Employee Ownership Australia *Making it your business*

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28 May 2020

Committee Secretariat
PO Box 6021
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By email: TaxRev.reps@aph.gov.au

Dear Sir / Madam

1 Introduction

Employee Ownership Australia ("**EOA**") welcomes the opportunity to make a submission on the tax treatment of Employee Share Schemes ("**ESS**") and the effectiveness of the 2015 ESS tax treatment reforms.

EOA was formed in July 2011 to ensure ongoing advocacy for broad based employee ownership and dynamic workplace participation in Australian companies. It engages with and assists companies that have or aim to implement employee ownership or employee share plans, whilst also being a key advocacy body for broad based employee ownership. EOA is independent and entirely member funded, and is the only independent, dedicated advocacy and education group in this space in Australia.

EOA's general view is that there are considerable opportunities to further simplify and improve the way in which employee equity is provided in Australia. Further reform would be particularly valuable to lessen the burden of implementing ESS arrangements in the following sectors:

- unlisted companies;
- start-ups; and
- mature "baby boomer" businesses that are looking to employee equity as a viable business succession strategy.

We advocate for tax and corporate regimes that promote, not prevent, the ability of business to engage in employee ownership. We believe appropriate tax and corporate law reform would help facilitate this goal.

We have prepared a separate submission to the Attorney-General's Department consultative process on Cooperative Workplaces in Australia regarding the value of employee equity in facilitating cooperative and mutually beneficial workplaces. It has not yet been lodged with the Attorney-General's Department as that consultation process is currently paused, however it has been included in draft form at **Annexure A** to provide additional context on the value of employee ownership.

We would be happy to discuss if you have any questions regarding our submissions.

2 Executive Summary

Our tax and regulatory regimes should promote, not prevent, employee ownership.

Our key observations on reform of the tax system is that it should be simplified to remove unnecessary complexity and to ensure that it is globally competitive.

It is critical that we have reform which produces an appropriate tax outcome reflecting the timing and access of the economic benefits available to employees – in many cases this is not the outcome under the existing tax rules.

There is significant opportunity to expand employee ownership via reform of the ESS rules insofar as they apply to the unlisted environment. This, in particular, facilitates start-up ventures and the succession of "baby boomer" businesses to employees.

The expansion of employee equity has long been recognised as a key to promoting economic growth and more effective workplaces.

We have dealt with the benefits of employee economic ownership in the attached draft submission to the Attorney-General's consultative process.

The success of employee ownership around the world can be shown to be positively measured against the three criteria identified in the discussion paper: driving jobs and wages growth, boosting productivity and strengthening the economy whilst ensuring the protection of employees' rights.

Leadership, workplace culture and sharing positive commercial outcomes are all inherent in employee ownership, and are all key components underpinning the success of employee ownership businesses and their increased productivity, innovation and performance.

Employee owned businesses also prove that "it is a fundamental fact of successful market economies that when employers and employees collaborate and work together to improve the performance of their business, they can jointly share the rewards from their efforts – including better job security, higher wages, prospects for career enhancement and better business performance".

The key is that we must identify the areas where employee ownership can have particular benefits and create focussed rules for the promotion of employee ownership in those areas.

There is a genuine desire to promote employee ownership in many organisations. The key is to create effective and coordinated regulatory settings that promote and facilitate that desire.

3 Submissions

Our submission addresses:

- the effectiveness of the 2015 tax reforms in promoting ESS arrangements and supporting start-up ventures;
- the challenges facing companies, including start-ups, in setting up ESS arrangements;

- the challenges facing "baby boomer business succession arrangements", the current approach to employee share trusts and the lessons learnt from our experience with the UK model for these vehicles; and

- the range of model documents made available by the Australian Taxation Office ("**ATO**") to facilitate companies entering into ESS arrangements and how the current offerings could be improved.

3.1 How effective have the 2015 changes been in bolstering entrepreneurship and facilitating start-up ventures?

Our assessment of the impact of the 2015 reforms could be broadly summarised as follows:

- the start-up regime was very helpful but has been underutilised due to both the tax and prudential requirements that must be satisfied before it is available (together with the restricted scope of the existing corporate relief from the prospectus rules); and

- while the 2015 reforms reduced much of the unnecessary complexity introduced by the 2009 tax amendments, there is ample opportunity to further simplify their operation. The current rules still produce considerable cost and complexity for businesses trying to implement ESS arrangements – as such, the impact of the 2015 reforms on entrepreneurship has been limited.

3.2 What are the current challenges facing companies in setting up an ESS arrangement? How can they be addressed?

The current tax rules are still overly complex to operate within and do not allow easy participation in ESS arrangements. We outline key issues with the tax rules and our proposed recommendations below.

