Appendix G – Newspaper reports

This selection contains reports from the press concerning employee share plans, their funding arrangements and tax consequences.

A creative deal for BHP's new boss [1]

Michael Laurence

The newly appointed chief executive of BHP, Paul Anderson, is seeking one of Australia's most creative and unusual remuneration deals. Unlike the arrangement for 95% of executive option schemes in this country, US-born Anderson wants to use a special-purpose trust to hold up to one million "performance rights".

Although BHP is not giving away much detail, Anderson's motives for using a trust, rather than holding the rights in his own name, are clear: if he meets performance and length-of-service hurdles, the trust structure will deliver considerable tax-deferral advantages for up to 10 years and, even before the shares are vested in his name, he will get a sizeable dividend flow. This is truly sophisticated tax planning, and illustrates the outstanding salary-packaging opportunities for executives who are prepared to think differently.

The performance rights are in addition to options that are based on company performance, as measured against Australian and international benchmarks.

Anderson has surprised colleagues with his determination to deal directly with professional advisers on the tax aspects of his package and with his determination to place much of his remuneration at risk by being performance-based. With one million performance rights and one million employee options, both dependent on performance, he is the first BHP boss to have any remuneration based on meeting

1 *Business Review Weekly*, 8 February, 1999.

defined achievement goals. However, previous chief executives have held company-provided BHP shares.

If shareholder approval for the performance rights and options is not gained later this month, BHP is obliged to provide Anderson with equal after-tax benefits in some other form.

The mechanics of the special-purpose trust are fascinating. Whenever Anderson meets staged short and long-term performance benchmarks, the trust will acquire BHP shares. However, Anderson could choose not to exercise his performance rights for up to 10 years and thus defer tax on the accumulated value acquired by the trust during this period. Meanwhile, he receives all dividends.

If he had taken the conventional course of immediately taking the rights in his own name, he would have had no access to the dividends before the rights were exercised. He receives the double benefit of tax deferral and a large income. Anderson will pay nothing for either the rights or, provided the performance goals are met, the shares themselves.

An independent trust could protect Anderson if he satisfied the performance criteria yet became involved in a dispute with the company for any reason. The trustee would have to transfer shares into his name, regardless of a possible disagreement between Anderson and his employer.

BHP can claim tax deductions for the cost of providing shares and, under a clause in the FBT Act, employee shares and options held in trust are not subject to fringe benefits tax, provided the securities are in the employer's company. Anderson's “performance rights” are options by another name.

As an executive who was appointed after an international headhunt, the magnitude of Anderson's package is not surprising. The really big money for performing executives comes from shares and options, not from cash salary. If a company really performs, cash salary must seem like pocket money.

Employee shares and options plans are coming up to harvest time [2]

Michael Laurence

Thousands of high-earning executives are about to participate in their seemingly crazy annual ritual of receiving hefty cash bonuses for top performance over the past financial year and immediately throwing half away in tax. Suddenly, a $100,000 bonus evaporates into $51,500 after tax. A smarter way to be rewarded for performance is through a combination of a cash bonus and tax-deferred shares/options in the employer's listed business.

2 *Business Review Weekly*, 22 June, 1998.

Whereas cash bonuses are taxed in an executive's hand at 48.5%, personal tax is deferred on executive share and option plans - and the employer is not subject to fringe benefits tax (FBT).

Kris Chikarovski, a director of the consultancy Remuneration Planning Corporation, suggests that executives whose employers do not have a share plan should begin lobbying now for the introduction of one by the end of next financial year. Shareholders must approve proposed share plans. “After shareholder approval, there is usually a lead time of two to three months before a plan is introduced,” he says.

A study by Equity Strategies shows how popular executive share and option plans are becoming. The share-plan consultancy has examined the 1997 annual reports of 122 of Australia's 150 biggest public companies in a search for executive share/option plans. In that year those companies introduced, amended or renewed 52 executive option plans and 15 share plans, and 78% of these plans contain performance hurdles.

Edward Wright, a director of Equity Strategies, says annual cash bonuses tend to reward executives for meeting short-term goals. Bonuses are often designed to encourage executives to reach individual or team targets. By contrast, shares and options tend to reward executives for meeting longer-term, company-wide hurdles such as gaining a certain return to shareholders. Share/option plans usually have performance targets of three to five years.

