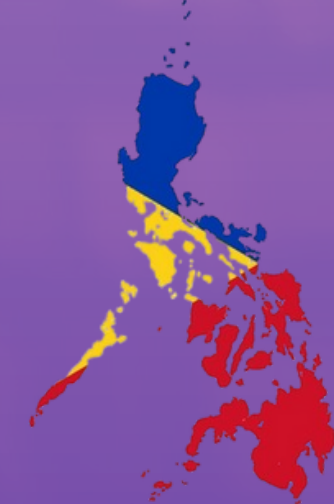




ESOPs for Australian Startups

Equity compensation strategies for
Australian startups expanding globally



Transform Your Talent Strategy with Employee Ownership

From board approval and shareholder agreements to employee education and clawback policies - practical guidance for successfully implementing share ownership plans in Australia and beyond.



**Equity-Based
Plans**



**Cash-Based
Plans**



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Unlocking the Power of Ownership

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Equity Compensation Strategies

Australian startups face a critical challenge: attracting top talent while managing cash burn rates that can make or break young companies. Traditional salary packages often cannot compete with established corporations, yet the war for talent has never been more intense. Employee Share Schemes (ESS) offer a solution that aligns employee interests with company success while preserving precious capital during growth phases.

Companies with ESS programs typically see higher annual sales growth and higher employment growth compared to non-ESS companies. More importantly for cash-strapped startups, ESS allows offering competitive total compensation packages without immediate cash outlay, converting future company value into current talent acquisition power.

Australia's regulatory environment favors startup ESS implementation. The ESS startup concession scheme, introduced in 2015, allows eligible employees to defer taxation until share disposal while benefiting from capital gains treatment instead of income tax rates. This means employees can receive equity compensation without immediate tax liability, while companies preserve cash.

Consider the practical impact: instead of offering a \$120,000 salary requiring immediate cash outlay plus superannuation and payroll taxes, startups can offer \$90,000 plus equity worth \$30,000 at grant with no immediate cash requirement. The employee receives comparable total compensation value while the company extends its runway and maintains operational flexibility.