(a) Aligning the conditions for income tax deferral for shares and rights

The conditions to obtain a deferred taxing point are different for awards made in the form of a ***share*** in a company (typically referred to as a restricted share) and awards made in the form of ***rights*** to acquire a beneficial interest in a share (such as options and performance rights). For share awards, there is an additional condition to obtain a deferred taxing point, being that at least 75% of permanent Australian employees, with at least 3 years service, have been entitled to acquire an ESS interest under an ESS. This condition is commonly referred to as "**the 75% test**".

Determining if this condition is satisfied can be a complex task in and of itself. At each grant date, it is necessary to consider whether or not, of all the employees in the business with at least 3 years of service, whether that be continuous or non-continuous, and who are Australian residents, has 75% of that particular pool of employees been offered to participate in an ESS offered by the company? For new companies that have been in existence for less than 3 years, there is also a lack of guidance for this situation. As a result, applying the 75% test can be a complex task.

As a result, a company must offer shares to most of its employees for those employees to access a deferred taxing point on the shares, while an issue of rights can be more restricted yet still access a deferred tax point.

There is no rationale for why this additional condition is required for awards of shares to obtain tax deferral as opposed to awards of rights to acquire shares. However, the effect of this additional condition is to create complexity, adverse tax implications for the unknowing, and to restrict the use of share awards in favour of rights.

Following the 2015 amendments, there also continues to be a requirement for a real risk of forfeiture in relation to offers of shares. The result of this difference is that offers which are in substance commercially the same can have different tax outcomes.

There are also important practical differences in offering shares rather than rights. For example, when an employee receives a share the employee becomes an actual shareholder, receives dividends and annual reports, and is able to vote in company meetings. These benefits are not available when an employee receives rights.

A crucial benefit of operating an ESS is the ability to align shareholders and employees. EOA considers that this alignment is most direct where an employee receives actual shares, rather than rights. A company may establish an ESS with alignment as a driving purpose but be unable (or easily able) to offer shares due to not satisfying the requisite tax deferral conditions. Instead, they are required to offer rights which results in an ESS that is more complex, less understandable, and less aligned between shareholders and executives.

Recommendation 1: In order to avoid any unnecessary complexity and to simplify the current ESS regime as much as possible, EOA recommends that a uniform test be introduced for both rights and shares. EOA recommends removing both the 75% test for shares and the real risk of forfeiture requirement for any uniform test.

(b) Increasing the $1,000 upfront tax concession

The current tax rules allow employees with taxable income of less than $180,000 per annum to purchase or receive free shares of up to $1,000 per year in their employer without paying income tax, provided certain conditions are met.

Two of the important conditions to access this concession are:

- that employees hold the shares for three years or until they cease to be an employee of that company; and
- that shares be offered on the same basis to at least 75% of employees.

Broad-based share offers are typically structured to take advantage of this concession.

This concession was first introduced in 1995, and the $1,000 limit was set in 1997. Since then the limit has not been indexed or increased and, consequently, the real value of the $1,000 concession has significantly decreased. The loss of alignment that accompanies this decrease in real value means that the benefit of an ESS may be outweighed by the cost of operation and compliance.

Increasing the $1,000 limit will ensure that employees derive greater benefit from company profits and may also assist in reducing the impact of low wage growth in Australia by producing a greater after tax benefit to the employees.

Recommendation 2: To encourage increased broad-based share ownership, EOA considers that the tax-free concession should be increased and for there to be provision for subsequent regular increase (for example, through indexation).

(c) Increase the $5,000 tax-deferred salary sacrifice plan limit

Should the deferral conditions for shares and rights not be aligned in accordance with recommendation 1 above, EOA would advocate for a change to the tax rules which currently allow companies to invite employees to sacrifice only up to $5,000 of their salary in return for shares in their employer.

Salary sacrifice plans have commonly been used by the broad-based population as a savings vehicle through which they can increase savings using pre-tax salary (i.e. salary which is not taxed until the occurrence of a deferred taxing point).

Salary sacrifice plans are an advantageous way for employees to acquire shares as, practically speaking, the number of shares that can be acquired through sacrificing pre-tax salary is almost double the number that can be acquired through post-tax salary contributions. The benefit of this faster accumulation of shares is that employees can receive a greater benefit in terms of share price increases and dividend payments.

Unfortunately, the $5,000 salary sacrifice cap is too limiting. Prior to 2009, there was no limit on the amount of salary that could be sacrificed (to purchase shares) for tax to be deferred under a pre-tax sacrifice arrangement. However, since 2009 employees can only defer tax for pre-sacrifice offers of up to $5,000 per year. This has inhibited the ability of employees to make meaningful savings through employee salary sacrifice plans. As a result of those changes, there has been a marked decline in the broad-based participation in salary sacrifice plans with many companies closing down their plans.

Recommendation 3: If the broader proposal to align the treatment of the deferral conditions for shares and rights is not accepted, in order to reinvigorate the use of salary sacrifice plans EOA recommends the removal of the $5,000 cap for pre-tax salary sacrifice into shares.