Wright says: “A growing trend will be to take part (of an incentive) in cash and shares; both the tax and the reward are deferred. This means a longer-tail for annual bonuses with part paid in cash up front and part in shares that may be forfeited down the track if, say, a project does not meet expectations.” For example, an executive might receive a bonus for having an idea, then shares if that idea can be transferred into a money-making enterprise for the company. The better the company does in future years, the more valuable the shares become.

Finding the right incentive

What is the most appropriate performance incentive for a company to gain the optimum from executives? Wright says: “There is no off-the-shelf solution. Each company is unique. The circumstances of the company, the outlook for the industry and the goals of the plan should be carefully considered.”

According to Equity Strategies research, more than seven performance hurdles are used in the executive plans that were introduced, modified or renewed during 1997. The main hurdles are a set increase in: total shareholder returns as measured by capital gains and dividends, the share price (by far the most prevalent hurdle), profit, earnings per share, and return on equity. Such companies as Westfield Holdings base their executive incentive plans on a special premium above a

certain target. And a number of companies adopt a variety of hurdles, including personal ones and others set at the board's discretion.

Wright says there is good reason companies often regard option plans as add-ons to share plans and other incentive schemes. “An executive option plan will lose its power to provide incentives if there is a drop in the share price below the exercise price. With shares, however, there should always be value.”

There are crucial differences in the tax obligations of an executive who participates in a share/option plan with various performance triggers if targets are met, or in what could be termed salary-sacrifice arrangements involving shares and options:

*Incentive share/option plans. No personal tax is payable in the year that the awards are promised. With shares, capital gains tax (CGT) usually becomes payable by the executive in the year that the actual stock is placed in the person's name. (With most incentive share schemes for executives, all - or a portion - of the shares are vested in the individual after three years provided performance hurdles are met.) With options, the executive generally does not pay CGT until the options are exercised some years after issue, even if the value of the underlying shares has increased markedly in the meantime.

*Salary sacrifice share schemes. These typically vest in the employee each year. Straight salary or cash bonuses are frequently exchanged for extra contributions to such plans. An employee does not pay tax on the shares - apart from income tax on annual dividends - until the sale of the stock, termination of employment or until 10 years after acquisition. At the point of taxation, CGT becomes payable on the full value of the shares.

Chikarovski of Remuneration Planning Corporation says the main attributes of share plans from an executive's perspective, rather than an employer's, are the tax deferral, the benefit of any increases in share prices, and the growth in dividends (in the case of salary-sacrifice schemes). Chikarovski says: “The amount of benefit from a share plan is not immediately diluted by tax.” So an executive is effectively gaining a leveraged position in the sharemarket because twice as many shares are acquired than could be bought if after-tax income were used. Chikarovski adds that executives benefit from any increases in share price. “Unlike cash, the shares endure as a reminder of past performances.”

Share and option incentive schemes may be appropriate for listed companies, but what about private companies? The owners of unlisted companies are usually reluctant to give away any of their equity, even to top-performing employees. Wright of Equity Strategies says the answer for private companies can be so-called phantom share schemes.

Phantom schemes create “units”, not actual shares, in a business. The units are based on a clearly defined method of valuing a private company, such as a

multiple of its earnings. As a private company's value rises, so does the value of the scheme's units.

Boost for Company Share Plans [3]

Hans van Leeuwen

Remuneration experts do not expect the Ralph business reforms to lead to major opportunities to rejig salary packaging, although employees using company share plans are set to benefit from the new capital gains tax regime.

Changes to fringe benefits tax involving cars and car parking have been deferred, so the focus is on whether there are ways to use the slashed CGT rates to boost employee share plans.

Remuneration Planning Corporation director Mr Geoff Price said that those in existing employee share plans would be affected in only a neutral or mildly positive way.

The trick will be to set up share plans which use company loans to buy shares, so that any gains are taxed at CGT rates, not income tax rates.

Employers may start to feel the heat from employees demanding new types of share acquisition plans which take the schemes out of the income tax system and into the CGT system.

For the two existing types of plan, the benefits largely come when the employee sells his or her shares.

Under the "exempt" plan, employees will be slightly better off because they get up to $1,000 of shares free of income tax. When they decide to sell the shares, they will pay tax at the CGT rate now half the rate it was two days ago.

