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Committee Secretary
House of Representatives Standing Committee on
Employment, Education and Workplace Relations
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Parliament House
CANBERRA ACT 2600

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APPLICATION OF EMPLOYEE SHARE SCHEME TAX PROVISIONS TO STAPLED SECURITIES

Dear Sir

Introduction

It is our submission that Division 13A of the *Income Tax Assessment Act 1936* (“ITAA”) is unduly restricted to the extent that its application is limited to the issue of “ordinary shares”, or the right to acquire such shares, under Employee Share Acquisition Schemes (“ESAS”).

The failure to provide the various taxation benefits associated with Division 13A in relation to other types of securities, the most notable for the present submission being stapled securities, represents a major deficiency within this legislation, and is clearly incompatible with what the Assistant Treasurer the Honourable George Gear stated as the purpose of the Division:

“to ensure that the tax concessions that are available under the new arrangements are directed at share schemes which encourage employees to own shares in the company in which they are employed or a holding company of the employer.”¹

¹ Speech by the Assistant Treasurer, Hon. George Gear, Moving Government Amendments during Second Reading of *Taxation Laws Amendment Bill* (No. 2) 1995, House of Representatives, June 22, 1995

Background

ESAS were first introduced to encourage employees to actively participate in the affairs of their employer by providing such employees with a financial stake in the company itself. Division 13A of Part III of the ITAA was introduced by the *Taxation Laws Amendment Act* (No. 2) 1995 to remedy the various deficiencies associated with the operation of the original legislation, Section 26AAC. However, the application of Division 13A has remained limited to providing taxation benefits in relation to the acquisition of ordinary shares, or the rights to acquire such shares, under ESAS.

Numerous advantages have been associated with ESAS including; providing financial incentives to increase employee performance, promoting industrial harmony, encouraging greater employee identification with both shareholder and company interests and increasing the level of national savings.

These benefits were recognised by Mr Peter Costello, the then Deputy Leader of the Opposition, who stated that:

“In government, the coalition will address such flaws as exist in the current scheme and introduce a new scheme designed not to discourage but to encourage wider employee share ownership. We will seek to promote and enhance the growth of employee share ownership plans and let them flourish right across the work force...”

“The coalition wants employees to have the opportunity to take a stake in the businesses which employ them. We want to see as many employees as possible owning shares through employee share schemes...”

“The coalition will increase participation in employee share schemes by opening up access to the discount available to employees in such plans by giving them fair treatment and allowing them to qualify. We plan to expand employee share ownership as part of our policy on national savings.”²

By limiting the operation of Division 13A to ordinary shares, or the right to acquire such shares, however, this legislation has restricted the number of employees who are able to participate in ESAS.

Of the numerous arguments which have endorsed the existence of the “ordinary share” restriction in Division 13A, there are no convincing arguments able to justify why this division should not operate in respect of stapled securities. For example, according to the Australian Taxation Office’s recent submission to this Inquiry, it was stated that:

² Speech by the Deputy Leader of the Opposition, Mr Peter Costello, during the Second Reading of *Taxation Laws Amendment Bill* (No. 2) 1995, House of Representatives, June 22, 1995.

“The reason that Division 13A of the ITAA only provides concessions for the provision of ordinary shares (rather than other types of shares) is that the rights contained in an ordinary share give an employee some basic guarantees concerning what is being provided by the employer. In particular, an ordinary share means that employee has a right to vote in the affairs of the employer. One of the primary purposes of Division 13A is to strengthen employee participation in Australian businesses (in particular, their own employer's business), with the aim of achieving increased employee productivity.”³

However, it is recognised that the same “basic guarantees” which are attached to ordinary shares continue to be present in relation to stapled securities. For example, these employees also acquire a proprietary interest in their employer organisation and similarly enjoy the same benefits which are attached to this interest, such as “a right to vote in the affairs of the employer.” By issuing stapled securities based on the personal performance of individual employees, these schemes are also able to achieve increased employee participation and productivity.

Issue

By limiting the application of Division 13A to ordinary shares, employees of entities who form part of a stapled security arrangement are unable to acquire a proprietary interest in their employer via an ESAS.

It should be noted that as at 30 June 1998, 16 separate entities issued stapled securities on the Australian Stock Exchange (“ASX”) comprising \$6 billion of market capitalisation⁴, and yet, due to the restrictive operation of Division 13A, the employees of these entities are prevented from participating in ESAS.

To demonstrate how Division 13A does not cater for stapled securities, we have set out below an example.

Assume a stapled security arrangement where the shares in a company are “stapled” to the units of a trust. Further assume that the stapled security is listed on the ASX. Whilst the company and the unit trust will continue to exist as separate legal entities, it is usual for each entities’ constitution documents to specify that the securities in each entity can only be dealt with together as a stapled security and not separately as individual securities.

If an ESAS were implemented for the company within the stapled security arrangement, an employee of the company would only be able to acquire a stapled security under the ESAS (ie. a share in the company stapled to a unit in the unit trust). Under the present Division 13A rules, as the rules are confined to “ordinary shares” in the employer, the company share component of the stapled security would be subject to the concessional tax

³ Submission by the Australian Taxation Office to the Inquiry into Employee Share Ownership in Australian Enterprises, by Michael D Ascenzo, Second Commissioner, Answer (3).

⁴ DATADISK listing of the Australian Stock Exchange Limited (Industrial) as at 30 June 1998.

treatment provided by Division 13A, but the unit in the unit trust component would not be subject to the concessional treatment.

This would mean the employer would be subject to Fringe Benefits Tax (“FBT”) in respect of the trust unit, the employee would not get the benefit of the concessional tax treatment provided by Division 13A for the trust unit and there would be a number of complex valuation issues relating to carving out the value, and consideration attributable to the company component of the stapled security. These issues would mean that an ESAS is unlikely to be implemented for stapled security arrangements.

Recommendation

The above inequity could be simply overcome by allowing Division 13A to apply to ordinary shares as well as any other instrument or security in the employer which is able to be dealt with by an employee, provided such instrument or security confers no less ownership entitlements to the employee securityholder than those securities held by other securityholders in the entity, or those usually conferred by ordinary shares in a company.

Should you have any queries in relation to the above, please do not hesitate to contact David Ireland on 8266 2883 or myself on 8266 3354.

Yours faithfully

Colin W Dunn
Partner