section 2 of this instruction guide.

## 6. Explanation of the standard ESS documents and how to use them

A set of standard documents designed to meet the ESS Start-Up Concession requirements have been developed by the ATO. It is intended only as one example of rules which companies might wish to adopt using Options. Companies can design a scheme to meet their own needs and objectives within the framework of the legislation. Companies should obtain professional advice where necessary.

In addition to a set of Model Option Plan Rules, a workable scheme will include ancillary documents such as an Offer Letter, an Acceptance Application form, and a Notice of Exercise.

The instructions below also explain the meaning and purpose of each rule within the Employee Option Plan. You have the choice of using the example documents or customising them to take into account your specific circumstances. If you intend to modify the documents they may still provide a helpful starting point for developing a set of ESS documents that meet your individual needs.

Guidance notes have also been included throughout the Employee Option Plan and the Offer Letter and are highlighted in instruction boxes. These notes are designed to assist in using the documents and should be deleted from the final versions of those documents.

Terms and details of the standard documents that can be decided by, or are specific to, the company are denoted by square brackets and yellow highlighting. Once they are completed, the brackets and highlighting can be removed.

### 6.1 Employee Option Plan — establishing the ESS and setting out its rules

The 'Employee Option Plan' establishes the company's ESS. Companies can offer Options to eligible persons under the terms of the Employee Option Plan and the specific terms of the Offer to each employee, which are contained in the Offer Letter. The Employee Option Plan should be attached to the Offer Letter, so that eligible persons can make informed decisions about the offer. At the time of giving these documents to eligible persons, a disclosure document or offer document (see Corporations Act Obligations above) might also be required to be provided to eligible persons.

If an eligible person wishes to accept the offer, they can use the acceptance letter annexed to the Offer Letter. They are then referred to as Participants (for the purposes of the Employee Option Plan definitions).

The table below sets out the purpose of the substantive rules contained in the Employee Option Plan and summarises their effect. The Employee Option Plan also contains instruction boxes detailing more specific matters and guidance.

Rule	Topic	Explanation and matters to consider
1	Administration of the ESS by the Board	The Board administers the Employee Option Plan and may delegate this power. The Board may determine the terms of any offer made to employees under the Employee Option Plan. The drafting is broad and any detailed or practical administrative steps can be separately agreed.
2	Vesting conditions may be set by the Board or a default vesting condition	The Board may set specific vesting conditions as part of the terms of an offer of Options. These will be set out in the Offer Letter. See further below for guidance on setting these conditions. If the board does not do this, a default

	applies	vesting condition applies — see rule 2(c). Options cannot be exercised until the vesting conditions are satisfied. Importantly, the Board may decide to accelerate or waive vesting conditions.
3	What happens when an employee ceases to be employed or contracted by the company?	<p>The Board may decide that the leaver's unvested Options lapse and/or may require the leaver to sell vested Options at their fair market value. This rule sets out procedures to follow in these events.</p> <p>The Employee Option Plan does not distinguish between 'good leavers' and 'bad leavers' but gives the Board discretion. If you wish to create specific rules for 'good leavers' or 'bad leavers', you should consider seeking legal advice.</p>
4	Can employees sell (dispose of) their Options?	<p>To ensure compliance with subsection 83A-45(4) of the Tax Act, employees may not sell their Options for 3 years. Also, they may not sell their Options until an Exit Event occurs, and where the Exit Event is a listing, employees may only sell their Options 180 days after the listing and after any other restriction imposed by an underwriter. This rule aims to prevent any rush in the market and resulting decrease in share price if employees and foundation members immediately seek to sell some or all of their equity in the event of a listing.</p> <p>However, a transfer to a nominee, family trust, and a deceased estate are permitted in certain circumstances. The Board may also permit other transfers.</p>
5	What happens when an employee exercises their Options?	<p>Once the relevant vesting conditions are satisfied, an employee may exercise their Options by giving the company a signed Exercise Notice. The form of the Exercise Notice is annexed to the Employee Option Plan. This rule sets out the company's obligations to issue shares to the employee and other procedural obligations in this event. This rule also requires employees to accede to any Shareholder Agreement in place at the time of exercise, or at the time one comes into place.</p>
6	What happens to the Options when an Exit Event occurs?	<p>An Exit Event is any of a listing, business sale or share sale. When an Exit Event occurs, the Board may decide to buy back or cancel Options (whether vested or not) at their fair market value, or may decide that the Options will vest. The Board may decide to require vested Options to be exercised. If an Exit Event occurs as part of a reconstruction (involving the interposition of a New Holding Entity), new Options issued by the New Holding Entity may be substituted for the Options or the Options may be purchased at fair market value.</p> <p>If requested by majority shareholders, the Board must issue a drag-along notice to the relevant Optionholders, requiring those employees to sell all of their Option Shares (except those subject to the restrictions in rule 4) on the same terms (including sale price) as those proposed by the majority shareholders. For example, if a bidder wishes to buy the entire company, and the majority shareholders agree to sell their shares to the bidder, the employee Optionholders will be 'dragged along' and required to sell their shares (for the</p>