Under the "deferred" plan employees won't be that much better off.

In this scheme, the employee sacrifices salary to buy shares, and income tax on the growth in the value of those shares can be deferred for up to 10 years. Eventually, however, all increases in the value of the share price are taxed as income.

Although the employee pays lower CGT if he or she sells the shares after exiting the scheme, there is no avoiding the income tax.

A share plan can be moved outside the income tax system if it uses loans. In a loan plan, the employee borrows money interest-free from the employer to buy shares, and any rise in the share price is then taxed at the much lower capital gains rate, which will be half the employee's marginal income tax rate. Essentially this is a

3 *The Australian Financial Review*, 23 September, 1999, p. 7.

form of gearing, and will work only if the share price rises, warned an Arthur Andersen tax partner, Mr Harold Payne.

"If you have a period of rapid inflation, the removal of indexation means you could end up worse off than under the current system," he said.

But putting aside the risks, the new CGT rates make loan-based share plans a lucrative prospect.

Employers may be less keen: they have to somehow fund the interest-free loan, and if the employee uses dividends to repay the loan then the shareholders are effectively paying for it.

But many employees may look to start exerting pressure on their reluctant bosses.

CGT Salary Options
(Using share plans)

Employer company lends $10,000 interest-free to employee.

Employee buys $10,000 of shares in employer company.

Dividends from the shares used by employee to pay back loan.

Employee sells shares 10 years later once loan is paid back.

Value of shares has risen to $20,000.

Employee (marginal income tax rate 48.5%) pays CGT at 24.25%. This is a CGT bill of $2,425, nearly half the amount payable under the current system.

Taxation: Ralph report leaves share plans out in the cold [4]

Michael Laurence

Participants in employee schemes are in danger of paying much more tax on capital gains than individual investors.

Employee share plans, rapidly becoming the new force in salary packaging for all levels of employees, will be severely penalised if the Government-accepted recommendations of the Ralph review of business taxation pass through Parliament. In a shock fallout from the review, tax-deferred employee share plans are at risk of losing much of their relative tax advantage.

In its proposal to halve capital gains tax (CGT) for individuals, the Ralph report provides no relief for people who hold shares through the burgeoning tax-deferred employee plans. This means that a top taxpayer who acquires shares

4 *Business Review Weekly*, Friday, 5 November, 1999.

using the plans would continue to pay tax at 48.5% on capital gains, whereas non-plan investors would pay tax on gains at 24.25%.

The treatment of tax-deferred employee share schemes under the Ralph report is even more difficult to comprehend because its Government-accepted recommendations provide for a cut in CGT for superannuation funds from 15% to 10%.

In another puzzling development, the wording of the Ralph report means that while participants in the tax-deferred share plans will pay tax at their marginal rates on capital gains, employees in the no-frills $1000-a-year tax-free contribution employee share plans will pay tax at half the rate on their gains. Yet both these types of employee share plans are specifically encouraged by tax law and are expected to become the dominant share plans for all levels of employees.

Under division 13A of the tax act, highly concessional tax treatment is given to the two bread-and-butter employee share schemes, the $1000 tax-free plans and the tax-deferred, salary-sacrifice plans. This division, enacted almost five years ago, exempts employers from fringe benefits tax in relation to the plans while providing valuable tax concessions for employees.

The first type of plan allows employees to devote a pre-tax amount of $1000 of their income each year to buy shares (the $1000 always remains tax free while subsequent gains are subject to capital gains tax). And the second type of plan provides for employees to direct unlimited portions of pre-tax salary each year to fund the entire value of the shares (the initial amount invested each year plus gains are subject to income tax yet the impost is deferred for up to 10 years). Income tax on tax-deferred plans must be paid after 10 years or earlier if the shares are sold or employment is terminated.

From a practical perspective, the tax-deferred plans enable a top taxpayer, for example, to acquire almost twice as many shares as would be possible with after-tax income. This provides excellent compounding if the shares rise in value. And although the shares are held in trust, employees receive dividends twice a year.

