Australian Government
Australian Taxation Office

Explanatory Statement

Income Tax Assessment (Methods for Valuing Unlisted Shares for the Employee Share Scheme start-up concession) Legislative Instrument 2025

General outline of instrument

1. This instrument is made under subsection 960-412(2) of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. The legislative instrument provides approved valuation methods for companies that provide ESS interests to eligible persons (generally employees) under an Employee Share Scheme (ESS) that meets the criteria for the ESS start-up concession under section 83A-33 of the ITAA 1997.

3. The instrument is a legislative instrument for the purposes of the *Legislation Act 2003*.

4. Under subsection 33(3) of the *Acts Interpretation Act 1901*, where an Act confers a power to make, grant or issue any instrument of a legislative or administrative character (including rules, regulations or by-laws) the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

Date of effect

5. This instrument commences on 1 October 2025.

Background

6. Schedule 1 to the *Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015* amended the ITAA 1997 to introduce a taxation concession for employees of certain small start-up companies (the start-up concession) and to provide the Commissioner with the power to approve methods, subject to any condition or conditions, for working out the market value of assets or non-cash benefits.

7. The instrument *Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015* was developed in consultation with industry, and registered to provide approved safe harbour valuation methods for companies that provide ESS interests under the start-up concession contained in section 83A-33 of the ITAA 1997.

Effect of this instrument

8. This instrument repeals and replaces the *Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015* instrument, which would otherwise sunset on 1 October 2025 and continues to provide safe harbour valuation methods that ease the financial and compliance burden for companies accessing the ESS start-up concession.

9. Access to the start-up concession is, among other requirements, subject to satisfying conditions relating to market value under subsection 83A-33(5) of the ITAA 1997, being that the discount on the ESS interest, if a share, is no more than 15% or, if a right (for example, an option)

the amount paid to exercise the right is no less than market value of the share when the ESS interest was provided. This instrument provides approved methods for valuing unlisted shares in a company for the purposes of determining if these conditions are satisfied. Valuations worked out using an approved method are binding on the Commissioner for this purpose.

10. A company that provides ESS interests to an individual is required, under Division 392 in Schedule 1 of the *Taxation Administration Act 1953* (Employee Share Scheme reporting requirements), to report certain information including an estimate of the market value of the interests to both the individual and the Commissioner. Companies eligible to apply the methods in this instrument could also use the resulting market value to satisfy their employee share scheme reporting requirements.

11. The instrument sets out two approved valuation methods. These provide a safe harbour market value that is binding on the Commissioner, for the purpose of applying subsection 83A-33(5) of the ITAA 1997, only if the conditions in subsection 6(1) of the instrument are met. The conditions are that the company provides ESS interests to participants under the start-up concession, and at the time of valuation the company's directors reasonably anticipate there will not be a change of control occurring within the period ending 6 months after the ESS interests are provided. There are additional requirements specific to each method.

12. Sections 7 and 8 of the instrument set out the two approved market valuation methods and associated conditions for using these methods. Method One at section 7 (the comprehensive method) is approved for companies that meet the conditions set out in subsection 6(1) of the instrument mentioned above. Method Two at section 8 (the Net Tangible Assets or 'NTA' method) is approved for companies that meet the conditions in subsection 6(1) and also the additional conditions set out in subsection 8(2) of the instrument.

13. It is not compulsory for companies to use an approved valuation method as provided in the instrument for the purposes of demonstrating eligibility for the start-up concession under subsection 83A-33(5) of the ITAA 1997. Importantly, eligible companies may choose an alternative market valuation method, however, they will not receive approval from the Commissioner under this instrument in relation to that alternative valuation method, unless (per subsection 6(2) of the instrument) the company meets the requirements at subsection 6(1) of the instrument and the method used results in a market value at least equal to what would have been worked out applying an approved method. The approved method used for comparison must have been available to the company, for example, the value from an alternative method that is at least equal to the value worked out using Method Two is not approved if the company could not use Method Two because it did not meet the additional requirements for that method.

14. In summary, this means that where a company is eligible to apply Method One at section 7 *and* Method Two at section 8 of the instrument, but chooses to use an alternative valuation method to work out the market value in subsection 83A-33(5) of the ITAA 1997, that alternative method is approved where the resultant value is not less than the market value worked out using either Method One or Method Two.

Valuation Method One – the comprehensive method

15. Method One set out in section 7 of the instrument is approved for all entities that meet the conditions in subsection 6(1) of the instrument.

16. Under this comprehensive method, the valuation of ordinary shares must be performed by either:

(a) the chief financial officer of the company, or

(b) a person having the skill, knowledge and experience to determine the market value of unlisted shares in a company.

This person does not need to be independent of the company.