		same price applicable to dragging shareholders).
7	Other obligations of employee Optionholders on a listing	Each employee Optionholder agrees to do all things reasonably required in connection with an actual or proposed listing and to hold and deal with their shares acquired under the Employee Option Plan in accordance with the Listing Rules.
8	What happens to the Options when a Reorganisation Event occurs?	A Reorganisation Event includes a return of capital, bonus issue, share split or consolidation or other internal reorganisation or recapitalisation. The terms of the Employee Option Plan will be varied by the Board so that Optionholders are not disadvantaged to account for the effect of the Reorganisation Event.
9	How does the Employee Option Plan impact on the employment relationship?	The Employee Option Plan does not form part of any employment contract, consultancy or directorship. An Offer of Options does not entitle employees to subsequent offers and does not entitle an employee to vote as a shareholder, receive dividends or to exercise any other rights of a shareholder.
10	General legal provisions	This includes rules stating that the company is not responsible for any taxes or duties payable by Optionholders and that the rules may be varied from time to time by the Board.
11	Definitions and interpretation	The meaning of defined terms is explained and other interpretation rules are set out.  Note that you may choose whether to include prospective employees, contractors or directors in the definition of eligible person.
Sch 1	Option Exercise Notice	Optionholders can use this notice when exercising their Options (see rules 2 and 5) and should complete the relevant details in the notice at that time.

## 6.2 Offer letter

As noted above, to make an offer to an eligible person under the Employee Option Plan, you must give a personalised Offer Letter to the eligible person. The Offer Letter contains the terms of the offer that are relevant to that employee and attaches the Employee Option Plan which contains the general terms of the offer.

You must decide on the offer terms applicable to each eligible person, as indicated in square brackets and highlighted in the Offer Letter, including:

- > the number of Options to offer
- > the exercise price per Option (which is usually the value of the shares at the date of grant as determined by the Board), and
- > the vesting dates and vesting conditions (which are discussed more below).

### 6.2.1 Vesting conditions

If you do not set specific vesting dates and conditions or if you do not include a specific statement that there are no vesting dates and/or conditions, then the default vesting rules in the Employee Option Plan will apply (see rule 2(c)). The default vesting rules provide for 25% of the Options to vest 12 months after issue and the remaining 75% to vest on a quarterly basis over the next 3 years. These

default vesting rules have been included because staged vesting is common. It is uncommon for all Options to vest at the same time or as a result of a single event occurring or target being met.

You should carefully consider what vesting dates, conditions or events are to be set. Vesting conditions should closely align with the company's goals and targets. Vesting conditions can include:

- > time based conditions where Options vest after specified time periods passing (and on which this Employee Option Plan is modelled). Options could vest on a monthly basis or quarterly basis for example, over a specified time period
- > performance based conditions, where Options vest once specified targets have been achieved. These targets could relate to the performance of the company, company group and/or the eligible person (which ensures that the eligible person's interests are aligned with the financial and other targets of the company and its shareholders). Financial targets can include internal rate of return, 'money on money multiples' or other financial metrics utilised by the company.

The vesting provisions may also operate so that a larger portion of Options vest if additional performance hurdles are achieved by the company.

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## Annexure 1: Corporations Act disclosure obligations and exemptions for the offer of options under the Employee Option Plan