Even with the Ralph report setback, the consultancy Remuneration Planning Corporation (RPC) expects the tax-deferred plans (unlike the $1000 plans) to join superannuation as the foremost personal savings methods for all levels of employees. RPC's latest annual survey of remuneration provided by 350 of Australia's largest listed companies shows that just 15% offer these types of share plans. This percentage has doubled in a short time and RPC expects 95% of companies in its survey to provide the plans within five years.

Research by the employee share plan consultancy Equity Strategies shows that companies that have introduced or modified such employee share plans within the past three years include AMP, ANZ Banking Group, Commonwealth Bank, Lend Lease and Macquarie Bank. As well, Axa, North Limited, Orica, Suncorp

Metway, St George Bank, Santos and Telstra are among employers to introduce or modify these types of share plans over the same time.

RPC's managing director, Chris Costello, 48, says the Ralph report's lack of a recommendation to cut taxes for tax-deferred employee share plans in line with CGT for individuals has taken him by surprise. RPC has designed and implemented share plans for many employers, including Westpac, Bank of South Australia and Keycorp. “I am sure the Ralph report did not cover tax-deferred share plans through an oversight,” Costello says. “It must be an unintended consequence.” He appears reasonably confident that the Government will be sympathetic once the significance of the flaw in the Ralph report recommendations is recognised.

Costello claims that the existing tax treatment of tax-deferred share plans is “illogical and inconsistent”. He questions why long-term capital gains for $1000 schemes and investments held by various entities (such as trusts and companies) should be subject to CGT whereas long-term gains of tax-deferred schemes are subject to income tax. “In both cases, the tax is on capital gains and, therefore, should be CGT,” he says.

This discrepancy in the tax treatment does not cause undue concern while personal income tax rates and CGT are aligned, as at present, because identical tax is paid on the gains (without taking into account the CGT relief for inflation during ownership). However, the Ralph report proposes to overturn that alignment.

Costello warns that the reduction in the relative benefits of tax-deferred share plans will encourage some employees to invest in much riskier geared shares. As reported in BRW's October 15 issue, geared shares will become much-more tax effective under the Ralph report's recommendation to halve personal CGT.

Intense lobbying for a reduction in tax on tax-deferred share plans will be concentrated on the parliamentary inquiry into employee share plans chaired by Brendan Nelson. Costello believes that members of the inquiry understand the merits of employees having shares in their employers' businesses.

The submission to the inquiry by the Department of Employment notes that the Government is “strongly supportive of employee share ownership schemes” and that international research shows that the schemes can lead to improved productivity, growth, profitability, employee commitment and satisfaction. Absenteeism and employee turnover are reduced, according to research quoted by the department.

The executive consultant to the Australian Employee Ownership Association, Gary Scarrabelotti, 48, has written to the inquiry to say that the deferred-tax plans are “disadvantaged” by the Ralph report. He agrees with Costello that adverse treatment of tax-deferred plans probably results from an oversight. “I have been

through the report with a fine-tooth comb and can find no mention of share plans."

Scarrabelotti's letter says the Ralph report "skews" the concessional tax treatment of employee plans under division 13A in favour of the $1000 schemes, which are designed to provide an entry into share ownership rather than a significant number of shares. "For the employees to develop a major stake in their employer's company requires widespread use of deferred schemes," he says. "The big winners from the Ralph report are likely to be the chief executives who would be especially attracted to leveraged (non-share plan) investments with a lower CGT liability (if the Ralph proposals are enacted)." By taking this course, not only half the amount of tax would be payable on capital gains but tax deductions for interest payments could be still claimed at 48.5%. Members of the Employee Ownership Association are typically employers with share plans. The banks are members.

Lend Lease's global executive for compensation, Ken Hill, says: "We have made submissions to the Government on the Ralph report and share plans. We are confident of a favourable hearing." Hill is a former president of the Australian Employee Ownership Association. Through share plans, Lend Lease employees throughout the world own 13% of the business. Hill has put much work into gaining favourable tax treatment for employee share plans and his comments are carefully measured. Lend Lease employees have been highly rewarded because the company has performed strongly on the sharemarket.

A director of tax accountants Greenwoods & Freehills, Ernest Chang, 35, says: "A lot of tax-deferred schemes will have to be rethought following the Ralph review." Chang says strategies can be adopted to bring a share scheme within the CGT rather than the income-tax net. He says one strategy is to forgo the tax-deferral provisions of division 13A and provide employees with a loan to buy shares. There would be no deferral of income tax and CGT (not income tax) at the lower rate recommended by the Ralph report would be payable upon the eventual sale of the shares.