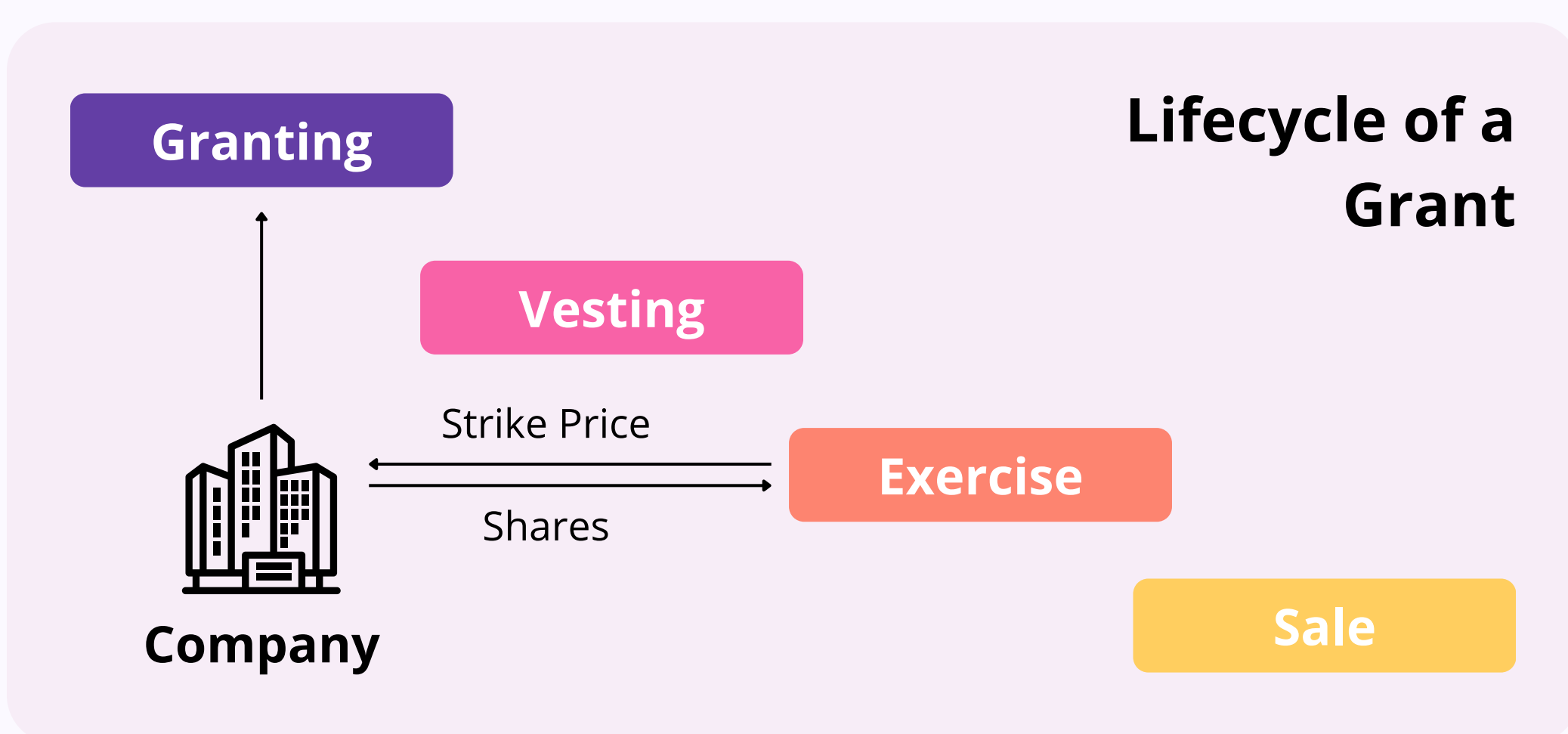
This playbook provides Australian private companies with practical frameworks for implementing ESS programs, maximising tax advantages, and managing compliance requirements. As Australian startups increasingly expand internationally, we also examine employee share option plans (ESOPs) considerations across key markets including India, the United States, United Kingdom, and the Philippines.

Glossary

Terminology

Granting: When a company formally awards equity interests to employees, establishing the terms, conditions, and number of units on the grant date, which begins the vesting period.

Vesting Period: The time an employee must remain with the company before earning the right to exercise their options or receive shares. Australian ESS typically follow four-year vesting periods with one-year cliff provisions.



Cliff Period: The initial waiting period before any shares begin vesting. After the cliff period expires, a portion of shares vest immediately. For example, under a one-year cliff in a four-year schedule, 25% of shares would vest after the first year.

Fair Market Value (FMV): The estimated current value of company shares. For startups qualifying for ESS concessions, the ATO permits alternative valuation methods, including the net tangible assets test.

Strike Price: The fixed price at which employees can purchase company shares under option plans, typically set at, or in cases below, FMV at grant date.

Exercise: When employees decide to purchase their vested options at the predetermined strike price, converting options into actual shares within specified timeframes.

Equity-Based Plans

Equity-based instruments create ownership alignment and benefit from Australia's favourable ESS tax treatment, allowing tax deferral until disposal and potential capital gains advantages (for startups concessions, or exercise for other deferred plans). However, they dilute existing shareholding and require complex valuation and compliance processes.

Share Options: Grant employees the right to purchase company shares at predetermined prices after vesting, representing the most common equity compensation while preserving cash flow.

Restricted Share Units (RSUs) or Share Rights: a right granted subject to vesting that converts into shares without requiring employee purchase at the time of vesting (RSUs) or upon exercise (Share Rights), typically used when companies reach stable valuations.

Loan Funded Shares: shares purchases by employees after receiving a non-recourse loan from a company - not classified as ESS for tax purposes, resulting in no income tax and just capital gains treatment.