(d) Simplify employee share buy-backs to facilitate creating an effective market for employee shares

The current restrictions which apply in the tax legislation associated with share buybacks are a major limitation to the use of ESS arrangements.

Once an ESS has been implemented, a major issue in the unlisted environment is the creation of a market to arrange for the disposal of shares by, and for, former employees. Employees of unlisted companies that operate an ESS have no ready way of realising value from the scheme - the employer must offer some form of opportunity to dispose of their shares where there is no ready third party market such as an IPO or trade sale, or could involve a shareholder or the company itself buying the shares from the employee when the employee wishes to sell.

Under the current tax regime for off-market share buybacks, the part of the purchase price that exceeds the part of that price that is debited against the company's share capital account is treated as a dividend paid to the shareholder by the company. Franking credits may be available in respect of this dividend. The balance of the purchase price paid for the shares is treated as capital proceeds for CGT purposes. lf the company debits the total amount of the buy-back to share capital so that the dividend amount is nil, such an arrangement could be captured by the anti-avoidance rules relating to capital streaming.

Consequently, the disposal of shares to the company under an ESS buy-back may lead to a significantly different tax outcome for a participant than if the shares were disposed of via an employee share trust or an existing shareholder. It can also be administratively cumbersome for the company, for example, with a company needing to obtain a ruling from the ATO every time such a buy back occurs to determine the dividend / capital split.

Recommendation 4: EOA recommends that a safe-harbour methodology be introduced for ESS buybacks for the purposes of determining the dividend / capital split, or for the allowance of an administrative treatment where no part of the purchase price paid to an ESS participant under an ESS buy-back is deemed to be a dividend.

(e) Cessation of employment as a tax trigger point

Currently tax legislation allows taxation on ESS awards to be deferred (rather than taxed at grant) where certain conditions are satisfied. One of the deferred taxing points is when the participant ceases employment.

The current rules can lead to a mismatch between the time when the participant is taxed and when the participant is able to access their ESS shares. This creates a number of problems:

- there may be a significant mismatch between the value of the shares when the participant ceases employment and is taxed and when the participant can gain effective access to the shares. This is particularly important when the value of shares at the time of cessation of employment exceeds the value when the participant can effectively gain access to them;

- a participant may not be able to acquire or sell their shares at the time that they cease employment to fund the tax, causing financial problems; and

- a participant may be required to amend an earlier tax return to correctly report the tax, increasing cost and complexity for the participant and the ATO. This will also necessitate the employer creating amended ESS statements – this can lead to extra cost, particularly where this process is outsourced, and complexity in explaining the process to the participant.

These problems can be overcome if cessation of employment is removed as a taxing point, and instead participants are taxed when they effectively gain access to the shares. Retaining cessation of employment as a tax trigger point creates an anomaly compared to other jurisdictions with high levels of employee ownership.

(f) Tax on cessation of employment and implications from the COVID-19 health crisis

The adverse tax implications that result from tax on cessation of employment have been further amplified in the current COVID-19 health crisis. Firstly, the current crisis has seen a significant number of employees made redundant. This has resulted in a large number of employees being considered “good leavers” and triggering a taxing event on their ESS awards due to cessation of employment. Therefore, there is an increased incidence of tax on cessation of employment in ESS.

Secondly, the sharp fall in the share market means that employees who ceased employment prior to the crisis are likely to have triggered a taxing event on cessation of employment at a significantly higher share price. Should any of these ESS awards vest in the future at a significantly lower share price, the value of the ESS awards at vesting (when the shares may be sold) may be significantly lower than the value of the ESS awards at the taxing point, being cessation of employment.

There can be circumstances where the value of the ESS awards at vesting is less than the tax payable on the ESS awards at cessation of employment.

Accordingly, the current health crisis is seeing the adverse tax implications of tax on cessation of employment playing out across an increased number of employees. The value of these ESS awards is falling at an alarming rate, widening the gap between the taxable value at cessation of employment compared to the current value of the ESS interest.

Recommendation 5: To ensure Australia is competitive in the global battle for talent, and to address potential impacts of the COVID-19 crisis, EOA recommends the removal of cessation of employment as a taxing point for those participants in receipt of share scheme benefits subject to genuine forfeiture conditions. Instead, participants should only be subject to tax when they acquire and can sell the shares underlying equity awards.

(g) Valuation expenses

The requirement to seek a valuation to minimise the risk for the employer and employee through the ESS adds considerable cost and complexity to the introduction of schemes. In many instances, it will prevent the introduction of an ESS entirely. This is a key concern for the "baby boomer succession arrangements" discussed below.

There are useful rules dealing with the valuation of equities but they are limited in their operation at the present time to arrangements which are within the scope of the start-up rules.

Recommendation 6: EOA recommends the introduction of simpler valuation rules for employee equity purposes to reduce cost and complexity.