Chang explains: "With a loan to buy shares, the employee would not have a tax liability on day one (the date of acquiring shares through a share plan) because of the liability for the loan." However, Chang says many employers will be unwilling to meet the cost of administering loans to thousands of their employees. And the principal of Equity Strategies, Edward Wright, says share plans with loans attached can be a "big pain" for employers. Wright says loan plans have to be designed to protect employees should the company share price fall below the amount outstanding on the loans. And RPC's Top 350 report refers to the "obvious shortcomings" of loan plans.

Scarrabelotti comments: "With loan plans, either the employee or the employer wears the risk if a company's stock falls in price. Some companies have a time

bomb hanging over their heads with possible debt from share loans (without adequate proper provisions)."

BHP has provided textbook examples of what can go wrong with share plans linked to loans. Under the terms of the BHP agreements, employees were to repay the loans on termination of their employment. With the company's rapid reduction in its workforce in recent years, accompanied by a once-falling share price, many participants in the share schemes were facing a future without an income and with a large debt to their former employer. Their shares were worth less than their debt. In some instances, BHP indefinitely deferred repayment. Telstra is determined not to make the same mistake with shares provided to its employees through interest-free loans. Under the Telstra plans, the loans are not repayable if the share price falls below the amount owing.

If the Government-accepted Ralph recommendations to halve CGT for individuals become law, consider the inequitable tax treatment of two top taxpayers: the first has a $200,000 capital gain following the sale of a privately purchased or inherited share portfolio, and will pay $48,500 tax; the second has an equivalent gain following the sale of shares in a tax-deferred employee share plan, and will pay $97,000 tax.

However, Sydney actuary and financial planner Graham Horrocks,54, makes a crucial point: a participant in a tax-deferred share scheme, after all taxes are paid, will still be ahead of a person who invests after-tax salary to buy identical shares. This is because the participant in the share scheme can buy almost twice as many shares as the other investor.

Employee share plans and superannuation make an interesting comparison. Under prime ministers Hawke, Keating and Howard, governments have progressively squeezed the opportunities to voluntarily save through superannuation.

Certainly, the Hawke Government introduced compulsory employer superannuation contributions, but the governments have reduced superannuation's tax effectiveness and accessibility to savings. And tough restrictions have been placed on how much can be contributed annually and saved in a concessionally taxed way through superannuation. By contrast, employees can make limitless (apart from conditions placed by an employer) contributions to tax-deferred share plans and have access to their savings at any time before retirement.

Horrocks gives the example of two investors who pay tax at the top marginal rate. The first makes a one-off, pre-tax contribution of $10,000 into a superannuation fund, while the second contributes the same amount into an employee share fund. Both keep their investments for 10 years before paying tax and receiving a cash payment.

The superannuation fund and the employee share enjoy identical performance, producing an annual dividend yield of 4.25% (80% franked) and capital growth of 6%. (Dividends in the share plan are paid directly to the employee and then immediately reinvested in shares producing identical returns.)

Although the superannuation contributions are subject to 15% contributions tax plus 15% tax surcharge on contributions of middle and higher-income earners, superannuation comes out ahead over the long term. After the payment of lump-sum tax or CGT after the 10 years, the superannuation investor will have savings of $15,683 against $14,780 from the employee share fund. What if the superannuation and the share plan investments were held for more than 10 years? Horrocks says that superannuation takes a big lead once the employees in the tax-deferred share plans are forced to pay tax (which is compulsory after 10 years or earlier if the shares are sold or the investor leaves the employer).

Unquestionably, employees of a solidly performing company may do much better than a balanced superannuation fund. However, the risks of investing through an employee share fund solely in the shares of one employer involves more risk than investing in conventional portfolio with a judicious balance of shares, property, bonds and cash.

The emergence of employee share plans is against the trend of salary packaging. During the past six years, successive governments have progressively removed much of the value of packaging. Gone are the tax benefits of packaging family holidays, private club memberships and almost anything else, even supermarket bills. Superannuation, employee share plans and company cars (the Government did not accept a Ralph report recommendation to increase fringe benefits tax on packaged cars) are the big three packaging benefits to remain tax effective.