17. In addition, the valuation must be in writing and take into account:

(a) the value of tangible and intangible assets of the company,

(b) the market value of similar businesses (including the use of earnings multiples),

(c) uplifts and discounts for control premiums, lack of marketability and key person risk,

(d) the present value of anticipated future cash flows.

18. The methodology used and resultant market valuation is required be endorsed in a written resolution by the directors of the company.

Example 1 – application of Method One

Drilling by Design Pty Ltd has been incorporated for 8 years and has performed very well, increasing its aggregated turnover to above the threshold for a small business entity. The company directors hire an additional 10 employees and want to offer each person ESS interests in the form of options to acquire 40 ordinary shares. The company wishes to rely upon a safe harbour valuation methodology approved by the Commissioner. To determine the exercise price of the options, they must first work out the value of an ordinary share in the company.

The company meets the conditions for approval of the comprehensive valuation method (Method One). However, because the company is no longer a small business entity under section 328-110 of the ITAA 1997 and has been incorporated for more than 7 years it does not meet the conditions for approval of Method Two.

The company accountant has the requisite skills, knowledge and experience to undertake valuations of unlisted shares in start-ups. The company arranges for the accountant to perform the valuation, taking into consideration the factors under section 7 of the instrument. The directors of the company sign off on the valuation provided, by resolution. This valuation satisfies the requirements under the instrument.

Valuation Method Two – the net tangible assets method

19. Method Two is approved for a company that meets the conditions in subsection 6(1) of the instrument and satisfies the following additional conditions:

(a) the company has not raised over $10 million in capital (either debt or equity combined) over the period of 12 months immediately before the time of valuation, and

(b) at the time of valuation, the company either:

i) is a small business entity as defined in section 995-1 of the ITAA 1997, or

ii) has been incorporated for not more than seven years, and

(c) the company has prepared, or will prepare, a financial report as defined in section 9 of the *Corporations Act 2001* for the year in which the time of valuation occurs.

20. A company that meets the conditions to use Method Two and Method One may choose to use Method Two.

21. A valuation under Method Two is carried out according to the following steps:

- Step 1 – work out the NTA of the company. The NTA of the company takes on its ordinary meaning and refers to the total assets excluding any intangible assets less liabilities (disregarding any preference shares accounted for as financial liabilities) as recognised by the company in its financial report. The value of the net tangible assets is required as at the time of valuation under the ESS provisions.

- Step 2 –work out the amount required to discharge the company's obligation in respect of its preference shares on issue at the time of valuation if those shares were redeemed, cancelled, bought back or otherwise satisfied at that time (disregard any contingencies as to the provision of that return and any return that would not rank before ordinary shareholders upon a winding up).
- Step 3 –subtract the Step 2 amount from the Step 1 amount.
- Step 4 –work out the value of the ordinary shares on issue by reference to the claim ordinary shareholders have on the amount remaining. This may take into account the extent to which any preference shares on issue are capable of participating together with ordinary shares in the residual assets of the company upon a winding up.

Example 2 – Method Two not approved

Four years ago, Chip Service Pty Ltd was established as a start-up company for developing and selling computer chips. Three months ago, the company secured a $125 million investment from a venture capital firm.

The company plans to issue ESS interests in the form of options to all 25 of their employees and wants to rely upon an approved safe harbour valuation methodology. The ESS interests will meet the criteria for a start-up ESS interest under section 83A-33 of the ITAA 1997.

Chip Service Pty Ltd is a small business entity and has not been incorporated for more than seven years, however the company has raised more than $10 million of capital within the last 12 months. Therefore, the company does not meet the conditions for approval of Method Two but may choose to apply the comprehensive valuation method (Method One) to determine an approved market value of the company's ordinary shares.

Example 3 – Method Two – ordinary shares

Geophysicaltech was incorporated 2 years ago and has 20,000 ordinary shares held in equal parts by its two directors. Since its commencement, the company has spent $10,000 on initial start-up costs.

The directors intend to provide ESS interests in the form of 1,100 options to acquire ordinary shares to each of their 2 employees. The ESS interests will meet the criteria for the start-up concession under section 83A-33 of the ITAA 1997.

Geophysicaltech Pty Ltd accounts are as follows:

- *Assets*
  - *cash = $80,000*
- *Equity*
  - *20,000 ordinary shares = $90,000*
  - *accumulated losses = −$10,000.*

Total assets equals $80,000 and total equity equals $80,000.

Geophysicaltech Pty Ltd qualifies as a small business entity under section 328-110 of the ITAA 1997. The company have not raised capital of more than $10 million within the previous 12 months. It prepares a financial report for the year in which the time of valuation occurs. The company directors do not anticipate a change of control within the period ending 6 months after the ESS interests have been provided.