3.3 Key impediments to 'baby boomer succession arrangements'

Another key area for reform is in relation to "baby boomer succession arrangements". There is a growing interest in promoting business succession arrangements that facilitate the transfer of an enterprise on the retirement of the business owner to its existing employees. If this transfer is not able to be undertaken, in many cases it results in either the ownership of the business being sold or the enterprise ceasing to operate.

Some of the key impediments are:

(a) **Tax imposed on retiring owners**

The tax imposed on retiring owners, particularly where they seek to transfer the enterprise to existing employees, should be on a concessional basis. In many instances, the retired owners may be assessed on a deemed market value of the equity interest even though it does not represent the value that they receive.

(b) **Limitations on the provision of financial assistance**

In most instances the effective enterprise transfer involves the enterprise providing financial assistance to the existing employees. The ability to provide this form of financial assistance is heavily regulated.

The current exclusions for small scale investors do not provide an effective means to exempt the retiring owner from extensive disclosure and regulatory obligations under the corporations law. The provision of financial assistance may in many instances be inappropriately treated as a deemed dividend under the tax rules.

Recommendation 7: EOA advocates the creation of an acceptable financial assistance regime which is able to be provided as part of an effective enterprise transfer without the current onerous corporate disclosure and regulatory obligations, and without being inappropriately treated as a dividend for tax purposes

(c) **Lessons from the UK model**

We believe that valuable lessons can be drawn from the UK model of employee share trusts.

The usual Australian approach involves a loan scheme with shares allocated to particular employees based on a nominal discount. The nominal discount is provided to ensure we fall within the ESS rules. The employees are then assessed on the nominal discount on day one. We also seek to undertake on a no goodwill basis.

The constituent documents seek to prevent the ability for the shareholders to dispose of their interests in the relevant entity. These documents will allow employees to hold the interests and receive dividend payments for so long as they are an employee. The securities are held by a complying Australian employee share trust. The existing shareholders may dilute their interest or, alternatively, transfer the securities on a no goodwill valuation to the employees.

In some cases, the trustee of the employee share trust will be a registered trustee (ASIC may take the view that it involves dealing in securities and the trustee therefore requires an AFSL). This adds additional complexity.

The UK model, by contrast, typically uses a discretionary trust for the benefit of employees with the trustee a company limited by guarantee. There are no allocated shares held in the employees share trust; it is simply a discretionary trust for the benefit of employees from time to time.

No beneficiary has a specific interest in any of the cash or shares. If there is an allocation of cash or shares then the employee ownership rules provide that it will be treated as a cash bonus and, accordingly, as salary.

There are periodic voluntary contributions to the trust from the company. The trust generally treats these as trustee accretions which are not liable to tax. Generally, the company would not seek a corporate tax deduction for the contribution made to the trust. At the same time, the trust does not pay tax on these contributions.

Recommendation 8: EOA recommends that the Committee consider the possible benefits of altering the Australian tax rules to provide:

- that contributions made to an associate of an employee not being liable to fringe benefits tax (which would largely depend on determining that the trust is not an "associate" of the employee);
- that, conversely, capital contributions to the trust are not treated as a dividend under Division 7A;
- that the franking credit rules (in particular, the "45-day rule") allow for the payment of fully franked dividends to employees; and
- that there are no CGT issues arising from the transfer of the shares to the employee share trust.

3.4 Is the current tax treatment of ESS relevant to start-up companies? What are the current challenges facing start-up companies in setting up an ESS arrangement?

The concept of the start-up concession is very sensible. Under these provisions a company can deliver an equity interest to employees whilst providing employees the opportunity to obtain the following tax concessions:

- no tax until the options (or underlying shares) are disposed of; and
- any gains realised are subject to capital gains tax and, if the options (or shares acquired on the exercise of options) are held for more than 12 months after the date the options are granted, only 50% of the gain is taxable (after deducting capital losses).

This provides a balance between ensuring that gains are ultimately assessed but that such assessment only occurs at the time the relevant employee is able to properly access the value of the shares.

However, there are a number of difficulties start-ups face in accessing the regime which could be addressed to increase its benefits and relevance.

(a) Broadening the definition of a 'start-up' for the purpose of the tax concession rules

Broadly, in order for a company to qualify as a "start-up" company for the purposes of the ESS start-up tax concessions, the following tests (at a company level) must be satisfied at the end of the most recent financial year – the company must:

- have an "aggregated turnover" of less than $50 million;
- not be listed on a stock exchange (also applicable to any group company); and

- not be incorporated for 10 years or more (also applicable to any group company).

EOA considers that these conditions are too restrictive, particularly when compared to similar concessional tax regimes in other jurisdictions, and may prevent genuine start-ups from granting equity awards under the concessions. For example, a participant may seek to use an existing company to commence a new business but the start-up concessions will not be available if that company was incorporated 10 or more years ago.