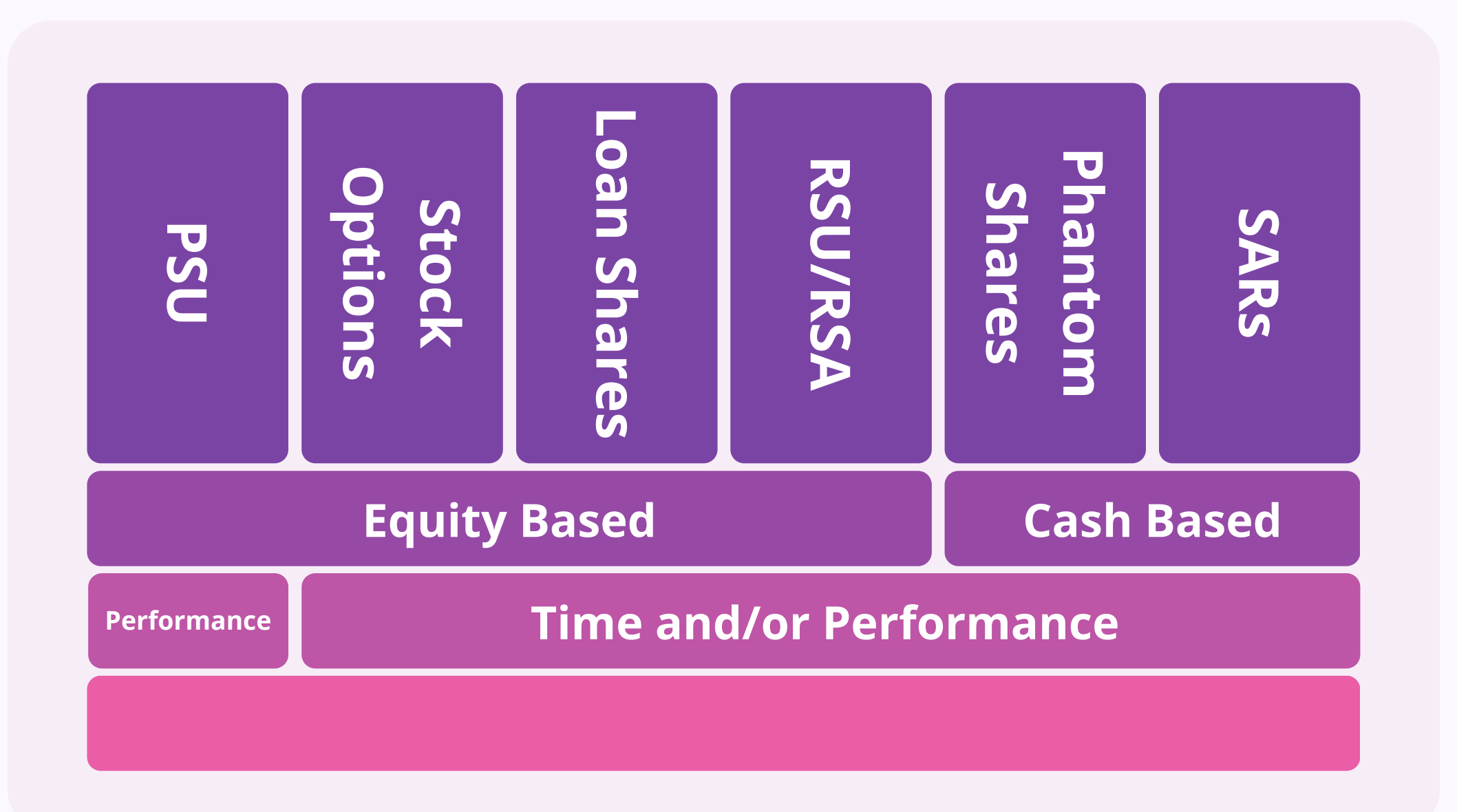
Restricted Stock Awards (RSAs): Provide immediate share ownership subject to employment restrictions, maintaining retention through forfeiture provisions.