RPC's Costello believes that employees will increasingly adopt a three-pronged approach to long-term savings: superannuation; non-superannuation investments unlinked to employment; and employee share plans.

By investing in the three ways, employees gain diversity of risk and investment performance. This diversity should provide a buffer if the Government changes the laws affecting either the tax effectiveness or access to an investment. The diversity will mean that fewer investments will mature or become taxable at the same time.

Five share-plan strategies [5]

Michael Laurence

1 Sidestep the dreaded tax surcharge on superannuation contributions by middle and higher-income earners. The value of salary-sacrificed contributions to tax-deferred share plans are not recorded on an employee's group certificate and not taken into account when calculating liability for the tax surcharge on packaged superannuation contributions for middle and higher-income earners. This means an employee earning, for example, $95,000 a year could completely bypass liability for the maximum 15% surcharge by putting $17,000 a year into a tax-deferred employee share plan. This strategy may particularly suit double-income couples that can afford to put a large portion of one partner's income to savings through share plans and surcharge-free superannuation.

The surcharge is based on “taxable income” that, in turn, is calculated by adding together an employee's cash income, pre-tax superannuation contributions and most packaged benefits but not contributions to a tax-deferred employee share scheme. For 1999-2000, the indexed surcharge begins at 1% for indexed taxable incomes of $78,208 and then progressively rises to the 15% maximum for incomes of $94,966.

2 Do not forgo the opportunity to participate at the very least in $1000-a-year share schemes. As the $1000 is never subject to tax, shares in a company would have to lose almost half their value before a top taxpayer is out of pocket. Unfortunately, section division 13A prohibits being in both the $1000 and the tax-deferred plans in the same year.

3 Carefully time the sale of shares obtained in a tax-deferred employee share plan to minimise tax. Sell the shares at a time when your taxable income is low, suggests Remuneration Planning Corporation's Chris Costello. Such times may include when an employee is on sabbatical or maternity leave. “Employees should keep in mind that share schemes are rolling arrangements,” Costello says. “They will be making contributions each year and can choose to sell at least a portion of their shares whenever money is needed or their tax rates fall.”

4 “Defuse” (Costello's word) the impact of having to pay tax at compulsory times on shares in a tax-deferred plan. (Tax must be paid after 10 years or earlier upon leaving the employer or selling shares.) Costello's strategy involves making continual large contributions of pre-tax salary to the plans while at the same time not being reluctant to sell shares whenever money is needed. Employees who make one or two large contributions to a tax-deferred plan and then stop may be unpleasantly surprised when a huge tax bill comes all in the one year.

5 *Business Review Weekly*, Friday, November 05, 1999.

5 Sydney financial planner Graham Horrocks says that once tax is automatically triggered, after 10 years in a tax-deferred plan or earlier, it makes sense to consider transferring the shares into a self-managed superannuation fund. No additional tax would be payable if the shares are immediately transferred. (Alternatively, the shares could be sold and the proceeds contributed to superannuation without paying the contributions tax or the contributions surcharge if a tax deduction is not claimed.) Once tax is paid after 10 years, there is no tax motivation to leave the shares in the company share scheme. (Of course, the company may be an exceptional performer and it would be unwise to sell the stock.) By transferring the shares to superannuation, dividends are taxed at a maximum of 15%. And upon the superannuation being at retirement, a 16.5% tax applies to lump sums (with a large tax-free component). Lump-sum tax can be indefinitely deferred by receiving superannuation as a private pension such as an allocated pension. Superannuation funds, including do-it-yourself funds, are not subject to CGT on capital gains of assets sold to pay a private pension.

Executive Tax Relief [excerpt] [6]

Peter Freeman

…the obvious approach for an executive receiving discounted shares or stock options in a company for which he or she works is to consider electing to pay tax on any initial gain immediately. As noted, once that has been done any future gain should benefit from the 50% gains tax concession.

An example would be an executive who received shares for no cost when their market value was $2. At present most elect to defer tax, which means the eventual gain is caught under the income tax regime. In this case, if the shares were subsequently sold for $10 tax would be payable on the whole amount, thus resulting a tax bill of almost $5 a share. The alternative would be to pay tax on $2 at the time the shares are issued, resulting in an initial tax bill of $1. When the shares are later sold for $10, half of the net $8 gain is taxable, resulting in tax at that time of almost $2. When the initial $1 in tax is added in the total tax bill is just on $3 - 40% less than if all tax had been deferred.