Recommendation 9: In order to allow a wider range of high growth companies to meet the definition of a start-up company for the purpose of the ESS start-up tax concessions, EOA considers that:

- the turnover limit should be increased or removed altogether in favour of an alternative test (for example, via a link to group balance sheet assets);
- the exclusion of companies that are 10 or more years old is too restrictive and should either be removed or the age limit increased; and
- listed companies that are otherwise able to meet the definition of a "start-up" company should be able to apply these concessions.

3.5 How have the standard documents provided by the ATO assisted businesses in providing ESS arrangements? What improvements can be made?

The ATO guides on the provision of employee equity are very useful, particularly in the detail they provide on the tax consequences and corporate regulation of the offering these securities. However, we consider that it would be helpful to continue to expand the range of guidance provided.

We also consider that it would be helpful to expand the range of standard documents available beyond the current template employee option and share plan offering documents.

In response to the Nuttall Review of employee ownership, the UK Department for Business Innovation & Skills released a range of model documentation to facilitate businesses moving to employee ownership. The documents available include:

- a model articles of association of a company with employee ownership;
- a model trust deed of an employees' share trust; and
- a model articles of association of a trustee company limited by guarantee. [1]

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[1] These documents can be accessed here – see https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/210450/bis-13-949-moving-to-employee-ownership-guidance-on-model-documentation.pdf; and

We consider that making similar documents available in Australia would be a most helpful addition to the current range of guidance and model documents the ATO provides. In particular, the provision of model documents for an employee ownership company / trust structure would help to facilitate businesses offering these arrangements in a simple, cost-effective manner.

4 Conclusion

Employee ownership provides a key to promoting economic growth and more effective workplaces. In the current economic environment this is more important than it has ever been.

There is a significant opportunity to promote employee ownership. We need to move to a mindset which ensures that we promote, not prevent, employee ownership in Australian business.

EOA would welcome the opportunity to discuss each of these points with you. [redacted]

Yours sincerely

[redacted]

Andrew Clements
Deputy Chairman
Employee Ownership Australia

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/387984/bis-14-1323-model-documentation-for-company-with-employee-ownership.pdf.

Annexure A – Submission to the Attorney-General's Department

Employee Ownership Australia *Making it your business*

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28 May 2020

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The Hon Christian Porter MP
Attorney-General of Australia

Dear Attorney-General

1 Introduction

Employee Ownership Australia ("**EOA**") welcomes the opportunity to make a submission on Cooperative Workplaces and how Australia can capture productivity improvements from more harmonious workplace relations.

EOA was formed in July 2011 to ensure ongoing advocacy for broad based employee ownership and dynamic workplace participation in Australian companies. It engages with and assists companies that have or aim to implement employee ownership or employee share plans, whilst also being a key advocacy body for broad based employee ownership. EOA is independent and entirely member funded, and is the only independent, dedicated advocacy and education group in this space in Australia.

As the discussion paper identifies, Australia's current industrial relations system suffers from conflict and adversarial behaviour that result in detriments to both employees and employers. The provision of employee equity can help solve these problems. Our submission focusses on employee ownership as a model for creating more engaged and cooperative workplaces and illustrates the range of mutual gains it generates for both employees and employers.

We also advocate for tax and corporate regimes that promote, not prevent, the ability of business to engage in employee ownership. We believe appropriate tax and corporate law reform would help to further encourage the use of employee equity to foster more cooperative and productive workplaces. We also provide our comments on the key impediments to offering employee equity.

We are preparing a separate submission to the recently announced Inquiry into the Tax Treatment of Employee Share Schemes, which will be available in due course.

We would be happy to discuss if you have any questions regarding our submissions.

2 Submissions

2.1 Employee ownership is a critical tool for creating mutually beneficial and cooperative workplaces

We believe that the provision of employee equity is a critical tool for producing mutually beneficial and productive work places for employees and employers. This has been identified through numerous studies associated with the provision of employee equity which have found resulting improvements in company performance and resilience, together with improvements in employee commitment, engagement and wellbeing.

Most recently, the Office of the Chief Economist made a number of findings associated with the provision of employee equity in their research paper, *The performance and characteristics of Australian firms with Employee Share Schemes* ("**Office of the Chief Economist Report**").[1] The findings include that firms with employee equity have lower employee churn, higher sales, higher value added, higher labour productivity and higher value added growth when compared with their non-employee ownership counterparts.[2]

The greatest benefits associated with the provision of employee ownership policy incentives are to small business. The positive correlation between employee ownership and performance weakens as firms get larger and older.

Despite the stronger correlation with small business performance, large mature firms are significantly more likely to use employee equity compared with young small and medium enterprises in Australia due to the cost to set up and administer these arrangements and the burden imposed by regulatory complexity.