Cash-Based Plans

Cash-based instruments avoid shareholder dilution and offer simpler administration but require actual cash outlays when obligations trigger and typically generate less employee loyalty than genuine ownership stakes.

Phantom Share Plans: Provide employees with cash payouts equivalent to share value appreciation without issuing actual equity. Employees receive cash payments when predetermined conditions are met.

Stock Appreciation Rights (SARs): Grant employees the right to receive cash payments equal to share value increases over specific periods without requiring share purchase.



Stakeholder Responsibilities

Founder

Strategic Vision and Governance

Founders design ESOP strategy balancing talent attraction and ownership preservation. Key responsibilities include determining pool sizes, establishing eligibility criteria and vesting schedules, obtaining board and shareholder approvals, and planning exit strategies with realistic value realisation expectations.

- Design ESOP pool size and eligibility criteria
- Secure board approvals and shareholder authorisations
- Plan exit strategies and liquidity expectations

Finance Team

Valuations and Reporting

Finance teams manage financial reporting, tax compliance, and valuations while tracking dilution impacts. They must issue ESS statements by 14 July and lodge ATO reports by 14 August, using specialised software for 50+ participants or multiple schemes.

- Ensure tax compliance and accurate financial reporting as per AASB 2
- Meet ESS reporting deadlines (July 14, August 14)
- Track dilution impact and manage share pools

Human Resources

Communication and Administration

HR serves as the primary ESOP interface with employees, developing educational programs and managing communications. Administrative duties include processing grants, tracking vesting schedules, handling employee departures, and integrating ESOP into recruitment strategies and reward framework.

- Develop employee training and communication programs
- Manage grant processes and track vesting schedules
- Consider equity as part of Total Reward

Employees

Understanding and Engagement

Employees must understand their ESOP agreements, tax obligations, and exercise timing strategies. Key responsibilities include reviewing and accepting grant terms, understanding vesting schedules, evaluating company prospects, and planning for tax liabilities and value realisation.

- Review and understand grant agreements and vesting terms
- Plan for tax implications and exercise timing
- Evaluate company growth prospects and exit potential

ESOP Implementation

Australia

ESS Startup Concession Framework



The ESS startup concession represents a favorable tax frameworks for startup equity compensation. This scheme allows eligible employees to reduce taxable discount income relating to their ESS interests to nil, effectively eliminating taxation until share disposal.

Company Eligibility Requirements:

- Australian resident taxpayer status
- Unlisted on any stock exchange
- Incorporated less than 10 years before relevant income year
- Aggregated turnover less than \$50 million
- Active business operations (not passive investment vehicles)

Scheme Structure Requirements:

- Share discounts limited to 15% of market value maximum
- Option exercise prices must equal or exceed market value at grant
- Minimum three-year holding period
- Formal ESS statements and ATO reporting compliance

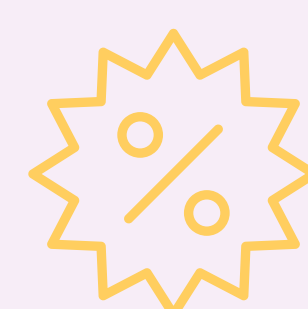
Employee Benefits



No upfront taxation on equity grants or exercise



Capital gains treatment on disposal (not income tax)



50% CGT discount available for shares held over 12 months



Straightforward ESS Reporting in the year of grants

Valuation Methodologies

Companies qualifying for ESS startup concessions may be able to utilise the ATO-approved net tangible assets valuation method, particularly beneficial for asset-light technology startups. This calculation follows the formula:

Net Tangible Assets Value:

$$\frac{\text{Company's net tangible assets} - \text{Preference share returns}}{\text{Total outstanding shares}}$$

This method often allows offering shares significantly below current market value, as most startups have limited tangible assets relative to their market valuation based on growth prospects and intellectual property.