While there are some special factors to take account of when applying this to executive option arrangements, there is little doubt it generally makes good sense to adopt the same strategy with option schemes. Separovich points out this sort of arrangement would generate particular benefits for executives involved in internet companies who often get a lot of their reward in the form of either shares and options.

6 *The Bulletin*, 20 February, 2000, pp. 70-71.

Probably the most obvious drawback with this whole approach is that the executive has to part with money to pay the initial tax bill. One alternative which overcomes this is explained by Robert Richards, principal of boutique corporate law firm Robert Richards & Associates. The arrangement, he says, involves the executive actually paying the market price for the shares, but doing so by using a interest-free, non-recourse loan from the company that issues the shares. Once this has been done, any future realised gain will be taxed under the gains tax system and so will benefit from the 50% rule.

Although the loan is interest-free, no fringe benefits tax has to be paid. This is because if a standard loan had been used to invest in the shares, the interest payable on this loan would have been tax deductable.[7] As for the loan being non-recourse, this is done to protect the executive against the costs incurred should the shares fall in value, a possibility executives in such major companies as Boral and Pacific Dunlop appreciate only too well.

Separovich say that loan schemes for executive shares already exist and have delivered major gains to those participating…

Spotless directors lift stake with $10m interest-free loan [8]

Glenda Price

Spotless Group executive directors Brian Blythe and Ron Evans each received a $500,000-a-year windfall yesterday when shareholders approved interest-free loans for them to buy shares worth a total of $10 million.

The going annual rate for a personal loan to buy the 1 million shares each would have been about 10 per cent.

A meeting of about 30 Spotless shareholders approved the loans, although two objected.

The share purchases will take Mr Blythe's stake to 4.1 per cent and Mr Evan's to 6.25 per cent.

Spotless chairman Mr Blythe receives his shares on top of remuneration that last year totalled $1.8 million. This figure included a $1.3 million bonus.

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7 This is confirmed by the ATO, submission no. 24.2. The ATO advised the Committee: 'Company loans, of this type, to employees being used to purchase any type of income producing asset, have the benefit of not incurring FBT. The rationale for this being the "otherwise deductible rule" provided for in the law. If the taxpayer had borrowed the money, at interest, in order to derive a dividend stream, then that interest would have been deductible. Thus the "otherwise deductible rule" means no tax benefit has been derived from the interest free loan from the employer'.

8 *The* Weekend *Australian*, March 4-5, 2000, p.33.

Mr Evans, a director of Spotless and chairman of the AFL, last year received a bonus of $1.1 million, to make a total collect of $1.6 million.

Based on yesterday's closing price, Spotless Group – which supplies catering and other services and offers a system to shift clothing on plastic hangers around factories – is valued at $696 million.

Max Barr, who addressed the meeting opposing the share scheme, said he believed for the size of the company, Mr Blythe and Mr Evans were 'already more than adequately compensated'.

Mr Barr said that in the past three years, Mr Blythe's remuneration had increased from $1.2 million to $1.8 million and Mr Evan's from $900,000 to $1.5 million.

'There's no question that Blythe and Evans are doing a good job for the company. They're doing an excellent job. But they are more than adequately rewarded, and a $5 million interest-free loan to each of them is over-the-top…".

Spotless Group last year reported a profit of $31.6 million, up 36.3 per cent on sales of $1.077 billion

Mr Blythe and Mr Evans also jointly own the Ted's Camera Store chain and according to the BRW Rich List – where they were listed as having assets of $110 million and $125 million respectively – they also own an orthodontic distribution company, Advanced Surgical Technology.

The meeting was told Mr Blythe and Mr Evans had not been given the opportunity to buy shares for many years, the loan scheme was cash-neutral, and Spotless believed in rewarding directors for boosting profitability.

Earlier three directors of Spotless Services – 67 per cent owned by Spotless Group – were each granted the right to buy 200,000 shares valued yesterday at $242,000 again with interest-free loans.

Spotless Group shares closed down 63c yesterday to $5.03. Spotless Services shares closed down 9c to $1.21.