2.2 Specific benefits of employee ownership

There is a substantial body of evidence demonstrating the benefits of employee ownership to both business performance and employee well-being. Importantly, these benefits are best realised when integrated with ensuring more general employee engagement.

Two critical points can be made about employee ownership:

1. The concepts of employee ownership / employee equity are interlinked and mutually reinforcing with employee engagement. As the *Sharing Success: The Nuttall Review of Employee Ownership* ("**Nuttall Review**") report identifies, there is a strong correlation between employee engagement and the provision of employee equity. [3] Employee owners are more likely to be engaged with their company and employee ownership can enshrine employee engagement into a company.[4]

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[1] *The performance and characteristics of Australian firms with Employee Share Schemes Research paper*, Hendrickson et al., Office of the Chief Economist (April 2017).
[2] See page 1 of the Office of the Chief Economist Report.
[3] *Sharing Success: The Nuttall Review of Employee Ownership* (July 2012). See, in particular, page 14.
[4] See paragraph 1.10 of the Nuttall Review.

David MacLeod and Nita Clarke's report, *Engaging for success: enhancing performance through employee engagement* ("**MacLeod Report**"), demonstrates the benefits of increased engagement: workplaces with high employee engagement have greater staff commitment, well-being and reduced staff turnover.[5]

2. Employee ownership creates benefits that can be shared between both employees and employers. For employees, employee ownership is linked to increased financial and non-financial well-being and higher performance. For employers, it is linked to increased business performance, resilience and innovation. These benefits are similarly mutually reinforcing: greater employee well-being is associated with greater productivity and gains for the company, while gains for the company will flow back to employees.

The benefits from employee ownership are usefully described in the Nuttall Review and we elaborate on them further below.[6] While these benefits should translate to greater opportunities for small business, they are not confined to that area.

Greater employee commitment, engagement and collaboration

This is regarded as the clearest benefit of employee ownership and there are a series of empirical studies which examine and illustrate it.

A survey of UK employee owned businesses by Burns (2006)[7] revealed that these businesses widely hold the view that greater employee commitment is the biggest advantage of an employee ownership model – 90.6% of the businesses surveyed felt they gained extra staff commitment from employee ownership. The broader literature on employee ownership and commitment also supports this link (see, for example, the Matrix Evidence Review 2010).[8]

Further research by Blasi et al. (2015)[9] found that workers at an employee ownership business were more likely to say their company had a collaborative management culture and that it was an excellent place to work.

The MacLeod Report specifically identified employee ownership as also having a profound and distinctive effect in facilitating employee high-performance.[10]

Enhanced employee well-being

Employee ownership and enhanced engagement have been associated with benefits to employee well-being. Research conducted by the Napier Business School found that a majority of workers at an

[5] *Engaging for success: enhancing performance through employee engagement*, report to Government by David MacLeod and Nita Clarke (2009).
[6] See page 22 of the Nuttall Review.
[7] *Good business: the employee ownership experience,* Burns (2006).
[8] *The employee ownership effect: a review of the evidence*, prepared by Matrix Evidence (2010).
[9] *Do broad-based employee ownership, profit sharing and stock options help the best firms do even better?* Blasi et al. (2015).
[10] See for example the discussion of engagement's effect on performance from page 11 of the MacLeod Report.

employee owned company were more satisfied compared to when they had worked for non-employee owned companies.[11]

The Nuttall Review also suggests well-being improves when employees are provided with a greater stake and involvement in long-term collaborative goals, a key feature of employee ownership.

Financial benefits for employees

Benefits to employees extend to enhanced financial well-being. US research has illustrated this gain sharing aspect of employee ownership: it is correlated with increased employee retirement savings; greater actual and perceived job stability; and higher median hourly wages. These benefits for employees can be substantial – a 2018 survey by the National Centre for Employee Ownership found US workers in companies with employee ownership had over twice the retirement savings than the national average.[12]

In the Australian context, the Office of the Chief Economist Report found significantly higher wages per employee in firms that had employee ownership structures in place.[13] Again, these gains can be substantial: mature, large firms with employee equity plans had 38% higher wages than their counterparts.

Reduced absenteeism

A number of empirical studies have examined the effect of employee ownership on absenteeism.

Research by Peel and Wilson (1991)[14] found that companies that implemented share option plans experienced rates of absenteeism 13% lower on average than those without share plans.

Improved business performance

Employee ownership also provides significant benefits to business. The Nuttall Review found that companies with employee ownership outperform other companies, while the Office of the Chief Economist Report found that growth and productivity was significantly higher in small firms with employee equity plans compared to their counterparts.[15]

The Employee Ownership Australia Index ("**EOA Index**"), which compares the performance of companies with employee ownership schemes open to their whole workforce to the performance of the ASX200, supports these claims.

The EOA Index shows that firms with employee ownership consistently outperformed the ASX200 across June 2011 – June 2017, shown in Figure 1 below.