Alternative formal valuations remain available but typically result in higher share values and reduced employee benefits. The net tangible assets method provides significant advantages for both companies and employees when implemented correctly.

Australia

ESS Startup Concession Framework

Recommended Instrument

The ESS startup concessions make stock options attractive for early-stage companies. It provides maximum value for both companies and employees during critical growth phases.

Later-stage companies should consider switching to tax-deferred Indeterminate Rights that can be granted in the form of options or RSUs with Board Discretion for cash settlement for maximum flexibility.

Compliance and Reporting

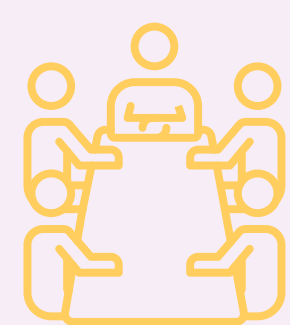
ESS programs require reporting for tax treatment and regulatory compliance, regardless of company size or employee participation levels.

Companies with more than 50 ESS participants or managing more than three different schemes must use ATO-approved software for electronic lodgement. This requirement ensures data accuracy and reduces compliance costs.

Documentation Requirements



Shareholder approvals for pool size and scheme terms



Board resolutions authorizing ESS implementation



Individual grant agreements



ESS statements detailing taxable events and amounts

Annual Reporting Dates

- **14 July:** Employee Statements
- **14 August:** ATO annual reports

Company Stage	Recommended Instrument	Benefits
Early stage to Series B	Stock Options	<ul style="list-style-type: none">• ESS startup concession eligibility• Cash preservation• Maximum upside potential
Series B+	Indeterminate Rights	<ul style="list-style-type: none">• Greater design flexibility• Tax-deferred treatment

Record Keeping Obligations:

- Grant dates, vesting dates, and disposal dates for all participants
- FMV at relevant dates with supporting documentation
- Vesting schedules and performance conditions
- Leaver provisions and their application
- Cash settlement and remittance records

Exit Strategies and Liquidity

Australia offers multiple exit opportunities including ASX listings, strategic acquisitions, and private equity transactions. Strategic acquisitions are common due to ASX market cap thresholds. Grant agreements should specify change of control provisions, acceleration clauses, and leaver provisions for optimal value realisation. Structure liquidity via secondaries is possible, but more commonly seen in later stages.

International Expansion

India

Technology and Innovation Hub

India offers the world's largest technology services market and fastest-growing digital economy, making it essential for Australian startup expansion. The country's software development and AI expertise provide significant scaling opportunities.



Tax Structure

Indian ESOP taxation follows dual-stage approach. Exercise triggers progressive salary income tax while share sales generate either short-term or long-term capital gains tax for unlisted shares.

Recommended Instrument

Options are widely used and well understood by employees. Companies should consider holding company structures to optimize money movement to simplify cross-border FEMA compliance.



Tax Withholding is required



Licensed Merchant Banker Valuation is mandatory (we can help!)



Exercise Price can be at discount to FMV

Philippines

Operations and SEA Access

The Philippines offers cost-effective operations, English-speaking workforce, and strategic Southeast Asian market access for Australian companies seeking regional expansion.



Regulatory Environment

All plans are treated as taxable compensation subject to withholding tax. Progressive income tax rates apply. SEC has strict requirements for compliance when issuing ESOP.

Recommended Instrument

Most companies opt for cash-based and phantom arrangements, due to high strict SEC rules, resulting in option grants being rare for foreign companies.



Monthly withholding tax remittance required



Time Zone advantage: 2-4 hour time difference



ASEAN access, Philippine Economic Zone Authority incentives

United Kingdom

Financial Services and European Gateway

The United Kingdom provides sophisticated financial services infrastructure, established regulatory frameworks for equity compensation, and access to European talent markets, offering credibility and market access for European expansion.



Regulatory Environment

The UK offers a range of tax-advantages plans, including EMI and CSOP, making equity compensation quite employee friendly. HMRC reporting and valuation requirements do come into play and should be considered in plan design.