The company meets the conditions for valuation Method Two to be approved but could alternatively choose to apply the more widely available Method One for which the conditions for approval are also satisfied.

Using valuation Method Two, the value of an ordinary share will be equal to the NTA of Geophysicaltech Pty Ltd at the time of valuation ($80,000), divided by the number of ordinary shares on issue (20,000), or $4.00 per share. Provided the company sets an exercise price of the options at $4.00 or more, the company can rely on this valuation method to establish that the market value requirements have been met for the employees to access the ESS start-up concession.

Example 4 – Method Two – ordinary shares and preference shares on issue

Bouncing Kangaroo Pty Ltd has two directors, who have invested $30,000 each for a 50% interest in the company (1,000 ordinary shares each). It has also issued 222 preference shares to an investor for a total consideration of $100,000.

The preference shares rank above ordinary shares upon winding up, and the preference shareholder would be entitled to a return of the original issue price upon redemption. The preference shareholder does not participate in the residual assets of the company on winding up. The preference shares are not classified as financial liabilities for accounting purposes and have no claims that rank equally with ordinary shares.

At the time of valuation, the company has assets of $125,000 in cash and no liabilities.

The directors agree to take on an employee and provide them with ESS interests in the form of rights (options) to acquire 100 ordinary shares, vesting in three years' time. The ESS interests meet the criteria for the start-up concession under section 83A-33 of the ITAA 1997.

Bouncing Kangaroo Co's accounts are as follows:

- *Assets*
  - *cash = $125,000*
- *Equity*
  - *2,000 ordinary shares = $60,000*
  - *222 preference shares = $100,000*
  - *accumulated losses = −$35,000.*

Total assets equals $125,000 and total equity equals $125,000.

Bouncing Kangaroo Pty Ltd qualifies as a small business entity under section 328-110 of the ITAA 1997. The company has not raised capital of more than $10 million within the previous 12 months. It prepares a financial report for the year in which the valuation occurs. The company directors do not anticipate a change of control within the period ending 6 months after the ESS interests have been provided.

The company meets the conditions for valuation Method Two to be approved but could alternatively choose to apply the more widely available Method One for which the conditions for approval are also satisfied.

Using the Method Two valuation Bouncing Kangaroo Co's value of ordinary shares is set out as follows:

- *Step 1 – net tangible assets equal $125,000*
- *Step 2 – the amount required to discharge the company's obligation in respect of its preference shares on issue at the particular time of valuation if those shares were redeemed, cancelled, bought back or otherwise satisfied at that time equals $100,000*
- *Step 3 – Step 1 – Step 2 = $125,000 − $100,000 = $25,000*

- *Step 4 – divide Step 3 amount by total number of ordinary shares = $25,000 ÷ 2,000 = $12.50 per share.*

At Step 1, net tangible assets (NTA) is calculated by: the value of total assets (excluding any intangible assets) less liabilities. There are no liabilities or intangible assets in this example. No adjustment is required for the preference shares because they are not classified as assets or liabilities in the financial reports of the company, instead, they are classified as the company's equity.

In a case where preference shares were classified as financial liabilities and do not participate with ordinary shares in the residual assets of the company on winding up, an adjustment would be required to exclude the amount required to discharge the company's obligation in respect of those preference shares, at Step 1.

Provided the company sets an exercise price of the options at no less than the market value of the shares at the time of grant, that is $12.50 or more, the company can rely on this valuation method to establish that the market value requirements have been met for the employees to access the ESS start-up concession.

Compliance cost assessment

22. To be advised.

Consultation

23. Subsection 17(1) of the *Legislation Act 2003* requires that the Commissioner is satisfied that appropriate and reasonably practicable consultation has been undertaken before they make a determination.

24. As part of the consultation process, you are invited to comment on the draft determination and its accompanying draft explanatory statement.

Please forward your comments to the contact officer by the due date.

Due date:	30 July 2025
Contact officer:	Nick Seal
Email:	Nick.Seal@ato.gov.au
Phone:	(03) 9285 1592

Statement of compatibility with human rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Income Tax Assessment (Methods for Valuing Unlisted Shares for the Employee Share Scheme start-up concession) Legislative Instrument 2025

This legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the legislative instrument

The purpose of this instrument is to provide a class of companies an approved valuation method to value unlisted ordinary shares for the purposes of complying with certain Employee Share Scheme provisions in the income tax law, and to outline the valuation methods that have been approved by the Commissioner as providing safe harbour assurance for these purposes.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms because it merely provides companies with methodologies for valuing unlisted shares that will be accepted by the Commissioner, where the conditions are met. Importantly, it will help reduce companies' compliance costs in relation to the income tax law and provide them with certainty regarding the approved valuation methods that can provide safe harbour assurance from the Commissioner.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.