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[11] See the *Health and wellbeing of employees in employee owned businesses* report prepared for the John Lewis Partnership and Employee Ownership Association by McQuaid et al. (2012).
[12] *S Corporation ESOPs and retirement security*, Wiefek and Nicholson (December 2018).
[13] See, in particular, pages 1 and 11 of the Office of the Chief Economist Report.
[14] *The impact on absenteeism and quits of profit-sharing and other forms of employee compensation,* Peel and Wilson (1991).
[15] See also: *Model growth: do employee-owned business deliver sustainable performance,* Lampel et al (2010).

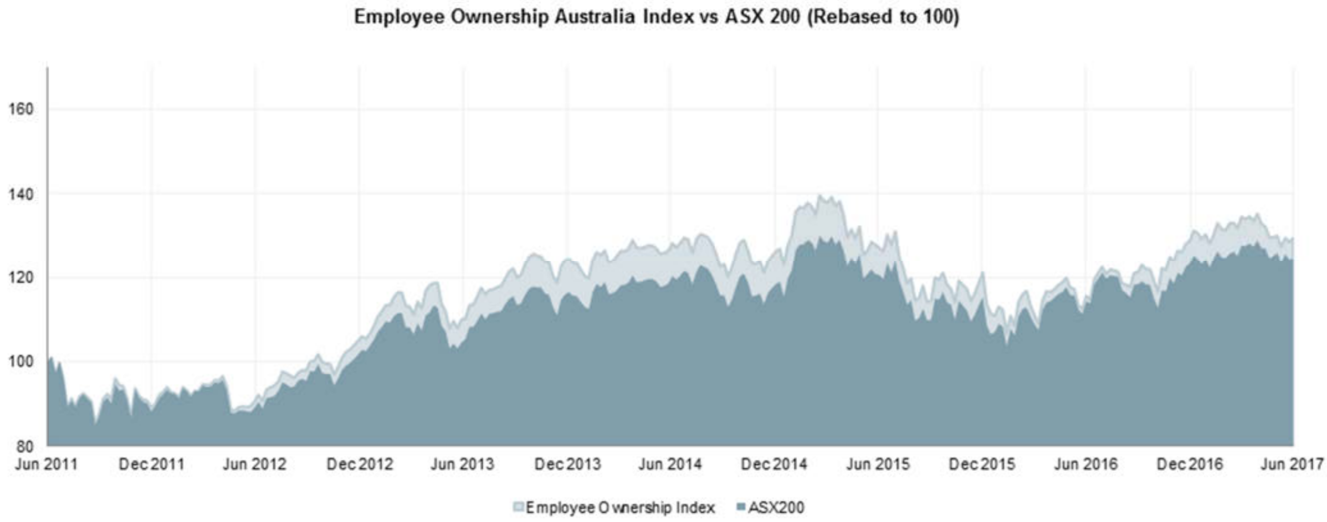

Figure 1

Employee-owned companies also outperform or match the ASX200 in three of five social sustainability factors, covering corporate risks; performance relating to employees; relationships with external stakeholders; and human rights. They are also twice as likely to show clear evidence of equal opportunity systems.[16]

Increased economic resilience

Firms with employee ownership have shown more resilience to economic downturns. UK research has found that employee owned firms demonstrated consistent sales growth during the 2008 – 2009 financial crisis compared to their non-employee owned competitors. [17]

Research in the US context by Kramer (2008)[18] found that the risk an employee owned company will not survive in a given year is 75% of the risk for a similar but non-employee owned company.

Driving innovation

UK research has found that employee ownership can drive innovation through a variety of mechanisms: [19]

- Employee owned companies perceive that they have a strong ability to attract and retain talented employees who then provide boosts to innovation.
- Employee ownership is a strong driver of employee engagement and involvement, both of which are associated with greater levels of innovation.

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[16] See https://employeeownership.com.au/employee-ownership-index/.
[17] *Model growth: do employee-owned business deliver sustainable performance,* Lampel et al (2010).
[18] *Employee ownership and participation effects on firm outcomes*, Kramer (2008).
[19] See, for example, page 15 of the Office of Chief Economist Report, page 10 of the Ownership Effect Inquiry literature review and page 22 of the Matrix Evidence Review.

Benefits of employee ownership - international case studies

The MacLeod Report and The Ownership Effect Inquiry Final Evidence Report[20] provide a series of helpful international case studies on the benefits associated with employee ownership and how it may be implemented. We draw your attention to these should you wish to examine concrete examples of employee ownership in practice.

3 What are the impediments to employers and employees currently providing employee equity arrangements in Australia?

The key impediments to providing employee equity arrangements can be broadly summarised as follows:

- The actual and perceived legal, tax, accounting and regulatory complexities of employee ownership.
- The lack of resources available to support employee ownership in a simple and cost-effective manner.
- The lack of awareness of the concept of employee ownership and its benefits.