Recommended Instrument

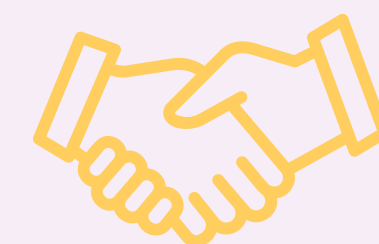
Stock Options remain the most tax-efficient equity instrument for UK private companies, offering significant tax advantages and cash preservation benefits essential for startup growth phases.



Qualifying Programs: <249 employees, <£30M gross assets



HMRC Approval: Advance clearance available for complex structures

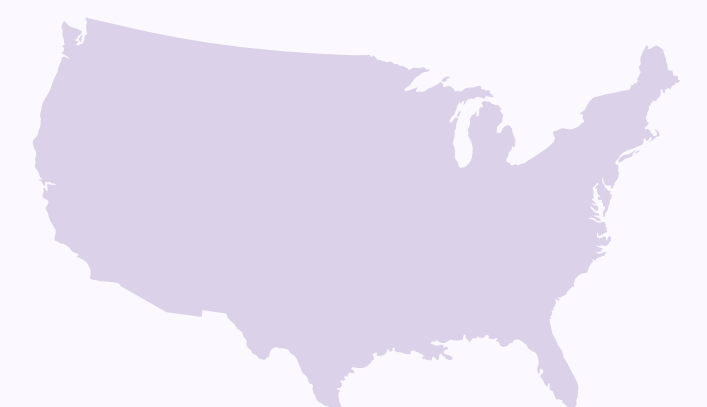


Strategic acquisitions and management buyouts

United States

Venture Capital and Exit Liquidity

The United States has a developed venture capital ecosystem, large consumer market, and liquid exit opportunities. For Australian startups seeking significant scale and global reach, US operations become essential.



Regulatory Environment

409A Valuations are a MUST. Qualified employee incentive stock options (ISO) are a tax-advantaged instrument with capital gains tax treatment and Non-Qualified Stock Options (NQSOs) trigger ordinary income tax at exercise.

Recommended Instrument

Stock Options are the preferred equity instrument for US private companies, providing tax efficiency through ISOs when possible, while preserving cash flow and maximizing employee upside potential during growth phases.



Strike price MUST be at 409A FMV to avoid tax penalties



Several tax forms may be required - like Form 3921 for ISO exercises



Strategic acquisitions, private equity, eventual IPO

Discover Qapita!

Strong businesses are built on solid foundations - we simplify equity management so you can focus on what matters most: leading and growing your company.

Cap Table Management

Track ownership, transactions, and updates in one secure platform - no more spreadsheets.

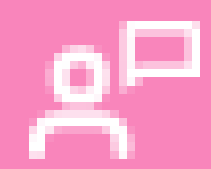
- ✓ Real-time visibility
- ✓ Scenario modeling



ESOP Advisory

Design and launch a cross-border ESOP, with full legal documentation support.

- ✓ Custom ESOP
- ✓ Compliance & best practices



Valuations

Get accurate, audit-ready independent valuation reports for ESOP AASB 2 financial reporting.

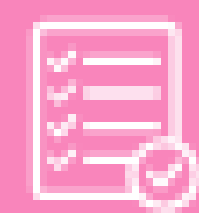
- ✓ Accurate and compliant valuations
- ✓ Accepted by top audit firms



ESOP Tax Support

From ESS Reporting support in Australia to Employee Tax guides in 160+ countries.

- ✓ Annual tax reporting support
- ✓ Information on global tax rules



Discover why these companies chose Qapita

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Trusted by 2,500+ startups and with 1,400+ equity plans designed, Qapita provides comprehensive equity management - from cap table and employee equity to accurate valuations for compliance and reporting.

Schedule a free consultation with us:



Jax Liu

Head of SEA & ANZ

+61 489 076 812 | +65 9756 7098

jax@qapita.com