These are the impediments identified in the Nuttall Review in the UK. We believe that the impediments in Australia are broadly equivalent. However, there is considerable emphasis and focus in the Australian market on the tax and legal complexities of employee ownership.

3.1 The actual and perceived legal, tax, accounting and regulatory complexities of employee ownership

We consider these elements to be a significant barrier to the provision of employee equity in Australia.

Unlisted entities face particular difficulties implementing employee ownership. The ability to provide employee equity for unlisted entities is more complicated not only because of the commercial structure associated with ownership of the entity but also the corporate and tax consequences associated with offering equity in unlisted vehicles.

Corporate restrictions on the provision of equity in unlisted vehicles through employee share schemes cause particular difficulty, primarily through the cost and complexity of complying with the relevant rules and the very limited exclusions available.

We have commented in detail on the corporate reform required in relation to employee share schemes in our submission to the Department of Treasury in response to Treasury's 2019 Consultation Paper on the proposed form of the regulation of employee share scheme offerings. (A copy of our previous submission is **attached**).

[20] Lampel et al (June 2018). This report formed part of the broader *Ownership Effect Inquiry* – we have provided a link in the 'Key research material' section of this submission.

The essential elements of reform can be encapsulated as follows:

1. Ensure tax rules and corporate regulations work efficiently.
2. Harmonise the tax and corporate rules.
3. Remove cessation of employment as a tax trigger point.
4. Facilitate "baby boomer" succession arrangements.

Our key observations on reform of the tax system is that it should be simplified to remove unnecessary complexity and ensure that it is globally competitive. It is critical that reform produces an appropriate tax outcome reflecting the timing and access of the economic benefits available to employees - in many cases this is not the outcome under the existing tax rules.

There is significant opportunity to expand employee ownership via reform of the employee share scheme rules insofar as they apply to the unlisted environment. This in particular facilitates start-up ventures and the succession of "baby boomer" businesses to employees.[21]

3.2 Lack of resources available to support employee ownership in a simple and cost-effective manner

One of the consequences of the complexity associated with the corporate and tax aspects of offering employee equity is the lack of simplicity and the resulting cost in providing employee equity.

The Australian Tax Office ("**ATO"**) provides a very useful guide to the provision of employee equity through market value options. It includes detail of both the tax consequences and the corporate regulation of offering securities. We consider that it would be helpful to continue to expand the range of guidance provided.

If this is accompanied by a simplification of the corporate and tax rules, we consider that it should be possible to provide employee equity, even in unlisted entities, in a simple and cost-effective manner.

3.3 Lack of awareness of the concept of employee ownership

As we have noted, the current regulation of employee share equity derives from a combination of both tax rules and corporate rules. As a result it is administered by both the ATO and ASIC.

There would be benefits in establishing a single body which incorporates key stakeholders and promotes the regulation and benefits of employee ownership in Australia.

[21] See the example provided on page 18 of the Nuttall Review.

4 Conclusion

We believe widespread employee ownership will "discourage adversarial behaviour and foster an environment where the preference of the parties is to cooperate and avoid a conflict model."

Our submission provides substantial "examples of the practices and techniques that foster and grow mutual benefits" and highlights what policy makers have already identified as the key issue - that "workplace culture is a critical area for improvement."

The success of employee ownership around the world – as this submission indicates – can be shown to be positively measured against the three criteria identified in the discussion paper: driving jobs and wages growth, boosting productivity and strengthening the economy while ensuring protection of employees' rights.

Leadership, workplace culture and sharing positive commercial outcomes are all inherent in employee ownership, and all are key components underpinning the success of employee ownership businesses and their increased productivity, innovation and performance.

Employee owned businesses also prove that "it is a fundamental fact of successful market economies that when employers and employees collaborate and work together to improve the performance of their business they can jointly share the rewards from their efforts – including better job security, higher wages, prospects for career enhancement and better business performance."

We would welcome the opportunity to discuss each of these points with you. [redacted]

Yours sincerely

Andrew Clements
Employee Ownership Australia

5 Key research material

The key research materials cited in this submission are listed below, together with links to access the relevant source documents and reports (all further research materials have been listed in the footnotes only):

Good business: the employee ownership experience, Burns (2006)

Engaging for Success: enhancing performance through employee engagement, report to Government by David MacLeod and Nita Clarke (2009)

The employee ownership effect: a review of the evidence, prepared by Matrix Evidence (2010)

Sharing Success, the Nuttall Review of employee ownership (2012)

The performance and characteristics of Australian firms with Employee Share Schemes, Hendrickson et al., Office of the Chief Economist (July 2017)

The *Ownership Effect Inquiry* (2019), including:

- *The Ownership Effect Inquiry – Final Evidence Report;*
- *The Ownership Dividend, the economic case for employee ownership* (the report itself); and
- *The Ownership Effect Literature Review*.